STATE OF NEW YORK
COURT OF APPEALS

LEHMAN BROTHERS INTERNATIONAL (EUROPE) (IN ADMINISTRATION), Plaintiff-Appellant, -against- AG FINANCIAL PRODUCTS, INC., Defendant-Respondent.	Appellate Division Case/Docket No. 2023-03409 County of New York Index No. 653284/2011

MEMORANDUM OF LAW IN SUPPORT OF PLAINTIFF-APPELLANT'S MOTION FOR PERMISSION TO APPEAL

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PRELIMINARY STATEMENT

This case presents an issue of statewide—and global—importance involving the interpretation of the ISDA Master Agreement, "probably the most important standard market agreement used in the financial world," *Lomas et al. v. JFB Firth Rixson, Inc.*, [2010] EWHC 3372 (Ch), ¶53 (Ex. R). This standard commercial agreement governs hundreds of trillions of dollars of financial derivatives, *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), including the multi-billion-dollar portfolio of derivatives at issue in this case. The decisions below disregarded express contractual terms requiring a reasonable valuation of derivatives upon their termination; departed from settled precedent interpreting the ISDA Master Agreement in other leading commercial jurisdictions; and cast substantial uncertainty over the valuation of trillions of dollars of pending derivative contracts subject to the same form agreement under New York law. This case presents this Court with its first opportunity to interpret the globally important ISDA Master Agreement, a critical tool for the financial industry in New York, and to establish uniformity of decision regarding the interpretation and enforcement of commercial contracts generally.

Until the decisions below, New York courts required contracting parties to apply an objective standard of reasonableness when performing discretionary

contractual valuation, and they required that contractual loss of bargain be measured by reference to the marketplace. For the reasons set forth below, permission to appeal should be granted so that the Court can restore the standard of reasonableness applicable to New York contracts and clarify the proper measurement of loss of bargain under New York law for a financial contract of fluctuating value.

In the years before the 2008 financial crisis, Plaintiff-Appellant Lehman Brothers International (Europe) (in administration) ("LBIE") bought credit default swaps ("CDS") from Defendant-Respondent AG Financial Products, Inc. ("AGFP") to protect against losses on more than $5 billion of subprime residential mortgages, high-yield commercial loans, and other financial assets. When the financial crisis hit, that protection became a massive asset to LBIE—and a massive liability to AGFP. By the end of June 2009, the 28 swaps at issue had a market value of more than $400 million in LBIE's favor as documented in AGFP's internal accounting records. As Justice Marcy Friedman—who presided over the case until her retirement before trial—recognized at summary judgment, it "cannot be disputed that, at the time of the terminations at issue, the financial crisis had significantly increased the prospect of shortfalls in timely interest and ultimate principal payments." Despite this, when AGFP chose to terminate its contracts with LBIE in mid-July 2009, triggering its obligation to value the swaps under the parties' ISDA

Master Agreement, AGFP claimed that they were worth roughly $20 million—*to AGFP*.

AGFP performed this illogical, unprecedented, and self-serving valuation by ignoring the market prices for CDS that it used in its own internal records and instead substituting its own subjective assumptions—derived from an affiliate's admittedly subjective estimates of insurance loss reserves—regarding how the subprime mortgages and other financial instruments referenced by the CDS would perform in the future. Using these subjective assumptions, AGFP claimed that future losses on the instruments would be *de minimis*: roughly $24 million for the sub-prime mortgage swaps, and zero for the other twenty-six CDS.

No one else projected such limited losses on these distressed instruments at the time. In fact, following trial, Supreme Court acknowledged that AGFP's projection differed from the next closest published projections by "hundreds of millions of dollars." Yet despite this massive discrepancy, and despite AGFP's failure to identify any other party that had ever valued terminated swaps in the same subjective manner, Supreme Court erroneously concluded that AGFP's valuation was "reasonable" under the parties' contract, and the Appellate Division, First Department affirmed.

The lower courts' decisions rest on two critical legal errors that warrant review by the Court of Appeals. *First*, the decisions below depart from well-settled New

York law—including prior rulings on summary judgment and interlocutory appeal *in this case*—that a contractual provision requiring performance of an obligation in a "reasonable" manner requires application of an *objective* standard of reasonableness. Here, AGFP applied a valuation methodology that was inherently and admittedly *subjective*: it knowingly and intentionally disregarded all available market evidence, and instead assigned a termination value to the financial instruments at issue based solely on internal, subjective projections regarding the losses the instruments might suffer. By blessing AGFP's unprecedented, subjective, and self-serving valuation, the decisions below eviscerate the limits that New York law places on the discretion enjoyed by parties required to perform contractual calculations "reasonably," and it deprives counterparties and reviewing courts of the ability to challenge or test those exercises of discretion. This Court should grant review to clarify the standard of reasonableness that applies when a party performs a valuation under a New York contract, and to clarify whether a party performs a calculation "reasonably" when it reaches a result completely at odds with objective, observable market evidence.

Second, the decisions below depart from equally well-settled New York law requiring that where a party calculates its loss of bargain as a measure of amounts owed under a contract, that loss of bargain is measured by reference to market prices. Here, despite choosing at the time of contract formation to calculate the termination

value of the parties' swaps based on market prices, and despite expressly purporting to have performed its valuation based on loss of bargain, it is undisputed that AGFP's valuation ignored market prices and other indicia of market value. By endorsing a valuation entirely at odds with market pricing, the decisions of the courts below conflict with basic principles of New York law and with the decisions of other courts in New York and abroad interpreting the very same industry standard contract. Permission to appeal should be granted so that this Court can resolve the critical issue of whether loss of bargain under the ISDA Master Agreement should be measured by contemporaneous market prices and data.

By departing from well-settled principles of New York law, the decisions below have introduced tremendous uncertainty for New York contracting parties applying the ISDA Master Agreement and other contracts by eliminating any check on discretionary contractual valuations subject to a reasonableness standard, including the customary and critical check provided by objective evidence of market prices. These checks were critical in the wake of the 2008 financial crisis, guiding market participants toward objective valuations of their derivatives trades and providing courts with the tools necessary to ensure the orderly resolution of claims. Unless reviewed, the lower courts' departures from longstanding New York law will encourage parties to value CDS and other assets or liabilities in a self-serving manner unconstrained by the safeguards provided by an objective standard of reasonableness

based on market prices. This will deny contracting parties the benefit of their bargains, undermine the market's ability to accurately account for termination-related exposures, and greatly increasing the risk of dispute and disruption in the event of another financial crisis.

The consequences of the decisions will be felt in New York and around the world. As a result of its global reach and widespread adoption, "judicial 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 (Eur.) (in Admin.) v. AG Fin. Prods., Inc.*, 60 Misc. 3d 1214(A), 2018 WL 3432593, at *10 n.11 (Sup. Ct. N.Y. County 2018) (Friedman, J.S.C.). The decisions below, which failed to apply the objective reasonableness standard and held market prices "irrelevant" to valuation under the ISDA Master Agreement, directly contradict both well-established New York law and the uniform approach of courts around the world that have interpreted the exact same, globally important commercial contract at issue here.

As the global center of the financial industry, New York has a particular interest in ensuring that commercial contracts, and especially universal market-standard contracts like the ISDA Master Agreement, are interpreted correctly and in a manner that promotes stability and predictability. A failure by the courts of New

York to restore limits on a valuing party's discretion risks undermining the contractual intentions of the participants in this multi-trillion dollar industry. In light of the global importance of the ISDA Master Agreement, the novel issues of law presented herein, the significant financial stakes of this dispute to the parties, and to ensure consistency with prior decisions of the Court of Appeals and the Appellate Division, leave to appeal should be granted.

