In a digital age and where significant assets may consist of dematerialised instruments, are our existing rules sufficient to provide a fair and effective regime governing the location of assets?

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INTELLECTUAL PROPERTY STATEMENT

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ABSTRACT

The failure of Lehman Brothers ("Lehman") in September 2008 resulted in the world's largest ever insolvency proceedings.[1] Almost eight years later, these have yet to be concluded. Much of the work of the lawyers involved with the Lehman insolvency has concerned questions of the ownership of assets held by the various Lehman entities at the time of its failure. Resolution of these matters has been no mean feat in view of the complex financial arrangements that Lehman had put in place. Practitioners and judges have had to (amongst other things) legally deconstruct transactions, interpret transaction documents and correctly allocate assets amongst the parties claiming them. The cross-border nature of the Lehman business and the fact that most of the assets in question were intangible, intermediated securities complicated matters further. These intermediated securities often formed part of the collateral used by Lehman for conducting its own business so that assets belonging to the ultimate investors became increasingly removed from their direct ownership. This doctorate seeks to understand the consequences for investors of the law relating to the holding of intermediated securities in the event of the insolvency of an intermediary and to consider whether the existing rules that govern such arrangements are fair and effective. Through an examination of selected English law and US Lehman cases, this Thesis explores the role of location in determining the law governing the proprietary effect of transactions involving intermediated securities and what, if any, conflict of laws issues arose as a consequence of the Lehman collapse. It concludes that, despite limited assistance from the case law in answering the question, the rules applied in the Lehman insolvency were, largely, both effective and fair to investors, albeit in the long term. Nevertheless, issues concerning the cross-border recognition of rights to intermediated securities remain and, with them, the challenge of achieving further harmonisation in an increasingly complex and fragmenting world. In view of the difficulties in imposing "top down" harmonisation or standardisation of laws across jurisdictions, the "bottom up" approach of the UNIDROIT Convention on Intermediated Securities provides the most realistic solution.

[1] According to the Lehman Brothers Holdings Inc. Chapter 11 Proceedings Examiner Report it was "the largest bankruptcy proceeding ever filed" <https://jenner.com/lehman/VOLUME%201.pdf 1>accessed 17 February 2016. The FDIC also described the Lehmans failure as the "largest financial bankruptcy in US history" <www.fdic.gov/regulations/reform/lehman.html> accessed 24 November 2015.

GLOSSARY

Administrators: the joint UK administrators of Lehman Brothers International (Europe) Limited, PricewaterhouseCoopers.

CCP: central counterparty.

EMIR: the EU European Market Infrastructure Regulations on OTC derivatives central counterparties and trade repositories.

Examiner's Report: the Lehman Brothers Holdings Inc Chapter 11 Proceedings Examiner Report produced by Anton R Valukas and published in March 2010.

FCARS: the UK Financial Collateral Arrangement (No 2) Regulations.

FCD: the EU Financial Collateral Directive.

FDIC: the US Federal Deposit Insurance Corporation.

Geneva Securities Convention: the 2009 UNIDROIT Convention on Substantive Rules for Intermediated Securities.

LBHI: Lehman Brothers Holdings Inc. LBHI went into US Bankruptcy Code Chapter 11 Proceedings on 15 September 2008.

LBI: Lehman Brothers Inc. LBI went into SIPA Trusteeship on 19 September, 2008.

LBIE: Lehman Brothers International Europe. LBIE went into administration on 15 September 2008.

LBSF: Lehman Brothers Special Finance Inc. LBSF went into US Bankruptcy Code Chapter 11 Proceedings on 3 October 2008.

Lehman: the Lehman Brothers Group.

OTC: over-the-counter.

SDNY: Southern District of New York.

SFD: the EU Settlement Finality Directive.

SFRS: the UK Settlement Finality Regulations.

SIPA: the US Securities Investor Protection Act.

SIPA Trustee: the US Trustee of Lehman Brothers Inc, James Giddens.

SIPC: the US Securities Investor Protection Corporation Act.

US court: unless otherwise distinguished, this means the US Bankruptcy Court of the Southern District of New York.

Chapter One

Introduction and Context

The question

In his speech to the INSOL Europe Academics Conference held in June 2012, Mr Justice Norris[2] outlined a number of issues faced by practitioners and which he considered deserved further inquiry from academics. One of the questions that he raised is the subject of this Professional Doctorate. The question was framed as follows:

> "In a digital age and where significant assets may consist of de-materialised instruments, are our existing rules sufficient to provide a fair and effective regime governing the location of assets?"[3]

The question was asked in the light of the financial crisis that began in 2007 and which led to the insolvency of a number of financial institutions including the international investment bank Lehman Brothers on 15 September 2008.[4] Prior to its demise, Lehman was an extremely complex financial institution providing services to clients which included the execution, clearing and settlement of both securities and derivatives trades as well as custody, financing, foreign exchange, stocklending and valuation services. In the UK, the majority of the entities with proprietary interests in the assets held by, or on behalf of LBIE on its insolvency were its prime brokerage clients.[5] The consequences of insolvency for the bank's global financial arrangements were almost overwhelming; the LBHI bankruptcy in the US has been described as "disorderly and costly"[6] and resulted in "disruptions in the swaps and derivatives markets and a rapid, market-wide unwinding of trading positions for those financial markets not subject to the automatic stay in bankruptcy".[7] The effects of the demise of Lehman were felt across many countries and the UK was particularly hard hit.

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[2] <www.ntu.ac.uk/PSS/Nottingham%20Law%20School/Publications/132264.pdfntu.ac.uk/nls> accessed 6 October 2015.

[3] Norris J (n 2) 3.

[4] Hereafter "Lehman". LBIE was the main UK operating company and went into administration in England; LBHI was the US holding company and went into US Chapter 11 Bankruptcy Proceedings. As to the timings of these processes see, for example, *Lomas & Others v JFB Firth Rixson* [2010] EWHC 3372 (Ch), [2010] All ER (D) 248 [30] for the details assumed by the English court.

[5] *Re Lehman Brothers International (Europe) (in administration) (No2)* [2009] EWHC 2141 (Ch), [2009] All ER (D) 36 [6]. Prime brokerage is discussed in Chapter 3.

[6] Federal Deposit Insurance Corporation '*The Orderly Liquidation of Lehman Brothers Holdings Inc under the Dodd-Frank Act*' (2011) 5 FDIC Quarterly 2, 1.

[7] FDIC (n 6).

Inevitably, many important issues arose as to the ownership of the assets held by Lehman institutions, spawning litigation in a number of jurisdictions.[8] Many of the issues were specifically considered in the English courts, resulting in a significant body of jurisprudence, some of which will be considered in this Document 5 (the "Thesis").[9] What is of particular interest to this study is the nature of the assets involved in the Lehman insolvency and the fact that they did not consist of tangible, real or personal property, but intangible, ethereal financial assets existing only as computerised book entries; the "de-materialised instruments" referred to by Norris J. So what are the rules relating to the location of these kinds of assets and what happens when a large financial institution such as Lehman becomes insolvent? Understanding these rules will ultimately enable a determination as to whether they support a fair and effective regime on insolvency, although further questions will be begged on the way to any such conclusion, including a consideration of "fair to whom?" a question identified in Document 4. For the reality is that, as the Cork Report[10] identified in 1982,

> "the effects of insolvency are not limited to the private interests of the insolvent and his creditors… other interests of society or other groups in society are vitally affected by the insolvency and its outcome."[11]

Although it was initially the author's intention to consider the question of "fair to whom" in this Thesis, it has become clear that it is beyond its scope to do so in any detail; any serious consideration of this issue must be a matter for further study. Some preliminary points may be made on the question of fairness and effectiveness more generally, however.

Document 2 considered the purpose of English corporate insolvency law and explored some of the US insolvency literature, recognising that there has been limited discussion of the philosophy behind the English system.[12] The objectives of the English system are

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[8] The progress reports produced by the administrators of LBIE between 14 April 2011 and 15 October 2015 variously list litigation in Luxembourg, Germany, the US (New York), Hong Kong, Athens and Seoul <www.pwc.co.uk/services/business-recovery/administrations/lehman/lehman-brothers-international-europe-in-administration-joint-administrators-14th-progress-report-12october2015.html> accessed 24 November 2015.
[9] The list of cases is set out at Appendix 1.
[10] Insolvency Law and Practice, Report of the Review Committee June 1982 Cmnd. 8558. The Cork Report led to the development of the current English regime.
[11] Cork Report (n 10) para 198 (i).
[12] Document 2, 30 -34.

perhaps best articulated by Goode, who lists the first objective as the maximisation of returns to creditors and the second objective as ensuring a fair and equitable means of ranking claims.[13] These reflect the aims of a good modern insolvency law, as outlined in the Cork Report. The Cork Report also refers to the importance of ensuring that the process of process of realising and distributing assets is undertaken honestly and competently and should be undertaken with the minimum of delay and expense.[14] This brief analysis indicates the importance in an insolvency process of ensuring both substantive fairness to creditors (through the maximisation of returns and the fair and equitable ranking of claims) and procedural fairness (in ensuring that the process is conducted honestly and competently). Thus any assessment of fairness will require a consideration of these matters. The question of effectiveness is distinct from that of fairness, but is connected in that it can be assessed by understanding whether the creditors obtained the maximum returns available to them and whether they did so in a timely manner and with minimum expense.

In his speech, Norris J observed that academics have a role in assisting practising judges and suggested several ways in which academics could usefully support the judiciary through their research. These were, first, by identifying relevant principles; second, by explaining the inter-relationship of those principles both within and across national legal systems; third, by comparing problems and solutions across systems of law; and fourth by collating and analysing data.[15] This Thesis will provide a response to the question raised by Norris J, taking account of his suggested approach to the research process. It will build on the work undertaken in Documents 2, 3 and 4 much of which has already addressed the identification of relevant principles and how they operate both on a national and a cross-border basis. Similarly, it will reflect upon a number of cross-border problems and solutions in this arena that have already been identified and considered at a preliminary level. At this stage, no data has been collated and analysed as the work to date has provided the groundwork for exploring the question by reference to a case study, which will form part of the Thesis. In order to give this proper context, it makes sense briefly to refer to Document 1 and reiterate the findings of Documents 2, 3 and 4.

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[13] *Principles of Corporate Insolvency Law* (4th edn Sweet & Maxwell 2011) 58.
[14] Cork Report (n 11), para 198 (g) and (e).
[15] Norris J (n 2) 2.

Document 1

Document 1 introduced the project and analysed the concept of assets held as dematerialised instruments, concluding that the assets in question were uncertificated debt and equity securities held through an intermediary or series of intermediaries and whose ownership was identifiable through digital (computerised) accounting records.[16] Document 1 also recognised that such securities could fall within the definition of financial collateral under the FCD[17] and the FCARS.[18] Work undertaken in subsequent documents has led to the conclusion that these assets are most correctly described as "intermediated securities" and this term will be used throughout the Thesis.[19]

Document 1 sought to look beyond issues of mere classification and to begin to understand the philosophical basis for this type of property interest. The starting point for the discussion in Document 2 was then identified and derived from Rudden's paper "Things as Thing and Things as Wealth" in which he observed that "there has been a profound, if little discussed evolution by which the concepts originally devised for real property have been detached from their original object, only to survive and flourish as a means of handling abstract value". [20]

Findings from Document 2: "Epistemology and identity – literature review and conceptual framework"

Document 2 explored the history and development of English property law in order to understand the nature and classification of intermediated securities within that branch of the law. It was important to understand this as a first step, before an understanding of their treatment on insolvency could be considered at a later stage in the study. As an epistemological enquiry, Document 2 sought to justify knowledge as true belief through a literature review and a discussion of relevant jurisprudence. Beginning with a consideration of different types of property, including abstract property rights in Roman law, the paper outlined a number of milestones in the history of English property law[21]

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[16] See Document 1; Uncertificated Securities Regulations 2001 SI 2001/3755 reg 3; Joanna Benjamin, Madeleine Yates and Gerald Montagu *The Law of Global Custody* (2nd edn Butterworths LexisNexis 2002) 15; Joanna Benjamin *Interests in Securities* (OUP 2000).

[17] Council Directive 2002/47/EC of 6 June 2002 on financial collateral arrangements [2002] OJ L168/43 as amended by Council Directive 2009/44/EC of 6 May 2009 [2009] OJ L146/37.

[18] Financial Collateral Arrangements (No 2) Regulations 2003 SI 2003/3226.

[19] Louise Gullifer (ed) *Goode on Legal Problems of Credit and Security* (5th edn Sweet & Maxwell 2014).

[20] Bernard Rudden '*Things as Thing and Things as Wealth*' (1994) OJLS 14, 1.

[21] For example, the fragmentation of interests in land in feudal times; the development of the trust; the emergence of intellectual property as a "new" form of property in the eighteenth century; the creation of the floating charge and security interests in assets other than land in the nineteenth; and, ultimately, the twentieth century concept of intermediated securities.

enabling a conclusion to be reached that intermediated securities are a form of intangible property (distinct from intellectual property) and are consequently *choses in action* and that the developmental milestones identified went some way towards supporting Rudden's thesis.[22]

Document 2 also outlined the conceptual framework for the study and drew on the work of Locke and Hohfeld. Locke's theory of "original acquisition" was explored and deemed to be relevant to the study to the extent that it provides a basis on which to consider whether property is held legitimately or illegitimately (even if his theory is otherwise flawed).[23] This is a critical question for any lawyer in the context of a corporate insolvency, as the legitimacy of any proprietary rights claimed in respect of the assets of the insolvent party must be established before property can be transferred to the claimant. The work undertaken by Hohfeld[24] in analysing the different legal relationships that may be held in respect of property also has relevance to the study; intermediated securities are not held by their owner, but through a chain of third parties each of which will have a different legal[25] relationship to the underlying asset.

In addition to seeking a philosophical justification for the rules of property and corporate insolvency law that exist today, Document 2 also contemplated at a meta-level how those rules came into being. Teubner's theory of autopoiesis and the concept of legal evolution was considered and analysed.[26] Whilst there is an underlying truth in the concept that the law gives itself legal validity through one legal operation giving rise to another, Document 2 concluded that this theory alone does not explain how the law has developed in this area. There is little UK jurisprudence that addresses the development of English corporate insolvency law; much of what is written comes from the US. One idea that has resonance for the English system, however, is the idea that the development of the property and corporate insolvency law rules that we have today has been largely pragmatic. This has been touched on by a number of corporate and insolvency law academics including

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[22] Although the application of real property concepts may possibly not have gone far enough for some; two years before Rudden's article, Fidelis Oditah had observed that the underdevelopment of personal property law and the absence of a doctrine similar to the real property doctrine of estates had led to curious results in priority claims involving personal property in *'Assets and the Treatment of Claims in Insolvency'* (1992) LQR 459, 486.
[23] John Locke, *Second Treatise of Government* (1690) Chapter V "Of Property" <www.gutenberg.org/files/7370/7370-h/7370-h.htm> accessed 24 January 2014; see the discussion by Alison Clarke and Paul Kohler in *Property Law; Commentary and Materials* (CUP 2005) 91.
[24] Wesley Hohfeld, *Fundamental Legal Conceptions as applied in Judicial Reasoning* (Yale University Press 1919).
[25] The term "legal" is used generically here as, under English law, many of these interests would be described as equitable.
[26] Gunter Teubner, *Law as an Autopoietic System* (Blackwell 1993) 2.

Whincop,[27] Armour[28] and Goode.[29] The pragmatic development can be seen at least in part as a consequence of practitioners flexing and manipulating the law in trying to resolve the legal problems of their time; rights became substantive when judges accepted their legal validity.[30] The recent remarks of Calnan, a City practitioner, add weight to this view:

> "One of the great advantages of the common law is that it has been flexible enough to adapt to changing commercial situations."[31]

A note of caution must be exercised here, in that it is contended that the notion of "pragmatism" described here probably owes more to pragmatism in its colloquial sense, described by Bix as worrying about "what works",[32] than to the school of philosophical pragmatism or the legal pragmatism of the early twentieth century.[33]

Document 2 also required an understanding of the importance of "identity" when approaching any question. What pre-conceptions does the writer have? What standpoint does he or she take to the matter in hand? It may never be possible to be truly objective, but an awareness of identity may at least help the writer to question certain assumptions he or she may otherwise make. It is also the case that a question may be addressed from a number of perspectives and so the standpoint ultimately chosen for any study must be carefully considered. As this professional doctorate seeks to resolve a question raised by a legal practitioner in a commercial context, it seems appropriate that the standpoint of this Thesis should be that of a commercial legal practitioner.

Findings from Document 3, Research Project 1

Document 3 developed the discussion of intermediated securities, exploring questions of ownership and possession. It analysed the distinctions between proprietary and contractual rights and between legal and equitable proprietary interests, exploring the English law construction that intermediated securities are held on trust by intermediaries for their investor owners. Critically, it identified the limitations of an English law analysis

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[27] Michael J Whincop, *An Economic and Jurisprudential Genealogy of Corporate Law* (Dartmouth Publishing Company 2001), 26.
[28] John Armour, '*The Chequered History of the Floating Charge'* (2004) 13 Griffiths L.Rev. 25.
[29] Goode (n 13) 69.
[30] See, for example, *Millar v Taylor* (1769) 98 ER 201 (intellectual property); and *Holroyd v Marshall* (1862)10 HLC 191, 220 and *re Panama New Zealand and Australian Royal Mail Co* (1870) 5 Ch App 318 (the floating charge).
[31] Richard Calnan, 'What Makes a Good Law of Security*?'* in Frederique Dahan (ed) *Research Handbook on Secured Financing in Commercial Transactions* (Edward Elgar 2015) 465.
[32] Brian Bix *Jurisprudence: Theory and Context* (5th edn Sweet & Maxwell 2009) 279.
[33] As considered by writers such as Roscoe Pound (see Chapter Seven).

in the "real world". Intermediated securities are bought and sold in the market place and such transactions are often international in nature. The owner may be based in one jurisdiction, the intermediary in another and neither may be England or Wales. Questions of asset location and ownership become far less clear cut in these circumstances. When the markets are functioning well and the solvency of trading partners is not in issue, the legal analysis of ownership and the jurisdictional rules that underpin any given transaction involving intermediated securities are likely to be of little or no concern to the parties involved. Where problems arise in the performance of contracts involving dematerialised assets and cause loss to be suffered, however, the parties will look to their legal rights and obligations either to recover their property or to seek recompense for what is owed to them. To the extent that these problematic contracts involve the movement of assets across borders, so will jurisdictional limits be tested: it may well be the case that the English law analysis is not recognised in the jurisdiction of a non-English counterparty. This then begs the question first, as to whether the ultimate owner's property rights will be recognised and upheld and second, if they are, what is the legal basis for doing so?

Findings from Document 4: Research Project 2

In the process of writing Document 3 it became evident that more work was needed to understand how intermediated securities are used in financial transactions. Understanding the precise nature of the intermediary's relationship to the securities it holds at any given moment is critical; in the event of the insolvency of the intermediary (as happened when Lehman ailed), questions are likely to arise both as to the allocation and to the ownership (or not) of assets held by the intermediary. The proprietary or contractual basis on which assets are held by an intermediary in such a situation must be understood before the correct allocation of assets to the correct counterparties or other creditors can be effected. Document 4 therefore considered types of financial collateral transactions and the potential negative consequences of rehypothecation. Where a client's intermediated securities are used as financial collateral and then re-used by an intermediary in a transaction with a counterparty, the intermediated securities are no longer available for that client, thus suggesting that the client's proprietary interest in the asset has been reduced to a contractual right to be compensated for the value of the asset by the intermediary. This is unlikely to be a problem for the client if the intermediary is solvent, but it becomes a problem if the intermediary is not. Whilst sophisticated parties may accept such a risk both by allowing rehypothecation and by factoring it into the pricing of transactions, the wider risk remains that financial contagion might result from chains of transactions involving reused collateral.[34]

The second part of Document 4 took a comparative approach (as had been envisaged in Document 2) and explored the civil law approach to property and ownership with reference to a number of European jurisdictions. The EU and US position was also analysed in respect of intermediated securities. The complexity of trying to determine the *lex situs* of intermediated securities became apparent. Inevitably, this comparative critique only scratched the surface of the issues (the extent of the discussion being limited by the scope of the doctorate), but some important themes emerged and provided background to the discussion that followed on the appropriate choice of law for intermediated securities. This, in turn, led to an analysis of the Geneva Securities Convention[35] as the culmination of the work that has been done, to date, on this important topic. Of particular relevance in this context, is the effort made in the Geneva Securities Convention to overcome what Gullifer has described as the "shortfall" problem (where there are insufficient securities available for allocation to their ultimate owners) and the "identification" problem (where it is not clear which securities belong to which client).[36] Broadly, the Geneva Securities Convention (the only current signatory of which is Bangladesh) [37] anticipates that an intermediary will always hold the same number of securities as are credited to its account holders[38] as well as providing for pro-rata sharing in the event of a shortfall.[39]

[34] A problem recognised in Recital 8 of Council Regulation EU/2015/2365 of 25 November 2015 on transparency of securities financing transactions and of reuse OJ L337/1.
[35] The 2009 UNIDROIT Convention on Substantive Rules for Intermediated Securities.
[36] Louise Gullifer, 'Ownership of Securities: the Problems Caused by Intermediation' in Louise Gullifer and Jennifer Payne (eds) *Intermediated Securities; Legal Problems and Practical Issues* (Hart Publishing 2010) 22-26. There are other issues outlined by Eva Micheler in '*Custody Chains and Asset Values: Why Crypto-Securities are Worth Contemplating*' CLJ 74 [2015] 505 for example, relating to the reduction of investor rights the more parties there are in a chain (511) which are noted, but cannot be discussed in detail here.
[37] According to the UNIDROIT website in the 91st Session of the Governing Council in Rome 7-9 May 2012 at page 2 www.unidroit.org/english/governments/councildocuments/2012session/cd91-05bc-e.pdf> accessed 24 November 2015).
[38] Article 24 (n 35).
[39] Article 26 (n 35).

Looking forward: the Thesis

Having set out the background to the Thesis, the question posed by Norris J now needs to be addressed. One concern at the outset is whether, as there is so much to discuss, 30,000 words will be sufficient to discuss it. As this already seems highly unlikely to the author, it is important to reflect that any doctrinal study is a starting point[40] and, if done well, will end with a new beginning. With that health warning in mind, it now makes sense to consider the structure and subject matter of this Thesis in more detail. What needs to be examined to answer the question and how should that examination be conducted?

[40] As I have been assured by my colleague, Professor Rebecca Parry.

Chapter Two

The Thesis: questions, research method and structure

The questions for the Thesis

The original question posed for this Thesis was whether "our existing rules [are] sufficient to provide a fair and effective regime governing the location of assets" when those assets are in dematerialised form. This study therefore seeks to understand the consequences for investors of the law relating to the holding of intermediated securities in the event of the insolvency of an intermediary. In particular, the study seeks to test the proposition that complex conflict of laws issues arise in the event of an intermediary's insolvency on the basis that intermediated securities issued in one jurisdiction might be held in a second jurisdiction, whilst the investor is located in a third jurisdiction and so forth; something which could result in "real world" problems for investors in getting their money back.

From the outset, the study has explored Norris J's question against the backdrop of the financial crisis. The question has been interpreted on the basis of two main assumptions. First, that the courts have been faced with complicated questions as to the law governing the location of assets following the insolvency of financial institutions which hold intermediated securities (such as Lehman); and second, that these questions have arisen as a direct consequence of the unravelling of complex, cross-border financial transactions. But are these assumptions correct? The fact that the question was asked by a senior legal practitioner might suggest that practitioners are uneasy about the law relating to the location of intermediated securities as it currently stands, a premise supported by the 2010 remarks of Moss:

> "Many of us see the field of intermediated securities as an area where sufficient certainty is lacking, particularly in relation to insolvency situations. The massive Lehman litigation currently under way rather proves my point".[41]

It is important to note at the beginning that the first assumption is predicated on a third assumption, which is that the question of location is actually important; implicit in the discussion thus far is the idea that location matters when determining the proprietary

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[41] Gabriel Moss 'Intermediated Securities: Issues Arising from Insolvency' in Louise Gullifer and Jennifer Payne (eds) *Intermediated Securities; Legal Problems and Practical Issues* (Hart Publishing 2010) 68.

effect of a transaction involving intermediated securities. But is this third assumption borne out in reality? It is clear that further interrogation of these initial assumptions is essential.

Questions one and two

The challenge for the Thesis is to determine the extent to which "real world" practical legal problems have occurred because of difficulties in establishing the law that governs the location of intermediated securities following the failure of sophisticated financial institutions. Before going further, however, the phrase "the law that governs the location of intermediated securities" requires further consideration. The reference to "location" formed part of the original question posed by the judge, quite possibly as a shorthand reference to the *lex situs* rule. As discussed in Document 4, the *lex situs* rule is the rule that applies where the question to be resolved concerns proprietary rights, so that the applicable law is that of the place where the asset is situated. There are, however, difficulties in applying the *lex situs* to intangibles because they do not always have a location and so attributing one will depend on the circumstances.[42] The specific question is, therefore, better framed by reference to "the law governing securities" although establishing an understanding of the relevance of location from primary legal sources will form part of the wider discussion of this Thesis.

In order to demonstrate whether or not these difficulties actually arose in the aftermath of the financial crisis, the following matters need to be explored. First, whether, following the insolvency of an intermediary that holds intermediated securities, the law governing securities was an issue in the decided cases that caused "real world" problems; second, if the law governing securities was in issue, to what extent did it result in the testing of jurisdictional limits in establishing the ultimate ownership of those assets; and third, what principles were applied across jurisdictions in achieving the proprietary effect (the ownership outcome) that was achieved? Having answered these questions it would then be possible to consider the question of the fairness and effectiveness of the regime affecting rights to intermediated securities on insolvency may be addressed. Collectively, these sub-questions form question one.

[42] Document 4, 36-38.

It is entirely possible that the investigation into question one may conclude that the issues as to the governing law of intermediated securities did not pose as big a problem in the aftermath of the financial crisis as might first have been thought. If this is so, then question two will be about analysing the reasons why this was so. In addressing these questions, it will be necessary to understand from the cases not just whether there were difficulties in establishing the location of intermediated securities for the purposes of determining the applicable law, but also what the term "location" is understood to mean in the case law. Ultimately, the answers to questions one and two will lead to a conclusion that there is either an actual or a theoretical "real world" problem associated with establishing the applicable law relating to assets in the form of intermediated securities, which will lead into questions three and four.

Questions three and four

Questions three and four will, inevitably, be linked. Question three will require a consideration of the legal frameworks that currently exist for determining conflict of laws issues to see (in the light of the outcome of question one) how far they helped to resolve the practical issues thrown up by the Lehman case study. Alternatively, in the event of having to address question two, they will need to be explored to understand how they might help to resolve theoretical practical problems that might arise on the insolvency of a large financial institution in future. The analysis will require a wider consideration of the extent to which the regimes examined can be considered to be fair and effective.

Insofar as the current law is found wanting, question four must consider what alternatives or improvements might be offered to the existing regime. The preliminary assumption as to the importance of location will need to be addressed to the extent that it remains ambiguous: is it in fact the case that the law of the location of intermediated securities is relevant in establishing the proprietary effect and validity of transactions involving intermediated securities? The analysis will necessarily include a reflection upon the coherence of the existing system of rules and an exploration of the application of the Geneva Securities Convention to theoretical problems.

