

GENERAL INTEREST QUESTION: Does Section 11.1(b)(iii) of the 2014 Credit Derivatives Definitions (or, as applicable, its predecessor, Section 9.1(b)(iii) of the 2003 Credit Derivatives Definitions) permit a Protection Buyer to induce a Failure to Pay Credit Event by providing consideration to a Reference Entity in exchange for the Reference Entity's agreement to withhold a payment under an Obligation?

This Statement is submitted in connection with a General Interest Question as to the interpretation of Section 11.1(b)(iii) of the 2014 Credit Derivatives Definitions and its predecessor, Section 9.1(b)(iii) of the 2003 Credit Derivatives Definitions (as applicable, the "Relevant Clause").

The CDS market operates based on the market participants' ability to accurately assess risk, which such participants currently do based on the working assumption that Reference Entities will endeavor to avoid default whenever possible to protect their reputations and their access to capital markets.<sup>1</sup>

The General Interest Question concerns, as acknowledged by the ISDA, "engineered defaults"<sup>2</sup> when a party to a CDS Transaction serves as the engineer. Parties to CDS Transactions involving at least two Reference Entities have used the Definitions as the scaffolding for an "engineered default," relying on the Relevant Clause as a "safe harbor" for their conduct.<sup>3</sup> Indeed there is a recent decision by the Supreme Court of the State of New York, Appellate Division, First Judicial Department, which held that the Relevant Clause expressly permitted a CDS party to act in a way "without regard to the existence of the swap or any adverse effect it might have on [the counterparty]'s position in the swap."<sup>4</sup>

In reaching that decision, the Appellate Division conceded that the Relevant Clause is "confusing" but did not consider any expert testimony (from the former General Counsel of ISDA, Kimberly Summe) necessary to shed light on it. Similarly, in a recent decision denying a request for a preliminary injunction, a federal district court appeared not to have given weight to the testimony of another expert (the former General Counsel and Chief Executive Officer of ISDA, Robert Pickel) regarding the intent of the Relevant Clause, either initially in 1999 or subsequently in connection with the changes to the Credit Derivatives Definitions.<sup>5</sup> Mr. Pickel disagreed the Relevant Clause sanctions the conduct in question, and Ms. Summe, had she been given the opportunity to testify, would have as well.

Given the strongly diverging views on the meaning of the Relevant Clause and the substantial, arguably existential, threat that the confusion presents to the CDS market, we believe the Determinations Committees should be convened to consider the General Interest Question and provide certainty to the market. This type of contractual interpretation relevant to the credit derivatives market generally is squarely within the purview of the Determinations Committees.

We confirm that a copy of this statement may be provided for information purposes only to the members of any Credit Derivatives Determinations Committee convened under the DC Rules in

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<sup>1</sup> Solus Alternative Asset Mgmt. LP v. GSO Capital Partners LP, No. 18 CV 232-LTS-BCM, 2018 WL 620490, at \*4 (Jan. 29, 2018).

<sup>2</sup> See, e.g., Sridhar Natarajan & Erik Schatzker, GSO's Goodman Backs Closing CDS Loophole That His Firm Mastered, BLOOMBERG, Mar. 9, 2018.

<sup>3</sup> GSO's Mot. Dismiss, ECF No. 91, at 19-20 (March 2, 2018), Solus Alternative Asset Mgmt. LP v. GSO Capital Partners LP, No. 18 CV 232-LTS-BCM.

<sup>4</sup> Good Hill Master Fund L.P. v. Deutsche Bank AG, 146 A.D.3d 632 (1<sup>st</sup> Dep't 2017).

<sup>5</sup> See Pickel Supp. Decl., ECF No. 34, ¶¶22-24 (Jan. 16, 2018), Solus Alternative Asset Mgmt. LP v. GSO Capital Partners LP, No. 18 CV 232-LTS-BCM.

connection with the General Interest Question to consider the issues discussed herein, and that it may be made publicly available on the ISDA Credit Derivatives Determinations Committee website. We accept no responsibility or legal liability in relation to its contents.