CADWALADER, WICKERSHAM & TAFT LLP
700 6th Street, NW
Washington, DC 20001
Telephone: (202) 862-2200
Facsimile: (202) 862-2400
Mark C. Ellenberg, Esq.
John H. Thompson, Esq.

One World Financial Center
New York, New York 10281
Telephone: (212) 504-6000
Facsimile: (212) 504-6666
Lary Stromfeld, Esq.

Counsel for *Amicus Curiae* the International Swaps and Derivatives Association, Inc.

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re:	Chapter 11
LEHMAN BROTHERS HOLDINGS INC., *et al.*,	Case No. 08-13555 (JMP)
Debtors.	(Jointly Administered)
MICHIGAN STATE HOUSING DEVELOPMENT AUTHORITY, a public body corporate,	Adversary No. 09-01728
Plaintiff/Counterclaim Defendant,	
v.	
LEHMAN BROTHERS DERIVATIVE PRODUCTS INC. and LEHMAN BROTHERS HOLDINGS INC.,	
Defendants,	
- and -	
LEHMAN BROTHERS SPECIAL FINANCING INC.,	
Defendant/Counterclaim Plaintiff.	

BRIEF OF *AMICUS CURIAE* THE INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC.

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page

Cases

Statutes

<u>Legislative History</u>

<u>Miscellaneous</u>

PRELIMINARY STATEMENT

The International Swaps and Derivatives Association, Inc. ("ISDA") submits this *amicus curiae* brief to defend the safe harbor protections given by Congress to financial market participants. Lehman's attempt to stretch this Court's decision in *Lehman Bros. Special Financing Inc. v. BNY Corporate Trustee Services Ltd. (In re Lehman Bros. Holdings Inc.)*, 422 B.R. 407 (Bankr. S.D.N.Y. 2010), well beyond its obvious limits threatens to transform the safe harbors from robust protectors of freely functioning markets into hollow provisions that will disrupt markets. Lehman's extreme position is at odds with the plain language of the statute, and wholly unsupported by any precedent, including *BNY*.

In this very case, swap counterparties have terminated thousands of transactions with Lehman, producing billions of dollars of termination payments and claims. The terminating parties have calculated termination amounts and transmitted notice of these amounts to Lehman. From these thousands of terminations, Lehman has culled a select few, including Michigan State Housing Development Authority ("MSHDA"), to assert *ipso facto* violations. These few cases were selected on the basis of a variation in contract wording from the standard termination provisions of the ISDA Master Agreement. The difference in wording is solely one of form, not substance. If Lehman can succeed in vitiating the contractual rights of MSHDA and similarly situated parties to calculate termination payments upon termination of safe-harbored contracts, then parties acting under the standard ISDA Master Agreement are at risk of similar, misguided arguments in the future.

STATEMENT OF INTEREST OF AMICUS CURIAE

ISDA is the global trade association representing leading participants in the derivatives industry. ISDA was chartered in 1985, and comprises more than 830 member institutions from 57 countries on six continents. These members include most of the world's major institutions dealing in privately negotiated derivatives, as well as many of the businesses, governmental entities and other end users that rely on over-the-counter derivatives to manage the market risks inherent in their economic activities. Since its inception, ISDA has pioneered efforts to identify and reduce the sources of risk in the derivatives market. Among its most notable accomplishments is the standardization of derivatives documentation through the promulgation of ISDA Master Agreements. Today, ISDA Master Agreements form the contractual foundation for more than 90% of derivatives transactions globally (including the transactions at issue here).

Because of its role in the development of the derivatives markets, ISDA is uniquely well-positioned to address the interpretation of the Bankruptcy Code's safe harbor provisions. Indeed, ISDA actively participated in the enactment of the 1990 amendments to the Bankruptcy Code that added section 560 and the other safe-harbor provisions, which were intended "to ensure that the swap and forward contract financial markets are not destabilized by uncertainties regarding the treatment of their financial instruments under the Bankruptcy Code." H.R. Rep. No. 101-484, at 1 (1990), *reprinted in* 1990 U.S.C.C.A.N. 223.

ARGUMENT

I. THE BANKRUPTCY CODE'S SAFE HARBOR PROTECTS THE RIGHT TO TERMINATE, LIQUIDATE AND ACCELERATE SWAP AGREEMENTS IN ACCORDANCE WITH CONTRACTUAL TERMS.