PROCEDURAL HISTORY, TIMELINESS, AND JURISDICTION

1. On November 28, 2011, LBIE filed a Summons and Complaint in Supreme Court, New York County alleging three causes of action against AGFP: (i) breach of the implied covenant of good faith and fair dealing in connection with AGFP's termination of CDS in December 2008; (ii) breach of contract in connection with AGFP's valuation of 28 CDS it terminated in July 2009; and (iii) breach of the implied covenant of good faith and fair dealing in connection with AGFP's valuation of the 28 CDS it terminated in July 2009. A126-29. By order dated March 15, 2013, Supreme Court (originally Friedman, J.) dismissed the first cause of action. A36.[1] AGFP filed Counterclaims for breach of contract, and seeking attorney fees and costs, on April 22, 2013. A139.

[1] All citations to "A__" herein are citations to the appendix filed in the Appellate Division, Case No. 2023-03409, NYSCEF Nos. 4-21 and filed electronically with this Court.

2. By order dated July 2, 2018, Supreme Court granted AGFP's motion for summary judgment in part, dismissing the third cause of action in its entirety and dismissing the second cause of action in part, but denying the motion with respect to "the reasonableness and good faith of" AGFP's valuation of the 28 CDS it terminated in July 2009. A75. AGFP sought interlocutory appeal with respect to the denial of summary judgment in connection with its valuation of those 28 CDS, but the First Department affirmed that portion of Supreme Court's summary judgment decision by Decision and Order dated January 17, 2019, and remanded for trial "as to whether defendants' loss calculation was reasonable and in good faith as required by the agreements." A9527-28 (citing *Hoag v. Chancellor, Inc.*, 246 A.D.2d 224, 230-31 (1st Dep't 1998) ("In determining whether conduct is objectively reasonable, industry norms may be appropriately considered.")).

3. The matter proceeded to trial in Supreme Court (now Crane, J.) in October and November 2021. Supreme Court found in favor of AGFP in a Decision After Trial dated March 8, 2023. A76; Ex. B.[2] Supreme Court entered Judgment in AGFP's favor on June 30, 2023. A16; Ex. C. LBIE was served with notice of entry on June 30, 2023, via e-filing. A14.

[2] All citations to "Ex. ___" herein refer to exhibits attached to the Affirmation of Andrew J. Rossman, filed concurrently herewith.

4. On July 10, 2023, LBIE timely filed a notice of appeal to the First Department. A12; Ex. F. The appeal challenged Supreme Court's finding that AGFP's valuation was "reasonable" under the parties' contract. Ex. G (Pl's App. Br.). The First Department affirmed Supreme Court's Judgment in a Decision dated March 14, 2024. Ex. A. LBIE was served with notice of entry on March 14, 2024, via e-filing. *Id.*

5. On April 16, 2024, LBIE timely filed in the First Department a Motion for Leave to Reargue, or in the Alternative, Leave to Appeal to the New York State Court of Appeals. Ex. K (Pl's Mot. for Reargument). The First Department denied the motion by summary order dated July 18, 2024. Ex. N.

6. On July 18, 2024, AGFP served notice of entry of the First Department's July 18 order. Ex. N. LBIE's motion to this Court for permission to appeal is timely, having been made on August 19, 2024. *See* Civ. Prac. L. & R. ("CPLR") § 5513(b) (motion for permission to appeal must be made within thirty days of service of notice of entry of Appellate Division's order denying permission to appeal); Gen. Constr. L. § 25-A(1) ("When any period of time, computed from a certain day, within which or after which or before which an act is authorized or required to be done, ends on a Saturday, Sunday or a public holiday, such act may be done on the next succeeding business day ….").

7. This Court has jurisdiction under CPLR § 5602(a)(1)(i) to grant Plaintiffs' present motion for permission to appeal because the order sought to be appealed from and reviewed (the March 14, 2024 First Department Decision, Ex. A) is an order of the Appellate Division affirming a final judgment of Supreme Court "which finally determines the action and which is not appealable as of right." CPLR § 5602(a)(1)(i).

QUESTIONS PRESENTED FOR REVIEW

1. Does an objective standard of reasonableness apply to a contractual provision requiring performance of an obligation to value a financial instrument in a reasonable manner? If so, does a party satisfy a contractual obligation to perform a valuation "reasonably" by basing its valuation on its own subjective views of value, untethered to and materially at odds with objective measures such as market price?

2. May a party calculate "loss of bargain," as a measure of Loss under the ISDA Master Agreement without regard to and in an amount that differs materially from the market value of the terminated derivative transactions?

LBIE preserved these issues below. *See* Ex. G (Pl's App. Br.) at 42-60 (arguing that Supreme Court erred by failing to apply an objective standard of reasonableness and by finding AGFP's Loss calculation to be reasonable); *id.* at 28-41 (arguing that Supreme Court erred by ruling that market values were "irrelevant"); A297, A311 (arguing the same in Supreme Court).

FACTUAL AND PROCEDURAL BACKGROUND

A. The ISDA Master Agreement

This case centers on the interpretation of the ISDA Master Agreement, a standard form contract published by the International Swaps and Derivatives Association ("ISDA") and used by counterparties to document their derivative transactions. It is "probably the most important standard market agreement used in the financial world." *Firth Rixson*, [2010] EWHC 3372, ¶53 (Ex. R). It is estimated to govern more than 90% of all derivatives transactions in the multi-trillion dollar over-the-counter ("OTC") derivatives market,[3] with the "vast majority" documented using the exact version at issue in this case. *Lomas v. Burlington Loan Mgmt. Ltd.*, [2016] EWHC 2417 (Ch.), ¶27 (Ex. S).[4] It has "been used over several decades as the basis for countless over-the-counter derivative transactions with a combined notional value of hundreds of trillions of dollars." *Godfrey*, 2012 WL 10007863,

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[3] *Lehman Bros. Holdings Inc., et al. v. Intel Corp.*, No. 08-13555, 2015 WL 7194609, at *1 n.1 (Bankr. S.D.N.Y. Sep. 16, 2015); Bank for International Settlements, *OTC derivatives statistics at end-December 2023* (2024), available at https://www.bis.org/publ/otc_hy2405.htm (reporting that the overall notional value of OTC derivatives at the end of 2023 was $667 trillion) (last accessed Aug. 18, 2024).

[4] *See also* ISDA, *Legal Guidelines for Smart Derivatives Contracts: The ISDA Master Agreement* (2019), 4 ("The ISDA Master Agreement is the standard contract used to govern all over-the-counter (OTC) derivatives transactions[.]"); *Intel*, 2015 WL 7194609, at *1 n.1 (same); *see generally* M. Konrad Borowicz, *Contracts as Regulation: The ISDA Master Agreement*, CAPITAL MARKETS LAW JOURNAL, 16(1) (January 2021) (same).

at *9. Indeed, this case alone involves derivatives with a potential value of $5.7 billion, which AGFP itself determined were worth $438 million to LBIE just three weeks before the relevant valuation date—an amount that, with interest, would entitle LBIE to a payment of more than $1 billion, as opposed to the more than $100 million LBIE will ultimately owe to AGFP if the decisions below are allowed to stand. *See* A8847, A8852.

Because of the "prevalence and fundamental importance to the financial system" of the ISDA Master Agreement, *Godfrey*, 2012 WL 10007863, at *9, it is now "axiomatic that it should, as far as possible, be interpreted in a way that serves the objectives of clarity, certainty and predictability, so that the very large number of parties using it should know where they stand." *Firth Rixson*, [2010] EWHC 3372, ¶53 (Ex. R); *see Intel*, 2015 WL 7194609, at *11 (same).

