

# Lehman Bankruptcy Court Holds Contractual Right to Triangular Setoff Unenforceable In Bankruptcy and Not Protected by Safe Harbors

October 11, 2011 | Client Update

In a recent decision issued in the Lehman Brothers Inc. SIPA proceeding in the Southern District of New York, *In re Lehman Brothers Inc.*, Case No. 08-01420 (JMP) (SIPA), slip op. (Bankr. S.D.N.Y. Oct. 4, 2011), Bankruptcy Judge James M. Peck held that a contractual right to effect a cross-affiliate setoff is unenforceable in bankruptcy. The court found that mutuality is a requirement for both common law and contractual setoff under Section 553 of the Bankruptcy Code, and that the contract did not create mutuality for purposes of Section 553. The court further held that the safe harbor provisions for swaps and other derivatives contracts in the Bankruptcy Code do not permit a party to exercise a contractual right to setoff where there is no mutuality.

While the ruling is consistent with the seminal case *Chevron Products Co. v. SemCrude, L.P.* (*In re SemCrude, L.P.*), 428 B.R. 590 (D. Del. 2010) and earlier decisions in the Lehman case that have stressed the requirement of strict “mutuality” for setoff in bankruptcy as well as a narrow reading of the safe harbors (such as *Swedbank AB v. Lehman Brothers Holdings Inc.* (*In re Lehman Brothers Holdings Inc.*), 445 B.R. 130 (S.D.N.Y. 2011)), this decision is significant in that it addresses the interplay between the safe harbors and the enforceability of cross-affiliate setoff or netting provisions.

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