



## CLIENT ALERT

DECEMBER 17, 2008

# Bankruptcy Court Issues Order Requested by Lehman for the Assignment or Settlement of Derivative Contracts

*Since the filing by Lehman Brothers Holdings Inc. (LBHI) and certain of its affiliated debtors of a motion to establish procedures for assigning and settling various "Derivative Contracts", approximately 100 parties filed objections to the motion. As of December 15, 2008, approximately 65 of those objections were resolved, including an objection made by the Official Committee of Unsecured Creditors (the "Committee").*

*On the eve of the scheduled hearing with respect to the motion, Lehman proposed a revised order, addressing many of the concerns expressed in the objections to the original motion. At the December 16<sup>th</sup> hearing, Judge James M. Peck granted the motion and signed the order as revised by Lehman. Objections that remain unresolved will be addressed at a hearing scheduled for January 14<sup>th</sup>, 2009 at 10 a.m. (EST). A summary of the key resolutions that were incorporated into the revised order is set forth below.*

### **Background on Lehman Motion re: Derivative Contracts**

LBHI and its affiliated debtors in bankruptcy proceedings under chapter 11 of the Bankruptcy Code (collectively, the "Lehman Debtors")<sup>1</sup> have estimated that they are party to approximately 930,000 "Derivative Contracts", consisting mostly of "securities contracts", "forward contracts", "repurchase agreements" and "swap agreements". As of November 13, 2008, the Lehman Debtors estimated that 197,000 Derivative Contracts had not been terminated and remained outstanding. Consequently, the Lehman Debtors filed a motion on November 13, 2008 (the "Motion") seeking an order from the Bankruptcy Court of the Southern District of New York (the "Bankruptcy Court") approving procedures to: (1) enter into final settlement agreements with counterparties that have terminated Derivative Contracts with the Lehman Debtors; and (2) assign Derivative Contracts that have yet to be terminated to third parties in order to realize their value. As of December 16, 2008, Lehman estimated that approximately 30,000 Derivative Contracts have not been terminated and remain outstanding.

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<sup>1</sup> The "Lehman Debtors" do not include Lehman Brothers, Inc., which is subject to a separate liquidation proceeding under the Securities Investor Protection Act (SIPA). A trustee appointed under SIPA is administering LBI's estate. In contrast the Lehman Debtors referenced in the motion described in this alert are authorized to operate their businesses and manage their properties as debtors in possession pursuant to the Bankruptcy Code.



### **Critical Resolutions Incorporated Into Order**

Among other things, the Bankruptcy Court's order (the "Order") incorporates the following key resolutions in response to certain objections to the Motion:

#### ***Overarching Change***

- *Oversight by the Committee.* The Order provides that the Lehman Debtors and the Committee shall negotiate in good faith to agree within 30 days of entry of the Order on protocols for the Committee's oversight of transactions entered into pursuant to the Assumption and Assignment Procedures and the Termination and Settlement Procedures. The Lehman Debtors may not consummate a transaction pursuant to the procedures set forth in the Order unless either: (1) the Committee consents, either through written notice or pursuant to the terms of an agreed Protocol or (2) the Court authorizes consummation of such transaction.

#### ***Assumption and Assignment of Outstanding Derivative Contracts***

With respect to the Procedures for the Assumption and Assignment of Derivative Contracts, the Order incorporates the following key resolutions in response to certain objections to the Motion:

- *Set-off rights preserved:* The Order preserves the rights of a party to setoff in respect of an assigned Derivative Contract and provides that such setoff rights shall attach to the proceeds of the assignment (provided, however, that no rights of setoff arising from agreements with any of the Lehman Debtors other than such Derivative Contracts or arising from other matters with respect to any of the Lehman Debtors may be asserted against the assignee).
- *Satisfying "adequate assurance of future performance" requirement:* In accordance with Section 365 of the Bankruptcy Code, a debtor may only assign a contract if it provides "adequate assurance of future performance" by the assignee of such contract. The Motion provided that the requirement to provide adequate assurance of future performance by the assignee would be deemed satisfied if the assignee or its credit support provider had a rating of A- or higher by Standard & Poor's or Fitch, or A3 or higher by Moody's. Several parties objected to this concept, and it was resolved in the Order that parties could object to an assignee regardless of the assignee's rating. Further, in the assignment notice, the Lehman Debtors will be required to identify all transactions under the Derivative Contracts and identify up to 12 proposed assignees, as well as information about the assignees' (or guarantors') ability to perform. A party would only be prohibited from objecting to an assignee if, after the payment of any Cure Amounts, the assignee would no longer have any ongoing payment or delivery obligations for the full term of the Derivative Contract (a "Fully Paid Contract").
- *Period of time to object to an Assignment Notice:* The Motion provided parties with five business days to object to an assumption and assignment. Parties objected to this time-frame, arguing that it would not be commercially reasonable

considering the complexity of the issues that need to be considered in order to determine the need for an objection. The Order provides that parties shall have either (i) ten business days to object in the case of Derivative Contracts consisting of fewer than 100 transactions (and fewer than 50 Fully Paid Contracts) or (ii) twenty business days in the case of Derivative Contracts consisting of 100 or more transactions (or 50 or more Fully Paid Contracts).

