



## Lehman Brothers Files Revised Plan and Discloses Estimated Recoveries

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On April 14, 2010, Lehman Brothers Holdings Inc. (“LBHI”) and its affiliates that are in chapter 11 (collectively, the “Lehman Debtors”)<sup>1</sup> filed their revised joint chapter 11 plan (“Lehman Plan”) and accompanying disclosure statement (“Lehman Disclosure Statement”) which sets forth estimates of creditor recoveries. Previously, on March 15, 2010, the Lehman Debtors had filed a placeholder plan to preserve exclusivity,<sup>2</sup> but such plan was not accompanied by a disclosure statement and unsecured creditors were left in the dark as to estimated recoveries. The Lehman Plan proposes an economic resolution of the claims of creditors, and incorporates resolutions of various inter-debtor, debtor-creditor and inter-creditor disputes. The Lehman Debtors assert that the Lehman Plan and its economic resolutions of complex issues will expedite administration of the chapter 11 cases, accelerate creditor recoveries and avoid potential enormous costs and extended time that would otherwise be incurred in litigating these issues. Thus, the bankruptcy case of the company whose failure precipitated the greatest financial and economic calamity in decades is entering its final phase.

### Lehman’s Proposed Economic Resolution of Substantive Consolidation and Other Issues

Before creditor recoveries could be determined, the Lehman Debtors subjected the following four sets of issues to what they characterize as an economic resolution:

- The first set of issues subject to a proposed economic resolution under the Lehman Plan is whether or not to substantively consolidate the separate bankruptcy estates.<sup>3</sup> Although many factors favoring substantive consolidation are present, the Lehman Plan does not seek substantive consolidation, but instead respects the corporate integrity of each of the Lehman Debtors. In fact, the Lehman Plan constitutes 23 distinct plans, one for each Lehman Debtor. Substantive consolidation would have benefitted creditors of LBHI or other asset-poor Lehman Debtors that are in worse financial condition than more solvent Lehman Debtors, and harmed creditors of more solvent Lehman Debtors by diluting their recoveries. Substantive consolidation would also have benefitted swap counterparties and other creditors who were owed money by one or more Lehman Debtors, but who owe money to different Lehman Debtors. Generally, the Bankruptcy Code does not permit creditors to offset amounts owing by one debtor against amounts owed to another debtor.<sup>4</sup> However, this bar to so-called triangular offsets will be rendered moot if the estates are substantively consolidated.
- The second set of issues subject to an economic resolution is the treatment of guarantee claims. LBHI’s liabilities under third party guarantee claims are limited to the aggregate liabilities of each primary obligor as of the bankruptcy filing date, as set forth in Schedule 6 to the Lehman Plan. Liabilities of primary obligors related to derivatives contracts such as swaps have been increased by 100% of the liability recorded on the balance sheet because prior to the bankruptcy filing such liabilities had been carried at the mid-point between the market bid and the ask for the purchase of such derivative contract or entry into an identical contract.<sup>5</sup> The Lehman Debtors also reserve the right to challenge the validity of various guarantee claims.
- The third set of issues subject to an economic resolution is the treatment of affiliate guarantee claims. The Lehman Plan proposes to allow affiliate guarantee claims in the aggregate amount of \$21.186 billion, with the allocation to be worked out within six months after the Lehman Plan becomes effective.
- The fourth set of issues subject to an economic resolution is the treatment of inter-company claims. Claims by and against foreign affiliates will be allowed

if reciprocity is shown in the allowance of the claims of the Lehman Debtors, and disallowed in the absence of such reciprocity. Affiliates may not seek to set off their affiliate guarantee claims against the claims of any Lehman Debtor. Inter-company claims among the Lehman Debtors and their affiliates will be honored in the amounts set forth in the books and records (except in the case of LBT, whose claims against LBHI are allowed at 50%).

