

From: Van Schaick, George V [gvanscha@lehman.com]
Sent: Thursday, July 10, 2008 3:44 PM (GMT)
To: Van Schaick, George V [gvanscha@lehman.com]; Feraca, John [joferaca@lehman.com]
Cc: Roberts, Garrett [Garrett.Roberts@lehman.com]; Lista, William [william.lista@lehman.com]; Luglio, Thomas [tluglio@lehman.com]; Webb, Michael A [mwebb@lehman.com]; Fleming, Dan (TSY) [dfleming@lehman.com]; Tonucci, Paolo [paolo.tonucci@lehman.com]; Miller, Marjorie A [mmiller@lehman.com]; Coghlan, John F. (Prime Services) [jcoghlan@lehman.com]
Subject: RE: Federated SubCustodial Agreement - JPMC's comments

From: Mocharko, Karl [mailto:KMocharko@federatedinv.com]
Sent: Thursday, July 10, 2008 11:14 AM
To: Shanley, Gail; Roberts, Garrett; julia.a.fox@jpmorgan.com
Cc: RS: Beneigh, Sara; RS: Zerega, Todd; RS: Dugan, Erin; RS: Whetzel, James
Subject: RE: Federated SubCustodial Agreement - JPMC's comments

Because JP Chase the triparty clearing bank is unwilling to negotiate in good faith with Federated, we will no longer pursue additional business with Lehman. We will also do as much current REPO as possible with dealers that utilize BONY as their custodian and only back with JPChase as necessary.

Karl Mocharko

Assistant Vice President / Senior Trader

Federated Investors

Business: 412-288-1975

Personal: 412-288-1447

kmocharko@federatedinv.com

From: Van Schaick, George V
Sent: Thursday, July 10, 2008 11:31 AM
To: Feraca, John
Cc: Roberts, Garrett; Lista, William; Luglio, Thomas; Webb, Michael A; Fleming, Dan (TSY); Tonucci, Paolo; Miller, Marjorie A; Coghlan, John F. (Prime Services)
Subject: FW: Federated SubCustodial Agreement - JPMC's comments

John,

We have been trying to negotiate triparty docs on new Federated funds

with Chase for over 6 months now. These new funds would have cash for "Non-Traditional collateral" (IG and NON-IG ABS, PL, Corps, etc.). Charles Witek previously outlined the issues below, and we sent to Mike Scarpa at JPM, after our April meeting with them. The issues are all changes from JPM's previous triparty docs.

Today Federated has notified us that JPM would now like to re-negotiate all its existing docs with Federated.

Federated has stated they are considering pulling all funding from Dealers that use JPM as a triparty agent and moving exclusively to BONY. They are more comfortable with them Legally, Operationally, and from a Client Service perspective.

They currently fund 900mm NON-IG PL/ABS, and would have at least another 500mm in these new funds.

I think we need to raise the issue again with JPM, but ultimately this might just be a good candidate to use in the BONY migration.

Thanks.
George

From: Witek, Charles
Sent: Wednesday, April 23, 2008 3:41 PM
To: Van Schaick, George V
Cc: Shanley, Gail
Subject: RE: Federated SubCustodial Agreement - JPMC's comments

OK.

To avoid confusion, we'll deal with Federated first, as it is a large issue, then I'll address the others in a third E-mail.

The markup of the Federated agreement, as JPMorgan would change it, is attached. I'll only discuss the major issues, but the fact that JPMorgan is choosing to make numerous changes to an agreement it accepted as recently as November is a problem in itself.

Significant issues include (listed by section):

1(j) JPMorgan added the language "The Margin Value of Securities shall equal or exceed the Sale Price at the times calculated by Bank pursuant to this Agreement." In effect, JPMorgan negated the agreement of the parties to margin on the Repurchase Price and substituted, for its own operational convenience, its own requirement that collateral be margined on the Sale (i.e. Purchase) Price. While that would normally be better for Lehman, as a registered investment company governed by the Investment Company Act of 1940, Federated feels that it is legally obligated to margin on the Repurchase Price, and will not enter into an agreement if margining on the Repurchase Price does not take place. JPMorgan's position that it will not margin on the Repurchase Price, for operational reasons, is new, having only arisen in the past month or so. Lisa-Lynn Boron conducted a substantial investigation into the issue in relation to one of her accounts, and discovered that there is no operational impediment at Lehman or at JPMorgan that prevents margining on the Repurchase Price.

1(n) Related to 1(j), above, JPMorgan deleted the definition of "Repurchase Price" and substituted its own simplified definition, which is not amenable to margining a term repo based on the Repurchase Price.

3(b) Again, as in point 1(j) JPMorgan changed the actual terms of the Transaction agreed to by Lehman and Federated, altering "Margin Value equal to the Repurchase Price" to "Margin Value equal to the Sale Price." Quite bluntly, whether we choose to margin on the Sale (Purchase) Price or the Repurchase Price is a business decision arising out of a negotiation between Lehman and Federated; it is none of JPMorgan's business and they should not be interfering in the economic terms of the transaction, particularly when Federated (and most investment companies) view this as a regulatory issue. Similar changes also occur in Section 3(c), 3(e).

