UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re: LEHMAN BROTHERS HOLDINGS INC., *et al.* Debtors.	Chapter 11 Case No. 08-13555 (SCC)
LEHMAN BROTHERS SPECIAL FINANCING INC., Plaintiff, - *against* - BANK OF AMERICA NATIONAL ASSOCIATION, *et al.*, Defendants.	Adversary Proceeding No. 10-03547 (SCC)

AMICUS CURIAE STRUCTURED FINANCE INDUSTRY GROUP'S BRIEF IN SUPPORT OF DEFENDANTS' MOTION TO DISMISS

CORPORATE DISCLOSURE STATEMENT

The Structured Finance Industry Group, Inc. (***SFIG***) has no parent corporation and no publicly held corporation has any ownership interest in SFIG.

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STATEMENT OF INTEREST[1]

The Structured Finance Industry Group, Inc. (***SFIG***) is a member-based trade industry advocacy group focused on improving and strengthening the broader structured finance and securitization market. SFIG has over 300 members from all sectors of the securitization market, including investors, issuers, financial intermediaries, accounting, law, and technology firms, rating agencies, servicers, and trustees. SFIG's core mission is to support a robust and liquid securitization market, recognizing that securitization is an essential source of core funding for the real economy. For more information, visit www.sfindustry.org.

SFIG's members—who are involved in every aspect of the structured finance industry and participate in securitization transactions in capacities as diverse as trustees, issuers, paying agents, structurers, and noteholders—have diverse economic interests in the various transactions to which they are party. However, this diverse membership shares the common goal of ensuring that agreements used to document securitization transactions are interpreted in accordance with their terms and that the law governing those transactions is applied in accordance with market expectations. Moreover, SFIG's members have a keen interest in ensuring the finality and predictability of securitization transactions. The validity and enforceability of the priority of payment provisions at issue in this litigation (***Priority Provisions***) is central to the functioning of securitization and swap markets. These questions implicate not only the collateralized debt obligations (***CDOs***) and credit-linked note programs at

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1 Although Fed. R. Bankr. P. 8017(c)(4) does not apply to proceedings in this Court, SFIG states, consistent with that Rule, that no party's counsel authored this brief in whole or in part; that no party or party's counsel contributed money that was intended to fund preparing or submitting the brief; and that no person other than SFIG, its members, and its counsel contributed money that was intended to fund preparing or submitting this brief. Capitalized terms used but not defined herein have the meaning assigned to them in the Omnibus Motion of the Noteholder Defendants to Dismiss the Fourth Amended Complaint, ECF No. 1156 (***Defs. Br.***).

issue in this litigation, but are likely to affect hundreds, if not thousands, of derivatives transactions, including currency and interest rate swaps, at the heart of the structured finance industry. As such, SFIG has an interest in ensuring that the Priority Provisions are interpreted and enforced by their terms, including to preserve the market expectation that they will be enforced in the event of a bankruptcy.

SUMMARY OF ARGUMENT

In this case, Lehman Brothers Special Financing Inc. (***LBSF***) seeks to undo dozens of transactions that it, or its affiliates, conceived of, marketed, and structured because, according to LBSF, enforcing these transactions as agreed to by the parties would mean that Noteholders receive a "windfall" at the expense of LBSF and its creditors. At the heart of the dispute are provisions that govern the order in which payment is made in structured finance transactions, including the CDO transactions at issue here. As is common in the market for structured finance products, in negotiating and structuring the transactions at issue here, the parties bargained for who would have the right to be paid first in the event the transaction was terminated. Unhappy with the deal it crafted and sold, LBSF now seeks to invoke inapplicable provisions of the Bankruptcy Code to invalidate these Priority Provisions. The Court should decline LBSF's request to reformulate the contracts structuring the transactions at issue.

First, permitting LBSF to walk away from deals that it structured would significantly undermine the certainty and finality provided by agreements documenting complex structured transactions, including the CDO transactions at issue here, which market participants require for the orderly functioning of the financial markets, and the US economy as a whole.

Second, LBSF negotiated and entered into these agreements and benefitted from having the Priority Provisions. It should not now be permitted to escape the effect of these provisions. In any event, LBSF is wrong about the defendants receiving a windfall because the defendants received only those funds to which they were contractually entitled. Under the transaction that LBSF crafted, it was not entitled to be paid prior to the Noteholders and it should be required to live by the bargain it struck.

Even more worrisome is LBSF's attempt to undermine the Bankruptcy Code's safe harbors. The Section 560 safe harbor expressly permits a party to cause the termination and liquidation of a swap agreement, anything else in the Bankruptcy Code notwithstanding. Arguments seeking to avoid Section 560, such as the notion that the Priority Provisions are not safe harbored because they are not "part of" the swap agreements, or that distribution of funds according to the Priority Provisions is not part of a swap agreement's "liquidation," ignore long-held market expectations about how documents constituting derivative transactions will be, and should be, interpreted. These arguments also run headlong into the safe harbor's plain text, which was designed to avoid uncertainty and therefore was crafted broadly to provide robust protection for market participants who are parties to a swap agreement, the counterparty to which files for bankruptcy.

Grafting counter-textual limitations onto the safe harbor would result in the invalidation of contractual provisions present in, and critical to the functioning of, nearly all structured financial products. Given the importance of structured financial products to the broader U.S. economy, SFIG respectfully requests that this Court reject LBSF's invitation to introduce needless uncertainty and volatility into these transactions.

ARGUMENT

A. The Transaction Documents Must be Enforced as Written to Ensure Confidence in the Structured Financial Products Market.

The structured financial products market, including the market for the CDO transactions at issue here, is composed of sophisticated market participants. It is thus not surprising that contracts documenting such transactions are heavily negotiated, with particular attention paid to contractual provisions dealing with termination, valuation, and payment obligations under the agreements.

