



Prime Brokerage and Custodian Agreements after the Latest Lehman Case

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Last week, the English High Court decided that certain assets held by Lehman Brothers International (Europe) (in administration) (LBIE) for prime brokerage customers were held by LBIE on trust for those customers. This means that such customers (predominately hedge funds) should get back their prime brokerage assets (subject to the identification and verification of the assets and the hedge funds), and that such assets will not be available to the unsecured creditors of LBIE.

LBIE is presently proposing a court scheme of arrangement and out-of-court scheme of arrangement to facilitate the return of the trust assets.

The case (*Lomas et al v. RAB Capital and Hong Leong Bank Berhad*, 21 October 2009) was a decision about the "International Prime Brokerage Agreement (Charge Version)" used by LBIE, but has wider implications for the prime brokerage, securities lending, repo and custodian businesses of other banks.

The case is important beyond the LBIE insolvency because it creates a trust relationship for most existing prime brokerage and custodian relationships in the London market. Some of the most obvious implications are:

- **Documentation:** Most prime brokerage agreements and custodian agreements are not drafted on the basis that the prime broker or custodian is a trustee. The agreements will need to be amended on the basis of fundamental decisions whether (a) the relationship is to be a trust relationship (which could be expressly excluded by agreement) and (b) if the relationship is a trust relationship, the fiduciary duties of the trustee are modified by agreement.
- **Duty of care:** The Trustee Act 2000 imposes a duty of care, fiduciary obligations and many other restrictions that may be inappropriate for a prime broker.

This memorandum is intended only as a general discussion of these issues. It is not considered to be legal advice. We would be pleased to provide additional details or advice about specific situations. For additional information on this important topic, please feel free to call upon your Dewey & LeBoeuf relationship partner.

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- Profits: English trust law prevents a trustee from using trust assets for personal gain. If prime brokerage assets are trust assets, there will be many restrictions on a prime broker trading or charging those assets, except for the sole benefit of the hedge fund customer. This defeats the purpose of most prime brokerage arrangements.
- Remuneration: The Trustee Act 2000 limits the remuneration of a trustee to "reasonable remuneration" unless another remuneration has been agreed upon in the "trust instrument".
- Dealing with investment banks: The LBIE case may also significantly complicate the buying and selling of bonds, shares and other securities (including securities lending and repos) and the creation of charges and mortgages over such securities. A counterparty will not know whether the prime broker is acting as a trustee or in its own capacity. If trust assets are being dealt with by the prime broker, then the counterparty should enquire whether the terms of the prime brokerage agreement allow the proposed transaction. If the transaction is not allowed, there could be a dispute about ownership of the securities. Resolution of that dispute will often depend upon whether the purchaser or chargee knew (or should have known) that the relevant securities were trust assets.

The imposition of trust law onto prime brokerage relationships will change the prime brokerage business in London. The imposition of trust law onto custodian relationships will not significantly change the custodian business in London but will mean that most custodian agreements need to be updated.

For more information, please contact Bruce Johnston at +44 20 7459 5052 or bjohnston@dl.com, or your Dewey & LeBoeuf relationship lawyer.