3(d) JPMorgan inserted language that, in the event that Federated is undercollateralized or Lehman has insufficient cash to repurchase the Purchased Securities on the Repurchase Date, JPMorgan can, without notice to Lehman, advance cash on Lehman's behalf and charge Lehman interest for such advance. That is contrary to the clearance arrangement between Lehman and JPMorgan, and JPMorgan Legal has been reminded of that fact on multiple occasions, yet they persist in demanding the change.

11 Indemnification provides the most egregious examples of JPMorgan high-handedness. ISSUE 1) The original Lehman/Federated agreement provided for Lehman giving JPMorgan a full indemnification for any losses not attributable to the Bank's negligence or willful misconduct, while Federated only indemnified for its own negligence, breach, insolvency or instructions, again with the carve-out for JPMorgan's negligence or willful misconduct. Such a "split indemnification" was commonly used in custodial undertakings involving a large or sophisticated counterparty, and has been accepted practice at both JPMorgan and The Bank of New York for years (and doesn't really harm Lehman, as JPMorgan could, in the event of an insolvent counterparty, always argue that Lehman already had an obligation to fully indemnify pursuant to the terms of the clearance agreement). However, a few months ago (I believe it was the late fall of 2007), JPMorgan, without any prior notice to or discussion with Lehman, arbitrarily decided that "split" indemnification would no longer be acceptable. In the case of Federated, they insisted that both parties provide a full indemnification to JPMorgan, a provision wholly unacceptable to Federated and contrary to prior agreements between JPMorgan and either Lehman or Federated.

ISSUE 2: To make matters worse, JPMorgan is insisting upon a new provision, which would have both Lehman and Federated "absolutely" indemnify JPMorgan (i.e., no carve out, even for JPMorgan's gross negligence or willful misconduct) for any losses "incurred as a result of complying with the instructions of" Lehman or Federated, even if following such instruction "constitutes or is alleged to constitute a violation of the rights of any party or a violation of an injunction, stay, order or law"! Pursuant to such agreement, if JPMorgan followed an instruction, no matter how obviously wrong or even illegal, JPMorgan would be entitled to full indemnification for any damages or claims that it suffered as a result. Needless to say, Lehman has never agreed to such a provision, does not have it in its boilerplate agreement, and is unwilling to accept it in the Federated document. Federated is equally opposed.

There are a number of other, lesser changes (although it should be noted that what seems "lesser" to me may be of greater importance to Federated.) However, the above points, in which JPMorgan 1) takes it upon itself to change the terms of the agreement between Lehman and Federated re margin, 2) is, through its Legal Department, insisting on changing the terms of the business relationship between Lehman and JPMorgan re advances and 3) is insisting on burdensome and unnegotiated changes in the customary indemnification provisions, should be viewed as the most offensive positions.

From: Van Schaick, George V
Sent: Wednesday, April 23, 2008 2:37 PM
To: Witek, Charles
Cc: Shanley, Gail
Subject: RE: Federated SubCustodial Agreement - JPMC's comments

please include all issues (not just Federated). we met with Chase this afternoon and hopefully that will result in some progress.

From: Witek, Charles
Sent: Wednesday, April 23, 2008 2:34 PM
To: Van Schaick, George V
Cc: Shanley, Gail
Subject: FW: Federated SubCustodial Agreement - JPMC's comments

George--

Before I send an E-mail outlining the precise legal issues (which I'll begin preparing immediately upon sending this one), I wanted to forward the below to you, because it gives a good overview of the issue.

Federated has a proprietary agreement that it negotiated with various dealers, including Lehman, and JPMorgan many years ago. The agreement was modified not long before I came to Lehman in order to modernize the document. As recently as last November, Federated, Lehman and JPMorgan entered into such document with no problems. However, JPMorgan reversed course with regard to the current Federated agreement, and refuse to agree to it without the substantial changes discussed in Todd Zerega's E-mail.

Although I recognize that Federated is a priority issue, I would point out that this is not a unique instance. In the past year or so, JPMorgan has become increasingly uncooperative, renegeing on previous agreements regarding acceptable language, dictating the form of agreements that they will review (e.g., they will no longer review a .pdf version of an agreement marked up by the client, but instead insist that Lehman or the client take the time to convert such .pdf into a blacklined Word document, in order to save JPMorgan the trouble of working with an inconvenient file) and taking positions contrary to either the clear language of an agreement (e.g., refusing to accept cash as repo collateral, despite a statement in the document that says "Securities shall always include cash") or refusing to take language acceptable in the Lehman-boilerplate form if inserted in a different form provided by the counterparty--something very similar to what is happening here.

From: marcus.c.johnson@jpmchase.com
[<mailto:marcus.c.johnson@jpmchase.com>]
Sent: Friday, April 18, 2008 2:06 PM
To: Zerega, Todd P.
Cc: Shanley, Gail
Subject: Re: Federated SubCustodial Agreement - JPMC's comments

Todd:

We cannot use this form without the changes that we have made. Feel free to call me if you wish to discuss specific comments.

