

A DECADE AFTER LEHMAN, JUDGE RECALLS PURE PANIC ON LAWYERS' FACES

In a Q&A with The Deal, former judge James Peck says the sale hearing of the investment bank on Sept. 19, 2008, is still 'probably the most dramatic and tense bankruptcy court hearing in history.'

BY STEPHANIE GLEASON

It's been nearly 10 years since Lehman Brothers Holdings Inc. collapsed into bankruptcy, triggered a global financial crisis and showed up in Judge James Peck's New York courtroom.

To commemorate the key anniversary, The Deal took a trip down memory lane with Peck, who left the bench in 2014 and now is global co-chairman of the restructuring practice at Morrison & Foerster LLP.

Lehman's liquidation plan, meanwhile, took effect in March 2012, with billions of dollars in creditor claims, not to mention fees, paid out over the ensuing years. Judge Shelley C. Chapman of the Manhattan bankruptcy court now presides over the case, which bears little resemblance to what roiled the markets in 2008.

Peck recalled his most memorable moment from the proceedings (the phrase "death spiral" is involved), whether he has any regrets about the case (none!) and who the hero was of the story (Harvey Miller of Weil, Gotshal & Manges LLP, of course). We hope you enjoy what follows, which has been edited for context and clarity.

The Deal: How did you find out that Lehman Brothers had filed for bankruptcy and that you'd been assigned the case?

James Peck: Those were two different events. I learned that Lehman had filed for bankruptcy on the morning of Sept. 15 when I picked up my morning newspaper and saw it on the front page of The New York Times. I arrived at the bankruptcy court later that morning for a previously scheduled meeting, and I learned directly from the clerk of the court, Kathleen Farrell-Willoughby, that Lehman was mine.

That must have been overwhelming.

I didn't feel overwhelmed as much as uncertain as to what I was getting into. I think the full dimensions of the Lehman bankruptcy didn't become clear until later. And, in fact, that first day, nothing happened in the case, at least from my

perspective. That first day, Sept. 15, did not involve any judicial action at all. What was the most memorable part of the case for you?

Even to this day, the most significant event in the case was the emergency 363 sale hearing that took place at the end of the first week on Sept. 19. That was probably the most dramatic and tense bankruptcy court hearing in history.

I still remember, rather vividly, having what was really the best seat in the courtroom, that the courtroom was packed and it was extremely hot, not only because of the time of year but because of the density of human beings that were in the room. I would say it was the closest to pure panic I have ever seen on the faces of so many distinguished lawyers.

My particular memory takes me to testimony of Barry Ridings, who was a witness called by Lehman Brothers when evidence was being put on. Barry at the time was head of Lazard [Ltd.]'s restructuring practice and testified about the importance of a sale. He said that unless the sale was approved right there and then, the world economy would essentially go into a death spiral. Those aren't the exact words he used, that's my recollection of the significance of what he said.

It seems like it would be hard to say no when presented with a motion like that.

There was no other realistic alternative for Lehman. The [sale] was manifestly needed, and I had no hesitation in approving it. Although getting to that point required a fair amount of management of a very chaotic scene.

Are there any decisions you would change now, with the benefit of hindsight?

This may demonstrate my own lack of self-reflection, but I've never looked back and wanted to change any decisions, and I don't expect I ever will. The job of a judge is to decide based on the facts and the law. The system itself self-corrects and allows parties to seek appellate relief. I'm satisfied with everything I did. I have no regrets.

What did the Lehman Brothers case teach you personally?

I learned a lot about the derivatives industry, and how it functioned, and the safe harbors. Many of my decisions were kind of groundbreaking when it came to dealing with how derivatives should be treated in a bankruptcy setting, either under Chapter 11 or the Securities Investor Protection Act. [Lehman's brokerage unit, Lehman Brothers Inc., entered a SIPA liquidation proceeding a few days later.]

