

March 24, 2015

A Second Home Run? Post-Petition Interest Claims Against Certain Lehman Entities May Be a Multiple of the Underlying Derivative Claims' Face Amount

Creditors with allowed claims against Lehman Brothers OTC Derivatives Inc. ("LOTC") and Lehman Brothers Commercial Corporation ("LBCC") have already recovered 100 cents on the dollar on account of their claims due to a surplus at those estates. That surplus also entitles claimants to post-petition interest ("PPI") *at potentially a multiple of their original claims* so long as creditors demand PPI before the newly established bar date of April 24, 2015 (the "PPI Bar Date") and such claim is allowed.

However, creditors must be vigilant. In certain instances, Lehman Brothers Holdings Inc. ("LBHI") (plan administrator of LBCC and LOTC) has argued that creditors waived their right to PPI in their termination and settlement agreements and/or that a much lower PPI rate applies based on its reading of default provisions contained in the ISDA Master Agreement. The strength of LBHI's objections remains uncertain.

Many of these same PPI claim issues are being litigated in the U.K. by LBHI's affiliate Lehman Brothers International (Europe) ("LBIE") in a proceeding known as "Waterfall II," which could have precedential value in determining the value of PPI claims against LOTC and LBCC here in the U.S.

This alert describes what claimholders should do to preserve and maximize their rights, including a description of the potential objections to PPI claims, the interest rate claimants should seek to assert, the PPI Bar Date process, and the nature of the issues involved in the Waterfall II proceeding.

Did I Really Release My Right to Collect PPI?

In connection with a recent declaratory judgment adversary proceeding brought by a group of hedge funds, LBHI challenged certain holders' rights to receive any PPI because, it argued, such rights were waived by the language contained in those parties' respective termination and settlement agreements. While the parties ultimately settled and LBHI purchased the underlying claims (at an undisclosed amount) as part of the settlement, LBHI may object to other holders' claims on similar grounds. Creditors should carefully review their termination and settlement agreements and be prepared to address those issues if they arise.

How Much Post-Petition Interest Can I Claim?

The method of calculating PPI under an ISDA Master Agreement is a major unresolved issue. The ISDA Master Agreement provides that when a party has defaulted, the non-defaulting party is entitled to interest "for the period from (and including) the original due date for payment to (but excluding) the date of actual payment, at the Default Rate." The Default Rate is the "rate per annum equal to the cost (without proof or evidence of any actual cost) to the relevant payee (as certified by it) if it were to fund or of funding the relevant amount plus 1% per annum." Such interest is to be compounded daily until the date of payment.

Where a claim has been traded by the original counterparty, LBHI has taken the position that the "relevant payee" for purposes of determining the cost of funding is the original counterparty's cost of funding, which tends to be lower

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than the cost of funding of current payees, such as distressed debt hedge funds. Not surprisingly, numerous claimholders (assignees) have taken the position that the applicable cost of funding should be the current assignee's cost of funding. Claimants should carefully consider this "relevant payee" issue and take appropriate steps to preserve their rights to secure the higher interest rate.

PPI Claim Process

Holders of PPI claims must complete an online questionnaire and upload certain backup documentation discussed below. Any claimant who fails to file a PPI claim by the April 24, 2015 PPI Bar Date, will be forever barred from asserting such claims. [Click here for a copy of the PPI Bar Date order.](#)

The PPI Bar Date order requires claimants to provide: (i) the amount of PPI sought; (ii) the method of calculation and the source of the interest rate used in the calculation; (iii) the Default Rate based on both its own cost of funding *and* the original counterparty's cost of funding; and (iv) any documentation supporting the foregoing.

With respect to the documentation required to establish post-petition interest, in addition to providing copies of the underlying contract(s) (i.e., an executed ISDA Master Agreement), a holder should provide a certification of its cost of funding and, if it is an assignee of the original counterparty, the original counterparty's cost of funding at the time of termination.

Where the assignor's cost of funding is unavailable, the assignee must provide a certification setting forth the efforts it made to procure such information or explaining why confidentiality issues preclude the assignee from disclosing such information.

Several hedge funds objected to the proposed scope and language of the proposed PPI Bar Date order, arguing that LBHI was attempting to require claimants to provide more information than is actually necessary under the ISDA Master Agreement to establish the default interest rate. Judge Chapman rejected these arguments and provided in the PPI Bar Date order that the order does not enhance or prejudice any substantive rights of the claimants under their agreements. Such issues will be addressed as part of the PPI claim reconciliation process.

In order to preserve and maximize their rights to PPI, claimants must immediately begin working to obtain all information and documentation required in order to submit a demand before the PPI Bar Date.

Reverberations from Across the Pond? LBIE Tackles Same Issues in the U.K.

While domestic creditors tackle PPI issues here in the U.S., similar issues are being litigated in the United Kingdom by the administrators of LBIE as part of the recent Waterfall II application to the High Court of Justice of England and Wales. [You can read updates on the Waterfall II proceeding by clicking here.](#) LBIE has paid all of its allowed creditors in full and is potentially holding a surplus of over £7 million (GBP).

The Waterfall II application seeks the guidance of the High Court in connection with some of the same issues relevant to PPI claimholders in the U.S., including (i) how default interest claims under ISDA Master Agreements are to be quantified; (ii) the identity of the "relevant payee" under the ISDA Master Agreement; and (iii) the impact of releases in certain agreements known as CRAs and CDDs (similar to termination and settlement agreements) on ISDA Master Agreement-based and statute-based PPI claims.

As part of the Waterfall II application, while not taking a formal position, LBIE advances certain arguments for the proposition that the "relevant payee," for the purpose of determining default rate under the ISDA Master Agreement, is the original counterparty, not an assignee. LBIE maintains, however, based on the language and context of the CRA and CDD agreements, that the CDDs did not waive contract-based PPI claims whereas the CRAs did. These

issues are expected to go to trial sometime in the fall. The outcome of these and other issues regarding Waterfall II will not only affect the recoveries of LBIE claimholders, including by potentially causing holders of subordinated claims against LBIE to be "out of the money," but also may have some precedential value in determining the allowability of PPI claims against LOTC and LBCC in the U.S.

Next Steps

We are closely monitoring all of the above issues. Holders of derivative and other claims against LOTC and LBCC who fail to take certain actions to preserve and maximize their PPI claims risk forgoing such claims or potentially failing to achieve the highest possible recovery.

Please contact any one of the parties below with questions about the PPI Bar Date, its requirements, analysis of your termination and settlement agreement, certification of cost of funding, the status of LBIE's Waterfall II litigation, or for help in filing a PPI claim.

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If you have any questions or need additional information about this alert, please feel free to contact the authors below or any one of your Kramer Levin attorney contacts:

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This memorandum provides general information on legal issues and developments of interest to our clients and friends. It is not intended to provide legal advice. Readers should seek specific legal advice before taking any action with respect to the matters we discuss here. Should you have any questions or wish to discuss any of the issues raised in this memorandum, please call your Kramer Levin contact.

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