Research method

The only way to determine whether the courts have been faced with issues concerning the law governing intermediated securities as a consequence of the unwinding of complex, cross-border financial transactions is to examine decided cases to see what issues arose.

This necessitates a systematic and rigorous evaluation of these cases through the adoption of a doctrinal research methodology coupled with an historical comparative element as was envisaged in the framework Document 2.[43] But which cases should be examined and in which courts and jurisdictions? Document 4 touched on the historical development of property law in a civil law context (with reference to France, Germany and the Netherlands) as well as the US. Tracing the author's understanding of the English, US and civil law positions into a real world, financial institution failure in each of these jurisdictions would provide the most comprehensive answer to the question posed. Although this approach would be ideal, it is not feasible within the limitations imposed by the Thesis. As a systematic review of all relevant case law is required, it is necessary to have full access to all the relevant case reports, in English. Whilst it would be possible to locate relevant case law in at least one of these civil law jurisdictions, if not all, it would be difficult for the author to be certain that all the relevant information had been isolated and also that any case law was accurately translated into English. It is also critical to the Thesis to evaluate the case law from those jurisdictions which are predominant in the global financial markets; although the European civil law jurisdictions identified are important, in this context, the US is also relevant. As the US market is significant in global terms and as US materials will not require translation, the best compromise for the Thesis is to consider the English law and US positions. A consideration of the issues from a civil law perspective must be a matter for further study.

There are several possible models that could be used to identify relevant cases for examination but, as part of the original contribution made by this Thesis, Lehman will be used as a case study for the following reasons.[44] As has already been discussed, Lehman was a global, systemically important financial institution which was involved in dealing with intermediated securities in cross-border transactions on a daily basis prior to becoming insolvent. It immediately falls within the parameters of the enquiry on the basis of its investment banking functions. Reference has already been made to litigation in both the English and US courts, which indicates that there is an existing body of jurisprudence that is likely to provide fertile ground for exploring this question. Whilst the case study

[43] "Epistemology and identity; critical review of the literature and development of a conceptual framework" so satisfying the necessary robustness required in the research process; Terry Hutchinson and Nigel Duncan '*Defining and Describing What We Do: Doctrinal Legal Research*' Deakin Law Review 1 (17) 83, 111-112.

[44] The word limit prevents a detailed discussion of possible models of enquiry other than to note that this approach has been anticipated in earlier documents. Although others have reviewed some of the Lehman cases (most notably Joanne Braithwaite in '*Standard Form Contracts as Transnational Law: Evidence from the Derivatives Market*' (2012) 75 (5) MLR 779 and '*The Impact of Crises by Way of the Courts*' (2014) 3 JIBFL 147) there has been no over-arching review.

approach may seem ideal, a note of caution should be sounded as it is not without limitations. First, it is possible that parties affected by the Lehman collapse may simply have accepted the consequences of the bank's failure and continued to run their businesses without taking further action or, to the extent that issues concerning conflict of laws were raised, chose to settle them out of court. Second, although this approach has the advantage of providing a specific number of cases for review, a disadvantage is that it can only provide an indicative answer to the question posed (that is, as to the extent to which the problem being examined is likely to arise in practice); after all, what can be demonstrated for this institution may not be demonstrated for others.[45] The size of the Lehman insolvency may, however, go some way to mitigate this disadvantage on the basis that if such issues are likely to arise, they are most likely to arise in this instance.[46] In an effort to widen the scope of the review, the Thesis will also briefly consider the MF Global case as a second example of an investment bank failure. MF Global was a far smaller institution than Lehman and did not fail until the autumn of 2011 (approximately three years after Lehman), but it may prove instructive.[47]

The Thesis will therefore examine the cases involving Lehman entities heard in the English courts after 15 September 2008 and glean additional information from the progress reports produced by the UK administrators of UK Lehman entities.[48] Similarly, the Thesis will consider relevant US cases heard after this date and supplement any findings with information obtained from the Examiner's Report.[49] It is important to review the case law in both these jurisdictions to understand whether, if the law governing the location of the assets was an issue in the English courts, it was also an issue in the US. The key institutions for the purposes of this study are likely to be the main holding companies in each jurisdiction LBHI (in the US) and LBIE (in the UK). Understanding the principles applied by the courts of these two jurisdictions when reaching their determinative outcomes is likely to be instructive for the purposes of eliciting principles that may be of

[45] Such as a central counterparty, for example.
[46] Examiner's Report, FDIC (n 1).
[47] MF Global Inc. went into Chapter 11 proceedings in the US on 31 October 2011 and MF Global (UK) Limited went into special administration in the UK on the same day <https://home.kpmg.com/uk/en/home/media/press-releases/2011/10/administrators-appointed-to-mf-global-uk-limited-and-mf-global-uk-services-limited.html> accessed 29 April 2016.
[48] PricewaterhouseCoopers (n 8).
[49] The US Trustee of LBHI was directed by the US Court to nominate an Examiner to report on a number of specified matters under its Order Directing Appointment of an Examiner Pursuant to section 1104(c)(2) of the US Bankruptcy Code, Docket No. 2569, *In Re Lehman Brothers Holding Inc.* Case No. 08-13555 (Bankr S.D.N.Y. Jan. 16, 2009); Examiner's Report Volume 1 <https://jenner.com/lehman> accessed 21 February 2016, 28.

global benefit, bearing in mind that these jurisdictions are home to two of the world's most important financial centres.

Methodology for identifying relevant English law cases

LBIE was the chief operating company of Lehman in the UK and its ultimate parent company was LBHI.[50] Each of these companies went into insolvency proceedings (administration and Chapter 11 respectively) on 15 September 2008.[51] Only cases after this date have therefore been catalogued as being relevant to the bank's insolvency proceedings.

A LexisNexis database search of the term "Lehman" on 8 July 2015 produced 184 results. Of these, 127 results related to cases that arose after 15 September 2008. The search was repeated on 19 November 2015 and 192 results obtained of which 134 related to the bank's insolvency. Of the relevant results, multiple entries for the same case appeared on the database where, for example, the same case had been reported in more than one set of law reports. For the purposes of the Thesis, only the case transcripts were reviewed. A schedule of cases with a brief summary of the issues raised in each case was produced.

In order to confirm that the schedule was accurate, two additional database searches were undertaken. First, a LexisNexis database search of the terms "Lomas" and then "Pearson" on 8 July 2015. This was on the basis that some cases involving Lehman entities were taken in the name of the lead administrators. Of the cases identified, only one case was not listed under the "Lehman" search and the schedule was updated accordingly. Second, a search of the term "Lehman" was undertaken against the Westlaw database on 19 November 2015 and the cases listed double-checked against the schedule. No omissions were found, so on this basis, the final list of 46 cases was deemed to be complete.

The list of the 46 Lehman cases identified and a précis of the issues they considered is set out in Appendix 2. These cases are further categorised in Appendix 3, following a preliminary review of the cases which enabled them to be placed into one of five (very general) categories as part of the process of establishing which cases were the most relevant to the Thesis. The classifications are as follows:

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[50] See the 2007 structure chart <http://jenner.com/lehman/docs/barclays/LBEX-LL%202165164-2165176.pdf> accessed 12 July 2015.
[51] *Firth Rixson* (n 4).

1. Cases concerning matters of contractual or statutory interpretation;
2. Hearings on minor matters;
3. Cases relating to schemes of arrangement or other settlements;
4. Pension cases; and
5. Cases on priorities.

A similar exercise was undertaken using the term "MF Global" identifying cases from 1 November 2011 onwards. Ten cases were identified on the LexisNexis database. The schedule of MF Global cases appears at Appendix 4.

Methodology for identifying relevant US cases

As discussed, LBHI was the ultimate parent company of LBIE[52] and went into Chapter 11 proceedings on 15 September 2008 in the US Court.[53] Only cases after this date have been catalogued as being relevant to the bank's insolvency proceedings.

A search of the LexisNexis international database of the term "Lehman" on 25 February 2016 produced 65 results. The cases were identified through a search of the category "Federal Court Cases Combined" and the search further refined to include only US Bankruptcy court cases. This seemed a surprisingly low number of returns when compared to the number of results obtained from the equivalent UK search. In view of this, a search of the term "Lehman" was undertaken on the Westlaw international materials database, searching "All Content/ US Materials/ Cases/Federal Bankruptcy Courts/New York". This produced 290 results. As the Westlaw database had produced a far greater number of hits, this source was considered to be more reliable than the LexisNexis database and was used as the basis for identifying relevant Lehman cases.

Of the 290 hits, 171 related to cases heard after 15 September 2008. These 171 cases were examined by reference to the description of the case that appeared on the database. Where the information was insufficient to determine whether the case was likely to be relevant for the Thesis, the link to the case transcript was followed and the case reviewed. A schedule of cases with a brief summary of the issues raised in each case was produced.

52 2007 structure chart (n 50).
53 *Firth Rixson* (n 4).

This enabled the cases to be placed in one of three categories. The first consisted of cases where the search term "Lehman" appeared in the case or the case report but did not relate to the investment bank's Chapter 11 proceedings. There were 51 of these cases and they required no further consideration. The second category of cases were those which either cited one of the cases in the Lehman litigation or otherwise referred to the Lehman bankruptcy. There were 73 cases in this category. The final category of cases directly involved LBHI or LBI (a US subsidiary of LBHI). There were 48 cases in this category and these were cross-referenced to the cases listed in the LexisNexis search; this only illustrated that there were gaps in the LexisNexis list and so the Westlaw list was definitively relied upon.

The cases in the second category were reviewed to determine whether any were relevant to the Thesis either because of a cross-border issue or an issue involving intermediated securities. Of these cases, ten related to MF Global, one of which was identified as requiring further analysis. The remaining cases in the second category were deemed not relevant. A précis of the 48 LBHI and LBI cases in the third category is set out in Appendix 4.

The LBHI and LBI cases were further classified in Appendix 5. A preliminary review of the cases placed them into one of three (very general) categories as part of the process of establishing which cases were the most relevant to the Thesis. The categories chosen were:

1. Cases with a cross-border element and/or which considered issues relating to intermediated securities;
2. Claims hearings on non-relevant matters; and
3. Cases relating to settlements and administrative matters.

To ensure that all relevant MF Global cases had been considered in addition to the ten MF Global cases produced as part of the Lehman search, a separate search was made of the term "MF Global" on the Westlaw database and a total of 51 cases were identified. These are listed in Appendix 6. A review of the 51 cases found only one likely to be relevant; this was the case identified as part of the Lehman search.

Structure

The Thesis will follow the structure that flows from the questions identified. The English Lehman cases that are deemed most relevant to the Thesis will be considered and any issues relating to the location of assets identified. This will enable a conclusion as to the extent of the problems associated with the location of assets in the "real world" to be reached. The MF Global case will be briefly reviewed as part of that discussion to provide an element of comparison and contrast. The US position will then be considered before exploring the effectiveness and fairness of the existing regime and postulating how improvements to it might be achieved.

Chapter Three
A critical review of the English case law

Introduction

The focus of this section is on the Lehman's litigation with the MF Global cases being considered at the end of the discussion to see whether they can provide any insights not obtained from the Lehman's study. As it is not possible to consider the detail of the 46 scheduled Lehman cases in this Thesis, only those identified as being most relevant to the question can be discussed. A preliminary review of the cases enabled them to be placed into five, broad categories (see Appendix 3) of which the most important category for this Thesis is that of "cases concerning matters of contractual or statutory interpretation" ("Category 1"). The remaining categories either concern specific issues (which at most have a tangential, rather than direct, relevance to the Thesis) or reflect relatively minor concerns. The reasons why these cases have been distinguished for the purposes of the Thesis will be briefly considered.

Discounted cases in categories 2-5

The second category of cases comprised "Hearings on minor matters" and included applications on a number of issues such as costs, time extensions and stays. Matters addressed were procedural rather than substantive and so these were quickly excluded. This same cannot be said for the cases in the remaining three categories, which have resulted in some important jurisprudence. The third category "Cases relating to schemes of arrangement or other settlements" is not entirely irrelevant to the discussion insofar as the position of secured creditors was considered in the context of a proposed scheme of arrangement. In *Re Lehman Brothers International (Europe) (in administration) (No2)*[54] the administrators asked the court to consider whether the court could sanction a Part 26 Companies Act 2006 scheme of arrangement between LBIE and the scheme creditors. The proposed scheme was an attempt by the administrators to achieve a speedy resolution and a degree of certainty for a group of clients for whom it held property on trust. The reason why the case is not relevant for the Thesis is because it was not disputed that the clients had a proprietary interest in the assets (intermediated securities) in question. The administrators wanted to vary or extinguish certain property rights under the proposed scheme for reasons of expediency. The court (quite correctly) held that the court had no

[54] [2009] EWHC 2141 (Ch), [2009] All ER (D) 36.

jurisdiction to do this under Part 26; a decision subsequently affirmed by the Court of Appeal.[55]

The fourth and fifth categories consisted of the pension cases and the cases on priorities. Both these groups of cases are irrelevant to the Thesis as they do not consider issues of location or proprietary effect.[56] The final category of cases, being the priorities cases, is probably most interesting for the fact that, in 2015, seven years after Lehman became insolvent, it became apparent that certain subordinated unsecured creditors might receive a dividend payment. This seems a remarkable outcome given the magnitude of the Lehman insolvency. The cases considered, amongst other things, the position of claims against LBIE.[57]

Refinement of Category 1 cases

Having dispensed with the cases in categories 2-5, it became necessary to further refine the classification of cases within Category 1. Some cases in Category 1 dealt with a particular issue (sometimes beyond the court of first instance) whilst other cases covering similar issues could, logically, be grouped together. As a result, the Category 1 cases were sub-categorised as follows:

1. The anti-deprivation case;
2. The CASS rules cases;
3. The RASCALs case;
4. The ISDA Master Agreement cases; and
5. The Extended Liens case.

The classification has been used to pin-point those cases where issues that were critical to the resolution of the Lehman's administration were considered. Having done this, it

[55] *Re Lehman Brothers International (Europe) (in administration) (No2)* [2009] EWCA Civ 1161, [2010] 1 BCLC 496.

[56] Nonetheless, it is worth noting that the jurisprudence from the pension litigation was extremely important. The question arose as to whether compliance with a Financial Support Direction served under the relevant pensions legislation should fall to be an administration expense for the relevant Lehman entities or should be treated as a provable debt. Treatment as an administration expense would have benefited the members of the pension scheme but would have been extremely disadvantageous for the unsecured creditors. Ultimately, the Supreme Court concluded that it was a provable debt. See *Nortel GmbH (in administration); In re Lehman Brothers International (Europe) (in administration)* [2013] UKSC 52, [2014] AC 209.

[57] *In re Lehman Brothers International (Europe) (in administration) (No 4)* [2015] EWCA Civ 485, [2015] 3 WLR 1205.

then becomes possible to distil the specific issues and isolate those most relevant for discussion in the Thesis.

It is worth undertaking a brief analysis of the 46 cases identified at this point. 37% of the cases (seventeen cases) turned on matters of contractual or statutory analysis. A further 37% of the cases were categorised as "minor" cases and the remaining 26% (fourteen cases) turned on specific matters that were considered not to be directly relevant to the Thesis. This might lead to an initial hypothesis that there will be little assistance gained from the Lehman litigation in answering the questions asked in this study. This could be surmised on two grounds. First, that only seventeen of the cases might possibly be relevant and second, the nature of the issues that arose in those seventeen cases. The cases in Category 1 are linked by the fact that they appear to have dealt with the interpretation of English law contracts and statutes. It is not immediately apparent that any questions as to the location of intermediated securities arose; to the extent that they have, they appear to have been addressed through the application of existing contractual rules. The question as to which law should determine the proprietary effect of a particular transaction does not, at first blush, appear to have been in dispute at all.

This hypothesis necessarily needs to be tested through a deeper examination of the cases. A number of the Category 1 cases raised issues of such complexity that they required consideration in the Court of Appeal and the Supreme Court. All of the cases in Category 1 require further analysis to establish whether they raised any issues relating to the location of intermediated securities and, more specifically, whether they raised any conflict of laws issues in the determination either of the location of the intermediated securities in question or the proprietary effect of a particular transaction involving intermediated securities. At the outset of this analysis, it is important to examine the jurisprudence to obtain an understanding of how Lehman ran its business; how and when were assets transferred between parties and, at any given moment, who was their legal owner? Having completed this exercise, the Category 1 cases can then be examined, by class, in more detail.

Context: shortfall and identification problems in the early cases

In terms of establishing the context of the enquiry, the early post administration cases are useful for understanding how Lehman carried out its business operations and managed its client accounts. They also illustrate the immediate problems faced by its clients following its insolvency; unsurprisingly, shortfall and identification problems quickly arise.

It is clear from the very first case that the location of the assets held by insolvent Lehman entities was a significant issue for its clients. Within a few days of LBIE's administration, RAB Capital Plc had applied to the court for directions to be given to the LBIE administrators that assets held by LBIE under custodian arrangements should be returned to it. The judge (quite correctly) refused to make the order on the grounds that dealing with claims in the administration was a matter for the administrators rather than the court. He also noted that this was not a matter that could be quickly addressed, since LBIE was:

> "not the de facto custodian of the relevant assets. Those assets are in New York where the sub-custodian is an American company in liquidation."[58]

In fact, the American company had been asked to return the assets, but at the date of the court hearing had not done so. The cross-border nature of the custodian arrangements put in place by Lehman therefore became an immediate concern on its insolvency. Typical questions for any company in this position would be: what if the insolvent American company did not have their assets (the shortfall problem) or, even if it did, failed to recognise the English company's ownership (and therefore priority) and determined to apply the assets elsewhere in the insolvency?

The cross-border implications of the Lehman prime brokerage arrangements also need to be considered. These arrangements were explained in the second case in the administration, *Four Private Investment Funds v Lomas and Others*[59] which also illustrates the extent of the authority granted to LBIE to use client assets for its own purposes. The following extract from the case details the intercompany arrangements. Clients placed securities with LBI:

[58] *RAB Capital Plc v Lehman Brothers International (Europe)* [2008] EWHC 2335 (Ch), [2008] BCC 915 [6].
[59] [2008] EWHC 2869 (Ch), [2009] BCC 632.

> "as their "prime broker" as security for the payment and performance of their obligations and liabilities to any Lehman Group Entity. LBI… transferred the securities to LBIE which was authorised under the contractual arrangements to make loans to the [clients] and provide other services…. LBIE was authorised to lend the securities to itself or others, and to pledge, re-pledge, hypothecate and rehypothecate them."[60]

Thus the prime brokerage clients were also exposed to the real possibility of a shortfall in the recovery of their assets particularly where rehypothecation by LBIE may have passed their assets beyond LBIE's ownership. In *Four Private Investment Funds*, the applicants wanted the court to direct the LBIE administrators to provide them with more information about their securities. The issue for the investment funds was not so much about requiring immediate repayment, but more about satisfying themselves that their assets were still available so that they could update their own investors and ensure that confidence was maintained in their own institutions. The judge (again, quite correctly) refused to make the order on the basis that administration was a collective process and the administrators were required to perform their functions in the interests of the creditors as a whole; it was not for the court to interfere with the day to day running of the administration in a case such as this, where there was no suggestion that the administrators were behaving improperly.

The judgment is more important here, however, for explaining how Lehman entities held securities on behalf of clients. In the UK, LBIE held securities lodged by clients by way of collateral in a pooled client account, so that assets belonging to a number of different clients were mixed.[61] In the US, it was not just client monies that were mixed:

> "US securities traded, received or held by LBIE for its clients or for its own account were generally held in a single "omnibus" account at the Depositary Trust Company (the "DTC") in the United States managed by LBI."[62]

The particular issue raised for clients with securities in the omnibus or pooled accounts was that of the "identification" problem; how did they know which securities were theirs?

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[60] Ibid [6].
[61] Ibid [20].
[62] Ibid [22].

This problem was potentially worse for clients in the US, since both client and LBIE monies were mixed. Inevitably, the collective nature of the administration in the UK and the US Chapter 11 proceedings would at best mean a delay for clients in retrieving their assets and at worst mean that their assets might not be available at all (the "shortfall" problem once again).

This preliminary work provides the backdrop against which the Category 1 cases can now be considered. Understanding the processes and mechanisms that supported the Lehman financial operations is critical to the Thesis as it will be necessary to determine whether the movement of intermediated securities between the various parties involved in any transaction under scrutiny has a contractual or a proprietary effect.

The Category 1 cases: anti-deprivation[63]

The first case for analysis is the anti-deprivation case ("*BNY Trustee*"). It came to court in England in November 2009 and was ultimately determined in the Supreme Court in July 2011. A superficial examination of its facts suggests that it is a relevant case for Thesis because it addressed issues relating to the location of collateral held by a custodian in a securities account. In fact, although location was an issue, the case ultimately turned on the drafting of certain contractual terms under a complex structured finance arrangement, which will be briefly explained.

LBIE had set up a programme designed to provide credit insurance for Lehman entities; essentially, this was a credit default swap. The model involved the issue of loan notes to investors by a Lehman company issuer which was incorporated in a tax efficient jurisdiction. The cash generated from the loan note issue was used by the issuer to buy government bonds and other securities (the "collateral"). The collateral was lodged with a trustee which held it on behalf of the issuer. At the same time, the issuer entered into a swap arrangement with a Lehman entity (in the present case, Lehman Brothers Special Finance Inc ("LBSF")) as its swap counterparty. LBSF received the yield on the collateral and in return paid the issuer the equivalent amount of the interest and capital due to the noteholders. The collateral was charged in favour of the trustee as security for the issuer's obligations to the noteholders and to LBSF.

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[63] *Perpetual Trustee Co Ltd v BNY Corporate Trustee Services Ltd* [2009] EWHC 1912 (Ch), [2009] 2 BCLC 400. Note that the abbreviation of this case has been chosen for consistency rather than convention as, ultimately, Belmont rather than Perpetual pursued the litigation to the Supreme Court.

This might appear straightforward, but there was a catch in the security entitlement arrangements which was the issue in this case. In the event of the insolvency of LBSF,[64] the respective priorities of the noteholders and LBSF were reversed, so that the noteholders, rather than LBSF, were to be paid out first. Following the insolvency of LBSF, the representatives of the noteholders brought a claim against the trustee demanding that the collateral be realised to redeem amounts outstanding on the notes in priority to any claim of LBSF. Unsurprisingly, this position was contested by LBSF. On the face of it, this was a simple contractual dispute between two parties as to the true construction of the documents.

At this point, it becomes necessary to introduce the US aspects of the case and the basis on which LBSF contested the noteholders' position. Although the transaction documents were governed by English law,[65] the parties to the transaction were not all based in England. LBSF, for example, was a US company incorporated in Delaware with its principal office in New York. LBSF did not accept that the noteholders had priority and brought a complaint against the trustee (which held the collateral) in the US court. Although the trustee was a subsidiary of a US bank, it was incorporated in England and so based in England rather than the US.

Thus began two different strands to the case, one running in the US court and one in the English court. In the US, LBSF contended that the noteholders were prohibited from relying on the priority provisions set out in the transaction documents as they had the effect of modifying the interest of a debtor as a consequence of the bankruptcy filing and that this was in breach of the protection afforded by Chapter 11.[66] In the UK, LBSF contended that the noteholders could not rely on the contractual terms giving it priority over the collateral on insolvency, since it was against public policy to contract out of the mandatory provisions of the Insolvency Act 1986, following the *British Eagle* case.[67] At first instance, the Chancellor held that the *British Eagle* principle was not engaged by the terms of the transaction documents.[68] LBSF appealed, but lost in both the Court of Appeal

[64] LBSF went into Chapter 11 proceedings on 3 October 2008, *BNY Trustee* (n 63) [3].
[65] With the exception of those relating to the purchase of collateral, which was irrelevant.
[66] *BNY Trustee* (n 63) [4].
[67] Ibid [6], following *British Eagle International Airlines v Compagnie Nationale Air France* [1975] 1 WLR 758.
[68] *BNY Trustee* (n 63) [65].

and the Supreme Court.[69] The Supreme Court concluded that the contractual agreement to reverse the priorities in the event of the insolvency of LBSF was not contrary to public policy. Where there was no intention to evade the insolvency legislation, the courts should, it was held, give effect to the contractual arrangements of the parties involved.

Although the *BNY Trustee* case was significant for its consideration of the scope of the rule that is variously described as the "anti-deprivation" rule or the rule from *British Eagle,* it does not obviously assist in answering the questions posed by this Thesis.[70] Despite this, there is one aspect of the case that merits an observation. In January 2010, Judge Peck, sitting in the US Court, held that the same contractual provisions that were upheld in England were in breach of the US Bankruptcy Code.[71] Despite this and the subsequent UK Supreme Court affirmation of the conflict between the approaches of the English court and the US court, there the US litigation of this case ended. Why? The Perpetual noteholders and LBSF settled their dispute, although the Belmont noteholders did not. (It has not been possible to find any details of the terms of the settlement on the record that might shed light on the discussion, but it is plain that the Perpetual noteholders were not represented in the Supreme Court proceedings.) [72]

It is possible that the reason why LBSF chose not to pursue proceedings in the US was because the collateral was held by an English incorporated trustee situated in England. As a practical matter, if the collateral was determined as being located in England, its relocation to the US would have required LBSF to obtain a US judgment to the effect that LBSF was entitled to the collateral and for the English court then to recognise and enforce that judgment in England. Even if LBSF had obtained a US judgment, the opposing approach to the anti-deprivation principle taken by the English court might suggest that difficulties would have arisen with recognition and enforcement of the US judgment, which would have led to cost and delay. So it is possible that the location of the collateral was

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[69] *Belmont Park Investments PTY Limited v BNY Corporate Trustee Services Ltd* [2009] EWCA Civ 1160, [2009] All ER (D) 87; *Belmont Park Investments PTY Limited v BNY Corporate Trustee Services Ltd* [2011] UKSC 38, [2011] All ER (D) 259.

[70] It has been argued that the Court of Appeal conflated the anti-deprivation principle and the *pari passu* rule in this case (see, for example, Davies J '*The Nature and Scope of the Anti-Deprivation Rule in the English Law of Corporate Insolvency – Part One'* International Corporate Rescue, Special Issue (Chase Cambria Company (Publishing) Ltd 2011). The two rules are distinct: the anti-deprivation rule determines the size of the pie, whereas the *pari passu* rule determines how much of the pie each party will get.

[71] *Re Lehman Brothers Holdings Inc* 422 BR 407 (US Bankr SDNY 2010).

[72] Orrick, Herrington and Sutcliffe LLP '*Lehmans reaches settlement with Perpetual in Dante case'* <www.lexology.com/library/detail.aspx?g=e999cbae-b6a4-410b-b8e7-3bcfdf1e1ff8> (accessed 5 February 2016) and *BNY Trustee* (n 69) UKSC.

a factor in the outcome of the litigation, even if it the question of location was not an issue in the case.

Category 1 cases: the CASS rules cases

Four cases concerned the so-called "CASS rules".[73] The CASS rules were issued by the Financial Services Authority ("FSA") in its capacity as regulator of the financial services industry in the UK and set out the basis on which client money should be held by financial institutions. All of these cases dealt primarily with determining whether cash held by LBIE fell within the scope of the CASS rules and belonged to secured creditors or formed part of the general assets available to unsecured creditors.

The first of these cases was the International Prime Brokerage Agreement ("IPBA") charge case.[74] LBIE had taken on prime brokerage arrangements for a number of hedge funds under standard form documentation in the form of the IPBA charge. In this capacity, LBIE had entered into two types of arrangement with its counterparties: title transfer arrangements and security transfer arrangements. Under the former arrangements, LBIE had absolute ownership of the assets whilst under the latter, LBIE held the assets as custodian, an arrangement that would be understood as a trust as a matter of English law (as discussed in Documents 3 and 4).

