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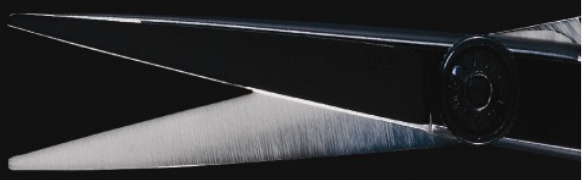

Lehman Brothers

Some Points for Clients

This note considers certain of the legal implications relating to Lehman's demise, focusing primarily on issues surrounding the administration process in England.

Immediate Client Considerations:

Failed trades

Prime Brokerage arrangements

Lehman entities acting as swap counterparties and in relation to repos

Lehman entities as lenders or agents under credit facilities

Cross-border issues

1. Introduction

On 15 September 2008, PricewaterhouseCoopers LLP (**"PwC"**) were appointed joint administrators of:

- Lehman Brothers International (Europe) – the principal UK trading company
- Lehman Brothers Ltd
- LB Holdings PLC
- LB UK RE Holdings Ltd

Some further details are set out at the foot of this note.

We set out below some key generic considerations for clients that are likely to arise following the insolvency of the UK Lehman entities. Of course, specific advice should be taken for particular arrangements and transactions. Further details about the administration process can be found at the end of this document.

2. Immediate client considerations

Given the financial demise of Lehman, clients are likely to face immediate concerns regarding their arrangements and operations with Lehman. These may include:

2.1 Failed trades

As a general matter, unsettled market contracts effected with Lehman on an exchange (such as the LSE) and/or cleared through a central counterparty (such as LCH Clearnet Limited) will have been closed-out under the default rules of the exchange and/or clearing house. The relevant default official will determine the value of the unsettled (closed-out) market contracts, take an account of what is due from one party to the other and set-off to produce a cash settlement amount either due to or from the defaulting party.

Clients may, however, have entered into OTC cash or derivatives transactions with a Lehman entity which may not be subject to the default rules of an exchange or clearing house. In such circumstances, consideration will need to be given to what action to take in relation to failed trades which remain unsettled.

As a general matter of English law, unless the time for performance of a market contract has been made "of the essence", then a mere default in performance by Lehman on the intended settlement date will not (in the absence of an express contractual right of termination) entitle the counterparty to terminate.

2.2 Prime Brokerage Arrangements

It is important to analyse whether it will be appropriate for a client to exercise any contractual rights of termination (and close-out) that it may have under the Prime Brokerage Arrangements with the relevant Lehman entity.

One particular issue here is the need to determine whether the relevant Lehman entity has reserved a "right of use" over any collateral provided by a client to secure its obligations to Lehman. A right of use will allow Lehman (acting through its administrator) to deal with the collateral as beneficial owner. The exercise of such a right will convert the collateral-giver's residual proprietary rights into an unsecured claim on the Lehman entity for delivery of collateral "equivalent" to the original collateral. Termination of the contract would terminate this right of use.

If Lehman has provided custody services to a client under prime brokerage arrangements, consideration needs to be given as to how to procure the return of the client's assets held in safe-keeping and, as a practical matter, to set-up alternative custody arrangements to safeguard and administer the client's assets

2.3 Lehman entities acting as Swap Counterparties and in relation to Repurchase Agreements

In determining whether to exercise any terminations, in particular of swaps, consideration should be given as to whether there is scope for trying to agree a non-default settlement or to follow a default termination route. In the case of the latter an issue is whether, if market quotation is used, it would produce a commercially reasonable result. If not, then Loss should be the default position. There are also different approaches between the 1992 Master Agreement and the 2002 Master Agreement in dealing with terminations. Consideration also needs to be given to the applicable governing law in the context of the location of any collateral, and set-off and whether the latter is effective across a variety of different transactions.

2.4 Arrangements where Lehman entities act as Lenders or Agents under Credit Facilities

Clients will need to consider the legal and practical implications where one of the counterparties to its credit facilities has entered a formal insolvency process. This may affect the operation of the facility and there may be possible transfer and payment implications, such as the likelihood of a Lehman UK entity meeting any continuing funding obligations it may have under the particular facilities or, where it acts as agent, continuing to fulfil its role in relation to the distribution of payments to syndicate members and the processing of transfer certificates.

