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Court of Appeals
State of New York

LEHMAN BROTHERS INTERNATIONAL (EUROPE)
(in Administration),

Plaintiff-Appellant,

– against –

AG FINANCIAL PRODUCTS, INC.,

Defendant-Respondent.

RESPONSE IN OPPOSITION TO PLAINTIFF-APPELLANT'S MOTION FOR PERMISSION TO APPEAL

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STATE OF NEW YORK
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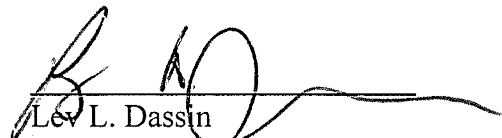
CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 500.1(f) of the Rules of the Court of Appeals, Defendant-Respondent AG Financial Products Inc. hereby submits the following statement.

AG Financial Products Inc. (a Delaware corporation) is a direct, wholly owned subsidiary of Assured Guaranty US Holdings Inc. (a Delaware corporation), which is a direct, wholly owned subsidiary of Assured Guaranty Ltd. (a Bermuda exempted company limited by shares).

Dated: September 3, 2024
New York, New York



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PRELIMINARY STATEMENT

This case is a straightforward contract dispute. The Trial Court held a bench trial to decide whether Assured "reasonably determined" how much it was owed pursuant to the clear and unambiguous terms of the parties' agreement after LBIE defaulted on twenty-eight bespoke credit default swap transactions (the "Transactions").[1] After conducting a five-week trial, hearing testimony from eleven witnesses, reviewing thousands of pages of exhibits and hundreds of pages of post-trial briefing, the Trial Court issued a well-reasoned thirty-six page opinion (the "Decision After Trial") in Assured's favor, holding that Assured's calculation of its "Loss," namely the amount owed pursuant to the parties' agreement, was reasonable and that LBIE did not meet its burden to prove otherwise. A-76–111.[2] The Trial Court's decision is consistent with New York law, fully supported by the factual record, and simply reflects the application of well-settled law to the facts of this case.

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[1] Plaintiff-Appellant Lehman Brothers International (Europe) (in administration) is referred to throughout as "LBIE;" Defendant-Respondent AG Financial Products Inc. ("AGFP"), together with its affiliate Assured Guaranty Corp. ("AGC"), which guaranteed the relevant contractual obligations, are referred to as "Assured."

[2] All Citations to "A-__" refer to the appendix filed in the Appellate Division, Case No. 2023/03409, NYSCEF Nos. 4–21, and filed by LBIE with this Court.

LBIE appealed, making a series of arguments that mischaracterized the law, the evidence, and the Trial Court's decision. The Appellate Division reviewed more than 150 pages of additional briefing, asked penetrating questions and made perceptive comments at oral argument, and then unanimously affirmed "for the reasons set forth in [the Trial Court's] well-reasoned decision." Ex. A, Decision and Order, *Lehman Bros. Int'l (Eur.) v. AG Fin. Prod., Inc.*, No. 2023/03409 at 1 (March 14, 2024), NYSCEF No. 30 (the "Decision").[3] The Appellate Division considered LBIE's arguments, found them "unavailing," and held "there is no basis to disturb the trial court's determination." Decision at 1–2.

LBIE then moved the Appellate Division for reargument of, or, in the alternative, for leave to appeal to the Court of Appeals from, the Appellate Division's Decision, by misleadingly recasting its arguments as presenting novel legal issues. The Appellate Division summarily, and appropriately, denied LBIE's motion on July 18, 2024. Ex. N, Order, *Lehman Bros. Int'l (Eur.) v. AG Fin. Prod., Inc.*, No. 2023/03409 at 1 (July 18, 2024), NYSCEF No. 34.

LBIE's Motion for Leave to Appeal (the "Motion") now seeks a *fourth* bite at the apple, essentially repeating in a different form the same baseless arguments that the Trial Court and Appellate Division (twice) considered and rejected. But

[3] All Citations to "Ex.__" refer to exhibits attached to the Affirmation of Andrew J. Rossman filed by LBIE with its Motion for Leave to Appeal.

LBIE comes nowhere close to satisfying this Court's strict requirements for leave to appeal. LBIE argues that permission to appeal should be granted on two grounds: (1) because the Trial Court erred in its "application of an objective standard of reasonableness," and (2) because the Trial Court erred in "finding [that] market values [were] irrelevant" to a party's calculation of its "loss of bargain" as a measure of Loss under the ISDA Master Agreement. Motion at 24, 28. Neither of these purported grounds satisfy this Court's requirements for obtaining leave because neither even involves a question of law. Instead, LBIE's arguments in the Motion merely reflect its disagreement with the Trial Court's factual findings, including how it weighed the evidence, made credibility determinations, and how it applied the law to the facts of this case. And, even if that were not the case, neither issue involves a question of law that is "novel or of public importance, present[s] a conflict with prior decisions of this Court, or involve[s] a conflict among the departments of the Appellate Division." Rules of Ct. of Appeals (22 N.Y.C.R.R.) § 500.22(b)(4). LBIE's request for permission to appeal must be denied.

Both of LBIE's purported grounds for appeal are simply attempts to manufacture an appellate issue where none exists. LBIE's arguments rely entirely on mischaracterizations of the key terms of the parties' agreement, well-settled

New York contract law and other legal precedents, the law of the case, the evidence presented at trial, and the Trial Court's detailed findings.

On the first ground, LBIE's argument that the Trial Court applied a "subjective" standard of reasonableness is flatly inconsistent with the Trial Court's explicit and thoroughly reasoned application of an objective standard of reasonableness. LBIE's argument is semantic at best, and its complaint is really just with the result. There is overwhelming evidence supporting the Trial Court's finding that Assured calculated its Loss following LBIE's default in an objectively reasonable manner, including testimony from Assured's fact and expert witnesses that the Trial Court found credible and persuasive.

LBIE's second ground for appeal is equally baseless. There is overwhelming contractual, legal, and factual support for the Trial Court's determination that Assured was *not* required to use market prices to determine its "loss of bargain" when calculating its Loss and that LBIE's purported "evidence" of market prices was not relevant to Assured's bargain. In assessing the relevance of market prices, the Trial Court and Appellate Division considered and correctly rejected all of LBIE's arguments because they rightly concluded as a matter of contract interpretation that the express terms of the parties' agreement did not require Assured to use market prices in determining its Loss; the economic bargain that the parties struck did not require it; and relevant New York law did not require

it. In fact, the evidence at trial, including from LBIE's own experts, demonstrated that no market prices were available at the relevant time for the instruments at issue here, and that the market prices that were available were severely dislocated and, therefore, were not an accurate or reliable indicator of value or loss. A-79–94. The Trial Court also correctly found that the valuation model created by LBIE's experts solely for this litigation generated hypothetical prices that were speculative, commercially unreasonable, and "has no application to the real world at the time." A-106. And, as the Trial Court correctly pointed out, Assured ran a well-designed auction with the world's leading financial institutions, and not one of them bid a single dollar on even one of the Transactions. Indeed, contemporaneous internal memoranda and presentations prepared pre-litigation by two of LBIE's most knowledgeable traders (that LBIE now conveniently seeks to disavow) admitted that a market-based valuation for the Assured Transactions was not reliable and that the Transactions had little to no actual value to LBIE.

Finally, LBIE tries to argue that this case and the issues it raises are of public importance, and, employing extraordinary hyperbole, claims that the decisions below have introduced "tremendous uncertainty" into financial markets, and that, if not corrected, the consequences will be felt not only in New York but around the world. Motion at 34–35. This is absurd. It has been more than eighteen months since Justice Crane issued her Decision After Trial, and there is

no sign of any such uncertainty, and LBIE notably does not even purport to offer any support for this speculative claim. This is a straightforward contract case, and the rulings of the Trial Court and Appellate Division were guided by the actual terms of the parties' agreement. As Presiding Justice Renwick summarized during argument at the Appellate Division, the Trial Court rightly determined that Assured "followed [the] terms of the contract, considered all relevant circumstances, and therefore carried its burden to demonstrate that its valuation was commercially reasonable and in good faith." Ex. J at 10:10–15. This approach is consistent with the interpretation of the same ISDA Master Agreement adopted by ISDA itself, other U.S. courts, and courts around the world. Indeed, the only thing about this case that could possibly introduce uncertainty into financial markets is a ruling in LBIE's favor, which would be contrary to the plain language of the parties' agreement, well-settled New York law regarding the interpretation of contracts, and the expectations of how the ISDA Master Agreement and Loss operate.

