# New York Supreme Court

## Appellate Division—First Department

LEHMAN BROTHERS INTERNATIONAL (EUROPE) (in Administration),

*Plaintiff-Appellant*,

– against –

AG FINANCIAL PRODUCTS, INC.,

*Defendant-Respondent*.

**Appellate Case No.: 2023-03409**

**REPLY MEMORANDUM OF LAW IN FURTHER SUPPORT OF MOTION FOR LEAVE TO REARGUE, OR IN THE ALTERNATIVE, LEAVE TO APPEAL TO THE NEW YORK STATE COURT OF APPEALS**

DORF NELSON & ZAUDERER LLP
475 Fifth Avenue
New York, New York 10017
(212) 485-0005
mzauderer@dorflaw.com
jcohen@dorflaw.com

QUINN EMANUEL URQUHART & SULLIVAN, LLP
51 Madison Avenue, 22nd Floor
New York, New York 10010
(212) 849-7000
andrewrossman@quinnemanuel.com
davidmader@quinnemanuel.com
owenroberts@quinnemanuel.com
sagevandenheuvel@quinnemanuel.com

*Attorneys for Plaintiff-Appellant*

New York County Clerk's Index No. 653284/2011

"[J]udicial construction of the [ISDA Master] Agreement … has the potential, through principles of *stare decisis*, to affect thousands of non-parties and millions of transactions in [New York and] jurisdictions around the globe governed by precisely the same language." *Lehman Bros. Int'l (Europe) (in Administration) v. AG Financial Prods., Inc.*, 60 Misc. 3d 1214(A), 2018 WL 3432593, at *10 n.11 (Friedman, J.S.C.). LBIE has identified two core legal errors of significant public importance: Supreme Court's failure to apply the New York law-mandated objective standard of reasonableness, and its misinterpretation of the parties' ISDA Master Agreement in a manner inconsistent with governing New York law. AGFP pretends these legal errors do not exist, instead dedicating pages to the trial court's factual determinations—many of which were plainly erroneous, as set forth in LBIE's appellate briefs—while ignoring the underlying and faulty legal rulings and the consequences they will have far beyond this case.

*First*, Supreme Court committed reversible legal error below, and this Court erred on appeal, by failing to apply the correct legal standard. "[T]he question whether the evidence adduced meets the standard required is one of law for our review." *People v. Leonti*, 18 N.Y.2d 384, 389 (1966); *accord Guerrero-Lasprilla v. Barr*, 589 U.S. 221, 227 (2020) ("[T]he question whether a given set of facts meets a particular legal standard [presents] a legal inquiry.").

Here, there is no dispute that the law required Supreme Court—and this Court—to apply an *objective* standard of reasonableness when evaluating AGFP's Loss calculation under the parties' 1992 ISDA Master Agreement. *See* A54 (citing "substantial authority that an objective standard of reasonableness applies to a contractual provision requiring performance of an obligation in a reasonable manner"); A77 (acknowledging objective standard). At trial, as contemplated by this Court on interlocutory appeal, LBIE presented overwhelming evidence of a uniform or highly consistent market practice of calculating Loss by reference to market values. LBIE Appeal Br. (NYSCEF No. 22) at 20-25. AGFP's witnesses did not offer any contrary evidence, *see* A4176-77, A4640-41, A3696, and the handful of documents on which Supreme Court relied were either irrelevant or *supported* the existence of such a market practice, LBIE Appeal Br. at 45-48. Supreme Court's misapplication of the appropriate legal standard to the trial evidence, and this Court's affirmance, constitute legal errors subject to review by the Court of Appeals.

Moreover, even if the evidence did not support the existence of such a market practice, AGFP was still required to meet *its* burden by demonstrating that its Loss calculation was objectively reasonable. It was not: AGFP points to its own practices and procedures, which are the very definition of a *subjective* determination. *See* Black's Law Dictionary (11th ed. 2019), 'Subjective' ("1. Based on an individual's

perceptions, feelings, or intentions, as opposed to externally verifiable phenomena."); *compare id.*, 'Objective' ("1. Of, relating to, or based on externally verifiable phenomena, as opposed to an individual's perceptions, feelings, or intentions."). The only *objective* factors AGFP cites are the methodologies employed by two ratings agencies to estimate future losses on the assets backing two of the twenty-six trades at issue—but as Supreme Court itself acknowledged, these ratings agencies projected losses "hundreds of millions of dollars" greater than AGFP. A109. It was legal error to rule, as Supreme Court ruled and as this Court affirmed, that AGFP's inherently subjective Loss calculation met the required standard of objective reasonableness.