Parties to a derivative transaction based on a credit default swap (***CDS***) may, for example, agree that upon the occurrence of a credit event in one of the reference securities, the swap counterparty is automatically entitled to be paid. Or, they may agree that the swap counterparty has the ability to demand payment, but does not have to do so. Parties may agree that the swap counterparty is always entitled to be paid first. Or, as is the case in these transactions, they may agree to subordinate or waive the right of a swap counterparty to be paid before the noteholder in order to obtain a higher rating for the notes being issued in the transaction or to make the notes more marketable to market participants. Or, the parties may agree that the non-defaulting party will be entitled to a "make whole" provision in the event the transaction is unwound early. The ability to customize the parties' rights and obligations is nearly infinite. However, the stability of this market depends on the enforcement of contractual terms to which the parties agreed. If parties are able to recut the deal and create for themselves new rights for which they did not bargain—after the deal has been executed and parties have relied on its terms in structuring their operations and affairs—the structured finance market will quickly become unpredictable and unstable, potentially undermining its viability, and, with it, the health of the U.S. economy.

Reduced to its essence, LBSF's argument is that had the Priority Provisions not been applied, LBSF would have received billions of dollars in value, which instead went to the various Noteholders. This argument ignores the market realities that drove the parties to agree to Priority Provisions in the first place. Moreover, LBSF's argument ignores the actual structure of these transactions. The Court should decline LBSF's invitation to revise the agreements documenting dozens of complex, heavily negotiated financial structures.

1. Background on the Transactions and Documentation.

To understand the flaw in LBSF's conception of the case, it is important to understand the transactions at issue. While the transactions differ from one another in certain important respects, their structures are largely similar. Moreover, not only are these transactions similar to one another, but, based on SFIG's knowledge, the structures of the CDOs at issue in this litigation are typical of those employed in the structured finance industry in general.

A typical CDO transaction consists of four components:

- **An Issuer**: An "Issuer," a special purpose vehicle, issues a series of notes or, in certain instances, trust certificates (***Notes***) notes to investors (i.e., the Noteholders). As is typical in the structured finance market, the Issuer is frequently created by the party marketing the transaction, which, here, would be affiliates of LBSF.
- **A Credit Default Swap or Swaps**: The Issuer also enters into a credit default swap with a counterparty (i.e., the Swap Counterparty), here LBSF, pursuant to which the Issuer sells the counterparty the protection of a basket of certain referenced securities. Typically, the securities in question are jointly selected by the Noteholder and the party marketing the transaction, here LBSF or one of its affiliates.
- **Collateral**: The Issuer uses the money received from the Noteholders to buy collateral. The collateral, which is generally a very highly rated liquid investment, secures the Issuer's obligations to both the Noteholders and the Swap Counterparty.
- **A Trustee**: Finally, a Trustee is appointed to hold the collateral in custody. The Trustee holds a lien on the collateral for the benefit of both the Noteholders and the Swap Counterparty.

The various components of the transaction are documented in a number of different contracts—a swap agreement, a note purchase agreement, indenture, etc. [2]— and are viewed by the market participants as a single integrated transaction, with all the various agreements informing the

[2] For purposes of this brief, references to "indenture" include the applicable indenture, trust deed, supplemental trust deed, and/or standard terms for indentures that govern the issuance of the Notes and the disposition of the collateral securing the Issuer's obligations to the Swap Counterparty and Noteholders.

interpretation and understanding of the other agreements. See Charles W. Smithson, Credit Portfolio Management 230-32 (2003).

Moreover, because of the number of parties involved in these complicated transactions, the parties negotiated the order in which they are to be paid in both the ordinary course and in the event of default. These negotiations can be lengthy and the Priority Provisions are relied on by the parties in entering these transactions. See Evan Jones et al., Lehman Bankruptcy Judge Prevents Trigger of CDO Subordination Provision Based on Credit Support Provider and Swap Counterparty Bankruptcy Filings, 127 Banking L.J. 338, 342-43 (2010) (describing how the parties' intent was not honored when Priority Provisions were struck down).

2. The Securitization Market Requires that Priority Payments Be Predictable.

The inclusion of Priority Provisions in these heavily negotiated transactions is not surprising. LBSF chose to include these provisions in these transactions because it received significant benefits for doing so. In marketing these transactions, LBSF and its affiliates (collectively, ***Lehman***) knew that Lehman was more likely to find buyers if the notes issued by the CDO were rated by a credit rating agency. Without such ratings, many investors (such as insurers and pension funds) would be unable to purchase the notes, leading to a decline in the CDO market. *See e.g.*, In re Lehman Bros. Mortg.-Backed Sec. Litig., 650 F.3d 167, 171 (2d Cir. 2011) ("Investment-grade ratings were crucial to the certificates' sale because many institutional investors must purchase investment-grade securities."); 12 C.F.R. Part 1 (limiting the legal investment authority of national banks based on the credit rating of the investment); Gretchen Morgenson, Pension Funds, Dancing a Two-Step with Ratings Firms, N.Y. Times, June 15, 2014 at BU1 (describing how state pension funds may only invest in securities if those securities are rated investment grade by a recognized credit rating agency).

Obtaining a high rating for these notes, however, required Lehman to delink the risk that it may default from the risk underlying the transaction as a whole. See Francesca Campolongo et al., Quantitative Assessment of Securitisation Deals 11 (2012) (mitigating counterparty risk requires delinking the counterparty's credit risk from the credit risk of the transaction). Indeed, mindful of the default risk posed by the swap counterparty—which is often, in SFIG's experience, the entity that designs the CDO structure—rating agencies have "required" that the risk be addressed. See, e.g., See Standard & Poor's, Global Cash Flow and Synthetic CDO Criteria, Mar. 21, 2002, at 22 ("Standard & Poor's has required that mitigation of the counterparty risk be addressed . . . . Typically, solutions include subordinating the termination [payment] in the waterfall to the rated noteholders."); Stefan Bund et al., Counterparty Risk in Structured Finance Transactions: Hedge Criteria, Fitch Ratings, Aug. 1, 2007, at 12 ("One way to provide additional protection to the noteholders in the event of a default by the counterparty is to make any termination payments owed by the SPV to the counterparty subordinate to any payments of interest and/or principal and the topping up of any reserve fund in the Structured Finance transaction's priority of payments."); Michael Drexler & Katrien van Acoleyen, CDO Spotlight: Counterparty Risk In Structured Finance Transactions, Standard & Poor's, Mar. 7, 2005, at 1 ("[M]itigated credit risk" can be achieved "by structuring the transaction in such a way that it would terminate with no loss to investors if the counterparty did not comply with certain downgrade provisions."); Standard & Poor's, Global Cash Flow and Synthetic CDO Criteria, Mar. 21, 2002, at 22 (solutions to counterparty risk include "subordinating the termination [payment] in the waterfall to the . . . noteholders); Standard & Poor's, Criteria for Rating Synthetic CDO Transactions, Sept. 2003, at 33 (requiring that the termination payment be sized or subordinated to the rated noteholder in the priority of payments).