- *Assignment of entire master agreement required:* The Order clarifies that, where a Derivative Contract is governed by a master agreement, the Lehman Debtors may only assume and assign the master agreement and all transactions entered into under the master agreement, whether the transactions are terminated or continuing, to a single assignee.
- *Assumption and assignment procedures shall not apply to validly terminated contracts:* The Order clarifies that the assumption and assignment procedures do not apply to or revive validly terminated Derivative Contracts.
- *Supporting detail for Cure Amounts:* The Order clarifies that the Lehman Debtors are required to provide similar details in support of the Cure Amounts that the parties objecting to such Cure Amounts are required to provide.
- *Time limit for assignment:* The Motion did not include a time limit for the Lehman Debtors to assume and assign a Derivative Contract. The Order provides that if an assignment is authorized in accordance with the procedures set forth in the Order, the Lehman Debtor has 60 days to assign the Derivative Contract.

### **Settlement of Terminated Derivative Contracts**

With respect to the settlement of terminated Derivative Contracts, the Order incorporated the following resolutions in response to certain objections to the Motion:

- *Set-off.* Settlement agreements may allow claims against the Lehman Debtors and may incorporate setoff or recoupment to the extent setoff or recoupment is legally valid.
- *Contractual rights/civil proceedings.* The Order clarifies that the termination and settlement procedures shall not supersede, suspend or otherwise modify (i) the legal and contractual rights of any parties to the extent such legal and contractual rights are enforceable in the Lehman Debtors' cases under the Bankruptcy Code or other applicable law; or (ii) the commencement or continuation of any civil proceeding by any party to a terminated Derivative Contract including, without limitation, any such adversary proceeding commenced or pending in the Bankruptcy Court.

**Remaining Objectors**

- Bank of America, National Association, Successor by Merger with LaSalle Bank National Association in its capacity as Trustee under certain Trust Agreements
- Bank of America, National Association, Successor by Merger with LaSalle Bank National Association, in its Capacity as Trustee under that certain Indenture Dated as of August 16, 2007 among Ceago ABS CDO 2007-1, Ltd., as Issuer, Ceago ABS CDO 2007-1, LLC, as Co-Issuer and LaSalle Bank National Association, as Trustee
- Bank of America, National Association, Successor by Merger with LaSalle Bank National Association, in its Capacity as Trustee under that certain Indenture Dated as of November 29, 2005 among Verde CDO, Ltd., as Issuer, Verde CDO, LLC, as Co-Issuer and LaSalle Bank National Association, as Trustee
- The Bank of New York Mellon, The Bank of New York Mellon Trust Company, N.A. and BNY Corporate Trustee Services Limited
- BRE Bank SA
- Bremer Financial Corporation
- BRM Group, Ltd.
- The City and County of Denver, Department of Revenue
- Citigroup Inc. and all of its affiliates, including Citibank, N.A.
- Danske Bank A/S, London Branch
- Deutsche Bank Trust Company America and Deutsche Bank National Trust Company
- EnergyCo, LLC and EnergyCo Marketing and Trading
- EPCO Holdings, Inc.
- First Choice Power, L.P.
- FPL Energy Power Marketing, Inc. and Florida Power & Light Company
- Georgetown University
- Gaston Christian School, Inc.
- HarbourView CDO III
- Institutio de Credito Oficial
- JA Solar Holdings Co., Ltd.
- Lahde Capital Management Inc.
- Lincore Limited, E-Capital Profits Limited and Cheung Kong Bond Finance Limited
- Metavante Corporation
- Northcrest, Inc.
- Norton Gold Fields Limited
- Occidental Energy Marketing Inc.
- Portfolio Green German
- Tobacco Settlement Financing Corporation
- QVT Financial LP
- Reliant Energy Power Supply, LLC
- Societe Generale, Canadian Imperial Bank Commerce, Calyon, Dexia Bank Internationale a Luxembourg SA, Dexia Credit Local, Dexia Kommunalbank Deutschland AG, Dexia Banque Belgique SA and Banif - Banco de Investimento, S.A.



- Standard Chartered Bank
- SunAmerica Life Insurance Company, AIG CDS, Inc., Lexington Insurance Company
- Carlton Communications Limited
- The Toronto-Dominion Bank
- U.S. Bank National Association
- The Walt Disney Company
- Wells Fargo, N.A., as trustee
- West Corporation

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**If you have any questions regarding the motion and objections described above or would like further information regarding the status of the Lehman proceedings, please contact one of the following:**

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