

CLIENT UPDATE

LEHMAN ALTERNATIVE DISPUTE RESOLUTION PROCEDURES: A PATH TO SWAP MONETIZATION?



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On September 17, 2009 the United States Bankruptcy Court overseeing the Lehman Brothers bankruptcy proceedings entered an order (the "Order") establishing alternative dispute resolution ("ADR") procedures for certain derivative contracts. The Order affects counterparties who have interest rate swaps or other derivative transactions with Lehman entities and who either have not made all required payments or have "purportedly terminated" their agreements. Counterparties who have performed in accordance with their existing obligations or who have consensually terminated their swaps are not subject to the Order.

The purpose of the Order is to promote "consensual recovery" with respect to what are referred to as Derivatives Contracts with Recovery Potential¹, and to encourage effective communication between the parties. In order to achieve these purposes, the Order contains the following procedures:

NOTICE/RESPONSE STAGE

The Order provides for a notice/response period during which the parties will have an opportunity to exchange settlement offers, schedule settlement meetings/discussions and, if possible, resolve any disputes on a consensual basis. During this period, Lehman is required to serve a Notice containing sufficient information to make the Counterparty aware of the general nature of Lehman's claim. This Notice (a "Derivatives ADR Notice") must provide a brief explanation of the basis for the claim and the amount being sought. The Notice is to set forth the specific amount Lehman would accept in full settlement and compromise. The Order provides a form of the Notice.

A Derivatives Counterparty is *required* to respond to the Notice in writing, within 30 calendar days from receipt of the Notice. In its Response, the Derivatives

Counterparty may agree to settle on the terms set forth in the Notice. Any acceptance must be in writing. Following an acceptance, the parties will execute a settlement and general release agreement. If the parties are involved in litigation, all claims will be dismissed upon execution of the release.

Alternatively, a Derivatives Counterparty may decline to settle for the amount sought, in which case it must include a brief explanation in its Response. A Derivatives Counterparty may provide a counteroffer in its Response. The Order provides a form for denials and counteroffers.

Derivatives Counterparties who fail to respond to Derivatives ADR Notices in a timely manner may be subject to sanctions from the Court, including an order or judgment for recovery of the amount sought by Lehman, or immediate entry into mediation (the "Mediation Stage").

Lehman has fifteen (15) days from receipt of a Derivatives Counterparty's Response to serve a Reply to the Response. In its Reply, Lehman is to: (1) modify its demand, (2) respond to any counteroffer, (3) provide additional information in support of its prior demand, or (4) reject any counteroffer. If the counteroffer is rejected, the dispute proceeds to the Mediation Stage.

At any time during the Notice/Response Stage, Lehman or a Counterparty may make a written request for a telephone settlement conference within 10 calendar days. Within 4 business days of a receipt of a request, the other party must respond by acceptance of one of the proposed dates and times or by a proposal for an initial settlement call no later than 5 calendar days from the earliest date set forth in the request. If the parties cannot agree on a mutually acceptable date, the matter immediately proceeds to the Mediation Stage.

¹ The Order contains certain defined terms which are used herein.

The parties are to reserve at least one hour for the initial conference to discuss settlement. No mediator or representative of the Court will participate in these discussions. The initial conference call, together with any further calls or meetings, are covered by Rule 408 of the Federal Rules of Evidence and analogous state evidentiary provisions², and the confidentiality provisions of the Order apply to the call(s) as if a mediator were present. If the parties agree, settlement conferences during the Notice/Response Stage can be held in person.

MEDIATION STAGE

The Order provides that Derivatives ADR Disputes which are not resolved through the Notice/Response Stage must proceed to mediation. Lehman is required to transmit sets of Derivatives ADR Notices and any applicable Response(s) and Replies to the appointed mediators for the purpose of allocating specific mediations.

The Order provides the mediators with the broadest possible discretion consistent with the Court's Standing Order relating to bankruptcy mediations, including: (1) the manner of allocating among themselves specific mediations; and (2) the ability to consolidate mediations involving the same Derivatives Counterparty. Once a specific mediator has been selected, the parties are required to contact the mediator to schedule the initial mediation. All mediation proceedings will take place in New York City unless otherwise agreed to by the parties and the mediator.

Any party may submit a Mediation Brief, which must be forwarded to the other party and filed with the mediator and the Creditors' Committee. In addition, the mediator may order that the parties prepare Mediation Briefs, which must be served, filed and received no later than five (5) calendar days prior to the scheduled Mediation.

Unless otherwise ordered by the mediator all participants in a mediation are to appear in person with a business principal who has settlement authority; *provided, however*, that, to the extent acceptable to the mediator, the business principal with

settlement authority on behalf of a Counterparty may attend a mediation by video conference at the expense of the Counterparty. The Creditors' Committee may attend and participate in all mediations. Counsel to the parties may also be present and participate within mediation. The mediation shall end upon request of a party and concurrence by the mediator.

GENERAL PROVISIONS

The procedural deadlines summarized above may be modified by: (1) the mutual consent of the parties, or (2) the Bankruptcy Court, for cause shown.

Each party must participate in good faith with the Derivatives ADR Procedures. If a mediator reports to the Court that any party is not cooperating in good faith with the Procedures, the Court may, without the need for further motion by any party, schedule a hearing and order Sanctions. If, after notice and a hearing, the Court determines that a party has not complied with the Procedures in good faith, that party may be subject to such sanctions as the Court deems appropriate. Litigation with respect to the issuance of Sanctions shall not delay the commencement of the Mediation Stage following completion of the Notice/Response Stage.

CONCLUSION

With ADR procedures having been adopted and approved by the Court, parties who are subject to the procedures may soon be in receipt of Notices from Lehman requiring a response. Unless otherwise provided in a specific order, compliance with the prescribed ADR procedures is *mandatory*. While no party is required to settle or compromise, every party to a dispute must serve the required responses, engage in the specified settlement communications and discussions, participate in any mediation in good faith, follow directions of the mediator, and otherwise comply with the procedures. It is thus critical that Derivatives Counterparties be aware of the Order's requirements, both as a potential means of resolving their disputes and in order to avoid being subject to sanctions.

If you have any additional questions regarding this Update or have any other Public Finance needs, please contact any member of the Public Finance Law Group.

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² The purpose of these provisions is to ensure that comments made by the parties - including demands, offers and statements as to possible liability - will not be admissible in a subsequent judicial proceeding.