For these reasons and those set out below, LBIE's Motion must be denied.

BACKGROUND

I. The Parties

Assured. Assured is a monoline insurer. A-6834–36. This means it is in the business of guaranteeing the payment flow of insured securities as those

payments come due in exchange for receiving regular, fixed, premium payments from its counterparties. *Id*. Assured offered this protection to counterparties under financial guaranties, or through its subsidiary, AGFP, under bespoke credit default swaps ("CDS"). A-1694–95. AGFP was thinly capitalized, had no employees, and no credit rating of its own. A-2733–34. As a result, in cases where AGFP entered into bespoke CDS, as it did here, the parties' economic arrangement depended on AGC (which was identified in the parties' agreement as AGFP's Credit Support Provider) also issuing a financial guaranty insurance policy that guaranteed AGFP's payment obligations. That policy was expressly incorporated into the agreement between LBIE and AGFP, which includes the 1992 ISDA Master Agreement, the schedule thereto, and all confirmations thereunder (together, the "Agreement"). A-7166.

Lehman Brothers International (Europe) (in administration). LBIE, a foreign subsidiary of Lehman Brothers Holdings Inc. ("LBHI"), was a broker-dealer that, among other things, bought and sold CDS. A-8429. On September 15, 2008, LBHI declared bankruptcy in the United States and LBIE entered administration in the United Kingdom. A-8429, 702–03.

II. The Transactions

Under the terms of the Transactions, "LBIE would make premium payments to Assured in return for Assured covering shortfalls of principal or interest as they

became due on" senior tranches of various underlying reference obligations. A-79. Each of the Transactions' underlying reference obligations is an asset-backed security ("ABS") whose payments are derived from cash collected from an underlying pool of mortgages or loans. A-352. Fourteen of the twenty-eight Transactions reference UK residential mortgage backed securities ("RMBS"), eleven reference collateralized loan obligations ("CLO"), one references a collateralized debt obligation ("CDO"), and two reference baskets of twenty U.S. subprime RMBS (instead of a single security) that were included in the ABX 2006-02 and 2007-01 indexes ("ABX"). A-80–81.

A. Assured's CDS Were Not Standard Or Easily Tradeable

The Transactions had "bespoke (monoline specific) terms" that were different from the standard terms of most CDS. A-105. As the Trial Court found, "Assured did not insure the value of the Transactions. It insured their payment flow as payments became due." A-78. This structure, known as "pay as you go," meant that Assured's only obligation was to pay actual shortfalls, if any, in interest and principal payments owed under the reference obligations as they came due. A-2812–13, 2831, 2863–64, 2868. The Transactions did not provide for "physical" or "cash" settlement—which apply to most other CDS and expose a protection seller to changes in the market prices of the reference obligations. A-2813–14. Lastly, unlike 97% of CDS, the Transactions did not require Assured

to post collateral based on changes in the market prices of the reference obligations. A-1465, 5431–32, 7051. Assured's business model was to sell protection, whether in financial guaranty or CDS form, and to hold those contracts to maturity. A-2731–34, 2911, 7852. Assured did not trade in and out of CDS positions. A-1699.

B. Structural Protections In The Transactions

As the Trial Court found, the Transactions had "significant structural protections" that made it highly unlikely that Assured would owe payments to LBIE. A-110. For the ABX, Assured only guaranteed senior tranches that would not incur losses until "junior tranches had suffered their losses entirely and had entirely been written down to zero." A-3959, 1201–02. There were also several layers of structural protection before any losses would be incurred on the ABX. First, "each of the mortgage loans [in the ABX] represent only about 80% of . . . the initial value of the home." A-3957. As a result, each loan was originally overcollateralized. A-3957. Second, the pools of loans backing each security were also overcollateralized, as the value of the mortgages in the pool was greater than the face value of the securities that were issued. The ABX pools could sustain losses of 5-10% before any ABX tranches incurred losses. A-3958. Finally, the pools generated additional cash flow because the "average interest rate paid on the" ABX was "lower than the average interest rate on the mortgages." A-3959.

The UK RMBS and CLOs had many of the same protections, as well as additional protections such as a "master trust structure" for UK RMBS under which new loans were always coming into the pool, providing an opportunity to maintain overcollateralization, additional reserve funds, and equity cushions. A-3960–61.

C. Express Contractual Language That Parties "Need Not" Calculate Loss Based On Market Prices

All twenty-eight Transactions were governed by a 1992 ISDA Master Agreement, which allows parties to choose the provisions that will govern in the event of early termination by selecting from either "First Method" or "Second Method" and either "Market Quotation" or "Loss." Here, the parties selected Second Method and Market Quotation. A-7160.

Market Quotation requires the Non-defaulting Party to solicit quotations from "Reference Market-makers . . . for an amount, if any, that would be paid to such party (expressed as a negative number) or by such party (expressed as a positive number) in consideration of an agreement between such party . . . and the quoting Reference Market-maker to enter into a transaction (the 'Replacement Transaction')." A-7147. But, "[i]f fewer than three quotations are provided, it will be deemed that the Market Quotation . . . cannot be determined," and the Non-defaulting Party should then calculate its "Loss." A-7148. The Loss provision gives the Non-defaulting Party discretion to determine its losses,

including based on its "loss of bargain," so long as it does so "reasonably" and "in good faith." A-7147. In doing so, the Non-defaulting Party "may (but need not)" use market rates or prices in its determination. A-7147. In its entirety, the Loss provision states:

> **"Loss" means**, with respect to this Agreement or one or more Terminated Transactions, as the case may be, and a party, the Termination Currency Equivalent of **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). Loss includes losses and costs (or gains) in respect of any payment or delivery required to have been made (assuming satisfaction of each applicable condition precedent) on or before the relevant Early Termination Date and not made, except, so as to avoid duplication, if Section 6(e)(i)(1) or (3) or 6(e)(ii)(2)(A) applies. Loss does not include a party's legal fees and out-of-pocket expenses referred to under Section 11. 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.**

A-7147. The Trial Court's July 2018 decision granting in part and denying in part Assured's motion for summary judgment (the "SJ Decision") established that Assured was, therefore, permitted "to select any methodology for calculating Loss, so long as such methodology is reasonable and in good faith." A-59–60.

Unlike Market Quotation or Loss, which determine the value of terminated

transactions and the quantum of payment, the choice between First and Second Method concerns the direction in which payments may be made. Under First Method, only the Defaulting Party may be required to make a payment to the Non-defaulting Party, whereas under Second Method, either the Defaulting or Non-defaulting Party may be required to make a payment to the other. A-6097–98.[4]

III. LBIE Defaulted

On September 15, 2008, LBIE filed for insolvency protection in the United Kingdom, entered into administration, and stopped making the fixed premium

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[4] LBIE's statement that under Second Method a gain may occur when termination relieves a Non-defaulting Party of performing obligations under a trade, Motion at 13–14, is misleading as Second Method in no way requires the Non-defaulting Party to use a particular methodology to calculate its Loss. Losses that the Defaulting Party may incur, if any, as a result of its own default are not relevant to the calculation. Contrary to LBIE's supposition that "[u]nder Second Method, therefore, one party's loss is exactly equal to the other party's gain," Motion at 13–14 n.6, courts interpreting the ISDA Master Agreement hold the exact opposite to be true. *See Anthracite Rated Invs., Ltd. v. Lehman Bros. Fin. S.A. in Liquidation*, [2011] EWHC (Ch) 1822 (Eng.) 127 ¶ 127 (Ex. O) ("[I]t is by no means axiomatic that, in relation to derivatives, one party's loss approximates to the other party's gain."). If, and only if, Assured received a gain as a result of LBIE's default, then Assured would be required by Second Method to pay that gain over to LBIE. If Assured had calculated that it would have to pay out more to LBIE in shortfalls in interest and principal than it would earn from premiums, then Assured would have had a gain and would have been required to pay that amount over to LBIE. But, as discussed below, the evidence at trial showed that Assured reasonably determined that it incurred a net loss of approximately $20 million, not a gain, when it terminated the Transactions. *See infra* at 18–24, 35–38.

payments it owed Assured under the Transactions. A-81, 995. Assured terminated the Transactions on July 23, 2009. A-7592. Extensive evidence at trial established that the Transactions had no real-world value to LBIE at the time of termination.

