



Bear Stearns: Ch. 11 never an option

by Matt Miller and John Blakeley Posted 03:24 EST, 17, Mar 2008

As **Bear Stearns Cos.** went into its death spiral last week, fiduciary duties forced bank directors and lawyers to at least map out the possibility of bankruptcy. Such a filing, however, would have been disastrous for the bank, its investors, its creditors and the marketplace, a wide range of bankruptcy experts believe.

Little would have been gained. Just about everything could have been lost.

"A bankruptcy is exactly what the Fed was trying to avoid," said Anders Maxwell, a managing director at New York investment banking firm **Peter J. Solomon Co.**

A bankruptcy made no sense for the company, either. Most critically, a broker dealer such as Bear Stearns cannot avail of the advantages of a Chapter 11, but is forced under existing laws to file for Chapter 7 liquidation, which means a quick winding down of the dealer's portfolios, according to Jeff Marwill, a Chicago-based restructuring partner at **Winston & Strawn LLP**. That liquidation is handled not by a typical bankruptcy trustee, but by a trustee appointed by the Securities Investor Protection Corp.

See also:

- [**Report: Bear's No.2 shareholder seeks to block sale**](#)
- [**Bear Stearns Merchant Banking reportedly weighing options**](#)
- [**Fed's open window likely to draw regulatory scrutiny**](#)
- [**Editor-in-Chief Robert Teitelman assesses J.P. Morgan/Bear Stearns deal**](#)
- [**East Side holdings is first to sue Bear Stearns**](#)
- [**What now for Bear Stearns' PE, VC affiliates?**](#)
- [**Bear Stearns Bump: How markets are treating other institutions**](#)
- [**For Bear Stearns, Ritchie bankruptcy filing is worth watching**](#)

"There is no such thing as a Chapter 11 for a securities and commodities broker," said Barbra Parlin, a New York-based partner at law firm **Holland & Knight LLP**. "A Chapter 11 bankruptcy doesn't help these types of entities in the same way it does other businesses."

What's more, under existing regulations, there is no stay for counterparty trades in a bankruptcy. Certain positions can be unwound even in bankruptcy. Those parties with profitable positions could demand payment, while those showing losses could have just sat back and let the company be liquidated.

So, Bear Stearns would gain no breather. It would be forced to honor its trades. The run on the bank could have continued. What's more, other brokerages could have come under unrelenting pressure as well. "I don't know why bankruptcy would be in anyone's best interest, even shareholders," said Maxwell. "You'd have a completely dysfunctional global economy."

Some shareholders argue that \$2 a share undervalues Bear Stearns assets. Lawsuits will almost certainly follow, arguing breach of fiduciary duty. However, a Chapter 7 bankruptcy liquidation would almost certainly have wiped out equity completely. The proposed takeover by **J.P. Morgan Chase & Co.** through the Federal Reserve, by contrast, guarantees creditors will recover 100 cents on the dollar.

The takeover "was a gift from God," said Laura Davis Jones, a Wilmington-based partner at restructuring specialist **Pachulski Stang Ziehl & Jones**.

To be sure, some Bear Stearns' operations could have filed for Chapter 11 and avail of the benefits of a voluntary filing, including acceptance and rejection of leases and stays of lawsuits. Those operations could have included Bear Stearns' investment bank and, most likely, some, if not all, of its real estate holdings. However, those are minor parts of the Bear Stearns empire. "About 90-plus percent of everything Bear Stearns does" wouldn't be eligible for Chapter 11, one bankruptcy lawyer estimates.

The vast bulk of the firm is its prime brokerage. That comes under Sec. 109(d) of the code, which simply states a securities or commodities broker, while eligible for Chapter 7, can't file for Chapter 11. This law came into effect in

Bear Stearns: Ch. 11 never an option.

1984, specifically as a reaction to the failure of a brokerage house called Lombard-Wall Inc. Lombard-Wall had filed for Chapter 11 in 1982, leaving not only clients, but counterparties out in the cold. "It brought the market to a standstill," Parlin said.

There have been some attempts to either circumvent the law or work around it. Drexel Burnham Lambert, for example, sold its brokerage operations and then filed for Chapter 11, Parlin relates. More recently, Refco Inc. filed for Chapter 11 on Oct. 17, 2005. While it had a huge registered commodity brokerage business, it also held an offshore vehicle that "did everything," according to a lawyer involved in the case, and should be allowed to use Chapter 11. The judge disagreed. Robert Drain, of the U.S. Bankruptcy Court for the Southern District of New York, ruled that if you engage in securities, you are a stock broker. "Refco lost and securities customers prevailed," the lawyer said.

Refco's brokerage assets were put into Chapter 7 on Nov. 25, 2005, while the other assets remained in Chapter 11.

The notion of a court-supervised timeout for Bear Stearns may, in theory, have been a good one, say bankruptcy experts. Unfortunately for the now-fallen brokerage firm, no legal mechanism allows such a breather.

"If anyone had been able to say 'stop' and give Bear more time," it could have survived, said the lawyer involved in Refco. But Bear Stearns just wasn't eligible for Chapter 11, he added.