

Below is a summary of the Court of Appeal's judgment of 2 August 2010 in relation to the ownership of client funds held by LBIE at the date of administration (the so-called "client monies" issue). Those funds were subject to a statutory trust imposed by Chapter 7 of the Client Asset Sourcebook, known as "CASS7" (the FSA's client money rules).

1. Background

The Court of Appeal ("Court") was asked to determine:

- a. the point in time when, in the conduct of its investment business, LBIE became a statutory trustee of client money for its clients; and
- b. the manner in which such funds are to be distributed following the commencement of administration.

The resolution of these issues has important implications for those LBIE clients who, as beneficiaries under a trust, will be entitled to prevent other creditors of LBIE from making a claim to those assets.

A number of differing interests were represented in the appeal. These included CRC Credit Fund Limited as the representative of non-segregated clients, Lehman Brothers Inc, Lehman Brothers Finance AG, Lehman Brothers Holdings Inc and GLG Investments PLC sub-fund: European Equity Fund. The Financial Services Authority and the Joint Administrators made submissions to assist the Court.

2. The Court of Appeal Decisions

- a. The Court upheld Mr Justice Briggs' decision, made in the High Court (handed down on 15 December 2009), that a statutory trust which attaches to client money attaches at the moment of receipt, not at the moment of segregation. The Court's confirmation of the High Court's decision means that for those clients affected (whether or not their accounts were segregated), as beneficiaries under a trust they can exclude other LBIE creditors from making a claim to those assets.
- b. The Court also upheld the decision that the money which was due and payable by LBIE to a client but which had not been appropriated to a client by LBIE prior to administration (e.g. by segregation) is not client money and does not therefore form part of the client money pool.



c. The Court also appears to have affirmed the High Court decision that LBIE is not obliged to make good any shortfall in the pool or in any segregated account resulting from under-segregation. A decision to the contrary would in any event offend insolvency law in the event of the liquidation of LBIE since the assets not subject to a trust would have to be distributed in accordance with the statutory scheme of distribution under the Insolvency Act 1986.

d. However, the Court overturned the High Court's decision that the only persons entitled to share in the client money pool were those whose funds were held in segregated accounts. All client money should have been segregated. Therefore, all clients who ought to have had their money segregated by LBIE prior to administration are now entitled to share in the client money pool, regardless of whether or not LBIE segregated their money.

3. Key considerations for the Court's decision

a. The FSA's client money rules (CASS7.7.2R) imposed a statutory trust on funds that LBIE received from or for its clients as soon as they were received. This view was formed despite the Court's obligations to conform with European law (the Markets in Financial Instruments Directive (2004/39/EC) requires the segregation of client money from the money of the investment firm).

b. Mr Justice Briggs had treated segregation like a declaration of a further trust for particular clients over and above the statutory trust formed on receipt. However, the FSA's client money rules create a single trust and not a series of individual trusts. A single trust would indicate that a single pooling was intended: applying the maxim "equality is equity", it is unlikely that a single trust would treat the beneficiaries in different ways, especially if only one form of treatment is expressed in the terms of the trust (CASS7). The creation of a single trust is an overarching reason for having a single pooling.

c. The Court acknowledged the difficulty noted by Mr Justice Briggs in allowing un-segregated claimants to share in the pool. This would introduce a burdensome stage in the pooling and distribution of client money. However, pooling and distribution had to be done fairly. A distribution which pooled money in segregated accounts but not other monies would be unfair for a number of reasons, including leaving clients in a "legal blackhole".

4. Implications and next steps

a. We understand that the Joint Administrators are considering the judgment to assess its implications for LBIE client money claimants and creditors, including issues of timing and distribution.

b. It is likely to take longer to return money to clients because the decision not only widens the scope of pre-administration client money that must be pooled but also the number of clients that are entitled to claim against that pool.

c. It is understood that certain parties are considering whether to seek permission to appeal to the Supreme Court.

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