

European Finance | November 30, 2009

## Lehman Brothers: English Court Rejects Proposed Scheme of Arrangement; Administrators Propose 'Claim Resolution Agreement' as an Alternative

The Court of Appeal has upheld the decision that the English Courts do not have jurisdiction to sanction a scheme of arrangement proposed by the administrators of Lehman Brothers International (Europe) ("LBIE"). As an alternative, LBIE's administrators have proposed that clients enter into a bilateral 'Claim Resolution Agreement' with LBIE (the "Agreement"), to agree a process for the return of client assets currently held on a segregated basis from LBIE's own assets and the determination of any liabilities of clients to LBIE and its affiliates.

The Agreement and the related Circular are nearly 200 pages long. Much of the complexity arises from the range of factual situations that the Agreement needs to deal with, the current uncertainty as to what assets LBIE will have available to it to settle clients asset claims and the fact that the correct interpretation of certain client money issues has not yet been determined by the English Courts. This client publication provides an outline of the reasons behind the scheme rejection and an overview of the terms of the Agreement.

### Rejection of the Scheme of Arrangement

In a previous client note we discussed the proposal by the administrators of LBIE (the "Administrators") to seek a Court-approved scheme of arrangement. If sanctioned, the scheme would have established a procedure for the return of the assets of certain of LBIE's clients that would have been binding on all such clients whether they agreed to it or not.

Under the proposals, a person would only be a Scheme Creditor if that person had both (a) a pecuniary claim against LBIE; and (b) a proprietary claim to a security, which had been held on a segregated basis at the time of administration.

The Court of Appeal upheld the High Court's decision that Part 26 of the Companies Act 2006 applies only to

creditors and not to beneficial owners of assets. The Court of Appeal concluded that the court's jurisdiction is restricted by the requirement that a scheme must be an arrangement between the company and its creditors - which means an arrangement which deals with their rights inter se as debtor and creditor. The Court did not therefore have jurisdiction to sanction a scheme that compromised the rights of clients over their own property held by LBIE on trust.

### The Claim Resolution Agreement

On 24 November 2009, LBIE distributed the Agreement to Eligible Offerees. The Agreement is substantially based on the outline of the proposed scheme distributed in July 2009 but is structured differently since, subject to certain acceptance thresholds, the Agreement will bind only

those clients who become Signatories by returning the Form of Acceptance and so accepting the offer to enter into the Agreement.

In October 2009, the Administrators stated that it was their intention to pursue a scheme alongside the Agreement, to ensure that Signatories are protected against claims from Non-Signatories.

Given that it now looks likely that a scheme will not proceed, Signatories face a continuing exposure to claims from Non-Signatories who might argue that the Signatories have received assets in which the Non-Signatories have a proprietary interest. Subject to identifying whom to claim against, Non-Signatories may conclude that it is easier to pursue Signatories than it is to recover assets from LBIE where insolvency laws protect LBIE.

Apart from the 90% (by value) acceptance threshold to make the Agreement effective (which reduces the volume of potential claims from Non-Signatories), there is nothing in the Agreement that protects Signatories from this risk.

## Key Dates

NB: LBIE may change or waive any deadline, subject to only limited constraints and/or notification requirements.

<b>24 November 2009</b>	<ul style="list-style-type: none"> <li>- Agreement circulated. Offer formally opens.</li> <li>- Updated 'Position and Balance Statements' posted in client portals.</li> </ul>
<b>29 December 2009 at 17.00 (London time)</b>	<ul style="list-style-type: none"> <li>- Acceptance deadline.</li> <li>- Acceptance Threshold Offerees must <math>\geq</math> 90% of the Acceptance Value of the relevant claims in aggregate for the Agreement to be effective.</li> <li>- Note: Forms of Acceptance received thereafter <i>may</i> be accepted but those clients will be charged higher (punitive) costs by LBIE.</li> </ul>
<b>January</b>	<ul style="list-style-type: none"> <li>- LBIE confirms receipt and official 'Accession Date' for each signatory.</li> </ul>

