DISCRETION AND LOSS

The question of how much latitude a Non-defaulting Party has when calculating Loss under the 1992 ISDA Master Agreement is considered in the judgment in *Lehman Brothers Finance AG (in liquidation) v (1) Klaus Tschira Stiftung GmbH (2) Dr H C Tschira Beteiligungs GmbH & Co KG* [2019] EWHC 379 (Ch), handed down on 22 February 2019.

Key issues

- A Non-defaulting Party has discretion as to the method of calculating Loss, but not as to what should be included within Loss.
- It will not always be necessary to calculate Loss as at the Early Termination Date.
- The Non-defaulting Party has some flexibility in the choice of live quotations or indicative valuations.

This is a topic that has already been the subject of a number of prior judgments, in both the English and US courts, including *Fondazione Enasarco v Lehman Brothers Finance SA* [2015] EWHC 1307 and *LBHI v Intel Corporation* (SDNY 16 September 2015). This decision further refines and clarifies the position. It should be noted that the concept of Loss and its calculation is only of relevance to ISDA Master Agreements up to the 1992 version; the 2002 ISDA Master refers instead to a Close-Out Amount, which has some differences in definition.

Tschira concerned the calculation of Loss following an Automatic Early Termination brought about by the collapse of Lehman Brothers in September 2008. The defendants had each entered into a series of collateralised equity derivatives with the Swiss Lehman trading entity to protect themselves against volatility in the SAP share price. Following Lehmans' demise on 15 September 2008, the derivatives trades became subject to Automatic Early Termination.

The position was made more complicated for the Tschira entities because the SAP shares they had deposited with LBIE as collateral for the equity derivatives transactions became caught up in the LBIE insolvency and were therefore unavailable for them to use as collateral for replacement transactions.

Faced with a situation when they did not know when, or even whether, the SAP shares would be returned to them, in December 2008 the Tschira entities eventually calculated their Loss on the basis of uncollateralised transactions, as at 16 October 2008.

The court found that this was not within the latitude afforded to a Non-defaulting Party. In particular, while a Non-defaulting Party does have discretion as to the method of calculating Loss, and does not necessarily need to do so as at the Early Termination Date, that discretion does not extend to discretion as to what should fall within Loss.

Instead, the court held that what the parties had intended by their use in the contract of the term "Loss", and thus the correct interpretation of the contract, was that Loss should be calculated in accordance with the usual common law principles applicable to assessment of contractual damages, including in

relation to remoteness. In this particular case, applying the usual test for remoteness, the judge found that it was not within the reasonable contemplation of the parties that the Tschira entities' collateral would be inaccessible in the event of a default by LBF and that as a result the Tschira entities could not calculate Loss on the basis of uncollateralised transactions.

The court then had to determine what the Tschira entities would have done had they calculated Loss correctly. It rejected LBF's submission that where a Non-defaulting Party was relying on indicative valuations that it must always do so using indicative valuations as at the Early Termination Date, as that would not always be possible (for example, if there was no available market at the time of the Early Termination Date).

In this particular case, the court determined that the Tschira entities should have determined Loss based on quotations or indicative valuations for collateralised replacement transactions as of a date as soon as reasonably practicable after the Early Termination Date.

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