

A landmark distribution: the single largest in a UK administration

Restructuring Trends



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An innovative and consensual approach to settle c\$9bn claims

We recently achieved a major landmark in the administration of LBIE with the distribution of c\$7.8bn to Trust counterparties – the single largest distribution out of a UK administration. Following a settlement agreement with LBI* we were faced with a complex situation where the recovery we were due to receive back as part of the settlement did not match our client's claims that had to be resolved. We developed and then implemented a highly innovative and consensual approach which achieved a 95% acceptance rate (by best claim value) and settled c\$9bn of claims of nearly 300 hedge funds. This represents one of the most significant and complex initiatives over the course of the entire administration.

Cross-border complexity

As the Lehman group's regulated broker-dealer in Europe, one of LBIE's major business areas was prime services, which involved LBIE acting as prime broker to institutional clients, mostly hedge funds. LBI acted as LBIE's primary clearing broker and custodian for LBIE's customers holding US securities.

The collapse of the Lehman group resulted in the insolvency of both LBIE and LBI. But whilst PwC administrators were appointed in the UK to LBIE on 15 September 2008, it was

not until 19 September 2008 that trustees were appointed to LBI in accordance with the Securities and Investor Protection Act 1970 ("SIPA") in the United States. The cross-border working of different regimes and objectives, and the complexity arising from the sheer volume of Lehman trades, presented significant challenges.

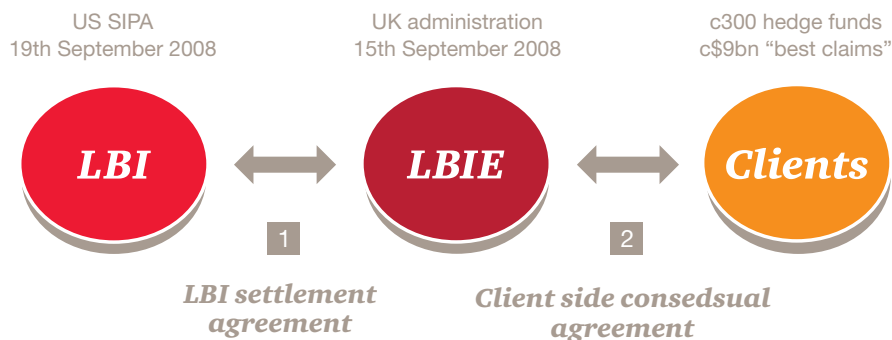
Settlement agreement with LBI

LBIE filed multiple claims against LBI and vice versa amounting to \$38bn, which were settled earlier this year. These included the settlement of an omnibus customer claim to recover customer property held by LBI, as a result of which LBIE received a pool of over \$9bn of cash and securities.

That settlement in its own right received a widespread favourable reception from the US and UK courts, as a model for commercial resolution of cross-border issues.

However, LBI did not record in its books and records whether client securities held in an omnibus client account were held for any particular customer of LBIE. A consequence of the settlement was that whilst significant value was protected, there was no legal precedent for delivering this to clients with unsecured and priority claims, because of a mismatch between the recoveries and the entitlements of clients.

Overview



Source: PwC

Definitions:

* LBI - Lehman Brothers Inc.

** LBIE - Lehman Brothers International (Europe) - In Administration

Consensual agreement with customers

There was significant legal uncertainty and complexity regarding LBIE's customers' basis for sharing in the pool. This reflected the unique interplay between UK administration and US SIPA procedures; non-coterminous appointment dates; diverse underlying contractual arrangements and customer jurisdictions; the mismatch between the securities claimed and the securities returned; and the variance in the relative performance of securities in the period since insolvency. Without a consensual solution, a protracted court process would have been likely, which could have led to disputes, lengthy delay and significant cost.

So we set about designing a solution to enable a more efficient and speedy distribution to customers. We developed a groundbreaking scheme in a consensual proposal to distribute in excess of \$9bn of cash and proceeds from the liquidation of securities to c300 hedge funds.

A cornerstone of our proposals was the allocation methodology. After evaluating numerous alternative approaches, we decided to allocate the pool relative to customers' "best claim". This meant for each customer the higher of their claim as at the SIPA date and at a recent date (representing current market value). Our approach also entailed the liquidation of securities received from LBI.

Having led counterparties through the process from conception to voting, we were delighted that our proposals achieved 95% acceptance (by customers' best claim), substantially exceeding the minimum threshold set for acceptance.

Distribution to customers

The overwhelming support for the proposals underscores the benefits of the consensual approach – founded on an attractive commercial and equitable resolution – allowing us to accelerate distributions to customers.

Following our orderly liquidation of in excess of \$5bn of securities received from LBI, omnibus Trust customers will receive in excess of 100% of their best claim. And so, on 26 September 2013, we made a first interim distribution of \$7.8bn in respect of the majority of eligible customers. A further distribution will be made next year once remaining tax and other reserves have been addressed. LBIE's unsecured creditors also benefited from this expedited resolution because \$2bn of these assets were appropriated from clients in settlement of their obligations to the "House" estate.

The \$7.8bn distribution is in addition to the £13.7bn of Trust assets returned bringing the total return to date to £18bn.

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"LBIE was faced with liquidating \$4.5bn across 3,500 securities in the midst of the tapering debate. Speed of execution, tight control of information and, in fixed income securities, creating pricing tension were key drivers to success. Inside four days we had successfully sold over 90% of our portfolio by value."

Billy Radicopoulous, LBIE Managing Director

The depth and complexity of the relationships between LBI, LBIE and its underlying customers, the different insolvency regimes and the sheer size of the claims presented a highly complex set of circumstances. The settlement agreement with LBI and the consensual agreement with customers have been defining milestones in the administration.

This initiative demonstrates how a scheme or consensual approach can be used to drive change. The innovative solution provides a precedent for using a consensual approach to help clients resolve claims management problems where they face high-value, high-volume claims and legal uncertainty or complexity.

Our experience also illustrates the value of living wills. Consideration of the potential issues that arise in the event of the untangling of complex, cross-border organisations could help the development of business models that avoid some of those issues arising in the first place.