A. LBIE's Contemporaneous Admissions That The Transactions Had No Real-World Value

In October 2008, shortly after LBIE entered insolvency, two of its "most knowledgeable" traders prepared a memorandum analyzing the value of the Transactions to LBIE in several possible scenarios and concluded that all scenarios were "unlikely to generate cash for LBIE because of a combination of counterparty risk, non-standard documentation, and overall credit soundness of the short positions." A-925, 7854. LBIE described the hold-to-maturity scenario—which calculated the value of the Transactions based on netting expected "losses versus the cumulative premium owed but not paid by LBIE" over the life of the contracts—as LBIE's "worst case." A-7852–53. This was because the "overall credit soundness of the short positions" meant that the referenced securities were unlikely to suffer significant losses. A-7854.

Nor were these admissions limited to a single memorandum, as LBIE falsely argues. Motion at 29 n.13. To the contrary, multiple additional LBIE memoranda and communications introduced at trial contained similar admissions. A December 2008 LBIE slide deck (prepared by one of the same traders) also admitted that the Transactions' value was "a fraction of any estimate based on standard terms," and

that "the appetite for other market counterparts to take over [the Transactions] is severely limited." A-5961. An email later that month from a third LBIE trader warned that the Transactions would be difficult to novate (assign to another party) because of the "non-posting [of collateral] of the counterparty [Assured]," and that a market-based valuation of the Transactions "grossly exaggerates" their value. A-5992. And in a June 2009 email, the leader of the team of LBIE traders tasked with valuing the Transactions acknowledged that they would only be worth "$10-15m" even if LBIE could find a party interested in novation, based in part on concerns that Assured, as a monoline, was "nearly bust and [was] restructuring to survive." A-5976.

B. LBIE Tried But Failed To Find Any Party Willing To Step Into Its Shoes

After LBIE's default, Assured considered three options: (1) do nothing, (2) terminate the Transactions, or (3) allow LBIE time to attempt to novate the Transactions to another creditworthy counterparty, with Assured's consent. A-2872. Assured preferred to maintain its bargain, if possible, so it chose to allow time for potential novation, A-2884–85, 2893–94, and informed LBIE that it was "receptive to exploring that option." A-7787. The challenge, as LBIE acknowledged internally, was the non-standard terms of the Transactions (including a lack of collateral posting), as well as the counterparty credit risk involved in facing Assured. Recognizing this challenge, LBIE designed a complex

structure, which it dubbed "Project Rioja," to "transform [its] monoline contract [with Assured] into a standard ISDA contract" that would be more "palatable" to market participants. A-7797. This structure involved creating a special purpose vehicle that would step into LBIE's shoes on the Transactions with Assured, while simultaneously issuing collateralized CDS with standard terms on the same reference obligations to a third-party purchaser. A-5963, 7799. LBIE described this structure as "[a]llow[ing] for the crystallisation of the mark to market value on CDS Contracts that have remote default risk," and it explained that "LBIE will be cashing this money to the extent that either [Assured] does not default, or the [reference obligations] do not default (or both)—and this is a high probability scenario." A-5965, A-7797. In other words, LBIE reached the same view as Assured: that the reference obligations were unlikely to experience significant shortfalls. This admission is devastating to LBIE's attempt in this litigation to challenge Assured's assessment as unreasonable.

In late 2008 and early 2009, LBIE tried to find counterparties interested in novation. A-886, 7779–86. The only expression of interest came from a trader at Nomura, who (tellingly) had been a trader at LBIE. A-1040. He said he was initially "very interested in the transaction[s]," A-7806, and Nomura signed a confidentiality agreement in December 2008. A-7807. But nothing came of LBIE's attempt to novate to Nomura. A-2893, 2903. And, at trial, LBIE offered

no evidence of any party prepared to take LBIE's positions in the Transactions. A-982–83.

C. Anticipating Litigation, LBIE Solicited Indicative Bids

Although LBIE tried to use three indicative bids (not firm bids by parties willing to transact) to provide "market color" of the Transactions' market value, the Trial Court correctly found the evidence showed the indicative bids were nothing more than attempts to "bolster" LBIE's "litigation position against Assured" and did not reflect the Transactions' value. A-82–83 (citing A-913–14).

First, the evidence showed that LBIE started looking for indicative bids only after its attempts to solicit firm bids failed. A-1064–65, 6866. When it became clear that no one would "give [LBIE] a firm quote," LBIE's in-house attorney encouraged its traders to "just ask for [a] quote without specifying firm or indicative," because "[f]or purposes of challenging [Assured's] valuation, even indications should help." A-5994, 1052.

None of the parties that provided an indicative bid "was actually willing to make a binding offer." A-82. LBIE's own exhibits revealed what the Trial Court found to be "hesitation on the part of" the would-be bidders. A-82–83 (citing A-8487–98). For example, Citi's trader emphasized that "[a]ll bids are subject to a satisfactory counterparty and variety of internal approvals within Citigroup." A-8485. JPMorgan similarly warned that its indicative bids were "contingent on

us knowing and agreeing [to the] counterparty and getting legal to check [that] confirmations are in line with what JP Morgan uses." A-8482.

The third bid, which was received from Nomura, did not "purport any degree of accuracy in these levels" and asked LBIE to "please bear in mind that these are not firm protection bids[,] . . . that none of these prices are actionable" and that "[t]his is not an offer or an invitation to trade." A-8488. Even though the Nomura trader submitting the bid was another former LBIE employee—who analyzed the Transactions while at LBIE, A-7852, and as the Trial Court noted, "must have known Assured was the counterparty," A-83—Nomura's bid warned that "prices might differ substantially once we know the exact identity of our potential source of protection." A-8488.

IV. Assured Terminated The Transactions

After unsuccessfully attempting to engage LBIE in settlement negotiations, Assured delivered a notice of termination to LBIE on July 23, 2009 (the "Early Termination Date") and followed the post-termination process established in the ISDA Master Agreement.

A. Valid Market Quotation Auction Did Not Yield A Single Bid

After terminating the Transactions, Assured engaged Henderson Global Investors Ltd., a leading financial advisor, to design and execute an auction of the Transactions as required under the ISDA Market Quotation process. A-41. Not

one bidder was willing to pay a single dollar to step into LBIE's position in the Transactions. Bidders chose not to bid based on concerns similar to those LBIE identified in its internal analysis, including because of a lack of demand for the protection and a lack of appetite to enter into uncollateralized trades facing either Assured or monolines more generally. A-6056, 6070–72, 6079.

Although LBIE tried to dismiss the auction as a mere pricing exercise, the Trial Court rejected that argument at summary judgment after finding that LBIE failed to challenge "in any material respect" Assured's proof "that the structure and design of the auction was reasonably calculated to increase the likelihood that the Market Quotation process would be successful." A-48. Because there was no party willing to take LBIE's place and make periodic premium payments in exchange for protection on shortfalls in the underlying securities, Assured could not preserve the benefit of its bargain by entering into replacement transactions.

B. Assured Calculated Its Loss As Loss Of Bargain

The financial consequence of LBIE's default for Assured was that it would no longer receive premium payments from LBIE over the life of the Transactions and would no longer have to make floating payments in the event of any interest or principal shortfalls. A-2911. As a result, Assured calculated its loss of bargain by calculating the net present value of these two payments streams (i.e., premium payments and floating payments), which is sometimes referred to as a discounted

cash flow analysis. A-2911, 7594.[5] Assured's calculation of the first payment stream was straightforward because the premium amounts were contractually fixed. A-88, 7594. Specifically, Assured determined that the present value of the premiums LBIE would have paid Assured from the Early Termination Date through the end of the life of the Transactions was $35,191,751.62. A-7594. LBIE had also already failed to pay $13,049,366.23 in premiums as of the Early Termination Date, resulting in a total amount owed by it to Assured of $48,241,117.85. A-7594–95.

