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: <u>e.g.</u>, 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

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