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Court refuses to modify $45 billion sale of Lehman assets to Barclays

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On February 22, 2011, Judge James M. Peck of the United States Bankruptcy Court for the Southern District of New York issued a decision declining to modify the September 20, 2008 Sale Order that approved the sale to Barclays PLC ("Barclays") of assets collectively comprising the bulk of the North American investment banking and capital markets business of Lehman Brothers Holdings Inc. ("LBHI"), Lehman Brothers Inc. ("LBI") and certain of their affiliates (together "Lehman"). Barclays paid $45 billion for Lehman securities valued at $49.7 billion in what the court described as "the largest, most expedited and probably the most dramatic asset sale that has ever occurred in bankruptcy history." Indeed, throughout the 103 page decision, the court repeatedly cited to the unprecedented circumstances of the sale, which occurred during the pinnacle week (dubbed "Lehman Week") of what the court aptly described as the greatest financial crisis of our lives.

The essence of the challenge by movants LBHI, the Official Committee of Unsecured Creditors (the "Committee"), and the Trustee of Lehman Brothers Inc. under the Securities Protection Act ("SIPA") (the "SIPA Trustee") (together, "Movants")—made pursuant to Federal Rule of Civil Procedure ("FRCP") 60(b), which provides multiple grounds upon which a court may relieve a party from final judgment—is that Barclays negotiated an alleged secret $5 billion discount in the final moments of the sale, which was not approved by the court, and did so primarily through a Clarification Letter filed with the court two days after the sale.

The Clarification Letter

The Clarification Letter was drafted to address several complications and list some of the assets moving over from Lehman to Barclays. At the time of the sale, the court was aware that the Clarification Letter was not final, but that the language of the letter would not materially modify the terms of the transaction approved by the Sale Order in a way that would adversely impact Lehman's bankruptcy estate. Two days after the sale, on September 22, 2008, the Clarification Letter was filed with the court but was never submitted for final court approval.

In the two and a half years prior to seeking modification of the Sale Order, which the court described as a "most unusual after the fact challenge to the fairness of a transaction of global significance, a transformative combination in the financial services industry that was accomplished at a time of fear and major dislocation in the markets," the parties very clearly relied on the Clarification Letter as a valid and binding part of the transaction. For example, in a joint submission with Barclays dated September 29, 2008, Movant LBHI described the letter as "clarifying the intention of the Parties with respect to certain provisions of the Purchase Agreement, amend[ing] the Purchase Agreement in certain respects, and . . . binding . . . the Parties." The SIPA Trustee cited and relied on the

Clarification Letter in a settlement motion and, just weeks before filing the Rule 60(b) motions, the SIPA Trustee stipulated that the Clarification Letter was part of the approved Purchase Agreement. As such, the court held that "[a]lthough the omission from the Sale hearing of any meaningful discussion of the Disputed Assets may have deviated from the core principles of disclosure underlying section 363 of the Bankruptcy Code, such a failure does not render the Clarification Letter unenforceable in this instance because the parties themselves have acted in reliance upon the Clarification Letter and have treated the document as enforceable."

The Backdrop to the Sale

In its decision, the court repeatedly cited to the unprecedented circumstances of the sale of Lehman's assets to Barclays and the harm that would have ensued had the sale not been consummated, describing the scene as "a war zone," "a catastrophic week," "organized chaos," "a bad situation" in which "coordination was difficult" and in which "everyone was sleep deprived and stressed out" during "marathon negotiating and drafting sessions." Indeed, using the term "fog of Lehman," the court recalled the "confusion, ambiguity and uncertainty" that prevailed during Lehman Week resulting from the enormity of the transaction and the impossible time constraints in completing it. As such, the court explained that everyone involved in the transaction—including the court—expected that there would be errors, omissions and miscommunications and that it would have been impossible to comprehend fully every aspect of the acquisition, including the fair market value of all of the assets being transferred, including those described in the Clarification Letter.

The Non-Disclosures Were Not Cause for Rule 60(b) Relief

While the court readily acknowledged that it did not possess "some very basic information regarding the transaction" during Lehman Week, it ultimately held that the failure to disclose that information was not cause for relief under Rule 60(b). While Rule 60(b) motions should be liberally construed when "substantial justice" will be served, they are properly granted only upon a showing of exceptional circumstances. In this case, the Movants relied on the following grounds: (1) mistake, inadvertence, or excusable neglect; (2) newly discovered evidence; (3) innocent or intentional misrepresentation or fraud . . . by an opposing party; and (4) fraud by any other party or fraud on the court.

As the court explained, those claims were all based on the allegation that certain crucial facts about the sale were not disclosed to the court. The court found, however, that the complained of non-disclosures did not affect the fairness of the sale hearing or its outcome and that there was a lack of any substantial evidence to support a finding that the Sale Order was procured by fraud, misrepresentation or wrongdoing of any kind.

The court relied heavily on the testimony of a Barclays' expert who testified that "the book value of the assets being acquired by Barclays was not understated . . . by a significant amount, particularly not by $5 billion, and that the book value according to Lehman's financial records was approximately $70 billion or less." Moreover, many of the assets being valued were illiquid, which would have made them difficult to value even under normal circumstances.

Reverting to the unprecedented circumstances of the sale, the court noted that while the disclosure problems were real, they were due to "the 'fog' of Lehman and the emergency of a magnitude unlike any that has ever occurred in any sale hearing" making the disclosure failures understandable and forgivable.

Moreover, as the court repeatedly made clear, the only options on the table were a sale to Barclays or liquidation, the latter not being a viable option as "the disintegration of the [Lehman] enterprise and the liquidation that would have occurred had there been no sale to Barclays would have resulted in far greater harm and losses in the financial

markets than actually were experienced in September 2008 and succeeding months of the financial crisis."

While the facts of the sale transaction itself are complex, the holding of this case is ultimately simple; the process was imperfect, but necessary to stave off a worsening of the already devastating financial crisis.

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