To calculate the second payment stream, the present value of the floating payments, Assured used the same regular-course-of-business models that its surveillance and loss reserving groups used to estimate expected losses for all of its transactions. A-2913, 5765, 7595. Assured's analysis showed there were no expected losses on twenty-six of the Transactions (all of the UK RMBS, CLO, and CDO Transactions), which continued to be investment-grade during the financial crisis. A-1767–68, 5809–55, 5949–55, 7598–600. This conclusion was consistent with the extensive structural protections in these securities, described above, and

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[5] LBIE attempts to characterize Assured's discounted cash flow analysis as an insurance-specific methodology. Motion at 28–30. LBIE ignores the fact that a discounted cash flow analysis is a well-established valuation methodology used in a variety of contexts, including by LBIE's own experts when calculating Loss under 1992 ISDA Master Agreements in other cases. *See infra* at 35.

with Assured's underwriting analysis, which showed that Assured would not incur a single dollar of loss on the UK RMBS, unless "home prices . . . [had] declined and losses . . . [were] more severe than [anything] ever . . . experienced in the UK market including [during] the bombing of London and the economic fallout around those times," or on the CLOs, unless losses were "two times [historic] averages on the corporate loan losses." A-3962–63, 2794–95, 2819–20.[6]

Assured originally projected no losses on the ABX Transactions, but its updated analysis in 2009, which took into account developments in the housing market and the performance of the mortgages, determined there was the potential for losses. A-1697–98, 5794–804, 7838–50. As a result, these Transactions were elevated to Assured's Chief Actuary for the calculation of expected losses. A-1760–61. To do so, Assured used the same methodology it used for calculating expected losses on all transactions referencing similar securities (U.S. subprime RMBS). A-1760–61. Assured's model—which was run on the industry-standard

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[6] LBIE wrongly argues that Assured's determination that these twenty-six CDS would not suffer losses, effectively "cancelled decades' worth of protection." Motion at 18. LBIE simply ignores the extensive evidence Assured presented at trial in support of its determination, which the Trial Court credited. *See infra* at 37–38. LBIE's argument is akin to paying for home insurance and then complaining to the insurer that the house never burnt down. That is not how insurance or these CDS worked. But for LBIE's default, Assured would not have been in the position to terminate the transactions; once Assured did so, it was entitled to calculate its loss of bargain, which included determining the likelihood it would have to make payments to LBIE under these CDS.

Intex platform—relied on three key parameters: (1) how many borrowers in the relevant RMBS pools would default on their mortgages (represented as the cumulative default rate or CDR), (2) how many would prepay (represented as the prepayment rate), and (3) how severe losses on mortgages in default would be (represented as the loss severity). A-1794–95. In each case, Assured set these inputs based on actual market data for the specific RMBS at issue—which was available through Intex. A-1706–07.

Assured then had to apply its judgment to determine how defaults, prepayment, and loss severity would evolve over time. A-1760. In doing so, Assured took into account relevant market conditions, including the severity of the downturn in the housing market that had begun in 2007 and the many indications that the housing market was beginning to stabilize, including based on unprecedented government intervention by the Obama administration. A-1728–32. Specifically, Assured continued to use historically high default rates in its model based on then-current observed data for a period of between twenty-four and twenty-seven months, and determined that, over time, each of the parameters in its model would eventually return to normalized historical levels. A-1606. Based on this modeling, Assured calculated that the present value of the expected losses on the two ABX Transactions would total $27,577,817.65, which it would have been required to pay LBIE. A-7598, 7604, 1761–65. Subtracting this amount from the

$48,241.117.85 in unpaid and future premiums owed by LBIE resulted in a Loss calculation of $20,663,300.20 owed by LBIE to Assured. A-1761–65, 7595, 7603–04.[7] This is the economic loss that Assured suffered as a result of LBIE's default as of the Early Termination Date.

There was extensive evidence at trial showing the reliability of Assured's modeling. First, the judgments that Assured made about how to model losses over time were consistent with those made by other market participants who engaged in similar analysis, including Moody's and Standard & Poor's ("S&P"). A-4371–73. Both expressed the view that housing prices would stabilize in the first half of 2010, consistent with Assured's modeling. A-6326, 6355. Similarly, Moody's, which provided extensive disclosure regarding its methodology, explicitly discussed how seasoning and government programs would curtail the severity and duration of losses. A-6630–31, 4027–28, 4363–66, 4370–72. Additionally, the expected losses that Assured calculated for the ABX Transactions closely tracked the contemporaneous expected loss calculations published by Moody's and S&P for US subprime RMBS of the same vintage: Assured projected 28% lifetime

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[7] The original statement of calculations, A-7591–602, contained an inadvertent transposition error, which Assured notified LBIE of in July 2019. A-1763–64, 1833–35, 7603–04.

collateral losses, while Moody's projected 30% and S&P 32%. A-4041–42, 6625, 6325.

Second, Assured's models were regularly used for multiple business purposes. Assured relied on the same models: (1) in its underwriting process, where accurate modeling was critical to its decisions to enter into new transactions, A-2844–46, 2856, 5797, 7842; (2) after entering into transactions, to monitor their credit quality and determine which transactions required increased surveillance or remedial action, A-6838–39; (3) to determine its regulatory loss reserves for its entire portfolio, including "literally hundreds of transactions" unrelated to this dispute, A-1563–64, 2913, 4001; (4) as the basis for its financial reporting to investors, A-3772–74, 3798, 6795–96, 6809–10, 6838–41, 6849–50, 7683; and (5) as the basis for reporting required by its insurance industry regulators. A-3772–74, 3871, 9059. As the Trial Court found, "accurate modelling was essential to [Assured's] risk management." A-89.

Third, because Assured's expected loss methodology was critical to its business, it was subject to multiple layers of internal and external review. A-1710–14, 4002–03. That process began with "a large Surveillance Department" that continuously worked on loss projections. A-1690–91. Additionally, each quarter, Assured's Reserve Committee updated its loss reserve models in light of recent market developments. A-1687, 1709, 1748, 6838–39. The Reserve Committee

consisted of the most senior, experienced personnel at Assured, including its CEO, CFO, Chief Surveillance Officer, Chief Accounting Officer, Chief Actuary, and General Counsel. A-1710–11. The updated models were then reviewed by the Audit Committee of Assured's Board of Directors. A-1711–12, 1715–16. Without the Audit Committee's approval, Assured could not file its Form 10-K with the Securities and Exchange Commission ("SEC"). A-1711–12. Finally, Assured's independent auditor, PwC, also conducted an audit of the loss reserve assumptions and issued an opinion for the Company. A-1715, 3808–09, 4003. The strength of Assured's loss reserving model was critical to its success through the financial crisis. A-2728.

Finally, the methodology Assured used to calculate Loss was consistent with how it described the value of its CDS transactions in the extensive disclosures it filed as a publicly-traded, regulated insurance company. A-3772–74. Assured repeatedly stated that its economic obligations under its CDS transactions were limited to protecting against shortfalls in interest and principal payments on the reference obligations as they came due. A-1694–96, 3777–78, 3973. It similarly made clear that market prices were "not meaningful at all" to its business, explained to its investors that they were not a measure of economic loss, and could not trade in and out of its CDS positions, so could not realize any mark-to-market gain or loss. A-3784, 6847, 3782.

V. Financial Crisis And Market Dislocation

There was extensive evidence at trial that during the financial crisis, many securities (including the U.S. subprime RMBS referenced in the ABX Transactions at issue here) were trading at prices substantially lower than their fundamental value. This extreme dislocation in the markets further supported Assured's decision to calculate Loss using a discounted cash flow analysis, which tracked the parties' actual economic obligations under the contracts, rather than by using a model based on dislocated market prices, like the one created by LBIE's litigation experts.

For example, a contemporaneous report from the US Department of Treasury described a then-present "[n]egative [e]conomic [c]ycle" in which "declining asset prices [] triggered further deleveraging, which [] in turn led to further price declines." A-7122–25. A scholarly analysis published in October 2009 (based on prices through June 30, 2009) concluded that "ABX.HE indexes [were] inconsistent with any reasonable assumption for mortgage default rates[.]" A-6385. Tellingly, the number of bids on MarkIT's CDS platform "fell by a third during 2008–July 2009, because there were far fewer market participants[.]" A-85 (citing A-3991–92). LBIE's experts admitted that markets were in disarray. One described the financial crisis as "the largest crisis . . . since the Great Depression." A-1272. Another acknowledged "severe" market dislocation in early 2009 and

that "[m]any market participants, accountants, the financial press, and even the US Congress recognized the extraordinary divergence" between market price and fundamental value at the time. A-7004.

PROCEDURAL HISTORY

I. Summary Judgment

In July 2018, the Trial Court issued the SJ Decision. The SJ Decision, later affirmed by the Appellate Division, dismissed LBIE's claim for breach of the implied covenant of good faith and fair dealing and dismissed LBIE's breach of contract claim based on the design and execution of Assured's Market Quotation auction. With respect to LBIE's sole remaining claim for breach of contract based on Assured's calculation of Loss, the SJ Decision held that Assured, as the Non-defaulting Party, was free to "to select any methodology for calculating Loss, so long as such methodology is reasonable and in good faith" and that Assured had the "discretion to calculate Loss without reference to market prices." A-59–60, 62. The SJ Decision held that LBIE raised a genuine question of fact about one issue, whether Assured's Loss calculation departed from "standard industry practice," and that a trial was necessary to determine whether Assured's exercise of its discretion "was objectively reasonable" and "made 'in good faith.'" A-59, 62.