As a practical consequence of LBIE's work as a prime broker, it received cash in respect of the securities that it held as custodian. There were various reasons for these cash receipts, for example, where securities were redeemed in exchange for cash or LBIE received dividend payments and so forth. The difficulty for the beneficiary under the custodian relationship was that the IPBA charge specifically excluded any cash receipts from the custodian relationship. Any cash sums were simply non-segregated and did not form part of the client money. Whilst this arrangement might seem surprising in hindsight, it was not specifically prohibited by the provisions of the CASS rules and reflected the commercial reality of the market place. This was that, as prime broker, LBIE had a right of use over the counterparty's assets for its own ends and profit subject to certain

[73] The CASS rules were the rules set out in the Client Assets Sourcebook. At the time, these gave effect to Council Directive 2004/39/EC of 21 April 2004 on markets in financial instruments [2004] OJ L 145/1.

[74] *In the Matter of Lehman Brothers International (Europe) (in administration) and RAB Market Cycles (Master) Fund Limited* [2009] EWHC 2545 (Ch), [2009] All ER (D) 313.

contractual obligations to the counterparty. [75] These were to provide the counterparty with equivalent securities and, failing that, a cash sum.[76]

Nevertheless, the legal effect of this arrangement was that a beneficiary under a custodian arrangement whose intermediated securities were turned into cash, lost its beneficial proprietary interest in the securities and found it replaced with a lesser contractual right to prove for the debt in LBIE's insolvency. The judge had no difficulty in determining that the holding of securities as custodian amounted to a trust under the IPBA charge,[77] but it was less clear that the cash held by LBIE after its insolvency was subject to the same protection. The judge held that it was, on the ground that the parties, had they put their minds to it, would have implied such a term into their agreement; the alternative was that cash receipts were a windfall to LBIE on its insolvency.[78]

This case is instructive for the fact that it addresses issues of fairness. The judge considered that it was imperative for the administrators to pay the beneficiaries under the custodian arrangements the necessary cash sums to reflect the amounts due in respect of their securities. This was the only way to "remedy the injustice which the retention of that windfall [by LBIE] would otherwise bring about." [79] Although it is not possible to explore this point in greater detail in the Thesis, it could be considered that there are two types of fairness in issue in this context. Here, it was considered unfair by the court that LBIE should obtain a windfall. This idea appears to be rooted in the concept of unjust enrichment, yet, technically, a sophisticated party who has contracted to allow its assets to be rehypothecated could have no legitimate expectation to be anything other than an unsecured creditor in the circumstances that transpired in this case. In contrast, a party who has contracted on the basis that its assets are held on trust would be treated unfairly if the trust arrangement was not honoured.

The issue in the second CASS rules case (which went to the Court of Appeal and the Supreme Court) was slightly different.[80] In that case, LBIE had failed to identify client

[75] Ibid [30].
[76] Ibid [38].
[77] Ibid [72].
[78] Ibid [94]-[96], [106].
[79] Ibid [109].
[80] *Re Lehman Brothers International (Europe) (in administration)* [2009] EWHC 3228 (Ch), [2010] 2 BCLC 301; *Re Lehman Brothers International (Europe) (in administration)* [2010] EWCA Civ 917, [2010] All ER (D) 15; *Re Lehman Brothers International (Europe) (in administration)* [2012] UKSC 6, [2012] 3 All ER 1.

money and, as a consequence, failed to segregate it as was required under the CASS rules. This meant that money that should have been held on trust for clients in the period prior to its insolvency, was not. It also meant that it was unclear whether those clients whose monies had not been segregated could benefit from the client money pooling arrangements and the *pari passu* application of those funds that existed under the CASS rules. The pooling arrangements and *pari passu* application were specifically intended to address the possibility of a shortfall in the client monies held by LBIE in the event of its insolvency. LBIE's failure to segregate monies was significant: US$3 billion worth of client money claims were brought in respect of an actual holding of US$2.16 billion.[81]

It would be wrong to suggest that this second CASS rules case was not extremely important; it was. There was an enormous amount of money at stake and, at first instance alone, more than 70 separate issues were raised by the administrators and considered both in extensive written submissions and in the course of twelve days' oral argument.[82] The fact that the case was subsequently appealed is a further indication of its importance, as is the fact that there was no consensus on certain points either in the Court of Appeal or in the Supreme Court. Despite this, the case does not assist in answering the questions that are the subject of this Thesis other than, perhaps, to raise a question of fairness. The case is useful for its consideration and reiteration of the English law of trusts and for its brief consideration of the application of the CASS trust as a matter of Scottish law, but that is all.[83] The legal analysis relating to the English law of trusts remains unchanged. Without the creation of a trust, segregation of funds alone would not be sufficient to give a party priority over those funds for the purposes of UK insolvency law.[84]

In order to understand the possible "fairness" issue, the outcome of the case should be briefly outlined. The case turned on the construction of the CASS statutory trust. In the Supreme Court it was unanimously held that the statutory trust arose on receipt by LBIE of the money.[85] The Supreme Court also had to consider two additional issues first, whether the pooling arrangements (whereby funds belonging to secured creditors would

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[81] EWHC 3228 (n 80) [2]-[4].
[82] EWHC 3228 (n 80) [13]-[14].
[83] UKSC 6 (n 80) [7]-[15]. The comparative law discussion in Document 4 considered the difficulties for civil law jurisdictions (such as Scotland) in recognising the English law trust. The Supreme Court observed that, whilst it might be technically more appropriate to understand the Scottish "trust" relationship in terms of the fiduciary duty owed by an agent, Parliament would not have intended UK citizens north of the border to have less protection than its citizens in the south.
[84] Ibid [47] (Lord Walker).
[85] Ibid [62] (Lord Walker).

be pooled and shared *pari passu*) applied to client money held in its general, non-segregated "house" accounts and second, whether the monies in the pool should be shared out on a "claims" or a "contributions" basis. The "claims" basis anticipated that monies in the pooled accounts should be shared amongst all those clients whose funds should have been segregated at the time of LBIE's insolvency, whilst the "contributions" basis would allow the pooled funds to be shared only with those clients whose funds had been purposely segregated under the CASS rules. It was ultimately held that the claims basis applied. This was upheld on the basis that distribution under general trusts law could be distinguished from the CASS trust, which envisaged a particular model of distribution. The approach taken in construing the CASS rules was a purposive one; the intention of the CASS rules was to protect those who had deposited monies with the firm.[86] Whilst this approach does seem fair, bearing in mind that the failure of LBIE to segregate monies had resulted in both a shortfall and an identification problem for its clients, it is not without controversy. On a purposive interpretation, the CASS distribution rules provided a mechanism to share fairly the limited assets available amongst all the relevant parties regardless of whether they had been properly protected by LBIE or not. Nonetheless, this conclusion flew in the face of a standard trust arrangement which would only have recognised as beneficiaries those parties who had made contributions.

Category 1 cases: the RASCALS case

RASCALS was the acronym used for the LBIE working group on the Resettlement and Safe Custody and Global Settlement of securities. This group had been put in place to address specific regulatory problems arising as a consequence of having a "hub" company dealing with the acquisition, sale and lending of securities in a particular geographical area.[87] There were two RASCALS mechanisms, one automatic and the other manual. The mechanisms applied to the trades undertaken between LBIE as a "hub" company and third party clients (colloquially referred to as "the street") in which LBIE used assets beneficially owned by certain of its affiliates. The transactions were title transfer arrangements effected by book entries. As far as the world was concerned, LBIE was the title holder for the purpose of dealing with the street, even if the beneficial interest in the assets it held in fact lay with one of LBIE's affiliates. Sums due as between LBIE and the affiliates were approximated with each leg of the title transfer arrangement leading to a rough off-setting

[86] Ibid [126]-[127] (Lord Clarke).
[87] *Re Lehman Brothers International (Europe) (in administration); Pearson v Lehman Brothers Finance SA* [2010] EWHC 2914 (Ch), [2010] All ER (D) 232 [5]-[7].

of amounts due between the parties. Final settlement between LBIE and the affiliate took place, automatically, at the point at which the securities were sold back to the street.[88]

The problem was that, following LBIE's insolvency, the automatic processes did not stop and carried for just over a week. When the automatic process was stopped, the outstanding title transfer arrangements had their second leg scheduled for that day.[89] LBIE claimed all the securities that it held for itself whilst the affiliates claimed that they, in fact, were beneficially entitled to the securities.

Once again, the case turned on whether the affiliates could demonstrate that LBIE held the securities on trust for them. At first instance, it was held that the RASCALS programme amounted to an intention by the parties that LBIE held the beneficial interest of the "rascalled" securities on trust for the affiliates. This was because the programme had been created to enable certain global functions of the bank to take place and this required LBIE to contract with the street on behalf of various affiliates. Thus the RASCALS programme established the necessary certainty of intention to establish a trust. The judge, relying on *Hunter v Moss*[90] was satisfied that the necessary certainty of subject matter existed to give effect to a valid trust even though the securities in question were held in various pooled accounts.[91] It is important to note that, quite correctly, the judge did not consider that any title transfer arrangements in place prior to the RASCALS programme would have created a trust. This is entirely consistent with general trusts law. The Court of Appeal approved this decision.[92]

Once the existence of the trust was established, a second question arose as to whether, at the time of LBIE's insolvency it held the beneficial interest in the securities for itself or for its affiliates. The Court of Appeal dismissed LBF's appeal, holding that LBIE held the interest for itself. This turned on whether, in acquiring securities from the street as the first leg (the "on-leg") of the title transfer, the various off-setting approximations amounted to payment by LBIE; LBIE claimed beneficial ownership on the basis that it had

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[88] Ibid [16].
[89] Ibid [22].
[90] [1993] 1 WLR 934. The debate as to certainty of subject matter for intermediated securities was discussed in Document 4, 12.
[91] *Pearson* (n 87) [315].
[92] *Re Lehman Brothers International (Europe) (in administration); Pearson v Lehman Brothers Finance SA* [2011] EWCA Civ 1544, [2011] All ER (D) 232.

paid for them without receiving the benefit of the second leg (the "off-leg") part of the transaction. [93]

The judgments are instructive for readers who are not investment bankers. The discussions in the case included some extremely interesting background information as to how LBIE and the wider Lehman entities ran their business. The analysis of the case here has been greatly simplified and a number of specific issues not considered (the nuances associated with manual RASCALS, for example, have not been discussed). Other than addressing the necessity of establishing certainty of intention and subject matter in establishing a trust, this case offers little material that will assist in answering the questions raised in this Thesis. One point that was picked up by Mr Justice Briggs in both this case and the RAB Market Cycles case was the importance of the decision in *Hunter v Moss*[94] in establishing certainty of subject matter for those with interests in pooled funds following the analysis of beneficial co-ownership.[95]

Category 1 cases: The ISDA Master Agreement cases

Before the ISDA Master Agreement ("Master Agreement") cases are considered in any detail, it is necessary briefly to explain the development of the Master Agreement and its place in the financial markets. This will inform the discussion of the transactions that were in issue in this group of cases, so that, where necessary, the proprietary effect of particular transactions can be properly understood.

The Master Agreement is, essentially, a standard form document used in the financial services industry that was developed by the International Swaps and Derivatives Association ("ISDA") in the early 1990s and has from time to time been amended (most relevantly for the Lehman cases, in 2002). Its intention is to provide legal certainty and reduce credit risk in the swaps and derivatives markets, largely through ensuring the enforceability of arrangements for the provision of collateral as well as the enforceability of netting arrangements.[96] The Master Agreement standard terms form part, but not the whole, of any particular swap or derivative contract between the parties; the whole

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[93] Ibid [133].
[94] [1993] 1 WLR 934.
[95] *Pearson* (n 87) [233] and *RAB Master Cycles* (n 65) [56].
[96] 'About ISDA' <http://www2.isda.org/about-isda/> accessed 7 February 2016. Note that there are various forms of Master Agreement in the industry. See, for example, Johansson's (albeit slightly outdated) discussion in *Property Rights in Investment Securities* (Springer 2010) 71.

contract comprises the Confirmation, the Master Agreement and the Schedule with the contract being interpreted by reference first the Confirmation, then to the Schedule and lastly to the Master Agreement.[97]

An examination of the cases illustrates that the issues at stake related to the interpretation of specific clauses in the Master Agreement. In *Firth Rixson,*[98] the issue was whether LBIE's default under certain swap arrangements (which was caused by its insolvency) meant that its swap counterparties were obliged to pay sums due to LBIE under the swap agreements.[99] It was held at first instance and in the Court of Appeal that they did not. For as long as there was an uncured event of default, the non-defaulting counterparties had no obligation to pay LBIE.[100]

The facts in *Carlton*[101] were broadly the same as those in *Firth Rixson* and so both cases were appealed together. In the Court of Appeal, the question from *Carlton* arose as to whether section 2 of the Master Agreement engaged the anti-deprivation principle. This was on the basis that the suspension of the non-defaulting party's obligation to make payments under the swap whilst the event of default was continuing, prevented the recoverability of assets belonging to the bankrupt's estate. This would, therefore, disadvantage creditors. The Court of Appeal had the advantage of being able to apply the Supreme Court decision in *BNY Trustee*[102] and was satisfied that the anti-deprivation rule was not engaged. On the facts, there was no intention to avoid the insolvency legislation and whilst the outcome might be "criticised as imperfect… it cannot be said to be uncommercial".[103]

The last three cases for consideration in this category address a number of technical points. The *Commodity Services* case concerned the interpretation of a letter of credit governed by English law and a Master Agreement governed by New York law. [104] The parties sought a determination as to whether Calyon could set-off sums due from Lehman

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[97] *Firth Rixson* (n 4).
[98] Ibid.
[99] *Lomas and Others (together the Joint Administrators of Lehman Brothers International (Europe)) v JFB Firth Rixson Inc; Lehman Brothers Special Financing Inc v Carlton Communications Ltd; Pioneer Freight Futures Co Ltd (in liquidation) v Cosco Bulk Carrier Co Ltd; Britannia Bulk plc (in liquidation) v Bulk Trading SA* [2012] EWCA Civ 419, [2012] All ER (D) 29 [6].
[100] Ibid [62].
[101] *Lehman Brothers Special Financing Inc v Carlton Communications Ltd* [2011] EWHC 718 (Ch), [2011] All ER (D) 309.
[102] *BNY Trustee* UKSC (n 69).
[103] *Firth Rixson* (n 99) [92] (Longmore LJ).
[104] *Lehman Brothers Commoditv Services Inc and Credit Agricole Corporate and Investment Bank (formerly Calyon)* [2011] EWHC 1390 Comm, [2011] All ER (D) 26.

Brothers Commodity Services against its own obligation under the letter of credit. It was concluded that Calyon could do so. In contrast, in *Anthracite*, the court had to consider the meaning and effect of the early close out provisions in two derivatives contracts that incorporated the 1992 Master Agreement.[105] This required a highly technical analysis of the terms of both agreements (requiring the judge to refer to principles of contractual interpretation). Anthracite had issued loan notes and had protected the principal sum by entering into derivatives contracts (credit default swaps) with Lehman Brothers Finance SA ("LBF") to ensure that in the event of early redemption, it would have the necessary cash available to repay them in full. LBF was eligible for certain regular payments under the arrangement and, recognising that these may be reduced in the event of early repayment, entered into an agreement with Anthracite that it would be compensated by way of an early termination cash settlement amount. Ironically, LBF's insolvency caused a default in the derivatives agreement and triggered an early redemption event. Anthracite claimed against LBF whilst LBF denied the claims and claimed the early termination cash settlement amount. It was held that LBF was not entitled to receive the early termination sum.[106] The judge considered the mechanisms for calculating the loss suffered by the parties concluding that the "value clean" principle applied.

The "value clean" principle was given further consideration in the *Lehman Brothers Finance* case in the Court of Appeal. [107] In this case, the court had to determine whether a Side Letter formed part of the Master Agreement for the purpose of determining certain close out amounts on the termination of various intercompany swaps and derivatives contracts. These contracts had been entered into between LBIE and other Lehman entities and had been recorded electronically as intercompany accounting entries rather than by way of paper transaction confirmations. In the Court of Appeal the issue arose as to the place of the Side Letter in determining the value of a replacement contract when it came to determining the close out losses. Should the contractual terms of the Side Letter be assumed to be terms in any replacement contract?[108] LBIE claimed that these were material terms whilst LBF claimed that the valuation required the Side Letter to be

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[105] *Anthracite Rated Investments (Jersey) Ltd v Lehman Brothers Finance SA (in liquidation); Fondazione Enasarco v Lehman Brothers Finance SA* [2011] EWHC 1822 (Ch), [2011] All ER (D) 171.
[106] Ibid [111].
[107] *Lehman Brothers International (Europe) (in administration) Lehman Brothers Finance SA* [2012] EWHC 1072 (Ch), [2012] All ER (D) 159; *The Joint Administrators of Lehman Brothers International (Europe) v Lehman Brothers Finance SA In the matter of Lehman Brothers International (Europe) (in administration)* [2013] EWCA Civ 188, [2013] All ER (D) 132.
[108] *Lehman Brothers Finance* EWCA (n 107) [4] (Arden LJ).

excluded on the basis that a "value clean" approach required an assumption that conditions had been fulfilled. Overturning the judgment at first instance, the Court of Appeal held that the Side Letter should be taken into account. At first instance, the judge had considered that taking the terms of the Side Letter into account would be inconsistent with the value clean approach. The Court of Appeal disagreed, largely because the jurisprudence until that time had referred to the 1992 Master Agreement and in this case, the 2002 Master Agreement had been used. The same approach could not be taken to the 2002 Master Agreement since it was worded differently to the 1992 Master Agreement. None of these cases raises any issues that relate to the location of assets nor did they consider any issues as to the proprietary effect of any particular transactions.

Category 1 cases: The Extended Liens case[109]

Although this is the last case in this category, it is one of the more interesting cases for the purposes of the Thesis. It was a wide ranging judgment that addressed issues of:

> "the interpretation, characterisation, validity and present effect of what may loosely be described as security provisions in two standard form documents."[110]

At the outset, the judge referred to two unusual features of the case. The first of these was that the security interest was described as a "general lien". This seemed an incongruous term in the context, since, as a matter of English law, liens are best described as arising by operation of law and so they are generally not considered to be a consensual form of security; further, a general lien is a form of legal lien that works to protect trade creditors.[111] A legal lien is a possessory security interest which most usually arises where a bill for the provision of services is unpaid, enabling the provider of services to refuse to release the property until the bill is paid.[112] As the judge observed, the general lien in this

[109] *Re Lehman Brothers International (Europe) (in administration) and others* [2012] EWHC 2997 (Ch), [2012] All ER (D) 32.

[110] Ibid [1].

[111] Although Briggs J includes liens in the category of consensual security in his judgment (ibid [17]). This appears to be because he viewed the general lien as a contractual lien (which is an extension of the legal lien to include enforcement rights and the power of sale) and also in recognition of the fact that "lien" is a term used in the US to describe a security interest similar to a charge or a mortgage. See Richard Calnan *Taking Security: Law and Practice* (2nd Ed Jordans 2011), 372-373 and 385.

[112] This is the legal lien often used by car mechanics and dry cleaners. Liens can also be created by statute and can exist in equity, the most notable being the unpaid vendor's lien over property between exchange of contracts and the receipt of the purchase price.

case had the usual associated rights of retention and sale, yet was used to create a security interest in intermediated securities.[113]

The second unusual feature was that the security interest was not just intended to secure the debts owed by LBF to LBIE, but also to secure LBF's debts to an imprecisely defined group of LBIE's affiliates within the Lehman Group. In addition, the terms on which the general lien was established were unclear.[114] This second issue was dealt with quite quickly; it was held that it was not conceptually impossible for such an arrangement to exist in that there was no requirement for a chargee (here LBIE) to be a fiduciary or trustee of the creditor (here the creditors were LBIE's affiliates). Briggs J held that it was enough for the chargee to have an enforceable right to be able to appropriate the charged assets in respect of the specified obligation.[115]

Thus the first point for consideration was the characterisation of the interest created. Preliminary discussion considered the nature of a lien, but it was quickly determined that this was not relevant as the arrangement was most obviously characterised as a floating charge.[116] As discussed in Document 4, this was relevant because the securities were used in transactions which fell within the definition of security financial collateral arrangements under the FCARS.[117] Transactions under the FCARs are exempt from formalities, including registration requirements. The rationale for eliminating formalities in financial collateral transactions was explained in the underlying FCD.[118] The approach was designed to promote the efficiency of the financial markets. As a matter of English law, the registration of company charges (including floating charges) is essential, since failure to register them in accordance with the provisions of Part 25 of the Companies Act 2006 renders them invalid as against an administrator, liquidator or creditor of the company.[119] The process of registration is, however, time consuming and impractical in the context of securities transactions as is any requirement for formal, written transaction documentation; dispensing with these formalities is perceived to be advantageous for market efficiency. What is required under the legislative provisions is that the collateral

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[113] *Extended Liens* (n 109) [3].
[114] Ibid.
[115] Ibid [41], [43]. This issue was only briefly addressed in the judgment and it is beyond the remit of this Thesis to spend time reviewing it, as it is only tangential to the enquiry. It is not clear that this point was correctly decided (I am grateful to Hamish Anderson for his insights on this).
[116] Ibid [15].
[117] FCARS (n 18).
[118] FCD (n 17)
[119] Section 859H(3).

is under the collateral holder's "possession and control". It was this aspect of the case that generated the most discussion.

The case considered, in great detail, the development of the FCD. This included a review of the *travaux preparatoire.* The particular issue was what amounted to "possession and control" in the context of holding financial collateral. Did the fact that the collateral provider could deal with the financial collateral held by the collateral holder (LBIE) mean that LBIE could not demonstrate the necessary possession and control for the charge to fall within the scope of the financial collateral arrangements? If this was the case, then the floating charge would be invalid. It was ultimately concluded that LBIE's floating charge did not fall within the definition of a security financial collateral arrangement for the purpose of the FCARS.[120] The judge concluded that, although LBIE held assets belonging to LBF that were subject to the charge in favour of LBIE and the affiliates, prior to the crystallisation of the charge these assets were held by LBIE as custodian. The fact that LBF had not dispossessed itself of these assets, meant that they could not be regarded as being under LBIE's possession or control for the purposes of the FCARS.[121]

Analysis: answering question 1

The first challenge for this Thesis was to find out whether practical legal problems have arisen because of difficulties in determining the law governing the location of intermediated securities following the failure of sophisticated financial institutions. An analysis of the Lehman cases heard in the English courts would suggest they have not. As the review of the cases in the previous section indicates, much of the discussion has concerned the contractual interpretation of complex financial documentation. To the extent that the cases covered issues relating to the proprietary effect of particular transactions, these cases concerned transactions governed by English law and so principles of English law were applied. There was much reiteration of the basis on which intermediated securities are held by intermediaries for their underlying beneficiaries as a matter of English law; namely on trust with the beneficiary retaining the equitable proprietary interest. There have been no conflict of laws issues raised whereby one jurisdiction claimed that the proprietary interest in specified securities was determined by their law rather than the law of a different jurisdiction; the only case where location may have had an impact was the *BNY Trustee* case, but the question of location was not litigated. The conduct of the

[120] *Extended Liens* (n 100) [160].
[121] Ibid [147].

administration appears to have been both substantially and procedurally fair; as discussed at the beginning of the chapter, even unsecured creditors have received a dividend and the thoroughness of the legal argument undertaken suggests a rigorous process has been followed in determining claims. The only major criticism that can be made as to the effectiveness of the process is in terms of the delays to creditors in receiving payments, but it is hard to see how this could have been avoided in view of the complexity of the financing arrangements in place.

It was suggested at the outset of the analysis that what might be the case in one investment bank insolvency (albeit that the Lehman insolvency was the biggest the world has seen) may not be true for another. So it could be the case that just because issues of location did not arise in the Lehman case, they may have arisen in other cases involving insolvent financial institutions which dealt with intermediated securities. The only other investment bank insolvency that has happened in recent years is that of MF Global group which went into administration in the UK and Chapter 11 in the US in November 2011. [122]

The MF Global cases

A database review of MF Global cases from November 2011 onwards, revealed ten cases. These cases were analysed to determine whether, unlike the Lehman cases, they had raised issues relating to the proprietary effect of certain transactions as a consequence of issues relating to the location of intermediated securities. Following this analysis, it was clear that they did not. The MF Global cases (perhaps unsurprisingly in view of the nature of the business undertaken by both institutions) covered similar issues to those raised in the Lehman litigation and only one case went beyond the court of first instance (and was not on an issue material to this Thesis). Of the cases that touched on proprietary interests, two cases considered the CASS rules and followed the Lehman decisions[123] and one was a request from the client money trustee for directions to enter into a settlement agreement.[124]

[122] In fact it went into special bank administration under the Investment Bank Special Administration Regulations 2011 SI 2011/245 which were not in place at the time of the Lehman demise.
[123] *Re MF Global UK Ltd (in special administration)* [2013] EWHC 92 (Ch), [2013] All ER (D) 221; *Joint administrators of MF Global UK Ltd v Attestor Value Master Fund LP in Re MF Global UK Ltd (in special administration)* [2013] EWHC 2556 (Ch), [2014] 1 WLR 1558.
[124] *Re MF Global UK Ltd (in special administration)* [2014] EWHC 2222 (Ch), [2014] All ER (D) 88.

Conclusion

The analysis supports a conclusion that the UK administration was fair and was as effective as it probably could have been in the circumstances. The jurisdictional issues that might have been thought to arise on the failure of Lehman in relation to the location of intermediated securities and the proprietary effect of particular transactions did not, in fact, arise in the English cases. This question now needs to be explored from the perspective of the US litigation to see whether the same conclusion can be drawn for that jurisdiction. Following the US analysis, it will be necessary to identify the reasons why these theoretical issues did not arise.

Chapter Four
A critical review of the US case law

Introduction

The initial hypothesis made before the process of reviewing the US Lehman cases began, was that few, if any, would prove to be relevant. This was on the basis first, that the Lehman bankruptcy judge had entered into a cross-border protocol with a number of jurisdictions (the UK was not a party to this protocol) that enabled him to obtain:

> "a series of bi-lateral agreements that became essential building blocks for Lehman's consensual plan"[125]

which (it was assumed) reduced the number of complex issues going to trial (the "Lehman Protocol"). Ultimately, two settlement agreements were entered into in April 2013; the first amongst the LBI Trustee, LBIE and the LBIE administrators[126] and the second between the LBI Trustee and the LBHI entities.[127]

A further reason for the hypothesis that few US Lehman cases would prove to be relevant was that litigation in the UK had not resulted in any relevant cases. In many respects, the Lehman entities in the UK and US were similar in that they both used trans-national documentation, such as the Master Agreement, and this was either governed by English or New York law depending upon the jurisdiction of the relevant entities. This suggested that, to the extent that issues arose in the US in the context of swaps and derivatives transactions, they were likely to be similar to those in the UK and to relate to matters of construction and interpretation.

As the methodology for identifying the relevant US case law has already been explained, the cases derived from that exercise will now be explored. Appendix 5 sets out the classification of the US Lehman cases, of which only cases in the first category, being "*Cases with a cross-border element and/or which considered issues relating to intermediated securities"* were deemed to be relevant to the Thesis. Only one of the MF

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[125] James Peck *Cross-Border Observations Derived from my Lehman Judicial Experience* (2015) 3 JIBFL 131, 133.
[126] *In re Lehman Brothers Inc.* (US Bankr SDNY 2013) WL 1618029.
[127] *In re Lehman Brothers Inc.* (US Bankr SDNY 2013) WL 1618023.

