No 7942 of 2008

IN THE HIGH COURT OF JUSTICE

CHANCERY DIVISION

COMPANIES COURT

IN THE MATTER OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (IN ADMINISTRATION)

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

(1) ANTHONY VICTOR LOMAS
(2) STEVEN ANTHONY PEARSON
(3) PAUL DAVID COPLEY
(4) RUSSELL DOWNS
(5) JULIAN GUY PARR
(as the joint administrators of the above named company)

Applicants

- AND -

(1) BURLINGTON LOAN MANAGEMENT LIMITED
(2) CVI GVF (LUX) MASTER S.À R.L
(3) HUTCHINSON INVESTORS LLC
(4) WENTWORTH SONS SUB-DEBT S.À R.L
(5) YORK GLOBAL FINANCE BDH, LLC
(6) GOLDMAN SACHS INTERNATIONAL

Respondents

JOINT STATEMENT OF ROBERT S. SMITH AND NEIL B. COHEN OF AGREED AND NON-AGREED ISSUES AS TO MATTERS OF NEW YORK LAW

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1. Judge Robert S. Smith (Ret.) and Professor Neil B. Cohen, experts instructed by the attorneys for Wentworth Sons Sub-Debt S.à r.l. and by the Senior Creditor Group (*i.e.*, CVI GVF (Lux) Master Sarl, Hutchinson Investors, LLC, Burlington Loan Management Limited, and their relevant affiliates), respectively, have prepared this Joint Statement to assist the High Court of Justice (the "High Court") in its consideration of the Lehman Brothers International (Europe) Waterfall II application on certain questions of New York law arising in the context of the ISDA Master Agreement.

2. Unless otherwise stated, Professor Cohen and Judge Smith agree on the propositions of New York law contained in this Joint Statement.

I. General Principles of Contract Interpretation

3. Under New York law, it is the task of courts to enforce the agreement made by the parties rather than reform it. A court may not make or vary a contract to accomplish its notions of abstract justice or moral obligation. (Cohen Rep. ¶ 25).

4. Among the basic principles of contract interpretation under New York law are that a court will interpret a contract as written, since its words are considered the best evidence of the parties' intent, and that when parties set down their agreement in a clear, complete document their writing will be enforced in accordance with its terms. (Smith Rep. ¶ 15; Cohen Rep. ¶¶ 27, 31-32.)[1]

5. Evidence outside a contract itself ("extrinsic evidence") generally is not admissible to supplement or change the written words of the contract. (Smith Rep. ¶ 15; Cohen Rep. ¶ 31.)

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[1] Citations to "Smith Rep." refer to the Expert Opinion of Robert S. Smith as to Matters of New York Law dated June 25, 2015; those to "Cohen Rep." refer to the Expert Opinion of Professor Neil B. Cohen as to Matters of New York Law dated July 24, 2015; and those to "Smith Reply Rep." refer to the Reply Opinion of Robert S. Smith to the Expert Opinion of Neil B. Cohen as to matters of New York Law dated August 13, 2015.

However, a court will consider extrinsic evidence of the parties' intent to the extent that the words of the contract are found to be ambiguous and their meaning is not made clear by an examination of the contract as a whole. (Smith Rep. ¶ 15, 20; Cohen Rep. ¶¶ 29, 30, 33.)

6. The question whether a written contract is ambiguous or unambiguous is a question of law for the court to resolve. New York courts tend to take a narrow view of what constitutes ambiguity, even when there is disagreement about a contract's meaning. (Smith Rep. ¶ 17; Cohen Rep. ¶ 34.)

7. The fact that the parties to a contract advance differing interpretations does not, standing alone, make it ambiguous. (Smith Rep. ¶ 18; Cohen Rep. ¶ 37.)

8. Under New York law, all contracts contain an implied covenant of good faith and fair dealing. The implied covenant requires that neither party do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract. The application of this requirement varies depending on the circumstances to which it is applied. In addition, where the contract contemplates the exercise of discretion, the obligation of good faith and fair dealing includes a promise not to act arbitrarily or irrationally in exercising that discretion. (Smith Rep. ¶¶ 22, 33; Cohen Rep. ¶ 38.) If compliance with the covenant of good faith and fair dealing is raised as an issue in this case, the burden of persuasion will be on the party that asserts lack of compliance.

