UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

FINANCE ONE PUBLIC COMPANY LIMITED, Plaintiff, -against- LEHMAN BROTHERS SPECIAL FINANCING INC., Defendant.	Index No.:00 Civ. 6739 (CBM)

INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC.'S *AMICUS CURIAE* MEMORANDUM OF LAW IN SUPPORT OF DEFENDANT LEHMAN BROTHERS SPECIAL FINANCING INC.'S MOTION TO RECONSIDER, AMEND OR ALTER JUDGMENT PURSUANT TO RULES 59(e) AND 60(b) OF THE FEDERAL RULES OF CIVIL PROCEDURE

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The International Swaps and Derivatives Association, Inc. ("ISDA") submits this amicus memorandum of law in support of defendant Lehman Brothers Special Financing Inc.'s motion to reconsider, alter and amend the Court's Judgment entered July 17, 2003, awarding plaintiff Finance One Public Company Limited ("Fin One") pre- and post- judgment interest (hereinafter, "Interest Opinion").

PRELIMINARY STATEMENT

ISDA is the publisher of the ISDA Master Agreement (Multicurrency−Cross Border) (as copyrighted by ISDA in 1992, the "ISDA Master"), a document in use throughout the world in the "over-the-counter," or privately negotiated, derivatives markets. The ISDA Master, which was drafted for ISDA by its counsel, as directed by its members, provides a comprehensive agreement structure to govern over-the-counter derivatives transactions from inception to termination. The ISDA Master offers uniform terms with respect to, among other things, the mechanics of termination, including the calculation of a termination payment and any interest thereon. It has been estimated that the ISDA Master now governs many trillions of dollars of notional amount of transactions. See ISDA 2002 Mid-Year Market Survey, available at www.isda.org.

Lehman Brothers Special Financing Inc. ("LBSF") and Fin One entered into an ISDA Master and derivatives transactions thereunder. Finance One Public Company Limited v. Lehman Brothers Special Financing, 215 F. Supp.2d 395, 397 (S.D.N.Y. 2002). On July 25, 1997, LBSF informed Fin One that it was terminating the derivatives transactions, which Fin One agrees that LBSF was entitled to do under the parties' ISDA Master. Fin One at 398, 400. Four days later, on July 29, LBSF informed Fin One that it had calculated an aggregate Settlement Amount (as defined in the ISDA Master, essentially the value of the transactions to

one party or the other) of approximately $9.7 million owing to Fin One. LBSF simultaneously and in the same letter asserted a set-off with respect to the Settlement Amount, producing a net amount of approximately $12,000 payable to Fin One (which we understand was paid by LBSF). Id. at 398-99.

Fin One later filed a lawsuit against LBSF, challenging LBSF's set-off. Id. at 399. Ultimately, after determining that Thai law controlled the issue of set-off and appointing a Special Master in Thai law who offered alternative approaches to set-off, the Court ruled that LBSF was entitled to a set-off of approximately $4.3 million, roughly 45% of the set-off that LBSF had claimed initially. Finance One Public Co. Ltd. v. Lehman Bros. Special Financing, Inc., 2003 WL 2006598, at *2 (S.D.N.Y. May 1, 2003). Subsequent to that ruling, the Court determined that, pursuant to the ISDA Master, LBSF owed Fin One approximately six years' interest on approximately $5.4 million of disallowed set-off at the Default Rate (this term and all other capitalized terms not otherwise defined have the meanings set forth in the ISDA Master). The Court determined that the Default Rate in this case was to be in the 17% to 18% range, based on a Thai baht interest rate incurred by Fin One in 1997.

The early termination provisions of the ISDA Master were carefully designed to assure parties appropriate notice of amounts payable. The ISDA Master reflects precise and deliberate distinctions in the computation of interest amounts based on both the existence (or not) of notice of the amounts payable and the relative equities of the parties in causing early termination. The ISDA Master also specifies the currency in which amounts (including interest amounts) relating to early termination are to be paid.

The Interest Opinion, unfortunately, does not correctly reflect either the language or the intent of the ISDA Master. ISDA urges the Court to reconsider and revise the Interest

Opinion, both to achieve a correct result in the instant case and to avoid creating a dangerous precedent that will chill future efforts of over-the-counter market participants to fully pursue their legitimate and important set-off rights.

STATEMENT OF INTEREST

ISDA is the global trade association representing leading participants in the privately negotiated derivatives industry, a business which includes interest rate, currency, commodity, credit and equity swaps, as well as related products such as caps, collars, floors and swaptions. ISDA was chartered in 1985, and today numbers over 600 member institutions from 46 countries on six continents. These members include most of the world's major institutions that deal in and leading end-users of privately negotiated derivatives, as well as associated service providers and consultants. Since its inception, ISDA has pioneered efforts to provide standard documentation for derivatives in order to reduce the sources of risk in the derivatives and risk management business.