The ISDA Master Agreement allows parties to elect, at the time of contract formation, how their derivatives trades will be valued in the event of an early termination. *Intel*, 2015 WL 7194609, at *6; A7141-42. Here, the parties agreed that their derivatives would be valued in the first instance by reference to the 'Market Quotation' method, A7160, which assigns a value based on the market price of the derivatives as determined through a poll of derivatives dealers, A7147-48. They also agreed that if (as routinely happened) the strict requirements of the Market

Quotation method could not be satisfied, the derivatives would instead be valued according to the 'Loss' method. A7141, A7160. Loss is defined as follows:

> "*Loss*" means . . . an amount that party reasonably determines in good faith to be its total losses and costs (or gain, in which case expressed as a negative number) in connection with this Agreement or that Terminated Transaction or group of Terminated Transactions, as the case may be, including any loss of bargain, cost of funding or, at the election of such party but without duplication, loss or cost incurred as a result of its terminating, liquidating, obtaining or reestablishing any hedge or related trading position (or any gain resulting from any of them). . . . A party will determine its Loss as of the relevant Early Termination Date, or, if that is not reasonably practicable, as of the earliest date thereafter as is reasonably practicable. A party may (but need not) determine its Loss by reference to quotations of relevant rates or prices from one or more leading dealers in the relevant markets.

A7147.[5]

Of critical importance here, the parties also agreed that the valuation would be subject to the "Second Method" approach, A7160, a no-fault two-way payment provision that requires a non-defaulting party to make a termination payment to the defaulting party if an early termination results in a gain to the non-defaulting party. A7141-42.[6] Such a gain might occur, for instance, when termination of the trades

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[5] The decisions below misinterpreted the final sentence of the Loss definition to allow a non-defaulting party to disregard *all* evidence of market value—an interpretation that is not supported by logic or ISDA's own guidance, and one that had been expressly rejected on summary judgment. A62; *see infra* Part II.B.

[6] Under "Second Method," if the valuation of the terminated derivatives results in "a positive number," *i.e.*, a loss to the non-defaulting party greater than $0, the defaulting party must pay that amount to make the non-defaulting party whole. However, if the valuation results in "a negative number"—in other words, when termination results in a *gain* to the non-defaulting party—then the non-defaulting

relieves the non-defaulting party "of the requirement to perform its obligations" under "a disadvantageous" derivatives trade. *Peregrine Fixed Income Ltd. v. Robinson Dep't Store Public Co.*, [2000] EWHC 99 (Comm.), ¶¶29-30 (Ex. T); A7141-142.

B. The Parties' Credit Default Swaps

Between August 2005 and May 2008, LBIE and AGFP entered into the 28 credit default swaps at issue here. Through the swaps, LBIE agreed to make a series of periodic payments to AGFP, in return for AGFP's promise to cover up to $5.7 billion in shortfalls of principal and interest suffered by a referenced group of financial products, including securities backed by U.S. subprime mortgages, British residential mortgages, and risky "high yield" commercial loans, many of which were not scheduled to mature for decades. *See generally* A7208-587; A7598-600. The swaps were documented under market-standard terms or varied only with respect to the timing of certain payments or the requirement to post collateral; none of the trades were subject to non-standard terms regarding the *amount* that either party would owe under the swaps. A2002-03; A2308-11; A5259.

The onset of the financial crisis in 2008 materially increased the chance that those referenced securities would suffer losses that AGFP would be required to

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party must pay the absolute value of *that amount* to the Defaulting Party. A7141-42. Under Second Method, therefore, one party's loss is exactly equal to the other party's gain.

cover. As Supreme Court (Friedman, J.) acknowledged on summary judgment, it "cannot be disputed that, at the time of the terminations at issue, the financial crisis had significantly increased the prospect of shortfalls in timely interest and ultimate principal payments." A74. As the risk of shortfalls grew, the derivatives became significantly more valuable to LBIE and became a correspondingly growing liability to AGFP; between June 2008 and June 2009, AGFP's own accounting records reflect that the mid-market value of the derivatives grew from $216 million to $438 million in LBIE's favor. A8848-52.

C. AGFP Terminates and Values the Swaps

In July 2009—ten months after LBIE entered into bankruptcy administration, which constituted an Event of Default under the ISDA Master Agreement—AGFP chose to terminate the 28 CDS. A7588-90. Because the parties had elected to value their swaps upon early termination on a market basis using the "Market Quotation" process, AGFP was required to solicit quotations from derivatives dealers representing the amount those dealers would be willing to pay or receive to enter into new transactions with AGFP "that would have the effect of preserving for [AGFP] the economic equivalent of" the terminated CDS. A7147-48. AGFP sought to do this by engaging a consulting firm to conduct an "auction" in September 2009. A6729. As was extremely common, and in fact expressly contemplated and addressed by the ISDA Master Agreement itself, the auction failed to generate any

quotes. A6738; A2910. As AGFP's own expert's express testimony at trial made clear, and as Supreme Court had previously ruled on Summary Judgment, the auction's failure did not mean the CDS had no value. A3710.

Because it was unable to calculate a value under the Market Quotation method, AGFP was required to value the terminated CDS using ISDA's Loss methodology. "Loss and Market Quotation are intended to produce Early Termination Payments in broadly similar amounts when measuring the loss of payments or deliveries due after the Early Termination Date," *Intel*, 2015 WL 7194609, at *18, as is the case here. Indeed, this so-called "cross-check principle," first articulated by English courts interpreting the ISDA Master Agreement, has since "hardened into hornbook law in the context of contracts for which deliveries or payments were to be made *after* the Early Termination Date." *Id.* at *15-16. As Supreme Court explained on summary judgment, "[i]t would make no sense to hold as a matter of law that, because the Market Quotation process was unsuccessful, [AGFP] was free to adopt a methodology that results in a termination payment completely divergent from the cost of replacing the Transactions." A67.

Yet that is exactly what AGFP did. Just three weeks before the Early Termination Date, AGFP had looked to widely available public sources of market data—including daily prices published by leading market data vendor Markit—to value the trades internally as being worth $438 million to LBIE. A8852. Rather

than use the industry-standard market-based valuation, or even look to the underlying sources of market value information—including prices published by Markit on the valuation date itself—AGFP instead calculated Loss on the basis of an entirely separate, subjective process by which its insurance company affiliate, Assured Guaranty Corp. ("AGC"), set loss reserves for financial insurance products. A7594-95. No party to an ISDA Master Agreement has ever used such an insurance loss reserve process to calculate Loss. A1380; A385; A1951; *see* A3696.

As ISDA itself has explained, "CDS are not insurance for numerous reasons," including due to "differences in accounting, tax, bankruptcy and other regulatory treatment." *Aon Fin. Prods. v. Societe Generale*, No. 06-1080, 2006 WL 1517230, at n.2 (2d Cir. May 8, 2006) (Brief of Amicus Curiae). And although Supreme Court erroneously assumed in its Decision After Trial that AGFP was itself an insurance company, A78, it is not. In fact, AGFP was established for the specific purpose of executing derivative transactions (such as the credit default swaps at issue here) that insurance companies are expressly prohibited from entering. A1698-99, A8845. Yet by applying an insurance reserve methodology that explicitly "does not apply to … derivatives instruments," A8860-61, AGFP purported to value the 28 CDS at issue based on the reserve amount that the insurer AGC would have taken had the CDS been insurance instruments subject to those inapplicable regulations—regulations that expressly permitted the use of a subjective valuation methodology.

