New York County Clerk's Index No. 653284/11
Appellate Division–First Department Case No. 2023-03409

Court of Appeals

of the

State of New York

LEHMAN BROTHERS INTERNATIONAL (EUROPE) (In Administration),

Plaintiff-Appellant,

– against –

AG FINANCIAL PRODUCTS, INC.,

Defendant-Respondent.

MOTION FOR LEAVE TO FILE BRIEF FOR *AMICUS CURIAE* CLAYTON P. GILLETTE IN SUPPORT OF PLAINTIFF-APPELLANT'S MOTION FOR PERMISSION TO APPEAL

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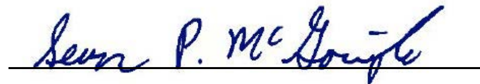
PLEASE TAKE NOTICE that, upon the annexed affirmation of Sean P. McGonigle, dated September 18, 2024, and the accompanying proposed brief, *Amicus Curiae* Clayton P. Gillette, the Max E. Greenberg Professor of Contract Law at New York University School of Law, will move this Court on September 30, 2024 at 10:00 a.m. or as soon thereafter as counsel may be heard, at Court of Appeals Hall, 20 Eagle Street, Albany, New York 12207, for an order pursuant to Rule 500.23 of the Rules of Practice of the Court of Appeals of the State of New York granting Professor Gillette leave to file the accompanying brief as *Amicus Curiae* in support of Plaintiff-Appellant in the above-captioned action and for such other and further relief as the Court may deem just and proper.

Dated: September 18, 2024
New York, NY

Respectfully submitted,



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Sean P. McGonigle, an attorney duly admitted to practice before the Courts of the State of New York, hereby affirms the following to be true under penalty of perjury pursuant to CPLR § 2106:

1. I am a Partner at Wollmuth Maher & Deutsch LLP, counsel for *Amicus Curiae* Clayton P. Gillette, in the above-captioned action.

2. Clayton P. Gillette is the Max E. Greenberg Professor of Contract Law at New York University School of Law.

3. I submit this affirmation in support of *Amicus*' motion for leave to file an *Amicus Curiae* brief in the above-captioned action.

4. A copy of the proposed *Amicus Curiae* brief is attached hereto.

5. This Court may grant a nonparty leave to file an *Amicus Curiae* brief if the nonparty "demonstrate[s] that the parties are not capable of a full and adequate presentation and that movant could remedy this deficiency; movant could identify law or arguments that might otherwise escape the Court's consideration; or [if] the proposed *amicus curiae* brief otherwise would be of assistance to the Court[.]" Rule of Practice 500.23(a)(4)(i).

6. As the parties' briefs demonstrate, the key issue in dispute in this appeal is whether loss calculations under certain ISDA Master Agreement provisions must be commercially reasonable and judged by an objective standard.

7. *Amicus* is uniquely well situated to assist the Court in addressing this question. *Amicus* is a New York-based legal scholar nationally recognized for his expertise in contracts, commercial law, and local government law. He has researched, published, and taught in the areas of contracts and commercial law since 1978, and has served as an expert witness or consultant on New York contract law in multiple arbitrations and litigation, including the interpretation of the ISDA Master Agreement under New York law.

8. By virtue of his research and scholarship, *Amicus* maintains a deep professional interest in promoting a proper understanding of the principles of New York law at issue in this case.

9. Moreover, by virtue of his research and scholarship, *Amicus* is well positioned to assist the Court's decision-making process in this significant matter—and is capable of presenting arguments and perspectives to this Court that the parties alone are not capable of presenting, which would assist the Court's deliberations. The enclosed *Amicus Curiae* brief describes fundamental principles of loss calculation under the ISDA Master Agreements and New York contract law that will aid in the Court's interpretation of the contract at issue here.

10. Granting *Amicus* leave to file an *Amicus Curiae* brief would not impose an undue burden on the Court, given that the proposed brief is within the 7,000-word

limit on *Amicus Curiae* briefs, and because it will aid the Court's consideration of the issues.

11. No party's counsel contributed content to this brief or otherwise participated in the brief's preparation. *Amicus'* counsel at Wollmuth Maher & Deutsch LLP has assisted in the brief's preparation.

12. Edward Macnamara, Gillian Bruce, and David Kelly are licensed insolvency practitioners who, in their individual capacities, are the Joint Administrators of Lehman Brothers Holdings PLC (in Administration), an affiliate and indirect creditor of Plaintiff-Appellant Lehman Brothers International (Europe) (in Administration) which has compensated *Amicus* for his time preparing this *Amicus Curiae* submission at his ordinary hourly rate. As court-appointed administrators, Mr. Macnamara, Ms. Bruce, and Mr. Kelly act in the interest of that entity's creditors, collecting debts owing to the entity and distributing monies collected to its creditors, treating all debtors and creditors fairly and consistently in accordance with their respective rights, and accordingly have an interest in promoting the adoption of legal rules that provide for consistency and *ex ante* certainty regarding the value of creditor claims arising out of contracts governed by New York law in bankruptcy situations.

13. However, the opinions and conclusions expressed in *Amicus*' brief represent *Amicus*' own independent views. They do not necessarily represent the views of New York University School of Law, where he teaches.

14. Other than as set forth above, no other person or entity contributed money that was intended to fund preparation or submission of the brief.