9. New York courts also adhere to the principle that an interpretation that renders the parties' agreement absurd is to be avoided. (Smith Rep. ¶¶ 22, 23; Cohen Rep. ¶ 66.)

10. In Judge Smith's view, it is also a principle of New York law that an interpretation of a contract that places one party at the mercy of another, or permits one party to take unfair advantage of the other, is disfavored. (Smith Rep. ¶23.) Professor Cohen generally agrees, but

notes that the implied covenant of good faith and fair dealing that is included in every contract as a matter of New York contract law largely prevents situations in which a party would be allowed to take such unfair advantage. (Cohen Rep. ¶¶ 43, 44.)

II. Principles Relevant to the Question of Whether "Relevant Payee" in the Definition of "Default Rate" Refers to the Original Counterparty or its Assignee

11. New York law generally permits the assignment of a claim for an amount due under a contract, including the right to collect interest on that amount, and there is no rule of New York law that would prohibit assignment in this case. (Smith Rep. ¶ 25; Cohen Rep. ¶ 48.)

12. The claims assigned in this case are "payment intangibles" as that term is defined in Section 9-102 of the New York Uniform Commercial Code ("the NY UCC"), and the assignments of those payment intangibles are governed by Article 9 of the NY UCC. (Cohen Rep. ¶ 49.)

13. In Section 9-404(a), Article 9 of the NY UCC provides, in relevant part, that "the assignee is subject to all of the terms of the agreement between the assignor and the account debtor." (Cohen Rep. ¶ 50.)

14. The experts disagree somewhat as to the implications of Section 9-404(a) on the determination of who is the "relevant payee." In Judge Smith's view, Section 9-404(a) codifies the so-called "stand in the shoes" maxim of the New York law of assignments: *i.e.*, when an assignment has occurred, an assignee is said to "stand in the shoes" of the assignor, such that the assignee acquires no greater rights than the assignor had at the time of the assignment. In Judge Smith's opinion, the "stand in the shoes" maxim is substantially correct, and has not been materially altered by New York's adoption of the Uniform Commercial Code. (Smith Reply Rep. ¶¶ 4, 6.)

15. Professor Cohen, pointing, as an example, to attorneys' fees cases, notes that it is not uncommon for the dollar amount of remedial provisions to be measured by a cost to an assignee, even if that is not identical to the cost that would hypothetically have been incurred by an assignor. In Professor Cohen's opinion, the statement that an assignee "stands in the shoes" of the assignor works as a loose aphorism, but it is not a precise statement of the legal rule. In his view, the precise statement of the rights acquired by an assignee of a payment intangible is found in Section 9-404(a) of the NY UCC, which states in relevant part that "the assignee is subject to all of the terms of the agreement between the assignor and the account debtor." Thus, in his view, the applicable New York law of assignments – NY UCC Section 9-404(a) – provides that the assignee is subject to all the same terms of agreement as the assignor, but what the terms of that agreement mean in the context at hand (*i.e.*, identifying who is the Relevant Payee of an assigned claim) is a matter of contract interpretation and is not determined by the application of a common law aphorism of assignment law. (Cohen Rep. ¶¶ 50-54, 58.)

16. It is Judge Smith's opinion that the attorneys' fees cases referred to by Professor Cohen are different in important ways from claims for interest based on "cost to fund or of funding" under the ISDA Master Agreement, and therefore have little if any bearing on the present issue. Specifically, the amount of attorneys' fees, unlike an interest rate, does not usually depend on the identity of the person incurring the cost; and a party seeking to recover attorneys' fees must ordinarily produce proof of fees actually incurred, while the ISDA Master Agreement permits recovery based upon a party's hypothetical cost of funding. (Smith Reply Rep. ¶¶ 9-11.) In Professor Cohen's view, the cases do have bearing on the matter at hand; in both situations, the issue relates not to the initial performance obligation of the defaulting party but, rather, to measuring the cost required to make the enforcing party whole as a result of the default. (Cohen

Rep. ¶ 57.) Moreover, Professor Cohen notes that, while attorneys' fees vary widely and there is no reason to expect that the fees incurred by one party to enforce its rights would be identical to the fees incurred by another party, the attorneys' fees cases do not require a showing that the fees incurred by the assignee are equal to (or no greater than) those that would have been incurred by the assignor. Professor Cohen further states that the fact that the ISDA Master Agreements permit recovery based on a party's hypothetical cost of funding has no bearing on the question of whether the relevant payee for these purposes is the assignor or the assignee.