For 26 of the CDS—covering *$5.2 billion* in potential losses that AGFP would be required to cover—AGC interpreted the insurance regulations to mean that it was not required to take any insurance reserve at all. A1560-62. As a result, even though the termination of those 26 CDS relieved AGFP of its obligation to cover up to $5.2 billion in losses that had indisputably become more likely to occur, AGFP purported to calculate the total value of its expected future payments for all of those 26 CDS to be $0, while simultaneously calculating that it would receive tens of millions of dollars in payments from LBIE over the remaining term of those swaps as if they had not been terminated. A7598-600. In effect, AGFP cancelled decades' worth of protection, while simultaneously charging LBIE for the full cost of that coverage as if it were to remain in place until maturity.

For the remaining two CDS, covering *$500 million* in losses on the widely quoted ABX index of subprime housing securities, the insurance reserve model indicated that losses were likely to occur and that a reserve was therefore required. Yet rather than determining the magnitude of those expected losses by looking at daily published market prices—or even its own internal accounting records, which reflected a value for these two trades of $352.5 million *in LBIE's favor* just three weeks before the valuation date, A8852—AGFP instead used its own conveniently self-serving insurance reserve projections to determine that the subprime securities

protected by the ABX CDS would incur losses of only $24 million, less than one-tenth the losses implied by its internal valuation. A7598; A7603-04; A9302.

In fact, during the year prior to termination, AGFP regularly valued the ABX CDS at levels consistent with published market prices. Only when calculating Loss as of July 23, 2009 did AGFP select a very different valuation:

Date	Market Published Price[7]	AGFP ABX Valuation[8]	Difference (%)
6/30/2008	$203,750,000	$204,100,000	0.17%
9/30/2008	$197,825,000	$198,250,000	0.21%
12/31/2008	$277,325,000	$275,000,000	0.84%
3/31/2009	$362,425,000	$370,000,000	2.09%
6/30/2009	$352,614,828	$352,500,000	0.03%
7/23/2009	**$328,915,632**	**$24,214,686**	**92.64%**

AGFP's Loss valuation was not based on any contemporary market data. In fact, Supreme Court itself acknowledged in its Decision After Trial that it was lower than the losses projected by anyone else at the time—including by all three credit ratings agencies and all major financial institutions—by "*hundreds of millions of dollars*." A109 (emphasis added).

D. The Proceedings Below

LBIE filed suit against AGFP in November 2011; AGFP subsequently brought counterclaims. A114, A139. In 2018, Justice Friedman, who presided over

[7] A8567-A8583; A8627-A8659; A1299-A1300; A9302; A9328-A9333.

[8] A8848-A8852; A1825-A1827. The figure for July 23, 2009, reflects AGFP's Loss calculation. A7598; A7603-04; A9302.

the case from 2012 until her retirement prior to trial in 2020, denied AGFP's summary judgment motion with respect to AGFP's Loss calculation. A51-75. Justice Friedman ruled that in requiring a "reasonable" calculation of Loss, the ISDA Master Agreement imposed an "objective standard of reasonableness" to be tested against "industry norms," including evidence of a "uniform or highly consistent practice of calculating Loss in a particular manner under similar circumstances." A54-65. She also rejected AGFP's argument that its inability to value the trades using the Market Quotation method rendered market prices irrelevant or justified a valuation completely divorced from market value. A67.

AGFP appealed, arguing *inter alia* that Justice Friedman had erred in ruling that (i) an objective standard of reasonableness applied and (ii) market values were relevant. A9358-9421. The Appellate Division, First Department rejected each of AGFP's arguments and remanded the matter for a trial to test the objective reasonableness of AGFP's Loss calculation. A9527-28.

Trial occurred beginning in October 2021. In the opening paragraphs of its Decision After Trial, issued on March 8, 2023, Supreme Court (Crane, J.) acknowledged that Justice Friedman had "found an issue for trial" because AGFP "did not use market prices in calculating its own loss" and that the issue to be tried was therefore "whether Defendant AG Financial Products, Inc's [] calculation of the 'Loss' on 28 Credit Default Swaps ('CDS') was objectively reasonable and made in

good faith under the parties' ISDA Master Agreement as of the July 23, 2009 termination date.'" A76 (alteration in original) (citation omitted).

Yet Supreme Court made no further reference to the applicable objective standard of reasonableness, and it did not apply an objective standard to AGFP's valuation. Instead, it departed from the prior decisions of Justice Friedman and the First Department by ruling that market prices were "irrelevant" and that AGFP's expressly subjective calculation, which gave no consideration to market practice or market value and which was demonstrably inconsistent with all contemporaneous published projections by hundreds of millions of dollars, was "reasonable." A107, A110. On that basis, Supreme Court entered judgment in favor of AGFP, requiring LBIE to pay AGFP more than $100 million (inclusive of interest and fees) in connection with the termination of trades that, according to AGFP's own internal valuation, were in fact worth hundreds of millions to LBIE. A16-18; A8852.

E. The Appeal of Supreme Court's Judgment

Supreme Court entered Judgment on June 30, 2023. A14-18. LBIE appealed, raising three separate grounds for reversal: *first*, that Supreme Court erred in ruling market values "irrelevant," Ex. G 28-42; *second*, that Supreme Court erred in failing to apply an objective standard of reasonableness, *id.* 42-49; and *third*, that Supreme Court erred in finding AGFP's Loss calculation to be reasonable, *id.* 49-60.

The Appellate Division, First Department heard oral argument on February 21, 2024. During oral argument, members of the panel expressly dismissed "whatever the case law is out there," disregarded concerns about AGFP's unprecedented valuation by stating "[t]here's always a first time for everything," and otherwise demonstrated basic confusion regarding the parties' positions. Ex. J at 8:4-24, 18:16-25, 20:21-21:5. By Decision and Order entered March 14, 2024, the First Department affirmed the Judgment for the reasons set forth in the Decision After Trial without any discussion of the merits. Ex. A. It also mistakenly characterized the Decision After Trial, without explanation, as being "based upon [Supreme Court's] resolution of expert testimony." *Id.*[9]

Plaintiff timely moved for reargument or leave to appeal on April 15, 2024. Ex. K (Pl's Mot. for Reargument). The First Department denied Plaintiff's motion on July 18, 2024. Ex. N.

<u>REASONS WHY PERMISSION TO APPEAL SHOULD BE GRANTED</u>

Pursuant to 22 NYCRR 500.22(b)(4), permission to appeal should be granted where "the issues [presented for review] are novel or of public importance, present

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[9] The First Department did not cite any conflicting expert testimony, and on the critical issues of fact—the market practice for valuing CDS and the mid-market price of the CDS at issue—there *was* no conflicting expert testimony. *See infra* p. 28-29 (AGFP's experts testified that they had no opinion regarding market practice); A9256 (AGFP's valuation expert accepting LBIE's $484.5 million mid-market value of the CDS for purposes of analysis); A4294-A4297 (same expert conceding he did not propose any other alternative market valuation).

a conflict with prior decisions of this Court, or involve a conflict among the departments of the Appellate Division."

Here, the questions presented for review arise from decisions of the First Department and Supreme Court that conflict with prior decisions of this Court, the First Department itself, and every other jurisdiction that has interpreted the same industry-standard contract. The questions presented also raise novel questions of law, since this Court has yet to interpret the ISDA Master Agreement, which has emerged as a key pillar of New York's multi-trillion-dollar derivatives industry since its introduction more than thirty years ago.[10] Finally, the issues raised in this case are of significant public importance for New York's role as a center of global finance and a site for the predictable and equitable resolution of contract disputes.