Global cases scheduled in Appendix 6 was deemed to be fall into the same category,[128] resulting in a total of nine US cases for analysis.

The ipso facto clause cases as they apply to jurisdiction

The first US case with a cross-border perspective was heard in January 2010 when the US court made its determination of the matter that was also in issue in the English law *BNY Trustee* case.[129] As previously discussed, the US court held that the "flip" clause was an unenforceable *ipso facto* clause, that any enforcement of the clause would be in violation of the automatic stay and that priority lay with LBSF.[130] This was in direct contrast to the position established by the English court, which was that the contractual provisions were valid, effective and enforceable as a matter of English law and so established noteholder priority. The US court reached its decision having considered the nature of the contract between the parties, concluding that it was an executory contract (being one where an element of performance remains due on both sides) and therefore one which could not be modified or terminated by an *ipso facto* clause under section 365(e) of the US Bankruptcy Code.[131] Although this decision has been criticised in the US, it has not been the subject of an appeal.[132]

It is worth noting at this point that the US court also considered the effect of the Safe Harbour provisions in section 560 of the US Bankruptcy Code in this case. Bank of New York had contended that priority should be given to the noteholders on the grounds that they were in the position of a non-defaulting swap counterparty and were therefore protected by the Safe Harbour provisions. The Safe Harbour provisions were important, because if they were deemed to apply, they would have enabled the contract to be terminated precisely because of the debtor's (LBSF's) insolvency. Essentially, the Safe Harbour provisions protect the rights of a non-defaulting swap participant either to liquidate or terminate a swap transaction or to offset or net off any payment amounts due under the swap agreement in a case where the defaulting counterparty has become insolvent or entered into bankruptcy proceedings. The US court held that there was no

[128] *In re MF Global Inc.* 492 BR 407 (US Bankr SDNY 2013).
[129] *In re Lehman Brothers Holdings Inc.*422 BR 407 (US Bankr SDNY 2010).
[130] Ibid 11.
[131] Ibid 7, 8.
[132] See, for example, the discussion in *In the matter of Lehman Brothers Australia Limited (in Liquidation)* NSD 2102 [2011] [37].

evidence that the noteholder priority arrangements formed part of the swap agreements in place. This meant that they could not be protected under the Safe Harbour legislation.[133]

In August 2015, the issues that arose in the *BNY Trustee* case were almost replicated in the *Shield* case,[134] although the focus of the court in *Shield* was on the nature of the court's jurisdiction. LBSF claimed that Shield's actions outside the US had a sufficient effect upon the position of LBSF within the US that the court was entitled it to exert its *in personam* jurisdiction over Shield. Failing that, LBSF claimed that the court was entitled to exert its *in rem* jurisdiction, on the grounds that the proceedings concerned a dispute over property belonging to the LBSF estate.[135] Needless to say, the transaction in question was complex.

Shield was a Guernsey based company, whose ultimate parent was French. It was the beneficial owner of a US $40 million note issued by an Irish company, "Ruby". Ruby had granted security over the US $40 million worth of assets to a Trustee to hold on behalf of the noteholders. The assets themselves were held by a custodian based in England. At the same time, Ruby had also granted a security interest over the same assets in favour of LBSF (involved in the transaction as Ruby's counterparty in a credit default swap). This was under the same style of *ipso facto*, or "flip", clause that had been seen in the *BNY Trustee* case. All the transaction documents were governed by English law and the forum and choice of law clauses required any disputes to be heard in England and governed by English law.[136]

When LBHI went into insolvency proceedings, the default enabled Shield to terminate the swap. Shield directed the Trustee to liquidate the collateral and make a distribution to Shield, which it did in May 2009. In September 2010, LBSF began proceedings to contest the application of the collateral in favour of Shield.[137]

Shield claimed that the US court had no *in personam* jurisdiction over it as it did not have minimum contacts with the US and the US court agreed[138] The US court nonetheless asserted its *in rem* jurisdiction, based on the premise that it had "exclusive jurisdiction of

[133] Ibid 11.
[134] *In re Lehman Brothers Holdings Inc.,* 535 BR 608 (US Bankr SDNY 2015).
[135] Ibid 612.
[136] Ibid 613-614.
[137] Ibid 615-617.
[138] Ibid 620, 627.

all the property, wherever located, of the debtor *as of the commencement of such case* [*ibid*] and of property of the estate".[139] According to the court, the property of the estate comprised the transaction documents as well as LBSF's security interest in the assets held by the custodian.

The approach of the US court to jurisdiction was reaffirmed in the *ANZ Nominees* case[140] where the facts and issues were similar to the *Shield*[141] case. ANZ Nominees was an Australian bank and the sub-custodian of collateral held as security in respect of certain notes issued by a company incorporated in the Cayman Islands. The transaction documents were governed by either New York or Australian law and contained a flip clause under which the collateral would either go to LBSF (as swap counterparty) or the noteholders. Following LBSF's default, ANZ Nominees paid the noteholders and LBSF contested this on the basis that the *ipso facto* clause was unenforceable.[142] Although counsel for ANZ Nominees successfully argued that the fact that it had not yet been proved that the *ipso facto* clause was unenforceable meant that LBSF could not claim a proprietary interest in the distributed funds for the purposes of establishing the court's *in rem* jurisdiction, the court relied on both *BNY Trustee* and *Shield* for establishing that LBSF had a proprietary interest in the transaction documents and collateral.[143]

The *Shield* and *ANZ Nominees* cases are useful for affirming the extent of the US court's jurisdiction. The cases make it explicit that the US bankruptcy court's jurisdiction is far wider than that of other US courts which may "only exercise *in rem* jurisdiction over property physically within the court's jurisdiction at the time of the suit".[144] Despite this, the cases are less instructive for the Thesis than might have been hoped. Although all three cases have disputed the question of "who gets the assets on insolvency?" there has been no dispute as the location of those assets.

[139] Ibid 627.
[140] *In re Lehman Brothers Holdings Inc.*544 BR 16 (US Bankr SDNY 2015).
[141] *Shield* (n 134).
[142] *ANZ Nominees* (n 140) 21-25.
[143] Ibid 41-42.
[144] Ibid 41.

The ipso facto clauses in other contexts

The *BNY Trustee* case was also considered in two other relevant US Lehman cases, the *Ballyrock*[145] case and the Michigan State Housing Development Authority (*"MDHSA"*)[146] case. The decision in *BNY Trustee* was followed in *Ballyrock,* where a swap agreement entered into by Ballyrock and LBSF was terminated on LBHI's bankruptcy. The issue arose as to whether a clause in the agreement which deprived LBSF of the right to collect a termination payment because of LBHI's insolvency was an unenforceable *ipso facto* clause. It was held that the clause was unenforceable, directly applying the decision in *BNY Trustee*; the judgment also reiterated the point that such clauses were not entitled to protection under the Safe Harbour provisions.[147]

In the *MSHDA* case, the decisions in *BNY Trustee* and *Ballyrock* were distinguished*.* MSHDA had entered into various interest rate swaps with a subsidiary of LBHI which were governed by an ISDA Master Agreement. The issue arose as to whether a term in the contract which required certain liquidation procedures to be implemented in the event of LBSF's bankruptcy that were more favourable to the non-defaulting party (here MSHDA), constituted an unenforceable *ipso facto* clause.[148] It mattered to LBSF because, if LBSF could have used a different method for calculating the sums due under the swap (which it could have done if its bankruptcy filing were to be disregarded), it would have recovered a lot more money.

The court considered the scope of the provisions of sections 365(e) and 560 of the US Bankruptcy Code. In this case, it was the bankruptcy of LBSF which determined the choice of method to be used to calculate the settlement amount under the swap agreement. The Safe Harbour provisions under section 560 specifically exclude swap agreements from the general rule that disallows *ipso facto* clauses, enabling any contractual right to liquidate a swap transaction to be exercised. The court went on to explain how the *MSHDA* case could be distinguished from *BNY Trustee* and *Ballyrock.* In *BNY Trustee,* the flip clause was in a supplemental agreement that was not part of the swap agreement and, in any event, it did not deal with issues of liquidation so fell outside the scope of section 560. This was also the case in *Ballyrock*, where the provision in issue similarly changed the priority of payment rather than addressing the liquidation of amounts of due.

[145] *In re Lehman Brothers Holdings Inc.*422 BR 31 (US Bankr SDNY 2011).
[146] *In re Lehman Brothers Holdings Inc.*502 BR 383 (US Bankr SDNY 2013).
[147] 452 BR 31 (US Bankr 2011) 5, 6.
[148] *MDHSA* (n 146) 3.

Although these cases deal with broadly the same issue, other than the cross-border aspect that arose in *BNY Trustee*, they add little directly to the questions being considered in this Thesis. Critically, what has become clear from these cases, is the importance of the Safe Harbour rules and their importance in protecting swap transactions.

Miscellaneous cases

The Safe Harbour rules were also considered in the *Swedbank* case.[149] The case was considered worthy of review for its cross-border aspects. LBHI had held a deposit account with a Swedish bank, Swedbank, in Sweden. LBHI had entered into various transactions with Swedbank including acting as guarantor in respect of various ISDA governed swap arrangements and had entered into a Master Agreement with Swedbank governed by English law. At the date on which the LBHI Chapter 11 proceedings commenced, there were approximately 2 million Swedish Krona in the account. By November 2009, the amount in the account had increased to approximately 83 million Swedish Krona (roughly US$11.7 million). Swedbank sought to set off this sum against the sum of US$32 million which it claimed was owed to it by LBHI. LBHI contended that Swedbank was in breach of the automatic stay and should release the funds in the account to LBHI.

Swedbank claimed that it could rely on the Safe Harbour provisions governing swap transactions to net off the sums owed between the parties. The US court nevertheless held that it could not do so, because there was no mutuality in the set-off claimed. Much of the money that was in the account had been deposited post-petition and the debts and credits could not be said to be in the same right and between the same parties in the same capacity as was required under US law.[150]

The difficulty here for the US court was that the money was not within the jurisdiction and so it would have required the assistance of the local Swedish court to recognise and enforce the US judgment and have the funds released. Although there was a cross-border aspect to this case, as with the *BNY Trustee* litigation, the issues it raised are not of direct relevance to the Thesis.

The second case that falls into the "miscellaneous" category is the *Bank of America* case, which similarly concerned set-off and provides a cautionary tale for anyone responsible for

[149] *In re Lehman Brothers Holdings Inc.,* 433 BR 101 (US Bankr SDNY 2010).
[150] Ibid 5.

drafting security documents.[151] It was analysed less for its cross-border aspects than for its exposition of the behaviour of other banks towards the Lehman entities in the period before the group became insolvent.

Bank of America was one of Lehman's principal clearing banks. Whilst it expected temporary negative balances to occur during the course of the banking day, in July 2008, it discovered that Lehman had a US $650 million overnight overdraft in one of its accounts. As a consequence, it negotiated a security agreement with LBHI that required LBHI to lodge cash collateral as protection against the intra-day overdraft risk it posed.

After LBHI's bankruptcy proceedings commenced, Bank of America removed funds from the cash collateral account to set against other obligations owed to it by LBHI, in breach of the automatic stay. Bank of America contended that it was permitted to do this under the terms of the security agreement and claimed that this action was exempt from the automatic stay. (As a matter of English legal practice, the Bank of America contention might be understood as arguing that a transaction specific covenant to pay clause in a debenture was intended to work as an all monies clause; it is unlikely that an English court would have accepted this argument.) The issue was one of construction and the US court held that the security agreement did not cover indebtedness beyond the overdrafts and did not apply to obligations owed by LBHI to Bank of America under derivative agreements. Ultimately, the security agreement only protected the overdraft amounts; an irony that was not lost on the US court which referred to Bank of America "asking for more and getting less".[152] Bank of America had wanted additional protection for its position, yet had failed to draft a definition of "indebtedness" that would enable funds in the account to be applied as part of a general right of set-off. Bank of America was required to return the funds.

Although this case adds little directly to the questions being consider in the Thesis, it resonates with a number of the English law judgments that had to determine how certain complex transaction documents should be construed in the light of inadequate drafting.

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[151] *In re Lehman Brothers Holdings Inc.,* 439 BR 811 (US Bankr SDNY 2010).
[152] Ibid 7.

The SIPA customer cases

Three of the cases identified (two Lehman cases, the other the MF Global case) were considered potentially relevant for their discussion of repo transactions and the nature of possession. All the cases revolved around the definition of who is a "customer" of a bankrupt broker-dealer for the purposes of protection under SIPA.[153] The SIPC trust fund will compensate SIPA customers up to a specified amount for losses incurred by those customers as a consequence of having entrusted securities or cash to a broker-dealer which has become insolvent.[154] The particular issue of whether claims constituted "customer" claims had arisen in a number of Lehman cases[155] and, in the first Lehman case considered here, the representative claimants were three banks, described in the judgment as "typical of the class of claimants" asserting such rights (the "*Three Banks"* case).[156]

The claimants had entered into various repo transactions governed by an industry standard Master Repurchase Agreement.[157] The nature of these transactions has been discussed in Documents 3 and 4, but it makes sense briefly to outline a typical repo transaction (as described in the case) to put this case in context. Essentially, there are two stages to a repo contract which are generally described as a "repo" from the seller's perspective and a "reverse repo" from the buyer's perspective. Stage one requires the seller to transfer securities to a counterparty buyer in exchange for cash. The buyer simultaneously agrees to transfer the securities back to the seller in exchange for cash at an agreed future date. At stage one, the value of the securities transferred is generally higher than the cash paid (this serves as protection against any market fluctuations) and when the original seller buys the securities back (stage two), the price will include a fee (the effect being equivalent to the payment of interest on a loan).[158]

In the *Three Banks* case, the claimants were held not to be customers entitled to SIPA protection on the grounds that there was no property of the claimants in the claimants' accounts with LBI on the date of its bankruptcy. Appreciating this decision requires an understanding of the three types of delivery possibilities in these transactions. The first

[153] 15 USC § 78111(2)
[154] See the SIPC website www.sipc.org/about-sipc/sipc-mission accessed 20 April 2016.
[155] See, for example, cases 24 and 28 of Appendix 4.
[156] *In re Lehman Brothers Inc.* 492 BR 379 (US Bankr SDNY 2013) 380-381.
[157] Ibid 382.
[158] Ibid 383.

is the bilateral arrangement, whereby the securities are delivered against the payment of cash; the second is the "hold-in-custody" arrangement, whereby the purchased securities remain in a blocked account of the seller for the buyer until the repo ends; and third is the tri-partite arrangement whereby the buyer and seller enter into a contract with a third party which acts as intermediary between the counterparties.[159]

In this case, the arrangements were all bilateral. When assessing whether the claimants had "entrusted cash or securities" to the broker-dealer for the purposes of SIPA,[160] the court had to look at whether or not there was "actual possession" of the cash or securities by the broker-dealer; explaining the term "entrustment" as "receipt, acquisition or holding of" the relevant asset and that the parties':

> "contractual expectations and retained interests [were] insufficient in themselves to establish the key possessory elements that are needed to establish entrustment".[161]

On the facts, although LBI had set up delivery versus payment accounts for the various counterparties, it did not hold any assets in them.[162] Because no customer property was entrusted to LBI, the claimants were not entitled to customer protection under SIPA. The problem for the claimants was, of course, that LBI failed to meet its contractual obligation to return the securities to them under stage two.

A similar issue arose in the US in the MF Global insolvency, only this time in the context of bilateral TBA contracts to buy and sell mortgage-backed securities.[163] These kind of futures contracts work so that, during the period between the trade and settlement date (which can be several weeks) the parties enter into two contracts to obviate the need to actually deliver securities on the settlement date. Under the first contract, A agrees to buy a specified number of securities at a specified price from B on the settlement date and under the second contract, A agrees to sell the same number of securities, at a different price to that specified under the first contract, to B on the settlement date. On the

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[159] Ibid.
[160] 15 USC § 78111 (2).
[161] *Three Banks* (n 156) 388.
[162] Ibid 388.
[163] *MF Global Inc.* 492 BR 407 (US Bankr SDNY 2013). TBA is an acronym for "to-be-announced" as the agreement to buy or sell the securities is at a future date "to be announced" and the securities for delivery are not specified until the time of the contract (410).

settlement date, it only then becomes necessary to pay the difference in the price between the paired contracts and this is done on a delivery versus payment basis. This means that, during the period between the trade and the settlement dates, the parties continue to hold the property to be exchanged and the broker-dealer, which acts as intermediary, does not hold the property of either of the contracting parties. It is clear from this that, at no time during the course of a TBA contract, are securities "entrusted" to the broker-dealer for the purpose of SIPA. Unsurprisingly, the claimants were held not to be SIPA "customers" and were not entitled to SIPC compensation. The difference between this case and the *Three Banks* case was that, here, no securities had been transferred; rather MF Global had failed to make the payment due at the end of the contract.

Both these cases illustrate that a party wishing to benefit from SIPC compensation could only do so in a case where it had lodged securities with a broker-dealer and where those securities were actually in the possession of that broker-dealer at the time of the insolvency. This was reiterated in the final case in this category considered here and which involved interest rate swaps.

In the second of the Lehman SIPA cases[164] FirstBank had posted collateral with LBSF under a Master Agreement. The Master Agreement allowed LBSF to appoint a custodian and, accordingly, it appointed LBI. The Master Agreement also allowed LBSF to use the posted collateral. The arrangements between LBSF and LBI were governed by a Master Repurchase Agreement (the "MRA") under which the title to the posted collateral was deemed to pass to LBI. LBI then used the posted collateral (that is, the collateral originally provided by FirstBank) to enter into various repo transactions, as it was entitled to do under the MRA. LBSF was not obliged to repurchase the posted collateral, so the MRA included a close-out provision that required the immediate payment by LBSF of the agreed purchase price. The LBSF-LBI repos were documented in the relevant stock ledger. The failure of LBHI triggered an event of default under the swaps and terminated LBSF's right to use posted collateral. On the event of default, LBSF repurchased a number of its positions from LBI, but some remained outstanding. LBSF ultimately failed to pay the amount necessary to repurchase the posted collateral. The posted collateral had been used by LBI for a number of repo transactions that it had entered into with Barclays. When Barclays purchased LBI's assets in the days after its bankruptcy filing, it was agreed that

[164] *In re Lehman Brothers Inc* 61 Bankr Ct Dec 220, 88 UCC Rep Serv 2d 268 (US Bankr SDNY 2015).

the repo transactions between Barclays and LBI would terminate. The LBI assets were subsequently sold and the sale included the posted collateral.

FirstBank's claim that it was a SIPA customer failed for two reasons. First, because the court held that LBI had not been "entrusted" by FirstBank (the relationship was one of "mere delivery") and second, because LBI did not hold any of FirstBank's posted collateral on the filing date (because it had been purchased from LBI by Barclays under a separate repo agreement).[165]

What is interesting about these three cases for the Thesis is that they all addressed the issue of possession and, in the *FirstBank* case, the issue of location. In *FirstBank,* the claimant argued that:

> "the modern indirect holding system for securities… is grounded on… interests in *securities positions*… and not on the physical location of *securities.*"[166]

The court, it is submitted correctly, rejected FirstBank's claim that its securities position should have been protected by the indirect holding system.[167] This was on the grounds that LBSF was contractually entitled to rehypothecate the collateral that had been posted by FirstBank. LBSF had then exercised its contractual rights by selling FirstBank's collateral to LBI. As LBI was not in a contractual relationship with FirstBank, so no claim could be made by FirstBank against it.[168]

FirstBank's claim is not supported by the law as it has been discussed in Documents 3 and 4. As with the *Three Banks* case, the *FirstBank* case demonstrates a real example of the "shortfall" problem, described earlier.[169] At law, an absolute transfer of title had taken place and it was the location of the securities (which were then in the hands of LBI) that mattered for the purposes of determining ownership.[170] FirstBank could identify the series of transactions through which its securities had passed, but had no right to reclaim them,

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[165] Ibid 9.
[166] Ibid.
[167] Ibid.
[168] A little like the old-fashioned game of "pass the parcel". If the music stops (default) and you are holding the parcel (collateral), it is yours. If you have handed it on to someone seconds before the music stops, you have nothing. Small children instinctively understand these rules and abide by them even if they seem unfair at times.
[169] Outlined at p7.
[170] Interestingly, the quotation from FirstBank refers to the "physical" location of the assets, albeit that they are intangible.

since the new absolute owner was LBI; FirstBank's proprietary interest in the securities had been downgraded to a personal right to claim for their value.

This example raises the question of the "fairness" of the rules, which is pertinent to the Thesis. Was it unfair that FirstBank could not reclaim its securities from LBI and subsequently Barclays? The court appeared to give short shrift to FirstBank's arguments, stating that:

> "The loss FirstBank incurred was not due to the failure of its broker-dealer, but by its own failure to submit a claim against its counterparty or credit support provider".[171]

There are a number of questions raised by this statement. Why did FirstBank not bring personal and proprietary claims against all those who might be potentially liable to it? Was this a failure on the part of its legal counsel to give it good legal advice or was FirstBank acting on its own initiative? Second, is the law in this area deficient? Was FirstBank right to feel aggrieved that its property had been taken from it and passed on to someone else? Or was it enough to say that the law offered it alternative means of redress through a personal claim against LBSF and that the court knew, that, had it done so it would either have recovered in full, or had a greater chance of recovering in full?

Conclusion on the US Lehman and MF Global cases

Having completed a review of the US Lehman and MF Global cases, it is apparent that the hypothesis outlined in the introduction to this chapter was not entirely correct: the location of assets was an issue in some of the SIPA customer cases, albeit that it was not raised from a cross-border perspective. An exploration of the US cases has identified that the theoretical shortfall problem caused by an intermediary having used a party's securities in repo transactions for its own ends was a real world problem. Although only two of the three SIPA customer cases discussed here involved a "loss" of securities as a consequence of them having been rehypothecated by the intermediary, there were two other SIPA customer cases listed in Appendix 4 which were not considered (due to the methodology adopted) but which may have been brought for the same reasons, bearing in mind Judge Peck's remarks in the *Three Banks* case, that it was "the latest in a series of similar

[171] *FirstBank* (n 164) 9.

proceedings".[172] It is clear that the SIPA customer claims were being pursued in order to obtain compensation from SIPC with a view to maximising the claimants' chances of full recovery in the insolvency.

Otherwise, there was little discussion in the cases as to the location of assets. Where cross-border disputes have arisen, the law governing the location of the assets has not been disputed by the parties, rather they have disputed the question as to whom the assets in a particular jurisdiction belong. In many of the cases, this has turned on the question of contractual interpretation and whether a clause will be determined to be an unenforceable *ipso facto* clause.

Two further points are worthy of comment. It must be noted that, as a matter of US law, the US bankruptcy court has global jurisdiction. This was reiterated in *ANZ Nominees* where the court cited section 431(a) of the US Bankruptcy Code and section 1334(e) of title 28 of the United States Code as confirmation that the US Congress "explicitly gave bankruptcy courts global reach over the debtor's property".[173] This means that (in theory at least) location does not matter for US purposes; a US claimant can simply assert entitlement to its assets wherever they are in the world and the US bankruptcy courts will uphold the US claimant's rights. Clearly, as was noted in *ANZ Nominees*, local (practical) assistance is required for any such claim to be effective within the jurisdiction where the assets are to be found (in *ANZ Nominees*, for example, LBSF will still have to enforce the judgment of the US court in Australia).[174] The raises the issue of cross-border judicial co-operation which will ultimately determine whether the approach of the US bankruptcy court in claiming global jurisdiction in the application of US insolvency laws is effective and produces fair outcomes for all parties (and not just US based claimants). This is essentially a matter of comity; will the US claimant's interest be upheld by the local court? (Although a more interesting question might be as to whether the US bankruptcy court would uphold a non-US claimant's claim to contested property in the US). Much work has been done in seeking to establish a universal approach to the recognition of parties' rights on insolvency through the implementation of initiatives such as the UNCITRAL Model Law,[175] but cases such as *BNY Trustee* illustrate that gaps remain.

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[172] *Three Banks* (n 156) 380.
[173] *ANZ Nominees* (n 140) 41.
[174] Ibid.
[175] United Nations Commission on International Trade Law ("UNCITRAL") *Model Law on Cross-Border Insolvency* 1997 United Nations.

The second point of note is that all the parties involved in these cases (other than in the SIPA customer cases) either understood or took for granted the rules relating to the location of assets, to the extent that they were relevant to understanding the rights of disputing parties' to those assets, where those assets were intermediated securities. The Safe Harbour provisions provided some comfort for those engaged in swap transactions by enabling their positions pre-default to benefit from close out netting. This might suggest that the regime in place is effective, although this requires further consideration, as does the question as to whether the regime is fair. FirstBank, it is submitted, did not think that the regime was fair, although the court considered that FirstBank was the author of its own misfortunes.[176] The court's view may well be correct; it seems likely that FirstBank was a sophisticated institution and would have been in a position to contract for the best terms e*x ante*. This would indicate that the US approach was essentially fair.

[176] As will be seen in Chapter 6, approved unsecured claims against LBI received a dividend, even though 100% recoveries are not anticipated at the time of writing.

Chapter Five
The Examiner's Report

Introduction

The US case law has indicated that the shortfall problem was more than a theoretical one, as is evidenced by cases where certain institutions sought to establish that they were SIPA customers; they did this in order to be eligible for SIPC compensation, it is contended, to make good their losses. For a fuller understanding of the wider US Lehman position, brief mention must be made to the Examiner's Report produced by Anton R Valukas and published in March 2010.[177] The broad purpose of the Examiner's Report was to determine whether there were any "colorable" (that is, plausible) legal claims that could be brought against Lehman entities, executives or certain third parties. The claims were referable to three heads: first, claims arising from Lehmans' financial condition and failure; second, administrative claims or claims for preferences or voidable transfers; and third, claims in respect of specified transactions.[178] Inevitably, much of the content of the Examiner's Report (which ran to nine volumes) had no direct relevance to the Thesis. Despite this, there were two elements of the Examiner's Report that merit further discussion.

Article 8 of the Uniform Commercial Code ("UCC")

One of the issues that the Examiner's Report specifically considered was whether any colorable claims could be brought against Barclays as a consequence of the transfer to Barclays of securities belonging to LBHI affiliates by LBI in the immediate aftermath of the Lehman's collapse (see the *FirstBank*[179] case above). The Examiner concluded that no claim could be brought against Barclays for losses suffered by the LBHI affiliates on the grounds of an improper transfer.[180] For FirstBank, this was a different issue from that discussed in the SIPA customer case, where FirstBank had sought to bring a claim against LBI. This was about trying to establish whether the LBHI affiliates could bring a claim against third parties which had acquired their assets.

The Examiner's conclusion was based on an analysis of the conflict between state law (which generally determines the property interests in a debtor's estate for the purposes

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[177] *In re Lehman Brothers Holding Inc.* (n 49).
[178] Examiner Report (n 49) Volume 1, Section I.
[179] *FirstBank* (n 164).
[180] Examiner's Report (n 49) Volume 5, 2064ff.

of the US Bankruptcy Code)[181] and the law governing the transaction, in this case, New York ("NY") law which had enacted the revised Article 8 of the UCC on securities and securities entitlements.[182] Under NY UCC section 8-110(b), it was the jurisdiction of the securities intermediary (here LBI) that governed whether the LBHI affiliates could bring a claim against LBI as securities intermediary for transferring assets to Barclays. In order to bring a case against a third party, it had to be shown that Barclays had not only provided valuable consideration for the securities but also controlled them and further, that Barclays had colluded with LBI for the purposes of violating LBI's obligations.[183] On the facts, there was no evidence of collusion. The discussion is relevant to the Thesis as the Examiner's Report outlined the law that determines whether or not a proprietary claim could be made against a third party. There was no dispute over the *location* of the assets in this instance; the parties agreed that Barclays had the necessary control over the assets to establish this.

