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ANDREW J. ROSSMAN
(Time Requested: 15 Minutes)

New York Supreme Court

Appellate Division—First Department

Appellate Case No.: 2018-3437

LEHMAN BROTHERS INTERNATIONAL (EUROPE) (in administration),

Plaintiff-Respondent,

– against –

AG FINANCIAL PRODUCTS, INC.,

Defendant-Appellant.

BRIEF FOR PLAINTIFF-RESPONDENT (FILED UNDER SEAL)

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PRELIMINARY STATEMENT

Between 2005 and 2008, Plaintiff-Respondent Lehman Brothers International (Europe) (in administration) ("Lehman") purchased credit protection from Defendant-Appellant AG Financial Products, Inc. ("Assured") in the form of credit default swaps referencing securitizations of mortgages or corporate loans. As the buyer of credit protection, Lehman agreed to make periodic fixed premium payments to Assured. As the seller of credit protection, Assured agreed that if the loans in the referenced securitization under-performed, resulting in shortfalls of principal and/or interest payments, Assured would pay Lehman for the shortfalls.

As the economy spiraled towards the Great Recession, the loans in the referenced securitizations began to under-perform, and Assured's payment liability exposure to Lehman began to balloon. By early 2009, expected losses—and Assured's consequent expected payment obligations—had grown enough that both parties considered the trades to be worth hundreds of millions of dollars in Lehman's favor. Yet when, in July 2009, Assured exercised its right to terminate and value the trades as a consequence of Lehman's entry into administration the previous year, Assured claimed that the trades were in fact worth $23 million *to Assured*, a conclusion that defied market reality.

At trial, Assured will have the opportunity to try to justify this manifestly irrational result as being reached "reasonably" and in "good faith" as required by the

agreement governing the parties' trades. Assured seeks to avoid that reckoning, but offers no basis to reverse the well-reasoned determination of Supreme Court (Friedman, J.S.C.) that the reasonableness and good faith of Assured's conduct cannot be resolved on summary judgment.

Supreme Court's thirty-eight page Order denying summary judgment should be affirmed so that Supreme Court can resolve contested questions of fact with full information following a bench trial. It is well-settled New York law that where a contract requires a party to act reasonably and in good faith, breach of those requirements is an issue of fact that properly considers evidence of relevant ordinary practice. Contrary to Assured's characterization, Supreme Court did not consider market practice evidence in construing the parties' contract, but rather recognized, properly, the need to evaluate such evidence in determining whether Assured's conduct in these specific circumstances was in fact reasonable and in good faith.

In particular, Supreme Court properly ruled that the considerable evidence in the record raises, at the very least, contested issues of fact regarding whether it was reasonable and in good faith for Assured to ignore the market value of its trades with Lehman, and instead to assign a value based solely on the internal, subjective "payment model" it used for purposes of calculating loss reserves.

Likewise, Supreme Court properly ruled that even if Assured were justified in valuing the trades using an idiosyncratic "payment model," summary judgment

would still be inappropriate. The record evidence demonstrates widespread and significant disparities between the future loss assumptions Assured employed and the far more pessimistic assumptions of other market participants. Moreover, Assured altered these assumptions the month before it used them to value the trades at issue, in each instance making its forecasts more optimistic, and thus more favorable to itself. There are, at the very least, contested issues of fact regarding whether it was reasonable and in good faith for Assured to assume, in the depth of the financial crisis, that the value of credit protection it sold to Lehman at the height of the market had actually moved in Assured's favor.

