



## Recent Bankruptcy Court Decisions Affecting Counterparties to Open or Terminated Derivative Contracts With Lehman Brothers Entities

On September 17, 2009 Judge Peck of the United States Bankruptcy Court for the Southern District of New York issued two orders that may significantly impact parties who held, or still currently hold, derivative contracts with Lehman Brothers Special Financing Inc. (LBSF) or any of the other debtors in the Lehman Brothers bankruptcy cases (the Debtors). The first order (the ADR Order) approved alternative dispute resolution procedures (the Procedures) that will be used to resolve many of the disagreements that the Debtors have with derivative counterparties who may owe money to the Debtors upon termination of currently open derivative contracts and to obtain additional recoveries by the estate on derivative contracts that were previously terminated and had a termination payment paid to the estate. In the second order (the Metavante Order) the court found that the particular derivative counterparty in the matter addressed by the court could not ignore its contractual payment obligations to the Debtors and continue to preserve its termination rights. Each of these two orders is discussed more fully below.

### The ADR Order

By the ADR Order, Judge Peck approved the Procedures, making the Procedures available to the Debtors with respect to *both open and terminated* contracts as to which the Debtors believe monetary

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recoveries (or further monetary recoveries) are possible. The Debtors expect that the Procedures will ultimately provide a significant source of funds for the bankruptcy estate.

The Procedures involve two stages – the Notice/Response Stage and the Mediation Stage. The Notice/Response Stage is initiated when one of the Debtors issues notice (a Derivatives ADR Notice) to its counterparty or to an indenture trustee representing counterparties. This notice will contain a description of the Debtors' affirmative claim, including a brief explanation for the demand and the amount sought, and a demand for settlement, including the amount that the Debtors would accept in full settlement of the dispute.

A party receiving a Derivatives ADR Notice has 30 calendar days to respond (45 days for indenture trustees). Once the notice is received, the counterparty or indenture trustee's participation in the Procedures is mandatory. A response should either agree to settle the demand or deny the demand, including a brief explanation for such denial, and, if appropriate, a counteroffer. A counterparty's failure to provide timely response may result in either judgment in favor of the Debtors or immediate entry into the Mediation Stage. At any time during the Notice/Response Stage, either party may request an initial telephonic settlement conference. Any party not complying in good faith with the Procedures may be subject to sanctions as specified in the ADR Order.

Any dispute that is not resolved through the Notice/Response Stage proceeds to the Mediation Stage. The ADR Order appointed three mediators and specified that all mediation proceedings will take place in New York, unless the parties and the mediator otherwise agree. Parties involved in the Mediation Stage may serve mediation briefs on each other five days or more prior to the mediation date. Parties bear their own attorneys' fees and other costs of the Procedures, except that the mediators' costs are borne by the Debtors.

**Any party receiving a Derivatives ADR Notice from any of the Lehman Brothers Debtors would be well-advised to consult with counsel immediately.**

### **The Metavante Order**

In the Metavante Order, Judge Peck found that Metavante Corporation, a nondefaulting derivative counterparty who owed periodic swap payments to the

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Debtors, was required to either terminate its positions or continue to fulfill its contractual obligations, including by making required payments to the Debtors. In short, Metavante could not expect to benefit under its derivative contract once it had suspended performance.

Metavante is a Wisconsin-based financial-technology company that had entered into a fixed-to-floating interest rate swap agreement (the Agreement) with LBSF in 2007 to hedge variable rate debt. Under the Agreement, Metavante paid LBSF amounts based on a fixed rate, while LBSF paid Metavante amounts based on a floating rate. Either LBSF or Metavante was obligated to make a quarterly payment to the other, depending on the difference between the prevailing floating interest rates and the fixed rate.

After the Debtors (including LBSF) filed for chapter 11 bankruptcy protection in Fall 2008, prevailing rates fell to historic lows, so Metavante's regularly scheduled payment obligations, and the theoretical termination value of the swap payable by Metavante, increased significantly. Metavante stopped making payments to LBSF, relying on a section of the Agreement that provided that the bankruptcy constituted an event of default that excused its performance. Notably, Metavante did not exercise its right to terminate the Agreement upon occurrence of an event of default.

Eventually, the Debtors filed a motion to compel Metavante's performance under the Agreement with respect to the regularly scheduled payments, alleging that Metavante had failed to make more than US\$6.6 million in payments to LBSF. The Debtors argued, and the court agreed, that under the Bankruptcy Code, Metavante was obliged to either terminate the Agreement within a reasonably prompt period after the chapter 11 filing or continue to perform. The court reasoned that while terminating or accelerating a derivatives agreement after the chapter 11 filing may be permissible under the Bankruptcy Code's "safe harbor" provisions, which protect nondefaulting derivative contract counterparties, Metavante could not otherwise fail to perform without terminating its agreement with the LBSF.

We expect the Debtors to rely on the Metavante Order in actions against other, similarly situated counterparties. **We recommend that any parties who did not terminate derivatives contract positions with Lehman Brothers entities and who have suspended performance under derivatives contracts to contact counsel immediately to discuss the potential impact of the Metavante**

**Order.**

For further information, please contact one of the Squire Sanders lawyers listed in this alert.



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