Specifically, the Examiner noted,

> "Article 8 substantially limits the right of "entitlement holders", such as the LBHI affiliates to recover from third parties losses resulting from wrongful transfers of their securities by a securities intermediary".[184]

Thus the rights of the party which views itself as the ultimate beneficial owner of the intermediated securities has rights that are lesser than ordinary property rights. Article 8 specifically prohibits the entitlement holder from bringing a proprietary claim under the common law against the third party unless the securities intermediary has colluded in making an improper transfer. Specifically, for FirstBank and any other parties whose securities had been sold on, there was no possibility of tracing into the hands of Barclays on the basis of a constructive trust as this was specifically prohibited by the statute.[185] Like the FCD, the policy objective is to smooth commercial transactions; in this case to ensure that third parties will only be pursued in cases where a strong claim can be brought

[181] 7632 11 U.S.C. § 363(b), 541(a) (2006) (US) available at https://www.law.cornell.edu/uscode/text/11/541 (accessed 21 February 2016).
[182] Available at http://codes.findlaw.com/ny/uniform-commercial-code/ucc-sect-8-110.html (accessed 21 February 2016). The issue of jurisdiction under the UCC was discussed in Document 4. It is assumed that the Barclays securities were in a US account.
[183] NY UCC § 8-503 (US). Available at https://www.law.cornell.edu/ucc/8/8-503 (accessed 21 February 2016).
[184] Examiner's Report (n 49) Volume 5, 2067.
[185] NY UCC § 8-503(e) (US).

against them. As has been observed in earlier documents, this policy objective is a manifestation of the tension between the protection of the ultimate investor and the requirements of an efficient market.

As was seen in the FirstBank case, the rehypothecation of FirstBank's assets (by first LBSF to LBI and then by LBI to Barclays) took effect under the contractual arrangements in place between the parties. LBSF failed to pay the necessary funds to LBI for it to re-transfer collateral to LBSF as part of FirstBank's securities entitlement but as the transfers could not even be classified as "wrongful" there were no means for FirstBank to establish a claim. In the absence of fraud or wrong doing, therefore, there is little that the ultimate investor in the position of FirstBank can do other than to contract for better *ex ante* protection, or failing that, claim in the insolvency and hope that the dividend will be as close to 100% as possible. The only other possibility for a claimant in this position is that the state will intervene. In the US, this has happened through the protections afforded to SIPA customers, but such protections do not apply to all circumstances as the FirstBank situation illustrates.

Repo 105[186]

The second matter of interest in the Examiner's Report is the section of the report that considers the "Repo 105" issue. Although on the face of it this can be construed purely as a matter of accounting, a closer inspection takes it to the heart of understanding the role that property interests play in determining the effects of particular transactions. In addition to the property law issue that it throws up, it also forces the reader to reflect upon the ethical considerations associated with effecting legal transactions through the provision of legal opinions and whether the intervention of lawyers can have an effect on the "fairness" of an outcome in the event of insolvency. As the Repo 105 matter concerned an English law legal opinion, this issue is relevant to the Thesis bearing in mind its identified standpoint of the practising lawyer.

The discussion in Chapter 4 of repo and reverse repos illustrated that they are, essentially, a mechanism for borrowing and lending either cash or securities that equates to a secured lending transaction.[187] Their purpose is to make money grow; rather than having cash or

[186] There were, in fact, two schemes, Repo 105 and Repo 108, which were collectively referred to as Repo 105. See Examiner's Report (n 49) Volume 3 fn 2847.
[187] Chapter 4, 49.

securities sitting idly in an account, they are put to use to generate an income stream by enabling the lender to charge the borrower for the use of the cash or securities in question. Because these transactions lead to a transfer of ownership, they can also be construed as outright sales. The perspective taken on a particular transaction can affect how it is treated for accounting purposes. Loans will appear on the balance sheet of the company in question, whilst inventory that has been sold will not.

Under the Repo 105 agreements, Lehman borrowed tens of billions of US dollars which it used to pay down its debts. Whilst its balance sheet showed a reduction in leverage as a consequence, it did not show the corresponding obligation on the balance sheet to repay the debt. It used the Repo 105 transactions in the periods before it was required to produce a public report on its financial situation and used them increasingly during 2007 and 2008. It never publicly disclosed either its use of these methods, or its accounting treatment of them.[188] Further, Lehman actively misrepresented its treatment of the transactions by claiming in its financial statements that all repos were treated as financing arrangements rather than sales for accounting purposes.[189] This lack of transparency makes it difficult to see how the Lehman approach to the undertaking of these transactions was anything other than deliberately deceptive.

This submission is supported by the fact that when Lehman first began to use Repo 105 transactions in 2001, it could not get a US legal opinion to support their construction as a "true sale" for US accounting purposes. Instead of running the Repo 105 transactions through the US business, LBSF and LBI therefore transferred their securities inventory to LBIE, which executed the transactions on their behalf, relying on the basis of a legal opinion that characterised the transactions as true sales which was issued by Linklaters, an English law firm. [190]

It is not surprising that an English law firm characterised these transactions as sales since that is the correct English law analysis.[191] As Kershaw and Moorhead acknowledge, however, English counsel were not asked whether the Repo 105s constituted a sale for the purposes of US accounting requirements, rather they were asked whether, as a matter of

[188] Examiner's Report (n 49) Volume 3, 733-734.
[189] Ibid 735.
[190] Ibid 740. Linklaters is one of the most influential and successful global law firms based in the City of London.
[191] See Documents 3 and 4.

English law, the transaction constituted a sale.[192] Despite this, the legal opinion provided by Linklaters helped to support an accounting treatment in the US that clearly did not reflect what would be expected either of an English company's balance sheet in terms of providing a "true and fair view" of the company's financial position[193] or of a company complying with US generally accepted accounting principles.[194] This is something that should give practising lawyers, as reflective practitioners, pause for thought. It has been submitted that the development of English corporate law has been essentially pragmatic; the flexibility of English law has enabled lawyers to adapt it to resolve legal problems to meet the needs of clients wishing to do business. Arguably, the lawyers in question may have thought that was all that they were doing here (if they questioned what they did at all) and, in any event, the opinion that they delivered was correct as a matter of English law and it is not clear what, if anything, they knew about the wider transaction. But looking beyond the face value of the transaction, were any other considerations at play? Were they simply following a client's instructions to make a transaction work that otherwise would not work (and thus enabling the march of commerce and economic progress) or were they choosing not to consider the possible consequences for investors (at best, potential financial losses and at worst insolvency) of issuing a legal opinion that would support a questionable accounting policy? Should lawyers make transactions work at any cost? The Repo 105 mechanism was ultimately duplicitous, but it was given validity through judicious forum shopping for the right legal opinion.

Conclusion

Having reviewed the English and US Lehman and MF Global cases as well as the Examiner's Report, no major cross-border issues arose that related to the law governing the location of the securities. Nonetheless, both the identification and shortfall problems do appear to have arisen in in the context of the Lehman companies' dealings with intermediated securities. This means that the problems thrown up in the event of the insolvency of an intermediary are "real world" problems and not merely theoretical. What is interesting is

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[192] David Kershaw and Richard Moorhead '*Consequential Responsibility for Client Wrongs: Lehman Brothers and the Regulation of the Legal Profession*' (2013) 76(1) MLR 26-61, 36.
[193] Section 396 Companies Act 2006.
[194] The US position was complicated by the tension between US GAAP and compliance with Statements of Financial Accounting Concepts ("SFAC") and Standards ("SFAS"). Lehman focused on the compliance requirement for SFAS 140 which required certain over-collateralisation requirements to be met as a means of establishing a loss of control over an asset enabling it to be equated as a sale. Examiner's Report Volume 3, 755 -756; in the Examiner's Conclusions (963-4ff) it was noted that technical compliance was not enough; the courts required an accurate reflection of the company's overall financial status.

that the problems do not appear to be evidenced in the cases in quite the same way on both sides of the Atlantic.

There were clearly issues with the identification of assets held by intermediaries in the English law cases as was evident from Lehman's failure to comply with the CASS rules; had Lehman complied with its obligations to segregate client assets it would have been far more straightforward for the administrators to identify and return assets than it was. This is illustrated in the second CASS rules case discussed where the failure properly to segregate client monies had resulted in a shortfall and the Supreme Court had to adopt a purposive "claims" rather than "contributions" basis for distributing funds.[195] This issue does not arise in the US Lehman cases identified.

In the US, two of the SIPA customer cases discussed provide evidence for the proposition that the use of an investor's securities for the intermediary's own repo transactions can result in a shortfall for the investor in the event of the intermediary's insolvency. The same result was not evident from a reading of the English law cases, but this is probably because the shortfall problem was exposed in the US because the investors sought compensation from an alternative source (the SIPC fund). Absent the SIPC fund, the shortfalls experienced by these US investors would, presumably, have been hidden amongst the other claims in the insolvency.

It is also clear that, in the absence of fraud, the ultimate investor's proprietary interest in the securities it has lodged with an intermediary is extinguished when they are transferred to a third party under a repo transaction. The investor's proprietary interest is replaced with a personal claim. The investor is specifically prohibited from claiming that a constructive trust in its favour exists over the securities held by the third party under UCC Article 8 803(e).

[195] *Second CASS Rules* case (n 80).

Chapter Six

Analysis and evaluation: answering questions one and two

Introduction

As has been discussed in Chapter 2, the original question posed for this Thesis was whether "our existing rules [are] sufficient to provide a fair and effective regime governing the location of assets" when those assets are in dematerialised form. The question was asked in the fall out from the financial crisis which had led to serious losses being suffered by many sophisticated financial institutions through their financial market activities involving electronically held securities. The crisis affecting financial institutions had a significant social impact, resulting in the insolvency of businesses and a decline in the standard of living for many citizens across the US and the EU.[196] It therefore matters whether the rules that deal with intermediated securities are fair and effective, not only for investors but because of the repercussions for society that result from the insolvency of financial institutions and the impact of their failure on the financial markets.

The two particular areas of concern for the ultimate investors of intermediated securities in this context are first, actually being able to identify their assets where they are held in a pooled account and second, determining whether all their assets are actually available for return (the "identification" and "shortfall" problems discussed in Chapter 1) which becomes a matter of applicable law. The shortfall problem must be distinguished from the problem of a reduction in market value. In any insolvency, the value of a company's assets will be diminished, whether they are sold on a going concern basis or as part of a fire sale. The shortfall problem arises where the intermediary holding a pool of assets for investors has insufficient assets available to go around; a situation which might arise where securities have been rehypothecated. The investor protections against the consequences of a shortfall caused by rehypothecation on insolvency were deemed worth of further consideration, since the effect of a shortfall is that an investor loses its ownership right in the asset and replaces it with an *in personam* claim for the monetary equivalent, which is of limited or no value on the intermediary's insolvency.

[196] The negative consequences of the global financial crisis for the EU are implicit in the European Commission's Green Paper *Building a Capital Markets Union*, COM (2015) 63 final, Brussels, 18.2.2015.

Preliminary work on the Thesis question had indicated that addressing this question in an insolvency context could raise complex conflict of laws issues. Chapter 2 identified a number of questions that needed to be answered in order to determine whether this was the case. Question one required an examination of the Lehman case law to elicit answers on the following points: first, whether, following the insolvency of Lehman, the law applicable to intermediated securities was an issue in the decided cases that caused "real world" problems; second, if the law was in issue, to what extent did it result in the testing of jurisdictional limits in establishing the ultimate ownership of those assets; and third, what principles were applied across jurisdictions in achieving the proprietary effect (the ownership outcome) that was achieved? Once these questions were answered it would then be possible to consider the question of the fairness and effectiveness of the regime affecting rights to intermediated securities on insolvency.

Was the law governing the location of intermediated securities an issue in the cases?

The findings from the cases and the Examiner's Report have illustrated that, whilst the question of location was considered in some (very few) of the cases, it was not considered from the perspective of the law governing the location of the assets in question and was rarely considered in a cross-border context. This finding largely rebuts the first two assumptions made in Chapter Two when interpreting the question for the Thesis. A third assumption that needed to be challenged was the extent to which location actually matters when determining the law that governs the proprietary effect of a transaction involving intermediated securities. This requires a consideration of what "location" might mean in the context of intermediated securities.

The nature of intermediated securities was considered in Document 4 and the particular difficulties of determining the *lex situs* of intangibles noted. There are those who contend that intermediated securities are not property and that they are obligations and there are yet others who contend that they are *sui generis.*[197] Although, as a matter of English law intermediated securities and interests therein are considered to be property,[198] there have been difficulties associated with the application of the *lex situs* rule. In which jurisdiction

[197] See, for example, Eva Micheler 'The Legal Nature of Securities: Inspirations from Comparative Law' in Louise Gullifer and Jennifer Payne (eds) *Intermediated Securities; Legal Problems and Practical Issues* (Hart Publishing 2010) 131.

[198] The term "proprietary" is used with caution here. As Yeowart and Parsons note, referring to the existence of proprietary interests in intermediated securities in the international domain is not necessarily helpful as other jurisdictions may consider the same interests to be contractual or falling within a different category. Geoffrey Yeowart and Robin Parsons *Yeowart and Parsons on the Law of Financial Collateral* (Edward Elgar 2016) 319.

should they be located? Ooi has observed that determining *situs* by reference to the location of securities certificates, issuer records or the jurisdiction of a company's incorporation is unsatisfactory as none of these serve as a suitable "connecting or localising element" for the purpose of identifying the investor as the holder of the securities.[199] Establishing the correct choice of law rules is important, however, because it is critical to reducing risk in financial markets by increasing certainty of outcomes.

As discussed in Document 4, the *lex situs* question has been addressed in the context of the settlement of securities transactions[200] and in transactions involving financial collateral[201] through the use of PRIMA (Place of the Relevant InterMediary Account). UCC Article 8-110(b)(1) (also discussed in Document 4)[202] has a similar effect in that it is the jurisdiction of the securities intermediary that determines whether an investor has a "securities entitlement" against the intermediary. In his consideration of this issue, Haentjens has noted the slight differences in the ways in which the intermediary's account is established in each case. For the purposes of the SFD, the relevant account is the place where securities are registered; for the FCD it is the place of the securities account whilst under UCC Article 8-110, the parties are free to choose the applicable law.[203] Whilst these approaches could be argued to be an attempt to apply the *lex situs* rule to intangibles, as Haentjens remarks, in reality, the UCC approach has little connection with this rule.[204] It is submitted that Haentjens is correct to suggest that:

> "to consider the intermediary's location a 'place' in the sense of the traditional *situs* rule would be confusing or at least highly artificial… it is controversial if intangibles actually have a *situs* at all."[205]

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[199] Maisie Ooi 'The Choice of a Choice of Law Rule' in *Intermediated Securities: Legal Problems and Practical Issues* (2010) Hart Publishing, at p220.
[200] Council Directive 98/26/EC of 19 May 1998 on settlement finality in payment and securities settlement systems [1998] OJ L166/45, implemented in the UK as the Financial Markets and Insolvency (Settlement Finality) Regulations 1999 (as amended by Council Directive 2009/44/EC of 6 May 2009 amending the financial collateral and settlement finality directives [2009] OJ L146/37). Council Directive 2001/24/EC of 4 April 2001 on the reorganisation and winding up of credit institutions is also slightly different again in that under Article 24, the enforcement of proprietary rights in financial instruments is governed by the law of the Member State in which the register is located.
[201] FCD (n 17) (as amended by Council Directive 2009/44/EC of 6 May 2009 amending the financial collateral and settlement finality directives [2009] OJ L146/37) Art 9.
[202] Document 4, 39.
[203] There are slight variations between all three systems, as noted by Matthias Haentjens, in *The Law Applicable to Indirectly Held Securities: the Plumbing of International Securities Transactions* SDU Uitgevers (2006), 21.
[204] Ibid.
[205] Ibid.

This effectively rebuts the third assumption made at the outset of Chapter 2; it seems that place, or location bears little real relevance to the determination of the proprietary effect of a transaction involving intermediated securities.

So what was said about location in the cases? In the SIPA customer cases (where the parties were apparently all in the same jurisdiction) location was equated with possession, defined in the *Three Banks* case as "receipt, acquisition or holding of"[206] the asset for the purposes of the SIPA legislation. (It is submitted that this suggests equivalence with the English law requirement of "control" of financial collateral, since the concept of "possession" of intangibles is otherwise an artificial one).[207] A second facet to the notion of location (and one that goes beyond the concept of jurisdictional location) came from the Examiner's discussion of "off balance sheet" location in the Repo 105 transactions.[208] For accounting purposes, it did not matter where the assets actually were, as long as they were not ascribed as a liability on the balance sheet of the relevant US Lehman entities.

What, if any, relevant issues arose from the cases reviewed?

It has been concluded that neither the English law nor the US litigation raised any significant conflict of laws issues that related to establishing ownership rights in respect of intermediated securities. The English law cases discussed the proprietary effect of a number of transactions in cases such as (but not exclusively) the Extended Liens case and a number of the cases involving the CASS rules. Ultimately, most of the cases revolved around who owed what to whom and on what basis assets should be paid out. It seems that this was also the case in the US litigation. To the extent that a clearing house or custodian held Lehman assets, they either sought directions from the court as to whom the assets should be paid, as in *The Options Clearing Corporation ("OCC") v Barclays Capital Inc et al* where OCC sought directions as to which of four banks should be paid monies it held under various letters of credit;[209] or they were directed by the court to

[206] *Three Banks* (n 156) 388.
[207] The *Extended Liens* case concluded that it was not possible to take a lien over an intangible as well as considering the issue of "possession and control". The reasoning in the *Extended Liens* case relating to the requirement for more than mere administrative control was recently approved by the ECJ in *Private Equity Insurance Group SIA v Swedbank AS* (Case C-156/15). Yeowart and Parsons have argued that the concept of possession is not irrelevant in the context of intangibles, as it is possible to have possession of a negotiable instrument.
[208] Examiner's Report (n 49) Volume 3, 732.
[209] See the Trial Pleading (US Bankr SDNY 2008) WL 5187894; 445 BR 143 (US Bankr SDNY 2011).

transfer monies to a particular party, as in a number of the US *ipso facto* cases discussed in Chapter 4.

What the US cases usefully illustrate is that the shortfall problem caused by rehypothecation was a real and not just a theoretical one. This is evidenced in the *Three Banks* and *FirstBank* cases where intermediated securities belonging to the claimants had been used as collateral by LBI under repo transactions and had passed into the hands of third parties and so was unavailable for re-transfer at the relevant time. The fact that this problem was not evidenced in the English law cases in the same way does not necessarily mean that similar shortfalls did not occur in transactions involving Lehman's UK clients; clearly they were anticipated by the claimants in the English *Four Private Investment Funds* case. The US evidence for the shortfalls came to light because the claimants brought SIPA claims for compensation. These claims were only litigated where the SIPA Trustee for LBI did not recognise the claimants as SIPA customers or otherwise wanted directions on the point. SIPA claims were, therefore, largely dealt with out of court. In fact, these claims were not just made by US based claimants. An examination of the Administrators' webpages provides the necessary evidence to show that SIPA claims were made as part of an Omnibus claim by the Administrators on behalf of customers of LBIE

> "whose cash, securities or other assets were (or should have been) held by LBI on the Filing Date."[210]

Whilst it is not possible to identify the circumstances that caused each of the LBIE customers to experience a shortfall, it seems likely that at least some of the individual customer losses can be attributed to the re-use of financial collateral along the lines experienced by the US claimants. Having established this link, it makes sense to try and understand the quantum of the SIPA claims as this will go some way to illustrating just how serious the shortfall problem was for the purpose of understanding its "real world" impact.

It is difficult to obtain a precise understanding of the true value placed on the Omnibus claim by the SIPA Trustee. According to the Client Asset Updates issued by the Administrators, the SIPA Trustee initially agreed to allow Omnibus claims worth US$6.2

[210] <www.pwc.co.uk/services/business-recovery/administrations/lehman/lehman-client-money-and-assets-update-200109.html accessed 26 April 2016.

bn. This was later increased to US$8.3 bn,[211] illustrating that the size of the SIPA claim made through LBIE alone was considerable, albeit that this was not the final figure as the method used for the valuation of the claim was a matter of dispute between the Administrators and the SIPA Trustee. The Administrators contended that only by understanding the contractual and historical course of dealings of each customer would it be possible to determine the correct sum due, whereas the SIPA Trustee preferred to calculate the sums due on an aggregate basis.[212] In February 2012, the Administrators lodged a formal objection to the SIPA Trustee's approach.[213] A year later, LBIE and the SIPA Trustee entered into a Settlement Agreement, the details of which are not a matter of public record.[214]

Whatever the true figure attributed to the value of the Omnibus claim, it must be treated with caution. The figure does not necessarily equate to the value of the shortfall attributable to LBIE customers' rehypothecation claims. The classification of LBIE customer claims was not straightforward and there were other factors that could have led to a customer experiencing a shortfall in addition to that caused by repo transactions (illustrated above by LBI's inability to re-deliver securities). These included problems with unwinding open trades and problems in transferring prime brokerage account property.[215]

According to the Trustee's Realization Report published in 2015, the remaining outstanding shortfall on the SIPA claims was valued at US$15.2 billion. The causes of the losses are attributed to three factors: first, the sale of certain LBI assets to Barclays; second the high valuations attributed to securities pledged as collateral at the time of the Lehman insolvency; and third, the high number of claims brought by its affiliates against LBI for assets which had plummeted in value. [216] The assets attributable to particular categories of shortfall claim were as follows:[217]

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[211] www.pwc.co.uk/services/business-recovery/administrations/lehman/lehman-client-asset-21072011.html accessed 26 April 2016.
[212] LBIE maintained omnibus accounts with LBI, but the securities held were on an aggregate, rather than customer, basis. See LBI Trustee's Preliminary Investigation Report and Recommendations 25 August 2010 (the "Trustees Investigation Report") <http://dm.epiq11.com/LBI/Project> accessed 23 April 2016; *Four Private Investment Funds* (n 59).
[213] <www.pwc.co.uk/services/business-recovery/administrations/lehman/lehman-client-assets-update-210312.html> accessed 26 April 2016.
[214] Statement regarding approval of LBI Agreements with LBIE and LBHI 16 April 2013 <http://dm.epiq11.com/LBI/Project> accessed 2 May 2016.
[215] Trustee's Investigation Report (n 212) 74 paras 159 – 164, 3.
[216] Trustee's Preliminary Realisation Report dated 23 February 2015 (the "Trustee's Realisation Report") <http://dm.epiq11.com/LBI/Project> accessed 23 April 2016.
[217] Trustee's Realisation Report (n 216) 6 (table reproduced here).

Assets (In Millions)	Net realized Versus Filing Date
Securities on Hand	981
Proprietary Cash Book Entries	(150)
Receivables	95
Trade Unwind and Close Outs	(958)
Barclays Repurchase Agreement	(4,500)
Clearing Bank Collateral Liquidations	(1,895)
Due From Affiliates (including RACERS)	(5,961)
Equity Value of Subsidiaries / PIK Note	(1,700)
Goodwill, Fixed Assets and Other	(780)
Post-Petition Income	2,150
Excess Customer Property	2,201
TOTAL	(15,204)

There is little detailed guidance to explain these figures, but it is reasonable to assume that part of the shortfall in the Proprietary cash book, Trade Unwind and Close Outs, Barclays and Affiliates accounts was attributable to repo transactions.[218] From the limited information available and for the purpose of determining whether the location of intermediated securities led to real world problems, it seems reasonable to conclude that, when used in repo transactions where the re-delivery leg was not completed, the resulting shortfall was in the region of billions of US dollars.

Having said that, it must be stressed that, whilst these sums are large, the completion of the major settlement agreements between LBI and LBIE as well as LBHI in 2013 would suggest that most customer claims were addressed to a reasonable degree of satisfaction; losses would have been suffered during the period, nevertheless, as customers did not have access to their funds for investment purposes until the point of settlement. The Trustee's Realisation Report recognises that unsecured creditors will not make a full recovery, but notes that LBI customer claims were satisfied in full and that US$ 114.7bn has been distributed.[219] Similarly, recoveries made in the LBIE administration have been better than might have been anticipated at the outset of the insolvency. Senior creditors have received 100% of their unsecured claims and projections indicate a surplus prior to the payment of post-administration interest, non-provable claims, subordinated debt and shareholder claims.[220]

[218] Trustee's Realisation Report (n 216) 9-14.
[219] Trustee's Realisation Report (n 216) 3.
[220] Administrators 15th Progress Report, April 2016, 9 <http://www.pwc.co.uk/business-recovery/administrations/lehman/lbie-15th-progress-report.pdf> accessed 2 May 2016.

Why was the law applicable to intermediated securities not in issue in the cases?

As has already been noted, the law governing the location of the assets was not raised as an issue in the cases. This is interesting because the Trustee's Investigation Report does refer to difficulties in recovering property from what were described as

> ""good control" locations in foreign jurisdictions" [and noted that] "obstacles attributable to differing laws or insolvency regimes present formidable challenges."[221]

There is little elaboration on this point other than in a footnote which commented that:

> "Other LBI custodians or depositories around the world exhibited varying ranges of acceptance of the Trustee's powers."[222]

It is also clear that LBIE's failure to comply with the English CASS rules caused shortfall problems for LBI. LBIE held accounts with a number of foreign clearing houses and exchanges which were meant to hold property belonging to LBI customers; as previously discussed, at the time of LBIE's administration, it had failed to segregate cash sums due to its customers and those of LBI and, therefore, they were not available to be handed back.[223]

So why were these cross-border issues not manifest in the case law? There are probably two main reasons for this. First, as was anticipated in the introduction to Chapter Four, the Lehman Protocol played a significant part in reducing the amount of cross-border litigation; the paving of the way for consensual agreement through a series of bilateral agreements with insolvency practitioners in relevant jurisdictions would have played a huge part in reducing the costs of the insolvency. The US Court had to deal separately with LBIE (because the Administrators refused to sign up to the Lehman Protocol) but the parties nonetheless successfully avoided litigation and pursued a settlement.[224] The second reason is that certain statutory and regulatory protections provided a degree of protection for counterparties involved in transactions with Lehman entities, either because they determined the proprietary effect of the transaction or because they preserved counterparty rights and interests in intermediated securities by avoiding the automatic

[221] Trustee's Investigation Report (n 212) 116.
[222] Ibid.
[223] Ibid 121.
[224] Chapter 4, 42.

stay. As the role played by PRIMA and UCC Article 8 in determining the law that governs the proprietary effect of a transaction involving intermediated securities has already been considered, the next step is to consider the role played by the SFD[225] and the US Bankruptcy Safe Harbour provisions[226] in the event of a counterparty insolvency.

