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Estate matters

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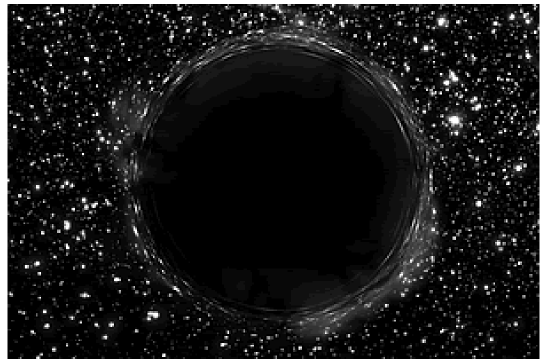

Now, the eulogy for Lehman. Let us start with some superlatives:

Lehman Brothers Holdings Inc. died on the morning of Sept. 15, 2008, at the age of 158, felled by an overdose of easy money, too-clever-by-half financial engineering, risky bets, bad debt, CEO Richard Fuld's extraordinary hubris and, ultimately, profoundly spooked markets. America's fourth-largest investment bank left behind 25,000 employees. Its outsized Chapter 11 filing is by far the largest bankruptcy in history. Lehman's liabilities totaled $613 billion at the time of the filing. Unsecured claims of Lehman's 30 largest claimants alone show bond debt and bank loans of approximately $150 billion.

To put the scope of Lehman's demise in perspective, WorldCom Inc.'s meltdown garnered the previous corporate bankruptcy record, with $34.3 billion in liabilities. Russia a decade ago defaulted on debt of about $100 billion, which marked the largest default ever, until, that is, Lehman trundled along. Following the savings and loan crisis, the Resolution Trust Corp. in the '90s closed down more than 700 banking institutions. Their total assets were just over half the amount of Lehman's total $639 billion at the time of its failure.

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And Lehman was the smallest of Wall Street's independent investment banks by the time it expired.

While the sales of Lehman's broker-dealer operations and its wealth management assets were being hammered out with a stopwatch running, the rest of the Lehman bankruptcy promises to drag on for years. This is no "quick, bury the corpse, wipe your hands and be done with it" effort. Tony Lomas, a **PricewaterhouseCoopers** partner who was named joint administrator of Lehman's bankrupt British subsidiaries, told a news conference Monday that he expects the liquidation will be even more complex than the six-year effort necessary to unwind Enron Corp.

"Everything about this case is unprecedented," says John Bicks, a New York-based restructuring partner at **Sonnenschein Nath & Rosenthal LLP**. "Coming up with the best plan, coming up with a way of obtaining maximum value, is a long-term proposition. These assets weren't built in a year. They won't be dismantled in a year."

Then, the promise of good that might come from this colossal failure:

True, Lehman's failure has already taxed the financial system. As the company unwinds, it will test the efficacy of the bankruptcy court and bankruptcy laws themselves. Cleaning up a mess of this size and complexity will take its toll on thousands of individuals and myriad institutions. So far, at least, the country's bankruptcy regime has proven remarkably adept. "It is not simply the scale and complexity, but the reach of the case, literally into every corner of the globe," says Bicks. "But there's no doubt the bankruptcy system is capable of accommodating a case this large."

Now, the details:

Lehman's holding company filed for Chapter 11 in the U.S. Bankruptcy Court, Southern District of New York. The case is before Judge James Peck, who was appointed to the bench in January 2006 after three decades as a bankruptcy lawyer, first with **Duane Morris LLP,** then with **Schulte Roth & Zabel LLP**.

On Sept. 16, a Lehman subsidiary called LB 745 LLC filed as well. That sub is the owner of Lehman's worldwide headquarters.

By law, Lehman's broker-dealer subsidiary, Lehman Brothers Inc., couldn't file for reorganization in the bankruptcy court. Instead, any bankruptcy of a broker-dealer is governed by the Securities Investor Protection Act of 1970, which mandates trustee-supervised liquidation.

The Lehman Brothers Inc. liquidation plan came on Sept. 17 and was due to be filed by Friday. It finessed the system. As conceived by Lehman's debtor counsel, **Weil, Gotshal & Manges**, Lehman Brothers Inc. would be put into a Securities Investor Protection Corp.-supervised bankruptcy. A SIPA trustee would then agree to the sale of Lehman Brothers Inc. to London-based Barclays Capital, free and clear of other liens, encumbrances and liabilities. The bankruptcy judge would then bless the transaction. In effect, the process is analogous to a Chapter 11 prepackaged bankruptcy. Peck indicated he would do everything possible to consummate a deal.