Thus, to obtain the desired ratings for the notes that Lehman was structuring and selling, FAC ¶ 2, Lehman had to include the Priority Provisions. Moreover, not including these provisions would have substantially impaired Lehman's ability to sell these notes. The Priority Provisions are of critical importance to the market for structured financial products and institutions who participate in those markets because they clearly delineate the circumstances under which one party (i.e., the Noteholders) will be paid first, and the circumstances under which a different party (i.e., the Swap Counterparty) will be paid first. Absent the certainty created by the Priority Provisions, market participants may become unwilling to participate in the market for structured financial products altogether.

Priority Provisions are also important to noteholders for the same reasons they are important to the rating agencies. Indeed, in SFIG's experience, noteholders frequently want structural seniority, such as the Priority Provisions, before purchasing a structured financial product, because although they may be willing to take the risk that a reference basket will perform poorly, they may not want to take the risk that the swap counterparty will default. The Priority Provisions eliminate that risk, facilitating liquidity in the markets for structured financial products. LBSF's position here—that Priority Provisions are invalid and fall outside the safe harbors—would mean that an investor in a CDO must always bear the risk of the swap counterparty going bankrupt and, therefore, would undo the fundamental economics of the deal. That, however, is counter to the well-settled expectations of market participants, who have relied on the Priority Provisions in structuring thousands of derivative transactions, many of which are scheduled to last for years, if not decades.

A ruling in LBSF's favor would not only permit LBSF to undo the bargain it previously struck, but would have the broader effect of putting the validity of thousands of transactions in doubt. That, in turn, will undermine the stability of the market for structured financial products, and, given the structural importance of those markets, have a potentially broader impact on the economy of the United States. See Evan Jones et al., supra, at 343-44 (explaining how a ruling finding the Priority Provisions are unenforceable could reach beyond synthetic CDOs and have "broader implications for many market participants in terms of financing opportunities, risk mitigation and, for banks, capital requirements"). Indeed, it is precisely the risk of such contagion that motivated Congress to pass the safe harbors in the first place, to promote market stability and predictability by permitting market participants to terminate and unwind such contracts in the event of a counterparty's bankruptcy, and to immunize transfers received in connection with such contracts from the powers of the Bankruptcy Court. H.R. Rep. No. 101-484, at 2 (1990), reprinted in 1990 U.S.C.C.A.N. 223, 224 ("U.S. bankruptcy law has long accorded special treatment to transactions involving financial markets, to minimize volatility. Because financial markets can change significantly in a matter of days, or even hours, a non-bankrupt party to ongoing securities and other financial transactions could face heavy losses unless the transactions are [resolved] promptly and with finality.").

Having benefited from these provisions, LBSF should not now be permitted to reinterpret the deal to obtain additional benefits and avoid the adverse consequences of the Priority Provisions. Indeed, the mere fact that a contractual provision becomes disadvantageous to the debtor upon the debtor's default is not a reason for a court to refuse to enforce it. See In re United Merchs. & Mfrs., Inc., 674 F.2d 134, 137 (2d Cir. 1982) (authorizing payment of liquidated damages based on a debtor's default). The Court should not rewrite the contracts between the parties merely because one of the parties now claims that it is prejudiced by the contract's application. To do otherwise would undermine the certainty and finality that contracts are designed to achieve.

3. Under the Transaction Documents, LBSF Was Not Entitled to Payment.

In any event, LBSF's claim that the Priority Provisions hand the Noteholders a windfall at the expense of LBSF and its creditors misrepresents LBSF's rights under the agreements. As is the case in all derivative transactions, the contractual provisions outlining when, and to whom, payment was to be made were negotiated.

Under the transaction documents, as is typical with CDO transactions, the Noteholders were entitled to receive payment on regularly scheduled dates. See, e.g., Offering Memorandum for the Series 2006-1 Segregated Portfolio of 801 Grand CDO SPC, dated July 11, 2006, Decl. of Shannon M. Leitner, Ex. B, at 3, dated December 21, 2015 (***Leitner Decl.***). In contrast, LBSF, as a purchaser of credit default protection, was entitled to receive cash payments only if certain conditions were satisfied.

One circumstance in which LBSF was entitled to be paid ahead of the Noteholders, was an "Issuer Event," as defined in the applicable swap documentation:

1. The Issuer's failure to pay; or
2. The Issuer's insolvency or bankruptcy; or
3. The payment or performance by the Issuer of its obligations under the transaction becoming illegal; or
4. The payment or performance by the Issuer becoming subject to certain withholding or similar taxes; or
5. An additional event permitting LBSF to terminate the swap agreement, such as the occurrence of an event of default under an indenture.

See, e.g., Omnibus Motion of the Noteholder Defendants to Dismiss the Fourth Amended Complaint, Ex. A, ECF No. 1195, at 15-16 (stating that LBSF held a senior right to payment in the case of an Issuer Event but that it has not and cannot claim one has occurred.). Here, there is no allegation in the FAC or elsewhere that any Issuer Event occurred.

Absent an Issuer Event, LBSF would receive payment ahead of the Noteholders only if (i) a Credit Event occurred and (ii) LBSF satisfied certain additional contractual obligations to create payments due to LBSF. The Fourth Amended Complaint is wholly devoid of any allegation that at the time the transactions at issue were terminated, LBSF was entitled to receive any payment on account of any Credit Event that had already occurred. Thus, at the time the transactions were terminated, LBSF was not entitled to be paid ahead of the Noteholders.

