

**SUMMARY OF LEHMAN'S PROPOSED PROCEDURES FOR THE
SETTLEMENT OR ASSUMPTION AND ASSIGNMENT OF PREPETITION
DERIVATIVE CONTRACTS**

On November 13, 2008, the attorneys for Lehman Brothers Holdings Inc. and its affiliated debtors (the "Debtors") in the chapter 11 cases filed a motion in the United States Bankruptcy Court for the Southern District of New York entitled Notice of Debtors' Motion for an Order Pursuant to Sections 105 and 365 of the Bankruptcy Code to Establish Procedures for the Settlement or Assumption and Assignment of Prepetition Derivative Contracts (the "Motion").

In the Motion, the Debtors specify their proposal for the treatment of derivative contracts¹ that have not yet been terminated by counterparties. By the Motion, the Debtors are requesting an order from the Bankruptcy Court granting the Debtors permission to deal with each such derivative contract in accordance with the Debtors' proposed procedures without having to seek court approval each time the Debtors take an action with respect to a derivative contract.

The Debtors state that they "are party to approximately 930,000 derivative contract transactions, of which approximately 733,000 are purported to have been terminated."

In connection with derivative contracts that have not yet been terminated, the goal of the Debtors is to assume and assign some or all of the "in the money" derivative contracts (i.e., those that would result in a net payment to the Debtors) to third parties in exchange for cash payments. The proposed procedure for assuming and assigning these contracts includes delivery of a notice to each contract counterparty providing (i) five business days' notice to the counterparty of the assumption of the counterparty's derivative contract and the assignment of such contract to a third party, (ii) a statement regarding whether the assignee is a Qualified Assignee² (in which case the Motion does not appear to provide the counterparty with a right to object to such assignee)³ or, if such assignee is not a Qualified Assignee, the identity of the assignee and

¹ The Debtors generally define derivative contracts as contracts "in which the contractual obligations and values are keyed to one or more underlying assets or indices of asset values and subject to movements in the financial markets," which include "securities contracts," "forward contracts," "repurchase agreements," or "swap agreements" and which in some cases are governed by "master netting agreements," as each term is defined in the Bankruptcy Code. In addition, the Debtors state that certain derivative contracts were entered into pursuant to master agreements such as an ISDA Master Agreement.

² The Debtors would limit assignees to "Qualified Assignees," which are entities that have a long-term unsecured rating of A-, A- or A3 from Standard & Poor's, Fitch or Moody's Investors Services, respectively, or whose credit support provider has such a rating. Unless the Debtors solicit bids from at least four (4) potential assignees, they will be required to obtain Creditors' Committee consent to assume and assign a derivative contract pursuant to the proposed procedures.

³ There does not appear to be any requirement for the Debtors to provide advance notice of the identity of a Qualified Assignee nor any requirement that the Qualified Assignee be located in the United States. In addition, to the extent that a derivative contract did not provide for bilateral credit support, counterparties could be left with unsatisfactory credit exposure to a Qualified Assignee.

(iii) any amounts proposed by the Debtors to be paid to cure existing defaults under the contract (“Cure Amounts”). A counterparty will be deemed to have received adequate assurance of future performance from the Debtors’ proposed assignee, notwithstanding any consent right in the derivative contract regarding the identity of the assignee, if either (a) the assignee or its credit support provider is a Qualified Assignee or (b) the Debtors, after payment of any Cure Amounts, would no longer have any payment or delivery obligations under the derivative contract (other than upon exercise of an option exercisable in the Debtors’/assignee’s discretion). With respect to derivative contracts that might require the return of posted collateral as part of a Cure Amount, the Debtors will either return such collateral to the counterparty or pay an amount equal to its value, and the Debtors’ proposed manner of returning such collateral will be set forth in the notice delivered to the counterparty.

The counterparty will have five business days after the date of service of the notice to object to such assignment on the grounds of (i) the proposed Cure Amount, (ii) the need to cure a default or termination event other than an event related to the commencement of the case under the Bankruptcy Code or (iii) in cases in which the assignee is not a Qualified Assignee, the sufficiency of the adequate assurance of future performance. Grounds for objection do not include the identity of the Qualified Assignee. Objections would ultimately be resolved in the Bankruptcy Court. Should the counterparty not file a timely objection, it will be deemed to have consented to the Cure Amount and to the assignment of its derivative contracts to the proposed assignee. After the objection deadline, the counterparty will be precluded from claiming (a) a failure of adequate assurance of future performance from the assignee and (b) that any defaults under the contract have not been cured, and shall be deemed to have waived any right to terminate the derivative contract or designate an early termination date under such contract as a result of any default that occurred and/or was continuing prior to the assignment date. Any setoff rights against the Debtors by the counterparty with respect to the derivative contract will be lost as part of the assignment to the third party.

In any instance in which a derivative contract is memorialized pursuant to a master agreement, in accordance with the proposed procedures, the Debtors propose that they may assume and assign all, but not fewer than all, of the derivative contract transactions entered into pursuant to the master agreement.

In respect of all derivative contracts (whether terminated or not), the Debtors are generally looking for permission to enter into and consummate termination agreements with counterparties that resolve and fix the amounts owing between the Debtors and the applicable counterparty, provide for application of collateral and release the parties from future obligations.

Finally (although the following is not part of the order being sought by the Debtors), the Debtors state in their Motion that, in connection with derivative contracts that purport to have been terminated, the Debtors reserve all rights to (i) dispute such alleged terminations and (ii) argue that any particular derivative contract at issue does not constitute a derivative contract subject to the “safe harbor” provisions of the Bankruptcy Code (pursuant to which parties to certain types of financial contracts are entitled to exercise certain contractual rights to terminate and/or accelerate obligations thereunder, notwithstanding a debtor’s bankruptcy filing). The Debtors also state in their Motion that they reserve their rights to contest any calculation of market value

and application of any remedies (such as rights of setoff or liquidation of collateral) to which the counterparty may have previously availed itself.

The hearing on the Motion is set for December 3, 2008. Any objections to the proposed procedure for assuming and assigning derivative contracts that the Debtors are looking to authorize, including objections to the definition of “Qualified Assignee” set forth in such procedure, must be filed by November 28, 2008.

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This memorandum was prepared by Marc Abrams, Michael Kelly, Thomas French and Jack Habert. The Task Force (which includes UK insolvency professionals from our strategic ally, Dickson Minto W.S., and attorneys from our European offices) was formed to respond to client questions and provide targeted advice in connection with the proposed government bailout and the credit crisis (including the Lehman Brothers Holdings Inc. bankruptcy). If you have any questions about this memorandum, please contact any of the members of the WF&G Government Rescue and Credit Crisis Task Force listed below or the attorney with whom you regularly work.

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