II. The Trial

The Trial Court held a five-week bench trial from October 18, 2021 to November 19, 2021. During its case-in-chief, LBIE offered a single fact witness (a former director at PricewaterhouseCoopers ("PwC"), which served as administrator for LBIE after it filed for insolvency) and four expert witnesses. Assured offered three fact witnesses (its former President, its Chief Financial Officer, and its Chief Actuary) and three expert witnesses. The Trial Court also permitted LBIE to present a rebuttal case, during which it introduced additional testimony from two of its expert witnesses. In total, the parties introduced more than 300 exhibits, totaling more than 12,000 pages.

The parties submitted two rounds of post-trial briefing (roughly 300 pages in total) and fifteen pages of supplemental briefing at the Trial Court's request on discrete questions relating to the effect of rejecting LBIE's valuation.

III. Decision After Trial

In a detailed, methodical, and well-reasoned thirty-six page decision, the Trial Court ruled that Assured's calculation of Loss was "objectively reasonable and made in good faith." A-76. On LBIE's breach of contract claim, the Trial Court found that LBIE failed to prove there was a standard market practice from which Assured's conduct departed and that "LBIE's valuation, [which] relied entirely on market prices its experts constructed for this litigation, was insufficient

to meet LBIE's burden to prove its own calculations were reasonable." A-77. On Assured's counterclaim, the Trial Court found that Assured met its burden to show that its conduct was "commercially reasonable and in good faith." A-79; *see also* A-110 ("Thus, Assured demonstrated *prima facie* that is calculations were reasonable and in good faith.").

IV. Appellate Division Decision

LBIE appealed the Trial Court's decision to the Appellate Division, First Department. The Appellate Division reviewed more than 150 pages of additional briefing and heard oral argument on February 21, 2024. At oral arguments, the Appellate Division focused on the key issues and questions and demonstrated a clear understanding of the case. LBIE's surprising assertion that the panel was confused and dismissive can only be a function of the fact that the panel disagreed with LBIE's arguments and is belied by the full record of the proceeding.[8]

On March 14, 2024, the Appellate Division unanimously affirmed the Trial Court's judgment. The court affirmed "for the reasons set forth in [the Trial

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[8] For example, LBIE cites to Justice Oing's questioning as disregarding "whatever case law is out there." *See* Motion at 22. But Justice Oing was asking about the language of the Parties' agreement and whether any provision precluded Assured's actions. Ex. J at 8:4–11:1. This was merely consistent with the Trial Court's SJ Decision. At summary judgment, the Trial Court found that the ISDA Master Agreement was not ambiguous and that the Loss provision did not "categorically prohibit[] a Non-Defaulting Party, like Assured, from calculating its Loss without reference to market prices." A-60.

Court's] well-reasoned decision," finding there was "no basis to disturb the [T]rial [C]ourt's determination, which was based upon its resolution of conflicting expert testimony." Decision at 1.

LBIE then moved to reargue or, in the alternative, for leave to appeal. After receiving more than sixty pages of additional briefing, the Appellate Division denied LBIE's motion. *See* Ex. N.

LEGAL STANDARD

Leave to appeal a civil decision to this Court may only be granted if it "merits review," which requires the motion to raise issues of law that are "novel or of public importance, present a conflict with prior decisions of this Court, or involve a conflict among the departments of the Appellate Division." 22 N.Y.C.R.R. § 500.22(b)(4). Leave to appeal is properly denied where the case involves settled general legal principles and the dispute "involves mere application to unique facts." N.Y. Court of Appeals Civil Jurisdiction and Practice Outline, p. 16 (2023), https://www.nycourts.gov/ctapps/forms/civiloutline.pdf. This Court has held that it "is without power to review findings of fact if such findings are supported by evidence in the record." *Dalton v. Educ. Testing Serv.*, 87 N.Y.2d 384, 391 (1995).

ARGUMENT

I. There Is No Basis For Appeal On The Issue Of Whether The Trial Court Correctly Applied The Objective Reasonableness Standard

LBIE's first purported basis for seeking permission to appeal is to ask this Court to "clarify the applicable standard or reasonableness" to "the exercise of contractual discretion." Motion at 24. In support of this request, LBIE argues that the decisions below are inconsistent with case law from this Court requiring the application of an "objective standard of reasonableness to the exercise of contractual discretion," that the Supreme Court did not apply such an objective standard, and instead applied a subjective standard in ruling in Assured's favor. *Id.* All of these arguments lack merit and mischaracterize what actually happened below; the arguments were also raised below before the Appellate Division, which considered and correctly rejected them.[9]

Most importantly, there is no dispute that the issue at trial was whether Assured's determination of Loss was objectively reasonable. And there is no legitimate basis for LBIE to dispute that the Trial Court applied that standard in

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[9] LBIE's attack on the Appellate Division as "mistakenly characteriz[ing]" the Decision After Trial "as being 'based upon [Supreme Court's] resolution of expert testimony," Motion at 22 n.9, is plainly false. The Trial Court's opinion not only makes clear that it found LBIE's expert testimony unpersuasive, but also approvingly cited and relied on the testimony from Assured's experts. *See*, *e.g.*, A-85–87, 89–92, 96, 104–106.

determining that Assured's Loss calculation was objectively reasonable. The Trial Court stated at the outset of its decision that the issue to be decided at trial was whether Assured's Loss calculation was "objectively reasonable." A-76. And, as the Appellate Division recognized, the Trial Court's detailed and "well-reasoned" analysis confirmed that it applied this standard correctly. Nothing in the Trial Court's analysis is inconsistent with any prior decisions from this Court, and there is no reason for this Court to "grant leave to appeal to clarify whether an objective standard of reasonableness applies to a contractual duty to perform a valuation reasonably." Motion at 26.

LBIE's further arguments to support this purported basis all fail. *First*, LBIE claims that the Trial Court overlooked that objective reasonableness is also law of the case based on the SJ Decision, and that its decision created "conflicting decisional law." *Id*. This is not true. The Trial Court exactly followed the framework set out in the SJ Decision for determining and evaluating objective reasonableness. The Trial Court explained in the SJ Decision that "[i]t is a basic tenet, applied across a wide range of legal issues, that the question of what is reasonable may require consideration of the facts and surrounding circumstances in the case." A-58. In so doing, the Trial Court followed this Court's guidance in *Bethel v. New York City Transit Auth.* that there is only one reasonableness standard in New York, and that "standard provides sufficient flexibility, and

leeway, to permit due allowance to be made . . . for all of the particular circumstances of the case which may reasonably affect the conduct required." 92 N.Y.2d 348, 353 (1998). In its Decision After Trial, the Trial Court applied this standard to the facts of this case.

Second, the SJ Decision did not, as LBIE incorrectly claims, require the Trial Court to credit LBIE's evidence of industry norms and practice and find any departure from that purported practice to be unreasonable. Motion at 26–27. Rather, the SJ Decision is clear that "[i]n determining whether conduct is objectively reasonable, industry norms <u>may</u> be appropriately considered." A-22 (emphasis added) (citing *Hoag v Chancellor, Inc.*, 246 A.D.2d 224, 231 (1st Dep't 1998). The SJ Decision thus explained that "[w]here, as here, evidence is submitted that there *may* be a uniform or highly consistent practice of calculating Loss in a particular manner under similar circumstances, and the Non-Defaulting Party deviates from that practice, that deviation raises a genuine question of fact as to the Non-Defaulting Party's reasonableness or good faith in calculating Loss." A-27 (emphasis added). And even where such a uniform industry practice is proven, the Trial Court was clear that "[n]othing in this decision should be read as holding that deviation from industry practice is determinative. There may, of course, be legitimate reasons for a Non-Defaulting Party to deviate from standard practice in calculating Loss, especially during times of market turmoil." *Id.* The

Trial Court emphasized that "[t]his decision should be read as holding only that evidence of departure by Assured, as the Non-Defaulting Party, from standard industry practice is a factor, among others, to be considered in assessing its reasonableness and good faith in calculating Loss." A-27–28. In short, the Trial Court merely held that LBIE had raised a genuine question of fact for trial and that trial was necessary to test LBIE's purported evidence. A-64. After conducting a five-week trial, the Trial Court ultimately found that LBIE "came nowhere close" to proving the existence of a uniform standard industry practice for determining Loss, let alone that Assured departed from such a practice.[10] A-104; *see infra* at 34–35.