Unable to allege that it was owed any payments, LBSF instead alleges that it was "in the money" on these transactions, see FAC ¶ 7. LBSF's "in the money" claim is misleading because it is based on a present day projection of what payments LBSF might receive on account of possible future defaults in the reference portfolios if the transaction were to run to maturity. That is, LBSF's claim is based on a September 2008 guess as to how many entities whose obligations made up the referenced basket of securities would default and the valuation of those defaults. Given the length of the deals—which generally lasted more than a decade, see, e.g., Leitner Decl. Ex. B, at 2—it is, at best, speculation that LBSF ever would have become entitled to these monies. Depending on the assumptions that were used in the model, the actual number of "Credit Events" could have been far fewer than what was assumed. In any event, although LBSF could have drafted the contract to provide that it would be paid on the basis of its models, that is not what the deal that LBSF did negotiate provided for. Those deals provided for LBSF being paid prior to the Noteholders only under certain limited circumstances which never occurred. Indeed, it is notable that Noteholders with fixed interest rate notes here similarly bargained only for the right to receive interest which actually accrued up to the notes were repaid and not for any "make-whole" or yield protection rights to compensate them for the loss of the potential interest rate benefit had the transaction run to original maturity. See Leitner Decl. Ex. B. The lack of a "make-whole" provision in these transactions simply demonstrates that multiple parties bargained for and received some rights, but not others. While the fixed rate Noteholders did not bargain for or obtain a senior right in the collateral to make them whole for the loss of future interest payments due on the Note, LBSF did not bargain for or obtain a right to be paid before the Noteholders in the event the transaction terminated early to compensate them for the loss of a potential benefit which might result from the occurrence of possible, but not certain, credit events.

LBSF should be forced to abide by the deal it crafted. Permitting it to improve its position because it filed for bankruptcy not only creates absurd incentives, but undermines market participants' confidence that their contracts will be applied according to their terms. This is a result that, SFIG respectfully submits, should be avoided.

B. The Bankruptcy Code's Safe Harbors Must Be Interpreted in Accordance with Standard Market Practices and Plain Meaning.

SFIG endorses the Noteholder Defendants' argument that the Priority Provisions, as applied in this case, do not constitute ipso facto clauses. Defs. Br. at 12-26. Even if they did, the Court should nevertheless dismiss the FAC because the transfers made in accordance with the Priority Provisions are protected by the Bankruptcy Code's Section 560 safe harbor. That safe harbor provides, in pertinent part:

> The exercise of any contractual right of any swap participant or financial participant to cause the liquidation, termination, or acceleration of one or more swap agreements because of a condition of the kind specified in section 365(e)(1) of this title or to offset or net out any termination values or payment amounts

> arising under or in connection with the termination, liquidation, or acceleration of one or more swap agreements shall not be stayed, avoided, or otherwise limited by operation of any provision of this title or by order of a court or administrative agency in any proceeding under this title.

The proper interpretation of this safe harbor, and of the related safe harbors contained in Sections 546 and 362(b)(17) of the Bankruptcy Code, are of tremendous importance to SFIG and its members. Market participants, including SFIG's members, negotiate thousands of financial agreements worth billions of dollars with the safe harbors in mind. These safe harbors are key to market participants' expectation that should their counterparty fall insolvent they will be able to terminate swap agreements, 11 U.S.C. § 560, to cause the liquidation and acceleration of the swap agreements, 11 U.S.C. § 560, to exercise contractual set off rights, 11 U.S.C. §§ 362(b)(17) & 560, and to be secure that the transfers they receive in connection with the financial contracts will be immune from the Bankruptcy Code's avoidance claims, 11 U.S.C. § 546. Absent the safe harbors, participants in the nation's financial markets would have less certainty in their transactions, and the bankruptcy of one participant could potentially lead to contagion and market instability with adverse effects for the economy as a whole. See Mark Sherrill, In Defense of the Bankruptcy Code's Safe Harbors, 70 Bus. Law. 1007, 1030 (Fall 2015) (applying the automatic stay to Lehman's counterparties could have caused "unsustainable losses" and "would have led to some form of domino effect, exacerbating the crisis"); 136 Cong. Rec. S7535 at 10 (daily ed. June 6, 1990) (remarks of Sen. DeConcini) (explaining safe harbors were meant to stabilize domestic markets).

Seeking to avoid such instability, for over thirty years Congress has acted to insulate participants in the structured finance markets from the risk posed by a counterparty's bankruptcy. See, e.g., id. (safe harbors enacted "to provide certainty for swap transactions and thereby stabilize domestic markets by allowing the terms of the swap agreements to apply notwithstanding the bankruptcy filing"). Congress did so by passing the first safe harbors in 1982 and, over time, consistently expanding the scope of the safe harbors. Thus, in 1982, Congress enacted a safe harbor for securities transactions, see 1982 Amendments to Bankruptcy Code, Pub. L. No. 97-222, 96 Stat. 235 (now codified, as amended, at 11 U.S.C. §§ 362(b)(6), 546(e), 555, 556 (2012)); see also H.R. Rep. No. 97-420 (1982), reprinted in 1982 U.S.C.C.A.N. 583. In 1984, it extended that safe harbor to repurchase agreements, see 1984 Amendments to Bankruptcy Code, Pub. L. No. 98-353, §§ 391-96, 98 Stat. 333 (now codified, as amended, at 11 U.S.C. §§ 362(b)(7), 546(f)), 559 (2012)); see also S. Rep. No. 98-65 (1983). In 1990, it created the safe harbor at issue here—11 U.S.C. § 560—to expressly permit the termination of swap agreements. See 1990 Bankruptcy Amendments, Pub. L. No. 101-311, § 106, 104 Stat. 267; H.R. Rep. No. 101-484, at 5 (1990), reprinted in 1990 U.S.C.C.A.N. 223. Then, in 2005, Congress substantially expanded the scope of the safe harbors by (a) expressly including contractual acceleration and liquidation rights in the scope of Section 560 (previously only "termination" was included expressly) and (b) broadening the definition of "swap agreement" to include security agreements or other credit enhancements as protected components of the swap agreement. See Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 907(j), 119 Stat. 23; H.R. Rep. No. 109-31, at 20 & n.79 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 105. And, in 2006, it amended the Code yet again to expand the safe harbor for master netting agreements. Financial Netting Improvements Act of 2006, Pub. L. No. 109-390, § 5, 120 Stat. 2692, 2697 (codified at 11 U.S.C. § 362(b)(17)).

