Lehman Brothers Dismantles in Bankruptcy

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The author reviews developments in the largest bankruptcy filing to date.

September brought the largest bankruptcy filing in U.S. history. On September 15, 2008, after failed efforts at to obtain a federal bail-out or an out-of-court acquisition by Barclays Capital Inc. ("Barclays"), failed, Lehman Brothers Holdings, Inc. ("LBHI") filed a voluntary petition for relief under Chapter 11 of the United States Bankruptcy Code[1] in the United States Bankruptcy Court for the Southern District of New York ("Bankruptcy Court"). Shortly thereafter, the Lehman Brothers entity that owned the Lehman Brothers headquarters in Manhattan also filed a Chapter 11 petition. On September 19, 2008, a liquidation proceeding under the Securities Investor Protection Act of 1979 ("SIPA") was commenced against Lehman Brothers Inc. ("LBI"), the Lehman Brothers entity that operated, *inter alia*, the Lehman Brothers North American broker/dealer business (*see* "the Stock-Broker Liquidation of Lehman Brothers, Inc., below). The SIPA case was transferred to the bankruptcy court. In early October, 15 additional Lehman Brothers entities filed Chapter 11 petitions in the Bankruptcy Court.

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THE SALE OF THE NORTH AMERICAN BROKER-DEALER BUSINESS

One of the primary goals of the Lehman Brothers bankruptcy proceedings has been to expeditiously liquidate various assets and lines of business of the Lehman Brothers entities to preserve value, and the purpose of the SIPA proceeding was the transfer of customer accounts so that customers would have access to their assets. In furtherance of those goals (even though the SIPA proceeding had not yet been commenced), on September 17, 2008, LBHI filed a motion to sell its U.S. and Canadian capital markets and investment banking businesses, including the fixed income and equities cash trading, brokerage, trading and advisory businesses, investment banking operations and LBI's business as a futures commission merchant (collectively, the "North American Broker-Dealer Business") to Barclays. As consideration for the sale, the Lehman Brothers entities will receive approximately $1.3 billion in cash from Barclays. Barclays has agreed to assume approximately $45 billion in Lehman Brothers obligations and has agreed to fund $2.5 billion necessary to cure defaults under contracts assumed and assigned to Barclays.

The hearing on the sale began at 4:00 p.m. on Friday September 19, 2008 and continued into the early morning hours on October 20, 2008. The overflow crowd in attendance filled three courtrooms, with a standing-room only crowd filling the main courtroom. The author was lucky enough to be in the main courtroom and didn't have to rely on an audio hook-up to listen to the proceedings. Part of the presentation made by LBHI's attorneys concerned changes to the sale transaction, necessitated in part by a purported $30 billion drop in the value of the assets between September 15, 2008 and September 19, 2008. At the conclusion of the hearing, Judge James M. Peck entered an order approving the sale. There have been appeals from Judge Peck's order approving the sale, including an appeal by at least one hedge fund. However, none of the appellants obtained stays of Judge Peck's September 20, 2008 sale order. Hence, it is likely that those appeals will be moot by the time they are heard.

As part of the sale of the North American Broker-Dealer Business, LBHI assumed numerous contracts with various vendors and assigned

them to Barclays. Barclays, on its part, agreed to pay the amounts necessary to cure any defaults under the contracts. The contracts, as well as the amount necessary to cure any defaults thereunder, were purportedly identified in lengthy schedules attached to the motion papers, which have since been supplemented. For vendors with numerous contracts with Lehman Brothers entities, however, neither the original nor the supplemental schedules provided sufficient information to identify the contracts actually being assumed. Barclays has until November 19, 2008 by which to identify any additional contracts of LBHI and LBI it wishes to be assumed and assigned to it as part of the sale of the North American Broker-Dealer Business.

There have been numerous objections to the amounts that Barclays proposes to pay vendors to cure any defaults under the contracts. Some of the objections are limited to an objection to the proposed cure amount. In that regard, it appears that LBHI and LBI may have calculated the cure amounts as of August 31, 2008. Using August 31, 2008 as a cut-off date would not take into account the amount of any defaults occurring or accruing in September. Additionally, for many vendors, even the amended schedules of cures do not sufficiently identify the contract that was assumed.