Third, LBIE claims that it presented at trial "extensive and unrebutted evidence that standard market practice is to value terminated derivatives by reference to an objective measure: the market value of the derivatives," Motion 27–28, and the fact that the Trial Court ruled against LBIE and rejected this evidence must show that the Trial Court applied the wrong standard. *Id.* ("[I]f

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10 Similarly, the Appellate Division on appeal merely affirmed that "plaintiff raised an issue of fact as to whether defendant's loss calculation was reasonable and in good faith" and that the SJ Decision "properly considered plaintiff's evidence, including expert reports, in support of its claim that defendant's calculations were not reasonable under the circumstances"—thus requiring a trial for the consideration of that evidence and determination of whether any of it actually supported Plaintiff's claim. A-9527–28.

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."). But this argument lays bare that LBIE's real disagreement with the Trial Court's decision is not about the standard it applied, but about how the Trial Court weighed the evidence and the outcome the Trial Court ultimately reached. *See Dalton*, 87 N.Y.2d at 391 (noting that where, as here, there is evidence to support the trial court's findings, the Court of Appeals is "without power" to review those findings).

LBIE is in any event wrong about the record. As the Decision After Trial makes clear, there was extensive support in the record for the Trial Court's factual finding that LBIE came "nowhere close" to satisfying its burden and completely "failed to prove the existence of a uniform market practice of resorting to market prices to determine 'Loss.'" A-103–04. This includes admissions by LBIE's own experts, treatises and industry reports, case law interpreting the ISDA Loss provision, and guidance published by ISDA itself (the industry group responsible for drafting the Master Agreement) that contradicted the existence of any purported uniform market practice for calculating Loss. Notably:

- LBIE's experts admitted that they did not perform any systematic study or market survey to support the existence of a uniform market practice requiring Non-defaulting Parties to calculate Loss based on market prices, nor could they point to any. *See* A-420, 1434, 2106–07, 2643–44.

- LBIE's experts had themselves departed from the purported uniform market practice in other lawsuits where they were hired to calculate Loss under the 1992 ISDA Master Agreement. *See* A-104–05 (discussing how two of LBIE's experts did not rely on market prices and instead used a discounted cash flow analysis in the *Devonshire* and *Solstice* cases).

- Treatises by leading scholars affirmed that there was no consensus that Loss requires the use of market data. *See* A-6903–04, 6950.

- Industry reports—including reports on which LBIE's experts purported to rely—demonstrated the absence of any industry-wide consensus for valuing terminated transactions. *See* A-3623, 6218, 7834.

- Case law interpreting the ISDA Loss provision, including the *Intel* and *Devonshire* decisions, supported the Trial Court's conclusion that there was no market consensus requiring a single methodology for calculating Loss. *See* A-98, 104.

- And ISDA, which LBIE's own witness referred to as "the voice of the derivatives industry," issued guidance in its User's Guide to the 1992 ISDA Master Agreement that "'Loss' is supposed to be flexible, [and] involves more than what a Market Quotation exercise would take into consideration." A-98, 457.

In light of this overwhelming evidence, the Appellate Division affirmed the Trial Court's decision, concluding that LBIE did not satisfy the standard for overturning that decision, which would have required LBIE to show "that the court's conclusions could not be reached under any fair interpretation of the evidence." Decision at 1 (quoting *Watts v State of New York*, 25 A.D.3d 324 (1st Dept 2006)).

Fourth, LBIE argues that, even apart from market practice, the evidence Assured presented was insufficient to show that its Loss calculations were objectively reasonable. LBIE calls Assured's methodology for calculating its Loss "unprecedented" and "subjective," Motion at 4, 31–32, but the Trial Court properly

rejected this as purely rhetorical. LBIE's own valuation expert conceded at trial that all models require the application of subjective judgment, A-2089–90, including the alternative "litigation-driven" model that LBIE presented at trial. A-4885. LBIE's "subjectivity" argument also fails to address the *reliability* of Assured's model, which is at the heart of reasonableness, as the Trial Court understood. A-90. In any event, LBIE's contention is mere quibbling with the factual findings of the Trial Court, pressing the same arguments that have been rejected both at trial and by the Appellate Division. There is no basis for a different result here.[11]

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[11] LBIE cites to a number of cases which LBIE contends stand for the proposition that an objective standard of reasonableness requires reference to some sort of external factor for verification. *See* Motion at 24–26. Assured's Loss calculation would satisfy any of the standards that LBIE invokes because Assured utilized extensive objective and examinable market information. *See* A-90–96. But LBIE's cases all arise from the exercise of discretion in contexts completely unrelated to the facts of this case. *See Alper Blouse Co. v. E.E. Conner & Co.*, 309 N.Y. 67 (1955) (concerning a buyer's exercise of discretion to reject a shipment of goods that allegedly failed to conform to a sample the buyer had received previously); *J.D. Cousins & Sons, Inc. v. Hartford Steam Boiler Inspec. & Ins. Co.*, 341 F.3d 149 (2d Cir. 2003) (involving vessel inspector's discretion not to certify that a vessel met the design and construction codes set by the American Society of Mechanical Engineers); *T.W. Oil, Inc. v. Consol. Edison Co. of N.Y.*, 57 N.Y.2d 574 (1982) (evaluating discretion of buyer to reject shipment of oil cargo); *U.S. Fid. & Guar. Co. v. Am. Re-Ins. Co.*, 20 N.Y.3d 407 (2013) (holding, in a case evaluating the objective reasonableness of reinsurance allocations, that "[r]easonableness does not imply disregard of a cedent's own interests"); *FMC Corp. v. Unmack*, 92 N.Y.2d 179 (1998) (finding that reasonableness in tax assessment cases merely requires that "the documentary and testimonial evidence

Assured introduced at trial voluminous evidence in support of the objective reasonableness of its methodology, including documents and testimony from Assured's fact and expert witnesses. This includes:

- Evidence that Assured calculated its Loss for all twenty-eight Transactions using the same ordinary course-of-business model that its surveillance and loss reserving groups used for multiple critical business purposes unrelated to this litigation. *See* A-89; *see also supra* at 23.

- Evidence that Assured's loss reserve methodology was "(1) independent and (2) subject to multiple layers of oversight," including by Assured's Loss Reserve Committee, by a separate Audit Committee, comprised of independent directors of Assured's parent holding company, and by Assured's independent outside auditor, PwC, as part of a "full audit." *See* A-89, 1710–14, 3809; *see also supra* at 23–24.

- Documentary evidence and testimony from Assured's Chief Actuary establishing the basis for Assured's calculations with respect to *each* of the twenty-eight Transactions. *See* A-1682–85, 1705–09, 1761–73.

- Credible expert testimony demonstrating that Assured's methodology appropriately accounted for the structural protections within the Transactions that mitigated potential losses, unlike the valuation model proposed by LBIE's expert for purposes of this litigation, which the Trial Court found was invented "out of whole cloth." *See* A-106, 3960–63, 4071–72.

- Evidence that Assured would have exposed itself to significant negative repercussions, such as underreporting losses and overpaying on its purchases of RMBS, if its models had been overly optimistic as LBIE contends. *See* A-1757–59.

- Evidence of substantial similarities between Assured's methodology and those used by the only two independent rating agencies that disclosed

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proffered by petitioner is based on 'sound theory and objective' rather than on mere wishful thinking") (citation omitted).

their methodology for projecting losses on similar instruments. *See* A-4363–72, 4027–28, 6631, 6355; *see also supra* at 22.

- Evidence that Assured's Loss calculations were consistent with LBIE's own pre-litigation internal assessments. *See* A-925, 5961, 5992, 5976, 7852–54; *see also* s*upra* at 13–14.

- Evidence that two of LBIE's own experts had utilized discounted cash flow valuations in previous cases. *See* A-104–05.[12]

In short, the record plainly supports the Appellate Division's conclusion that "there is no basis to disturb the trial court's determination." Decision at 1.