As Congress itself observed, this unidirectional evolution reflects the need "to keep pace in promoting speed and certainty in resolving complex financial transactions." H.R.

Rep. No. 101-484, at 2 (1990), reprinted in 1990 U.S.C.C.A.N. 223, 224. As Congress explained,

> U.S. bankruptcy law has long accorded special treatment to transactions involving financial markets, to minimize volatility. Because financial markets can change significantly in a matter of days, or even hours, a non-bankrupt party to ongoing securities and other financial transactions could face heavy losses unless the transactions are resolved promptly and with finality.

Id.

Courts around the country have recognized the Congressional mandate to immunize complicated financial transactions from the disruption of the bankruptcy process. As the Seventh Circuit recently explained, the safe harbors "reflect[] a policy judgment by Congress" that "chose finality over equity" by exempting financial transactions from many of the Bankruptcy Code's provisions. See Grede v. FCStone, LLC, 746 F.3d 244, 253-54 (7th Cir. 2014). Likewise, the Second Circuit and courts in this District repeatedly have noted that the safe harbors require a "broad and literal interpretation." Picard v. Citibank, N.A. (In re Madoff Secs.), 505 B.R. 135, 142-43 (S.D.N.Y. 2013); Enron Creditors Recovery Corp. v. Alfa, S.A.B. de C.V. (In re Enron Creditors Recovery Corp.), 651 F.3d 329 (2d Cir. 2011) (safe harbors should be interpreted broadly to promote certainty and predictability); Official Comm. of Unsecured Creditors v. Am. United Life Ins. Co. (In re Quebecor World (USA) Inc.), 719 F.3d 94, 99-100 (2d Cir. 2013) (stressing importance of promoting stability in the financial markets when interpreting the safe harbor). Indeed, courts of appeals and district courts repeatedly have resisted invitations to interpret the safe harbors narrowly. See, e.g., Thrifty Oil Co. v. Bank of Am. Nat'l Tr. & Sav. Assoc., 322 F.3d 1039, 1050-51 (9th Cir. 2002) (Bankruptcy Code should not be interpreted "[i]n a way that would either (1) needlessly discourage the invocation and flexibility that has made interest rate swaps such a valuable risk management and financial tool, or (2) inject unnecessary legal uncertainty into the swap market"); see also Enron, 651 F.3d 329 (rejecting narrow reading of safe harbor to protect only ordinary course transactions); Picard v. Ida Fishman Revocable Tr. (In re Bernard L. Madoff Invs. Secs. LLC), 773 F.3d 411 (2d Cir. 2014) (rejecting Ponzi scheme exception to the safe harbors); Whyte v. Barclays Bank PLC, 494 B.R. 196 (S.D.N.Y. 2013) (rejecting and criticizing attempt to evade bankruptcy court safe harbors).[3]

In this case, the termination of the swap and the distribution of the collateral in accordance with the Priority Provisions is protected by the Bankruptcy Code's safe harbor. As such, a reasonable application of the safe harbor to this case requires the dismissal of LBSF's claims against the Noteholders. In particular, Section 560 of the Bankruptcy Code protects the validity and enforceability of the Priority Provisions. Section 560 provides that, notwithstanding the bankruptcy of a counterparty, a "swap participant" may "exercise contractual rights" "to cause the liquidation, termination, or acceleration of one or more swap agreements." 11 U.S.C. § 560. The Priority Provisions constitute rights of the Issuers (and the Trustees), who are "swap participants" within the meaning of the Bankruptcy Code. See 11 U.S.C. § 101(53)(C) ("swap participant" is "an entity that . . . has an outstanding swap agreement with the debtor"); see also FAC ¶ 55 ("The Issuers and LBSF were parties to one or more Swap Agreements in connection with each CDO."). As the Trustees acted on behalf of the Issuers, and were permitted to do so by contract, the Priority Provisions were "exercised" by a swap participant. And in doing so, the

[3] While many of the authorities cited in this section focus on the safe harbor of Section 546, there is no reason to believe that Congress intended for the safe harbors of Section 560 and 362 to be read narrowly. To the contrary, the safe harbors, while codified in different sections of the Bankruptcy Code serve the same purpose: promoting finality and stability in the financial markets. Rhett G. Campbell, Energy Future and Forward Contracts, Safe Harbors and the Bankruptcy Code, 78 Am. Bankr. L.J. 1, 55 (2004) ("Perceiving a need for stability and smooth functioning in financial markets, Congress granted special treatment [in the form of] safe harbors in bankruptcy for these and similar transactions.").

Trustees "cause[d] the liquidation, termination or acceleration of a swap agreement" based on the bankruptcy of LBHI.[4]

LBSF argues that (i) the Priority Provisions are not within the scope of the safe harbors because they are not part of the swap agreement and (ii) the definition of "liquidate" in Section 560 does not permit the distribution of the proceeds of the collateral underlying the swap agreement to the counterparty. LBSF's reading of the contracts and the safe harbors is at odds with market expectations and, if accepted by this Court, would undermine confidence in the stability and certainty of structured finance transaction—a result this Court should resist.

1. The Priority Provisions Are Contractual Rights Governing a Swap Agreement.

Despite Lehman's argument to the contrary, the CDO transactions at issue here involve swap agreements that need to be read along with all transaction documents as an integrated whole. The Bankruptcy Code defines the term "swap agreement" broadly to include, among other things: (1) any term and condition incorporated into a swap agreement by reference; (2) any security agreement, security arrangement, or other credit enhancements connected with a swap; (3) any "agreement or transaction that is similar to any" swap agreement; or (4) any "combination" of such similar agreements. 11 U.S.C. § 101(53B). The Priority Provisions at issue here constitute part of the swap agreements under several of these options: they are incorporated by reference into the swap agreement; they constitute a security agreement related to a swap agreement; and they are agreements that are similar to any swap agreement. LBSF nonetheless contends, relying on the Bankruptcy Court's previous decision in Lehman Brothers

4 Importantly, from inception, Section 560 was intended to permit the swap counterparty to determine what is owed to whom, see S. Rep. No. 10-253 (1990), and nothing in Section 560's legislative history suggests that once those amounts were determined, they could not be distributed to the party to which they were owed.