Settlement Finality and Safe Harbour provisions

One of the major risks faced by the global financial system is that of settlement risk; what happens if a counterparty to a financial contract goes into insolvency proceedings after the instruction to make a transfer has been given? Will the counterparty be paid in full? Even if the trade is completed despite the insolvency, or is completed moments before the insolvency proceedings began, what then? The risk remains that the transaction could be set aside as a preference or a transaction at an undervalue under relevant insolvency legislation. To provide certainty for those entering into financial markets contracts, the EU settlement finality rules ensure that trades are completed.[227] A similar effect is achieved by the US Bankruptcy Code Safe Harbour provisions through the disapplication of the automatic stay on proceedings[228] to swap transactions, so that they can be liquidated, terminated or accelerated, enabling the counterparty to offset or net any amounts due to it as a consequence[229] in circumstances where there has been a default in an executory contract.[230]

As a matter of English law, the SFRs prevent a transaction that has been completed from being set aside as a preference or a transaction at an undervalue in relation to a disposition of property or the transfer of collateral security.[231] The SFRs and the FCARs respectively prevent a collateral security transfer[232] and a charge under the financial collateral arrangements from being set aside. In the US, as was discussed in the *FirstBank* case, it is extremely difficult to trace. It is not possible, in the absence of fraud, to set aside a transaction; further, it is also necessary to show collusion on the part of the third party, making it almost impossible to follow the money.

Conclusion

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[225] SFD and SFRS (n 200).
[226] 11 US Bankruptcy Code § 559 – 560 <https://www.law.cornell.edu/uscode/text/11/559> accessed 2 May 2016.
[227] SFD (n 200) Art 3; in the UK SFRS (n 188) Regs 16-19.
[228] 11 US Bankruptcy Code.
[229] 11 US Bankruptcy Code § 559 -560.
[230] 11 US Bankruptcy Code § 365(e).
[231] SFRS (n 200) Reg 17(1).
[232] SFRS (n 200) Reg 16(3); FCARS (n 13) Reg 10(1).

As has been seen from the discussion in this Chapter, the determination of location for the purposes of determining the proprietary effect of a transaction involving intermediated securities is something of a fudge. Established legislation in the EU and the US has, to a large extent, proved effective in providing certainty in the financial markets, both by setting rules on applicable jurisdiction in the settlement of transactions and by determining outcomes in the event of counterparty default. These provisions are designed to make the markets work efficiently and to ensure that parties to financial contracts have sufficient certainty in the legal consequences of their transactions. Even so, the adoption of PRIMA within the EU has its shortcomings. Yeowart and Parsons consider the difficulties of establishing "the country in which the relevant account is maintained" for the purposes of Article 9 of the FCD, bearing in mind that the account itself is intangible. They suggest that it is still necessary to identify the "physical associations" of the account; if these are found in one country, the matter is straightforward, but if not, which country's attributes should prevail? [233] As Yeowart and Parsons point out:

> "this approach does not appear to yield a rule that provides *ex ante* certainty for all or even the majority of cases involving the use of intermediated securities as collateral."[234]

Another issue raised by the Safe Harbour provisions is that of fairness. Although close out netting arrangements provided certainty for the counterparties following the insolvency of LBHI (which triggered a default in LBI's transactions), the SIPA Trustee considered that LBI was significantly disadvantaged by the actions of its counterparties. A particular problem for LBI was that it went into liquidation four days after LBHI's Chapter 11 proceedings began. The SIPA Trustee lacked access to LBI's information systems during this point and various counterparties held onto and/or failed to segregate customer assets. Although the SIPA liquidation order implemented a temporary stay, it did not apply to all counterparties (specifically the clearing banks).[235]

Having considered some of the difficulties that clearly still remain in the current regime, it is now necessary to explore it and critique it in more detail.

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233 Yeowart and Parsons (n 198) 318.
234 Ibid.
235 Trustee's Investigation Report (n 212) 123-127.

Chapter Seven

Analysis and evaluation: answering question three

Introduction

The third question posed at the outset of this Thesis was to understand how far the current legal framework for determining conflicts of law issues in respect of intermediated securities helped to resolve any of the Lehman issues. In the event that there had been no practical application of the rules in the Lehman cases (as has proved to be the case), the question was posed in the alternative, that is, to be addressed from a theoretical perspective. The analysis and evaluation in Chapter Six indicates that the unease felt by practitioners in relation to the existing conflict of laws rules at the outset of this study[236] remains and has been articulated most recently by Yeowart and Parsons.[237] Parallels may be drawn with recent EU case law involving tort claims, which have highlighted the difficulties that occur when trying to establish a location for financial losses for the purposes of determining jurisdiction.[238]

As discussed in Documents 1-4, the issues raised in this study stem from the fact that much of the world's wealth is held in the form of securities. These securities are not directly held by their investor owners, but are held through a series of intermediaries. As a matter of English law, they would be understood to be held on trust, with the ultimate investor holding an equitable proprietary interest in the intermediated securities. The particular problem identified is that England is just one of many jurisdictions in the chain of intermediaries between the investor and the holder of the asset and there is no certainty that English law will apply to such an arrangement to ensure that the ultimate investor's rights are upheld on that basis.

Intermediated securities play a critical function in the financial markets in the management of credit risk. In addition, intermediated securities can, in certain circumstances, be re-used (rehypothecated) by an intermediary for their own ends.[239] In other words,

[236] Moss (n 41) in 2010 and Norris J (n 2) in 2012.
[237] Yeowart and Parsons (n 198).
[238] It is not possible to address these in any detail other than to note the potential uncertainty caused by the decision determining jurisdiction in the case of *Harald Kolassa v Barclays Bank plc* (C-375/13), a matter which concerned securities held by an intermediary. The more recent decision of *Universal Music International Holdings BV v Schilling* (C-12/15) may serve to limit the effect of the *Kolassa* decision, although the cases are distinguishable.
[239] Yeowart and Parsons (n 198) Chapter 11.

intermediated securities (which are generally debt securities)[240] can be used as financial collateral to generate income for a finance house or an institutional investor. The use of financial collateral in this way is important for wealth generation and has an impact on the wealth of many members of society to the extent that the generation of wealth increases the value of pension and insurance funds. Getting the law right in this area is, therefore vital for the global economy.

The discussion thus far has focused on the failure of a large financial institution, such as Lehman, that undertakes investment banking activities for clients. Issues relating to the settlement and clearing of transactions have, therefore, been considered in that context. It is beyond the scope of this Thesis to consider in detail the role played by central counterparties ("CCPs") in maintaining the stability of the financial markets and in their use of financial collateral, other than to note the following. The extensive use of over-the-counter ("OTC") derivatives was considered to have had a de-stabilising effect on the financial markets and resulted in a great deal of legislation to shore up the risks associated with OTC derivatives.[241] Within the EU, this included the introduction of EMIR[242] and within the US, the Dodd-Frank Act.[243] Through this legislation, it is ultimately intended (amongst other things) that standard OTC contracts are cleared and that other OTC contracts are reported to ensure greater transparency in financial transactions.[244] Whilst there is much to be admired in the new, global regulatory architecture, it must not be forgotten that much of it has been in response to the problem caused by institutions like Lehman which were considered "too big to fail". Although EMIR establishes stringent prudential requirements, it is submitted that the creation of these extremely large trading platforms introduces a different form of systemic risk. Certainly within the EU work is being done on resolution and recovery regimes for financial market infrastructures, but one wonders what institution will be of sufficient size to take on their obligations should such a CCP fail.[245]

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240 Ibid Chapter 19.

241 Note that Schyler Henderson disagrees with this analysis in his paper *'Unintended Consequences of Misconceived Reforms: Part III'* (2013)8 JIBFL 480.

242 Council Regulation EU/648/2012 of 4 July 2012 on OTC derivatives, central counterparties and trade repositories [2012] OJ L201/1.

243 Dodd-Frank Wall Street Reform and Consumer Protection Act 2010.

244 For a fuller understanding of this topic, see Yeowart and Parsons (n 198) Chapter 20 and Changmin Chun 'Cross-Border Transactions of Intermediated Securities' Chapter 1 for a consideration of the application of Geneva Securities Convention to CCPs.

245 This is a risk that Henderson (n 241) has also raised. The foreword to the Bank of England March 2016 report on Financial Market Infrastructures indicates that it is "actively involved" in developing proposals for the CCP resolution and recovery <www.bankofengland.co.uk/publications/Documents/fmi/annualreport2016.pdf>.

Existing frameworks

When Lehman failed, LBIE had to go into administration under the Insolvency Act 1986 because, at that stage, there was no special resolution regime for a failing investment bank in the UK which enabled its business to be transferred to another financial institution and, at that time, the possibility of bail in did not exist. One of the major concerns for investors was that it took so long before their funds were released as the administrators had to unravel so many complex transactions. As Yeowart and Parsons observe, the US SIPA process was perceived to be much more efficient, as much of LBI's prime brokerage activity was immediately transferred to Barclays.[246] In addition to the delays caused by the administration, the problems of identification associated with the failure of LBIE to comply with the CASS rules caused further delays as it was not possible simply to pay out a pro rata share of the assets to all the interested investors, whether secured or unsecured, as shares had to be allocated by reference to proprietary claims, which came first.[247] Whilst many investors may ultimately not have experienced a shortfall in receiving the full amount of their claim (as discussed in Chapter Six, both in the US and the UK it appears that those with proprietary interests have been paid in full; in the UK, unsecured creditors have also been repaid in full and it is now a matter of determining how the surplus should be addressed[248]), they will have experienced a cash flow problem which, at the very least, would have damaged their own business.

The English insolvency system did not easily lend itself to an insolvency of the magnitude and complexity of the Lehman case. Despite this, it is probably fair to say that it was as well managed as it could have been and that great pains were taken by the administrators to apply to the court where necessary for directions to ensure fairness to creditors. This has been evidenced most recently in the *Waterfall* judgments, which deal with the priority of payments.[249] It is also fair to say that the Lehman insolvency would not happen in the same way again. This is for a whole number of reasons, including increased transparency in relation to securities financing transactions within the EU,[250] increased regulatory

[246] Yeowart and Parsons (n 198) 497. Although this may be perception rather than reality as litigation subsequently ensued.
[247] Hence the suggestion to seek the sanction of the English court for a scheme (n 54).
[248] <www.pwc.co.uk/services/business-recovery/administrations/lehman/update-entitlements-to-surplus-28-march-2014.html> accessed 6 June 2016).
[249] *Re Lehman Brothers International (Europe) (in administration)* [2015] EWCA Civ 485, although a number of issues will be taken to the Supreme Court in October 2016. <www.pwc.co.uk/services/business-recovery/administrations/lehman/update-waterfall-i-application-supreme-court-of-the-united-kingdom-appeal-listing-5-may-2016.html>.
[250] Securities Financing Regulation (n34).

scrutiny and accountability, changes to capital and liquidity requirements through the introduction of CRD IV,[251] changes to the CASS rules and the introduction of a specific investment bank resolution framework which includes bail in.

More specifically to the conflict of laws question, as has been seen, this has been discussed in the context of the existing approach taken in the SFD, the FCD and in UCC Article 8. Broadly, the jurisdiction for the determination of proprietary interests in relation to intermediated securities is determined by the jurisdiction of the place of the account holder. This is not the only approach, however. As discussed in Document 4, there are two other approaches to this issue, in the Hague Convention[252] and Geneva Securities Convention. The Hague Convention recommends that the parties to a transaction agree the choice of law for that transaction. Although this approach is similar to that adopted under UCC Article 8, there are a number of criticisms of this approach (identified by Ooi).[253] The first is that there is a lack of transparency, since the agreement is made between intermediary and investor. The second is that, should an unconnected jurisdiction be chosen, it would lead to difficulties on enforcement. Finally, within in EU context, there was a concern that if non-European laws were chosen, this could affect the stability of EU settlement systems.[254] The Geneva Securities Convention addresses substantive law issues through becoming part of the substantive law of a contracting state. Where a conflict of laws issue arises, the applicable law would be determined by reference to the law of the state in question; if the state had adopted the Geneva Securities Convention then it would be applied.[255]

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[251] Comprising Directive 2013/36/EU of 26 June 2013 on the prudential supervision of credit institutions [2013] OJ L176/338 and Regulation EU/575/2013 of 26 June 2013 on prudential requirements for credit institutions [2013] OJ L321/6.

[252] The Hague Convention on the Law Applicable to Certain Rights in respect of Securities held with an Intermediary.<www.hcch.net/index_en.php?act=conventions.text&cid=72> accessed 5 March 2015.

[253] Ooi (n 199) 225.

[254] The debate about choice of law is similar to that surrounding Article 14 of the Rome Regulation, where the boundaries between contract and property are blurred in the context of assignment, with different jurisdictions taking different approaches as to whether the law governing the assignment carries the proprietary aspects too. Various suggestions have been made as to which is the proper law to govern the proprietary aspects. In *The Proprietary Aspects of Assignment and Choice of Law* (2009) 125 LQR 671, 697, Michael Bridge suggests either that the proper law should be that of the assignor and assignee or, in view of the artificiality of ascribing intangibles a *lex situs,* that the parties should choose. Fentiman points out the pitfalls of the latter approach as does Kieninger. See Richard Fentiman, *Assignment and Rome I: Towards a Principled Solution* in Law and Financial Markets Review July (2010) 405 and Eva-Maria Kieninger *Collateralisation of Contracts* European Review of Contract Law (2013) 9(4): 430-454.

[255] Article 2 (n 35).

Fairness and effectiveness

What does all this mean for fairness and, further, fairness to whom in this context? It is submitted that fairness to investors encompasses fairness to consumers, bearing in mind the role played by institutional investors such as pension funds and insurance companies in the financial markets. There are three elements to this. First, protecting owners of intermediated securities from identification problems; second, protecting owners of intermediated securities from shortfall problems and third, ensuring a fair pay out. As has already been identified, improvements in the process for managing failing investment banks should prevent them going into insolvency proceedings and, to the extent that payouts have to happen, they will be made on a pro-rata basis.[256] This is consistent with the approach taken in the Geneva Securities Convention.[257]

Insofar as protecting investors from the consequences of a shortfall, a little more consideration needs to be given to the re-use financial collateral. It is submitted that the re-use of financial collateral is essential to the efficient functioning of the financial markets and enables growth in financial assets which is to the advantage of all. What is also essential, is that the risks posed by this market function are properly understood by those participating in the market place and that the necessary regulation is in place to protect participants from market failure. The use of "haircuts" by which additional amounts of collateral are placed at one side of a transaction to protect against their devaluation on the return leg were not always sufficient to protect counterparties at the height of the financial crisis. In such extreme circumstances, it seems unlikely that much more could have been done. Increased transparency in securities financing transactions has already been addressed within the EU.

The role of solicitors in ensuring the fairness of financial transactions

It is submitted that the calibre of the legal argument in the English Lehman litigation was second to none. Combined with the judgments, it serves to demonstrate how hard working and erudite the solicitors, barristers and judges involved in the cases were. But there are some areas of uneasiness associated with the Lehman case, specifically in relation to the issue of the English law Repo 105 opinion. It is submitted that this cannot be ignored in considering the "fairness" of our existing system bearing in mind the nature of this doctorate and the importance of reflection in professional practice.

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[256] SI 2011/245 (n 122).
[257] Article 26 (n 35).

Kershaw and Moorhead note two important points about the issuing of legal opinions. First, they note the "gatekeeper" function of the legal opinion. Behind the legal opinion that is issued stands not just the partner who signed it, but stand all the partners of the firm. This gives the opinion weight and, when it is provided to a regulator, confidence that the company in respect of which the opinion is given, is compliant with the regulator's requirements. There is, thus, a delegation of regulatory power given to lawyers through the opinion process.[258] The second point that they make is that lawyers are trained to act in their client's interests and their notion of "zeal" in the client's interest supports the contention of this Thesis that commercial lawyers use their creativity to drive innovation. They note that:

> "Zeal may provide intellectual, commercial and economic benefits"[259]

but also share the author's concern that the legitimacy of zeal may be questioned, citing examples of lawyers helping their clients to avoid taxes, or to avoid complying with environmental regulation or supporting their clients in arguing that torture may be lawful.[260] Such approaches damage the view of lawyers as adhering to the rule of law and acting in the public interest.

Kershaw and Moorhead argue that current rules of professional conduct are not enough to protect society from the work of transactional lawyers,[261] as no rules or guidelines are set out for them. They contend that rules setting out the consequential responsibility of transactional lawyers should be drafted to set limits on their activities. They recognise that these would be worthless without proper enforcement by the Solicitors Regulation Authority ("SRA"). They are right to argue that lawyers should be prepared to take consequential responsibility but it is submitted that most lawyers take their responsibilities extremely seriously. Existing professional regulation requires solicitors to (amongst other things) uphold the rule of law and the administration of justice; act with integrity and behave in a way that maintains the trust the public holds in them.[262] Equally, solicitors know that they are protected from their mistakes through the extremely expensive professional indemnity insurance that they are required to take out. Whilst this helps to

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[258] (2013) 76(1) MLR 26-61, 41-42.
[259] Ibid 46.
[260] Ibid.
[261] The majority of whom are solicitors regulated by the SRA.
[262] http://www.sra.org.uk/solicitors/handbook/code/content.page

give them the confidence to take action in their client's interest at a time when the lines of demarcation on ethical matters are less than clear and so possibly take a risk, it is submitted that no solicitor would ever wish to have a professional conduct claim brought against them in view of the serious consequences it could have for their career.

The majority of lawyers are honest and hard-working; if a party is driven to draft an opinion that, like the Repo 105 opinion, ultimately serves to support a transaction that misleads the market, then there is either a problem with the individual or the system. Whilst questions must be asked about what the partner who wrote the Repo 105 opinion knew when he wrote it,[263] it must equally be recognised that, if he had not written it, it is highly likely that another Magic Circle law firm would have done. Hilary Sommerlad argues that there is a paradox between relying on market mechanisms and maintaining justice as a public good and asks how professional regulation can:

> "be effective against the amorality of the economic logic of the market".[264]

This issue forms part of the discussion raised at the end of Document 4: namely, how far can lawyers support a financial system in which they play a key role but which may be damaging social stability?

Kershaw and Moorhead may overstate the case in seeking additional regulation for transactional lawyers, but it is essential that the SRA is diligent in enforcing the current rules of professional conduct. There is a danger that, if the SRA does not, lawyers could be accused of protecting their vested interests in the international market place (an issue touched on Document 4). In this case, the issue of the legal opinion would have satisfied the client and perhaps help to have ensured that the (English) law firm maintained a lucrative relationship with a wealthy (US) financial institution. As an aside, by giving legitimacy to the transaction in exercising the "gatekeeper" function ascribed to legal opinions by Kershaw and Moorhead, the lawyers in question clearly played a role in the development of financial transactional law.

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[263] Did the author know that it would be used to support the US accounting treatment? Ought he to have surmised that this was the case or investigated further as to how the opinion was to be used?

[264] '*Some Reflections on the Amorality of the Market Place'* Legal Ethics (2010) 13(1): 93-96, 96.

Lawyers, it is contended, have been subject to less ethical criticism than bankers following the financial crisis, but then their roles are very different. Post 2008, the financial services industry has been attacked for its lack of ethical behaviour. This has led to a re-thinking of the regulatory framework for financial services and the introduction of a Senior Managers Regime[265] to try and change the culture of the industry as well as to ensure that individuals are aware of their personal responsibilities so that they know what they are accountable for.[266] It is too early to tell whether these changes will make a difference, but at least an attempt has been made to try and correct what are clearly systemic failures within the governance mechanisms hitherto employed by the financial services industry. It is beyond the scope of this Thesis to explore the regulation of legal practitioners in any serious degree of detail, but it is critical that practitioners take seriously their rules of professional practice at all times and, more specifically, the guidance issued by the City of London Law Society on the issuing of opinions. This guidance identifies a "Golden Rule", namely that in writing an opinion, a firm should be mindful of the rules of professional conduct and never ask another firm to provide a legal opinion that it would not have been prepared to provide itself.[267] One criticism that may be made of the guidance is that it does not, perhaps, go far enough in that it deliberately does not seek to advise on a number of specific types of financial transaction. Nonetheless, the general principles provide a clear ethical direction.

It has been submitted in this Thesis that the law in this area has developed pragmatically, in the sense that the law has tended to adapt to achieve an outcome that "works". Lord Hoffmann's remarks on avoiding judgments that suggest that an area of commercial practice is conceptually impossible have previously been cited in support of this submission.[268] In his papers on the Scope and Purpose of Sociological Jurisprudence, Pound produced a classification of schools of jurists and methods of jurisprudence, observing in the first of these the blurring of the distinction between analytical, historical and philosophical jurisprudence.[269] In his discussion of analytical jurisprudence and the imperative theory of law, Pound recognised that meeting new situations only by making deductions from established principles results in a neglect of the ends to be served by the

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[265] Through (predominantly) the Financial Services Act 2012 and the Financial Services (Banking Reform) Act 2013.
[266] www.bankofengland.co.uk/pra/Pages/supervision/strengtheningacc/default.aspx accessed 25 April 2016.
[267] <www.citysolicitors.org.uk/attachments/article/121/Issues-to-consider-when-providing-opinion-letters-(latest).pdf> accessed 25 April 2016.
[268] *Re BCCI No.8* [1998] AC 214 at 228.
[269] Harvard Law Review (1911) 24 (8) 591, 591 – 594.

law.[270] For Pound, the "pragmatic criterion" that considers not only how the law is to be made and exercised but also how its purpose is best achieved is "sound":

> "The true juristic theory, the true juristic method, is the one that brings forth good works".[271]

And that, it is submitted, is the point; in this context, good works should be (it is submitted) synonymous with the practice of law that both upholds the law and is evidenced by high standards of professional conduct. A pragmatic approach to the law has many advantages, but without the necessary checks and balances, it can lead to unhappy outcomes.

Conclusion

From the analysis that has gone before, it is reasonable to conclude that the insolvency regime applied post the Lehman failure was as fair as it could be within the constraints of the systems in place in September 2008. Great pains were taken by the US court to negotiate with parties in other jurisdictions to achieve a satisfactory outcome. Within the UK, the Administrators worked extremely hard to negotiate with the SIPA Trustee to achieve the best outcome for the LBIE administration and took pains to get directions from the court to ensure that the interests of creditors, both secured and unsecured, were protected as far as possible. Having said that, the UK administration could have been more effective, as evidenced by the delays caused in returning assets to creditors. As discussed earlier in this chapter, it is likely that, were the Lehman failure to happen again, it would be better handled, largely us a result of the changes to the regulation of the segregation of client accounts and the legislation relating to the resolution of a failing bank which would now ensure the transfer of its functions to a solvent entity.

Mindful of the standpoint of the legal practitioner taken in this study and also mindful that this is a professional doctorate, the role of the legal practitioner must be considered in any discussion of fairness. The Repo 105 legal opinion should make lawyers pause for thought for the impact that it had, albeit that the circumstances of the reliance placed upon it were not necessarily anticipated by the firm that issued it. It is imperative that practitioners

[270] Ibid 596.
[271] Ibid 598.

ensure that they abide by rules of professional conduct synonymous with taking a pragmatic approach that brings forth good works.

Chapter Eight

Recommendations and Conclusions: Answering Question Four

Introduction

As has been concluded at the end of Chapter 6, the adoption of PRIMA, whilst going some way towards establishing sufficient certainty in the market place in the context of intermediated securities, remains inadequate. A problem highlighted by, amongst others, Haentjens[272] in 2006 remains a problem for practitioners as noted by Yeowart and Parsons in 2016.[273] That this problem requires resolution is evident not just from their work, but from the responses to the European Commission's 2015 Green Paper on Building a Capital Markets Union.[274] As the responses to question 22 of the Green Paper make clear, the equal treatment of all parties whether within the EU or in third countries is critical to the economy of the EU.[275] Questions 26 and 27 of the Green Paper dealt specifically with issues relating to the harmonisation of securities ownership rules and conflict of laws issues within the EU. Many respondents advocated harmonisation of the securities ownership rules whilst some specifically advocated the proposals of the Geneva Securities Convention.[276] There was also considerable support for harmonisation of the rules relating to financial collateral and settlement finality.[277] Further work on this within the EU is ongoing at the time of writing.[278]

But are changes to the existing regime that seek a uniform approach to the determination of which national law should govern cross-border holdings of securities really necessary? McFarlane and Stevens contend that they are not. For them, the introduction of legislation will not only stifle legal innovation, but may also lead to unanticipated consequences; further, it may result in costly litigation on marginal issues and ultimately increase

272 Haentjens (n 203). As Haentjens demonstrated in his study, different jurisdictions have different understandings of the effect of PRIMA, 69.
273 Yeowart and Parsons (n 198).
274 European Commission, '*Building a Capital Markets Union: Summary of Responses*' <http://ec.europa.eu/finance/consultations/2015/capital-markets-union/docs/summary-of-responses_en.pdf> accessed 5 May 2016.
275 Ibid 11.
276 Ibid 13.
277 Ibid 13.
278 European Commission, '*Capital Markets Union: First Status Report*' Brussels 25.04.2016 SWD (2016) 147 final <http://ec.europa.eu/finance/capital-markets-union/docs/cmu-first-status-report_en.pdf> accessed 14 June 2016, 12.

transaction costs as market participants will require legal advice.[279] The fact that no major conflict of laws issues arose in the Lehman case might suggest that their arguments are well founded. In fact, in his 2012 Denning Lecture, Briggs J observed that:

> "the peace between potentially rival insolvency jurisdictions had been achieved without blood letting".[280]

Briggs considered that this was due to the fact that the contracting parties involved had agreed which jurisdiction governed the transactions between them and therefore that jurisdiction had determined the legal effect of the transaction. To the extent that the case in question had involved the distribution of property, it had been managed by the jurisdiction in which the property had been situated.[281] This approach harks to that of the Hague Convention and might suggest that it is a sound one.

But a caveat should be attached to this view, as this happy outcome may not be replicated in every circumstance. Not all jurisdictions are as sophisticated as the US and the various EU Member States. Moss was concerned as to what might happen if an issue arose where the counterparty was based in China.[282] More tellingly, the lead US judge in the Lehman proceedings, the Hon James M Peck has recently remarked that:

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> "Judges and former judges, academics and practitioners can all strive for universal procedures, like the Lehman Protocol, that will extend to cross-border insolvency cases, but I am convinced that economic actors seeking to maximise recoveries inevitably will revert to what is in their own self-interest. Such actors will choose to co-operate across borders only where it serves their goals to do so. That leads to a grim recognition. We do business globally but resolve insolvency claims locally." [283]

Judge Peck's assertion is an argument for doing nothing, suggesting that whatever is done will ultimately prove to be irrelevant. On the other hand it must be better to try to attempt a degree of co-ordination or harmonisation to try to overcome such nationalistic

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[279] Ben McFarlane and Robert Stevens 'Interests in Securities: Practical Problems and Conceptual Solutions' in Louise Gullifer and Jennifer Payne (eds) *Intermediated Securities; Legal Problems and Practical Issues* (Hart Publishing 2010) 59.
[280] <www.bacfi.org/files/Denning%20Lecture%202012.pdf> accessed 5 May 2016, 20.
[281] Ibid.
[282] Moss (n 41) 64.
[283] Peck (n 125) 133.

approaches and do our best, as Pound suggests, to achieve "good works". This is increasingly important in a world where major elections loom in the US and the UK. Whilst a successful Brexit campaign in the UK is unlikely to result in the bonfire of financial regulation that those voting for it might wish (certainly in the short term), a less certain political landscape may cause problems in cross-border transactions involving insolvent entities in the future. McFarlane and Stevens have argued that legislative intervention will increase transaction costs and the costs of litigation, but it is hard to see how these costs could possibly be worse than the costs incurred in the Lehman case.[284]

So what approach should be taken to addressing the problems posed by potential cross-border legal conflicts relating to intermediated securities? Although it has not been possible to explore the globalisation literature in any detail in a study of this brevity, there are one or two observations that might usefully be made by reference to this discipline. Lehavi notes the tension that the implementation of cross-border instruments imposes on states where they have to rescind a degree of their sovereignty in yielding to a proposed supranational mechanism as well as the "normative complexity in harmonising national arrangements".[285] He goes on to suggest that "Different property issues may call for different models along a local/global continuum"[286] although noting the difficulties of establishing harmonised property norms.[287]

With so much work having been done on the Geneva Securities Convention, it would make sense to adopt its provisions. Yet no country other than Bangladesh has ratified it to date. As it requires three ratifications before it comes into force and has already been on the books for the last six years, it seems unlikely that this will happen any time soon. It is submitted that some practitioners think it of little relevance.[288] But does this mean that the work has been in vain?

