P.R.I.M.E. Finance
Panel of Recognized International Market Experts in Finance
Valuing Derivatives in Close-out

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New York Law of Contract Damages

- 3 Interests: restitution; reliance; expectation
- Will give effect to contract – but not always
- Let’s be reasonable
  - Antipathy to abuse of power: e.g., implied covenant of good faith and fair dealing; duty to mitigate
Evolution of a Standard Form Agreement
“The ISDA”

• ISDA 1985 Code – Choice of: Agreement Value, Indemnification or Formula
• 1987 Master Agreement – Market Quotation with Loss Fallback
• 1992 Master – Choice of Market Quotation (with Loss Fallback) or Loss
• 2002 Master – Close-out Amount:
  • Act in good faith and use commercially reasonable procedures to reach a commercially reasonable result
  • Use “any relevant information, including without limitation…”
    a) quotations
    b) third party market data
    c) a) or b) information, but internally derived

Priority mandatory unless Determining Party “reasonably believes in good faith” otherwise
Facts Matter

• Intel – ISDA “Loss” Case
  • Prepaid share forward
  • Loss was the agreed termination method: Intel paid $1 billion upfront; Lehman posted $1 billion in collateral; share quantity to be delivered was to have approximated $1 billion
  • Lehman failed to deliver any shares and claimed it was due the return of its collateral less the market value of the undelivered shares
  • Intel asserted its $1 billion Loss calculation was reasonable and in good faith
  • Held for Intel
  • Dicta – “cross-check” of market pricing v. Loss may apply on other facts (potentially blurring distinct liquidation valuation measures)

• American Home Case v. Well Fargo Case
  • Question of repo default pricing and section 562 of the US Bankruptcy Code: model v. market price
  • American Home – model was credibly commercially reasonable and prevailed
  • Wells Fargo – market liquidation price prevailed