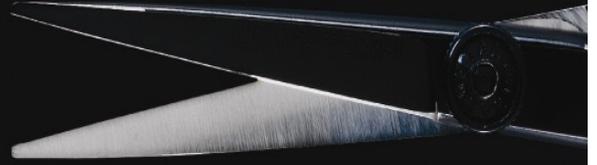


# Lehman Agreements

## Initial court hearing



Wider lessons learned from court's refusal to determine claim pursuant to prime brokerage agreement.

### Introduction

The urgent court application made last night by investment management company RAB Capital raised some important preliminary principles, which may impact on potential claims arising from agreements with Lehman. Full details of the hearing are set out below and the points to note include:

- at this early stage, it is for the administrators, not the courts, to determine claims under prime brokerage arrangements;
- the court will not intervene simply because a party's position may be severely prejudiced if a claim is not adjudicated until a later stage by the administrators;
- the court is reluctant to open the floodgates to claims by investment funds and companies;
- prime brokerage arrangements are extremely complex – claims adjudication by the courts at short notice will rarely be possible (for example, because of complex jurisdictional issues).

### The facts

Yesterday evening, Mr Justice Morgan heard an urgent vacation application by RAB Capital ("RAB") arising as a result of the administration of Lehman Brothers International (Europe) ("Lehman"). The Respondents were the administrators of Lehman. The application related to issues arising under a prime brokerage agreement and a subsequent deed of amendment between Lehman and RAB.

RAB issued two applications. The first application was a substantive application in order to determine RAB's rights to US Treasury bills and their proceeds. The second application, which was the application being heard, was for directions as to the conduct of the substantive application. In particular, RAB wanted the substantive application to be heard this Friday (26 September 2008), contrary to the normal procedure in the Insolvency Rules requiring that 14 days' notice be given to the respondent.

RAB's application related to two bills; one bill for approximately US\$45 million which matured last week, and one bill for approximately US\$5 million that is due to mature on 11 December 2008. In its substantive application, RAB intended to seek a ruling from the court that it was entitled to the redemption proceeds of the bill that had already matured and the rights constituted by the bill maturing on 11 December 2008.

RAB explained that the reason for the urgency was that RAB is required to publish details of its net asset value ("NAV") on 1 October 2008. If the proceeds of these bills are not recovered by this date, it is likely that the RAB funds would have to suspend the calculation of NAV, which would mean redemptions and further share issues would also be suspended. This may, in turn, affect funds of hedge funds which are invested in the RAB funds.

The thrust of RAB's submissions was that, although the prime brokerage agreement gave Lehman a "right of use" over its securities, the subsequent deed of amendment meant that these specific bills were excluded from the right of use and therefore the securities remained in the custodian account, held by Lehman as trustee for RAB. If this argument were accepted, RAB would have retained its proprietary rights in the bills and their proceeds. If this argument were rejected, it would only have an unsecured claim against Lehman for the delivery of assets equivalent to the original securities.

### Key considerations

- No early court determination of claims
- Severe prejudice to a party's position will not encourage court intervention
- Danger of floodgates
- Complexity of agreements between parties and Lehman

## The decision

Mr Justice Morgan refused to grant the application that RAB's rights against Lehman be determined on 26 September 2008.

In relation to the substantive application, he held that it did not raise a legal issue; this was the type of issue which should be dealt with by the administrators in the course of the administration and was not a matter for the courts. He said that this was a broad policy judgment and that he was keen not to set a precedent for other funds, who could all argue they had a unique problem.

Mr Justice Morgan also said that, if he allowed the application and the substantive hearing to take place at such short notice, it would almost certainly be de-railed by other legal issues arising. For example, in this case, it appeared that the bills may have been transferred to Lehman Inc. and therefore there was a preliminary issue as to how in practice the assets could be recovered as a matter of New York law.

Mr Justice Morgan has granted RAB leave to appeal his decision at the Court of Appeal. RAB has indicated that it will be appealing. Given the position of RAB, it is expected that any appeal will take place before 1 October 2008.

The administrators were represented by William Trower QC and Daniel Bayfield of 3-4 South Square. RAB was represented by Simon Mortimore QC and Andreas Gledhill, also of 3-4 South Square.

## Disclaimer

Please note that the contents of this memorandum provide only an overview of the legal implications surrounding Lehman's current financial circumstances and insolvency. They are intended for guidance only and should not be relied upon as legal advice. Clients' circumstances will differ in each case.

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