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[10] This Court has regularly accepted for review cases involving the interpretation of widely-used, industry standard contracts. *See, e.g.*, *Donohue v. Cuomo*, 38 N.Y.3d 1 (2022) (collective bargaining agreement); *Beal Sav. Bank v. Sommer,* 8 N.Y.3d 318 (2007) (syndicated loan agreement); *R/S Assocs. v. New York Job Dev. Auth.*, 98 N.Y.2d 29 (2002) (commercial loan agreement); *Charlebois v. J.M. Weller Assocs., Inc.*, 72 N.Y.2d 587 (1988) (general contractor's agreement); *Methodist Church of Babylon v. Glen-Rich Const. Corp.*, 27 N.Y.2d 357 (1971) (architecture services contract). The ISDA Master Agreement has been recognized as the most important standard form agreement in the financial world. *Firth Rixson*, [2010] EWHC 3372, ¶53.

I. PERMISSION TO APPEAL SHOULD BE GRANTED TO CLARIFY THE APPLICABLE STANDARD OF REASONABLENESS

A. The Decisions Below Conflict With This Court's Decisions Requiring Application Of An Objective Standard Of Reasonableness To The Exercise Of Contractual Discretion

As a matter of law, AGFP was required to calculate Loss "reasonably." A7147. As Supreme Court held on summary judgment—and as the First Department affirmed on interlocutory appeal—there is "substantial authority that an objective standard of reasonableness applies to a contractual provision requiring performance of an obligation in a reasonable manner." A58 (*citing MBIA Ins. Corp. v. Patriarch Partners VIII, LLC*, 842 F. Supp. 2d 682, 704-05 (S.D.N.Y. 2012); *Christie's Inc. v. SWCA, Inc.*, 22 Misc. 3d 380, 383-84 (Sup. Ct. N.Y. County 2008); Restatement [Second] of Contracts, § 228)); A9527-28; *see* A9358-9421. An objective standard requires consideration of "externally verifiable phenomena, as opposed to an individual's perceptions, feelings, or intentions." Black's Law Dictionary (11th ed. 2019), 'Objective'; *compare id.*, 'Subjective' ("Based on an individual's perceptions, feelings, or intentions, as opposed to externally verifiable phenomena.").

This Court has repeatedly and consistently applied an objective standard of reasonableness to both contractual and statutory clauses granting one contract counterparty discretion over the exercise of its contractual rights. This Court has explained that "[w]hile the power to [exercise discretionary authority] is an

untrammeled one where the object of the contract is to gratify taste, serve personal convenience, or satisfy individual preference, a different rule ordinarily prevails in this state, for commercial contracts" where the object relates to matters that can be tested against external and objective facts. *Alper Blouse Co. v. E.E. Conner & Co.*, 309 N.Y. 67, 70-71 (1955) (quotation marks and citations omitted); *accord J.D. Cousins & Sons, Inc. v. Hartford Steam Boiler Inspec. & Ins. Co.*, 341 F.3d 149, 153 (2d Cir. 2003) (standard of contract performance is objective where it can be measured against "external and objective facts, similar to issues of merchantability, operative fitness, or mechanical utility").

For example, in the context of the Uniform Commercial Code, this Court has held that a seller's "reasonable grounds" for believing a non-conforming tender would be accepted is "tested objectively" and must encompass the "commercial standards of fair dealing." *T.W. Oil, Inc. v. Consol. Edison Co. of New York*, 57 N.Y.2d 574, 586 (1982). This Court has likewise recognized that a secured party seeking to dispose of collateral following a counterparty default—a scenario highly analogous to the valuation of terminated derivatives following default under an ISDA Master Agreement—must do so in a "commercially reasonable" manner, which "invites consideration of accepted business practices as a guide to what is most likely to protect both debtor and creditor." *Bankers Trust Co. v. J.V. Dowler & Co.*, 47 N.Y.2d 128, 134 (1979). This is a fundamental principle of New York

law—it "evolved long before our adoption of the Uniform Commercial Code" in which it is now codified. *Id.* at 134 n.4; *see also U.S. Fid. & Guar. Co. v. Am. Re-Ins. Co*., 20 N.Y.3d 407, 420 (2013) ("objective reasonableness" determines the validity of an allocation of settlement payments for reinsurance purposes); *FMC Corp. v. Unmack*, 92 N.Y.2d 179, 188-89 (1998) ("objective data" required to credibly challenge property tax valuation).

Given these precedents, this Court should grant leave to appeal to clarify whether an objective standard of reasonableness applies to a contractual duty to perform a valuation reasonably. Review will permit this Court to establish a uniform standard of reasonableness for the ISDA Master Agreement and other commercial contracts governed by New York law, and to establish guardrails on the limits of reasonableness for lower courts to follow to avoid the kind of abuse present here.

B. The Decisions Below Overlook That Objective Reasonableness Is Law Of The Case, Thereby Creating Conflicting Decisional Law

Here, Supreme Court was obligated to apply a standard of objective reasonableness not only under this Court's precedents, but under the law of the case doctrine. The Appellate Division affirmed Supreme Court's denial of summary judgment and remanded this matter for trial for the specific purpose of determining whether AGFP's valuation was objectively reasonable when measured against external evidence—including, in particular, evidence of market practice. A9527-28 ("Despite the discretion afforded to the defendant under the parties' agreements to

calculate its loss after the [swaps] had been terminated, plaintiff raised an issue of fact as to whether defendants' loss calculation was reasonable and in good faith as required by the agreements.") (citing *Hoag*, 246 A.D.2d at 230-31 ("In determining whether conduct is objectively reasonable, industry norms may be appropriately considered.")). "An appellate court's resolution of an issue on a prior appeal constitutes the law of the case and is binding on the Supreme Court, as well as on the appellate court and operates to foreclose reexamination of [the] question absent a showing of subsequent evidence or change of law." *Kenney v. City of New York*, 74 A.D.3d 630, 630-31 (1st Dep't 2010) (quotation marks omitted). The First Department decision below is thereby in conflict with Supreme Court's prior summary judgment decision in this action, creating confusion as to the standard to be applied where there exists a contractual duty to perform a valuation reasonably.

C. The Decisions Below Failed To Apply The Objective Standard Required By New York Law

This case merits review because the factual record is fully developed, and it establishes that if Supreme Court had applied the objective standard of reasonableness required by New York law and law of the case, it should have found for LBIE.[11] LBIE presented extensive and unrebutted evidence that standard market

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[11] LBIE's discussion focuses on Supreme Court's decision and not the First Department's decision because the First Department's decision, not much more than one hundred words, fails to provide any analysis or insight into the basis for its ruling, which merely adopts the reasons set forth in Supreme Court's decision.

practice is to value terminated derivatives by reference to an objective measure: the market value of the derivatives. This evidence included hours of expert testimony, A347-410, A1191-367, A1380-537; A2353-593, A-4889-5209; A-5251-389, direct evidence of how LBIE's dozens of other derivatives counterparties valued hundreds of terminated credit default swaps covering losses on identical and similar securities after LBIE's default, A808-09, A824-26, A832-46, A8507-18; SEC filings by AGFP's own parent corporation acknowledging that AGFP might need to "make a mark-to-market payment" on early termination consistent with "market practice for derivative contracts," A7770; and the affirmation by industry leaders—including ISDA itself—that "in determining close-out amounts market inputs should be used unless doing so would produce a commercially unreasonable result," A7836.[12]

By contrast, AGFP has never identified a *single* instance in which *any* ISDA party used a subjective insurance reserve methodology to satisfy its contractual obligation to calculate Loss for terminated transactions. None of AGFP's experts opined that AGFP's methodology was consistent with market practice or any other objective indicia of reasonableness. One conceded that he was "not an expert in