<b>2010</b>	
<b>29 January 2010</b>	<ul style="list-style-type: none"> <li>- Open Financial Contracts not terminated before the relevant Accession Date are deemed terminated.</li> <li>- Deadline for submission of valuation statements and revisions by Trust creditors that are determining parties.</li> </ul>
<b>26 February 2010</b>	<ul style="list-style-type: none"> <li>- Bar Date (pursuant to Court Order confirming this date as the bar date).</li> <li>- Final date by which Trust Asset Signatories must submit an Asset Claim or provide all further information about Asset Claims.</li> </ul>
<b>Post Bar Date</b>	<ul style="list-style-type: none"> <li>- Distribution of Asset Claims will commence but timing of distribution and identification and valuation of Asset Shortfall claims remains uncertain.</li> </ul>
<b>30 June 2010</b>	<ul style="list-style-type: none"> <li>- Deadline by which acceptance conditions for Non-Trust Asset Offerees must be fulfilled.</li> <li>- All acceptances by Non-Trust Asset clients will be deemed ineffective if an unsecured creditors scheme is promoted before this date.</li> <li>- Agreement will lapse (for Non-Trust Asset Offerees) if all conditions not satisfied.</li> </ul>

## Scope and Characterisation of the Agreement

The Agreement is an offer to clients with trust asset claims, which includes claims to non-rehypothecated securities ('TA Offerees') who may also have non-proprietary claims against LBIE pursuant to Financial Contracts (such as ISDA Master Agreements) and clients with no ownership claims to Segregated Assets but who are parties to Financial Contracts ('NTA Offerees'). TA Offerees that enter into the Agreement ('TA Signatories') have different rights and obligations under the Agreement from NTA Offerees that also accede to the Agreement ('NTA Signatories') and LBIE intends to prioritise dealing with TA Signatories. The objective of including NTA Offerees in the Agreement seems to be to encourage counterparties to Open Financial Contracts to terminate them now and to agree the amount of their unsecured claim on LBIE using a standardised valuation methodology

The Agreement is structured as a complete exchange of rights: Signatories to the Agreement will, broadly, waive and release their claims against LBIE and other Signatories to the Agreement (under whatever law those rights arise) and instead receive new English law rights against LBIE under the Agreement to ascertain Asset Claims and their overall Net Contractual Position.

Signatories will need to consider the tax and accounting implications of this exchange of claims.

The Agreement is a binding, irrevocable agreement to accept the outcome of the close out calculation and asset distribution process provided in the Agreement. It is of course unusual to agree to something where the actual outcome remains uncertain. The Agreement allows LBIE to enter into bilateral amendments with particular Signatories. It is currently unclear if this process can be used to achieve greater certainty for the Signatory (e.g. to resolve material differences in position and balance statements before committing to an agreement that allows LBIE to determine those amounts, subject only to a limited dispute resolution process).

The Agreement recognises that a Signatory may have guarantee or similar claims (e.g. against Lehman Brothers Holding Inc. as guarantor of LBIE) and seeks to retain the right for clients to claim under those guarantees. However, the Signatory assumes all risk of such claims being compromised as a result of the Agreement requiring them to give up all rights under the original agreements pursuant to which LBIE's obligations may have been guaranteed.

The offer to NTA Offerees is conditional on the courts not sanctioning a scheme of arrangement or CVA for unsecured creditors of LBIE before 30 June 2010. If such a scheme is approved, any acceptances by NTA Offerees will be deemed ineffective and the NTA Offerees will fall under the remit of the scheme and not the contractual solution provided by the Agreement.

## Asset Claims

The Agreement establishes a regime to determine TA Signatories' Asset Claims. The Agreement will not bind Non-Signatories. Court directions may still be necessary before any distribution of Trust Assets.