Assured's arguments on appeal cannot mask the complex and fact-intensive nature of the parties' dispute regarding Assured's conduct. The contract requires that Assured exercise its discretion in valuing the trades reasonably and in good faith, and that, if the trades represent a payment liability at the time of their termination, Assured pay Lehman the value of the liability it has been able to terminate. Yet the record here shows that, prior to termination, Assured had decided it would never pay Lehman the net value of the trades; that rather than terminating the trades at the time of Lehman's entry into administration (like nearly every other Lehman counterparty), Assured spent months trying to exit the trades without having to pay Lehman their market value; that Assured had decided, before terminating the trades, that it would calculate a termination value based on its own subjective and

idiosyncratic "payment model" rather than the contractually mandated market-based valuation measure; and that Assured revised the overly-optimistic assumptions and economic forecasts underlying that "payment model" in its own favor immediately before using it to value the trades. The reasonableness and good faith of Assured's conduct in turning a massive payment liability *to* Lehman into a claim for tens of millions of dollars *from* Lehman cannot be resolved as a matter of law. Summary judgment was properly denied, and Supreme Court's Order should be affirmed.

COUNTERSTATEMENT OF QUESTIONS PRESENTED

1. Where a commercial contract requires a party to engage in certain conduct reasonably and in good faith, does a dispute regarding the reasonableness and good faith of that party's conduct give rise to an issue of fact as to which evidence of commercial practice is relevant?

    a. Answer of Supreme Court: Supreme Court correctly answered yes.

2. Where the record reveals sharp disputes between the parties regarding the reasonableness and good faith of a party's choice of valuation methodology and the actual calculation of amounts owed upon termination of credit derivatives governed by a commercial contract, do those disputes preclude summary judgment and require trial?

    a. Answer of Supreme Court: Supreme Court correctly answered yes.

COUNTERSTATEMENT OF THE CASE

A. Lehman's Purchase Of Credit Protection From Assured

Between 2005 and 2008, Lehman bought credit protection from Assured on thirty-seven financial instruments. Each of these derivatives referenced underlying securitizations of American subprime residential mortgages (the "ABX Transactions"), British residential mortgages (the "UK RMBS Transactions"), or specific collateralized loan or debt obligations (the "CLO Transactions"). R.46 n.1, R.92. In each case, Lehman, as the protection buyer, agreed to make periodic "fixed" payments to Assured for the life of the transaction, while Assured, as the protection seller, agreed to make "floating" payments to Lehman in the event of payment shortfalls on the referenced securities. *See, e.g.*, R.364-67. The value of the credit protection was inversely related to the expected performance of the loans: if the loans did not perform—if the borrowers failed to make required principal or interest payments—the market value of the credit protection increased. Accordingly, as the rates of default and delinquency among the loans increased during the financial crisis, the market value of the swaps moved hundreds of millions of dollars in Lehman's favor. *See, e.g.*, SR.17.

B. The Lehman-Assured ISDA Master Agreement

The financial instruments at issue are governed by an ISDA Master Agreement, which sets the terms on which Lehman and Assured enter into credit default swaps with one another. R.326-47. This Master Agreement reflects the 1992

version of the International Swap Dealers Association's ("ISDA") template for a bilateral derivatives trading relationship. R.327.

Among other things, the Master Agreement sets forth the parties' rights and obligations in the event that a party terminates a transaction prior to its maturity, as Assured did here. R.334-36 (§6 "Early Termination"). The Agreement provides that if an "Event of Default" or a "Termination Event"—any one of a number of contractually defined triggers (R.331-33 (§5 ("Events of Default and Termination Events"), R.350-51 ("Additional Termination Event"))—occurs, the "Non-Defaulting Party" may, but need not, terminate all affected transactions. If the Non-Defaulting Party does elect to terminate, it does so by designating an "Early Termination Date" and calculating "Payments on Early Termination." R.334-35 (§6(e)).