[12] The use of an objective measure is also implicit in the parties' selection of the no-fault, two-way "Second Method" calculation option. A7160, A366-67. A rule permitting the non-defaulting party to substitute its own subjective view of valuation in the place of an objective measure would fundamentally undermine the no-fault nature of Second Method, effectively putting a thumb on the scale in favor of one party over the other.

market practice for calculating Loss under an ISDA Master Agreement," A4176-77; the second admitted that he was "not offering an opinion on whether the Loss calculation was consistent with market practice under the ISDA Master Agreement," A4640-41; and the third—ISDA's former outside counsel—admitted that he advised market practitioners calculating Loss to "look at the market price," A3696.[13]

In the face of this one-sided evidence, Supreme Court's conclusion that LBIE "came nowhere close to proving a uniform market practice to value utilizing only market prices," A104, was plainly erroneous; the sources it cited in support of this conclusory assertion are either irrelevant[14] or actually *support* the existence of a consistent market practice.[15] And although Supreme Court suggested that two of

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[13] AGFP has argued that LBIE itself considered the swaps to have been worthless, but its support consists of a single memorandum prepared outside of the ordinary course of business by a single LBIE employee based on demonstrably erroneous assumptions nine months before the Early Termination Date—which nevertheless assigned the swaps a market value of between $230 million and $1.2 billion in LBIE's favor. A932; A971-72; A1134-36; A1141; A7852-54. In any event, Supreme Court found this document to be of "little utility," A967, and properly gave it no weight, A108.

[14] Supreme Court cited three hearsay reports analyzing market conditions in a variety of financial markets months or years before the relevant valuation date, none of which addresses the method for valuation of swaps under an ISDA Master Agreement. *See* A6385 (October 2009 report about 2006-2008); A6558 (October 2008 report about 2007-2008); A6264 (March 2009 report about 2006-2008).

[15] Supreme Court cited a 2009 article by an AGFP expert (and former ISDA counsel) noting the difficulty of valuation in "distorted market[s]," but ignored that the same article suggests, as a "guide" to the calculation of Loss, "reference to neutral third-party indicators of value, such as market prices." A7132. Similarly, Supreme Court cited an academic treatise discussing valuation where there is no

LBIE's experts had "utilized different valuations in other cases," A104, it ignored that in both cases those valuations—neither of which involved application of an insurance reserve methodology—were specifically designed to establish an *objective* measure of value by estimating the market price. *See Barclays Bank PLC v. Devonshire Trust*, 2013 ONCA 494 (Can.), at ¶287 (adopting expert's methodology, which was "consistent with a mark-to-model or mark-to-market approach"); A2312-14 (explaining that valuation used a "market rate" to generate a market price).

Yet even if the record contained no evidence of a consistent market practice, this Court's precedents indicate that an objectively reasonable standard would still require a comparison of AGFP's valuation to contemporaneous market valuations. *See supra* Part I.A. This case therefore provides this Court with a unique vehicle to address the factors courts should weigh when assessing objective reasonableness.

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ready market for a terminated instrument (notwithstanding the well-settled rule in this state that such treatises are hearsay, *see* N.Y. Practice Series, Evidence in New York State and Federal Courts § 8:71), but ignored the treatise's guidance that where there is no "available market," valuation might instead be achieved with a "pricing model" that uses "market inputs to estimate the value of a transaction." A6885. And Supreme Court cited an English case that referenced "valuation and liquidity difficulties" in 2009, ignoring the decision's ruling that valuation in such circumstances must nevertheless be based on a "replacement transaction quotation"—that is, a market value. *Anthracite Rated Invs. (Jersey) Ltd. v. Lehman Bros. Finance S.A.*, [2011] EWHC 1822 (Ch) (Eng.) at ¶¶84, 112-16 (Ex. O).

D. Supreme Court Erroneously Applied A Subjective Standard By Endorsing AGFP's Off-Market Valuation

Supreme Court's error was not merely its failure to properly understand and weigh the trial evidence of a consistent market practice of valuing terminated derivatives by reference to objective market prices. Even more fundamentally, Supreme Court failed to appreciate the import of the undisputed fact that AGFP "used a subjective internal set of projections that were more favorable to Assured than what the market consensus was." A1680-81; *see also* A1687 (AGFP witness testifying that "by its very nature, that's a subjective estimate").

For 26 of the 28 CDS, AGFP did not assign a value based on any estimate of the magnitude of losses that were likely to occur; instead, because its insurer affiliate took no regulatory reserve on those 26 trades, AGFP simply assumed that no losses were likely and that the protection it had sold to LBIE was therefore worthless (even as it sought to charge LBIE for the full cost of that protection as if it was to continue through maturity, decades later). A1560-62, A7598-600. But AGFP's insurer affiliate interpreted insurance regulations to require no reserve *even if future losses were possible*, as long as it determined—subjectively—that those losses were not more than 50% likely to occur. A1560-62.[16] While that may be an appropriate basis

[16] An event that is less than 50% likely to occur can of course come to pass. If the weather forecast says there is a 45% chance of rain, one might think twice before going for a walk without an umbrella. AGFP simply assumed it would never get caught in the rain.

for setting insurance reserves, valuation requires consideration of *all* future events that might impact value. A bond with a 49% chance of defaulting is obviously worth far less than an otherwise identical bond that has only a 1% chance of defaulting—but AGFP's approach to Loss would value the two bonds equally. An approach that equates a risk of less than 50% with a risk of zero cannot satisfy AGFP's burden to prove the reasonableness of its valuation in support of its counterclaims seeking damages in connection with these 26 trades.

For the remaining two CDS, AGFP did purport to calculate the actual likelihood of loss as a basis for valuation, but once again that calculation was inherently subjective, based on a series of assumptions regarding the future performance of subprime mortgages. A1686-87; A1706-07; A1722-23. Those assumptions were not based on contemporaneous data about the housing market; in fact, in large part they were not based on any data at all. A1728-29; A1605-06; A1611-24; *see* A9310.

By accepting and approving of a *subjective* and unbounded approach to fulfill a contractual obligation that required *objective* reasonableness, Supreme Court effectively dispensed with the guardrails of reasonableness under New York law. Had AGFP relied on externally verifiable data, instead of its own assumptions, it would have projected losses directly in line with the observed market price—and with the market value it was recording in its own books. A9322; A8852.

While AGFP consistently valued the CDS in LBIE's favor for at least a year prior to termination, it selected an entirely different calculation when determining Loss as of July 23, 2009:

Date	AGFP Total Valuation of the CDS[17]
6/30/2008	$215,903,625
9/30/2008	$270,478,148
12/31/2008	$403,543,398
3/31/2009	$489,714,380
6/30/2009	$437,909,535
7/23/2009	**($20,663,300)**

If Supreme Court had applied the correct standard of reasonableness, it should have recognized that using a subjective methodology to turn a liability that the market measured in the hundreds of millions of dollars into, somehow, an asset, was contrary to the parties' agreement—especially as to AGFP's counterclaims seeking the full value of premiums for protection it cancelled decades before maturity, where AGFP bore the burden of proof. A77.[18]

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[17] A8848-52; A1825-27. The figure for July 23, 2009, reflects AGFP's Loss calculation.