The arguments that LBIE presents also do not raise any issues of public concern. Although LBIE asserts that the Trial Court's decision has created "significant uncertainty and confusion" in the financial markets, Motion at 34, LBIE cites no support whatsoever to show that is true. This is hardly surprising because, as the Appellate Division correctly recognized, the Trial Court's decision is consistent with prior case law and simply applies that law to the facts of this case. It is also consistent with guidance from ISDA itself, which has explained, citing its User's Guide to the ISDA Master Agreement, that the Loss provision,

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[12] In the *Solstice* case, the parties disputed the value of a terminated swap after they had selected market quotation and failed to receive a sufficient number of bids. A-2093–94, 2095. LBIE's expert conceded that his calculation in that case reflected the "net present value of the part[ies'] future contingent payment obligations under the swap." A-2095. Similarly, in *Devonshire*, LBIE's expert "estimate[d] loss" by using "a cash flow projection of losses." A-7001; *see also infra* at 47–48. In doing so, she rejected the "dramatically" different result produced by the counterparty's unadjusted model based on market prices. A-392.

"carefully crafted as an alternative to Market Quotation, to allow flexibility," is a measure "guided solely by good faith reasonableness and open to a universe of calculation methods." ISDA's Amicus Brief in Support of Def. Intel Corp.'s Mot. for Summ. J. at 19, *Lehman Bros. Holdings Inc. v. Intel Corp.*, Case No. 13-1340-scc (Bankr. S.D.N.Y. Jan. 20, 2015). *See also In re Lehman Bros. Holdings Inc. v. Intel Corp.* (*"Intel"*), 2015 WL 7194609, at *12 (Bankr. S.D.N.Y. Sept. 16, 2015) (finding that the drafters of the 1992 ISDA Master Agreement intended for Non-defaulting Parties to have "wide discretion" in calculating Loss and for such calculations to be "conclusive and legally enforceable" in order to "mitigat[e] the risk of fact-specific disputes and the attendant risk of protracted litigation . . ."). Indeed, it is *LBIE's* approach, if adopted, that would have led to market uncertainty and upheaval by unsettling clear-cut New York law principles that the words of a contract guide its interpretation,[13] and it is only *LBIE's* continued litigation of this matter that could foster any uncertainty.[14]

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[13] Ex. J at 8:18–23 (Justice Oing: "Look, whatever the courts—whatever the case law is out there, my training always takes me back to the agreement itself, the contract itself. . . . [B]ecause believe it or not, the answers are in the contract, right?").

[14] The cases that LBIE cites to argue that "[t]his Court has regularly accepted for review" contractual interpretation cases, Motion at 23 n.10, are readily distinguishable from this matter. *Donohue v. Cuomo* involved the interpretation of a collective bargaining agreement between New York State and state employees, which clearly presented a matter of public interest, unlike the private contract at

II. There Is No Basis For Appeal On The Issue Of Whether The Trial Court Departed From New York Law On How To Calculate "Loss of Bargain"

LBIE also argues that the decisions below departed from New York law by permitting a "loss of bargain" valuation that was different from the market value of the terminated CDS, and that this Court should permit an 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." Motion at 35. LBIE raised these very same arguments below on appeal, and the Appellate Division considered and correctly rejected them. This Court should do the same here.

First, LBIE argues that New York law requires that "loss of bargain" as used in the Loss definition of the 1992 ISDA Master Agreement be determined by

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issue in this case. 38 N.Y.3d 1 (2022). Similarly, each of the other cases that LBIE cites involved state actors or questions of public policy, and thus inherently implicated public interest. *See Matter of Methodist Church of Babylon v. Glen-Rich Const. Corp*., 27 N.Y.2d 357 (1971) (concerning arbitrability of claim in light of unperformed conditions precedent to contractual right to arbitration in light of futility doctrine); *R/S Assocs. v. New York Job Dev. Auth*., 98 N.Y.2d 29 (2002) (involving the interpretation of a contract with a public benefit corporation created by amendment to the New York State constitution); *Charlebois v. J.M. Weller Assocs., Inc.*, 72 N.Y.2d 587 (1988) (determining whether a contract was invalid as a matter of public policy); *Beal Sav. Bank v. Sommer*, 8 N.Y.3d 318 (2007) (requiring the Court to interpret a contract that lacked a specific statement controlling whether an individual lender in a syndicate can take action contrary to the will of all other syndicate members).

reference to market prices. *Id*. at 36. But that argument contradicts the plain language of the Master Agreement, which states that in calculating its Loss, "[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." A-7147. In the SJ Decision, the Trial Court accordingly explained that "the Loss provision could not be clearer in stating that a party 'may (but need not)' calculate Loss using market quotations of rates or prices. . . . The Loss provision thus by its terms affords the Non-Defaulting Party the discretion to make the determination as to whether use of market prices to calculate Loss is appropriate in a particular case." A-60–61. This is law of the case. The Trial Court thus found in its Decision After Trial that "under the ISDA Master Agreement, the non-defaulting party 'need not' consider market prices, especially where to do so would render the Termination amount 'commercially unreasonable.' . . . ISDA's 'Loss' provision is flexible enough to take into account all types of 'loss of bargain,' even Assured's, which had nothing to do with market prices." A-99–100. And the Appellate Division correctly interpreted this language the same way, explaining during argument that it could not see any provision of the ISDA Master Agreement that prohibited the Loss calculation methodology that Assured used. Ex. J at 14:7–9 (Justice Oing: "I just don't see somewhere in this agreement, I mean, that you'd be required to" use market prices.). Contrary to LBIE's claims, this is consistent with other decisions

interpreting the same Loss definition, which have concluded that the Non-defaulting Party has "discretion and flexibility in selecting the means for calculating its Loss" including the "discretion not to use market quotations in determining Loss." A-98 (quoting *Intel*, at *12), 99 (citing *Intel*, at *11). The Trial Court's decision is also consistent with other decisions that have similarly approved the use of discounted cash flow valuations to calculate Loss under the ISDA Master Agreement. *See supra* 38 n.12. LBIE's argument urging a different interpretation of this language, an argument rejected at every stage below, is no basis for an appeal to this Court.

The cases LBIE cites do not help it. Most do not even involve ISDA agreements or the interpretation of similar contractual provisions, and have no application here. Motion at 18–20. *White v. Farrell* addressed whether to measure damages as of the date of the breach of contract to purchase a piece of land or as of the date the land was resold. 20 N.Y.3d 487, 489 (2013). Likewise, *Cole v. Macklowe* dealt with the purported breach of an agreement between business partners related to their ownership interests in various properties. 64 A.D.3d 480, 480 (1st Dep't 2009). And the cases that do involve ISDA agreements involve entirely different and unrelated provisions. *Credit Lyonnais* was about Market Quotation, and the court held that a Market Quotation auction was conducted in bad faith because the bank that held it improperly tried to influence the bidders.

The High Risk Opportunities Hub Fund Ltd. v. Lyonnais, No. 600229/00, 2005 WL 6234513, at *5, 7-8 (Sup. Ct. N.Y. Cnty. July 6, 2005). *Sal. Oppenheim* was also about Market Quotation and addressed whether a defendant could use quotations obtained before the termination. *Lehman Brothers Finance, S.A. v. Sal. Oppenheim Jr.& CIE. KGAA*, [2014] EWHC 2627 (Comm.) ¶ 27 (Eng.) (Ex. Q). The other cases, *Bank of America* and *Ballyrock,* are both disputes about whether "priority provisions" of the ISDA agreement could be enforced under the Bankruptcy Code. Neither involved the valuation of transactions executed under an ISDA agreement, let alone the Loss definition, and both are irrelevant to this case.[15]

Second, LBIE argues that the Trial Court departed from New York law in finding market prices irrelevant to Assured's Loss calculation based on its finding that financial markets were "dislocated." Motion at 38–39. This argument, too, misses the mark. As the Trial Court found, based on substantial evidence, the markets relevant to the transactions here were illiquid and dislocated during 2009;

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[15] In *Bank of America*, a dispute between two big banks, Market Quotation was used for some of the Transactions and Loss was used for others, but there "the method of calculation has no material effect on the dispute here." *Lehman Bros. Special Financing Inc. v. Bank of Am., NA.*, 553 B.R. 476, 481, 485 n.28 (Bankr. S.D.N.Y. 2016). The *Ballyrock* case does not even mention the Loss definition or address the use of market prices to determine Loss. *Lehman Bros. Special Fin. Inc. v. BallyrockABS CDO 2007-1 Ltd.*, 452 B.R. 31 (Bankr. S.D.N.Y. 2011).

