National Litigation Consultants' Review

Information, guidance, and resources from the nation's leading financial forensics experts

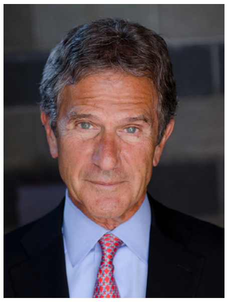
VOLUME 3, 2013

The Lehman Examination - A Team Effort

By Anton R. Valukas and Robert L. Byman

Summary: The Lehman bankruptcy remains the largest bankruptcy ever, exceeding the value of the next five largest combined; its filing set off a financial crisis from which we have yet to fully emerge. The court appointed an examiner, tasked to answer a broad range of questions about cause and effect. The examiner's report, filed 14 months after appointment, was 2,200 pages, plus 2,000 pages of appendices. The judge who commissioned the report described it as "one of the most extraordinary pieces of work product I have ever encountered." The press reaction was the same. Business Week, for example, described the report as the "single most penetrating document we have on the recent misbehavior on Wall Street." The excellence of the report was the result of extraordinary collaboration between the lawyers and the financial consultants.

Anton R. Valukas



Robert L. Byman

Anton R. Valukas and *Robert L. Byman* are partners at Jenner & Block LLC. Mr. Valukas, chairman of the firm and a former United States Attorney, was appointed as examiner in the Lehman Bankruptcy; Mr. Byman served as Mr. Valukas' lead counsel and chief of staff in the examination.

In January 2008, Lehman Brothers, one of the largest and most storied investment banking houses, reported record revenues of nearly $60 billion and record earnings of over $4 billion for its fiscal year ending November 30, 2007. Its stock traded in the low $60s. A scant eight months later, on Friday, September 12, 2008, Lehman's stock closed under $4, having lost nearly 95 percent of its value. Lehman's bankruptcy, filed the following Monday, was the largest in US history—with scheduled assets of $691 billion, it was larger than the next five—Enron, General Motors, WorldCom, Washington Mutual, and CIT—combined. The Lehman bankruptcy set off a global economic calamity, as the Dow Jones plunged 504 points the day of the filing.

On January 20, 2009, Judge James M. Peck appointed an examiner to serve as a court-appointed fact finder. Judge Peck directed the examiner to address 10 areas, ranging from granular detail, such as whether and to what extent any of Lehman's myriad subsidiaries had administrative claims against the parent holding company (LBHI) resulting from sweep transactions in the days and hours before the bankruptcy filing; to general issues, such as whether colorable claims existed against officers and directors for Lehman's demise; to the overall, big picture, such as (to paraphrase), "How on earth did this happen?"

As vast as the scope of the assignment was, the universe of potential materials available to bear on those questions was gargantuan. Lehman had more than 25,000 employees at the time of its bankruptcy filing; its electronically stored documents alone were estimated at three petabytes, the equivalent of 350,000,000,000 pages, which, if printed and stacked, would create a pile 21 miles high. And that was just Lehman. More than 1,600 parties filed appearances in the Lehman bankruptcy, and each was a potential source of documents and witnesses.

The examiner used careful search terms to cull the most promising documents from the universe, ultimately reviewing 34 million pages of documents. The examiner carefully identified the people who were central to the issues, ultimately interviewing more than 250 individuals.

Although the court set no deadline, the examiner self-imposed a February 2010 date to file his report, so that it would be relevant and useful to plans of reorganization anticipated to be offered by the debtors and other parties several months later. The report, initially filed under seal on February 10, 2010, was in nine volumes—2,209 pages of text, approximately 2,000 pages of appendices, with more than 8,200 footnotes and citations to more than 3,500 documents. Judge Peck pronounced the report "the most outstanding piece of work product ever produced by an examiner."[1]

There is an old joke about a stranger who stops a local in a rural backwater to ask "Can you tell me the best way to get to the capital?" The local contemplates a bit and says, "Well, I wouldn't start from here." The Order of Appointment told the examiner where he needed to go, but where was he to start?

The answer, of course, was to assemble a team. Not simply a legal team, which eventually consisted of nearly 50 full-time lawyers, dozens of others who performed spot assignments, and over 70 contract attorneys focused on document review, but also consultants on a wide array of topics. Critically, this horde of consultants and lawyers needed to integrate into a single team.

Some consulting needs were known early on; other needs revealed themselves as the work unfolded. Clear from the start was the need for valuation experts to opine on whether Lehman's valuations of its individual assets were appropriate. Those opinions would be on a wide range of both real and derivative assets: equities, bonds, futures, options, real estate, mortgage-backed and asset-backed securities, collateralized debt obligations, swaps, and virtually every type of asset from the mundane to the exotic.

It was clear from the start that the team should include accounting experts, both forensic and traditional. Solvency experts were required. Clear as these needs were, it was obvious that the full extent of required expertise would only be known as the investigation unfolded. As it turned out, the team needed expertise in additional areas, including clearing bank procedures, Federal Reserve facilities, generally accepted audit standards, and regulatory regimens.