WHEREFORE, for the reasons set forth herein, *Amicus* respectfully requests that the Court grant this motion in all respects, grant *Amicus* leave to file his attached proposed brief of *Amicus Curiae* in this appeal, and grant such other and further relief as the Court may deem just and proper.

Dated: September 18, 2024
New York, NY

Respectfully submitted,

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ATTACHMENT

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STATUS OF RELATED LITIGATION

Pursuant to the Rules of Practice of the New York Court of Appeals, 22 N.Y.C.R.R. § 500.13(a), *Amicus Curiae* states that he is not aware of any related litigation as of the date of filing this brief.

CORPORATE DISCLOSURE STATEMENT

Pursuant to the Rules of Practice of the New York Court of Appeals, 22 N.Y.C.R.R. § 500.1(f), *Amicus Curiae* states that no such corporate parents, subsidiaries or affiliates exist.

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INTEREST OF *AMICUS CURIAE*

Amicus Curiae, Clayton P. Gillette, is the Max E. Greenberg Professor of Contract Law at NYU School of Law.[1] He has been a member in good standing of the New York Bar since 1977. He has researched, published, and taught in the areas of contracts and commercial law since 1978, and has served as an expert witness or consultant on New York contract law in multiple arbitrations and litigation, including the interpretation of the ISDA Master Agreement under New York law. Professor Gillette has a professional interest in promoting a proper understanding of the principles of New York law at issue in this case.

[1] Institutional affiliation is listed for identification purposes only.

PRELIMINARY STATEMENT

This case presents unresolved issues of New York law that affect the interpretation of the ISDA Master Agreement, a standard form that dominates the multi-trillion-dollar international market in financial derivatives. As importantly, the case implicates New York's primacy as the favored jurisdiction for sophisticated commercial contracts, including the ISDA Master Agreement. Sophisticated parties are likely to select New York law and a New York forum so long as that law is relatively certain and reflects the legal principles to which parties would otherwise have bargained.

The decisions below in this matter, however, confer on a party determining Loss[2] under an ISDA Master Agreement a degree of latitude that significantly increases the uncertainty faced by contracting parties. That is because those decisions allow one party to calculate Loss based on its internal motivations for entering such agreements, disembodied from market prices or proxies for them. This is inconsistent with longstanding New York law that grants priority to measures based on market prices or their proxies when determining damages or "loss of bargain." Whether New York law should expand the concept of "loss of bargain" to comprise calculations made without reference to market-based criteria thus

[2] Except as otherwise defined, capitalized terms have the same meanings set forth in the briefs of Plaintiff-Appellant LBIE and Defendant-Respondent AGFP.

presents a novel issue crucial to the interpretation of ISDA Master Agreements and contracts generally. This Court should accept this appeal in order to bring stability to that interpretation and thus provide the certainty necessary for sophisticated commercial parties to avail themselves of New York law.

Accepting this appeal to provide such clarification would also resolve a conflict between the decisions below and a more general principle of damages under New York contract law. Unlike most other jurisdictions, New York law restricts breach of contract liability to those damages that were within the "contemplation of the parties" at the time the contract was executed, *i.e.*, a "tacit agreement" test. It is dubious that at the time of contracting, a party to the ISDA Master Agreement would have contemplated that its default exposed it to liability based on the nature of its counterparty's business, rather than on the lost market value of contractual performance. This Court, therefore, should accept this appeal to determine whether New York's longstanding tacit agreement test continues to apply and, if so, whether it applies to Loss determinations under the ISDA Master Agreement.

ARGUMENT

I. THE DECISIONS BELOW INTRODUCE UNCERTAINTY INTO THE CALCULATION OF LOSS AND THUS THREATEN NEW YORK'S POLICY OF ENCOURAGING SOPHISTICATED COMMERCIAL PARTIES TO SELECT NEW YORK LAW.

This case addresses the crucial issue of what a party to an ISDA Master Agreement governed by New York law can consider when calculating a reasonable

amount of its Loss. This is an important issue for the proper interpretation of global bilateral derivative trade agreements governed by New York law. However, it also implicates a more general and explicit policy of New York law warranting this Court's attention. Through its enactment of General Obligations Law § 5-1401, the New York Legislature has encouraged sophisticated commercial actors in high-value transactions to select the New York justice system to govern their contractual disputes.[3] *See, e.g.*, *Ministers and Missionaries Ben. Bd. v. Snow*, 26 N.Y.3d 466, 472 (2015); *Babcock & Wilcox Co. v. Control Components, Inc.*, 161 Misc.2d 636, 640-41 (Sup. Ct. N.Y. County 1993).

Sophisticated parties are likely to select New York law to govern their transactions where two conditions are satisfied. First, sophisticated parties will select New York law when its contract rules are consistent with the risk allocations to which most parties would have agreed had those rules not existed. As Judge Cardozo

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[3] General Obligations Law § 5-1401(1) provides, in relevant part:

> The parties to any contract, agreement or undertaking, contingent or otherwise, in consideration of, or relating to any obligation arising out of a transaction covering in the aggregate not less than two hundred fifty thousand dollars, including a transaction otherwise covered by subsection (a) of section 1-301 of the uniform commercial code, may agree that the law of this state shall govern their rights and duties in whole or in part, whether or not such contract, agreement or undertaking bears a reasonable relation to this state.

