



## CLIENT ALERT

JANUARY 28, 2009

# Meet Lehman's Liquidators: Alvarez & Marsal to Liquidate Investment Bank, Reconcile Derivative Claims

*Lehman Brothers Holdings Inc. and its affiliated debtors have retained Alvarez & Marsal North America, LLC ("A&M") as chief restructuring consultants, and one of A&M's principals is now acting as Lehman's Chief Executive Officer. A&M's key responsibilities are to maximize recovery of Lehman assets and mitigate potential Lehman liability, and this mandate includes the reconciliation of claims related to the Lehman entities' derivative contracts.<sup>1</sup> To date A&M has dedicated over 500 people to achieving its objectives and may be eligible for incentive fees as high as 25% of its normal fees if the court determines that A&M made "a substantial contribution to the management and mitigation of the claims against the estates."*

### A&M Background

A&M specializes in providing turnaround and restructuring assistance to companies in crisis. A&M's activities vary greatly and, as noted in a *Fortune Magazine* article in February 2008, "With some clients, A&M dispatches teams to work much like consultants - looking over the books and talking ideas - but about a hundred times faster. In thornier cases the firm does the dirty work itself, usually with Tony Alvarez, Bryan Marsal, or another partner stepping in as CRO - chief restructuring officer - and doing triage like ordering layoffs, selling off assets, and making overhead cuts."

A&M has gained recognition in recent years by working on a number of high profile restructuring or liquidation projects, including the winding up of Arthur Andersen after the Enron debacle and the turnaround of HealthSouth after its accounting scandal.

### A&M's Lehman Engagement

Due to the size and complexity of Lehman's businesses, Lehman Brothers Holdings Inc. ("LBHI") and its affiliated U.S. debtors (collectively, "Lehman")<sup>2</sup> quickly

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<sup>1</sup> Note that Lehman has defined "Derivative Contracts" in its recent motions as including "securities contracts", "forward contracts", "repurchase agreements" and "swap agreements".

<sup>2</sup> Please note that the affiliated Lehman debtors do not include Lehman Brothers, Inc., Lehman's U.S. broker dealer entity, 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



determined that it needed to engage experienced restructuring consultants. A&M was retained shortly after LBHI filed its Chapter 11 petition on September 15, 2008. The bankruptcy court approved of such action retrospectively in December and agreed to the appointment of Bryan Marsal as Lehman's Chief Restructuring Officer. Earlier this month Marsal replaced Richard Fuld as Chief Executive Officer of LBHI.

A&M was hired in order to manage Lehman's assets and oversee the administration of claims filed against Lehman. A&M's stated purpose in this instance is to maximize distributions to creditors and appropriately minimize claims in order to benefit all of Lehman's creditors in a fair manner and in accordance with applicable law. Specifically, A&M's key responsibilities are to:

- Maximize recovery value of Lehman assets;
- Mitigate potential liability / reconcile claims (including those related to derivative contracts);
- Meet the needs of the Court / US Trustee / Unsecured Creditors Committee (in terms of reporting, cost effective administration, timely completion of an exit).

A&M has stated that its objective is to position Lehman to exit from bankruptcy in 18-24 months. However, the U.S. bankruptcy court judge overseeing the Lehman proceedings has indicated that greater international coordination and protocols for creditor claims will be needed to resolve matters efficiently and meet this goal.

### **A&M's Compensation and Incentive Fees**

A&M charges Lehman at an hourly rate ranging from \$175 for analysts to as high as \$850 for managing directors. As of January 2009, A&M had staffed over 500 persons on the Lehman restructuring, including over 350 legacy and former Lehman personnel. In addition to these hourly fees, A&M is seeking incentive fees as high as 25% of its hourly fees. Specifically, A&M's requested incentive fee would be equal to the sum of (i) 0.175% of unsecured distributions in excess of \$15 billion and (ii) an amount to be determined at the conclusion of the Lehman bankruptcy cases based on A&M's performance, subject to an overall cap of 25% of A&M's total hourly fees over the term of the engagement. Although the court approved A&M's requested fees in December, the court provided that any incentive fees will be subject to, among other things, the court's determination at the conclusion of the Lehman bankruptcy cases that A&M has made "a substantial contribution to the management and mitigation of the claims against the estates".<sup>3</sup>

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Lehman debtors referenced in this alert are authorized to operate their businesses and manage their properties as debtors in possession pursuant to the U.S. Bankruptcy Code.

