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December 2011 / Special Alert

A legal update from Dechert's Business Restructuring and Reorganization Group

# Claims Under TBA Contracts Do Not Qualify as Customers' Claims in Broker-Dealers' Liquidation

Judge James M. Peck of the United States Bankruptcy Court for the Southern District of New York on December 8, 2011 issued an opinion on a motion of the Lehman Brothers Inc. ("LBI") trustee ("Trustee") to confirm his determination that certain claims relating to settled on delivery-versus-payment "to be announced" ("TBA") contracts do not qualify as customer claims against the LBI estate and therefore are not entitled to Securities Investor Protection Act ("SIPA") coverage.

Several creditors, counterparties to TBA contracts with LBI, had sought designation of their TBA contract claims as customer claims seeking to recover the economic benefit of their transactions (*e.g.*, the difference between the prices of the TBA contracts on the trade date and the prices of the TBA contracts on the date LBI filed for bankruptcy which prompted their TBA contract counterparties to cover the transactions in the market). Having these claims classified as customer claims would have made Securities Investor Protection Corporation ("SIPC") insurance available to meet the claims. Without such a designation, the TBA contract claims are simply for breach of contract, and the TBA contract counterparties are simply unsecured creditors of the LBI estate — at the bottom of the order of recovery priority.

In order to have qualified as a customer claim under SIPA, the TBA contract claims would have had to be for "securities received, acquired or held" by LBI or cash on deposit with LBI "for the purpose of purchasing securities." Because TBA contracts are settled on delivery-versus-payment, the TBA contract counterparties did not deliver any assets into LBI's custody to effect their transactions. Judge Peck agreed with the Trustee, holding that the TBA contracts did not involve an entrustment of property to LBI and therefore a return of customer assets. As Judge Peck put it: "The claims necessarily are for contract damages and not for 'securities received, acquired or held' by LBI or cash on deposit with LBI 'for the purpose of purchasing securities' under SIPA."

It is noteworthy that Judge Peck held the that the creditors have convincingly established that TBA contracts are essential for the Agency MBS market, that the contracts have a number of similarities to securities, and that they are the main avenue for investors to gain access to the second largest securities market in the U.S. Since, however, these contracts do not involve the delivery or entrustment of property to LBI, the resulting claims do not qualify as customers' claims under SIPA.

In addition, Judge Peck held that, although TBA contracts have many characteristics of a security, they do not qualify as such under SIPA. Parsing through the statutory definition of "security" under SIPA, Judge Peck found that TBA contracts do not fit the definition and that even though they are similar to securities in certain respects, "similarity is not enough for purposes of statutory construction."

Judge Peck found that as a result, the "net equity of a customer claim could be calculated for an account that is empty and does not have securities positions." He analogized the TBA contract counterparty claims to claims involving broker-dealers' failure to execute or comply with buy or sell orders, which were determined to be breach of contract claims rather than customer claims.

This is the first known decision in the United States to address these issues.

Dechert LLP

## Practice group contacts

If you have questions regarding the information in this legal update, please contact the Dechert attorney with whom you regularly work, or any of the attorneys listed. Visit us at www.dechert.com/business_restructuring.

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