Special Financing Inc., v. BNY Corp. Trustee Services Ltd. (In re Lehman Brothers Holdings Inc.), 422 B.R. 407 (Bankr. S.D.N.Y. 2010) (***Perpetual***), that the Priority Provisions are outside the scope of the safe harbor because they are not a "part of" the swap agreement, simply because they are located in a document bearing the title "Indenture" rather than "Swap."[5] However, across the financial system, the structured financial transactions at issue here, are designed, implemented, and understood to be a single, unified transaction.

Under standard market practice, the swap agreement and indenture constituting a CDO transaction are intended to be read together as a single integrated agreement. See ISDA Master Agreement, Decl. of Brian Krakauer, Ex. E-6, ECF No. 1196-1 (***Krakauer Decl.***); Leitner Decl. Exs. A, C, & E. For example, in the 801 Grand transaction which is at issue in this case, both the indenture and the swap agreements reference the CDO transaction on their faces. Indeed, the very first page of the relevant swap confirmation refers to the swap as the "Credit Derivative Transaction entered into between Lehman Brothers Special Financing Inc. ('Party A') and 801 Grand CDO SPC." See Leitner Decl. Ex. E, at 1. Both sets of instruments cross-reference the other: the very first provision of the swap schedule, located immediately below the document title and emphasized in italics, incorporates all definitions in the indentures that are not otherwise defined. See id. Ex. A, at 1. In total, the 801 Grand CDO swap schedule references the indenture 21 times. See id. Ex. A.

5 As an initial matter, to be covered under the Section 560 safe harbor, the Priority Provisions need not be "part of" a swap agreement. Instead, they need only be "contractual right[s] of any swap participant or financial participant to cause the liquidation, termination, or acceleration of one or more swap agreements." 11 U.S.C. § 560 (2012). Those rights do not even need to be written; they may "aris[e] . . . by reason of normal business practice." Id. The payment priority provisions of a synthetic CDO, which are written, and which reflect normal business practice, fall squarely within the protection of this safe harbor.

In typical CDO transactions, including those at issue here, the swap agreement and the indenture are designed to function together. Again, the 801 Grand transaction provides a useful example. There, LBSF's payments under the swap agreement were the main source of funds used by the Issuer to pay the noteholder under the indenture. See Leitner Decl. Ex. C, at 20-21 (defining "Interest Collections" and "Interest Collections Payment Account"), 56 (funds received pursuant to credit default swaps to be deposited in Interest Collections Payment Account), 45 (Interest Collection Payments Accounts to be source of payments to noteholders). In this very case, LBSF concedes that in entering these transactions, and specifically the credit default swap, it was purchasing credit default protection, see, e.g., FAC ¶ 2, and that the parties actually selling that protection through the swap agreement were the Noteholders. FAC ¶ 55. Indeed, that swap agreement would not have been entered into in the first place unless the Issuer also sold notes to the Noteholders. See, e.g., Krakauer Decl. Ex. E-6; Leitner Decl. Ex. A. And the schedule to the 801 Grand swap agreement expressly stated that LBSF could recover under the swap only from the collateral held by the Trustee, for the benefit of the Issuer, under the indenture—and, then, only subject to the Priority Provisions. See Leitner Decl. Ex. A at 11.[6] In short, effectuating transactions frequent in the structured finance markets, including the transactions at issue here, see Krakauer Decl. Ex. E-6; Leitner Decl. Exs. A & E, requires not a

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[6] The fact that the Priority Provisions were included in the Indenture, rather than the swap documents themselves, merely reflects drafting conventions in the market for structured financial products. In these transactions, the swap agreement is documented pursuant to a standard ISDA Master Agreement and its accompanying schedule and confirmations (collectively, the ***Master Agreement***). The Master Agreement is a form contract agreement that is designed for two parties, designated within the agreement as Party A and Party B. See Krakauer Decl. Ex. E-6. By contrast, the Priority Provisions govern not only the two parties that are party the swap agreement, but a number of additional parties, and therefore were included in the indenture or trust deed but then incorporated by reference into the swap agreement.

single agreement, but rather a number of agreements that are read together.[7] Thus, understanding the transaction at issue here, a court cannot review any one of the agreements that make up the transaction. Rather, all of the agreements must be read and interpreted together. See This Is Me, Inc. v. Taylor, 157 F.3d 139, 143 (2d Cir. 1998) ("Under New York law, all writings forming part of a single transaction are to be read together.").

Market participants, including SFIG members, entered into these transactions relying on the expectation, firmly grounded in black-letter law, that courts would read and honor the various agreements used to effectuate a single transaction together as a single contract. See, e.g., This Is Me, Inc., 157 F.3d 139, 143; Gordon v. Vincent Youmans, Inc., 358 F.2d 261, 263 (2d Cir. 1965) ("[I]t is both good sense and good law that these closely integrated and nearly contemporaneous documents be construed together."); 11 Samuel Williston & Richard A. Lord, A Treatise on the Law of Contracts § 30:26 (4th ed. 2010) (multiple documents effectuating a single transaction should be construed as a single agreement); Restatement (Second) of Contracts § 202 (Am. Law Inst. 1981) ("A writing is interpreted as a whole, and all writings that are part of the same transaction are interpreted together.").[8] Following this long established principle, courts interpreting agreements documenting CDO transactions, similar to those at issue here, have consistently found the various agreements effectuating a CDO transaction to satisfy the test for a single integrated agreement. See, e.g., MBIA Ins. Corp. v. Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A., No. 09 Civ. 10093(RJS), 2011 WL 1197634, at *6 (S.D.N.Y.

7 Indeed, Judge Peck conceded as much in a prior case, where he held that a swap agreement and indenture "established the terms that governed the transactions." Lehman Bros. Special Fin. Inc. v. Ballyrock ABS CDO 2007-1 Ltd. (In re Lehman Bros. Holdings Inc.), 452 B.R. 31, 35 (Bankr. S.D.N.Y. 2001).

