

GMRAS AND DETERMINING "FAIR MARKET VALUE": BROAD DISCRETION OF THE NON-DEFAULTING PARTY RE-AFFIRMED BY COURT OF APPEAL

The English Court of Appeal has ruled on the construction of the close-out default valuation provisions under a repo agreement. The Court's judgment reaffirms that, in reaching a determination of "fair market value", the non-Defaulting party has considerable discretion when making a determination in its "reasonable opinion" as long as it acts rationally and not arbitrarily or perversely.

THE ORIGINAL CLAIM

LBI EHF v Raiffeisen Bank International AG EWCA Civ 719 is one of a number of cases following on from the collapse of the Icelandic banking system in the autumn of 2008. The appellant LBI EHF (formerly Landesbanki islands hf, an Icelandic bank) ("LBI") had entered into a number of repo trades with the respondent, Raiffeisen Bank International AG ("RBI"). The repo trades were on the terms of the Global Master Repurchase Agreement 2000 edition (the "GMRA"). Following the failure of LBI on 7 October 2008 RBI gave notice calling an Event of Default.

The GMRA provides for the non-Defaulting Party to serve a Default Valuation Notice by the fifth dealing day after the Event of Default has occurred (the "Default Valuation Time") utilising one of three valuation methods.

No Default Valuation Notice was served by RBI by the Default Valuation Time (of 15 October 2008). In such circumstances the GMRA provides, by paragraph 10(e)(ii) that "... the Default Market Value of the relevant Equivalent Securities ... shall be an amount equal to their Net Value at the Default Valuation Time" and paragraph 10(d)(iv) defines Net Value by reference to "fair market value" (see box).

Following service of the Default Notice on LBI on 8 October, RBI asked for bids from 10 institutional counterparties. These were bids obtained in a distressed market as it was shortly after the collapse of Lehman Brothers. RBI used those bids in its determination of fair market value.

In the High Court judgment in March 2017 Knowles J. concluded that the figures used by RBI met the requirement for a rational, honest determination of fair market value as at 15 October 2008.

Key issues

- Broad discretion of non-defaulting party under GMRA in determining "fair market value" reaffirmed
- But it must be at rationally and not arbitrarily or perversely

"Net Value" and "fair market value"

"Net Value" is defined by paragraph 10(d)(iv) of the GMRA as meaning: "... at any time, in relation to any Deliverable Securities or Receivable Securities, the amount which, in the reasonable opinion of the non-Defaulting Party, represents their fair market value, having regard to such pricing sources and methods (which may include, without limitation, available prices for Securities with similar maturities, terms and credit characteristics as the relevant Equivalent Securities or Equivalent Margin Securities) as the non-Defaulting party considers appropriate, less, in the case of Receivable Securities, or plus, in the case of Deliverable Securities, all Transaction Costs which would be incurred in connection with the purchase or sale of such Securities."

THE APPEAL

LBI argued that the words "fair market value" in the definition of "Net Value" in paragraph 10 of the GMRA require the non-Defaulting Party to make an assessment of the price from the perspective of an unimpaired/willing buyer and an unimpaired/willing seller, neither being under any particular compulsion to trade. Accordingly, it would be wrong to base "fair market value" on prices or quotes achieved in a distressed or illiquid market. In such a market it would rather be necessary to ascribe a notional or theoretical value to the securities.

The Court considered LBI's argument made no commercial sense and was certainly not dictated by the terms of the provisions under consideration which, as Blair J said in *Lehman Brothers International (Europe) v Exxonmobil Financial Services BV* [2016] EWHC 2699 (Comm), provide for a "broad" assessment of "fair market value".

Moreover there is no express or implied provision in the GMRA limiting the exercise of this discretion. Therefore in determining the "fair market value" the only limitation on the non-Defaulting was that it must have acted rationally and not arbitrarily or perversely.

The Court of Appeal dismissed LBI's appeal.

CONCLUSION

The Court of Appeal judgment reaffirms that the non-Defaulting Party under a GMRA has a wide discretion, including in a distressed market, in reaching a determination of "fair market value", as long as it acts rationally and not arbitrarily or perversely.

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