Counterparties to a 1992 ISDA Master Agreement must choose between two "payment measures" that will apply in the event of an Early Termination. R.335-36 (§6(e)(i)). The "<u>Market Quotation</u>" payment measure requires the Non-Defaulting Party to solicit quotations for Replacement Transactions "that would have the effect of preserving ... the economic equivalent of any payment or delivery ... by the parties ... that would, but for the occurrence of the relevant Early Termination Date, have been required after that date." R.341-42. After discarding the highest and lowest quotes, the average of the remaining quotes is the assigned value. R.342. If three

quotations are not provided, or if the Non-Defaulting Party reasonably determines that the received quotations do not produce a "commercially reasonable result," the contract defaults to the "Loss" payment measure as a fallback. *Id.*

The "Loss" payment measure requires the Non-Defaulting Party to calculate "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" the terminated derivatives transactions. R.341. The Loss calculation may include "any loss of bargain" and "cost of funding," and it allows the Non-Defaulting Party to include "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)," provided that the losses (or gains) on those separate but related transactions do not duplicate other claimed losses (or gains). *Id.* In calculating its loss (or gain), the Non-Defaulting Party "may (but need not)" make "reference to quotations of relevant rates or prices from one or more leading dealers in relevant markets." *Id.* However determined, the loss (or gain) is to be calculated "as of the relevant Early Termination Date, or, if that is not reasonably practicable, as of the earliest date thereafter as is reasonably practicable." *Id.*

In addition to selecting a payment *measure*, the parties to a 1992 ISDA Master Agreement must also choose between two payment *methods*. R.335. Under "First Method," a payment is only required if the Defaulting Party owes money to the Non-

Defaulting Party. *Id.* Under "Second Method," by contrast, if the Non-Defaulting Party would experience a *gain* upon early termination—for example through the elimination of a payment liability to the Defaulting Party—then (putting aside any unpaid amounts owed by the Defaulting Party) the "Non-Defaulting party will pay the absolute value of that amount to the Defaulting Party." R.336.

In the Schedule to their Master Agreement, Lehman and Assured chose to value terminated transactions using Market Quotation and to employ the two-way payment obligation required by Second Method. R.350. The parties agreed that their Master Agreement would "be governed by and construed in accordance with the laws of the State of New York (without reference to choice of law doctrine)," rather than English law. R.357. And the parties further agreed that, in addition to the default and termination triggers in their Master Agreement, a failure by either party to maintain a minimum specified credit rating would also constitute an "Additional Termination Event." R.350.

In addition to the parties' Master Agreement and Schedule, each transaction was governed by its own trade confirmation which, in some instances, altered provisions of those contracts. For example, the trade confirmation documents for some of the transactions eliminated the additional termination trigger for downgrades to Assured's credit rating. *E.g.*, R.378. Similarly, some confirmations provided that Lehman's failure to deliver certain "reports and other information

relating to" the underlying securities would constitute another "Additional Termination Event." R.119. Under this form of "Additional Termination Event," however, instead of using the payment measures and methods discussed above, Lehman would be required to pay Assured any accrued and unpaid premiums and "no [other] amount" would be "payable by either party in respect of the termination." R.120.

C. Assured's Termination Of The Transactions

On September 15, 2008, Lehman Brothers Holdings Inc. ("LBHI")—Lehman's affiliate and designated "Credit Support Provider" under the Master Agreement (R.349, R.356)—filed for bankruptcy protection under Chapter 11 of the U.S. Bankruptcy Code. That same day, by order of the English High Court of Justice, Chancery Division, Lehman was placed into administration under the UK Insolvency Act (1986). R.108-09. Both events constituted continuing "Events of Default" under the Master Agreement. R.332 (§5(a)(vii)).

Unlike the vast majority of Lehman's counterparties, Assured did not immediately exercise its right to terminate its Lehman-facing derivatives, suggesting that, at least in September 2008, Assured recognized that termination would result in a payment to Lehman. R.3418. Instead, Assured kept the credit protection transactions in effect and entered into discussions about alternatives to unilateral termination, which would trigger the payment measures and methods in the Master

Agreement. R.1080-84. The parties discussed a negotiated consensual termination; an assignment or novation to a third party or a special purpose vehicle; and the continuation of the transactions to maturity. *Id.*; R.3515.