The Agreement envisages LBIE obtaining an order of the English Courts to set a bar date by which time clients with Trust Asset claims must submit those claims to LBIE. Submission of claims by that bar date will not require clients to accept the Agreement, but if claims are not submitted, such clients may lose any proprietary claims that they have.

It is currently unclear whether there will be a bar date in respect of claims by LBIE affiliates that may be secured on client assets held by LBIE. The Agreement requires clients to represent either that there are no such claims against them, or to disclose them so that they can be taken account of in the claims resolution.

There are no obligations on LBIE to distribute Asset Claims by a particular date. The timing of distribution of any Trust Assets held at LBI remains particularly uncertain.

## Claims Under Financial Contracts

The Agreement sets out a mechanism for the termination and close-out of all Financial Contracts between Signatories and LBIE. Claims and liabilities under all Financial Contracts will be netted-off to determine a single net claim. Signatories will be effectively granted full set-off rights across all Financial Contracts with LBIE, even if their original agreements did not include such a non-statutory right of set-off.

However, the Agreement modifies the way in which contractual obligations under Financial Contracts will be valued by applying certain overriding valuation methodologies. These include valuing all short positions and rehypothecated securities as at 12 September 2008, preventing any interest claims by clients since 15

September 2008 and providing for interest to be payable on unpaid amounts due to LBIE at a 100 basis points over one month LIBOR since 15 September 2008.

The Agreement gives LBIE final and sole discretion to determine the net financial position for each Signatory, which LBIE will evidence in a final client position statement. This can only be challenged by a Signatory under the dispute resolution mechanism set out in the Agreement. This illustrates that it is critical that Signatories review the interim position and balance statements that they have received carefully and submit to LBIE details of any errors.

If the net figure is a claim against LBIE, this will be an unsecured claim against LBIE. If the net figure is a liability due to LBIE, a TA Signatory cannot recover their entitlement to available Trust Assets until that liability is paid or secured. TA Signatories will be permitted to set-off such net financial contract liabilities against any amounts owed to them by LBIE in respect of asset shortfall claims (claims to Trust Assets that cannot be met due to a shortfall in the relevant stock line).

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

If you wish to receive more information on the topics covered in this memorandum, you may contact your regular Shearman & Sterling contact person or any of the following:

**Ian Harvey-Samuel**  
London  
+44.207.655.5000  
ian.harvey-samuel@shearman.com

**Barnabas Reynolds**  
London  
+44.20.7655.5528  
barney.reynolds@shearman.com

**Clifford Atkins**  
London  
+44.207.655.5957  
catkins@shearman.com

**Azad Ali**  
London  
+44.207.655..5659  
azad.ali@shearman.com

**Thomas Donegan**  
London  
+44.207.655.5566  
thomas.donegan@shearman.com

**Katerina Rainwood**  
London  
+44.207.655..5156  
katerina.rainwood@shearman.com

**Donna Parisi**  
New York  
+1.212.848.7367  
dparisi@shearman.com

**Azam Aziz**  
New York  
+1.212.848.8154  
aaziz@shearman.com

## Effect on Claims Trading

The Agreement does not allow a Signatory to set-off any claims bought/transferred to the Signatory after 12 September 2008 against positions they held prior to that date. The Signatory will be treated as if it were a separate party to the Agreement for each distinct set of positions.

Claims may be transferred post-Accession provided they are sold to another entity that is or becomes a Signatory to the Agreement and only if *all* claims and liabilities against LBIE are transferred together.

## Position of Non-Signatories

The Agreement is structured so as to incentivise clients to accept it before the first acceptance deadline of 29 December 2009. Clients that accept later and those who do not accept are told that they will be charged higher costs and that their claims will take longer to resolve. If they seek to agree bilateral arrangements with LBIE at a later date, Non-Signatories will not benefit from any mutual releases granted by Signatories. Non-Signatories may be required to give indemnities and credit support to LBIE against any distributions of Trust Assets that they may receive.