SALE OF ASIAN/PACIFIC, MIDDLE EASTERN AND EUROPEAN ASSETS

In addition to the Barclays sale, Nomura Holdings, Inc. has purchased LBHI's assets in the Asian/Pacific Region, the Middle East and Europe. The Asian/Pacific Region assets alone sold for $255 million. Unfortunately for Nomura, as many as 60 percent of LBHI's employees in Japan have left the business. Many have gone to Barclays' Asian/Pacific operations.

SALE OF LEHMAN BROTHERS INVESTMENT MANAGEMENT DIVISION

On September 29, 2008, LBHI and certain (then) non-debtor affiliates entered into an agreement to sell their stock and the assets pertaining to

that portion of the Lehman Brothers Investment Management Division ("IMD") that had not been sold to Barclays, to IMD Parent, LLC, an entity controlled by private investment funds sponsored by Bain Capital Partners, LLC ("Bain") and Hellman & Friedman ("H&F") for $2.15 billion. The agreement was amended on October 3, 2008. IMD encompasses Neuberger Berman, Lehman Brothers Assets Management and the Alternative Investment Group, as well a portion of Lehman Brothers' private equity business. It provides customized managements services for high-net-worth clients, mutual funds and other institutional investors, serves as a general partner for private equity and other investment partnerships, and has minority stake investments in certain alternative investment managers. The assets to be sold include equity interests and assets relating to:

- the Neuberger Berman business (particularly its private asset management business, equities mutual funds, equities sub-advised funds, equities WRAP, equities global balanced portfolio and equities institutional separate accounts business);
- the fixed income business;
- parts of the hedge fund of funds and single manager businesses;
- the private funds investment group of the private equity business; and
- certain assets related to the Asian and European asset management businesses.

As with the sale of the North American Broker-Dealer Business to Barclays, this sale will involve the purchasers' assumption of certain Lehman Brothers' obligations under contracts that will be assumed by LBHI and assigned to the purchaser in connection with the sale. Under the purchase and sale agreement, the purchaser may elect to acquire the equity interests in the relevant Lehman Brothers entity or the assets of that entity. Also under the purchase and sale agreement, the purchaser will have between 45 and 60 days from the date of the execution of the purchase and sale agreement in which to designate the equity interests or the assets (including contracts to be assumed and assigned to it) that it wish-

es to acquire.

The proposed sale has generated significant opposition. Opponents contended that the proposed bidding procedures chilled competitive bidding and that the consideration that the Lehman Brothers debtors will actually receive will be much lower than the $2.15 billion purchase price. A hearing on the debtor's motion for approval of bidding procedures and to set a date for the auction sake of IMD was held on October 16, 2008. LBHI had negotiated resolutions of a number of the objections prior to the hearing, but a number remained unresolved. Judge Peck heard evidence at the hearing and read a long and complex opinion in to the record. The parties were then advised to prepare and agree on the form of an order. Judge Peck entered an order approving the bidding and sale procedures on October 22, 2008.

SALE OF CERTAIN LEHMAN BROTHERS INVESTMENTS

On October 8, 2008, LBHI and its affiliated debtors filed a motion for the approval of the sale of its 45 percent equity interest in R3 Capital Management LLC to a hedge fund in exchange for $250 million in cash and investment in another R3 Capital Partners fund. The R3 Capital Partners sale was approved on October 16, 2008. LBHI had previously filed a motion for authorization to sell its interests in a gas and electricity supplier, Eagle Energy Partners I LP to a French Utility for $230.4 million. The Eagle Energy Partners sale was approved by Order dated October 17, 2008.

LITIGATION TO RECOVER FUNDS

It is not surprising that the Lehman Brothers bankruptcies have generated substantial finger-pointing. Bank of America, among other parties to derivative transactions and swap agreements with Lehman Brothers entities, is seeking to recover hundreds of millions of dollars in excess collateral that it had posted with various Lehman Brothers entities. According to published reports, Bank of America alone is purportedly looking to recover $470 million in assets. Two motions were filed seeking authorization to conduct discovery of LBHI and its affiliates (as well

as the trustee in the LBI SIPA liquidation proceeding) to determine the disposition of Lehman Brothers assets during the run-up to the September 15, 2008 bankruptcy filing. One motion was denied on October 16, 2008; the other motion was adjourned from that date to November 5, 2008.