A companion statute, General Obligations Law § 5-1402, permits New York courts to entertain lawsuits in high-value transactions where the parties have agreed to submit to the jurisdiction of New York courts. These statutes make clear that "public policy favors New York courts retaining lawsuits where New York is the designated forum." *Credit Francais International, S.A. v. Sociedad Financiera De Comercio, C.A.*, 128 Misc.2d 564, 572 (Sup. Ct. N.Y. County 1985).

famously stated in concluding that the presence of a material breach will be determined by reference to what most parties would have considered to be adequate performance, "[i]ntention not otherwise revealed may be presumed to hold in contemplation the reasonable and probable. If something else is in view, it must not be left to implication." *Jacob & Youngs, Inc. v. Kent*, 230 N.Y. 239, 242 (1921). By providing background rules consistent with most parties' preferences, New York law reduces the costs that sophisticated parties must incur to negotiate and document their transactions, since most parties need only accept the background rules that already exist. If New York contract rules are not consistent with most parties' preferences, sophisticated parties must either incur the costs of bargaining for alternatives or elect to have their transactions subject to the background rules of other, more favorable jurisdictions.

Concomitantly, sophisticated parties will select New York law if that law indicates with clarity the risks that each party undertakes by entering into a contract. As this Court has recognized when justifying various principles of New York contract law (such as the plain meaning rule and parol evidence's limited role in contract interpretation), parties are likely to choose New York law when it is certain and consistent with the parties' intent. *See, e.g.*, *Vermont Teddy Bear Co. v. 538 Madison Realty Co.*, 1 N.Y.3d 470, 475 (2004) (New York's plain meaning rule has special import "where commercial certainty is a paramount concern, and where . . .

the instrument was negotiated between sophisticated, counseled business people negotiating at arm's length") (citation omitted).

The decisions in this case threaten the achievement of those goals. Those decisions introduce substantial uncertainty related to the reasonable calculation of Loss under the ISDA Master Agreement by allowing for calculations that fail to refer to market prices or other objective criteria, such as substitutes for unavailable market prices. Instead, the court permitted AGFP, the affiliate of a monoline insurer, to value its Loss according to its own motive for entering the transactions (to receive the cash flow from premium payments) and based on insurance loss reserve estimates that were calculated for regulatory purposes unrelated to market losses at the time of termination. Even if this Court were to affirm the decisions below, accepting this appeal would bring necessary certainty as to how parties can calculate Loss, and thus permit informed decisions as to whether contracting parties should select New York law to govern their ISDA Master Agreement transactions.

The uncertainty that follows from the decisions below also implicates the preference that rules of New York contract law reflect the risk allocations to which parties would otherwise have bargained. By calculating Loss in accordance with its own motivation for entering into the contract, AGFP made use of information beyond LBIE's contemplation at the time the contract was executed. Allowing Loss to be calculated in that manner would deter a counterparty from entering

transactions—or from having New York law govern transactions—because of the difficulty it would face in determining its exposure or pricing the risk of calculations dependent on unknown motivations of the determining party. To fulfil the legislative desire for New York law to govern high value commercial transactions, the Court must address whether sophisticated commercial parties would bargain for a tacit agreement that permitted such a subjective methodology of determining Loss, instead of one attentive to market measures.

II. THE DECISIONS BELOW RAISE CRITICAL QUESTIONS ABOUT THE INCORPORATION OF MARKET INFORMATION IN REASONABLE DETERMINATIONS OF LOSS.

A. The ISDA Master Agreement Requires Calculations of Loss to be Reasonable in Order to Reduce Incentives to Act in a Self-Interested Manner.

Under an ISDA Master Agreement, Loss—for any party—means "an amount that party reasonably determines in good faith to be its total losses and costs (or gain . . .) in connection with this Agreement. . . ." A7147[4] (definition of Loss). As the decisions below indicate, the Loss measure for determining payment obligations after Early Termination of an ISDA Master Agreement is characterized by more flexibility than the alternative Market Quotation measure. Ex. B[5] at 24-25. That flexibility, however, is a bug of the ISDA Master Agreement, not a feature. To the

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[4] All citations to "A__" herein refer to the appendix filed in the Appellate Division, Case No. 2023/03409, NYSCEF Nos. 4-21.

[5] All citations to "Ex. __" herein refer to exhibits attached to the Affirmation of Andrew J. Rossman, filed with LBIE's motion to this Court for leave to appeal.

extent that the Loss measure allows a party to inject more subjective criteria into its calculations, or to choose a methodology that increases the benefit it would receive from a counterparty's default compared to alternative methodologies, the flexibility of Loss is a characteristic to be constrained, not celebrated. As a leading commentator on derivatives transactions has stated, "[t]he disadvantages of loss are its apparent lack of objectivity." Schuyler K. Henderson, Henderson on Derivatives 977 (2d ed. 2010). That is because a party calculating Loss has incentives to maximize its own loss or minimize its own gain, thereby increasing the payment it anticipates from the counterparty or reducing the payments it must make to the counterparty after an Early Termination. In short, the party determining a termination payment imposes on the counterparty the moral hazard of being "tempted to eke out a profit from the termination." *Id.* at 976.

