

# Investor Alert



## Dante Multi Issuer Secured Obligation Programme – UK courts rule in favour of investors

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**Institutional investors that hold repackaged or other structured Notes from Lehman Brothers which were arranged or sold over the past decade or more have been awaiting the outcome of the judgment of the UK courts as to the value of their investments. The Court of Appeal has now ruled, and those investors should now take advice to ensure that their interests are protected.**

### Case summary

#### The court proceedings in relation to the Dante SPV – a summary

Many series of Notes under this Programme were sold in bespoke transactions to institutional investors around the globe. The Programme enabled a range of special purpose vehicles (SPVs) to issue repackaged Notes<sup>(1)</sup>. Some series of Notes were secured on the SPV's rights under a swap agreement with one or more Lehman entities. In the event that the Notes were to be redeemed prior to their Maturity Date, there may not have been sufficient value in the collateral for those transactions to ensure that Noteholders would be repaid principal in full. Typically, any amount due to the swap counterparty as a result of the early termination of the swap agreement would rank above the claims of Noteholders. However, there is a crucial exception in many of these transactions in the event that the Notes become repayable prior to the Maturity Date as a result of the termination of the swap agreement caused by an Event of Default of the swap counterparty (or the swap counterparty Guarantor).

Perpetual, acting as trustee for a section of the Dante Noteholders, brought proceedings in England against BNY to recover the collateral held on trust by BNY for the benefit of Perpetual under the Dante Notes and LBSF under the swap agreement. Perpetual argued that owing to the insolvency of LBHI and LBSF, which were specified to be Events of Default under the terms of both the swap agreement and the Dante Notes, the "flip" provision in the trust deed relating to the collateral was triggered so as to change the order of priority over the collateral in favour of Perpetual. Perpetual therefore sought the release of the collateral from BNY, who, adopting a neutral position, had previously declined to release it without a direction from the court. LBSF was joined as a party to the proceedings to oppose the release of the collateral to Perpetual.

The enforceability of those provisions has been tested in the English courts – a summary of the recent judgment of the Court of Appeal is given here. The Court of Appeal found in favour of the investors.

**Accordingly, it is now very important for investors in any series of Notes issued under the Lehman Secured Obligation Programme to examine the legal documentation very closely. Failure to understand these fine distinctions in their rights may well incur significant and unnecessary losses for investors.**

The High Court agreed with Perpetual that the "flip" provision had been triggered, rejecting LBSF's argument that the alteration of LBSF's priority on insolvency was void under English law as a breach of the "anti-deprivation rule".

In particular, investors should be aware that those who are representing the US Administrator of the relevant Lehman entities have challenged in the US Bankruptcy Courts the effectiveness of the termination of relevant swap agreements, but are also actively seeking to negotiate settlements with holders of outstanding transactions. Investors and counterparties should consider their positions without further delay. Crucial questions may include whether any underlying swap transaction with the Lehman counterparty has been effectively terminated and whether recently delivered Credit Event Notices may yet have an effect on the claim to repayment of principal to investors. The outcome of those questions may have a significant impact on the ultimate pay-out to investors...

LBSF appealed and the Court of Appeal judgment was handed down on 6 November 2009. The Court of (Continued overleaf)

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Appeal unanimously upheld the High Court's decision confirming that provisions in contracts governed by English law which subordinate the rights or beneficial entitlements of a swap counterparty on an insolvency or other default will generally not be prohibited by English law. The Court considered that LBSF's prior ranking right to the proceeds of the collateral had always been contingent and, given that LBSF had never unconditionally owned a prior ranking right, there was no removal of a vested asset to which LBSF could lay claim at the start of its insolvency proceedings.

LBSF is currently seeking permission from the Supreme Court to appeal the Court of Appeal decision.

### Prospects of Relief for the Dante Noteholders

Notwithstanding Perpetual's success so far, the English courts have decided to postpone granting the relief sought by Perpetual so as not to preclude any request for assistance under the Cross-Border Insolvency Regulations 2006. This arises out of the parallel proceedings issued by LBSF against BNY in the US for a determination of the validity of the "flip" provision under US bankruptcy law.

BNY has applied for the US court to dismiss LBSF's claim. If BNY succeeds, the English courts should order the release of the collateral to Perpetual, making the fortunes of the underlying Noteholders more certain. However, if the US court takes a contrary view to the English courts as to the validity of the "flip" provision, LBSF would most likely seek to enforce the collateral in the UK via the 2006 Regulations. Even in this event, it seems that the final decision in this significant legal battle would rest with the English courts.

<sup>(1)</sup> The SPV issuers under the Programme include: ANGIOLIERI FINANCE PLC, AQUAMARINE FINANCE PLC, BERYL FINANCE LTD, BOCCACCIO FINANCE PLC, CITRINE FINANCE PLC, DIADEM CITY CDO LIMITED, DIAMOND FINANCE PLC, GMG FINANCE LIMITED, JUPITER QUARTZ FINANCE PLC, LION CITY CDO LIMITED, MERLIN FINANCE S.A., ONYX FUNDING LIMITED, PEARL FINANCE PLC, PETRARCA FINANCE PLC, QUARTZ FINANCE PLC, RUBY FINANCE PLC, SAPHIR FINANCE PLC, TOPAZ FINANCE LIMITED AND ZIRCON FINANCE LIMITED.

This is a summary of recent developments. It should not be regarded as a substitute for advice on how to act in any particular case. For further information please contact one of the authors.

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