Additionally, the Committee of Unsecured Creditors ("Creditors Committee") has filed a motion for authorization to (a) investigate the conduct of JP Morgan Chase Bank in the days leading up to the bankruptcy filing, (b) to obtain information necessary to determine the intent, effect, consideration and financial condition of LBHI in connection with certain guarantees and transfers between LBHI and JP Morgan Chase Bank before the bankruptcy filings.

PRACTICE TIPS

Creditors and other parties-in-interest in the Lehman Brothers bankruptcy cases should take the following steps:

Monitor the docket for important notices

Diligent monitoring of the docket in these fast-moving cases is necessary because the Lehman Brothers debtors have been seeking significant types of relief (including sales of valuable assets) on shortened notice, justifying expedited relief on the need to resolve their bankruptcy cases as quickly as possible to maximize value. In particular, the docket should be monitored for: (i) notices of any bar dates set for filing proofs of claim; (ii) motions by the debtors to (a) assume, (b) assume and assign; or (c) reject any of their contracts; and (iii) motions for the sale of assets (which often include motions for authorization to assume and assign contracts). Several of these motions have already been filed so interested parties should not delay in this important review.

Review and analyze all payments the creditor or party-in-interest has received from a Lehman Brothers debtor during the two years preceding the bankruptcy filings

Payments may be vulnerable to avoidance and recovery by the Lehman Brothers debtor (or a trustee or plan administrator) as preferen-

tial transfers if they were received either during the 90 days immediately preceding the bankruptcy filing or, during the year immediately preceding the bankruptcy filing, if the creditor or party-in interest is an insider or affiliate of the Lehman Brothers debtors. Payments made during the two years immediately preceding the bankruptcy filing are vulnerable to avoidance as fraudulent transfers, if (i) certain "badges of fraud" are present or, (ii) if (a) the Lehman Brothers debtor did not receive reasonably equivalent value in exchange for the payment and either (a) the Lehman Brothers debtor was insolvent at the time of the payment or was rendered insolvent because of the payment, (b) the Lehman Brothers debtor was undercapitalized at the time of the payment, (c) the Lehman Brothers debtor intended to incur debts it knew were beyond its ability to repay, (d) or the transfer was made to an insider under an employment agreement and not in the ordinary course of business. With respect to fraudulent transfer liability, creditors and parties-in-interest should be aware that a payment by one Lehman Brothers debtor of the obligations of another Lehman Brothers entity may be considered a fraudulent transfer.

Review and analyze the respective ongoing rights and obligations under any contracts with a Lehman Brothers entity

If the benefits to the Lehman Brothers party are valuable, it is likely that the Lehman Brothers party will attempt to assume the contract and assign its rights to a third party to generate funds for the bankruptcy estate. However, to assume and assign a contract, the Lehman Brothers party will have to cure any defaults under the contract and provide adequate assurance of future performance. Hence, as part of any review and analysis of a contract with a Lehman Brothers entity, the total amount of any default by the Lehman Brothers party should be calculated so that the a determination may be made whether to object to a proposed assumption and assignment of the contact.

Any analysis of a contract with a Lehman Brothers entity should also include a determination whether the contract is of a type that can be assumed by the Lehman Brothers party in its bankruptcy or, if it can be assumed, whether it can be assigned to a third party. If the contract cannot be assumed or, if it can be assumed, but cannot be assigned to a third

party, and the Lehman Brothers entity is in default under the contract, consideration should be given to a motion for relief from the automatic stay to terminate the contract. A termination of the contract could eliminate, or at least substantially reduce, any obligations of a creditor or party-in-interest to the Lehman Brothers party to the contract.

Once a bar date for filing proofs of claim has been set, a creditor must make a determination whether to file a claim

To receive a dividend in a Lehman Brothers bankruptcy, a creditor must file proof of claim if the Lehman Brothers debtor has not scheduled the creditor's claim or has scheduled the claim as either a contingent, unliquidated or disputed claim. Before filing a proof of claim, a creditor must consider whether filing a claim is in its best interest. If the creditor is subject to significant potential preference or fraudulent transfer liability, it may be in the creditor's best interest to forego filing a proof of claim. By doing so the creditor may preserve the right to a jury trial, which it would lose with respect to a preference or fraudulent transfer action if it filed a proof of claim.

NOTE

[1] 11 U.S.C. § 101, et seq.