UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
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In re:

LEHMAN BROTHERS SECURITIES AND ERISA LITIGATION

This document applies to:

09 MD 2017 (LAK)

In re Lehman Brothers Equity/Debt Securities Litigation, 08 Civ. 5523 (LAK)
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MEMORANDUM AND ORDER

As Kenny Rogers taught at least one generation with his hit song, *The Gambler,* in both life and in poker

> "You got to know when to hold 'em, know when to fold 'em,
> Know when to walk away and know when to run."

His advice applies also to litigation – you "got to know when to hold 'em" by pressing on with a lawsuit, "know when to fold 'em" by taking the best settlement you think you can get, and know "when to walk away" by dropping an unpromising case.

Each of us makes his or her own decisions about when to "hold 'em," when to "fold 'em," and when to "walk away" both in life and in poker. The same is true of most litigation in the sense that the client, with the advice of counsel, makes the decision. But there is an important qualification in class action litigation – the named plaintiffs and the lawyers for the class do not have the same right to make those decisions. No class action can be settled without the Court approving the settlement as fair, reasonable, and adequate for the simple reason that most of those affected – the members of the class – are not materially involved in the litigation and are largely uninformed. The Court thus acts as a surrogate for the absent class members, and it is obliged to be properly informed before approving a class action settlement.

This is a class action brought on behalf of persons who purchased or otherwise acquired securities of Lehman Brothers Holdings, Inc. ("Lehman") under the Securities Act of 1933[1] and the Securities Exchange Act of 1934.[2] As Lehman is in bankruptcy, the defendants include, among others, underwriters of Lehman securities and former officers and directors of Lehman.[3]

Plaintiffs' Lead Counsel have presented to the Court for approval two proposed settlements. The first, with almost all of the underwriter defendants, already has been approved and will involve the payment to the class and its counsel of $426.2 million. The second, with the officers and directors (the "D&O Settlement"), if approved, would be in the amount of $90 million. The entire $90 million, it is proposed, would come from insurance previously purchased by Lehman. The former directors and officers, despite the fact that each of them, if the settlement were approved, would pay nothing, yet would be released from all claims that were or might have been asserted against them in this action.

The Court held a fairness hearing with respect to these proposed settlements on April 12, 2012. It then made clear that it felt the information available to it with respect to the proposed D&O Settlement was insufficient in a number of respects, including the lack of substantial information regarding the ability of the directors and officers to satisfy a judgment in this case in

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1 15 U.S.C. §§ 77a *et seq.*

2 15 U.S.C. §§ 78a *et seq.*

3 The director defendants are Michael L. Ainslie, John F. Akers, Roger S. Berlind, Thomas H. Cruikshank, Marsha Johnson Evans, Sir Christopher Gent, Roland A. Hernandez, Henry Kaufman, and John D. Macomber. The officer defendants are Richard S. Fuld, Christopher M. O'Meara, Joseph M. Gregory, Erin Callan, and Ian Lowitt. The director and officer defendants collectively are hereinafter referred to as the "individual defendants."

the event the plaintiffs did not settle with them and ultimately prevailed.

At the Court's urging, Lead Counsel has made a further submission which has answered some of the Court's questions.[4] Although the Court is grateful for counsel's efforts, key information still has not been disclosed.

The Proposed Settlement

It is important to begin with some basic facts about the proposed D&O Settlement and the means by which it was reached.

The individual defendants began the litigation with $250 million in insurance coverage. That coverage eroded quickly as a result of defense costs in this and other cases. By the end of 2010, the remaining coverage was down to $180 million. Moreover, there were and remain many claims, actual and potential, against that fund in addition to this case.

Counsel and a respected mediator engaged in lengthy and difficult settlement negotiations over a protracted period. According to the mediator, the insurance carrier consistently took the position that it would contribute in this case only to a settlement that resolved all the claims against all the individual defendants. Counsel for the individual defendants consistently took the position that they would not contribute anything toward a settlement of this case, other than what was provided by Lehman's insurance. Moreover, they were adamant that the specifics of the individual defendants' personal financial information remain confidential and not be disclosed directly to the Lead Plaintiffs or Lead Counsel.

Lead Counsel nevertheless candidly admit that they "were conscious of the fact that

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[4] *See* DI 888; DI 889.

there would be a potential public hue and cry about the officers of Lehman Brothers getting off the hook without paying any money."[5] So they sought to head off such a controversy.

They engaged a highly respected former judge of this Court, Honorable John S. Martin, Jr., for the purpose of determining:

> "whether the Officer Defendants' combined *liquid* (including non-liquid assets which are easily converted to cash or the equivalent) net worth, exclusive of primary residences and pensions, exceeds $100 million."[6]

This charge subsequently was modified somewhat to clarify that the phrase "non-liquid assets which are easily converted to cash or the equivalent" was intended to include non-cash assets such as marketable securities that are easily converted into cash and did not "include other hard assets that are often difficult to value and whose value can shift dramatically over time" such as "art, antiques, vacation homes, illiquid limited partnership interests and the like."[7]

With assistance of a forensic accounting firm, Judge Martin had the five officer defendants (Ms. Callan and Messrs. Fuld, Gregory, Lowitt, and O'Meara) complete net worth questionnaires that required them to disclose to Judge Martin – notwithstanding the exclusive focus of his assignment with respect to liquid assets – secondary residences and other real estate holdings, retirement accounts, aircraft, watercraft, hedge funds, artwork, jewelry, and other holdings.[8] Judge Martin was provided also with financial transaction records and explanations of individual financial

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5 Tr., Apr. 12, 2012, at 32:17-20.