It was one team, but perhaps it is more accurate to call the overall structure a "league," comprised of a multitude of teams of lawyers and consultants, with the examiner as league commissioner, overseeing the individual substantive teams. There the metaphor breaks down—unlike a sports league, there was no competition among these teams—there was a single common goal and the team structure was just that—structure to make the work more efficient. The legal team organized as five sub-teams—Team One handled coordination of the other four teams, each of which was assigned specific substantive subjects of the investigation. The consulting firm's lead consultant was assigned to Team One and individual consultants, with specific expertise, were assigned to each of the four substantive teams.

The overall effort required that neither the lawyers nor the consultants lapse into a silo mentality. The teams needed full and constant communication to avoid repetition or redundancy. Throughout the 14-month investigation, team leaders met weekly to discuss progress and goals, so that every team, every consultant knew what the other teams were doing, how everyone's work fit into the big picture.Teams shared hot documents immediately with all team leaders. As interviews were conducted, flash summaries were circulated to all teams within 24 hours so that key information was immediately available to inform ongoing interviews. Full summaries were circulated in due course to ensure that a record was maintained.

It was in the interview process that the team organization proved so critical. For example, three of the most critical witnesses were the three individuals who had served as Lehman's CFO in the two years leading up to the bankruptcy: Chris O'Meara, Erin Callen, and Ian Lowitt. Every substantive team and every consultant had questions for these three (as they did for most other witnesses). But the witnesses and their counsel were not about to sit for multiple interviews; nor would it have been efficient to do so. So Team One, acting as the coordinator of the substantive teams, assumed responsibility for those interviews. Each substantive team submitted their questions in advance to the single lawyer assigned to conduct all three interviews. The lawyer drafted an interview outline and circulated it to the teams so that nothing was forgotten. The interviews went forward with a single consultant sitting in to represent the collective views of the consulting team. The use of a single interviewer and consultant for three witnesses with a common background made for the most efficient way to harvest their recollections.

But there was no one-size-fits-all; a completely different approach was taken with Lehman's auditor. Again, every team, every consultant, had questions for the auditor. But Lehman's auditor, as an entity, was actually a collection of many individuals. Separate interviews of separate persons was bound to lead to multiple and likely inconsistent answers to the same question. So the examiner proposed, and Lehman's auditor agreed to, an unusual protocol that got to the ultimate facts in the most efficient possible way. Rather than separately interview each of the individuals who were central to the audit relationship, and rather than assign the interviewing to a single interviewer or team, the examiner proposed to Lehman's auditor that there be a tag team of questioners and that the answers be given by committee in separate sessions divided by subject matter. Here is how it worked: specific topic areas and related documents were identified and provided well in advance to Lehman's auditor so that the examiner could select the best persons to conduct interviews on those particular subjects, and so that Lehman's auditor could designate individuals who could amass the auditor's collective knowledge on those subjects. Substantive areas were divided into separate sessions. For each session, Lehman's auditor identified two to five representatives who collectively possessed knowledge on those particular topics. Questions were addressed to the assembled individuals, not to any one individual. Someone would answer, sometimes to the nods of the others, sometimes with others chiming in with additional facts or corrections. Using Lehman's auditor's collective, consensus answer was always provided. Over the course of four sessions, four different lawyers and four different consultants took the lead on particular topics to address questions to four or five different individuals, depending upon the subjects and required expertise for the scheduled topics. This team approach got to the end result in a fraction of the time that traditional one-on-one interviews would have taken, with a far clearer record devoid of inconsistencies among different witnesses.

The consultants were integral to the entire process. The consultants did not simply assist in the investigation; they provided education to the legal team. The consultants put together tutorials on certain areas of expertise so that the lawyers would have a better understanding of complicated financial subjects, such as derivative instruments, Statement on Financial Accounting Standards 157 valuations, and the mechanics of repo transactions. And true to their word to candidly admit when some bit of needed expertise exceeded their in-house resources, from time to time, the consultants would direct the examiner to others or bring in outside consultants.

The value of these tutorials went beyond internal education—they helped fulfill the examiner's mandate that directed him to cooperate with governmental agencies. When the government learned about the examiner's commission of these tutorials, they asked—and the examiner, of course, agreed—to have the tutorials repeated for the government lawyers to assist them with their own investigations.

The report was well received both in substance and in the way it was written. Judge Peck said, "It reads like a best seller. And it's so well organized that that it's actually useful." The *American Lawyer* said that the "…examiner…and his team of…litigators produced a…feat of research and writing." The report read well, in a single voice, because its final edits were carefully reviewed and edited by the examiner himself and lead counsel to ensure consistent style. But the initial drafts—the substance of the report—had many authors. Sometimes the lawyers would do the initial draft of a particular section; sometimes the consultants would do so.

The Lehman bankruptcy was a unique event; the examination was perhaps even more so. But history need not repeat itself for this useful truism to emerge: good things happen when lawyers and consultants work closely together as a team.

Endnotes:

1. The details and methodology used by the examiner are set out throughout the 4,200 pages of the report and appendices and are far too diverse and complex to summarize in this article. The reader with such an interest can find those details in the report, available online at http://jenner.com/lehman/.