Useful Websites

PricewaterhouseCoopers LLP (www.pwc.com)

Bank of England (www.bankofengland.co.uk)

FSA (www.fsa.gov.uk)

Euroclear (www.euroclear.com)

LSE (www.londonstockexchange.com)

London Clearing House (www.lchclearnet.com)

Insolvency Service (http://www.insolvency.gov.uk)

2.5 Cross-Border Issues

Contracts with Lehman UK counterparties may be governed by US law or, in certain circumstances, by both US and UK law. In addition, assets held by Lehman counterparties may be located in either the US or the UK or both. In such circumstances cross-border legal advice may be required to determine the exact legal rights of a client. We are well-used to co-ordinating cross-border advice should this be appropriate.

3. The appointment of administrators over Lehman entities in England

The administrators of the Lehman entities listed above have been appointed to wind down those companies in as orderly manner as possible and "to work with management and trading counterparties to agree the manner in which the assets and liabilities will be handled"[1]

Administration is a statutory procedure, governed by the Insolvency Act 1986 as amended by the Enterprise Act 2002, under which an administrator will seek to either rescue an insolvent company or realise value from its assets for the benefit of creditors. An administrator, a licensed insolvency practitioner, is an officer of the Court and acts as a statutory agent on behalf of the company. The administrator's duties are to act in the best interests of the company's creditors as a whole. As soon as a company enters administration, a “statutory moratorium” takes effect which means that no action can be taken (or continued) against the company or its property, without the consent of either the administrators or the Court.

The directors of each FSA-authorised Lehman entity would have obtained the consent of the Financial Services Authority prior to appointing administrators. In addition, a company may only be put into administration if one of the statutory purposes of administration is likely to be achieved. Those purposes are as follows:

- Rescuing the company as a going concern;
- Achieving a better result for creditors as a whole than would be likely if the company were wound up; and
- Realising property in order to make a distribution to one or more secured or preferential creditors.

The second objective can only be pursued by the administrator if a rescue as a going concern is (i) not reasonably practicable or (ii) would not achieve as good a result for creditors as pursuing some other course. The realisation of property (the third objective) can only be pursued by the administrator if it is not reasonably practicable to achieve either of the first two objectives and provided that it would not unnecessarily harm the interests of the creditors of the company as a whole.

The administrator has an obligation to obtain the best price reasonably obtainable in the circumstances for the company's business and assets, with proceeds being distributed in due course to creditors in accordance with their respective priorities.

Administrators are licensed insolvency practitioners (in the UK usually accountants) who are given wide powers to carry on the company’s business and realise its assets. In so doing they must carry out their functions in the interests of all creditors.

The administrators' appointment will automatically cease to have effect at the end of a 12 month period. This can be extended once for a period of up to six months with the consent of the company's creditors, or any number of times by Court order for a period determined by the Court.

Please note that administration operates on an entity, rather than group basis. Just because one company is in administration, does not mean that its subsidiaries are also in administration. Where a Lehman UK company is not in administration then its affairs will remain under the control of its directors rather than the administrators.

[1] Tony Lomas, joint administrator and partner at PricewaterhouseCoopers LLP

4. Administration Moratorium

Perhaps the most significant effect of appointing administrators is the statutory moratorium, which has the effect of prohibiting creditors from taking action against the company or its property without the consent of either the administrators or the Court. This means that, without consent, no steps can be taken:

- to wind up the company;
- to enforce security over its property; or
- to continue or commence a legal process against the company.

Commercial contracts are usually unaffected by the appointment of administrators save where they contain an automatic termination clause or a clause allowing a counterparty to terminate on the appointment of an administrator. Despite the moratorium, such provisions would in most cases allow the counterparty to terminate the contract. Similarly, close-out and netting provisions of contracts with a company in administration are not affected by the moratorium and can be exercised in accordance with their terms without the consent of the Court or the administrator.

5. Financial collateral arrangements – exception to the moratorium

Certain creditors of a company in administration may be able to realise their security over that company's property notwithstanding the statutory moratorium. This is by virtue of the disapplication of the moratorium in relation to a "security financial collateral arrangement" (an **"SFCA"**) under the Financial Collateral Arrangements (No. 2) Regulations 2003.

An SFCA is, in essence, a fixed charge granted by Lehman in favour of a corporate body over financial instruments - such as shares, debentures and money market instruments – and cash (in the form of a deposit or other claim for repayment). This excludes a charge over banknotes and coins and the better view is that a charge over contractually-based investments (such as options, futures and CFDs) would also not qualify as an SFCA.

Floating charges do not generally qualify for protection as an SFCA unless and until the charge-taker has taken control of the relevant assets (for example by taking possession upon crystallisation).

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.

Travers Smith LLP
19 September 2008

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