

**BANKRUPTCY JUDGE**

The World After Lehman

He presided over the biggest bankruptcy in U.S. history - Lehman Brothers. Now a legal consultant, Judge James Peck tells Handelsblatt that you never know where the next financial crisis might come from.

BY MICHAEL BRÄCHER

James Peck was never afraid of big cases. But he knew the one that landed on his desk in New York in September 2008 was different. Investment bank Lehman Brothers had filed for bankruptcy, making it the biggest company to do so in U.S. history. More than \$600 billion in debts were being demanded back by creditors across the globe. The world looked like it was about to go under.

Judge Peck, who had only gotten the job as a bankruptcy judge in 2006, wound up working on the case for more than five years, pulling together a plan that would see creditors get back about \$80 billion of their money. Since 2014, he has been working for the international law firm Morrison & Foerster.

Judge Peck, why did Lehman have to fall?

James Peck: I'm not sure if it had to fall. I was not involved in the decision about the filing. I dealt with the consequences. And my impression is that Lehman's failure was particularly dramatic because it wasn't fully anticipated. And because it was not anticipated, very little planning had been made for the bankruptcy. It was very disorderly because it was so abrupt.

WHY IT MATTERS

Judge James Peck offers a unique view of how the 2008 financial crisis unfolded and warns that, while we are better prepared today, you can never be fully equipped to deal with the consequences.

FACTS

Lehman Brothers became the biggest bankruptcy in U.S. history in 2008. The matter still hasn't been fully laid to rest.

James Peck was randomly assigned the Lehman case. He worked on it for five years.

The collapse of the bank had reverberations across the world and contributed to the global financial crisis.

Lehman's failure was the starting point of a worldwide financial crisis. Some people say it should have been avoided. That Lehman should have been bailed out.

Had Lehman been bailed out, there would not have been a failure. And if there hadn't been a failure, what would the world look like today? I don't know.

But you must have thought about it.

Oh, I have.

And what do you think?

Maybe we'd be at greater risk today if Lehman had not failed. Allowing Lehman to fail - and the consequences of that failure - led to a more robust set of procedures to protect the stability of the financial system today. In a way, the Lehman failure may have been the best thing.

So we are better prepared - as long as we assume that the next "Lehman"- event looks like the last one. But what if systemic risk looms in a corner in which we are not expecting it?

The problem with planning for the future is that it is based upon the past. I think that today's risks to the financial system are unrelated to the derivatives market that may have contributed to Lehman's failure. They are also probably unrelated to issues of capital adequacy, because greater steps have been taken to increase core capital in major financial institutions.

What might be the biggest danger to financial stability today?

Who knows? It might be cyber-terrorism - just to pick something out of the news. Private customer information is stolen every day. Terrorists could attempt to mess up the banking system. There are undoubted risks. Some of them are imaginary, some of them are real, and some of them have not been imagined yet.



JAMES PECK

The judge oversaw the collapse of Lehman Brothers in 2008. In 2014 he joined law firm, Morrison & Foerster, as co-chair of its global Business Restructuring & Insolvency Group.

Source: Dick Duane/
Handelsblatt

Would you say that the financial system is more stable today?

I think that we are better prepared for the consequences of the financial failure of a major institution than we were in 2007/2008. There is an appreciation that you can't allow a failure like Lehman's in which all the affiliates all over the world went into separate proceedings. We have recognized that is important for the operating company affiliates to remain in business and to be well-capitalized. We also have a so-called Single Point of Entry-Resolution (SPE).

How does it work?

It assumes that there is loss absorption capacity within the capital structure of the enterprise. And if these losses can be absorbed - ideally by creditors and not by the taxpayer - you can preserve the integrity of the business. This is like shock absorbers on a car: The road can be rough, but the passengers aren't going to be jugged. Hopefully it works. It just isn't tested yet.

Meanwhile, the Lehman case is still not closed.

That's true. But the major issues have been resolved. The "Plan of Reorganization" was confirmed in December 2011. There have been seven interim distributions to creditors. Tens of billions of dollars have been distributed, and more are to come.

Will the case ever come to an end?

It will take a number of years, mainly because of litigation claims. They will take some time to unravel.

Are you waiting for that day to come?

I am not the judge anymore. But let me put it this way: I hope I'm alive when it is over.

You were randomly assigned with the Lehman case. Did you immediately grasp the significance?

I knew it was huge. But at the time while I recognized how big it was, I didn't recognize just how big it was: Even today, I'm still learning things about what Lehman meant to the world economy. It's an ever-unfolding story.

What was it like to be part of that story?

It's hard to describe. I think that the most dramatic part was my decision to approve the transaction between Lehman and Barclays Capital.

Barclays wanted to acquire the core business of Lehman for \$1.35 billion. You had to approve that transaction.

I remember every moment of it. The meeting started at 4 o'clock in the afternoon and ended at about quarter to 2 o'clock in the morning. There were lots of objections. I had some of the best lawyers in the world in my courtroom. The issues were unsettled, and very important.

Everybody could tell this was a momentous hearing. The outcome was significant not only to the creditors of Lehman but to the broader world economy. I had a sense of awesome responsibility. And I have never forgotten that. In the end I approved the transaction.

With hindsight, would you have decided differently?

No. I'm perfectly comfortable with my decisions. I know that some of them - like the Barclays transaction - were unpopular. But being a judge is not about being popular. It's about making a decision at the time that you are confronted with the problem, confronted with the facts that you were presented with at the time. And then moving on. I never looked back. Except to reflect on how awesome the experience was, sitting where I was sitting, at a time when the world appeared to be coming to an end.

Stocks are approaching new all-time-heights, Wall Street's banks are reporting enormous earnings, their CEOs are receiving enormous bonuses. Is history repeating itself?

I take no position on the earnings of Wall Street banks, and I am not antagonistic to compensation. But I am antagonistic to the lack of accountability for failures of oversight. The reforms since the Lehman failure are designed, among other things, to heighten the awareness of managers, boards of directors and senior level employees of financial institutions with respect to unbridled risk. Are all the procedures in place that we need? I doubt it. Will we ever have all the procedures in place? I doubt it.

If someone had asked you at the time whether you wanted to take the Lehman case, would you have accepted it?

I would have said: Absolutely. Even knowing what I know now, I would say the same.

Judge Peck, thank you very much for the interview.

Video: Lehman's bankruptcy judge describes his philosophy at an event on the fifth anniversary of the investment bank's collapse.

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