



## Back to the Drawing Board

### Setbacks dog the administrators of Lehman in Europe

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In a turn of events that may be a surprise to none, the administration proceedings for Lehman Brothers International, Europe – or LBIE – have encountered more stumbling blocks to further delay the distribution of assets to LBIE’s prime brokerage customers.

As discussed in our August article (The Hedge Fund Journal, Issue 49) Wrapping up Lehman: the implications of PwC’s scheme of arrangement, LBIE’s administrators applied to the High Court in London for a ruling regarding the propriety of a scheme of arrangement. This scheme was designed to provide a cohesive, streamlined process for returning so-called trust property held by LBIE to certain of its creditors. The trust property in this case refers to segregated assets, derived assets or recovered assets held in custody that have been trapped at LBIE since 15th September 2008. A public hearing on the scheme was held before Mr Justice Blackburne at the Royal Courts of Justice in London on 29th and 30th July 2009.

On 21st August, Mr Justice Blackburne rendered judgment: the court viewed the primary question before it as whether it has “jurisdiction under Part 26 to sanction a scheme, so that it becomes binding on dissentients, which has as its purpose the distribution of property held by a company on trust”. Mr Justice Blackburne ruled that the court does not, in fact, have jurisdiction to approve a scheme that would bind dissenters whose property was held or controlled by LBIE in trust for its clients. He reasoned that the determination of the contractual terms that govern LBIE’s relationship with its clients, and the net contractual positions and attendant security rights, are all matters between LBIE and its clients directly and thus are matters over which the High Court has no jurisdiction. “In my judgment, this case provides no support for the proposition that a scheme designed to deal with (and, so far as necessary, alter) the property rights of persons who happen also to be creditors of the scheme company constitutes a compromise or arrangement within the scope of Part 26 ... property rights of LBIE’s clients – their asset claims in the terminology of the scheme – are enjoyed quite independently of any claims which those clients have against LBIE arising out of LBIE’s defaults.”

Steven Pearson, one of LBIE’s administrators, immediately reacted with disappointment. “The proposed scheme sought to significantly reduce the period clients have to wait before they get their assets back,” he said. “This judgment is disappointing as it could create further delay for many of LBIE’s clients.” Shortly thereafter, on 25th August, the administrators indicated their plans to move forward by appealing the judgment of the High Court and simultaneously reworking the scheme in a way that might obtain High Court approval while maintaining the administrators’ goal of a fair and expeditious return of client assets. On 10th September, the administrators filed an appeal

application with the Court of Appeals, accompanied by a request for a hearing on an expedited basis. The appeal was heard on 26th and 27th October in the Court of Appeal (Civil Division) and on 6th November 2009, Lord Justice Longmore and Lord Justice Patten upheld Justice Blackburne’s ruling, dismissed the appeal and ruled that the proposed scheme of arrangement could not be implemented as proposed. To keep open its remaining options, the joint administrators have made an application to the Court of Appeal for permission to appeal this ruling to the Supreme Court of the United Kingdom.

In the meantime, rather than sit idly by as the appeal process moved forward, the administrators have gone back to the drawing board and, on 5th October, outlined in broad strokes their concept for a proposed contractual alternative to the scheme, an alternative that would require no judicial approval, as it would simply entail a bilateral contractual resolution of trust property issues between LBIE and each of its customers electing to participate. The contractual alternative essentially would mirror the terms of the proposed scheme; it would feature a bar date, prescribe methodologies for valuing customers’ net equity and allocating and distributing trust property and afford creditors the chance to choose a standardised settlement arrangement. Unlike the scheme, however, under which creditors merely would be agreeing to a process for determination of their claims, it would also permit creditors to know the precise amount of their allowed claims before executing definitive agreements.

Only those creditors that agree would be bound by the alternative structure. Thus, one obstacle to the success of the contractual alternative is the possibility of litigation (against the administrators or other creditors) by dissatisfied non-consenting creditors – who would have their claims determined on an individual basis outside of the contractual arrangement. For this reason, the administrators have suggested that 90% of creditors (measured by value) would have to agree to the contractual alternative before it will be implemented.

The existence of non-consenting creditors may create additional difficulties for the administrators and consenting creditors. First, there will be no finality for consenting creditors; e.g., if there is a shortfall in a particular stock line to which numerous creditors have claims, additional investigation may be required to properly allocate and distribute the securities in question. Second, valuation issues could delay the distribution of assets to creditors, as the administrators would have to make valuation determinations regarding non-consenting creditors before determining the precise amounts available to consenting creditors. Finally, the administrators likely would lose the protection of negotiated, contractual indemnities with respect to non-consenting creditors.

The administrators have applied to the court to set 31st January 2010 as a bar date for the submission of trust property claims (this bar date is already a month beyond the bar date proposed in connection with the scheme). The High Court indicated in its decision that the setting of a bar date is well within the powers of the court and the court would approve an application for the setting of a bar date, regardless of the result of the scheme appeal. The bar date will provide the administrators sufficient information to begin the return of trust property to those who sign on to the contractual alternative.

The administrators hope to be able to distribute copies of the contractual alternative by late November. In the interim, they are embarking on road trips to promote the contractual alternative and respond to creditors’ initial questions. A copy of the slides from the road trip presentation is available at [www.pwc.co.uk/pdf/lehmans\\_MFA\\_AIMA\\_presentation\\_9oct.pdf](http://www.pwc.co.uk/pdf/lehmans_MFA_AIMA_presentation_9oct.pdf).

The administrators expect that the contract sent to creditors will contain a circular, representing the offer, and a form of instrument to allow creditors to accept. If a sufficiently high number of creditors send in their acceptances, as noted above, expected to be 90%, the contractual alternative will be implemented. Once creditors have signed onto the alternative, distributions are expected to be made fairly promptly for the stock lines as to which there is no shortfall.

Although the scheme presents the most comprehensive and efficient result for the return of trust property, only a successful appeal to the Supreme Court of the United Kingdom can revive that option. Otherwise, if the contractual alternative is not accepted by sufficient numbers, LBIE’s creditors should be prepared for a protracted process of one-off negotiations. The cost such a process will be borne by all creditors, as it will come out of trust property, thereby reducing amounts ultimately available for distribution. The administrators thus hope that the contractual alternative, which is expected to significantly shorten the time required (and, consequently, the cost) to return the vast majority of trust property to creditors, wins the approval of an overwhelming majority of creditors. Absent such approval, the LBIE administration will drag on, and the assets in the administrators’ custody – which according to the administrators have lost more than \$5 billion in market value in the last 13 months – could lose substantially more value as the creditors sit helplessly waiting for a final determination. **THFJ**

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