[18] Though they were not any part of AGFP's calculations, Supreme Court cited the projections of certain credit ratings agencies, which it characterized as "similar" to the projections of AGFP, as support for the reasonableness of AGFP's conduct. A92. But Supreme Court itself acknowledged that the projections of the credit ratings agencies differed from AGFP's projections by "hundreds of millions of dollars." A109. Supreme Court committed legal error in ruling that this massive discrepancy, directly attributable to AGFP's subjective approach, completely divorced from objective third-party measures of value, was "insufficient to amount to being legally unreasonable." *Id.*

E. This Court's Review Is Necessary To Prevent Significant Uncertainty And Confusion On This Issue Of Public Importance

By determining that AGFP's valuation was reasonable despite its divergence from market prices by nearly half a billion dollars, the decisions below fail to apply the required objective standard of reasonableness to the parties' New York contract. *See People v. Leonti*, 18 N.Y.2d 384, 389 (1966) ("[T]he question whether the evidence adduced meets the standard required is one of law for our review."). That failure introduces significant uncertainty and confusion into New York law by depriving contract counterparties and reviewing courts of a critical check on contractual discretion.

If a party can demonstrate "reasonable" performance based solely on its own subjective and unbounded views even in the face of directly contradictory external evidence, parties enjoying such discretion will be incentivized to pursue their own self-interest, and their counterparties will be deprived of a guardrail that has always been a critical part of New York law. As ISDA's former outside counsel acknowledged at trial, "equipping Loss with the tests of reasonableness and good faith" was intended to "allow a diligent reviewing court the means to reign in any wild flights of calculational fancy." A3720. The decisions below deprive reviewing courts of those means, putting contracting parties "at the mercy of their [counterparty's] whim." *Rohn Indus., Inc. v. Platinum Equity LLC*, 911 A.2d 379, 383 (Del. 2006) (applying New York law).

Because of the ISDA Master Agreement's "prevalence and fundamental importance to the financial system," *Godfrey*, 2012 WL 10007863, at *9, it is now "axiomatic that it should, as far as possible, be interpreted in a way that serves the objectives of clarity, certainty and predictability, so that the very large number of parties using it should know where they stand." *Firth Rixson*, [2010] EWHC 3372, ¶53 (Ex. R); *see Intel*, 2015 WL 7194609, at *11 (same). This Court's review is necessary to promote such certainty and predictability by affirming the applicability of the standard of objective reasonableness in New York contracts requiring "reasonable" performance, and to determine whether an off-market valuation such as AGFP's meets this standard of reasonableness.

II. PERMISSION TO APPEAL SHOULD BE GRANTED TO CLARIFY WHETHER LOSS OF BARGAIN IS MEASURED BY REFERENCE TO MARKET PRICE

The decisions below further depart from settled New York law by permitting a "loss of bargain" valuation completely untethered from the market value of the terminated CDS. This Court should grant leave to appeal to establish whether, under commercial contracts such as the ISDA Master Agreement, a party may calculate "loss of bargain" in an amount that differs materially from contemporaneous market values.

A. Loss Of Bargain Is Measured By Reference To Market Price

The ISDA Master Agreement allows a party to calculate Loss based on its "loss of bargain," A7147, and that is what AGFP claims to have done here, A9416. New York law could not be clearer: such loss of bargain is determined by reference to market price. This Court has previously held that loss of bargain damages measure "the difference between the contract price and the fair market value of the property at the time of the breach." *White v. Farrell*, 20 N.Y.3d 487, 494 (2013) (quoting 25 Williston on Contracts § 66:80 (4th ed.)). Where a party seeks compensation for "'the deprivation of an item with a determinable market value, the market value at the time of the breach is the measure of damages.'" *Cole v. Macklowe*, 64 A.D.3d 480, 480 (1st Dep't 2009) (quoting *Sharma v. Skaarup Ship Mgt. Corp.*, 916 F.2d 820, 825 (2d Cir. 1990) (applying New York law)). As an *independent* assessment of value regularly used by market participants and courts alike, market price provides a critical objective reference point that Supreme Court should have used to test the reasonableness of AGFP's Loss calculation.

B. Review Will Permit This Court To Assess Whether Supreme Court Erred In Ruling That Market Prices Were Irrelevant

Supreme Court departed from the bedrock New York law principle that loss of bargain is measured by reference to market price when it ruled that market prices were "irrelevant" to AGFP's valuation of the CDS. A107. This Court should grant

leave to appeal to assess whether Supreme Court's interpretation of the ISDA Master Agreement is consistent with New York law regarding loss of bargain.

First, Supreme Court contended that "the ISDA Master Agreement … specifically stated that Assured 'need not' consider market prices in [its Loss] calculation." A78. The ISDA Master Agreement says no such thing. The language Supreme Court relied on does not refer to *all* market prices or values, but only one *particular* source of pricing information: quotations from leading dealers. Specifically, it provides that "[a] party may (but need not) determine its Loss by reference to *quotations of relevant rates or prices from one or more leading dealers* in the relevant markets," A7147 (emphasis added). There are myriad pricing sources, including records of recent transactions, start- and end-of-day values published by data providers, and market-based pricing models. By making dealer quotations a specifically permissible, though not required, source, this sentence does not license parties to disregard market values entirely when calculating Loss.

In fact, ISDA itself has explained that this sentence was intended to allow a party to value terminated derivatives using dealer quotes even if those quotes were "not necessarily in accordance with the technical requirements set forth in Market Quotation," which *requires* the use of quotations from leading dealers. A8241-42. Moreover, at summary judgment, Justice Friedman rejected AGFP's argument that the cited provision "must be read as effectively removing the issue of use of market

prices from the analysis of a Non-Defaulting Party's reasonableness and good faith," A62. Though that ruling was affirmed on interlocutory appeal, Supreme Court improperly disregarded this law of the case and misinterpreted the contract when it adopted AGFP's erroneous interpretation of the Loss provision after trial.

Second, Supreme Court dedicated a significant portion of its Decision After Trial to a finding that financial markets were "dislocated," supposedly rendering the readily available and observable market prices on the CDS at issue unreliable as a basis to calculate Loss. A84-87. Setting aside the absence of any evidence sufficient to support this conclusion, AGFP's own consistent use of market prices to value the trades in the ordinary course during this time undermines any such conclusion. A8852.[19] Moreover, New York courts have held that market value remains relevant *even where prices cannot be directly observed*, and that in such circumstances it is appropriate to calculate damages using a "hypothetical market value based on expert

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[19] AGFP's ordinary course valuation of the trades also undermines Supreme Court's erroneous conclusion that AGFP's inability to perform a "Market Quotation" valuation suggests that the trades had no market value. A87. And while AGFP has pointed to its own creditworthiness as a reason why the auction was unsuccessful, AGFP did not factor credit risk into its Loss calculation, A1342, and it is irrelevant as a matter of law. *See, e.g.*, *Am. List Corp. v. U.S. News & World Report, Inc.*, 75 N.Y.2d 38, 44-45 (1989); *Peregrine*, [2000] EWHC 99 Comm. ¶30 (Ex. T).

testimony." *Credit Suisse First Bos. v. Utrecht-Am. Fin. Co.*, 84 A.D.3d 579, 580 (1st Dep't 2011) (quotations omitted).[20]

Third, Supreme Court suggested that market values were irrelevant because AGFP was entitled to determine "*its* Loss," which Supreme Court interpreted to allow AGFP to adopt its own subjective valuation of the CDS based on its own idiosyncratic business interests. A107-08. But New York law is once again clear that loss of bargain damages "compensate the plaintiff for the 'market value' of the asset in 'contradistinction to any peculiar value the object in question may have had to the owner.'" *Schonfeld v. Hilliard*, 218 F.3d 164, 178 (2d Cir. 2000); *see also People v. Collier*, 22 N.Y.3d 429, 435 (2013) (one party's "subjective interpretation of the agreement does not control"). In other words, New York law dictates that one party's loss is ordinarily the other party's gain—a principle also expressed in the no-fault, two-way Second Method calculation provision in the ISDA Master Agreement, which the parties selected here. Under both New York common law and the plain terms of the ISDA Master Agreement, the value of financial instruments should not differ according to the subjective views of the contracting

[20] *Accord In re American Home Mortgage Holdings, Inc.*, 411 B.R. 181 (Bankr. D. Del. 2009) (holding that even where markets are dislocated, "the purpose remains the same—to determine as accurately as possible what the sale price would be, i.e., price discovery").

counterparties. Review will permit this Court to determine whether the decisions below erred in determining that market pricing was irrelevant.