----- Original Message -----

From: "Zerega, Todd P." [TZerega@ReedSmith.com]
Sent: 04/18/2008 01:28 PM AST
To: Marcus Johnson
Cc: <gail.shanley@lehman.com>
Subject: FW: Federated SubCustodial Agreement - JPMC's comments

Marcus,

I wanted to get back to you regarding your extensive comments on Federated's Subcustodial Undertaking. A master form of this Subcustodial Undertaking specifically for Federated Investors, which I have attached for reference, was negotiated with your predecessor Charles Witek. This form of agreement has also been approved by all of Federated's repo counterparties. The agreement is currently in use for all Federated repo counterparties. However, due to a change in custodian on certain Funds Federated needs to put in place the same agreement as in place currently for its other Funds. Federated does not wish to renegotiate an agreement that was painstakingly finalized to the satisfaction of all parties. For example, the indemnification language, definition provisions, and representations were also discussed at length among all parties until an acceptable form was drafted. To revisit this issue would cause Federated to incur unnecessary legal expenses and costs as well as delay the execution of agreements that they wish to utilize. With that being said, it is our understanding that the language added regarding fund transfers (Section 12) is something that Federated has agreed to in the form of a side letter and therefore Federated is willing to agree to add it to the master agreement.

Please let me know if you would like to discuss further but based on my conversations with Sara Lehman only had one minor comment on the subcustodial which Federated accepted and we would like to move forward with execution.

Best Regards,

Todd

From: Shanley, Gail [mailto:gail.shanley@lehman.com]
Sent: Thursday, April 03, 2008 1:53 PM
To: Beneigh, Sara M.
Cc: Roberts, Garrett
Subject: FW: Federated SubCustodial Agreement - JPMC's comments

Sara,

I received the attached from Marcus at JPMC. After you have had a chance to review let's chat.
Thanks

Gail

From: Euisun.Lisa.Lee@chase.com [mailto:Euisun.Lisa.Lee@chase.com]
Sent: Thursday, April 03, 2008 12:14 PM
To: Shanley, Gail
Cc: Janowski, John Patrick; marcus.c.johnson@jpmchase.com
Subject: Fw: Federated SubCustodial Agreement

Hi Gail: attached please find clean and marked versions of the acceptable Federated agreement. Thanks!

Redline:

Clean:

Euisun Lisa Lee
Assistant Vice President
JPMorgan Chase Bank, NA
1 Chase Manhattan Plaza, 25th Floor
New York, NY 10005
NY1-A424
Tel: (212) 552-1618
Fax: (212) 383-0250
euisun.lisa.lee@chase.com

----- This message is intended only for the personal and confidential use of the designated recipient(s) named above. If you are not the intended recipient of this message you are hereby notified that any review, dissemination, distribution or copying of this message is strictly prohibited. This communication is for information purposes only and should not be regarded as an offer to sell or as a solicitation of an offer to buy any financial product, an official confirmation of any transaction, or as an official statement of Lehman Brothers. Email transmission cannot be guaranteed to be secure or error-free. Therefore, we do not represent that this information is complete or accurate and it should not be relied upon as such. All information is subject to change without notice. ----- IRS Circular 230 Disclosure: Please be advised that any discussion of U.S. tax matters contained within this communication (including any attachments) is not intended or written to be used and cannot be used for the purpose of (i) avoiding U.S. tax related penalties or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

* * *

This E-mail, along with any attachments, is considered confidential and may well be legally privileged. If you have received it in error, you are on notice of its status. Please notify us immediately by reply e-mail and then delete this message from your system. Please do not copy it or use it for any purposes, or disclose its contents to any other person. Thank you for your cooperation.

* * *

To ensure compliance with Treasury Department regulations, we inform you that, unless otherwise indicated in writing, any U.S. Federal tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (1) avoiding penalties under the Internal Revenue Code or applicable state and local provisions or (2) promoting, marketing or recommending to another party any tax-related matters addressed herein.
Disclaimer Version RS.US.1.01.03

pdcl

This communication is for informational purposes only. It is not intended as an offer or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. All market prices, data and other information are not warranted as to completeness or accuracy and are subject to change without notice. Any comments or statements made herein do not necessarily reflect those of JPMorgan Chase & Co., its subsidiaries and affiliates. This transmission may contain information that is privileged, confidential, legally privileged, and/or exempt from disclosure under applicable law. If you are not the intended recipient, you are hereby notified that any disclosure, copying, distribution, or use of the information contained herein (including any reliance thereon) is STRICTLY PROHIBITED. Although this transmission and any attachments are believed to be free of any virus or other defect that might affect any computer system into which it is received and opened, it is the responsibility of the recipient to ensure that it is virus free and no responsibility is accepted by JPMorgan Chase & Co., its subsidiaries and affiliates, as applicable, for any loss or damage arising in any way from its use. If you received this transmission in error, please immediately contact the sender and destroy the material in its entirety, whether in electronic or hard copy format. Thank you. Please refer to <http://www.jpmorgan.com/pages/disclosures> for disclosures relating to UK legal entities.