The Supreme Court published on 29 February its long-awaited decision in the Lehman Brothers case concerning the treatment of monies held by the UK investment bank (in one form or another) for its clients. On two of the three critical questions addressed by this case, the decision was reached by a 3 to 2 majority among the justices.

When reading the judgments of the justices, one almost has the impression that they are a continuation of the litigants' own arguments, such is the disagreement between the majority and the dissenting minority. But there is nevertheless a result, however hard-won and contentious, as follows:

- The statutory trust which arises by operation of client money rules made under the Financial Services and Markets Act 2000 arises on receipt of funds from a client, rather than at the moment of their segregation from the investment firm's own accounts (all judges, from the High Court through to the Supreme Court, have agreed on this principle);

- The client money pool which arises on the failure of the investment firm, as provided for by the client money rules in the FSA's Client Assets sourcebook (CASS), includes monies identified as client money but held in a firm's own (unsegregated) accounts as well as the monies actually segregated in client money accounts (this was the view of the majority of the Supreme Court); and

- Those entitled to submit their claims against the pool of client money thus enlarged, include all those clients who, as against the failed investment firm, were entitled to have their money treated as client money regardless of whether their money was in fact segregated or can in fact be identified in the firm's own accounts as having been so segregated (another majority decision, hotly contested by the minority).

On the critical third question of entitlements, the majority in the Supreme Court thought it decisive that their judgment gave some protection to the greatest number of clients, however chaotic that protection proves to be in practice, and that this is the result most in accord with the EU regime which the CASS rules implement in the UK (the Markets in Financial Instruments Directive).

The minority, on the other hand, thought it inconceivable that clients whose money had been properly segregated should be taken to have understood and accepted that their monies, segregated and in theory therefore 'protected', could become a "compensation fund" for other clients of the investment firm whose monies had not been so segregated.

This judgment is unfortunately just the end of the beginning. Creditors pursuing client money claims against the Lehman estate remain in the hands of the administrators, who must settle on a scheme for returning client monies to the (now enlarged) constituency of entitled creditors. Creditors will feel this distribution cannot come soon enough: the CASS rules seek "to facilitate the timely return of client money... in the event of the failure of a firm" but almost three and a half years on the process seems anything but timely.
Substantial practical matters must now be addressed. In particular:

- The administrators must go back to the High Court for directions to determine which principles and techniques should be applied to give effect to the Supreme Court’s judgment, especially in relation to tracing client money in Lehman’s own (unsegregated) accounts.

- Clients’ “entitlement” to client money protection, which Lehman expressly agreed to provide under some contracts, will have to be established. This will of course potentially open the door to more litigation as clients look to establish and enforce their entitlements.

So is it fair to say that the UK’s regime for protecting client money, in the sense of providing certainty of protection and timely return on a firm’s default, now lies in ruins? Quite possibly, if only for the following reasons:

- An investment firm client which has insisted on the separate segregation of its money, in a properly constituted client bank account, and which is satisfied that this has in fact been done, still has no certainty that the investment firm has complied with its obligations to segregate the funds of all other clients. These aggrieved (or litigious) other clients may now make claims on monies held in that segregated client bank account in the event of the firm’s failure; and their claims could well be so large as to dilute to an irrelevance the first client’s genuinely believed entitlement.

- There is at present no regulatory mechanism, and arguably no statutory framework, which allows for such a mechanism to be created, to identify and arbitrate between such competing client claims.

- Accordingly, the slightest irregularity or lack of timeliness in dealing with any client money on the part of a failed investment firm means that the process of distribution of all client money is likely to be both uncertain as to amount and painfully slow.

We now expect the FSA to complete its earlier review and overhaul of the CASS rules, which had been partially put on hold pending the resolution of this piece of litigation. An overhaul is now doubtless required, most likely including an end to the ‘alternative approach’ for segregating client monies, which allows for temporary comingling with the firm’s own monies prior to segregation, and which is currently permitted by the CASS rules.

In the meantime, UK investment firm clients will continue to look closely at arrangements for the holding of money and assets by their brokers; many will want to opt for tailored segregation arrangements, even if that comes at a price (although, as noted above, this may provide more limited protection than supposed), and record-keeping and reporting obligations will remain a key element of any negotiations over terms.

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1 In the matter of Lehman Brothers International (Europe) (In Administration) and In the matter of the Insolvency Act 1986 [2012] UKSC 6