<sup>3</sup> Certain bankruptcy practitioners have expressed doubt as to whether the court will approve the requested incentive fees at the conclusion of the Lehman cases. In particular, some objectors have argued that the bar would be set too low if A&M were to earn a bonus after distributing only \$15 billion to unsecured creditors. However, depending on A&M's performance, a significant bonus does not appear to be outside the realm of possibilities.



## **A&M's Derivatives Team and the State of Lehman's Derivatives Book**

In the Lehman restructuring A&M has established six different asset teams, one of which is dedicated to derivatives. Key A&M, Lehman and external counsel contacts for the derivatives team are listed at [www.lehmanbrothersestate.com](http://www.lehmanbrothersestate.com).

A&M has identified the reconciliation of derivative claims as one of its major pending open issues in relation to mitigating potential liabilities of the estate.<sup>4</sup> Among the challenges faced by A&M in this regard are the large number of derivative trades and counterparties.

According to A&M's latest report on the "The State of the Estate", 98% of the over 900,000 derivatives trades<sup>5</sup> on Lehman's books have been terminated since Lehman's insolvency filing, leaving only 18,000 trades remaining open as of January 2, 2009. Lehman's derivatives receivables total \$23.8 billion and payables total \$13.0 billion, in each case based on marks net of collateral as of September 12, 2008. There are over 6,100 counterparties, 3,930 of which are expected to owe Lehman money and 2,190 of which are expected to be owed money by Lehman based on the estimated receivables and payables.

### **Strategy for Reconciling Derivative Claims**

In November 2008 Lehman filed a motion with the bankruptcy court to obtain the right to settle derivative contracts that purportedly have been terminated by counterparties without the need for court review and approval in each instance. In addition Lehman requested the ability to assign derivative contracts that have not been terminated.

The bankruptcy court granted the requested order (with some modifications in response to creditor objections) in December 2008 and approved procedures requested by Lehman that will allow Lehman to: (1) enter into final settlement agreements with counterparties that have terminated derivative contracts; and (2) assign derivative contracts that have yet to be terminated to third parties in order to realize their value.<sup>6</sup> Lehman may not, however, consummate a transaction pursuant to the procedures set forth in the order unless either: (1) the Official Committee of Unsecured Creditors consents, through written notice or pursuant to the terms of an agreed protocol, or (2) the bankruptcy court authorizes consummation of such transaction.<sup>7</sup>

Although it appears no derivatives claims have been settled at this point, A&M noted in its recent report on the estate that "substantial progress has been made and momentum is building on derivatives book." A&M also stated that derivative claims "may

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<sup>4</sup> See presentation entitled "Lehman Brothers Holdings Inc. – The State of the Estate" dated as of January 14, 2009, available at [www.lehmanbrothersestate.com](http://www.lehmanbrothersestate.com)

<sup>5</sup> See supra Note 1.

<sup>6</sup> See Teigland-Hunt LLP's Client Alerts dated December 2, 2008 and December 17, 2008 for more information about Lehman's motion, creditors' objections and the bankruptcy court's order.

<sup>7</sup> Certain objections to the Lehman motion remain outstanding, and the hearing to address them has now been adjourned to March 25, 2009.



be resolved in a more expeditious and reasonable time period if a mediation process is developed. Consideration of that concept is underway.”

## Conclusion

Given A&M's bold restructuring objectives for Lehman and the performance-based component of the firm's compensation, parties to outstanding or terminated derivative contracts should be prepared for heightened scrutiny of their claims in respect of such contracts as well as other Lehman agreements.

## How We Can Help

Teigland-Hunt LLP has assisted many of its clients in the negotiation and settlement of claims and disputes in relation to OTC derivative transactions and other trading agreements. Our firm's practice is focused on advising financial institutions and asset managers with respect to trading activities and documentation in the world's leading financial and commodities markets. Consequently our lawyers offer exceptional experience in the negotiation and interpretation of derivative contracts as well as the industry's other principal trading agreements.

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**If you have any questions regarding the Lehman proceedings or would like assistance with your Lehman claims, please contact one of the following:**

**Lauren Teigland-Hunt**      +1 212 269 1002      [lteigland@teiglandhunt.com](mailto:lteigland@teiglandhunt.com)

**GuyLaine Charles**      +1 212 269 1016      [gcharles@teiglandhunt.com](mailto:gcharles@teiglandhunt.com)

**Teigland-Hunt LLP**  
127 West 24<sup>th</sup> Street, 4<sup>th</sup> Fl, New York, NY 10011  
[www.teiglandhunt.com](http://www.teiglandhunt.com)

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