March 17, 2010

Lehman Brothers Debtors File Joint Plan

Lehman Brothers Holdings Inc. (LBHI) and its affiliated U.S. chapter 11 debtors (the "Debtors") filed a joint plan with the Bankruptcy Court on March 15, the last day on which the Debtors who filed petitions on September 15, 2008, had the exclusive right to file a plan. As a result of the filing, the Debtors have an additional 60 days during which no other party may file a plan.

While the 18-month exclusivity limit was set by Congress in amendments to the Bankruptcy Code in 2005, it is fair to say that cases the size and complexity of Lehman Brothers are probably not what Congress had in mind when imposing these limits. As a result, the Lehman Debtors have been forced to file a relatively generic plan that leaves a lot of room for modification. Indeed, a press release issued March 15 suggests that Lehman is reserving its rights to consider such incendiary issues as substantive consolidation if it cannot garner sufficient creditor support for the plan and, in particular, the treatment of LBHI guarantees (see below).

The plan, while called a joint plan, is legally a separate plan with similar terms for each of the Debtors and it is not a condition that a plan be confirmed for every Debtor. The plan separately classifies secured and unsecured claims for each Debtor, and for those Debtors with unique unsecured classes (e.g., LBHI's senior and subordinated note issuances), additional separate classes are established.

The Lehman Debtors, like most debtors whose plan essentially provides for a liquidation of assets (in these cases, over a projected three-year period), have proposed that any executory contracts or unexpired leases that have not been assumed or that are not the subject of pending motions to assume or placed on a Plan Supplement for assumption purposes (which can be amended up to the confirmation date of the plan), will be deemed rejected on the effective date of the plan. There are strict deadlines for the filing of damage claims arising out of rejected contracts. If those contracts are derivatives, claimants will have to comply with the bar date procedures for derivatives, which would include completing online derivative and, if applicable, guarantee questionnaires.

LBHI will act as the administrator for each of the Debtors and is given broad powers set forth in Section 6.1 of the plan. The joint plan also notes that the Debtors have filed a motion to create a new company, LAMCO, to manage and dispose of Lehman assets over time.

After satisfying allowed administrative and priority claims in full on the effective date of the plan, each Debtor will make initial distributions from its "Available Cash" and will make subsequent distributions semi-annually on March 30 and September 30 of each year (subject to a $10 million aggregate minimum of Available Cash). The plan gives the administrator the right to withhold payment from claims that it intends to object to even though the objection has not yet been made and provides that objections to claims may be made as late as two years after the effective date (or even later with court approval).

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This is contrary to the general rule that a proof of claim is deemed allowed unless and until it is objected to. The administrator also will not make a payment in respect of a claim if any portion of the claim is subject to dispute—a provision designed to create negotiating leverage for the administrator in the claim objection process and one which creditors' committees often fight. Finally, no interest will be paid on disputed claims that are ultimately allowed, giving an economic advantage to creditors whose claims are allowed sooner rather than later.

One of the more controversial features of the joint plan is the treatment of guarantee claims against LBHI. The plan essentially caps the amount of allowed guarantee claims by LBHI with respect to each primary obligor. The overall cap for all LBHI guarantee classes is approximately $94.1B. Based on reported statements from Bryan Marsal, this figure seems to be tied into LBHI's view of its overall worldwide guarantee liability, although how the figure was derived is unclear. To illustrate how the cap mechanism would work, LBHI guarantee claims of Lehman Brothers Special Finance Inc. (LBSF) obligations are placed in their own class and are capped at approximately $15.8B. If it turned out, for example, that aggregate allowed guarantee claims against LBSF were $31.6B (twice the cap), every allowed LBHI guarantee claim of an LBSF obligation would only be allowed at 50% of its allowed face amount against LBSF for purposes of sharing in LBHI's Available Cash. Thus, a creditor with an allowed claim against LBSF of $20 million would only have an allowed guarantee claim against LBHI of $10 million. In the unlikely event that the joint plan overestimates the aggregate allowed guarantee claims (i.e., all allowed LBHI guarantee claims are less than the $94.1B total cap), the surplus would be shared among classes of LBHI guarantee claims where there was a shortfall, pro rata, based on the ratio of a class's particular shortfall to the aggregate amount of all guarantee class shortfalls.

In recognition that it could take years to resolve all of the LBHI guarantee claims, the advantage to this approach is that it allows LBHI to more easily reserve a maximum amount of Available Cash attributable to guarantee claims and begin to make payments in respect of other allowed, undisputed claims against LBHI (e.g., bond claims) without first resolving all or most of the guarantee claims. The disadvantage is that for creditors in guarantee classes where the cap is below the allowed amount of allowed guarantee claims in the class, those claims will get a smaller distribution than other unsecured claims against LBHI without any meaningful legal basis for the discriminatory treatment.

Also potentially controversial is a cap on LBHI guarantee claims of affiliates that are capped at approximately $21.2B. The plan proposes to negotiate with affiliates and make an allocation proposal within six months of the plan's effective date. If the affiliates vote to accept the allocation by plan-voting majorities (2/3 in amount and majority in number), all affiliates will be bound to the allocation. If not, the bankruptcy court will be asked to allocate the $21.2B. Like the treatment of guarantee claims of non-affiliates, this treatment results in a lesser payment to affiliates holding guarantee claims if the total allowed affiliate guarantees exceed $21.2B.

There are other potentially controversial provisions regarding allowance of intercompany claims whose allowance by a holder of such a claim is based on reciprocity by that holder as to all other Debtors or Debtor-Controlled Entities. This provision is presumably aimed at affiliates in foreign insolvency proceedings.

It is not clear how voting will occur in respect of the plan as the Debtors are in a relatively early stage of the claim review process. The Bankruptcy Rules provide that a claim is allowed for voting purposes in the amount filed unless objected to.

The Debtors have sought an extension to April 14 of their time to file a disclosure statement in respect of the joint plan, but will presumably want to keep the process moving to try to avoid the filing of competing plans. As exclusivity ends on May 17 for the Debtors that filed on September 15, 2008, it is doubtful that they will be able to confirm a plan by that date, but they will have a head start on anyone wishing to file a competing plan.

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