Both parties acknowledged that as market conditions had deteriorated, and as the expected performance of the loans underlying the referenced securitizations consequently declined, the value of the trades had moved significantly in Lehman's favor. *E.g.*, R.1080-83. In the words of one Assured employee, the deterioration in the quality of the securities underlying the trades had "absolutely destroyed" their value to Assured, which as of April 2009 it assessed as $295 million in Lehman's favor. R.3430, SR.17. However, in correspondence with ratings agencies, Assured made plain that it did "not intend to take any action that would result in a net cash payment to Lehman." SR.8. Consistent with this pledge, Assured pursued several strategies to end the credit protection it had sold to Lehman without having to pay anything for the termination.

First, during negotiations following Lehman's bankruptcy, Assured sought to capitalize on Lehman's failure to make timely delivery of monthly trustee reports for certain securitizations, declaring Additional Termination Events as to nine transactions it could terminate on that basis. R.119. By using the failure to deliver reports, rather than Lehman's entry into administration, as the trigger for termination, Assured was able to avoid the Master Agreement's normal valuation

provisions and instead value those transactions on a "walkaway" basis that took account only of accrued unpaid premiums. R.120.

Second, as to the twenty-eight remaining transactions (referred to hereafter as the "Transactions"), Assured sent Lehman a PowerPoint presentation in July 2009 setting forth three proposed alternatives: (1) Assured could "do nothing" and allow the Transactions to remain in effect; (2) it could exercise its right to terminate and value the Transactions (a valuation Lehman might or might not challenge); or (3) the parties could come to a negotiated resolution. R.3515. Assured took the position, in advance of its termination of the Transactions, that the Market Quotation payment measure required by the parties' Master Agreement "cannot be operated in this case," that "the Loss method must be used," and that Assured would calculate Loss "on an ultimate credit loss basis, assuming hold to maturity, using cash flow models"—in other words, without consideration of the significant value the market assigned to the trades at the time. R.3512.

Subsequent discussions between the parties failed to produce a negotiated resolution, and on July 23, 2009 Assured sent Lehman a notice terminating the Transactions. R.771-74.

D. Assured's Valuation Of The Terminated Transactions

In light of the Master Agreement's requirement that payment calculations be performed "[o]n or as soon as reasonably practicable following the occurrence of an

Early Termination Date" (R.335), Lehman immediately sought to obtain contemporaneous information regarding the value of the Transactions. Lehman contacted traders at various derivatives dealers, including Citibank and Nomura, requesting quotes on credit derivative swaps with the essential characteristics (including reference security, currency, and initial or "strike" price) of the terminated Transactions and which would face a counterparty with Assured's credit rating. R.1184-85. Citibank and Nomura each responded with indicative price levels. R.1184, R.1188-89, R.1192. These quotations indicated that at the time of termination, the market assigned hundreds of millions of dollars of value to the credit protection Lehman had purchased from Assured. R.1533-34, R.1561-62.

Unlike Lehman, Assured made no immediate effort to collect pricing information. Instead, despite having pre-determined that the Market Quotation payment measure "cannot be operated in this case" (R.3512), Assured retained consultants to hold an auction nearly two months after termination. R.3086, R.3654. Assured imposed a variety of conditions on the auction, including that bidders execute a Master Agreement with Assured on Assured's terms (*see* R.3638, R.3640); abide by both a non-disclosure agreement and a list of non-negotiable bidding procedures (*see* R. 3640, R.3653-54, R.3657); and agree that although each bid had to be executable, Assured had no obligation to accept any of them (R.3625). A number of major derivatives dealers expressly declined to participate in the auction

given these conditions and demands, and none of the three that agreed to the conditions ultimately submitted a bid. R.3654, R.3657.

Assured then purported to calculate its "Loss" on the Transactions. It did so by first adding the present value of the payments Lehman would have made to Assured over the lifetime of the transactions to the accrued amounts Lehman already owed. R.3654-55. Assured then subtracted the present value of shortfall payments it predicted it would have made to Lehman over the lifetime of the transactions. *Id.* In this latter calculation, Assured relied on an internal 'payment model' that did not refer to any information regarding the market value of the credit protection Lehman had purchased or market data about the underlying securities. *Id.* Despite having acknowledged as late as April 2009 that the Transactions were worth hundreds of millions of dollars to Lehman (SR.17, SR.23-24), Assured purported to calculate a termination value of approximately $23 million *to itself*. R.3650-62.