8 This is hardly a recent development. See Restatement (First) of Contracts § 235 (Am. Law Inst. 1932); I Chitty on Contracts 12-067 (13th ed. 1896) (under English law, multiple documents are read as one where "the court, having regard to the circumstances, comes to the conclusion that the series of documents represents a single transaction").

Mar. 25, 2011) (reviewing documentation of a CDO transaction and concluding that documents "were part of a single, integrated transaction, and along with the parties, the Court reads them together"); Coöperatieve Centrale Raiffeisen-Boerenleenbank, B.A. v. Brookville CDO I Ltd., No. 08 Civ. 9565(RJS), 2008 WL 5170178, at *9 (S.D.N.Y. Dec. 10, 2008). Indeed, even the authority LBSF will likely rely on here conceded that parties entering into the transaction, such as those at issue here, relied on the expectation that the swap agreements would be read and understood together. See Lehman Bros. Special Fin. Inc. v. BNY Corp. Tr. Servs. Ltd. (In re Lehman Bros. Holdings Inc.), 422 B.R. 407, 422 n.9 (Bankr. S.D.N.Y. 2010) ("Capital was committed with [the priority of payments] embedded in the transaction."). Thus, this Court should rule that the swap agreements and indentures documenting the transaction at issue here are a single integrated agreement and therefore the Priority Provisions are part of a swap agreement. Such a ruling would not only be correct as a matter of law, but would give effect to what the parties intended when they structured these transactions.

The plain text of the Bankruptcy Code's definition of "swap agreement" also requires this result. First, "swap agreement" includes "any agreement, including the terms and conditions incorporated by reference in such agreement . . . ." (emphasis added)). 11 U.S.C. § 101(53B)(A)(i). The Priority Provisions here are set forth in the indenture and incorporated into the schedules to the ISDA Master Agreements. Accordingly, the Priority Provisions are part of a "swap agreement" under the Bankruptcy Code.

Second, "swap agreement" includes any "security agreement or arrangement or other credit enhancement related to any [swap] agreement." 11 U.S.C. § 101(53B)(A)(vi). Each indenture creates a security interest in the collateral on the part of (i) the Noteholders and (ii) LBSF, as a swap counterparty, and provides for the order in which those security interests would be enforced. See Leitner Decl. Ex. A, at 11; id. Ex. D. Thus, each indenture, including, in particular, the Priority Provisions contained in the Indentures, constitutes a "swap agreement."[9]

Third, the Bankruptcy Code's catch-all provides that "any agreement or transaction that is similar to any other agreement or transaction referred to in this paragraph" constitutes a swap agreement. See 11 U.S.C. § 101(53B)(A)(ii). Even if the Court concludes that the Priority Provisions, and the Indentures in which these provisions reside, do not constitute a security agreement, they are certainly more than sufficiently similar to such security agreements to warrant treating the Priority Provisions as part of a swap agreement. See Enron, 651 F.3d at 336 (where a definition includes a catch-all provision, courts should interpret the provision broadly). Thus, the plain language of the Bankruptcy Code's definition of "swap agreement" requires the dismissal of the claims against Noteholders.

Interpreting the definition of "swap agreement" as including the Priority Provisions is also consistent with the legislative purpose of Section 560. Congress enacted the safe harbor to recognize that the financial system is an enormously complex machine made of innumerable interconnected pieces, and that problems with a particular piece may endanger the rest of the system as a whole. As Senator Heflin explained, "[t]here is concern that if one of the parties to a swap agreement files for bankruptcy under the current Bankruptcy Code, the non-defaulting party is left with a substantial risk and, depending on the size of the swap agreement, could cause a rippling effect which would undermine the stability of the financial markets."

[9] It is also worth noting that Congress intentionally expanded the definition of "swap agreement" in 2005 to include security contracts, such as the indentures here, to ensure that such security agreements, in and of themselves, qualify for the safe harbor's protection. See H. R. Rep. No. 109-31 at 128 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 183–84. Thus, Congress understood that complex financial agreements, such as the CDO transactions at issue here, are often documented through several separate agreements which contain provisions necessary to the orderly functioning of the swap and wanted those additional agreements to be able to benefit from the safe harbor's protections.

Interest Swap: Hearing on S. 396 Before the Subcomm. on Courts and Administrative Practices of the Senate Comm. on the Judiciary, 101st Cong. 1 (1989). Analyzing swap agreements in isolation, without reference to the payment priority provisions incorporated into them, disregards Congress's recognition of the intertwined nature of financial arrangements. And, in doing so, it threatens Congress's purpose in enacting the safe harbor in the first place: ensuring that the bankruptcy of one entity does not result in uncertainty and instability in the financial system.

In sum, treating the payment priority provisions of the transactions at issue here as somehow ineligible for protection under the safe harbor disregards the way that the market structures and understands these instruments. It therefore defies Congress's instruction that courts must interpret the safe harbor by reference to "normal business practice," 11 U.S.C. § 560, and the definition of "swap agreement" by reference to "recurrent dealings in the swap or other derivatives markets," 11 U.S.C. § 101(53B)(A)(ii).

2. "Liquidation" Includes Distributing the Liquidated Collateral.

LBSF tries to evade Section 560 by arguing that the statute's reference to "liquidation" does not extend to the distribution of the funds obtained in the liquidation of the collateral in accordance with the Priority Provisions. Thus, under LBSF's interpretation of the term "liquidate," the Trustee could convert the collateral to cash but would then have to "sit" on the money, unable to distribute it according to the deal's requirements. Both the plain meaning of the term "liquidate" in Section 560 and market realities and expectations require the rejection of LBSF's argument.

The term "liquidate" is not defined by the Bankruptcy Code, and thus, in interpreting Section 560, "liquidate" must be interpreted based on its "ordinary, contemporary, common meaning." Perrin v. United States, 444 U.S. 37, 42 (1979); Enron, 651 F.3d at 334 (safe harbors should be construed in accordance with their "plain" meanings). Legal, financial, and general dictionaries all define "liquidate" to include the payment of the proceeds of the liquidation. See, e.g., Black's Law Dictionary (10th ed. 2014) ("To settle (an obligation) by payment or other adjustment; to extinguish (a debt) . . . . To determine the liabilities and distribute the assets of (an entity), esp. in bankruptcy or dissolution." (emphasis added)); Dictionary of Banking and Finance (4th ed. 2009) ("To pay a debt in full."); Oxford English Dictionary (2d ed. 1989) ("To clear off, pay (a debt).").