The selection of a self-interested methodology for calculating Loss may be apparent in this case. The court below allowed AGFP to use a methodology deployed to measure regulatory reserves because, in the court's view, AGFP had incentives to develop "accurate modeling" for regulatory purposes to avoid being left with "catastrophic" losses, and thus it was appropriate to use a similar methodology in calculating Loss. Ex. B at 3. But that approach ignores the similar self-interested incentives for calculating reserves and calculating Loss. Regulated entities will prefer to minimize the reserves that they must set aside in order to maximize

available working capital. They thus have incentives to select a reserve calculation methodology that minimizes their regulatory obligation. Of course, AGFP also desires to minimize the payments it must make when calculating Loss under an ISDA Master Agreement. AGFP's incentives to select a methodology that minimizes regulatory reserves therefore closely aligns with its incentives to select a methodology limiting its payments when calculating Loss. Permitting AGFP to calculate Loss by using a methodology similar to one used for reserve calculations therefore reinforces and exacerbates, rather than offsets, any self-interested motivation to maximize its benefit from using a particular Loss calculation methodology.

The calculating party's obligation to "reasonably determine[]" in good faith its total losses and costs for Loss serves as a constraint on the incentive to act in a self-interested manner. What constitutes a "reasonable" determination, therefore, should be considered through the lens of the need to place guardrails on the discretion of the calculating party. This Court can address those guardrails by clarifying the extent to which a party calculating Loss may use the "flexibility" inherent in that determination to act solely in its own self-interest, notwithstanding the consequences for its counterparty.

To constrain self-interested Loss calculations, some courts have adopted a "cross-check" principle that presumes that appropriate measures of Loss will

approximate the measure of Market Quotation, at least in cases where payments are to be made subsequent to Early Termination. *See, e.g., Anthracite Rated Investments (Jersey) Ltd. v. Lehman Brothers Finance S.A.*, [2011] EWHC 1822 (CH), ¶ 116(1) (Ex. O); *see also Lehman Brothers Int'l (Europe) v. AG Fin. Prods., Inc.*, 60 Misc.3d 1214(A) (Sup. Ct. N.Y. County 2018) (Ex. E) ("Summary Judgment Opinion") at 28-29 (citing *Anthracite* and *Australia and New Zealand Banking Grp. Ltd. v. Société Général*, [2000] CLC [CA] 833). The cross-check principle thus limits the ability of a calculating party to rely on criteria that favor its determination of gains and losses at the expense of the counterparty. As Justice Friedman concluded in the summary judgment opinion in this case, the cross-check principle should be applied in a case in which a Market Quotation auction fails. *See* Summary Judgment Opinion at 30.

The cross-check principle's underlying motivation, *i.e.*, the need to limit the discretion of the determining party in applying the Loss calculation's "reasonably determines" standard, remains even if this Court is not inclined to adopt the cross-check principle itself. Justice Friedman highlighted the need to address a determining party's discretion in the summary judgment opinion in this action:

> Although a monoline insurer that adopts an unreasonable methodology for projecting future losses for regulatory reserve purposes may be expected to suffer serious consequences, Assured itself appears to have acknowledged that " '[t]he establishment of the appropriate level of loss reserves is an inherently subjective process involving numerous estimates, assumptions and judgments by management, using both

> internal and external data sources with regard to frequency and severity of loss.'" . . . . The significance of Assured's characterization of its process as "subjective" has not been adequately addressed by the parties on this record.

Summary Judgment Opinion at 33 n. 16.

B. A Reasonable Determination of Loss Must Incorporate Objective Criteria.

The ISDA Master Agreement does not define "reasonableness." Nor does it specify what criteria may be considered in making a reasonable determination of Loss. However, New York cases from lower courts and federal decisions that purport to apply New York law do define "reasonableness," and they consistently define "reasonableness" in a manner that requires the acting party (here, the party making a Loss determination) to use objective criteria, rather than criteria serving its own interests. *See, e.g.*, *MBIA Ins. Corp. v. Patriarch Partners VIII, LLC*, 842 F.Supp.2d 682, 704-05 (S.D.N.Y. 2012) ("The requirement that Patriarch use 'commercially reasonable efforts' [in implementing an ISDA Master Agreement] in a timely manner provided an objective standard of reasonableness rather than Patriarch's mere subjective belief about what efforts Patriarch should take to obtain the Ratings."); *Christie's Inc. v. SWCA, Inc.*, 22 Misc.3d 380, 384 (Sup. Ct. N.Y. County 2008) (reasonableness standard in a contract suggests "the parties intended a standard of objective reasonableness to apply").

Within the context of ISDA Master Agreements, courts have also interpreted the requirement to act reasonably as referencing an objective standard. Thus, in *Peregrine Fixed Income Ltd. v. Robinson Department Store Plc*, [2000] EWHC 99 (Comm), ¶ 37 (Ex. T), the court noted that parties who selected Market Quotation as a measure of payments due on Early Termination must revert to Loss where use of a market quotation would not be "commercially reasonable." The court then concluded that whether a market quotation is commercially reasonable "is a matter which has to be judged not simply by reference to the interests of one or other party but by reference to the aims and objects of the Agreement insofar as they are to be gathered from its terms as a whole."

The commentary on the ISDA Master Agreement is also instructive. Henderson notes that the ISDA Master Agreement incorporates standards of good faith, commercially reasonable procedures and a commercially reasonable result, and then adds, "[i]t might be useful to clarify that commercial reasonableness should be determined after taking into consideration the interests of both parties." *See* Henderson, *supra*, at 982, n. 3.[6] This principle is also consistent with the objective of defining legal rules that reflect the parties' preferences at the time they entered

[6] While Henderson recites this principle in connection with determination of a close-out amount under the 2002 ISDA Master Agreement, he is using the principle to define commercial reasonableness, and there is no reason to conclude that that term has a different meaning under the 2002 ISDA Master Agreement than it does under the 1992 ISDA Master Agreement at issue in this case.

into their agreement. Presumably, and as discussed in Section III *infra*, neither party would have agreed to expose itself to a methodology for determining Loss based solely on the subjective interests of the counterparty.