E. Lehman's Challenges To Assured's Loss Calculation

Lehman filed suit in November 2011, alleging that Assured's valuation of all thirty-seven transactions breached the terms of the Master Agreement or the implied covenant of good faith and fair dealing. R.83-110. Lehman's First Cause of Action alleged that Assured breached the implied covenant of good faith and fair dealing by terminating nine transactions on a walk-away basis in December 2008, while the parties actively discussed the disposition of all of the transactions (R.98-99);

Lehman's Second Cause of Action alleged that Assured breached the terms of the Master Agreement through its termination of the remaining twenty-eight Transactions in July 2008 and its subsequent conduct in connection with its purported Market Quotation auction and Loss calculation. R.99. Lehman's Third Cause of Action alleged that the way Assured conducted its Market Quotation auction breached the implied covenant of good faith and fair dealing. R.100.

Assured moved to dismiss the implied covenant claims, and by Decision and Order dated March 12, 2013, Supreme Court granted Assured's motion with respect to Lehman's First Cause of Action relating to the nine swaps terminated on a walk-away basis, but denied Assured's motion with respect to the Third Cause of Action. R.119-28.

The parties thereafter engaged in extensive fact discovery, exchanging tens of thousands of documents, deposing nineteen fact witnesses, and seeking additional discovery materials from multiple third parties. The parties also submitted ten expert reports from seven expert witnesses, each of whom was deposed, on topics including the reasonableness of Assured's attempts to calculate termination payments using the Market Quotation payment measure, the reasonableness of Assured's decision to ignore market values and information when purporting to perform calculations under the Loss payment measure, and the reasonableness of the internal economic forecasts and assumptions on which Assured relied when calculating its supposed Loss. *See*

R.226-84, R.947-94, R.995-1044, R.1163-80, R.3099-3149, R.3155-3203, R.3663-3805, R.3815-25, R.3833-45, R.3907-45.

The fact evidence and expert submissions revealed sharp disagreements between the parties regarding every aspect of Assured's conduct in purporting to value the Transactions. *First*, with respect to Assured's attempts to employ the Market Quotation payment measure, Lehman presented evidence that Assured had decided to rely on the fallback Loss measure even before it engaged the consultants it hired to run its 'auction' (*e.g.*, R.3512) and that the conditions it imposed on bidding counterparties—which it refused to negotiate—deterred participation (*e.g.*, R.3637-38, R.3639-47, R.3648-49).

Second, the parties were also directly at odds with regard to the relevance of information related to the market value of the Transactions. Assured disregarded market information, pointing to evidence in the record that it claimed supported its own purported "payment model" to calculate Loss. In stark contrast, Lehman presented evidence that consideration of the price that the markets assigned to terminated transactions was standard in the calculation of Loss under 1992 ISDA Master Agreements. *E.g.*, R.3408-13. Lehman's experts also opined that the decision to ignore the market value of the Transactions was so inconsistent with market practice as to be unreasonable. *E.g.*, R.3099, R.3133-35, R.3155, R.3164-70.

Third, the parties likewise sharply disagreed with respect to the suitability of Assured's Loss calculation itself. Lehman presented evidence that Assured's economic forecasts relied on irrationally optimistic assumptions regarding future market conditions that were substantially out of step with the contemporary expectations and forecasts of other monoline insurance companies, derivatives dealers, and ratings agencies. *E.g.* R.3757-64. Lehman's experts opined that the resulting calculations significantly understated the forecasted amounts Assured presumed it would have had to pay to Lehman over the lifetime of the Transactions had they not been terminated, and that those calculations were therefore unreasonable. R.3669-70, R.3743-800.