By departing from the "substantial authority" requiring application of an objective standard, Supreme Court introduced significant uncertainty into every New York contract requiring "reasonable" conduct by one or both of the parties. There is a significant public interest in addressing and resolving this uncertainty, and reargument or leave to appeal is therefore warranted.

*Second,* Supreme Court committed reversible legal error below, and this Court erred on appeal, by misinterpreting the parties' contract to allow a calculation of Loss completely untethered to the market value of the terminated derivatives. AGFP itself *concedes* that Supreme Court's ruling finding market prices "irrelevant" was based on "the language of the Agreement." AGFP Opp. (NYSCEF No. 32) at 26. It

is axiomatic that "[t]he interpretation and construction of such documents as contracts … are matters properly treated as questions of law and are reviewable by this Court." *Gitelson v. Du Pont*, 17 N.Y.2d 46, 48 (1966). In this case—where the contract at issue governs hundreds of trillions of dollars of financial derivatives between parties entirely remote from the parties in suit, *see JPMorgan Chase Bank, N.A. v. Godfrey Ltd. P'ship*, No. 602920/2008, 2012 WL 10007863, at *9 (Sup. Ct. N.Y. County July 16, 2012), there is a clear and significant public interest in ensuring certainty and consistency in its interpretation and construction.

Supreme Court's ruling that market prices were "irrelevant" also raises a series of *additional* legal errors of broad legal consequence to businesses governed by New York law. AGFP claims to have calculated Loss based on "loss of bargain" pursuant to the parties' contract. A7147, 9416. But New York law—which governs the parties' contract—requires that loss of bargain be calculated by reference to market price, *White v. Farrell*, 20 N.Y.3d 487, 499 (2013), *even if* market prices are not directly observable, *Credit Suisse First Bos. v. Utrecht-Am. Fin. Co.*, 84 A.D.3d 579, 580 (1st Dep't 2011). By affirming Supreme Court's contrary ruling, the Decision stands in direct conflict with these Court of Appeals and First Department decisions applying fundamental damages principles.

AGFP contends that these cases (and many others cited by LBIE for the same proposition) did not involve precisely the same facts as this dispute—but that only

demonstrates the universal applicability of the principle. In any event, whether a rule of law applicable in myriad circumstances applies to the parties' New York law-governed contract is a quintessential question of law warranting review by the Court of Appeals to clarify the now uncertain and confused state of the law.

Similarly legal in nature were Supreme Court's (and this Court's) misinterpretation and misapplication of other cases construing the same contract at issue here. For example, AGFP repeats Supreme Court's erroneous interpretation of the *Devonshire* case when it contends (AGFP Opp. n.8) that Devonshire, as the non-defaulting party, "did not attempt to calculate a theoretical market price for the terminated transactions." That is because the parties had *amended their ISDA Master Agreement* to provide for an alternative calculation in the event Devonshire was the non-defaulting party. LBIE Reply Br. (NYSCEF No. 29) at 7 n.1. AGFP could have sought a similar amendment to the parties' Agreement here, but it did not, and Supreme Court's misapplication of *Devonshire* to the standard, un-amended ISDA Master Agreement constituted legal error.

These legal errors are subject to review by the Court of Appeals not only because they are wrong but because they raise issues of significant public importance. New York, as the world's financial capital, has a unique interest in ensuring the predictable and fair interpretation of the ISDA Master Agreement consistent with the principles of New York law by which it is governed. Supreme

Court's departure from well-settled New York law governing the calculation of loss-of-bargain damages, and its departure from the well-settled rules of construction governing the ISDA Master Agreement, raise legal issues of state-wide and indeed *global* public importance, necessitating Court of Appeals review.

LBIE has therefore identified legal errors that this Court appears to have overlooked or misapprehended, warranting reargument, and that present issues of significant public importance and conflicting caselaw that ought to be reviewed and resolved by the Court of Appeals.

Date: May 3, 2024

Respectfully submitted,

By: *Andrew J. Rossman*

Andrew J. Rossman
David S. Mader
Owen F. Roberts
Sage R. Vanden Heuvel (*pro hac vice*)
QUINN EMANUEL URQUHART & SULLIVAN LLP
51 Madison Avenue, 22nd Floor
New York, New York 10010
(212) 849-7000
andrewrossman@quinnemanuel.com

Mark C. Zauderer
Jason Cohen
DORF NELSON & ZAUDERER LLP
475 Fifth Avenue
New York, NY 10017
(212) 485-0005
mzauderer@dorflaw.com

*Attorneys For Plaintiff-Appellant Lehman Brothers International (Europe) (in administration)*