### Other Principal Terms of the Lehman Plan

Other highlights of the Lehman Plan include:

- Unsecured creditors are expected to receive distributions ranging between 14.7% and 100%. The recoveries are based on expected undiscounted cash flows from assets managed in an orderly liquidation over a period of five years ending December 31, 2014, with any remaining assets to be sold at that time. Estimated recoveries for general unsecured creditors of some of the principal Lehman Debtors are: 14.7% for LBHI; 24.1% for LBSF; 26.8% for LBCS; 30.8% for LBCC; and 44.2% for LCPI.
- The Lehman Debtors have substantial illiquid assets on which they anticipate significant recoveries post-confirmation. For example, for the five-year period ending December 31, 2014, the Lehman Debtors expect to recover \$11 billion from real estate assets, \$7.2 billion from loans, \$5.4 billion from derivatives, \$3 billion from inter-company receivables, \$1-\$2 billion from private equity and principal investments, and \$1-\$2 billion from Aurora Bank and Woodlands Commercial Bank. Obviously, creditor recoveries will depend on the success of the Lehman Debtors in liquefying these assets.
- A new asset management company known as LAMCO will assist the Lehman Debtors in managing long-term investments and illiquid assets to attempt to maximize recoveries. The Lehman Debtors will transfer their existing asset-management employees and infrastructure to LAMCO to manage the assets of the Lehman Debtors and possibly third parties.<sup>6</sup> Creating a new going-concern company under a liquidating chapter 11 plan is highly unusual, but the Lehman Debtors assert that their asset management business may have substantial value. LAMCO is also expected to aid the employee retention efforts of the Lehman Debtors.
- LBHI will serve as Plan Administrator for each of the Lehman Debtors, and in that capacity will, *inter alia*, resolve claims, make distributions and control the post-confirmation disposition of assets.

- The post-confirmation board of directors of LBHI will consist of nine persons selected by LBHI (with the consent of the Creditors' Committee), and the LBHI board will select the directors and managers of the other Lehman Debtors. Officers and managers in place as of the effective date of the Lehman Plan will continue in their positions.
- Secured, administrative and priority claims will all be paid in full.
- Stockholders will be wiped out under the Lehman Plan.

### Conclusion

The filing of the Lehman Plan represents an important step in a highly complex and contentious case. The Lehman Plan undoubtedly represents the fruits of months of negotiations among major constituencies in the case. While it cannot be gainsaid that economic resolutions of the complex issues raised in the Lehman case will expedite administration of the chapter 11 cases, accelerate creditor recoveries and avoid enormous costs and delay associated with litigation, reasonable people can argue over where lines should be drawn. Thus, the "rough justice" that the Lehman Debtors attempt to impose under the Lehman Plan may be subject to significant second guessing by creditors who will fare better if the estates are substantively consolidated, if guarantee claims are not limited in the manner prescribed under the Lehman Plan or if inter-company claims are treated differently.

The most likely line of attack by creditors opposing the Lehman Plan is its failure to seek substantive consolidation even though the Lehman Debtors concede that many factors favoring consolidation are present. For instance, Lehman operated as one company organized by business division, not necessarily by legal entity; LBHI's board of directors and executive committee had responsibility for Lehman's firm-wide strategy, risk, funding, liquidity, operations and products; one investment committee existed for all of Lehman's transactions; the Lehman Debtors shared administrative and back-office functions; certain Lehman Debtors had overlapping directors and officers; certain subsidiaries had no employees or physical locations; Lehman's cash management systems were centralized and managed on a firm-wide basis through LBHI; and tax returns were filed with the IRS on a consolidated basis. Most significantly, the Lehman Debtors concede that creditors transacted with Lehman as one economic enterprise and did not rely on the separate identity or credit of any single subsidiary.<sup>7</sup> On the other hand, Lehman maintained

detailed books and records of assets and liabilities on an entity by entity basis. The Lehman Debtors also note that many affiliates are in insolvency proceedings in foreign jurisdictions and significant affiliates are regulated entities, thus making consolidation of all Lehman affiliates (but not necessarily some or all Lehman Debtors) difficult. Nevertheless, recognizing their exposure on this issue, the Lehman Debtors state that, if it appears they will not obtain the requisite acceptances, they may elect to amend the Lehman Plan to provide for substantive consolidation of all or certain of the Lehman Debtors and their affiliates. It remains to be seen how this critical issue will play out in the Lehman bankruptcy case.