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[284] The Administrators' remuneration and disbursements to March 2016 were £978 million according to their April 2016 report <www.pwc.co.uk/business-recovery/administrations/lehman/lbie-15th-progress-report.pdf> 31 accessed 9 June 2016.

[285] Amnon Lehavi '*Unbundling Harmonisation: Public versus Private Law Strategies to Globalise Property'* Chicago Journal of International Law (2015) 15 (2) 452, 455 and 499. In a property law context, this has been manifest in the resistance of English lawyers to the introduction of a functionalist approach to secured transactions reform, despite initiatives from UNICTRAL (United Nations Commission on International Trade Law Legislative Guide on Secured Transactions, 2010, New York) as evidenced by the work of the City of London Law Society Financial Law Committee on its own Secured Transactions Code.

[286] Lehavi (n 285) 456.

[287] Ibid 515.

[288] One asked me why I was bothering to look at it, observing that it was more important for the law in Luxembourg and Brussels to work effectively.

Mooney contends that there are a number of ways to illustrate the success of a convention and one of these can be whether the ideas behind it are adopted by the EU.[289] Whilst it is possible that the EU will take on some of the thinking behind the Geneva Securities Convention in new Capital Markets legislation, it is not clear that this will make any real difference to practitioners. The EU system works well enough; as discussed in Document 4, the proprietary interests of investors are protected through Euroclear and Clearstream under the laws of Belgium and Luxembourg respectively[290] and much of the new EU post-crisis legislation has been directed at resolving some of the problems that arose in managing the cross-border protectionist instincts of Member States. Forward planning and greater information sharing across borders are key components of the new arrangements.[291] The real problem, as is the case in respect of bank failures more generally, is the unpredictability of third countries. As Judge Peck's remarks indicate, no amount of EU legislation can assist with that.

But whilst is it recognised that the wholesale adoption of the Geneva Securities Convention is highly unlikely, it is nevertheless submitted that the adoption of some of its principles within the EU would go some way toward "calibrating the optimal scope of supranational ordering", expressing what Lehavi describes as "both bottom-up and top down preferences".[292] Such an approach reflects both the pragmatic development of the law in this area (which might be seen as one of Lehavi's "grassroots drivers of change")[293] and the recognition at Member State level that some action is required to address a cross-border problem. Rather than dealing with this issue on a "universalist" basis, it instead goes some way along Lehavi's "continuum".

This approach might beg the question "why bother"? There are two main grounds for asking this question. First, as already identified, the European system seems to work reasonably well at the moment. Second, this approach will not assist with regard to dealings with third countries. The answer to the first question is that, whilst the European

[289] Charles W Mooney and Hideki Kanda, 'Core Issues under the UNIDROIT (Geneva) Convention on Intermediated Securities: Views from the United States and Japan' in Louise Gullifer and Jennifer Payne (eds) *Intermediated Securities; Legal Problems and Practical Issues* (Hart Publishing 2010) 130.
[290] The Belgian Royal Decree No 1962 of 1967 and the Luxembourg Securities Act of 1 August 2001, both as amended.
[291] An approach recommended in the SIPA Trustee's Investigation Report and manifest in Council Directive 2014/59/EU of 15 May 2014 on a framework for the recovery and resolution of credit institutions [2014] OJ L 73/190.
[292] Lehavi (n 285) 456.
[293] Ibid 461.

system may well work at the moment, it is not clear what the future holds. It would, therefore, be better to have a legislative consensus across the EU that is based on what have been rationally and carefully thought through principles, than not. This is the case even if transactions involving key jurisdictions such as Belgium and Luxembourg are currently working effectively. This contention is supported by the work of Moss, who was directly involved with the English law Lehman litigation and who roundly (and it is submitted correctly) rejected McFarlane and Stevens' proposition that substantive rules within the EU are unnecessary as long as a Member State understands each other Member State's choice of law rules. [294] The answer to the second question is that it makes sense to take action that will enhance legal certainty in many of the jurisdictions that do matter to the UK; as this will lead to an outcome that is neutral in respect of third countries, the third country perspective is irrelevant in taking this action.

With regard to the position of third countries, Moss advocates an approach beyond the EU; for him only a global solution would "provide certainty… safeguard investors' rights [and]… fortify confidence in financial markets".[295] Whilst this may be the most desirable outcome, as already stated, it remains unrealistic. This means that it becomes necessary to look at two sub-questions: first, which third countries are the most important in this debate; and second, how important is it to establish substantive rules for those countries? The main country of concern must be the US. As the Lehman litigation has been resolved between the UK and the US apparently amicably and competently (albeit slowly), there is an argument that co-operation could be expected in future similar cases rendering legislative harmonisation unnecessary,[296] although caveats remain. A particular issue arose in the *BNY Trustee* case, which led to a general principle of insolvency law being applied to the same facts in the US and the UK to produce entirely opposing decisions. Such an outcome may bode less well for future co-operation, particularly as increasing amounts of business are now conducted under the control and supervision of the US court. Indeed, it begs the question as to whether the US regime can truly be considered a common law system as the extent of codification increases.[297] A second caveat is the real possibility that a future US government will pursue a more isolationist approach.

[294] Moss (n 41) 68.
[295] Ibid.
[296] Successful co-operation between these two jurisdictions was also evident in the Robert Maxwell affair and is also supported by the fact that both have adopted the UNCITRAL Model Law on Cross-Border Insolvency.
[297] I am grateful to my supervisors for this observation.

The legal regimes adopted by other major economies will also be important. The emerging economies such as Brazil, India and China will be significant; none is currently a signatory of the Geneva Securities Convention and none has a similar track record of co-operation to that of the US on a major insolvency. Perhaps, in line with Lehavi's "continuum", it is worth looking beyond a harmonised approach for these jurisdictions and the aim should be to try and achieve alternative means of protection at a local level. One potential model for this local approach is the legislative protection offered through Belgian and Luxembourg law to investors whose assets are held in Euroclear and Clearstream.[298]

It may be that a radical new design can be taken to the holding of securities that moves the debate away from the need to harmonise regulation to protect investors. Micheler has recently contended that many of the problems caused by the indirect holding of securities can be avoided through the use of new technology. She argues that the platform used for Bitcoin may provide investors with the level of certainty combined with the flexibility of the financial markets.[299] It is certainly a very interesting suggestion and to be welcomed as a truly innovative approach to a difficult problem. Unhappily, it is not a suggestion that Thesis can explore in any serious detail on account of having insufficient understanding of the technology Bitcoin, let alone how it could be applied in practice.

Conclusion

Hindsight is a wonderful thing and, as Document 5 ends and Document 6 begins, it is apparent from the iterative nature of this doctoral study that the questions and assumptions framed at the outset did not result in the answers that might have been anticipated. But that does not mean that they were wrong or irrelevant: this Thesis is as interesting for what it did not discover as for what it discovered. In retrospect, it might seem naïve to think that the Lehman litigation considered in this Thesis would have raised significant conflict of laws issues when it was largely brought by the Administrators and SIPA Trustee seeking directions whilst they entered into settlement arrangements behind closed doors. But it was not an unrealistic approach to have taken in view of the remarks of practitioners such as Moss and Norris J at the time that it was chosen as a subject for study (albeit that it only really tested the English law regime).[300] The parties who suffered losses appear, to a large extent, to have "waited out" the formal insolvency proceedings

[298] The Belgian Royal Decree and Luxembourg Securities Act (n 278).
[299] Eva Micheler (n 30).
[300] Wenwen Liang, *Title and Title Conflicts in Respect of Intermediated Securities Under English Law* Cambridge Scholars Publishing (2013) 174.

and a number of jurisdictions entered into a settlement protocol for the purposes of the US proceedings. This may have been a pragmatic decision based on the cost of pursuing claims and a recognition from sophisticated market players that the management of the insolvency on both sides of the Atlantic was being undertaken with rigour. To that extent, they were rewarded by the ultimate recoveries, albeit that they lost the "time value" of their funds. This supports the contention that the processes were, broadly, both substantively and procedurally fair and, other than the delay in returning funds (which was attributable to the great complexity of the case) essentially effective.

The original contribution of this Thesis is, however, to demonstrate definitively that there were no major issues conflict of laws issues that arose in the English or US Lehman litigation, based on a thorough collation and analysis of data in the form of the relevant English and US Lehman cases. In addition, it has shown that despite this, it remains a real possibility that conflict of laws issues will arise in the future in transactions involving intermediated securities where an intermediary fails and that the law, as it currently stands, is unclear as to how this should best be addressed.

Whilst it is perfectly legitimate to take a *laissez faire* attitude to this issue and argue that things have been managed well enough in the Lehman case so that it does not matter, it is submitted that with so much global wealth tied up in intermediated securities, it behoves governments to legislate to protect the systems that the world relies on, as effectively as possible. As the next market failure may result from a different kind of financial institution from Lehman, the Lehman model of dealing with financial institution failure is unlikely to be sufficient. Much excellent work has already been undertaken in the field of intermediated securities, with some of the best legal minds having applied themselves to producing the Geneva Securities Convention. The approach of the Geneva Securities Convention is a functional and neutral one that deliberately seeks to avoid the pitfalls associated with drawing on the standard terminology and principles associated with different legal systems. The EU has failed to achieve consensus on any property law norms to date,[301] but it is submitted that the minimalist approach taken to harmonisation in the Geneva Securities Convention acknowledges the challenges of harmonisation; harmonised rules are adopted only "if clearly required to reduce legal or systemic risk or to promote market efficiency" and to the extent that an issue is not addressed by the harmonising

[301] Lehavi (n273).

law, then local law will be applied.[302] It is submitted that, the best outcome would be for the Geneva Securities Convention to be adopted as it has the advantage of providing a "bottom up" solution. As there has been limited appetite globally for this Convention to be adopted thus far, this may be hard to achieve. The next best thing must be for any future EU law on intermediated securities to draw on this work. Undoubtedly, tensions will arise in any future EU discussions, not least because of the possibility that different rules may develop for intermediated securities that are not consistent with rules for other forms of property, as envisaged by McFarlane and Stevens.[303] Further, the "top down" approach that comes from the imposition of an EU Regulation or Directive would require a degree of consensus across the EU that is likely to be difficult to achieve. In the absence of any clearer guidelines, the Geneva Securities Convention must be an excellent starting point for the discussion.

The Thesis has also provided evidence to support the proposition that the pragmatic approach taken by transactional lawyers to their work has led to its evolution. It is submitted that it is unlikely that this is true philosophical pragmatism, but an unconsciously pragmatic approach to their work in trying to ensure that client instructions are followed; such pragmatism leading to innovation in structuring transactions. There is a danger in this approach, however, if it means that the focus on getting the job done is at the expense of ethical considerations. The role of the legal opinion in providing a regulatory "gateway" is one area where practitioners need to special care. It is critical to the integrity of the financial system that lawyers maintain their own integrity in their transactional work and are not seen to be manipulating the outcomes of transactions to promote vested interests.[304] This is essential if society is to have the confidence in the legal profession in an ever more complex and fragmented world.

Paula Moffatt
1 November 2016

The law is stated as at 30 April 2016.

[302] Hideki Kanda and others *Official Commentary on the UNIDROIT Convention on Substantive Rules for Intermediated Securities* Oxford University Press (2012) 5.
[303] McFarlane and Stevens (n 279).
[304] Cautioned against by Michele Graziadei in 'Transplants and Receptions' *The Oxford Handbook of Comparative Law*, Eds Mathias Reimann and Reinhard Zimmerman, Oxford University Press (2006) 458.

APPENDIX 1

Schedule of English law Lehman cases

No.	Case	Issue	Decision	Relevance for Thesis
1	*RAB Capital Plc v Lehman Brothers International (Europe) (in administration)* [2008] EWHC 2335 (Ch)	Application for directions for return of assets.	Refused.	Limited; provides context.
2	*Four Private Investment Funds v Lomas and others* [2008] EWHC 2869 (Ch)	Application for disclosure (in relation to securities).	Dismissed.	Possibly for discussion of "unfair" (para 37) in context of stat.disclosure.
3	*Perpetual Trustee Co. Ltd v BNY Corporate Trustee Services Ltd, Lehman Brothers Special Financing Inc.* [2009] EWHC 1912 (Ch)	Application for stay pending outcome of case in New York court; interpretation of "flip" clause (anti-deprivation).	Held that *British Eagle International Airlines v Compagnie Nationale Air France [1975] 1 WLR 758* not engaged. Case adjourned.	Limited. A matter of contractual interpretation. Assets were held in UK based and claimed by a US-based Lehmans entity.
4	*Re Lehman Brothers International (Europe) (in administration) (No 2)* [2009] EWHC 2141 (Ch)	Application for directions (scheme of arrangement).	Scheme refused. Court did not have jurisdiction.	Limited. Explains LBIE's function as prime broker.
5	*In the Matter of Lehman Brothers International (Europe) (in administration) and RAB Market Cycles (Master) Fund Limited (1) Hong Leong Bank Berhad (2)* [2009] EWHC 2545 (Ch)	Application for directions (whether cash should be treated as trust money or made available to unsecured creditors) under terms of charge in standard form International Prime Brokerage Agreement ("IPBA").	The IPBA charge did not impose a trust or grant the Lehman counterparties a proprietary interest.	Useful discussion of alteration in status of assets held. See para 20: MCF was beneficial owner of securities worth US$50m; on their conversion to cash MCF became the holder of an unsecured debt.
6	*Perpetual Trustee Company Limited, Belmont Park Investments Pty Limited v N+BNY Corporate Trustee Services Limited, Lehman Brothers Special Financing Inc.* [2009] EWCA Civ 1160	Appeal from anti-deprivation case (see No. 3).	Appeal dismissed.	Limited as issues relate to questions of contractual interpretation.
7	*Re Lehman Brothers International (Europe) (in administration) (No 2)* [2009] EWCA Civ 1161	Whether the judge at first instance had erred in finding that the court had no jurisdiction to sanction a scheme.	Appeal dismissed.	Possibly of interest in considering notions of fairness (e.g. in changing (or not) rights of secured parties)
8	*Re Lehman Brothers International (Europe) (in administration)* [2009] EWHC 3228 (Ch)	Application for directions (application of the CASS rules).	No proprietary interest where money had not been segregated.	Limited, as issues relate to questions of statutory interpretation.

9	*Perpetual Trustee Co Ltd v BNY Corporate Trustee Services* [2009] EWHC 2953	Allocation of jurisdiction; comity.	Content of letter to be sent to Judge Peck in New York agreed.	None.
10	*In the matter of Lehman Brothers International (Europe)(in administration) and CRC Credit Fund Limited and others* [2010] EWHC 47 (Ch)	Supplementary written submissions on CASS 7 judgment.	Approved judgment on a number of technical points.	None.
11	*Re Lehman Brothers International (Europe) (in administration)* [2010] EWCA Civ 917	Appeal on the CASS 7 judgment.	Broadly upheld (some nuances as to specific issues).	Useful discussion of *pari passu* and fairness; contribution vs claims approach.
12	*Lehman Brothers International v CRC Credit Fund Ltd & others* [2010] EWCA Civ 1001	Ruling on costs and permission to appeal in relation to the CASS7 judgment.	Appropriate costs order made; possible appeal to Supreme Court discussed.	None.
13	*Re Lehman Brothers International (Europe) (in administration); Pearson and others v Lehman Brothers Finance SA and other companies* [2010] EWHC 2914 (Ch)	Application for directions (beneficial ownership of securities)	Judgment for the administrators.	Useful discussion of (1) how Lehmans ran its business and (2) *Hunter v Moss*. Much goes to the contractual basis on which LBIE acquired and held securities.
14	*Re Lehman Brothers International (Europe) (in administration)* [2010] EWHC 3044 (Ch)	Application for directions (costs of RASCALs).	Some departure from normal costs rules.	None.
15	*Re Nortel GMBH and others; Re Lehman Brothers International (Europe) (in administration) and others; Bloom and others v Pensions Regulator and others* [2010] EWHC 3010 (Ch)	Ranking of FSDs (provable debt or expenses of administration?).	FSDs were expenses of the administration.	None.
16	*Lomas & others v JFB Firth Rixson* [2010] EWHC 3372 (Ch)	Application for directions (construction and effect of ISDA on five interest rate swaps).	Payment obligations of counterparties suspended because of Lehman default.	Useful discussion of swaps, but otherwise just raised issues of contractual interpretation.
17	*Spencer v Lehman Brothers Ltd* [2011] EqLR 319	Employment tribunal case.	Transcript unavailable.	None.
18	*Lehman Brothers Special Financing Inc v Carlton Communications Ltd* [2011] EWHC 718 (Ch)	Application for directions (swaps).	Same principle as *Firth Rixson.*	None. Raised issues of contractual interpretation.

19	*In the Matter of Lehman Brothers International (Europe) (in administration)* [2011] EWHC 1233 (Ch)	Application for directions (second client money). application	Adjourned pending Supreme Court decision on first client money case. No protective costs order made.	None.
20	*Lehman Brothers Commoditv Services Inc and Credit Agricole Corporate and Investment Bank (formerly Calyon)* [2011] EWHC 1390 Comm	Consideration of various preliminary issues as to whether set-off possible.	Various; English law would determine the effect of the contractual agreement.	Limited; raised issues of contractual interpretation.
21	*Anthracite Rated Investments (Jersey) Ltd v Lehman Brothers Finance SA (in liquidation); Fondazione Enasarco v Lehman Brothers Finance SA and another* [2011] EWHC 1822 (Ch)	Construction and effect of early close-out provisions.	LBF not entitled to receive payment under contractual agreement.	None; raised issues of contractual interpretation.
22	*Re Lehman Brothers International (Europe) (in administration)* [2011] EWHC 2022 (Ch)	Application for directions (disclosure).	Refused.	None.
23	*Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd and Lehman Brothers Special Financing Inc* [2011] UKSC 38	Anti-deprivation case.	Appeal dismissed; anti-deprivation principle not offended.	Ultimately a question of contractual interpretation.
24	*Re Nortel GMBH (in administration) and other companies; Re Lehman Brothers International (Europe) (in administration) and other companies* [2011] EWCA Civ 1124	Treatment of FSD.	Appeal dismissed unanimously. ”	None.
25	*Pearson & ors v Lehman Brothers Finance SA & others* [2011] EWCA Civ 1544	Appeal against beneficial interests being given in favour of LBIE.	Appeal dismissed unanimously.	Useful discussion of processes of book entry transfers/street trades/title transfers.
26	*Lomas and others (together the Joint Administrators of Lehman Brothers International (Europe)) v JFB Firth Rixson Inc and others; Lehman Brothers Special Financing Inc v Carlton Communications Ltd; Pioneer Freight Futures Co Ltd (in liquidation) v Cosco Bulk Carrier Co Ltd; Britannia Bulk plc (in liquidation) v Bulk Trading SA* [2012] EWCA Civ 419.	Appeal against the decision that the non-defaulting parties were not obliged to pay.	Appeal dismissed unanimously.	Discusses the *Belmont* decision, but essentially an issue of contractual interpretation.

27	*Lehman Commercial Conduit (in administration) & Anor. v Gatedale Limited (in CVL)* 2012 EWHC 3083 (Ch) (2012 EWHC 848)	Application for directions (as to validity of a third party charge).	The remedy of subrogation was available.	None.
28	*Re Lehman Brothers International (Europe) (in administration) and another* [2012] UKSC 6	Appeal to Supreme Court on CASS 7 ruling.	Various issues; some allowed, some dismissed.	Discussion of contributions versus claims; Court of Appeal and Supreme Court both split..
29	*Lehman Brothers International (Europe) (in administration) Lehman Brothers Finance SA* [2012] EWHC 1072 (Ch)	Application for directions (side letter to ISDA Master Agreement).	Side letter formed no part of the valuation of loss.	None.
30	*Trustees of the Lehman Brothers Pension Scheme v Pensions Regulator and others* [2012] All ER (D) 11 (Jul); [2012] Lexis Citation 47	Application to strike out service of FSDs.	Application dismissed.	None.
31	*Re Lehman Brothers International (Europe) (in administration) and others* [2012] EWHC 2997 (Ch)	This case discussed a wide range of issues relating to the appropriate construction of security interests, the Financial Collateral Directive and the FCARs.	Various – including the characterisation of the "General Lien" as a floating charge.	A number of issues already discussed in Document 4 (see para 163 for analysis of how dematerialised securities are held). Questions of contractual interpretation.
32	*Lehman Brothers Bankhaus AG I Ins v CMA CGM* [2013] EWHC 171 (Comm)	An application by the administrators to determine (amongst other things) whether the English proceedings should be stayed until the outcome of the French proceedings.	Stay granted.	None.
33	*The Joint Administrators of Lehman Brothers International (Europe) v Lehman Brothers Finance SA In the matter of Lehman Brothers International (Europe) (in administration)* [2013] EWCA Civ 188	Whether the side letter formed part of contract.	Appeal allowed.	None. Discussion of the "value clean" principle in the context of close-out netting.
34	*Commonwealth Ave. Inc v Lehman Brothers International & Ors* [2013] EWCA Civ 458	Commonwealth Ave applied for permission to appeal from the judgment of Briggs J on the general liens case.	Leave to appeal granted.	None.

35	*In the matter of Lehman Brothers International Europe (in administration)* [2013] EWHC 1664 (Ch)	The administrators applied to the court for an order that they could execute the settlement agreement.	Granted.	None.
36	*Nortel GmbH (in administration) and related companies; In re Lehman Bros International (Europe) (in administration) and related companies* [2013] UKSC 52	Appeal as to whether FSDs were expenses of the administration.	Liabilities under FS regime, even if CN not served prior to administration, were provable debts;	None.
37	*Re Financing No 1 Ltd and others v Trustees of the Lehman Brothers Pension Scheme and another* [2013] EWCA Civ 751	Certain Lehmans companies wished to strike out application of pension trustees to issue them FSDs on various grounds.	Unanimous judgment, upholding decision of the Upper Tribunal.	None.
38	*In re Lehman Bros International (Europe) (in administration) (No 4)* [2014] EWHC 704 (Ch)	Applications for directions as to the correct order of priorities	Claims against LBIE were subordinated to provable debts and statutory interest on non-provable liabilities.	Limited; significant for up to date jurisprudence on the order of priorities on insolvency.
39	*Fondazione Enasarco v Lehman Brothers Finance SA and another* [2014] EWHC 34 (Ch)	Whether English proceedings should be stayed (main proceedings in Switzerland).	Refused.	None.
40	*Contrarian Funds LLC v Lomas and others; Re Lehman Brothers International (Europe) (in administration)* [2014] EWHC 1687 (Ch)	Application for a time extension to finalise proof of debt.	Refused.	None.
41	*Lehman Brothers Finance SA (in liquidation) v SAL Oppenheim JR & Cie KGAA* [2014] EWHC 2627 (Comm)	Miscalculation of the balance of early termination.	Claim allowed.	None.
42	*Lehman Brothers Finance AG (in liquidation) v Klaus Tschira Stiftung GmbH and another* [2014] EWHC 2782 (Ch)	Application for stay of English proceedings.	Stay would have been granted had Swiss proceedings not been dropped.	None.
43	*Re Lehman Brothers International (Europe) (in administration)* [2015] EWCA Civ 485	Appeal on order of priorities.	Various conclusions.	Some; for order of priorities.
44	*Fondazione Enasarco v Lehman Brothers Finance SA and another* [2015] EWHC 1307 (Ch)	Claim for sum following incorrect calculation of loss.	Claim allowed.	None.

45	*The Joint Administrators of Lehman Brothers International (Europe) (in administration) v Burlington Loan Management Limited and others* [2015] EWHC 2269 (Ch)	Application for directions (payment of post-administration interest)	Clarification on payment of post-administration interest.	None.
46	*Lomas and others v Burlington Loan Management Ltd and others; subnom Lehman Brothers International (Europe) (in administration)* [2015] EWHC 2270 (Ch)	Application for directions (construction and effect of standard form claim resolution agreement on currency conversion).	Currency conversion claims not affected by claim resolution agreements.	None.