A. Congress Enacted the Safe Harbors to Protect the Markets.

In order to promote rehabilitation, the Bankruptcy Code permits the debtor to assume most executory contracts and compel the counterparties to perform, provided that the debtor affords the counterparties the benefit of their bargains by curing any defaults and providing adequate assurance of future performance. *See* 11 U.S.C. § 365(a), (b)(1). In furtherance of this policy, sections 365(e)(1) and 541(c) of the Bankruptcy Code invalidate contractual provisions that terminate or modify the debtor's rights solely because of its bankruptcy – so-called "*ipso facto*" clauses. *Id.* at §§ 365(e)(1), 541(c). The anti-*ipso facto* provisions are complemented by the automatic stay. 11 U.S.C. § 362(a).

Congress has also recognized, however, that the operation of the Bankruptcy Code's anti-*ipso facto* and automatic stay provisions could destabilize the financial markets. It has therefore included various "safe harbors" in the Bankruptcy Code to exempt financial contracts from these provisions:

> U.S. bankruptcy law has long accorded special treatment to transactions involving financial markets, to minimize volatility. Because financial markets can change significantly in a matter of days, or even hours, a non-bankrupt party to ongoing securities and other financial transactions could face heavy losses unless the transactions are resolved promptly and with finality.

H.R. Rep. No. 101-484, at 2 (1990), *reprinted in* 1990 U.S.C.C.A.N. 223, 224. In the past 30 years, "[a]s new financial instruments have been developed, Congress has amended the 1978 Bankruptcy Code to keep pace in promoting speed and certainty in resolving complex financial transactions." *Id.*

As early as 1982, Congress amended the Bankruptcy Code to add safe-harbor provisions exempting payments made in the securities, commodities, and forward contract trades from the bankruptcy avoidance powers (except in cases of actual fraud) and providing that rights to liquidate such contracts in the event of bankruptcy cannot be "stayed, avoided, or otherwise limited by operation of any provision of this title." 1982 Amendments to Bankruptcy Code, Pub.

L. No. 97-222, 96 Stat. 235 (now codified, as amended, at 11 U.S.C. §§ 362(b)(6), 546(e), 555, 556); H.R. Rep. No. 97-420, (1982), *reprinted in* 1982 U.S.C.C.A.N. 583. In 1984, following a judicial decision that injected uncertainty as to the enforceability of repurchase agreements in bankruptcy, *see* S. Rep. No. 98-65, at 47 (1983), Congress acted again. *See* 1984 Amendments to Bankruptcy Code, Pub. L. No. 98-353, §§ 391-396, 98 Stat. 333 (now codified, as amended, at 11 U.S.C. §§ 362(b)(7), 546(f), 559); S. Rep. 98-65 (1983).

On both occasions, Congress sought to insulate the financial markets from the "ripple effect" that could result if a bankruptcy prevented counterparties to financial contracts from enforcing their rights upon default. *See, e.g.*, *Alfa, S.A.B. de C.V. v. Enron Creditors Recovery Corp. (In re Enron Creditors Recovery Corp.)*, 422 B.R. 423, 429 (S.D.N.Y. 2009) (McMahon, J.) ("Congress opined that the safe harbor would prevent 'the insolvency of one commodity or security firm from spreading to other firms,' which could otherwise 'threaten the collapse of the affected industry.'" (quoting H.R. Rep. No. 97-420, at 1 (1982), *reprinted in* 1982 U.S.C.C.A.N. 583), *aff'd*, 651 F.3d 329 (2d Cir. 2011).

In 1990, Congress extended safe-harbor protections to swap agreements. In the 1980s, over-the-counter derivatives products, or "swaps," were developed by the financial markets as a way to hedge or reduce various kinds of risk in a particular business.

> A "swap" is a contract between two parties ("counterparties") to exchange ("swap") cash flows at specified intervals, calculated by reference to an index. Parties can swap payments based on a number of indices including interest rates, currency rates and security or commodity prices.

Thrifty Oil Co. v. Bank of Am. Nat'l Trust & Sav. Ass'n, 322 F.3d 1039, 1042 (9th Cir. 2003). Even in the swap market's infancy, Congress recognized that swap agreements "are a rapidly growing and vital risk management tool in world financial markets," allowing financial institutions, corporations, and governments "to minimize exposure to adverse changes in interest and currency exchange rates." S. Rep. No. 101-285 (1990), *available at* 1990 WL 259288, at *2; *accord* H.R. Rep. 101-484, at 2-3 (1990), *reprinted in* 1990 U.S.C.C.A.N. 223, 224-25. In the following twenty years, the swap markets have only increased in size, complexity, and importance, growing from an estimated $1 trillion notional value of outstanding swap transactions in 1989 to $467 trillion in 2010. *Interest Swap: Hearing on S. 396 Before the Subcommittee on Courts and Administrative Practices of the Senate Committee of the Judiciary,* 101st Cong. 14 (1989); ISDA Market Survey, *available at* http://www.ISDA.org/statistics/pdf/ISDA-Market-Survey-annual-data.pdf.