The foregoing is only a general outline of some of the most salient terms of the Lehman Plan. Obviously, the economic resolutions proposed under the Lehman Plan will only take effect if the Lehman Plan is confirmed by the Bankruptcy Court.<sup>8</sup> There can be no assurance that the Lehman Plan will attain confirmation in its current form, as it is not unusual for a plan to be modified prior to confirmation to resolve

objections or address concerns raised by the Court or parties in interest. The author and other attorneys in Stevens & Lee's Bankruptcy and Financial Restructuring Group are available to discuss these and other issues emanating from the Lehman bankruptcy case in greater detail with you.

Copies of the [Lehman Plan](#) and [Lehman Disclosure Statement](#) can be accessed at Stevens & Lee's website by clicking the links.

For more information on how these issues may affect your rights, contact Nicholas F. Kajon at [nfk@stevenslee.com](mailto:nfk@stevenslee.com) or 212-537-0403. Mr. Kajon is a Shareholder of Stevens & Lee, P.C., and a member of the Bankruptcy and Financial Restructuring Group practicing in the New York office.

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<sup>1</sup> Not all of LBHI's affiliates are in chapter 11. LBHI's broker-dealer subsidiary, Lehman Brothers Inc., is in a liquidation proceeding under the Securities Investor Protection Act of 1970, and foreign affiliates are being administered in at least 13 foreign jurisdictions.

<sup>2</sup> By filing a plan on the last day they had the exclusive right to do so, the Lehman Debtors received the benefit of an additional 60-day period during which only they could solicit acceptances to a plan. 11 U.S.C. § 1121.

<sup>3</sup> Substantive consolidation has the effect of consolidating the assets and liabilities of multiple debtors, and treating them as if the liabilities were owed by, and the assets owned by, a single legal entity. In the course of satisfying the liabilities of the consolidated debtors' estates from the common pool of assets, inter-company claims are eliminated, as are guarantees from co-debtors. *See generally Third Circuit Reverses Substantive Consolidation of Owens Corning*, available at [http://www.stevenslee.com/news/Bankruptcy/OwensCorning\\_0905s.pdf](http://www.stevenslee.com/news/Bankruptcy/OwensCorning_0905s.pdf).

<sup>4</sup> *See, e.g., In re SemCrude, L.P.*, 399 B.R. 388 (Bankr. D. Del. 2009).

<sup>5</sup> *See* Exhibit 11 to Lehman Disclosure Statement for calculations.

<sup>6</sup> On April 15, 2010, the Bankruptcy Court authorized the Lehman Debtors to enter into an asset management agreement with LAMCO.

<sup>7</sup> In the Second Circuit where the Lehman case is pending, courts employ a two-step test for disregarding the separate identity of multiple corporations and ordering substantive consolidation: "(i) whether creditors dealt with the entities as a single economic unit and 'did not rely on their separate identity in extending credit;' or (ii) whether the affairs of the debtor are so entangled that consolidation will benefit all creditors." *In re Augie/Restivo Baking Co.*, 860 F.2d 515, 518 (2d Cir. 1988) (citations omitted). The *Augie/Restivo* court added that "resort to consolidation based upon entanglement should not be Pavlovian," and "should be used only after it has been determined that all creditors will benefit because untying is either impossible or so costly as to consume the assets." 860 F.2d at 519.

<sup>8</sup> Plan confirmation is governed by Section 1129 of the Bankruptcy Code. 11 U.S.C. § 1129.

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