C. Market Information Provides the Best Objective Criteria of Loss.

Since New York requires a reasonable determination of Loss to be objectively measured, this appeal provides the Court with an opportunity to identify what measures are sufficiently objective to satisfy that requirement. Market prices and market-based information typically provide the best objective measure of the consequences of early termination of an ISDA Master Agreement. Markets are inherently "impartial," as they do not favor either party. Thus, even in the absence of market quotations, substitutes that are based on market information may help to constrain a calculating party's incentive to "eke out a profit from the termination." Although the last sentence of the Loss definition allows, but does not require, the calculating party to "determine its Loss by reference to quotations of relevant rates or prices from one or more leading dealers in the relevant markets," A7147, this Court could (and should) conclude that market-based information—even if insufficient to create a firm or indicative quotation—is an integral part of any reasonable determination of Loss. Thus, that sentence may be read to render references to market quotations from leading dealers unnecessary, but not to preclude the need to incorporate market information or proxies for market prices.

This Court should accept this appeal to decide whether a determining party may ignore market information or proxies for market prices when market quotations from leading dealers are unavailable, thereby clarifying acceptable methodologies for measuring the reasonable determination of Loss.

i. New York Law and Case Law Involving ISDA Master Agreements Require that "Loss of Bargain" be Calculated by Reference to Market Prices.

The court below allowed AGFP to measure its Loss, not "by reference to quotations of relevant rates or prices from one or more leading dealers" that would have been permissible under the last sentence of the Loss definition or by use of models of proxies for that price, but by netting "the premium payments LBIE would have owed over the life of the transactions against the amounts Assured projected it would have had to pay to cover expected shortfalls in interest and principal." Ex. B at 13. The court viewed that methodology as the best means of determining AGFP's "loss of bargain," an explicit component of Loss under the Section 14 definition. *Id.* at 32-33. The court adopted that methodology on the grounds that AGFP was a monoline insurer that "made its money from the premiums it received for the protection it provided" and insured payment flows rather than the value of the transactions. *Id.* at 3 & n.1. The opinion below, therefore, raises the question—critical to the interpretation of an ISDA Master Agreement—of whether a reasonable determination of loss of bargain can depend on the determining party's business

model and motivation for entering the transaction rather than on any approximation of the market value of the transaction at the time of termination. Given the importance of that question and established New York law, if this Court were to accept such a basis for calculating loss of bargain, it should do so explicitly.

The ISDA Master Agreement does not define the term "loss of bargain." New York law, however, does define the term, and does so in terms of market price rather than idiosyncratic or special losses suffered by the aggrieved party. *See, e.g.*, *St. Lawrence Factory Stores v. Ogdensburg Bridge and Port Auth.*, 13 N.Y.3d 204, 207 (2009) (defining "benefit of the bargain" as "the alleged difference between the agreed-upon price of the property and its market value"); *Musick v. 330 Wythe Ave. Assocs., LLC*, 41 A.D.3d 675, 676 (2d Dept. 2007) ("The measure of damages for loss of bargain is the difference between the contract price and the market value of the property at the time of the breach, together with the incidental damages which flow from the breach.").

As the ISDA Master Agreement makes clear, there are times when market quotations will not reflect commercially reasonable values, and times when markets are sufficiently disrupted as to obscure a precise or narrowly defined market price. But those conditions do not necessarily warrant the conclusion that proxies for or approximations of market prices are irrelevant, or that in the absence of reliable market prices a party calculating Loss may revert to a highly personal concept of

"loss of bargain" disembodied from estimated market values. Instead, the structure of the ISDA Master Agreement and New York case law plausibly necessitate an effort to incorporate market information into a reasonable determination of Loss even when market quotations from leading dealers are unavailable.

For example, that desire is reflected in the requirement of Section 6(d)(i) that Loss be calculated on the Early Termination Date or as soon as reasonably practicable thereafter. A7141. Calculations of Loss promptly after termination are likely to approximate market values as of the Early Termination Date, while calculations may deviate from market value on the Early Termination Date if made later in time. *See Barclays Bank PLC v. Devonshire Tr.*, 2011 ONSC 5008, ¶¶ 368, 374 (Ex. V). The requirement that Loss be calculated on the Early Termination Date would make little sense if Loss could be determined without any concern for market prices at the time of termination, given that the reason for the requirement is to ensure that Loss approximates market values as of the Early Termination Date. On the other hand, AGFP's methodology was disassociated from *any* concern for market value at the time of termination.

Case law from other jurisdictions also suggests the preference for Loss or "loss of bargain" to be calculated by a market-related measure. As the court stated in *Anthracite*, [2011] EWHC 1822 (Ch), ¶ 116(2) (Ex. O):

> The identification of the non-defaulting party's loss of bargain arising from the termination of the Derivative Transaction requires a 'clean'

> rather than 'dirty' market valuation of the lost transaction. This means that the loss of bargain must be valued on an assumption that, but for termination, the transaction would have proceeded to a conclusion, and that all conditions to its full performance by both sides would have been satisfied, however improbable that assumption may be in the real world.