Echoing the concerns that drove Congress to act in 1982 and 1984, in 1989 Congress was concerned about "volatility in the swap agreement markets resulting from the uncertainty over their treatment in the Bankruptcy Code." H.R. Rep. No. 101-484, at 3 (1990), *reprinted in* 1990 U.S.C.C.A.N. 223, 225. As Senator Heflin explained, "There is concern that if one of the parties to a swap agreement files for bankruptcy under the current Bankruptcy Code, the nondefaulting party is left with a substantial risk and, depending on the size of the swap agreement, could cause a rippling effect which would undermine the stability of the financial markets." *Interest Swap: Hearing on S. 396*, 101st Cong. 1; *see also Interest Swap: Hearing on S. 396,* 101st Cong. 16 (statement of Mark C. Brickell, Chairman, ISDA) ("Participants in the swap market are concerned that, if a counterparty files for bankruptcy, the automatic stay and other provisions of the Bankruptcy Code could be interpreted to bar the implementation of . . . critical contractual provisions.").

Accordingly, Congress enacted the 1990 Amendments to the Bankruptcy Code, which were designed to provide certainty to the over-the-counter derivatives markets by protecting swap transactions from the effects of bankruptcy.[1] *See* 1990 Bankruptcy Amendments, Pub. L. No. 101-311, 104 Stat. 267; *see also* S. Rep. No. 101-285, at 1 (1990), *available at* 1990 WL 259288, at *1 (stating that the purpose of the bill is "to clarify U.S. bankruptcy law with respect to the treatment of swap agreements and forward contracts. The bill would provide certainty for swap transactions in the case of a default in bankruptcy . . . .").

Section 560 is a critical component of this statutory scheme. *See* 1990 Bankruptcy Amendments, Pub. L. No. 101-311, § 106, 104 Stat. 267. Section 560 was intended "to preserve a swap participant's contractual right to terminate a swap agreement and offset any amounts owed under it in the event that one of the parties to the agreement files a bankruptcy petition." *See* H.R. Rep. No. 101-484, at 5 (1990), *reprinted in* 1990 U.S.C.C.A.N. 223, 227. Through enactment of this safe harbor, Congress made clear that "the exercise of any such right shall not be . . . limited by operation of the Bankruptcy Code." *Id.* In other words, section 560 "means that these contractual rights are not to be interfered with by any court proceeding under the Code." S. Rep. No. 101-285 (1990), *available at* 1990 WL 259288, at *9; *see also* 136 Cong. Rec. 13, 153 (1990) (statement of Sen. De Concini) ("The effect of the swap provisions will be to provide certainty for swap transactions and thereby stabilize domestic markets by allowing the terms of the swap agreement to apply notwithstanding the bankruptcy filing.").

Congress amended section 560 again in 2005, acting on recommendations of the President's Working Group on Financial Markets. *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 907(j), 119 Stat. 23; H.R. Rep. No. 109-31, at 20 & n.79 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 105. Prior to 2005,

---

[1] ISDA actively participated in the enactment of the 1990 Amendments to the Bankruptcy Code. *See infra* note 2.

section 560 only referenced the right to "terminate" swaps. The 2005 amendment added "liquidate" and "accelerate".

Congress intended the addition of "liquidate" and "accelerate" in 2005 "to clarify that the provisions of the Bankruptcy Code that protect . . . rights to terminate under swap agreements also protect rights of liquidation and acceleration." H.R. Rep. No. 109-31, at 132 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 193. Section 560 currently provides, in relevant part:

> The exercise of any contractual right of any swap participant or financial participant to cause the liquidation, termination, or acceleration of one or more swap agreements because of a condition of a kind specified in section 365(e)(1) of this title [regarding the debtor's insolvency or bankruptcy] or to offset or net out any termination values or payment amounts arising under or in connection with the termination, liquidation, or acceleration of one or more swap agreements shall not be stayed, avoided, or otherwise limited by operation of any provision of this title or by order of a court or administrative agency in any proceeding under this title.