6 Berger Decl. [DI 889] Ex. D (emphasis added).

7 *Id.* Ex. G, at 2.

8 *Id.* Ex. F, at 1-2.

transactions in instances in which he sought such explanations.[9] It thus appears that Judge Martin and the accounting firm he retained were provided with extensive information concerning the complete financial positions of the five officer defendants – information that went far beyond whether their combined liquid net worth was more or less than $100 million.

Judge Martin was faithful to his charge, which reflected the competing interests of the Lead Plaintiffs and the officer defendants. He answered precisely the question that had been put to him, stating "I am satisfied that the Liquid Worth of the Officer Defendants taken together, is substantially less than $100 million."[10] Based on the question put to him, he quite properly did not address any holdings disclosed to him by the officer defendants that did not fall within the definition of "liquid net worth" that was laid out in the terms of his engagement.

The Difficulty

The argument for approval of the D&O Settlement is very straightforward, a variation on the old axiom that "a bird in the hand is worth two in the bush." There is $90 million of insurance money on the table. If the settlement were not approved, that $90 million likely would erode rapidly through payment of defense costs in this and other cases as well as settlements and judgments in other matters. It could be consumed entirely. Once it is gone, the directors and officers would be thrown back on their own resources, whatever they are, to defend themselves, buy peace, and/or pay judgments. Other material litigation risks would lie ahead if the class were to proceed to judgment. It ultimately may recover nothing on its claims against the individual

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9 *Id.* Ex. A, ¶ 23.

10 *Id.* Ex. G, at 3.

defendants. So the best course, Lead Counsel argues, is to take the $90 million – this despite the fact that Lead Counsel estimates the potential liability of the officers and directors if plaintiffs prevail at "many billions of dollars."[11]

Lead Counsel are able and distinguished. Their judgment may prove to be within the range of reasonableness despite the modest amount of the settlement when considered against these defendants' potential exposure. But the very limited mission they crafted for Judge Martin – that is, to confine their knowledge and that of the Court to the question whether the officer defendants' aggregate *liquid* net worth is less than $100 million while excluding any consideration of possible recovery from other forms of assets – does not permit the Court fully to consider the factors pertinent to approving or rejecting the settlement.

The standard governing this Court's consideration of any proposed class action settlement includes consideration of the following factors:

> "(1) the complexity, expense and likely duration of the litigation, (2) the reaction of the class to the settlement, (3) the stage of the proceedings and the amount of discovery completed, (4) the risks of establishing liability, (5) the risks of establishing damages, (6) the risks of maintaining the class action through the trial, *(7) the ability of the defendants to withstand a greater judgment,* (8) the range of reasonableness of the settlement fund in light of the best possible recovery, [and] *(9) the range of reasonableness of the settlement fund to a possible recovery in light of all the attendant risks of litigation."*[12]

In other words, the decision to accept or reject a proposed class action settlement always includes a comparison of the proposed settlement to the alternatives. Without knowing whether and to what extent these defendants could withstand a judgment in excess of the insurance money now on the

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11 DI 804, at 20.

12 *Detroit v. Grinnell Corp.,* 495 F.2d 448, 463 (2d Cir. 1974) (citations omitted) (emphasis added).

table, the Court would be severely handicapped in coming to an informed view on the question before it.

Were it difficult, costly, or time consuming to obtain that information, it might be reasonable to recognize that perfect information rarely is available and to make the best judgment reasonably possible in its absence.[13] But that is not the situation here with respect to the officer defendants.[14] The bargain that Lead Counsel and the officer defendants struck resulted in the assembly of critical information as to the ability of those defendants to withstand a judgment in excess of available insurance proceeds and the range of reasonableness of the settlement as compared to a possible recovery, discounted for the risks of litigation. At the same time, however, the formulation of the question answered by Judge Martin was such that his answer – no doubt well considered and correct – is not as informative as is necessary and appropriate for this Court now to properly consider all of the *Grinnell* factors. While it is entirely understandable that the officer defendants would not wish to share personal financial information with the Lead Plaintiffs and Lead Counsel, there is no sound reason why the information that already has been provided to Judge Martin should not be provided to the Court *in camera*. Moreover, that would involve no material delay or expense to anyone.

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See In re Auction Houses Antitrust Litig., No. 00 Civ. 0648 (LAK), 2001 WL 170792, at *6 (S.D.N.Y. Feb. 22, 2001) ("[S]ettlement court must assess . . . fairness . . . in a practical way on the basis of reasonably available information.")

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The Court recognizes that it lacks this information also with respect to the director defendants. In view of the exhaustive report of the examiner in the Lehman bankruptcy and this Court's own conclusion that the complaint here adequately pleads *scienter* on the part of all of the officer defendants, *In re Lehman Bros. Secur. & ERISA Lit.,* 799 F. Supp.2d 258, 294-98 (S.D.N.Y. 2011), it appears that the likelihood of recovery against the officer defendants is higher than that against the director defendants.

Conclusion

For the foregoing reasons, defendants Callan, Fuld, Gregory, Lowitt, and O'Meara shall file under seal for *in camera* review all documents, affidavits, questionnaires and other materials provided to Honorable John S. Martin, Jr. or his associates and accountants in connection with this matter. As the material already has been provided to Judge Martin, it shall be filed pursuant to this order no later than May 10, 2012 absent an extension by the Court for good cause shown.

SO ORDERED.

Dated: May 3, 2012

Lewis A. Kaplan
United States District Judge