F. The Decision On Appeal

At the close of fact discovery, Assured moved for summary judgment on Lehman's remaining claims for breach of contract (Second Cause of Action) and breach of the implied covenant of good faith and fair dealing (Third Cause of Action). R.159. In a 39-page Decision and Order dated July 2, 2018, Supreme Court granted Assured's motion in part and denied it in part. R.44-82. The court granted the motion with respect to Lehman's Third Cause of Action, and with respect to the Second Cause of Action to the extent Lehman alleged that Assured's conduct in connection with the Market Quotation auction breached the Master Agreement. R.50-58. Supreme Court, however, denied Assured's motion with respect to

Lehman's claim that Assured breached the Master Agreement by "improperly calculat[ing] Loss without reference to any market information and in a manner that was commercially unreasonable." R.58 (quoting Lehman's Complaint, R.99).

1. Triable Issues As To The Reasonableness and Good Faith of Assured's Choice of Loss Calculation Methodology

Supreme Court identified three issues raised by Assured's motion: the "scope and degree of Assured's discretion" to calculate Loss; the "extent to which evidence of market practice may be used to inform [the] court's interpretation of the Loss provision"; and the extent to which evidence of market practice may be used "to evaluate Assured's exercise of discretion in calculating Loss." R.60-61. The court first addressed the questions in the context of Assured's choice of calculation methodology.

In order to do so, Supreme Court reviewed New York law regarding contract interpretation, including the question of ambiguity and the circumstances under which New York courts (and federal courts interpreting and applying New York law) allow consideration of "industry custom and usage" evidence in determining whether a contract is ambiguous. R.61-63. Citing the Court of Appeals' decision in *Beardslee v. Inflection Energy, LLC*, 25 N.Y.3d 150 (2015), as well as decisions of this Court and other courts applying New York law, Supreme Court observed that a court may consider evidence of industry practice in interpreting commercial agreements, provided the court undertakes "a threshold inquiry to determine whether

the agreement *on its face* is reasonably susceptible of only one meaning." R.63-64. Supreme Court found this rule to be "particularly applicable in a case like this, in which the parties have chosen to structure their transactions using the ISDA Master Agreement, a highly specialized standard-form contract." R.64 n.10.

Supreme Court then reviewed the "substantial authority" in New York law establishing "that an objective standard of reasonableness applies to a contractual provision requiring performance of an obligation in a reasonable manner," as well as the "basic tenet" that "the question of what is reasonable may require consideration of the facts and surrounding circumstances in the case." R.65-66.

Within this legal framework, Supreme Court concluded that "the ISDA Master Agreement is *not* ambiguous to the extent that it provides that Loss need not be calculated using market quotations in every case," thereby determining that it did not need to consider evidence of market practice or custom and usage for the purpose of interpreting contract language. R.66-67 (emphasis added). The court then concluded that this unambiguous contract language did not "categorically prohibit[ ]" Assured from calculating Loss without reference to market prices and afforded Assured "the discretion to make the determination as to whether use of market prices to calculate Loss is appropriate in a particular case." R.68. Crucially, however, Supreme Court noted that its conclusion regarding Assured's discretion did not mean "that evidence of market practice with respect to the calculation of Loss is irrelevant

to the ultimate question before the court," namely "whether the methodology Assured actually used to calculate its Loss was reasonable and applied in good faith." R.68.[1] In the court's framing, the Master Agreement is not ambiguous with respect to the extent of the Non-Defaulting Party's discretion in calculating Loss, but it "is ambiguous as to whether Loss, *under the circumstances of this case*, was reasonably determined." R.66 (emphasis added, alterations and quotation marks omitted).