11 U.S.C. § 560.

As with the earlier amendments, Congress emphasized that the 2005 amendments were "intended to reduce 'systematic risk' in the banking system and financial marketplace," *i.e.*, "the risk that failure of a firm or disruption of a market or settlement system will cause widespread difficulties at other firms, in other market segments or in the financial system as a whole." H.R. Rep. No. 109-31, at 20 & n.78 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 105-06. Thus, for purposes of section 560, "it is intended that the normal business practice in the event of a default of a party based on bankruptcy or insolvency is to terminate, liquidate or accelerate . . . swap agreements . . . with the bankrupt or insolvent party." H.R. Rep. No. 109-31 at 133, *reprinted in* 2005 U.S.C.C.A.N. 88, 193.

As courts have recognized, the protection of swap agreements under section 560's safe harbor reflects a strong and long-standing Congressional policy of safeguarding the financial markets from the disruptive effects of a counterparty's bankruptcy filing. *See, e.g., Hutson v. E.I. du Pont de Nemours & Co. (In re Nat'l Gas Distribs.),* 556 F.3d 247, 259 (4th Cir. 2009) (swap safe harbors serve a "policy of protecting financial markets and therefore favoring an entire class of instruments and participants."); *Thrifty Oil*, 322 F.3d at 1050 ("The legislative history of the Swap Amendments plainly reveals that Congress recognized the growing importance of interest rate swaps and sought to immunize the swap market from the legal risks of bankruptcy."). Accordingly, consistent with its history and purpose, section 560's safe harbor should be construed in accordance with its plain meaning to uphold the broad protections that Congress intended to provide for the financial markets.[2]

B. <u>"Liquidation" and "Acceleration" of a Terminated Swap Includes Determination of the Settlement Amount Owed Pursuant to the Contractually Specified Methodology.</u>

a. ISDA Section 6(e) Shifts the Right to Calculate Termination Payments to the Non-Debtor when One Party Becomes a Debtor.

Section 6(e) of the standard ISDA Master Agreement provides that, after termination of an agreement based on an event of default, including a party's bankruptcy, the non-defaulting party must calculate the termination payment due to or from the defaulting party. This is often done by determining the future net payments due under the transaction, using the

[2] ISDA actively participated in the enactment of the 1990 Amendments to the Bankruptcy Code that added section 560 and the other related safe harbor provisions. *See* 136 Cong. Rec. S7534-01, S7536 (daily ed. June 6, 1990) (statement of Sen. DeConcini) (thanking ISDA for its role in the 1990 legislation). ISDA also collaborated with the President's Working Group on Financial Markets and played a substantial role in drafting relevant provisions of BAPCPA.

relevant forward price curve, accelerating those payments, and discounting the stream to present value. Alternatively, the non-defaulting party could obtain quotes for a replacement transaction. Those quotes generally also reflect the applicable forward price curve.

When bankruptcy is the event of default on which termination is based, the non-defaulting party is the non-debtor. Thus, ISDA Master Agreement Section 6(e) shifts to the non-debtor the right – and obligation – to calculate the termination payment (in accordance with the contractually specified methodology), simply because the other party became a debtor. The language of Section 6(e) of the 2002 ISDA Master Agreement, reads as follows:

> ***Payments on Early Termination.*** If an Early Termination Date occurs, the amount, if any, payable in respect of that Early Termination Date (the "Early Termination Amount") will be determined pursuant to this Section 6(e) and will be subject to Section 6(f).
>
> (i) Events of Default. If the Early Termination Date results from an Event of Default, the Early Termination Amount will be an amount equal to (1) the sum of (A) the Termination Currency Equivalent of the Close-out Amount or Close-out Amounts (whether positive or negative) determined by the Non-defaulting Party for each Terminated Transaction or group of Terminated Transactions, as the case may be, and (B) the Termination Currency Equivalent of the Unpaid Amounts owing to the Non-defaulting Party less (2) the Termination Currency Equivalent of the Unpaid Amounts owing to the Defaulting Party. If the Early Termination Amount is a positive number, the Defaulting Party will pay it to the Non-defaulting Party; if it is a negative number, the Non-defaulting Party will pay the absolute value of the Early Termination Amount to the Defaulting Party.[3]

---

[3] Section 6(e) of the 1992 ISDA Master Agreement similarly states that the non-defaulting – that is the non-debtor – party shall calculate the termination payment. Section 6(e) of the 1992 form reads as follows:

Payments on Early Termination. If an Early Termination date occurs, the following provisions shall apply based on the parties' election in the schedule of a payment measure, either "Market Quotation" or "Loss", . . .