This bit of legal shuffling followed the agreement announced the evening of Sept. 16 by Barclays Capital, the capital markets arm of **Barclays plc**, to acquire for a total of $1.75 billion in cash Lehman's securities business, its midtown Manhattan headquarters and two data centers. Barclays put a $250 million price tag on the operations side of the ledger, with the vast bulk of the value in the buildings. Barclays said the trading assets to be acquired were valued at $72 billion, with liabilities valued at $68 billion. Barclays has long coveted a major presence in the United States, and now it has one. Barclays pledged to retain about 10,000 Lehman employees.

The transaction must close by Sept. 23, according to the agreement. An expedited sale is considered absolutely critical, as both the British acquirer and the bankrupt debtor fear what the filing terms "rapid erosion" of asset values. Lehman agreed not to shop the deal to others. The transaction has a $100 million breakup fee.

Throughout the week, Lehman negotiated to sell an even bigger prize, its asset management business. This includes fund manager Neuberger Berman LLC, Lehman's private equity funds and its private wealth management unit. Before the filing, Lehman believed it could garner more than $4 billion. At press time, two potential bidders -- **Bain Capital LLC** and **Hellman & Friedman LLC** -- remain in the running, with a price thought to range from $3 billion to $4 billion.

Those subsidiaries could be put into a prepackaged bankruptcy filing or merely bundled as a Sec. 363 asset sale.

What will happen to Lehman's once-shining global empire is less certain. On the day Lehman filed, its U.K. subsidiaries were put into administration, the British equivalent of Chapter 11, after Lehman informed regulators it lacked resources to keep the British companies operating. That same evening, Japanese authorities shut down Lehman's brokerage and investment banking businesses. The following day, the subsidiaries filed for bankruptcy in a Tokyo district court, listing ¥4 trillion ($38 billion) in combined liabilities, according to credit researcher **Tokyo Shoko Research Ltd.** It marked the second-largest collapse in Japan since World War II, Tokyo Shoko said in a statement carried by local media.

On Sept. 16, Peck approved a motion under Sec. 362 of the Bankruptcy Code that extends a stay worldwide on possible foreclosures and seizures of assets.

For Lehman creditors, a critical aspect of the bankruptcy is what the court doesn't oversee. Under the Bankruptcy Code, swaps, repos and all varieties of futures instruments are exempted under the stay that normally governs lawsuits and contracts of a bankrupt company. So a counterparty trader can foreclose on contracts, liquidate them, terminate them and seize collateral if money is owed. The 2005 bankruptcy legislation broadened the definition of these exempted instruments to include every imaginable kind of swap.

Lehman engaged in hundreds of billions of dollars worth of these financial instruments, including highly risky credit default swaps.

Although it's impossible to know at this time, a majority of these swaps have already been terminated, say lawyers, quoting their clients. Lawyers agree that in the absence of these exemptions, big chunks of the financial market could have seized up while counterparty trades waited for the judge's approval to lift the stay. "I'm not sure how the market would resolve this if bankruptcy had not had these exemptions," says Leonard Klingbaum, a New York-based partner at **Kirkland & Ellis LLP**. However, he adds: "It remains to be seen if it helps stabilize the Lehman estate."

Lehman's legacy is difficult to fathom: History could record Lehman as the most notorious self-inflicted victim of Wall Street greed or the sacrificial victim in the government's handling of the crisis. It's now the biggest casualty of the mortgage mess. Few believe it's the last. "It's inevitable there will be a series of additional failures in the banking system. It's a foregone conclusion," says Anders Maxwell, a managing director at **Peter J. Solomon Co.**, who cried long and loud about the dangers of financial excess.

But Maxwell acknowledges that allowing all institutions to fail isn't the answer, either. Lehman may go down as a big one that died -- because it could. He contrasts Lehman with **American International Group Inc.** "With Lehman, the problems were easily identifiable, the risk easily quantifiable. With AIG, it was not at all clear, if you let it fail, who else would go down with them."