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Lehman Sues J.P. Morgan in Bankruptcy

Bankrupt investment bank Lehman Brothers has sued JPMorgan Chase & Co. alleging that J.P. Morgan illegally obtained billions of dollars from it in the days prior to their bankruptcy filing. J.P. Morgan was Lehman's one time 'clearing bank' or middleman between Lehman and its investors and creditors. This, according to Lehman, allowed J.P. Morgan to be privy to the financial condition of Lehman, especially when it continued to weaken. Lehman further alleged that J.P. Morgan's Chief Executive James Dimon and other top executives took advantage of this insider information to get Lehman to turn over $8.6 billion in collateral in September 2008, an act that significantly contributed to its lack of liquidity and its subsequent downfall.

Lehman's lawsuit goes on to allege that J.P. Morgan siphoned billions of dollars out of Lehman by demanding more collateral to cover its risks. This in turn ensured that J.P. Morgan would have the advantage over all other Lehman creditors, not just for its clearance exposure, but for all possible exposure that would have resulted from Lehman's bankruptcy.

On its part, Lehman felt the need to give in to J.P. Morgan's demands, fearing that should J.P. Morgan stop its clearing activities, it might have precipitated Lehman's immediate collapse.

Although the lawsuit did not come as a surprise to industry players, J.P. Morgan spokesman Joe Evangelisti described it as 'ill conceived and meritless' and said the company will vigorously challenge it.

In a recent report, a bankruptcy court examiner found that Lehman could pursue a legal claim against J.P. Morgan for making excessive collateral requests albeit not a very strong claim. In his report, the court examiner said that Lehman could recoup $6.9 billion of the $8.6 billion pledged to J.P. Morgan. At the same time, the court examiner chided Lehman for using certain accounting techniques to hide its leverage and deceive the market before it ultimately fell into bankruptcy. All the while, J.P. Morgan was among the only institutions to continue lending to Lehman before and after its bankruptcy.

Evangelisti used the bankruptcy court examiner's report to refute Lehman's allegations and claimed that it was due to Lehman's own poor decisions in taking on leverage and exposing itself to subprime mortgages that led to its eventual downfall and not any inappropriate use of confidential information on the part of any J.P. Morgan employee.

As it turned out, when Lehman could no longer get itself out of its downward spiral, the government declined to rescue it, forcing Lehman to file the largest bankruptcy in US history.