(i) Events of Default. If the Early Termination Date results from an Event of Default . . .

(3) Second Method and Market Quotation. If the second Method and Market Quotation apply, an amount will be payable equal to (A) the sum of the Settlement Amount (determined by the

b. The Contract Here Similarly Shifted the Right to Calculate Termination Payments to MSHDA when LBSF Became a Debtor.

Paragraph 2.2 of the Assignment Agreement, pursuant to which the MSHDA swap was assigned from LBDP to LBSF, and which simultaneously amended the swap agreement, states:

> Upon the termination of the Agreement, as assigned and amended pursuant to the terms hereof, and notwithstanding any other provision hereof or thereof, any Settlement Amount payable by the Counterparty shall be determined by LBSF pursuant to Part 1(i)(2) of the Schedule to the Agreement unless an Event of Default described in Section 5(a)(i) [failure to pay or deliver] or Section 5(a)(vii) [bankruptcy] of the Agreement has occurred with respect to LBSF as the Defaulting Party, in which event the Settlement Amount shall be determined pursuant to Section 6 of the Agreement as if LBSF is the Defaulting Party.

Clearly, the import of the MSHDA agreement is precisely the same as Section 6(e) of the ISDA Master Agreement. After a termination resulting from a Lehman bankruptcy, MSHDA would be the non-defaulting party and would calculate a termination payment in accordance with the methodology specified in Section 6 of the ISDA Master Agreement.

c. Lehman Attempts to Read "Liquidation" and "Acceleration" Out of Bankruptcy Code Section 560.

Even though numerous other parties have terminated thousands of transactions with Lehman and, with the protection of section 560 and other applicable safe harbor provisions,

---

Non-defaulting Party) in respect of the Terminated Transactions and the Termination Currency Equivalent of the Unpaid Amounts owing to the Non-defaulting Party less (B) the Termination Currency of the Unpaid Amounts owing to the Defaulting Party. If that amount is a positive number, the Defaulting Party will pay it to the Non-defaulting Party; if it is a negative number, the Non-defaulting Party will pay the absolute value of that amount to the Defaulting Party.

(4) Second Method and Loss. If the Second Method and Loss apply, an amount will be payable equal to the Non-defaulting Party's Loss in respect of this Agreement. If that amount is a positive number, the Defaulting Party will pay it to the Non-defaulting Party; if it is a negative number, the Non-defaulting Party will pay the absolute value of that amount to the Defaulting Party.

calculated termination payments in accordance with Section 6(e) of the ISDA Master Agreement, Lehman asserts that MSHDA is not protected by section 560 and, accordingly, cannot make the calculation in accordance with the agreed methodology. Lehman bases its position on the difference between the wording used in the MSHDA agreement and ISDA Master Agreement Section 6(e). But, plainly, the difference is entirely one of form. The substance of the MSHDA agreement is exactly the same as Section 6(e). Indeed, the MSHDA agreement even directs MSHDA to calculate the termination payment pursuant to Section 6 of the Master Agreement.[4]

Lehman characterizes paragraph 2 of the Assignment Agreement as a "Modification Provision," because it "expressly alters the rights of LBSF based upon LBSF's bankruptcy." Debtors' Cross-Motion, p. 1. But, as we have just seen, this swap and its so-called "Modification Provision" is no different from the thousands of other terminated swaps in this case. Indeed, paragraph 2 of the Assignment Agreement merely restored the normal terms of Section 6 of the ISDA Master Agreement. Contrary to Lehman's suggestion, no one is arguing that the early termination calculation methodology provision in this swap agreement is not an *ipso facto* provision.[5] Rather, the central point is that the *ipso facto* provision (and tens of thousands of other agreements like it) is safe harbored by section 560, and, thus, excepted from section 365(e)(1)(B).

[4] Section 6 of the Master Agreement had been modified in the original contract between MSHDA and LBDP, due to LBDP's unique operational requirements. Following the bankruptcy of LBHI, Lehman asked MSHDA to agree to the assignment of the contract to LBSF. The Assignment Agreement, in paragraph 2 quoted above, intended to restore normal Section 6(e) rules in the event of a LBSF bankruptcy.

[5] Lehman dedicates more than seven pages of their brief to the uncontested assertion that the early termination calculation methodology provision is an *ipso facto* clause and the irrefutable legal conclusion that non-safe harbored *ipso facto* provisions are not enforceable in bankruptcy.