But I'm going to consider your question to be more about me. And as I look back on it, I think that I demonstrated a capacity to deal with a crisis that I never imagined I'd be personally confronting in my career. It's hard to be completely objective about this, but I think I managed it rather well. It was definitely an unexpected event that curiously became routine for me.

What, more broadly, are the lessons of Lehman Brothers?

One takeaway for me is that certain institutions aren't just too big to fail but too complex to understand and effectively manage, and so failure is sometimes a surprise—even to those who are managing the business.

Another takeaway is that institutions like Lehman Brothers are global and interconnected. They represent a systemic risk unlike the failure of other kinds of enterprises. Whether it's too big to fail or too interconnected to permit to fail, I think there are some institutions that can't effectively go through the standard insolvency regime of their home country and need to be resolved in a cooperative way that is respectful of the impact those institutions have on the global economy.

For those institutions, is Chapter 11 the best way to deal with them?

I thought Chapter 11 worked remarkably well for Lehman Brothers, given the circumstances. It didn't necessarily work well as a model for what might happen next.

I think that the Lehman bankruptcy can't be viewed purely from the perspective of the United States: it is a global insolvency event that involved proceedings filed in multiple jurisdictions, and those various separate bankruptcies did not have a structure to work within. There was no supreme court of the world to resolve disputes among those courts.

Part of what made the Lehman bankruptcy such a remarkable event in the history of insolvency law is that the one enterprise, fragmented by the bankruptcy, ended up in proceedings where the former Lehman affiliates became adverse to one another. I believe that those looking back on this very consequential result of the failure determined, We can't let that happen again. There is a need for what has been termed "single point of entry" or "orderly liquidation authority" approach to dealing with a systemically important institution of the sort that Lehman was. But that's untested.

There was nothing about Chapter 11 itself that caused the damage. The damage was caused by the lack of planning and a global emergency created by the fact

that this institution collapsed suddenly without coordination in multiple parts of the world all at the same time. When you think about it, it's amazing the resulting crisis wasn't worse.

Is too big to fail still a problem for our economy?

We haven't yet changed human nature, we haven't altered the incentives of the global economy, and we haven't yet found a global solution to the failure of systemic institutions. So yes, I think we do still have the problem. I have no doubt that too big to fail is a problem today.

Financial institutions are bigger than they were 10 years ago, and the political environment is even more hostile to bailouts now. It is foreseeable, I believe, that at some point in the future a major institution will suffer some material adverse consequence -- be it from sabotage, from cyberattack, from sources we can't begin to fully imagine.

I also don't see something now that's the equivalent of subprime affecting the balance sheets of so many banks. But there could be another problem—we are imperfect beings, and we make mistakes, sometimes colossal ones.

Are the judges sitting there now likely to have another Lehman Brothers-type case?

I actually don't see at the moment anything that's on the horizon, nor can I easily imagine it. I also think that history is not going to be repeating itself. I do think that at some point there's going to be another financial crisis. What I don't know is whether that financial crisis will implicate the U.S. Bankruptcy Code or whether it will be managed by regulators working across borders.

You think it's more likely it will be managed by regulators?

I do. I do, because I think it's very difficult to put any federal judge in the position of having to decide something on a moment's notice that involves the transfer of assets from one institution to another. And I have some questions in my own mind as to whether judicial oversight is the right route for addressing the failure of financial institutions.

I think the likelihood of a successful outcome is greater if experts are dealing with the issues. Regulators are expert, central banks are expert in dealing with financial institutions. Bankruptcy courts are not necessarily expert at that.

Do you have any final thoughts about the Lehman Brothers case?

One thing I would say is that if there was a bankruptcy hero for this period of time, it was [debtor counsel] Harvey Miller. And I believe that it made a difference that the case was handled by someone with Harvey's stature and capacity to command the respect of so many people. And I have a strong sense that if Lehman had ended up with any other bankruptcy professional, it might have had the same outcome, but we might have been more worried about the process that we went through. Harvey had a very strong and capable hand, and I'm glad he had the case.