Supreme Court then reviewed Lehman's market practice evidence, which the court found "raises a triable issue of fact as to whether Assured has 'reasonably determine[d]' its Loss" as required by the Master Agreement. R.69-71. The court referenced the testimony of four of Lehman's experts that "it is standard industry practice to calculate Loss using market prices to approximate the cost of a replacement transaction" (R.69-70); the record evidence that the derivatives settlement framework developed by Lehman's U.S. affiliates to settle thousands of derivatives transactions used market information to determine prices for transactions governed by the Loss calculation measure (R.70-71); and the record evidence that of the dozens of Lehman's derivatives counterparties who terminated transactions governed by the Loss measure (or a substantially equivalent clause in the newer 2002

[1] *See also* R.69 ("To hold, as this court does, that the Loss provision affords the Non-Defaulting Party discretion to calculate Loss without reference to market prices does not mean that the Non-Defaulting Party's decision to ignore market prices can never be unreasonable or undertaken in bad faith. Discretion, after all, can be abused.").

form ISDA Master Agreement), only three counterparties calculated Loss amounts that deviated substantially from market-based calculations (R.71). Supreme Court concluded:

> Where, 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 issue of fact as to the Non-Defaulting Party's reasonableness or good faith in calculating Loss.

Id.

2. Triable Issues As To The "Cross-Check" Principle

Supreme Court observed that its "holding that a triable issue of fact exists as to whether Assured reasonably determined its Loss" was "supported by the so-called 'cross-check' principle" developed by English courts based on the observation that the Market Quotation and Loss measures are "aimed at achieving broadly the same result" and that accordingly "the outcome derived from one may be usefully tested by way of cross-check by reference to the other." R.72 (quoting *Anthracite Rated Invs. [Jersey] Ltd. v. Lehman Bros. Fin. SA*, [2011] EWHC 1822 (Ch), ¶ 116[1] [Eng.]). Noting that the parties "appear to agree that Market Quotation auctions often fail to produce replacement transactions," Supreme Court rejected Assured's argument that its failure to receive bids in its restrictive auction rendered the cross-check principle inapplicable. R.74. Instead, the court correctly ruled that the failure of the auction "does not necessarily mean that Assured was unable to replace the Transactions in the market, or that the price of a replacement transaction is

impossible to estimate," particularly in light of indicative prices Lehman had solicited itself. *Id.* Supreme Court noted that the parties dispute the reliability of those indicative quotations and found that "[a]t the very least ... the significant discrepancy between the indicative bids and Assured's Loss calculation supports a finding that triable issues of fact exist as to whether the cross-check principle is capable of application to this case and, if so, whether Assured's calculation of Loss satisfies the test imposed by that principle." R.75.

3. Triable Issues As To The Reasonableness And Good Faith Of Assured's Actual Calculation Of Loss

Supreme Court then determined that, separate and independent of the methodology Assured adopted, a bench trial was also required to determine whether Assured's calculation using that methodology was itself reasonable and undertaken in good faith. *Id.* The court first rejected Assured's argument "that its Loss methodology was reasonable as a matter of law because it was also used for other purposes in Assured's business," noting that the dispute between the parties' experts regarding "whether loss projections made for other business purposes constitute a reasonable basis for the measurement of Loss" under the ISDA Master Agreement raises "issues of fact which cannot be resolved on this record." R.77.

The court next observed the "sharp[ ]" dispute between the parties' experts regarding "the validity of Assured's assumptions in calculating Loss," recognizing that Lehman had submitted evidence that they "were unreasonable and out of line

with the estimates of other market participants," and concluding that the dispute between the parties' experts regarding the reasonableness of those assumptions "raises a material issue of fact for trial." R.77-78.

Supreme Court then addressed Assured's argument that its calculation should be considered reasonable *per se* because it is (according to Assured) "consistent with New York law on contract damages." R.78. The court noted the "persuasive authority that the ISDA Master agreement's formulae for calculating termination payments 'are not to be equated with, or interpreted rigidly in accordance with the quantification of damages at common law for breach of contract'" (R.78 (quoting *Anthracite*, [2011] EWHC 1822 (Ch), ¶¶ 116[3], 117, 126)), but it went on to rule that Assured had not established that its chosen methodology was in fact consistent with New York damages law (R.79). In particular, the court declined to rule "on the present record" that Assured's methodology "was a reasonable method for calculating Assured's loss of bargain" under damages law because it failed to account for any possibility of a replacement transaction. R.79-80. And the court noted that, even if Assured's chosen methodology was consistent with New York law, Lehman had raised triable issues of fact regarding the application of that methodology that precluded summary judgment. R.80.