Lehman, by necessity, urges an exceedingly narrow interpretation of section 560 that effectively reads "liquidation" and "acceleration" out of the statute. *See* 11 U.S.C. § 560. Lehman's contention is that calculation of a settlement amount is "merely ancillary" to the right to cause the termination, liquidation or acceleration of the swap agreement, and is therefore not a safe harbored right. This position cannot withstand scrutiny.

The Bankruptcy Code, like any statute, must be construed in accordance with its plain meaning. *See United States v. Ron Pair Enters.*, 489 U.S. 235, 242 (1989). Although not defined in the Bankruptcy Code, the ordinary meaning of "liquidation" is to determine the amount of a liability. *See* Black's Law Dictionary, 950 (9th ed. 2009) (defining "liquidation" to mean "[t]he act of determining by agreement or by litigation the exact amount of something (as a debt or damages)"; and "[t]he act or process of converting assets into cash, esp[ecially] to settle debts.").

This meaning of "liquidation" is reinforced by Congress' use of that term in other provisions of the Bankruptcy Code. *See Cohen v. De La Cruz*, 523 U.S. 213, 220 (1998) (construing the Bankruptcy Code in accordance with "the presumption that equivalent words have equivalent meaning when repeated in the same statute."). In the provision on which section 560 was modeled, *see* S. Rep. No. 101-285 (1990), *available at* 1990 WL 259288, at *9; H.R. Rep. No. 109-31 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 193, section 559 of the Bankruptcy Code provides a virtually identical safe harbor for repurchase agreements, protecting "the exercise of a contractual right of a repo participant . . . to cause the liquidation, termination, or acceleration of a repurchase agreement" if the counterparty becomes bankrupt. 11 U.S.C. § 559. Section 559 further provides that:

> In the event that a repo participant . . . liquidates one or more repurchase agreements . . . and under the terms of one or more such agreements has agreed to deliver assets subject to repurchase

> agreements to the debtor, any excess of the market price received on *liquidation of such assets* . . . over the sum of the stated repurchase prices and all expenses in connection with the liquidation of such repurchase agreements shall be deemed property of the estate, subject to the available rights of setoff."

Id. (emphasis added). Section 559 thus provides that the "liquidation" of a repurchase agreement includes the "liquidation . . . of assets" subject to that agreement, *i.e.*, reducing the assets to money in order to determine the net amount due to or from the debtor. *See Bankruptcy Law and Repurchase Agreements: Hearings on H. 2852 and H. 3418 Before the Subcommittee on Monopolies and Commercial Law of the House. Comm. on the Judiciary*, 98th Cong., 2d Sess. 72 (1984) (statement of Preston Martin on behalf of the Federal Reserve) ("The essence of a repurchase agreement is the liquidity afforded by the ease with which *the underlying security can be converted to cash* in the marketplace. Permitting *liquidation* of a security by repo holder but retaining those funds for the debtor's use rather than releasing them to the holder eliminates this liquidity.") (emphasis added).

That same fundamental meaning of "liquidation" is reflected in the corresponding safe harbor for securities contracts. *See* 11 U.S.C. § 555; *Thomas McKinnon Sec., Inc. v. Residential Res. Mortg. Invs. Corp. (In re Residential Res. Mortg. Invs. Corp.)*, 98 B.R. 2, 23-24 (Bankr. D. Ariz. 1989) (finding that sections 555 and 559 protects the counterparty's right "to liquidate immediately the underlying securities."); *Credit Agricole Corporate & Inv. Bank N.Y. Branch v. Am. Home Mortg. Holdings, Inc. (In re Am. Home Mortg. Holdings, Inc.)*, 637 F.3d 246, 256 (3d Cir. 2011) ("Section 559 applies only in the event that a repurchase agreement is liquidated, and the liquidation results in excess proceeds . . . ."). Accordingly, sections 555 and 559 make clear that Congress understood "liquidation" to mean establishing a net amount due on account of termination.

In fact, Lehman knows full well that calculation of a net amount due is the essence of liquidation. In a brief filed in the District Court concerning an appeal from the *BNY* decision, Lehman stated:

> Congress's use of "liquidate" in § 560 was not, as BNY and the amici contend, to allow liquidation of assets in connection with termination, but rather was in recognition that "liquidation" of derivative transactions specifically refers to the "liquidation of transactions" meaning reviewing terminated contracts and *calculating amounts owed either way*.