Certainly, courts have permitted parties to calculate Loss during periods of thin markets by using proxies for market value. For example, in *Merrill Lynch Capital Services, Inc. v. UISA Finance*, 2012 WL 1202034 (S.D.N.Y. April 10, 2012), *aff'd*, 2013 WL 4610024 (2d Cir. Aug. 30, 2013), MLCS was required to use Loss rather than the Market Quotation methodology, since it received only one live quotation. MLCS then determined its Loss by inputting "objective market data [into] the standard model for valuing options" of the type involved in the case. *Id.* at *23. The court concluded that MLCS's methodology provided a "sound basis" for establishing its Loss. *Id.* at *24. The court also found the results of MLCS' methodology consistent with three valuation models, implying that models alone were appropriate when market quotations were unavailable. *Id.* at *23-24.

Relying on market information rather than individual business objectives of the party making the Loss determination also promotes the goal of formulating legal rules consistent with the presumed expectations of sophisticated parties. Sophisticated parties that enter ISDA Master Agreements expect to have some sense of their exposure so they can determine the appropriate price they will pay for entering into the agreement. Knowing that Loss will be determined by reference to

market-based information allows sophisticated parties greater capacity to price the risks of transactions because they will have historical information about market movements and will be able to incorporate that information into their estimates and models of what will occur during the period covered by their agreement.

ii. New York Law Requires the Use of Credible Proxies of Market Price for Unavailable Market Prices.

Although amounts payable under the ISDA Master Agreement's Second Method and Market Quotation selections are not technically contract damages (insofar as Second Method attempts to calculate closeout payments rather than impose damages on a Defaulting Party), principles of New York contract law inform the interpretation of the ISDA Master Agreement's terms. *See, e.g.*, *Anthracite*, [2011] EWHC 1822 (Ch), ¶ 117 (Ex. O) ("The extended definition of Loss in Section 14 of the 1992 Master Agreement nonetheless uses certain words and phrases which were, I think, intended to be illuminated by reference to the general common law (or New York law) meaning. For present purposes the relevant phrase is 'loss of bargain'."); *Merrill Lynch Capital Services, Inc.*, 2012 WL 1202034, at *6 (applying New York damages law in ISDA case).

General New York contract law prioritizes the use of market-based information to determine the harm from a party's failure to perform. New York law often explicitly measures damages for breach of contract by reference to the

difference between contract price and market price. *See, e.g.*, N.Y. U.C.C. §§ 2-708, 2-713. New York law also provides for damages calculations measured by the difference between the contract price and the price at which the aggrieved party can procure a replacement transaction. *See* N.Y. U.C.C. §§ 2-706; 2-712. When an aggrieved party purports to measure damages by reference to a replacement transaction, however, New York law requires that the price of the substitute transaction reflect an approximation of the market price at the time of breach. Substitute transaction prices, in short, are useful as a measure of damages if—but only if—their prices are consistent with market prices.

The New York contract law principle that damages be measured by substitute transactions only when those transactions provide credible proxies for market prices and actual losses is apparent in *Apex Oil Co. v. Belcher Co.*, 855 F.2d 997 (2d Cir. 1988). In that case, the court concluded that, in order for a resale price to be used to measure damages, the resale had to occur "as soon as practicable after breach." *Id.* at 1007. That requirement, of course, is consistent with the obligation of a calculating party under an ISDA Master Agreement to reasonably determine Loss as soon as possible after an Early Termination Date. In *Apex*, the court found that the relevant "resale" was a sale of similar goods that occurred the day after the breach, thereby ensuring that the substitute transactions reflected market prices at the time of breach (even though the actual goods from the breached contract were available and were

resold several weeks later). The court cited commentary indicating that a resale transaction could only be used to measure damages if the resale price reflected the market price that would have been available at the time of the breach:

> [T]he object of the resale is simply to determine exactly the seller's damages. These damages are the difference between the contract price and the market price at the time and place when performance should have been made by the buyer. The object of the resale ... is to determine what the market price in fact was. *Unless the resale is made at about the time when performance was due it will be of slight probative value, especially if the goods are of a kind which fluctuate rapidly in value*. If no reasonable market existed at this time, no doubt a delay may be proper and a subsequent sale may furnish the best test, though confessedly not a perfectly exact one, of the seller's damage.

Id. at 1006 (citing 4 R. Anderson, Anderson on the Uniform Commercial Code § 2-706:25 (3d ed. 1983)) (emphasis in original).

Similarly, in *Bache & Co. v. Int'l Controls Corp.*, 339 F. Supp. 341, 352 (S.D.N.Y. 1972), *aff'd*, 496 F.2d 696 (2d Cir. 1972), the court concluded that a resale of securities had to occur "as soon as practicable" following notice of the buyer's refusal to accept their tender. The court noted that, as a general matter, a reasonable time for resale "depends upon the nature of the goods, the condition of the market," and other undefined characteristics. *Id.* at 351. The court also noted that "[g]enerally the courts have required the seller to resell the goods as near to the time of breach as reasonably possible when there is a ready market and a fluctuating price for the goods, particularly in cases of a declining market." *Id.* In light of the market conditions and fluctuating prices in that case, the court allowed substitute

transactions entered into within 30 days of the breach to be used to measure actual damages. *Id.* at 352. Restricting the period of resale suggests that the court sought to induce the aggrieved party to act as soon as possible after the breach to ensure that the price obtained in any substitute transaction reflected the market price at the time of the breach.