17. Judge Smith and Professor Cohen agree that the ISDA Master Agreements determine the meaning of the term "Relevant Payee" as used in those agreements. Judge Smith acknowledges that the parties to those agreements could if they chose attach a meaning to "Relevant Payee" that is in tension with or contrary to the "stand in shoes" maxim. It is Judge Smith's opinion, however, that, where an agreement is not explicit on the point, a New York court would give significant weight to the maxim in deciding whether an assignee should be entitled to an interest rate higher than the rate the original counterparty could have recovered. In Professor Cohen's opinion, NY UCC Section 9-404(a) directs a court to determine the meaning of the agreement between the assignor (the original counterparty) and the account debtor (LBIE) and does not authorize the application of a presumptive meaning of the agreement derived from the "stand in the shoes" maxim if the agreement is not explicit as to the meaning of Relevant Payee. (Smith Rep. ¶ 28; Cohen Rep. ¶¶ 52-53; Smith Reply Rep. ¶¶ 7-8.)

18. Judge Smith and Professor Cohen also disagree about the weight New York courts would give in their interpretation of the term "Relevant Payee" to the rule disfavoring an interpretation that places a party at the mercy of another or that permits one to take an unfair advantage of the other. It is Judge Smith's opinion that New York courts would give this rule significant weight

in this context. (Smith Rep. ¶ 23.) Professor Cohen, however, notes that the obligation of good faith and fair dealing imposed on the parties by New York contract law already serves to prevent such unfair advantage, and believes that a principle of contract interpretation that would go beyond application of the good faith obligation to rewrite the parties' agreement would be inconsistent with New York contract law. (Cohen Rep. ¶ 43.)

19. It is also Judge Smith's opinion that if a New York court found the term "Relevant Payee" ambiguous, it would be permitted to consider, as extrinsic evidence used to aid construction, the predecessor version of the ISDA Master Agreement (which used the term "Relevant Payee" in its definition of "Default Rate" but did not permit assignments of claims by Non-defaulting Parties). (Smith Rep. ¶ 24.) Judge Smith believes that a recent decision of the United States Bankruptcy Court for the Southern District of New York supports his view that the predecessor agreement is relevant. See Proposed Findings of Fact and Conclusions of Law on Cross Motions for Summary Judgment, *In re Lehman Brothers Holdings Inc. (Lehman Brothers Holding Inc. v. Intel Corporation)*, Case No. 08-13555(SCC) Adv. Pro No. 13-01340 (S.D.N.Y. Bkcy. Ct. September 16, 2015) at 20-21 (relying on 1987 ISDA Master Agreement to interpret 1992 version). Professor Cohen agrees that prior dealings between the parties to a contract may be relevant to interpretation of that contract. He notes, however, that the predecessor version of the ISDA Master Agreement does not represent a prior dealing between LBIE and the parties here, and is unaware of New York authority for the proposition that, when parties contract on the basis of a standard form agreement prepared by a third party, the meaning of their agreement can be determined by reference to predecessors of that third party's standard form without regard to whether the parties ever contracted with each other on the basis of that predecessor form. Professor Cohen further observes that while the Proposed Findings of Fact and Conclusions of

Law referred to by Judge Smith do note a reference to the 1987 ISDA Master Agreement in an explanation of the meaning of the 1992 Master Agreement in the User Guide for that document, and the bankruptcy court uses that reference in its analysis of the disputed issue in the case, this appears to be a situation in which the documentation between the parties (the 1992 Master Agreement and User Guide) explicitly refers to earlier forms (the 1987 materials) and analyzes the current documents in light of differences from their predecessors; thus, when the court refers to the 1987 ISDA Master Agreement, it is doing so in the context of interpreting the reference to it in the 1992 materials rather than introducing the 1987 materials as an independent basis for construction of the 1992 Master Agreement. Moreover, (i) the bankruptcy court cites no authority, much less opinions of New York courts, for its use of the predecessor document, (ii) there is no indication that the court found that the documents governing the disputed issue in the case were ambiguous, the essential element for introduction of extrinsic evidence under New York contract law (indeed, the court seems to have concluded that the agreement at issue was unambiguous; see Proposed Findings of Fact and Conclusions of Law at 8), and (iii) there is no indication that the matter was addressed at all by the parties. Thus, it is Professor Cohen's view that the Proposed Findings of Fact and Conclusions of Law do not provide precedential support for the proposition for which Judge Smith refers to them.