Joint Appellees Brief of Lehman Brothers Special Financing Inc. and the Official Comm. of Unsecured Creditors at 55, *BNY Corp. Trustee Servs. Ltd. v. Lehman Bros. Special Fin. Inc.*, Case No. 08-13555, Adv. Proc. No. 09-01242, No. M-47 (S.D.N.Y. Nov. 15, 2010) (emphasis added) (attached as Exhibit A). Lehman's brief on the same matter in the bankruptcy court, where they prevailed on the basis of precisely this argument, contains the same statement concerning the meaning of "liquidation" for purpose of section 560. Lehman Bros. Special Fin. Inc.'s Memorandum of Law in Opposition to BNY Corporate Trustee Servs. Ltd.'s Motion for Summary Judgment at ¶ 93, *BNY Corp. Trustee Servs. Ltd. v. Lehman Bros. Special Fin. Inc.*, Case No. 08-13555, Adv. Proc. No. 09-01242 (Bankr. S.D.N.Y. Oct. 23, 2009) ECF No. 68 (attached as Exhibit B). Having admitted in two briefs that "liquidation" for purposes of section 560 means "calculation of amounts owed either way," Lehman simply cannot argue here that MSHDA's calculation of "amounts owed either way" pursuant to paragraph 2 of the Assignment Agreement is not also protected conduct under section 560.

The plain meaning of "liquidation" in section 560 is further reinforced by its history and purpose. As discussed above, Congress recognized that the swaps and derivatives markets, like other financial markets, are volatile and marked by a high degree of interrelation among market participants. It enacted the safe harbor protections in response to concerns that a market participant's bankruptcy could have a cascading impact on the liquidity or solvency of other market participants and the stability of financial markets "unless the transactions *are resolved promptly and with finality*." *See* H.R. Rep. No. 101-484, at 2 (1990), *reprinted in* 1990 U.S.C.C.A.N. 223, 224 (emphasis added). To address these concerns, Congress enacted the safe harbors to exempt swap participants from the Bankruptcy Code's restrictions on the exercise of their contractual rights, allowing a counterparty to cause "the immediate termination" of all transactions, and to "determine . . . upon default, which party is owed how much." S. Rep. No. 101-285 (1990), *available at* WL 259288, at *3, *8. These protections were enacted precisely so that the unwinding of swap transactions would not be tied up in the bankruptcy courts.

Permitting a counterparty to terminate a swap agreement, but not to calculate the settlement amount owed in accordance with the contractually specified methodology, is a hollow protection that does nothing to advance section 560's intended purpose of increased market certainty and stability. Determining the settlement amount owed is essential to the safe harbored right to liquidate and accelerate a swap agreement. Indeed, uncertainty regarding the settlement amount of a swap agreement tied up in bankruptcy would severely limit a party's ability to arrange for alternative hedging transactions and would expose the party to substantial risk. Thus, the suggestion that the "liquidation" and "acceleration" of a swap agreement does not include the process of determining what will actually be paid to resolve it promptly and with finality is simply not consistent with the text or purpose of section 560.

C. "Liquidation" is Not a Synonym for "Termination."

Following a litany of citations calling for a "plain meaning" interpretation of the "clear and unambiguous" statutory language in section 560 of the Bankruptcy Code, Debtors

Cross-Motion, at 17-18, Lehman, apparently without irony, asserts that "[t]he inclusion of the word 'liquidation' in section 560 was . . . not intended as anything more than a synonym for 'termination' and closeout, which the safe harbor was designed to protect." Debtors' Cross-Motion, at 22. Lehman cites a leading derivatives treatise for the proposition that "each of the terms 'liquidation,' 'termination' and 'acceleration' in fact means '*closing out*' the relevant transactions – not an expansion of the safe harbor to encompass rights that are merely ancillary to the right to closeout a transaction." *See id.* (citing Anthony C. Gooch & Linda B. Klein, *Documentation for Derivatives: Annotated Sample Agreements & Confirmation for Swaps & Other Over the Counter Transactions* 305 (4th ed. 2002)). A closer examination of the treatise, however, makes abundantly clear that the authors actually reject Lehman's overly narrow interpretation of section 560. As stated by Gooch and Klein, "In the context of standard market forms of agreement, the rights protected by Section 560 are, for example, the rights provided for in Section 6 of the ISDA Master Agreement forms, involving the designation or automatic occurrence of an Early Termination Date and the *calculation of a single, net settlement amount* . . . ." *Id.* at 304 (emphasis added).