Credit Suisse First Boston v. Utrecht-America Fin. Co., 84 A.D. 3d 579, 580 (1st Dept. 2011) indicates that these principles apply even when a substitute transaction cannot be entered into because the market is thin. The court in that case noted that "damages are determined by the difference between the contract price for the asset and the fair market value of the asset at the time of the breach." *Id.* It then recognized that "[w]here, as here, that value cannot be readily discerned at the time of breach, the factfinder may determine 'hypothetical market value' based on expert testimony, a recent sale price, the price at which the party offered to sell the asset, or the price offered in the contract." *Id.* While the jury was entitled to consider "all relevant elements of the case" in determining damages, it was clear that those elements were to be used to approximate market prices as of the time of the breach. *Id.* The existence of a thin market complicated that issue, but it did not alter the objective of using market values to measure actual damages.

III. THE COURT OF APPEALS SHOULD ACCEPT THIS APPEAL BECAUSE THE DECISIONS BELOW UNSETTLE THE LONGSTANDING NEW YORK "TACIT AGREEMENT" TEST.

A. New York Imposes a Tacit Agreement Test for Recovery of Damages.

There is an additional reason for this Court to accept LBIE's appeal. The conclusion below that AGFP's status as a monoline insurer justified its methodology for calculating Loss presents an important potential conflict between calculation of Loss and longstanding principles of New York law concerning damages for breach of contract. Unless resolved by this Court, that potential conflict will necessarily unsettle established New York law in ways that increase uncertainty in New York contract law and that are therefore likely to deter sophisticated parties from selecting New York law to govern their transactions.

As noted above, the calculation of Loss is not technically a measure of damages for breach of contract when, as in this case, parties have selected Second Method and Market Quotation as the means of calculating a termination payment under the ISDA Master Agreement. *See* Section II(C)(ii), *supra*. That is because a termination payment under the ISDA Master Agreement does not necessarily reflect the amount a breaching party owes to an aggrieved party in a breach of contract action. Rather, a termination payment is intended to reflect close-out positions of derivatives transactions at termination; if those positions are favorable to a defaulting party, that party is eligible to receive a net payment from a non-defaulting

party. *See, e.g.*, *Lehman Bros. Holdings Inc. v. Intel Corp.*, 2015 WL 7194609 at *19 (S.D.N.Y. Sept. 16, 2015). This no-fault payment principle applies with equal force when, as was the case here, the termination payment is calculated under Loss and the requisite market quotations are unavailable.

Nevertheless, calculation of Loss under an ISDA Master Agreement does not deviate from New York contract principles, especially when New York law serves as the agreement's governing law. As the court in *Anthracite*, [2011] EWHC 1822 (Ch), ¶ 117 (Ex. O), concluded, terms within the definition of Loss are "to be illuminated by reference to the general common law (or New York law) meaning." Courts have applied New York law to ISDA Master Agreements governed by such law to resolve issues such as the legality of the transaction, *JPMorgan Chase Bank, N.A. v. Controladora Comercial Mexicana S.A.B. DE C.V.*, 29 Misc.3d 1227(A), at *13 (Sup. Ct. N.Y. County 2010), the elements of a breach of contract action, *id.* at *6, and—as indicated by the summary judgment opinion in this case—the applicability of trade usage and custom in assessing AGFP's discretion to ignore market prices. Summary Judgment Opinion at 18.

One core principle of contract law that New York has embraced and that distinguishes New York law from that of other jurisdictions is that recoverable damages include only those "particular damages [that] were fairly within the contemplation of the parties to the contract at the time it was made." *Kenford Co. v.*

County of Erie, 67 N.Y.2d 257, 261 (1986) ("*Kenford I*"); *see also Goodstein Constr. Corp. v. City of New York*, 80 N.Y.2d 366, 374 (1992). This Court has long interpreted the quoted phrase to mean more than just a breaching party's foresight that the aggrieved party would be damaged, which is an inference that presumably could be made in any commercial contract. Instead, the Court of Appeals has required the aggrieved party to demonstrate that the breacher is contractually liable for "the particular damages" suffered because that damage "was in the contemplation of the parties at the time of the execution of the basic contract or at the time of its breach." *Kenford I*, 67 N.Y.2d at 262. "In determining the reasonable contemplation of the parties, the nature, purpose and particular circumstances of the contract known by the parties should be considered, as well as 'what liability the defendant fairly may be supposed to have assumed consciously, or to have warranted the plaintiff reasonably to suppose that it assumed, when the contract was made.'" *Kenford Co. v. County of Erie*, 73 N.Y.2d 312, 319 (1989) ("*Kenford II*") (quoting Justice Holmes in *Globe Ref. Co. v. Landa Cotton Oil Co.*, 190 U.S. 540, 544 (1903)).