This case involves the determination of an interest amount payable upon early termination pursuant to the ISDA Master. The interest amount, as in the case at bar, may be a very significant sum, and miscalculation may produce a materially inequitable result. Most importantly, however, a precedent for such miscalculation may cause derivatives market participants to lose confidence in their ability to pursue their rights under the ISDA Master and applicable law, producing risk and uncertainty in the derivatives markets. ISDA has a substantial interest in ensuring that the ISDA Master is properly applied in a manner that encourages sound risk management practices and market stability. As the ISDA Master's publishing association, ISDA is especially suited to offer guidance as to the proper interpretation of the provisions at issue here.

ARGUMENT

POINT ONE

THE NON-DEFAULT RATE OR THE TERMINATION RATE, NOT THE DEFAULT RATE, SHOULD BE APPLIED.

Section 6(d)(ii) of the ISDA Master and related defined terms control the calculation of interest in this case. See Interest Opinion at *2. Section 6(d)(ii) provides that:

> [a]n *amount calculated as being due* in respect of any Early Termination Date *under Section 6(e)* will be payable on the day that *notice of the amount payable* is effective (in the case of an Early Termination Date which is designated or occurs as a result of an Event of Default) and *on the day which is two Local Business Days after the day on which notice of the amount payable is effective* (in the case of an Early Termination Date which is designated as a result of a Termination Date). Such amount will be paid together with (to the extent permitted under applicable law) interest thereon (before as well as after judgment) in the Termination Currency, from (and including) the relevant Early Termination Date to (but excluding) the date such amount is paid, at the Applicable Rate.

The definition of Applicable Rate referenced in Section 6(d)(ii) offers three possible rates: the Default Rate (based on the payee's cost of funds), the Non-Default Rate (based on the Non-defaulting Party's cost of funds) and the Termination Rate (based on both parties' cost of funds). The Court deemed the Default Rate to be applicable to LBSF's payment obligation. Interest Opinion at *2.

According to the definition of Applicable Rate, the Default Rate applies to obligations of a Defaulting Party (a party as to which there exists an Event of Default). LBSF obviously was not a Defaulting Party at the time it terminated its relationship with Fin One. Nor did LBSF became a Defaulting Party after that time. A failure to pay is an Event of Default under Section 5(a)(i) of the ISDA Master only if the payment in question was not paid "when due" and three local business days have passed "after notice of such failure is given to the party". In the case at hand, a specific amount payable by LBSF was calculated as due under the terms of

the ISDA Master, if at all, only quite recently (see discussion of Section 6(d) of the ISDA Master below). It further appears that notice of any failure to pay still has not been given to LBSF in a manner that complies with the terms of the ISDA Master.

The Default Rate may also apply to any party that has failed "to pay an amount under Section 6(e) . . . from and after the date (determined in accordance with Section 6(d)(ii)) on which that amount is payable." *As described in Section 6(d)(ii) set forth above, the date of effectiveness of notice of the amount payable pursuant to Section 6(e) is key to determining the date such amount is payable*.

Section 6(e) provides for calculation of payments on early termination. Most pertinently, it provides for calculation of an aggregate Settlement Amount and the application of rights of set-off. Sections 6(d)(i) and 6(d)(ii) of the ISDA Master formalize the requirement to deliver a notice with respect to calculation of the amount due under Section 6(e). Section 12(a) of the ISDA Master makes it clear that any notice pursuant to Section 6 must be given by the most reliable and verifiable means to the address specified by the parties in the Schedule to their ISDA Master. We are not aware of any such notice given by Fin One to LBSF with respect to the amount that the Court has determined is owed. The obvious goal of these provisions is to instill high procedural standards in the early termination process, so as to ensure clarity and certainty as to the parties' obligations.

We are aware of no notice given by Fin One in this case that would fulfill the requirements of the ISDA Master. LBSF did send a July 29, 1997 letter to Fin One that appears to comply with the relevant sections of the ISDA Master, reporting an aggregate Settlement Amount, a set-off and a payable of $12,305.27. LBSF's letter, of course, stated a payable completely different from the payable later determined by the Court after several years of

litigation. The payable computed by LBSF was based on the good faith assertion of a set-off right ultimately upheld in significant part by the Court. *In short, in this case it appears that Fin One never has given notice in compliance with the ISDA Master of the amount retrospectively determined by the Court to have been payable by LBSF which is a prerequisite to triggering the application of the Default Rate to LBSF*. Furthermore, there appears to have been absolutely no way for LBSF to establish what, if anything, it might owe beyond the $12,305.27 it initially paid until the Court's judgment regarding the amount of set-off was filed on May 1, 2003.

Assuming the Default Rate does not apply, choice of the appropriate Applicable Rate hinges on establishing whether termination is attributable to an Event of Default (a fault-based termination) or a Termination Event (a "no-fault" termination). In the former case, the Non-default Rate would apply. In the latter case, the Termination Rate would apply.