this included evidence showing "dislocation for the very transactions at issue in this case." A-87. The Trial Court thus correctly explained: "'If a market price is unavailable or the market is disrupted or dysfunctional, one must use a different method [than market prices].' Market prices leading to a commercially unreasonable valuation is especially likely during periods of severe market disruption where reliable market prices may not exist," and "LBIE never explains how [using market prices to calculate Loss] could have possibly worked in the first half of 2009 given the extreme dislocation in the market and the extreme illiquidity." A-100, 105 (citations omitted).[16]

Considering the evidence of market conditions at the time, the Trial Court correctly concluded that "LBIE's valuation was commercially unreasonable" because the pricing proxies it put forward reflected market dislocation and not the actual economics of the Transactions, which only required Assured to make payments for shortfalls that occurred on the referenced securities as they came due

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[16] LBIE misleadingly cites an internal Assured spreadsheet reflecting calculations made as part of Assured's GAAP accounting analysis to argue that Assured valued the Transactions at $216 million in LBIE's favor, Motion at 38 n.19, but that argument entirely misconstrues the evidence. As the Trial Court correctly found, the accounting analysis, reflected in this and similar spreadsheets, was prepared "for a completely different purpose" to "comply with GAAP for reporting obligations." A-108. The evidence at trial made clear that the analysis LBIE references did not reflect the "ultimate economic or expected loss" of the Transactions or even the ultimate GAAP reported number. A-3787–88.

over the life of the Transactions. A-108.[17] As the Trial Court explained, using "LBIE's valuation, a contrived proxy for market quotation, actually puts Assured in a worse position than if the Transactions had not been terminated." A-107. This would run contrary to the language of the Loss provision, its purpose as a "general indemnity" for Non-defaulting Parties, and New York law. *See supra* at 10–12.

Third, the Trial Court did not misapply the "cross-check principle"—which is the notion articulated by some *foreign* courts that the result of Loss and Market Quotation "may be usefully tested by way of cross-check reference to the other." A-98 (quoting *Anthracite Rated Invs., Ltd. v. Lehman Bros. Fin. S.A. in Liquidation*, [2011] EWHC (Ch) 1822 (Eng.)). Though LBIE describes cross-check as a "bedrock principle," Motion at 40, *Intel*, the only other U.S. case to even mention this principle, actually approved a Loss calculation that substantially diverged from market prices. 2015 WL 7194609, at *19. And ISDA

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[17] Here as well, LBIE relies on inapposite caselaw that does not involve ISDA Master Agreements. *See* Motion at 38–39. For example, *Schonfeld v. Hilliard* addressed how to calculate consequential damages in connection with the plaintiff's loss of "an income-producing asset" (i.e., television programming licenses). 218 F.3d 164, 176 (2d Cir. 2000). Similarly, *Credit Suisse First Boston v. Utrecht-America Finance Co.* addressed the calculation of damages resulting from the defendant's "failure to deliver an asset" in the absence of an agreed-upon contractual damages clause. 84 A.D.3d 479, 580 (1st Dep't 2009). And even there the court did not say, as LBIE asserts, that a "hypothetical market value based on expert testimony" was required, but merely stated that a party may choose to determine value in that way. *Id.*

itself has rejected the cross-check principle, stating that Loss and Market Quotation "could and *should* produce different results in certain scenarios." ISDA's Amicus Brief in Support of Def. Intel Corp.'s Mot for Summ. J. at 13, *Lehman Bros. Holdings Inc. v. Intel Corp.*, Case No. 13-1340-SCC (Bankr. S.D.N.Y. Jan. 20, 2015).

Nor did the SJ Decision hold that cross-check was law of the case; it merely concluded that there was a triable issue of fact "as to whether the cross-check principle is capable of application to this case." A-68. In fact, that decision held that the Loss definition permits Assured, as the Non-defaulting Party, the discretion "to select any methodology for calculating Loss, so long as such methodology is reasonable and in good faith" and that there is "nothing in the text of the definition of Loss that explicitly mandates any particular calculation method . . . ." A-59–60. The SJ Decision specifically rejected the notion that the Agreement "categorically prohibits" a Non-defaulting Party "from calculating its Loss without reference to market prices," and, as noted above, explained that "the Loss provision could not be clearer in stating that a party 'may (but need not)' calculate Loss using market quotations of rates or prices." A-60.

Consistent with the SJ Decision, after hearing the evidence, the Trial Court properly concluded that the cross-check principle has no application here because the Market Quotation auction failed and the real-world evidence showed no market

participant was willing to pay a single dollar to enter into LBIE's shoes on the Transactions. *See supra* at 14–15, 17–18. This was corroborated by LBIE's own contemporaneous internal memos and presentations candidly concluding (before any litigation had been filed) that market prices were not an accurate measure of loss, and that the Transactions were of little value to LBIE. *See supra* at 13–14. In other words, there were no reliable market prices against which to "cross-check" Assured's Loss calculation. And ultimately, the Appellate Division correctly considered and rejected LBIE's argument that the Trial Court's decision was somehow inconsistent with the Trial Court's previous decision on summary judgment. Decision at 2.

LBIE also argues that the Trial Court's decision is inconsistent with the holdings in a Canadian case, *Devonshire*, but LBIE misconstrues those decisions as well. To the contrary, the Trial Court correctly interpreted and applied *Devonshire* here after receiving two rounds of supplemental post-trial briefing on that case's relevance. *See Lehman Bros. Int'l (Eur.) v. AG Fin. Prod., Inc.*, No. 653284/2011 (NYSCEF Nos. 786–89). According to LBIE, the Ontario Court of Appeals' decision in that case stands for the proposition that a Loss calculation must include a risk premium in all cases. Motion at 41–42. But LBIE disregards that Devonshire, the Non-defaulting Party, calculated its Loss as the actual amount it would lose as a result of Barclays' default, taking into account the agreement

between the parties that set forth the parties' payment obligations. Like Assured, Devonshire did not attempt to calculate a theoretical market price for the terminated transactions, nor did Devonshire add a risk premium to its calculation. *See Barclays Bank v. Metcalfe & Mansfield*, 2011 CarswellOnt 9183 (Can. Ont. Sup. Ct. J.) (WL) ¶¶ 336-37. The trial court in *Devonshire* approved this Loss calculation, and it was not appealed. *See Barclays Bank PLC v. Metcalfe & Mansfield Alt. Invs. VII Corp.*, 2013 CarswellOnt 11271 (Can. Ont. C.A.) (WL).

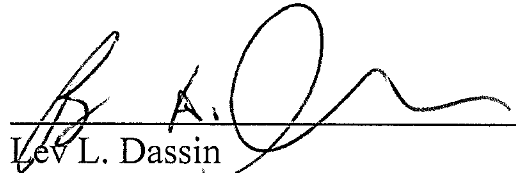
In sum, LBIE's arguments regarding the purported relevance of market prices do not warrant granting leave to appeal. LBIE has not presented a question of law that could be appropriately considered by the Court of Appeals. Instead, LBIE's arguments merely challenge the Trial Court's factual findings. And none of these arguments present an issue of such public importance that it requires review by this Court.

CONCLUSION

For the foregoing reasons, this Court should deny LBIE's Motion.

Dated: September 3, 2024
New York, New York

Respectfully submitted,



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COURT OF APPEALS
STATE OF NEW YORK

LEHMAN BORTHER INTERNATIONAL (EUROPE) (in administration), Plaintiff-Appellant, -against- AG FINANCIAL PRODUCTS, INC., Defendant-Respondent.	First Department Appeal No. 2023-03409 New York County Clerk's Index No. 653284/2011

AFFIRMATION OF SERVICE

I, Brendan Cyr, affirm the following pursuant to Rule 2106 of the Civil Practice Laws and Rules:

On September 3, 2024, true and correct copies of the Response in Opposition to Plaintiff-Appellant's Motion for Permission to Appeal, are being served by Federal Express, upon:

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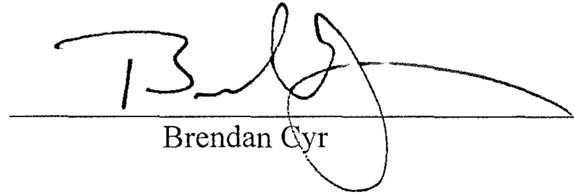
I affirm under the penalties of perjury under the laws of New York, which may include a fine or imprisonment, that the foregoing is true, and I understand that this document may be filed in an action or proceeding in a court of law.

Executed on September 3, 2024 at New York, New York.



Brendan Cyr