III. Principles Relevant to the Effect to be Given to a Payee's Certification of its Cost of Funding

20. Professor Cohen and Judge Smith agree that the implied covenant of good faith and fair dealing (described in ¶ 8 above) is relevant to the interpretation a New York court would give to the words "cost (without proof or evidence of actual cost) to the relevant payee (as certified by it) if it were to fund or of funding the relevant amount" in the ISDA Agreements, and thus to the

way in which a New York court would deal with a challenge by a Defaulting Party to a proffered certification. (Smith Rep. ¶ 32; Cohen Rep. ¶ 38.) Judge Smith and Professor Cohen also agree that in cases where a contract gives a party discretion to take a particular action, the implied covenant "includes a promise not to act arbitrarily or irrationally in exercising that discretion." *Dalton v. Educ. Testing Serv.*, 87 N.Y.2d 384, 389, 663 N.E.2d 289, 291 (1995); (Smith Rep. ¶ 32; Cohen Rep. ¶ 42; Smith Reply Rep. ¶ 13.)

21. Judge Smith concludes that the ISDA Master Agreements confer discretion of the sort at issue in *Dalton* and similar cases. Judge Smith believes that, in any case where more than one funding cost could be honestly certified, the conclusion that the certifying party has discretion in choosing among them is inescapable. (Smith Rep. ¶ 32; Cohen Rep. ¶ 65; Smith Reply Rep. ¶ 13.) Professor Cohen, while not interpreting the ISDA Master Agreements, agrees that, if they give the enforcing party the right to choose among several methods of funding in determining its funding cost, that right would constitute discretion within the meaning of *Dalton* and similar cases.

22. Judge Smith and Professor Cohen agree that the decision of the United States District Court in *Finance One Public Co. Ltd. v. Lehman Brothers Special Financing, Inc.*, No. 00 Civ. 6739 (CBM), 2003 WL 21638214 (S.D.N.Y. July 11, 2003) would be entitled to respectful attention from, but would not be binding upon, New York courts. They disagree, however, about the weight that New York courts would likely give to that decision. Judge Smith believes the *Finance One* court's statement that "the ISDA explicitly precludes an issue of fact contest with regard to the proper default rate" to be unsupported by authority, unexplained by the *Finance One* court, and, if intended as a generally applicable description of the ISDA Master Agreements, incorrect. Judge Smith concludes that therefore the precedential value of the case is

slight. (Smith Rep. ¶¶ 38-40.) Professor Cohen believes that *Finance One* has precedential value in New York courts because federal court decisions applying state contract law can be quite persuasive, particularly when the federal court sits in the state whose law it is applying. (Cohen Rep. ¶¶ 41, Fn.1, 62.) Moreover, Professor Cohen believes that the *Finance One* court's conclusions are supported by New York principles of contract law including freedom of contract and the implied covenant of good faith and fair dealing.

IV. Duty to the High Court

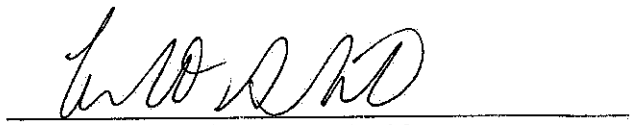
23. Judge Smith and Professor Cohen understand that the duty of each of them is to help the High Court on matters within his expertise. This duty is paramount and overrides any obligation to the parties from whom they have received instructions and by whom they are being paid. Each has complied and will continue to comply with that duty.

24. Judge Smith and Professor Cohen are aware of the applicable requirements of Civil Procedure Rules Part 35, Practice Direction 35, the Civil Justice Council Guidance for the instruction of experts in civil claims 2014, and the Practice Direction – Pre-Action Conduct.

V. Statements of Truth

I confirm that I have made clear which facts and matters referred to in this report are within my own knowledge and which are not. Those that are within my own knowledge I confirm to be true. The opinions I have expressed represent my true and complete professional opinions on the matters to which they refer.

Dated: September 29, 2015



Robert S. Smith

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Dated: September 29, 2015

Neil B. Cohen

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