POINT TWO

EQUITY AND SOUND MARKET POLICY PRECLUDE APPLICATION OF THE DEFAULT RATE.

The definition of Applicable Rate is intended to reflect the equities of the several situations it articulates. The Default Rate is most onerous to the payer. It reflects the payee's cost of funds plus 1% per annum. The Default Rate is intended to apply to a party that has caused a default termination (i.e., is blameworthy) or a party that has failed to heed a properly delivered termination payment notice. The Non-default Rate, to be paid by a Non-defaulting Party, simply reflects that party's own cost of funds with no additional spread. It effectively reflects any funding cost that the Non-defaulting Party may have saved by retaining the underlying amount during the appropriate interest accrual period and causes the saved cost to be paid to the other party. The Termination Rate applies in all cases in which Default Rate and

Non-default Rate do not apply, including in the case of accrual of interest pending timely payment following a termination due to a Termination Event (often a "no-fault" termination). The Termination Rate is based on the arithmetic mean of each party's cost of funds and is intended to fit the "no-fault" character of the termination itself.

As stated above, LBSF is not a Defaulting Party and has not failed to heed a payment notice that complies with the ISDA Master. There is no contractual or equitable foundation for causing LBSF to pay interest at the Default Rate.

Even more importantly, consider the precedential effect of imposing the Default Rate on LBSF. Every time an ISDA Master terminates early, the parties (typically one of the parties) must calculate and give notice of payments due. An error in calculation of a sum due should not be punished by the levy of an onerous interest rate in any case where (as in the instant case) a party acting in good faith has based its calculation on the important right to set-off (in this case ultimately affirmed in significant part by the Court).

The law of set-off, particularly across jurisdictional lines, can be complicated, but the proposition underlying set-off, that a party should not be obliged to pay another party that is withholding payment to it, is fundamentally simple and equitable. The ISDA Master specifically takes account of the possibility of set-off because the ISDA Master provides an elective mechanism for payment of an amount on early termination to a Defaulting Party (or an Affected Party in a Termination Event) when the market value of the terminated transactions runs in favor of the Defaulting Party or Affected Party. See Sections 6(e)(i)(3) and (4). The ISDA membership chose to provide this elective mechanism in the ISDA Master in recognition of the equities of not depriving a Defaulting Party or Affected Party of the value of its transactions. At the same time, in providing for the possibility of set-off, the ISDA membership recognized that

the equities would be instantly reversed if a party were obliged to pay a Defaulting Party or Affected Party that was withholding funds from it. In summary, to apply the interest rate applicable to a Defaulting Party to LBSF in this case is not consistent with the provisions of the ISDA Master, offends the basic equities underlying the terms of the ISDA Master and creates additional and unwarranted risks for parties attempting to exercise their rights under the ISDA Master and applicable law.

POINT THREE

THE APPLICABLE RATE SHOULD BE BASED ON INTEREST RATES THAT ARE RELEVANT TO THE TERMINATION CURRENCY.

As discussed above, we believe that the Default Rate should not be applied to the amount payable by LBSF. Regardless of which Applicable Rate option does apply, we believe that the Applicable Rate in this case should be based on U.S. dollar interest rates.

Section 6(d)(ii) of the ISDA Master requires that the amount payable in respect of any Early Termination Date under Section 6(e) must be paid together with interest thereon in the Termination Currency. (The Termination Currency is defined to be as specified in the Schedule to the ISDA Master, in this case, effectively, U.S. dollars). It is important to note that the ISDA Master provides with great care that the Termination Currency requirement applies to each element of a possible early termination calculation. See Section 6(e)(i) and the definitions of "Settlement Amount" and "Loss". Section 6(d)(ii) completes this process by applying this requirement to the interest calculation. This reflects the fact that choice of currency of payment is vitally important to those in the privately negotiated derivatives markets. See, e.g., Section 8(a) (Payment in the Contractual Currency).

That funding in different currencies is available at markedly different interest rates is of course obvious. In essence, to apply an interest rate available with respect to one currency to an underlying payable in another currency is an economic non sequitur.

The record indicates that the Court has relied on Thai baht borrowing rates for the interest rate it has applied to LBSF. See Interest Opinion at *2 and the various Mongkhon Affidavits cited therein. Although we understand Thai baht rates to be the only actually incurred rates presented to the Court by Fin One, we also note that each of the three rate options under the ISDA Master provides that the rates utilized need not have been actually incurred, and could therefore be determined on an extrapolated or synthetic basis.

Accordingly, we urge the Court, in calculating any of the Applicable Rate options, to reconsider the use of rates that are contrary both to the express terms of the ISDA Master and basic economic logic.

CONCLUSION

For the foregoing reasons, amicus curiae the International Swaps and Derivatives Association, Inc. respectfully requests that the Court reconsider the June 30, 2003 Memorandum Opinion and Order and accompanying Judgment entered on July 17, 2003.

Dated: New York, New York
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