



Implications of the Lehman Bankruptcy Entities on Multi-Lender Financings

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As you know, Lehman Brothers Holdings Inc. (“Lehman”) has filed for Chapter 11 in the Eastern District of New York. This is the largest bankruptcy filing in U.S. history and has understandably caused concern among the real estate lending community, as the filing will affect many firms and many transactions. While the case has just commenced and will likely play out over a substantial period of time, the Lehman filing has raised a number of important questions among our clients. These questions include:

- In syndicated financings with unfunded obligations, will Lehman be obligated to fund its share?
- What is the impact of the Lehman bankruptcy on transactions in which they are the administrative agent?
- In Senior/Subordinate or A/B financing structures, will the subordination provisions in Co-Lender or Intercreditor Agreements be enforced in bankruptcy?
- Will the other provisions in a standard syndicated Loan Agreement or Intercreditor or Co-Lender Agreement be enforceable in bankruptcy?
- Will restrictions on transfer of Lehman’s interest in a financing be enforceable in the bankruptcy?
- Who must other Lenders deal with (how will decisions be made) where Lehman is a Co-Lender in a transaction?

Initially, it should be noted that the only entities that are debtors in the bankruptcy case in the United States so far are Lehman Brothers Holdings Inc. and LB745 LLC (the owner of Lehman’s headquarters in New York City), although four UK Lehman entities, including Lehman Brothers International (Europe), were placed into administration in the UK. Consequently, for the time being, parties to contracts with Lehman subsidiaries and affiliates that are not in bankruptcy or administration, should proceed, although cautiously, with “business as usual.” However, as the cases progress and decisions are made with respect to which assets of Lehman are saleable and which are not, additional Lehman subsidiaries will likely file.

Future Funding Obligations

For parties that do find themselves dealing with Lehman, or a Lehman subsidiary in bankruptcy (collectively, “Lehman Debtor Entity”), as a co-lender, there are a few important things to remember. Neither the borrower nor a co-lender can compel a co-lender to lend under a pending lending agreement (such as a revolving credit facility). Where a loan obligation is pending, the bankrupt co-lender can simply refuse to comply with its lending obligations, and both the borrower and the other co-lenders are left with a breach of contract claim against the bankrupt co-lender. While the bankruptcy case does not generally give the Lehman Debtor Entity more rights against you, it does impair your ability to enforce contract rights against the Lehman Debtor Entity. Syndicated loan agreements, co-lender agreements, intercreditor agreements and similar agreements may provide some additional protections, such as a provision that subordinates the amounts owed to a “defaulting lender” to the amounts owed to non-defaulting lenders. These agreements need to be carefully analyzed to understand the extent of your rights as a co-lender against the Lehman Debtor Entity.

Additionally, it should be noted that a bankrupt co-lender’s refusal to lend does not necessarily excuse the obligation of the non-bankrupt loan participants to make future advances. Again, the rights of the co-lenders in this situation are determined by the language of the loan documents, which are often heavily negotiated.

Lehman as Administrative Agent

An agreement by Lehman or a Lehman Debtor Entity to serve as administrative agent or servicer for a financing (and collect agency or servicing fees) is an executory contract—a contract where material obligations remain due on both sides. The Bankruptcy Code gives a debtor broad power to assume such a contract, reject it (i.e., intentionally breach and walk away from it), or assign it to another party. The decision to take any of these options is largely up to the bankruptcy debtor and need only reflect sound business judgment—i.e., is the contract a profitable one worth keeping? While we would normally expect that a Lehman Debtor Entity would want to retain its role as agent or servicer (and collect its fees thereunder), that could change if the Lehman Debtor Entity disposes of its interest as co-lender. In that scenario, it might seek to assume and assign its agency function to make its debt position more marketable. Should the Lehman Debtor Entity fail to perform its obligations under the agency-related agreements pending its decision, the parties for whom Lehman is the agent would be required to ask the bankruptcy court to force a decision.

Subordination Provisions

Subordination agreements and subordination provisions in co-lender or intercreditor agreements, at least to the extent that they deal with payment subordination (as opposed to subordination of remedies), are enforceable against a bankrupt co-lender.

Other Co-Lender or Intercreditor Provisions

In most fully funded, non-revolving loans, funding of the loan constitutes substantial performance of the agreement and thus it is not executory. As a result, the provisions of the intercreditor or co-lender agreement would be enforceable against the Lehman Debtor Entity. However, whether an intercreditor or co-lender agreement is executory is a fact-specific analysis and must be determined on a case-by-case basis.

Transfer Restrictions

Syndicated loan agreements and intercreditor agreements frequently impose restrictions on the ability of co-lenders to transfer their portions of the loan. A Lehman Debtor Entity may well seek to avoid these restrictions to give itself a wider range of potential buyers for its debt assets. We would note that, while results may vary depending on the exact nature of the loan and the specific restriction, the Bankruptcy Code and the bankruptcy courts tend to provide debtors with significant protection to sell assets and generally look unfavorably at transfer restrictions.

Who Makes Decisions

Currently, Lehman is operating as a debtor-in-possession. That is, no bankruptcy trustee has been appointed or sought by any creditors. Consequently, Lehman's management can continue to administer its day-to-day affairs. However, the exact scope of Lehman's authority, beyond normal ordinary course transactions, will be determined by the bankruptcy court. For example, assets of a bankrupt Lehman entity cannot be sold without bankruptcy court approval unless done pursuant to an approved reorganization plan. If you are in a transaction that has not closed with Lehman or one of its subsidiaries, you must determine whether Lehman or the subsidiary has the authority to close the transaction. This analysis must be done even with non-bankrupt Lehman entities, as they might require capital or authorization from a bankrupt Lehman entity.

For Additional Information

Katten Muchin Rosenman LLP's Distressed Property Group includes attorneys from our national Real Estate, Litigation and Dispute Resolution, Bankruptcy and Creditors' Rights and Tax Planning practices and has extensive experience with distressed property litigation, bankruptcies and various transactional matters. In addition, our Bankruptcy and Creditors' Rights Practice has been engaged on behalf of creditors and debtors in real estate-related bankruptcies and state court insolvency proceedings, and routinely represents bidders for and purchasers of assets that are subject to such proceedings.

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