This plain meaning has also been affirmed in this District. See Mich. State Hous. Dev. Auth. v. Lehman Bros. Derivative Prods. Inc. (In re Lehman Bros. Holdings Inc.), 502 B.R. 383, 386 (Bankr. S.D.N.Y. 2013) (***MSHDA***) ("[T]he protected right to liquidate must include a way to execute the liquidation in order to infuse the safe harbored right with meaning."). Specifically, in interpreting the term "liquidation" in Section 560, the Bankruptcy Court held that "the ordinary meaning of 'liquidation' leads to the conclusion that the right to cause the . . . liquidation of a swap agreement must mean the right to determine the exact amount due and payable under the swap agreement." MSHDA, 502 B.R. at 393; see also S. Rep. No. 101-285 (1990) (the safe harbor of Section 560 was designed, from inception, to permit parties to a swap agreement to "determine . . . upon default, which party is owed how much."). The Bankruptcy Court further recognized that the "plain meaning" of Section 560 protects both the act of liquidating and the manner for carrying it out. MSHDA, 502 B.R. at 395.

Applying the plain meaning of the term "liquidation" and Judge Peck's reasoning in MSHDA to the case at hand, "liquidation" of the swap agreement necessarily includes (i) selling the collateral in the market, and (ii) determining the amounts owed to each party involved in the transaction, including LBSF and the Noteholders. See id. at 393. Accordingly, liquidating the collateral necessarily required the Trustees to apply the Priority Provision to determine which funds were due to LBSF, and which to the Noteholders. See id. ("liquidation of a swap must mean the right to determine the exact amount due and payable under the swap agreement."). Once the Trustee determined the amounts payable to LBSF and to the Noteholders, the Trustees were legally obligated to effectuate those payments and nothing in the Bankruptcy Code prevented them from doing so.

This plain reading is consistent with Section 560's purpose of ensuring a quick unwinding of all aspects of a transaction, thereby providing market participants with certainty, finality, and, if they are owed monies, the ability to redeploy their assets as they see fit. Indeed, the safe harbors' raison d'être is to permit market participants to terminate and settle swap agreements quickly and with finality, notwithstanding that one party to the transaction (or its guarantor) has commenced a bankruptcy proceeding. See, e.g., Enron, 651 F.3d at 336 (rejecting interpretation of safe harbor that would result in "commercial uncertainty and unpredictability"); Grede, 746 F.3d at 254 (safe harbors designed to promote finality); MSHDA, 502 B.R. at 394; see also H.R. Rep. No. 101-484, at 1 (1990), reprinted in 1990 U.S.C.C.A.N. 223 (safe harbors intended to "ensure that the swap . . . contract financial markets are not destabilized by uncertainties regarding the treatment of their financial instruments under the Bankruptcy Code.").

LBSF's argument also flies in the face of the way in which the term "liquidation" is used and understood in the market. Market participants understand the act of "liquidating" a position to include not only the sale of a position in the market, but the payment of the proceeds to the party entitled to receive the proceeds. Indeed, if accepted, LBSF's interpretation would mean that the Trustee could sell the collateral in the market, determine the share of the proceeds to which the Noteholders were entitled, but then would be unable to make any distribution to the

Noteholders, possibly for years. This would result in at least two consequences that are anomalous in the market. First, under LBSF's view of the world, the non-bankrupt party to a derivative transaction would lose access to funds to which it was entitled—potentially for years while the litigation concerning the monies at issue was resolved—rendering it unable to put those funds to work in the interest of its clients and shareholders. And, second, because, under LBSF's theory, a party to a CDO transaction in which one of the parties (or its guarantor) went bankrupt would be unable to receive the proceeds of the collateral to which it was entitled and while the dispute over the funds was adjudicated, it would bear the risk that its portion of the collateral would become devalued because of currency fluctuations or inflation.[10] This does not advance the congressional goal of insulating participants in the swap markets from financial instability; rather, it does the opposite, forcing market participants to bear new and incremental risk. Nothing about the Bankruptcy Code's language, legislative history, or, indeed, common sense, supports forcing such consequences on market participants. Indeed, such risks are among the precise risks that the safe harbors were intended to avoid.

10 The discussion herein is designed to identify the infirmities with LBSF's suggested reading of Section 560 and should not be read as suggesting that SFIG agrees with LBSF's position that it was the bankruptcy of LBSF that triggered application of the Priority Provisions. As SFIG understands, the Priority Provisions were triggered by the bankruptcy of LBSF's affiliate Lehman Brothers Holding Inc., weeks before LBSF filed for bankruptcy. See Defs. Br. at 9.

CONCLUSION

For the foregoing reasons, the Bankruptcy Court should find that the Priority Provisions are enforceable and that the Noteholders Motion to Dismiss should be granted.

Dated: New York, New York
December 21, 2015

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EXHIBIT B

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re: LEHMAN BROTHERS HOLDINGS INC., *et al.* Debtors.	Chapter 11 Case No. 08-13555 (SCC)
LEHMAN BROTHERS SPECIAL FINANCING INC., Plaintiff, - *against* - BANK OF AMERICA NATIONAL ASSOCIATION, *et al.*, Defendants.	Adversary Proceeding No. 10-03547 (SCC)

[PROPOSED] ORDER GRANTING MOTION OF THE STRUCTURED FINANCE INDUSTRY GROUP, INC. FOR LEAVE TO FILE AN AMICUS CURIAE IN SUPPORT OF DEFENDANTS' MOTION TO DISMISS

Upon consideration of the Structured Finance Industry Group, Inc.'s Motion For Leave To File Amicus Curiae Brief In Support Of Defendants' Motion To Dismiss, dated December 21, 2015, and for good cause shown, the motion is hereby GRANTED. The proposed amicus curiae brief, attached to the Motion as Exhibit A, shall be deemed FILED.

SO ORDERED.

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HONORABLE SHELLEY C. CHAPMAN
UNITED STATES BANKRUPTCY JUDGE