APPENDIX 2

Classification of English law Lehman cases

1.Cases concerning matters of contractual/statutory interpretation
The anti-deprivation case
Perpetual Trustee Co Ltd v BNY Corporate Trustee Services Ltd, Lehman Brothers Special Financing Inc. [2009] EWHC 1912 (Ch)
Perpetual Trustee Company Limited, Belmont Park Investments Pty Limited v BNY Corporate Trustee Services Limited, Lehman Brothers Special Financing Inc [2009] EWCA Civ 1160
Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd and Lehman Brothers Special Financing Inc [2011] UKSC 38
The International Prime Brokerage Agreement Charge case
In the matter of Lehman Brothers International (Europe) (in administration) (the Administrators of Lehman Brothers International (Europe) (in administration) and RAB Market Cycles (Master) Fund Limited (1) Hong Leong Bank Berhad (2) [2009] EWHC 2545 (Ch)
The CASS rules case
Re Lehman Brothers International (Europe) (in administration) [2009] EWHC 3228 (Ch)
Re Lehman Brothers International (Europe) (in administration) [2010] EWCA Civ 917
Re Lehman Brothers International (Europe) (in administration) and another [2012] UKSC 6
The RASCALS case
Re Lehman Brothers International (Europe) (in administration); Pearson and others v Lehman Brothers Finance SA and other companies [2010] EWHC 2914 (Ch)
Pearson & others v Lehman Brothers Finance SA & others [2011] EWCA Civ 1544
The ISDA Master Agreement cases
Lomas & Others v JFB Firth Rixson [2010] EWHC 3372 (Ch)
Lomas & others v JFB Firth Rixson Inc and others; Lehman Brothers Special Financing Inc v Carlton Communications Ltd, Pioneer Freight Futures Co Ltd (in liquidation) v Cosco Bulk Carrier Co Ltd; Britannia Bulk plc (in liquidation) v Bulk Trading SA [2012] EWCA Civ 419
Lehman Brothers Special Financing Inc v Carlton Communications Ltd [2011] EWHC 718 (Ch)
Lehman Brothers Commodity Services Inc and Credit Agricole Corporate and Investment Bank (formerly Calyon) [2011] EWHC 1390 Comm
Anthracite Rated Investments (Jersey) Ltd v Lehman Brothers Finance SA (in liquidation); Fondazione Enasarco v Lehman Brothers Finance SA and another [2011] EWHC 1822 (Ch)
Lehman Brothers International (Europe) (in administration) v Lehman Brothers Finance SA [2012] EWHC 1072 (Ch)
The joint administrators of Lehman Brothers International (Europe) (in administration) [2013] EWCA Civ 188
The General (Extended) Liens case
Re Lehman Brothers International (Europe) (in administration) and others [2012] EWHC 2997 (Ch)

2.Hearings on minor matters
RAB Capital Plc v Lehman Brothers International (Europe) [2008] EWHC 2335 (Ch)
Four Private Investment Funds v Lomas and others [2008] EWHC 2869 (Ch)
Perpetual Trustee Co Ltd v BNY Corporate Trustee Services [2009] EWHC 2953 (Ch)
In the matter of Lehman Brothers International (Europe)(in administration) and CRC Credit Fund Limited and others [2010] EWHC 47 (Ch)
Lehman Brothers International v CRC Credit Fund Limited and others [2010] EWCA Civ 1001
Re Lehman Brothers International (Europe) (in administration) [2010] EWHC 3044 (Ch)
Spencer v Lehman Brothers Ltd [2011] EqLR 319
In the Matter of Lehman Brothers International (Europe) (in administration) [2011] EWHC 1233 (Ch)
Re Lehman Brothers International (Europe) (in administration) [2011] EWHC 2022 (Ch)
Lehman Commercial Conduit (in administration) & Anor. v Gatedale Limited (in CVL) 2012 EWHC 3083 (Ch) (2012 EWHC 848)
Lehman Brothers Bankhaus AG I Ins v CMA CGM [2013] EWHC 171 (Comm)
Commonwealth Ave.Inc v Lehman Brothers International & Others [2013] EWCA Civ 458
Fondazione Enasarco v Lehman Brothers Finance SA and another [2014] EWHC 34 (Ch)
Contrarian Funds LLC v Lomas and others; Re Lehman Brothers International (Europe) (in administration) [2014] EWHC 1687 (Ch)
Lehman Brothers Finance SA (in liquidation) v SAL Oppenheim JR and Cie KGAA [2014] EWHC 2627 (Comm)
Lehman Brothers Finance AG (in liquidation) v Klaus Tschira Stiftung GmbH and another [2014] EWHC 2782 (Ch)
Fondazione Enasarco v Lehman Brothers Finance SA and another [2015] EWHC 1307 (Ch)
3.Schemes of arrangement and settlement cases
Re Lehman Brothers International (Europe) (in administration) (No 2) [2009] EWHC 2141 (Ch)
Re Lehman Brothers International (Europe) (in administration) (No.2) [2009] EWCA Civ 1161
In the matter of Lehman Brothers International Europe (in administration) [2013] EWHC 1644 (Ch)

4.Pensions cases
Re Nortel GmbH and others; Re Lehman Brothers International (Europe) (in administration) and others; Bloom and others v Pensions Regulator and others [2010] EWHC 3010 (Ch)
Re Nortel GmbH (in administration) and other companies; Re Lehman Brothers International (Europe) (in administration) and other companies [2011] EWCA Civ 1124
Trustees of the Lehman Brothers Pension Scheme v Pensions Regulator and others [2012] All ER (D) 11 (Jul)
Nortel GmbH (in administration) and related companies; Re Lehman Brothers International (Europe) (in administration) and related companies [2013] UKSC 52
Re Financing No 1 Ltd and others v Trustees of the Lehman Brothers Pension Scheme and another [2013] EWCA Civ 751
Priorities
Re Lehman Brothers International (Europe) (in administration) (No 4) [2014] EWHC 704 (Ch)
Re Lehman Brothers International (Europe) (in administration) [2015] EWCA Civ 485
The Joint Administrators of Lehman Brothers International (Europe) (In Administration) v Burlington Loan Management Limited, CVI GVF (Lux) Master Sàrl, Hutchinson Investors LLC, Wentworth Sons Sub-Debt Sàrl, York Global Finance BDH LLC [2015] EWHC 2269 (Ch)
Lomas and others v Burlington Loan Management Ltd and others; subnom Lehman Brothers International (Europe) (in administration) [2015] EWHC 2270 (Ch)

APPENDIX 3

English law MF Global cases

No.	Case	Issue	Decision	Relevance for Thesis
1	*Re MF Global Overseas Ltd (in administration); Re MF Global Finance Europe Ltd (in administration)* [2012] EWHC 1091 (Ch)	Whether special administrators correctly appointed.	They were.	None.
2	*Heis and others v MF Global Inc, Re Global UK Ltd (in special administration)* [2012] EWHC 3068 (Ch)	Whether the appointment of administrators constituted an event of default under the Global MRA.	Held that it did not (although liquidation would have done).	None.
3	*Mirador International LLC v MF Global UK Ltd* [2012] EWCA Civ 1662	Appeal against making payments to a broker.	Appeal dismissed.	None.
4	*Re MF Global UK Ltd* [2013] EWHC 1655 (Ch)	Administrators sought directions regarding payments.	Directions given.	None.
5	*Melzer v MF Global UK Ltd* C-228/11 EU	German domiciled individual claimed damages for failure to inform him of risks of investments.	German court would not be granted jurisdiction on the facts and basis of EU Regulation 44/2001.	None.
6	*Re MF Global UK Ltd (in special administration)* [2013] EWHC 92 (Ch)	Application of CASS rules.	Followed the claims basis from *Lehmans*; rejected the hindsight principle.	None.
7	*Heis and others (as joint administrators) of MF Global UK Ltd v Attestor Value Master Fund LP and anor (as representatives) Re MF Global UK Ltd (in special administration)* [2013] EWHC 2556 (Ch)	Application of CASS rules.	Followed the decision in LBIE v CRC Credit Fund [2012] UKSC 6.	Possibly: a client's provable debt would be reduced to the extent of a payment from the client money account; if there was still a shortfall, the client could prove for the remainder.
8	*Re MF Global UK Ltd (in special administration)* EWHC 2222 (Ch)	Application to court for client money pool trustee to enter into a settlement agreement.	Allowed.	None.
9	*MF Global UK Ltd (in special administration) sub nom Heis and others v MF Global UK Services Ltd (in administration)* [2015] EWHC 833 (Ch)	Was the service company entitled to pensions indemnity from the principal operating company.	Held that it was.	None.
10	*Re MF Global UK Ltd* [2015] EWHC 2319 (Ch)	Request for directions under s236 Insolvency Act.	Refused.	None.

APPENDIX 4

Schedule of US Lehman cases

No.	Case	Issue	Decision	Relevance for Thesis
1	*In re Lehman Brothers Holdings Inc.* 544 BR 62 (2015)	Damages claim for failure to fund. Agreement had damages waiver.	Damages waiver upheld.	Not relevant.
2	*In re Lehman Brothers Holdings Inc.* 544 BR 16 (2015)	Jurisdiction.	Expunged claims did not provide personal jurisdiction over claimant.	Possibly: cross-border case involving Australian entity.
3	*In re Lehman Brothers Inc.* 61 Bankr Ct Dec 220	Motion for summary judgment by Firstbank Puerto Rico.	Claim expunged.	Possibly: cross-border element. Bank sought return of securities.
4.	*In re Lehman Brothers Inc.* 541 BR 45 (2015)	Employee claim.	Disallowed.	Not relevant.
5.	*In re Lehman Brothers Holdings Inc.* 535 BR 608 (2015)	Jurisdiction.	Bankruptcy court lacked personal jurisdiction over foreign swap participant.	Yes: judgment discusses location of assets "Shield responds that LBSF's *in rem* theory fails because the property is not property of the estate, the property is not physically situated in the forum and…"
6	*In re Lehman Brothers Holdings Inc.* 530 BR 601 (2015)	Claim for contractual indemnification following purchase of allegedly defective mortgage loans.	Not known.	Not relevant.
7	*In re Lehman Brothers Holdings Inc.* Slip Copy (2014) WL8274868	Determination of plan to deal with mortgage backed securities.	Administrative	Not relevant.
8	*In re Lehman Brothers Holdings Inc.* 519 BR 47 (2014)	Claim based on restricted stock units.	Claim had to be subordinated.	Not relevant.
9	*In re Lehman Brothers Holdings Inc.* 515 BR 171 (2014)	Claims.	Parties lacked standing.	Not relevant.
10	*In re Lehman Brothers Holdings Inc.* 513 BR 624 (2014)	Claims about residential backed mortgage securities.	Not securities of the debtor.	Not relevant.
11	*In re Lehman Brothers Holdings Inc.* Slip Copy (2014) WL2766164	458th Omnibus objection.	Administrative.	Not relevant.
12	*In re Lehman Brothers Inc.* 503 BR 778 (2014)	Claims made by junior underwriters.	Claims subject to mandatory subordination.	Not relevant.

13	*In re Lehman Brothers Holdings Inc.* 502 BR 375 (2013)	Set-off and court's jurisdiction.	Pre-insolvency set-off allowed.	Not relevant.
14	*In re Lehman Brothers Holdings Inc.* 502 BR 383 (2013)	Consideration of *ipso facto* clauses.	Prohibition protected swap.	Relevant: considered the *BNY Trustee* case.
15	*In re Lehman Brothers Holdings Inc.* Not reported in BR (2013) WL6283572	Barclays brought civil contempt proceedings against Firstbank Puerto Rico for violation of bankruptcy order.	Not known.	Not relevant.
16	*In re Lehman Brothers Holdings Inc.* Slip Copy (2013) WL5908057	Motion to set aside claims as being covered by Omnibus Agreement.	Upheld. Administrative.	Not relevant.
17	*In re Lehman Brothers Inc.* 493 BR 437 (2013)	Late filing of SIPA claims.	Not known.	Not relevant.
18	*In re Lehman Brothers Inc.* 492 BR 379 (2013)	Whether counterparties to repos had "customer" claims under SIPA.	They did not.	Possibly relevant for discussion of repos/possession.
19	*In re Lehman Brothers Holdings Inc.* 492 BR 191 (2013)	Claim against bona fide purchaser for value.	Claim could not be asserted.	Not relevant.
20	*In re Lehman Brothers Inc.* Slip copy (2013) WL1618029	Settlement Agreement amongst LBI Trustee, LBIE and the LBIE Administrators.	Administrative.	Not relevant.
21	*In re Lehman Brothers Inc.* Slip copy (2013) WL1618023	Settlement Agreement between LBI Trustee and the LBHI entities.	Administrative.	Not relevant.
22	*In re Lehman Brothers Holdings Inc.* Slip copy (2013) WL819734	Concerned a party to whom a Lehman loan was made.	Not known.	Not relevant.
23	*In re Lehman Brothers Holdings Inc.* 487 BR 181 (2013)	Issue of administrative expenses.	Administrative.	Not relevant.
24	*In re Lehman Brothers Holdings Inc.* 474 BR 139 (2012)	Whether certain claims were "customer" claims under SIPA.	Claims were not customer claims.	Not relevant.
25	*In re Lehman Brothers Holdings Inc.* 474 BR 441 (2012)	Motion to strike portion of claim objection.	Motion was premature.	Not relevant.
26	*In re Lehman Brothers Holdings Inc.* Slip copy (2012) WL1933806	Claim bought by individual.	Not known.	Not relevant.

27	*In re Lehman Brothers Holdings Inc.* 469 BR 415 (2012)	Avoidance following demands from counterparties for additional collateral in run up to Lehmans insolvency.	Transfers were made "in connection with" securities contracts for "Safe Harbour" purposes.	Not really relevant other than to validate discussion in Valukas report as to what happened pre-insolvency.
28	*In re Lehman Brothers Inc.* 462 BR 53 (2011)	Whether certain claims were "customer" claims under SIPA.	Claims were not customer claims.	Not relevant.
29	*In re Lehman Brothers Inc.* 458 BR 134 (2011)	UBS AG sought pre-petition set-off.	Pre-petition set-off denied.	Although case involved a Swiss company, no cross-border issues arose as case governed by NY law.
30	*In re Lehman Brothers Holdings Inc.* 456 BR 213 (2011)	Whether debtor had claim against asset purchaser for shortfall in payments to ex-employees.	Debtor did not have a claim.	Not relevant.
31	*In re Lehman Brothers Holdings Inc.* Slip copy (2011) WL2006341	HR personnel claimed for post-petition work.	Not known.	Not relevant.
32	*In re Lehman Brothers Holdings Inc.* 452 BR 31 (2011)	Alleged unenforceability of swap termination payment clause as *ipso facto* clause	Swap agreement's defaulted termination payment did not fall within Safe Harbour (*sic*) provisions.in bankruptcy statute.	Possibly relevant for discussion of *ipso facto* clauses.
33	*In re Lehman Brothers Holdings Inc.* 445 BR 143 (2011)	Relief sought from sale order due to failure to disclose material information.	Not granted.	Not relevant.
34	*In re Lehman Brothers Holdings Inc.* Not reported in BR (2011) WL722601	Claims brought by two former employees of LBI to recover bonuses.	Not known.	Not relevant.
35	*In re Lehman Brothers Holdings Inc.* Not reported in BR (2011) WL722582	Claim to recover possession of shares allegedly improperly transferred by Lehmans on insolvency.	Not known.	Not relevant.
36	*In re Lehman Brothers Holdings Inc.* 439 BR 811 (2010)	Whether automatic stay exception for netting arrangements applied to bank set-off.	Exception did not apply to bank set-off.	Not relevant.

37	*In re Lehman Brothers Holdings Inc.* Not reported in BR (2010) WL4818173	Memo explaining how 66,000 proofs were being whittled down by means of objections to claims.	Administrative.	Not relevant.
38	*In re Lehman Brothers Holdings Inc.* Not reported in BR (2010) WL2889527	Claim in respect of unfulfilled funding obligations.	Claim dismissed.	Not relevant.
39	*Securities Investor Protection Corp v Lehman Brothers Inc.* 433 BR 127 (2010)	Clarification of correct date for purposes of calculating a customer's net equity claim	Date of filing of SIPA liquidation.	Not relevant.
40	*In re Lehman Brothers Holdings Inc.* 433 BR 113 (2010)	Whether late claims could be allowed on basis of "excusable neglect" theory.	They could not.	Not relevant.
41	*In re Lehman Brothers Holdings Inc.* 433 BR 101 (2010)	Whether Safe Harbour provisions did away with mutuality requirement for set-off.	They did not.	Possibly relevant because case involved ISDA Master Agrt and the payment of outstanding sums in Swedish KR.
42	*In re Lehman Brothers Holdings Inc.* 422 BR 407 (2010)	Whether a clause was a prohibited *ipso facto* clause.	It was.	Relevant as the US side of the *BNY Trustee* case.
43	*In re Lehman Brothers Holdings Inc.* 416 BR 392 (2009)	Whether bank had assumed funding obligations.	It had not.	Not relevant.
44	*In re Lehman Brothers Holdings Inc.* Not reported in BR (2009) WL6057286	Request to court to compel contractual performance and enforce automatic stay.	Order made.	Not relevant.
45	*In re Lehman Brothers Holdings Inc.* 404 BR 752 (2009)	Determination of when bank's debt arose for set-off.	Debt arose post-petition for set-off purposes.	Not relevant.
46	*In re Lehman Brothers Inc.* Not reported in BR (2008) WL5423214	Application of Federal Rules of Bankruptcy Procedure for discovery purposes.	Administrative.	Not relevant.
47	*In re Lehman Brothers Holdings Inc.* Not reported in BR (2008) WL4902202	Permissions given to debtors to use cash management processes subject to certain modifications and conditions.	Administrative.	Not relevant.
48	*In re Lehman Brothers Holdings Inc.* Not reported in BR (2008) WL4902179	Permissions given to debtors to pay employees, maintain insurances and pay pre-petition obligations.	Administrative.	Not relevant.

APPENDIX 5
Classification of US Lehman cases

1 Cases with a cross-border element and/or which considered issues relating to intermediated securities.
In re Lehman Brothers Holdings Inc. 544 BR 16 (2015)
In re Lehman Brothers Inc. 61 Bankr Ct Dec 220
In re Lehman Brothers Holdings Inc. 535 BR 608 (2015)
In re Lehman Brothers Holdings Inc. 502 BR 383 (2013)
In re Lehman Brothers Inc. 492 BR 379 (2013) * need hard copy of this case *
In re Lehman Brothers Holdings Inc. 452 BR 31 (2011)
In re Lehman Brothers Holdings Inc. 433 BR 101 (2011)
In re Lehman Brothers Holdings Inc. 422 BR 407 (2010)
2.Claims hearings on non-relevant matters
In re Lehman Brothers Inc. 541 BR 45 (2015)
In re Lehman Brothers Holdings Inc. 530 BR 601 (2015)
In re Lehman Brothers Holdings Inc. 519 BR 47 (2014)
In re Lehman Brothers Holdings Inc. 515 BR 171 (2014)
In re Lehman Brothers Holdings Inc. 513 BR 624 (2014)
In re Lehman Brothers Inc. 503 BR 778 (2014)
In re Lehman Brothers Holdings Inc. 502 BR 375 (2013)
In re Lehman Brothers Holdings Inc. Not reported in BR (2013) WL6283572
In re Lehman Brothers Inc. 493 BR 437 (2013)
In re Lehman Brothers Holdings Inc. 492 BR 191 (2013)
In re Lehman Brothers Holdings Inc. Slip copy (2013) WL5908057
In re Lehman Brothers Holdings Inc. Slip copy (2013) WL819734
In re Lehman Brothers Holdings Inc. 474 BR 139 (2012)
In re Lehman Brothers Holdings Inc. 474 BR 441 (2012)
In re Lehman Brothers Holdings Inc. Slip copy (2012) WL1933806
In re Lehman Brothers Holdings Inc. 469 BR 415 (2012)

In re Lehman Brothers Inc. 462 BR 53 (2011)
In re Lehman Brothers Inc. 458 BR 134 (2011)
In re Lehman Brothers Holdings Inc. 456 BR 213 (2011)
In re Lehman Brothers Holdings Inc. Slip copy (2011) WL2006341
In re Lehman Brothers Holdings Inc. 452 BR 31 (2011)
In re Lehman Brothers Holdings Inc. 445 BR 143 (2011)
In re Lehman Brothers Holdings Inc. Not reported in BR (2011) WL722601
In re Lehman Brothers Holdings Inc. Not reported in BR (2011) WL722582
Securities Investor Protection Corp v Lehman Brothers Inc. 433 BR 127 (2010)
In re Lehman Brothers Holdings Inc. 433 BR 113 (2010)
In re Lehman Brothers Holdings Inc. 433 BR 101 (2010)
In re Lehman Brothers Holdings Inc. 422 BR 407 (2010)
In re Lehman Brothers Holdings Inc. 416 BR 392 (2009)
In re Lehman Brothers Holdings Inc. Not reported in BR (2009) WL6057286
In re Lehman Brothers Holdings Inc. 404 BR 752 (2009)
3.Cases on administrative matters/ settlements
In re Lehman Brothers Holdings Inc. Slip Copy (2014) WL8274868
In re Lehman Brothers Holdings Inc. Slip Copy (2014) WL2766164
In re Lehman Brothers Inc. Slip copy (2013) WL1618029
In re Lehman Brothers Inc. Slip copy (2013) WL1618023
In re Lehman Brothers Holdings Inc. 487 BR 181 (2013)
In re Lehman Brothers Holdings Inc. Not reported in BR (2010) WL4818173
In re Lehman Brothers Inc. Not reported in BR (2008) WL5423214
In re Lehman Brothers Holdings Inc. Not reported in BR (2008) WL4902202
In re Lehman Brothers Holdings Inc. Not reported in BR (2008) WL4902179

APPENDIX 6

Schedule of US MF Global Inc. cases

No.	Case	Issue	Decision	Relevance for Thesis
1	*In re MF Global Inc.* Slip Copy (2016) WL 270180	Trustee objection to general creditor claim.	Not known.	Not relevant.
2	*In re MF Global Inc.* 535 BR 596 (2015)	Proposed sale of Chapter 11 debtors' assets.	Approved.	Not relevant.
3	*In re MF Global Inc.* 531 BR 424 (2015)	Whether debtor had breached customer agreement by liquidating customer's under-margined account without notice.	It had not.	Not relevant.
4	*In re MF Global Inc.* Slip Copy (2015) WL 1239102	Trustee's seventy-fifth objection to the general creditor claims.	Not known.	Not relevant.
5	*In re MF Global Inc.* Slip Copy (2015) WL 3507342	Trustee filed objection to claim of general creditor in relation to whether Morgan Stanley was selling positions on the market.	Not known.	Not relevant.
6	*In re MF Global Inc.* 515 BR 434 (2014)	Damages claim.	Customers of failed broker-dealers were not entitled to recover position losses as contractual damages.	Not relevant.
7	*In re MF Global Holdings Ltd.* 515 BR 193 (2014)	Motion to authorise certain payments out of directors and officers liability policies.	Not known.	Not relevant.
8	*In re MF Global Inc.* 512 BR 757 (2014)	Employee claims.	Rule governing class actions could be applied to claims process.	Not relevant.
9	*In re MF Global Inc.* Slip Copy (2014) WL 1320094	Period for filing a SIPA claim.	Administrative.	Not relevant.
10	*In re MF Global Holdings Inc.* Not reported in BR (2014) WL 3536977	Plan administrator objected to plaintiff's claim.	Not known.	Not relevant.

11	*In re MF Global Inc.* 506 BR 582 (2014)	Whether court needed to approve compensation of SIPA trustee's non-attorney professionals.	Administrative.	Not relevant.
12	*In re MF Global Inc.* Slip Copy (2014) WL 657321	Discussion of time limit for filing SIPA claims.	Administrative.	Not relevant.
13	*In re MF Global Inc.* Slip Copy (2014) WL 657321	Application for a late filed claim.	Not known.	Not relevant.
14	*In re MF Global Holdings Ltd* Slip Copy (2014) WL 3882363	Employee claim.	Subject to mandatory subordination.	Not relevant.
15	*In re MF Global Inc.* Slip Copy (2013) WL5232578	Valuation case.	Not known.	Not relevant.
16	*In re MF Global Inc.* Slip Copy (2013) WL 1686666	Trustee's objection to a claim filed by an individual.	Not known.	Not relevant.
17	*In re MF Global Inc.* Slip Copy WL 5232578	Motion for distribution.	Administrative.	Relevant.
18	*In re MF Global Inc.* Slip Copy (2013) WL 74580	Motion for Rule 2004 Examination.	Not known.	Not relevant.
19	*In re MF Global Inc.* Slip Copy (2013) WL 364207	Motion approving settlement agreement.	Administrative.	Not relevant.
20	*In re MF Global Holdings Ltd.* Slip Copy (2013) WL2352440	Order to show cause why sanctions should not be imposed against an individual.	Not known.	Not relevant.
21	*In re MF Global Inc.* Not reported in BR (2013) WL4511863	Motion to dismiss amended class action complaint; employee issue.	Not known.	Not relevant.
22	*In re MF Global Inc.* 492 BR 407 (2013)	Whether claimant was entitled to "customer" status under SIPA.	Claimant was not, following *In re Lehman Bros Inc.* 492 BR 379 (2013)	Relevant for discussion of ownership/possession of the repos.
23	*In re MF Global Inc.* 491 BR 355 (2013)	Claimants sought to establish that they were protected under SIPA.	Claim failed.	Not relevant.
24	*In re MF Global Holdings* 481 BR 268 (2012)	Whether SIPA trustee was an employer subject to certain federal laws.	SIPA was not.	Not relevant.
25	*In re MF Global Inc.* 478 BR 611 (2012)	Whether SIPA could assign potential malpractice claims.	It could.	Not relevant.

26	*In re MF Global Inc.* Slip Copy (2012) WL 3242533	Establishment of partial settlement agreement with a customer.	Administrative.	Not relevant.
27	*In re MF Global Holdings Ltd* Slip Copy (2012) WL5499847	Trustee's objection to claim filed by individual.	Not known.	Not relevant.
28	*In re MF Global Inc.* Slip Copy (2012)	Proposed protective order between MF Global Inc Trustee and MF Global Holdings Ltd Trustee.	Not known.	Not relevant.
29	*In re MF Global Holdings Inc.* Slip Copy (2012)WL3260393	Motion seeking order authorising SIPA trustee to file exhibit under seal.	Not known.	Not relevant.
30	*In re MF Global Inc.* Slip Copy (2012) WL 3242533	Objection filed to motion seeking authorisation to file exhibit under seal.	Not known.	Not relevant.
31	*In re MF Global Holdings Inc.* Slip Copy (2012) WL 1424670	Motion in respect of Stipulation Order between Trustee and statutory creditors committee.	Not known.	Not relevant.
32	*In MF Global Holdings Ltd.* Slip Copy (2012) WL 1438262	Motion requesting commodity customers to take priority in the MF Global Inc Chap 11	Not known.	Not relevant.
33	*In re MF Global Inc.* Slip Copy (2012) WL734195	Motion to approve first interim distribution for commodity futures claims.	Not known. Administrative.	Not relevant.
34	*In re MF Global Inc.* Slip Copy (2012) WL 769501	Issue of discovery.	Discovery was unnecessary.	Not relevant.
35	*In re MF Global Inc* Slip Copy (2012) WL2202978	Supplement to order regarding rejection of lease.	Not known.	Not relevant.
36	*In re MF Global Inc.* Slip Copy (2012) WL 763170	Extension of bar date sought.	Not known.	Not relevant.
37	*In re MG Global Inc.* Slip Copy (2012) WL2202973	Motion to uphold certain claims filed by an individual.	Not known.	Not relevant.
38	*In re MF Global Inc* Slip Copy (2012) WL 734175	Commodity customer sought relief on basis of domestic relations and child support sections of the bankruptcy code.	Not known.	Not relevant.

39	*In re MF Global Holdings Ltd* 469 BR 177 (2012)	Whether automatic stay should be lifted for insurance purposes.	It should. Administrative.	Not relevant.
40	*In re MF Global Inc.* 467 BR 726 (2012)	How customer's physical property should be dealt with.	As estate property eligible for pro rata distribution in SIPA liquidation.	Not relevant.
41	*In re MF Global Inc.* 466 BR 244 (2012)	Issue as to ownership of gold and silver bars.	Not known.	Not relevant.
42	*In re MF Global Inc.* Slip Copy (2012) WL5386101	Motion for stay pending appeal against an order assigning certain claims.	Not known.	Not relevant.
43	*In re MF Global Holdings Ltd* 466 BR 239 (2012)	Trustee's proposals for dealing with leases and contracts.	Did not comply with bankruptcy rules.	Not relevant.
44	*In re MF Global Holdings Ltd* 465 BR 736 (2012)	Application of Chapter 7 statute applicable to commodity brokers to Chapter 11 non-commodity broker debtors.	Not applicable.	Not relevant.
45	*In re MF Global Holdings Ltd* 464 BR 619 (2012)	Whether class action claim be dismissed or consolidated.	Dismissed.	Not relevant.
46	*In re MF Global Inc.* Slip Copy (2012) WL 769519	Motion to compel the Trustee to avoid using futures commissions merchants and clearing exchanges.	Not known.	Not relevant.
47	*In re MF Global Inc.* 464 BR 594 (2011)	Appointment of trustee in satisfaction of SIPA disinterestedness requirements.	Administrative.	Not relevant.
48	*In re MF Global Holdings Ltd* 462 BR 36 (2011)	Basis for election of creditors committee in SIPA liquidation.	Basis was not the Bankruptcy Code.	Not relevant.
49	*In re MF Global Holdings Inc* Slip Copy (2011) WL 6210374	Order sought to enable debtor to use cash collateral.	Unknown. Administrative.	Not relevant.
50	*In re MF Global Inc.* Slip Copy (2011) WL5357959	Trustee sought to establish procedures for issuance of *subpoenas* etc	Not known. Administrative.	Not relevant.
51	*In re MF Global Inc.* Slip copy (2011) WL 6792758	Application for assuming and assigning an unexpired lease.	Not known. Administrative.	Not relevant.

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