Using that tacit agreement test, this Court in *Kenford I* held that the aggrieved party could not recover prospective profits it would have earned had the breaching party performed. This Court concluded that those profits were outside the scope of liability that the parties would have assented to, in part because of their magnitude,

but also because "the evidence here fails to demonstrate that liability for loss of profits over the length of the contract would have been in the contemplation of the parties at the relevant times." *Kenford I*, 67 N.Y.2d at 262. Where there is no provision in the contract for the particular damages at issue, this Court held, "the commonsense rule to apply is to consider what the parties would have concluded had they considered the subject." *Id.* In a subsequent case involving the same parties, this Court again prevented the aggrieved party from recovering damages for the loss of anticipated appreciation in the value of land because there was no evidence that the breacher contemplated its assumption of liability for those damages at the time the contract was executed. *Kenford II*, 73 N.Y.2d at 315-16.

Therefore, under New York's well-developed tacit agreement test, breaching parties are not liable for damages suffered by the aggrieved party unless there is evidence that the breaching party assumed the risk of the particular harm that materialized. *Id.* This restriction effectively lets sophisticated commercial parties limit their liability to only those risks of which they have knowledge and have agreed to assume at the time of contract, and therefore to enable each party to accurately price their expected costs of entering into a contract. Without this test, a defaulting party would bear the risk for losses it was not compensated to take.

B. AGFP's Calculation of Loss Included Elements that Likely Were Not in the Contemplation of the Parties when the Agreement was Executed.

Encouraging accurate contract pricing by limiting a party's contractual exposure to the risks it contemplated is certainly as relevant in the context of derivatives contracts as it is in contracts for the sale of goods or development of property. And determining what a party contemplated by examining what it explicitly agreed to or by considering "what the parties would have concluded had they considered the subject" applies as readily to derivatives contracts as to other contracts. Nevertheless, the court below concluded that AGFP's Loss calculation was appropriate because of the type of party it purportedly was, without the requisite consideration of the typical objective of the underlying transactions. In fact, the court below concluded that "Assured's 'Loss' had nothing to do with market prices because Assured is a monoline insurer. Unlike LBIE, it was not in the business of trading and making a profit on the Securities. Its income derived from the premiums minus what it would have to pay to cover payment shortfalls in the Securities." Ex. B at 32.

But under New York contract law, the issue to consider when identifying the ISDA Master Agreement's damages analogue (*i.e.*, Loss), is not whether AGFP had a particular objective in entering into the transactions that affected its personal "loss of bargain." Rather, the relevant issues are whether, "in light of the nature, purpose

and particular circumstances of the contract known by the parties," LBIE, when it entered into the ISDA Master Agreement, reasonably contemplated that AGFP's objective of entering into the contract would be relevant to or used as the basis for determining Loss, and what liability LBIE "fairly may be supposed to have assumed consciously."

The court below indicated that the ISDA Master Agreement in this case contained "bespoke" terms. Ex. B at 30. But the court made no determination that those bespoke terms would have led LBIE to contemplate that any purported AGFP "loss of bargain" would be based on what the court described as AGFP's "completely different role" in the transactions. *Id.* at 32. Indeed, LBIE initially entered the relevant ISDA Master Agreement with ACE Capital Re Overseas Ltd., which was not a monoline insurer. A7157. Thus, it is dubious that it would have been in the contemplation of LBIE at the time the contract was executed that any calculation of Loss would be predicated on monoline-specific considerations. When AGFP took the assignment of the relevant ISDA Master Agreements, there do not appear to have been any amendments reflecting its monoline status or any bespoke termination provisions. Thus, even at that time, LBIE would not have contemplated that calculations of Loss would be attentive to AGFP's or its affiliate's idiosyncratic purposes for entering into the transactions, and LBIE would not have priced its participation in the transactions with AGFP's objective in mind.

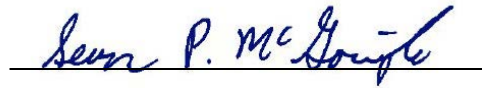
If this Court does not intend to deviate from the longstanding *Kenford* tacit agreement test, it should accept this appeal, not only to affirm the test but also to clarify what risks are within the contemplation of the parties to the ISDA Master Agreement. That step would avoid further unsettling New York law. If this Court concludes that the test does not apply to transactions involving the ISDA Master Agreement, it should also accept this appeal to explain that exception. In either instance, it is appropriate for the Court to accept this appeal to clarify the status of the *Kenford* tacit agreement test in light of the decisions below.

CONCLUSION

For the foregoing reasons, *Amicus Curiae* respectfully requests that this Court grant Plaintiff-Appellant's motion for leave to appeal and grant this motion for leave to appear as *Amicus Curiae* on the motion for leave to appeal, so that this Court can clarify these important issues specifically related to ISDA Master Agreements and generally applicable to New York contract law.

Dated: September 18, 2024
New York, NY

Respectfully submitted,



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CERTIFICATE OF COMPLIANCE

Pursuant to Court of Appeals Rules of Practice 500.1(j) and 500.13(c)(1), the undersigned certifies that the foregoing brief uses a proportionally spaced typeface (Times New Roman) in 14-point type and contains 6,831 words, exclusive of the contents listed in Rule of Practice 500.13(c)(3).

Dated: September 18, 2024

Sean P. McGonigle

STATE OF NEW YORK)
) ss.:
COUNTY OF NEW YORK)

AFFIDAVIT OF SERVICE BY OVERNIGHT FEDERAL 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.

On September 18, 2024

deponent served the within: **Motion for Leave to File Brief for *Amicus Curiae* Clayton P. Gillette in Support of Plaintiff-Appellant's Motion for Permission to Appeal**

upon:

See Attached Service Rider

at 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
September 18, 2024

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