Lehman's effort to repeal the 2005 additions of "liquidation" and "termination" to section 560 also defies the most basic canon of statutory construction – that each of "termination," "liquidation," and "acceleration," must be given independent meaning. *See Williams v. Taylor*, 529 U.S. 362, 404 (2000) (finding that it is "a cardinal principle of statutory construction that [courts] must give effect, if possible, to every clause and word of a statute.") (internal quotation marks omitted); *United States v. Menasche*, 348 U.S. 528, 538-39 (1955); *Pennsylvania Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 562 (1990) ("Our cases express a deep reluctance to interpret a statutory provision so as to render superfluous other provisions in the same enactment.”). Interpreting “liquidation” and “acceleration” as synonymous with “termination” renders the terms “liquidation” and “acceleration” entirely superfluous.

Indeed, Congress added “liquidation” and “acceleration” to section 560 in 2005 precisely to clarify that swap participants may exercise not only their contractual rights to cause a swap agreement’s “termination”, but also their rights to cause the acceleration of the agreement’s terms and the liquidation of the parties’ positions, *i.e.* the calculation of the net settlement amount owing upon termination. *See* H.R. Rep. No. 109-31, at 132-33 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 193; Edward R. Morrison & Joerg Riegel, *Financial Contracts and the New Bankruptcy Code: Insulating Markets from Bankrupt Debtors and Bankruptcy Judges*, 13 Am. Bankr. Inst. L. Rev. 641, 650-51 n.61 (2005) (stating that the phrase “liquidation, termination, or acceleration” was intended to clarify the “range of contractual rights exempt from the prohibition on *ipso facto* clauses.”). In amending section 560, as well as sections 555, 556, 559 and 561, to include “liquidation” and “acceleration,” Congress could not have intended that that the term “liquidation” would have no independent meaning. *See Conn. Nat’l Bank v. Germain*, 503 U.S. 249, 253-54 (1992) (finding that “courts must presume that a legislature says in a statute what it means and means in a statute what it says.”). To express the point more vividly, Lehman would have the Court believe that Congress purposefully amended section 560 in 2005 to add two words that had no meaning. Such a reading strains both credulity and common sense.

II. THIS COURT’S DECISION IN *LEHMAN BROS. SPECIAL FINANCING V. BNY CORPORATE TRUSTEE SERVICES* DOES NOT SUPPORT LEHMAN.

In *Lehman Bros. Special Financing Inc. v. BNY Corporate Trustee Services Ltd. (In re Lehman Bros. Holdings Inc.)*, 422 B.R. 407 (Bankr. S.D.N.Y. 2010), this Court determined that provisions in a CDO supplemental trust deed that subordinated payments due to LBSF, as swap provider, constituted unenforceable *ipso facto* clauses. *Id.* at 421. The Court further held that, because the payment priority provisions were not contained in the four corners of the swap agreement, the Bankruptcy Code's safe harbor protections did not apply. *Id.*

The *BNY* decision does not aid Lehman here, for two reasons. First, the *BNY* decision involved payment priority provisions, which governed the distribution of a swap agreement's proceeds *after* the proper party liquidated the swap agreement by calculating "who owes what to whom." The Court found that the payment priority provisions were ancillary to the liquidation of the swap agreement, and, therefore, were not protected by the safe harbor. Here, however, the case involves the swap's calculation provisions, themselves. Because the calculation provisions are essential to the liquidation and acceleration of the swap agreement, they are protected by the safe harbor.

Second, there is no dispute that paragraph 2 of the Assignment Agreement is part of the swap agreement. Because the calculation provisions are part of the swap agreement, they are protected by the safe harbor.

In the final analysis, Lehman's effort to extend the *BNY* ruling proves too much. If MSHDA were able to terminate the swap with LBSF, but not to calculate the termination payment in accordance with the swap agreement, then all non-defaulting swap counterparties are at risk. Section 560 is clear. It should be enforced in accordance with its terms.

CONCLUSION

For the foregoing reasons, ISDA respectfully requests that the Court grant MSHDA's partial motion for summary judgment in its entirety.

Dated: Washington, DC
August 20, 2012

CADWALADER, WICKERSHAM & TAFT LLP

/s/ *Mark C. Ellenberg*
Mark C. Ellenberg, Esq.
John H. Thompson, Esq.

700 6th Street, NW
Washington, DC 20001
Telephone: (202) 862-2200
Facsimile: (202) 862-2400

– and –

Lary Stromfeld, Esq.
One World Financial Center
New York, New York 10281
Telephone: (212) 504-6000
Facsimile: (212) 504-6666

Counsel for *Amicus Curiae* the International Swaps and Derivatives Association, Inc.