C. The Decisions Below Conflict With The Decisions Of Every Other Court Interpreting The ISDA Master Agreement

The bedrock principle that loss of bargain is measured by reference to market value has routinely been applied by courts interpreting the ISDA Master Agreement. *See Anthracite Rated Invs. (Jersey) Ltd. v. Lehman Bros. Fin. S.A.*, [2011] EWHC 1822 (Ch) ¶117 (Ex. O) ("[W]here damages are sought for loss of bargain … the cost of [a] replacement contract as at the breach date is likely to prove the most reliable yardstick for measuring the claimant's loss of bargain"); *Lehman Bros. Special Financing Inc. v. Bank of Am., N.A.*, 553 B.R. 476, 485 (Bankr. S.D.N.Y. 2016) (holding that "under Loss and using Second Method" "a termination payment is calculated using the mark-to-market value of the parties' swap positions"); *Lehman Bros. Special Fin. Inc. v. Ballyrock ABS CDO 2007-1 Ltd.*, 452 B.R. 31, 35 n.9 (Bankr. S.D.N.Y. 2011) ("Second Method . . . provides for an early termination payment to be made to the in-the-money party regardless of whether that party is in default"); *The High Risk Opportunities Hub Fund Ltd. v. Lyonnais*, 2005 WL 6234513, at *8 (Sup. Ct. N.Y. County July 6, 2005) (determining Loss using the parties' internal market-based value for the trades); *Lehman Brothers Finance, S.A. v. Sal. Oppenheim Jr.& CIE. KGAA*, [2014] EWHC 2627 (Comm.) ¶¶39-45 (Eng.) (Ex. Q) (using market prices to value terminated transactions under an ISDA Master

Agreement); *Devonshire*, 2013 ONCA 494 (Can.), ¶282-89 (Ex. U) (reversing trial court decision that "demonstrated a misunderstanding of the loss of bargain component of Loss" by failing to "take account of the *market implied* estimate of projected losses" reflected in market prices (emphasis added)).

In fact, the principle that "Loss and Market Quotation are intended to produce Early Termination Payments in broadly similar amounts when measuring the loss of payments or deliveries due after the Early Termination Date" has hardened into "hornbook law" in cases applying the ISDA Master Agreement. *Intel*, 2015 WL 7194609, at *16, 18; *see Anthracite*, [2011] EWHC 1822 ¶117 (Ex. O); *Britannia Bulk plc v. Pioneer Navigation Ltd.*, [2011] EWHC 692 (Comm.) ¶50 (Ex. P); *Peregrine*, [2000] EWHC 99, ¶221 (Ex. T). Citing this very line of cases on summary judgment, Justice Friedman recognized that "[i]t would make no sense to hold as a matter of law that, because the Market Quotation process was unsuccessful, [AGFP] was free to adopt a methodology that results in a termination payment completely divergent from the cost of replacing the Transactions." A67.

Supreme Court acknowledged that courts—including Justice Friedman's decision on summary judgment *in this case*—have held "that market quotation and Loss are supposed to reach broadly the same result," but it professed not to understand "why this should be the case" and, as a result, it erroneously disregarded the principle entirely. A107. Instead, Supreme Court relied heavily on a Canadian

trial court decision, *Barclays Bank PLC v Devonshire Tr.*, 2011 ONSC 5008 (Can.), which Supreme Court described as being "on all fours." A106-07. In *Devonshire*, the trial court rejected a Loss calculation based on market prices in light of dislocation in the relevant market on the early termination date. *Barclays Bank PLC v Devonshire Tr.*, 2011 ONSC 5008, at ¶¶422-23, 432 (Ex. V).

The Ontario Court of Appeal *reversed*, ruling that the trial court had "demonstrated a misunderstanding of the loss of bargain component of Loss," and explaining that by failing to "take account of the *market-implied* estimate of projected losses" reflected in market prices, the trial court had failed to "value the loss of bargain in relation to the CDS." *Devonshire Tr.*, 2013 ONCA 494 (Can.), ¶282-89 (emphasis added) (Ex. U). In fact, the Court of Appeal required a market-based valuation *even though the relevant markets had been dislocated* on the valuation date, endorsing a calculation proposed by an expert (who testified on behalf of LBIE here) that looked to a "normalized" market value in prior, non-dislocated periods. *Id.*[21]

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[21] Supreme Court dismissed the appellate court's ruling on the ground that it involved a valuation from Barclays's perspective rather than from the perspective of the Devonshire Trust, which had proposed an alternative, non-market valuation in the event it was found to be the non-defaulting party. A100-02 ("Here, we are not calculating LBIE's Loss (Barclays' equivalent), but rather [AGFP's] Loss (Devonshire's equivalent)."). Supreme Court's faulty assumption that Loss can differ materially based on the identity of the non-defaulting party is not only contrary to law, it is based on a mistake of fact: the parties in *Devonshire* had amended their ISDA Master Agreement to allow for a non-market valuation if the Trust was the

By ruling that market prices were "irrelevant" to AGFP's calculation of Loss, A107-08, and by entering judgment in AGFP's favor based on a Loss calculation that did not attempt to solve for market value, Supreme Court has contradicted this Court's precedents and the decisions of every other court to interpret the ISDA Master Agreement. The First Department repeated those errors in its affirmance. This Court should grant review to determine whether New York courts will interpret the Loss provision of the ISDA Master Agreement consistent with every other federal and foreign court to date, or whether New York will be the sole jurisdiction to hold that market prices are irrelevant to a Loss calculation based on loss of bargain.

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non-defaulting party. *Devonshire*, 2011 ONSC 5008 (Can.), at ¶¶328-30 (Ex. V). LBIE and AGFP made no such amendment here; rather, they agreed *a priori* to a second-method market quotation valuation under which one party's gain would be equal to the other party's loss. A7160, A7141-42.

CONCLUSION

For the foregoing reasons, the Court should grant Plaintiff-Appellant LBIE's motion for permission to appeal.

Date: August 19, 2024

Respectfully submitted,

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STATE OF NEW YORK	)		**AFFIDAVIT OF SERVICE**
	)	ss.:	**BY OVERNIGHT FEDERAL**
COUNTY OF NEW YORK	)		**EXPRESS NEXT DAY AIR**

I, Tyrone Heath, 2179 Washington Avenue, Apt. 19, Bronx, New York 10457, being duly sworn, depose and say that deponent is not a party to the action, is over 18 years of age and resides at the address shown above or at

On August 19, 2024

deponent served the within: **MOTION FOR LEAVE TO APPEAL**
upon:

ATTN: GENERAL COUNSEL
1633 BROADWAY, 23RD FL.,
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the address(es) designated by said attorney(s) for that purpose by depositing **1** true copy(ies) of same, enclosed in a properly addressed wrapper in an Overnight Next Day Air Federal Express Official Depository, under the exclusive custody and care of Federal Express, within the State of New York.

Sworn to before me on August 19, 2024

MARIANA BRAYLOVSKIY
Notary Public State of New York
No. 01BR6004935
Qualified in Richmond County
Commission Expires March 30, 2026

Job# 332112