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The Berkeley Applegate Order

One of the key issues facing insolvency officeholders in broker/dealer and, more typically, investment bank insolvencies is the question of trust assets. Counterparties and investors will assert arguments of trust status over cash and shares. Trust assets do not belong to the insolvent company. Instead, they sit outside the insolvent estate. The question is:- whose function it is to investigate those trust claims. The powers and functions of liquidators and administrators are clearly defined by insolvency legislation and broadly stipulate that the officeholders are empowered to administer and realise the assets of the company for the benefit of the creditors, since trust assets are not assets of the company. The question of assets held in trust is therefore problematic, both in terms of the officeholder's ability to investigate the alleged trust status (and the administration of those assets if they are deemed to be trust assets) and the recovery of professional fees for undertaking that investigation (and administration).

The Courts in England and Wales have recognised that, even though the officeholder has no statutory powers for dealing with trust assets, there is a residual equitable jurisdiction vested in the Courts to allow the officeholder to do this. The equitable jurisdiction arises from the proposition that the beneficiaries of the assets could gather together (or even act separately) and appoint a trustee(s) to realise or administer their assets. In the case of *Berkeley Applegate (Investment Consultants) No 2*, the Court concluded that it could authorise the insolvency officeholder to act as a quasi trustee in order to realise the assets. That conclusion is sensible from the point of view of pure logistics as well as limiting the cost and expense of any number of trustees becoming involved. The insolvency officeholder will have access to the records of the company as well as the computer operating systems. He is likely, therefore, to be in a position to determine trust status and administer them, and repatriate or rehypothecate the assets more quickly and economically than a separately appointed trustee or trustees.

As a consequence, and again based on equitable principles, the liquidator in the *Berkeley Applegate* case was able to recover fair compensation for his efforts in determining trust status. In a subsequent case (*Berkeley Applegate (Investment Consultants) No 3*), the Court held that equitable charges of this sort could not be levied against the company's assets (which should be distributed through dividends to the unsecured creditors) but, instead, should be charged on and deducted from the trust funds which had been investigated. Following this line of argument, the administrators of Lehman Brothers Investment Europe intend to seek an Order from the Court that their costs of investigating and administering the trust assets for counterparties should be met from the value of the trust assets themselves. The counterparties will be given notice of the hearing and will be entitled to be represented at the hearing.

From our experience of making *Berkeley Applegate* type applications on behalf of insolvency officeholders, it seems clear that the issue to focus on, from a counterparty's point of view, is the question of the fairness of the officeholder's compensation request in relation to the work which he has undertaken. As stated above, the compensation sought must be fair and in accordance with equitable principles. The question therefore is what work was it fair for the administrator to undertake in the particular circumstances of the assertions of trust status made by the counterparties. In addition, if there is a dispute as to the trust status, the Courts have determined that the officeholders' requests for compensation for their investigation should not attach to those disputed trust assets (*Local London Residential Limited* - a matter on which we advised the liquidator on a successful *Berkeley Applegate* type application). Therefore, the terms of the application should clearly identify how the costs have been incurred and allocated, so that creditors can be assured that none of the administrators' time spent dealing with trust assets will be charged against the company's assets.

The administrators in *Lehman* have indicated that their application is likely to deal with trust assets rather than client money. There are regulations which apply to the pooling of client money on an event of insolvency and there is a precedent for *Berkeley Applegate* type orders in relation to client money repatriation (*Seligmann Harris and Company (in Administration)* - a matter where we successfully secured a *Berkeley Applegate* type remuneration order in a case where client money had been unlawfully used to meet margin calls by a broker).

The trust assets involved in the *Lehman* application are likely to be OTC trades, shares and cash held pursuant to prime broking agreements and ancillary documentation. On exchange trades are likely to be subject to the default regulations of the individual exchanges, all of which will have a value determination mechanism.

If you would like to discuss any of the issues or concepts referred to above, please do not hesitate to contact Tony Griffiths or Edward Smith.

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