The court also declined to resolve on the summary judgment record the various factual disputes between the parties, including "the actual performance of

the Underlying Securities" and the proper import of documents purportedly reflecting Lehman's "internal analysis" of the Transactions. R.80. The court noted that even assuming these issues were relevant to Assured's reasonableness and good faith, neither was undisputed. R.80-81.

4. Supreme Court Identified Its Own Unresolved Questions Warranting Denial of Summary Judgment

Supreme Court concluded its Decision and Order by noting that the "context surrounding Assured's termination of the Transactions" constituted an additional fact that "supports denial of Assured's motion." R.81. The court noted that the parties had selected a "Second Method" approach to exchanging early termination payments, pursuant to which "the Non-Defaulting Party might be called upon to make a payment to the Defaulting Party in the event the Non-Defaulting Party derived a gain, as opposed to a loss, from termination of a Transaction." *Id.* Supreme Court observed that Lehman had submitted evidence that market participants and even Assured itself believed that the value of Lehman's credit protection had increased substantially by the time of the terminations—the result of a change in market conditions that, the court said, "cannot be disputed." R.81-82. In light of these record facts, Supreme Court concluded that "Assured's calculation of a termination payment to *itself*," rather than to Lehman, raised "a genuine question of fact as to the reasonableness and good faith of Assured's calculation of its Loss." R.82 (emphasis added).

This appeal followed.

ARGUMENT

"[S]ummary judgment is a drastic remedy and should not be granted where there is any doubt as to the existence of factual issues; issue-finding, rather than issue-determination, is the key to the procedure." *Birnbaum v. Hyman*, 43 A.D.3d 374, 375 (1st Dep't 2007). "Summary judgment is inappropriate in any case where there are material issues of fact in dispute or where more than one conclusion may be drawn from the established facts." *Friends of Thayer Lake LLC v. Brown*, 27 N.Y.3d 1039, 1043 (2016). The movant's "burden is a heavy one," *William J. Jenack Estate Appraisers & Auctioneers, Inc. v. Rabizadeh*, 22 N.Y.3d 470, 475 (2013), which is not met "where there is any doubt as to the existence of such issues, [] or where the issue is arguable." *Pirrelli v. Long Island R.R.*, 226 A.D.2d 166, 166 (1st Dep't 1996).

As Assured's counsel has written, "litigation of contractual disputes under the 1992 Master Agreement is likely to give rise to a 'battle of experts' concerning the propriety of each party's respective calculations and the underlying methodologies." Thomas J. Moloney, *Valuation under the 1992 ISDA Master Agreement*, in 7 Bus. & Com. Litig. Fed. Cts. § 80:60 (Robert L. Haig ed., 4th ed. 2017). As is the case here, "[c]onflicting expert affidavits raise issues of fact and credibility that cannot

be resolved on a motion for summary judgment." *Bradley v. Soundview Healthcenter*, 4 A.D.3d 194, 194 (1st Dep't 2004).

Supreme Court applied the proper legal standard to Assured's motion for summary judgment on Lehman's breach of contract claim and correctly recognized that unresolved issues of fact abound in the record. This Court should affirm Supreme Court's well-considered conclusion that it required a fuller presentation of the evidence, tested by the adversarial process during a bench trial, before deciding this case.

I. UNDER NEW YORK LAW, WHETHER A PARTY COMPLIED WITH A CONTRACTUAL REQUIREMENT TO ACT REASONABLY AND IN GOOD FAITH IS A QUESTION OF FACT

A. "Reasonable" And "Good Faith" Are Fact-Specific Standards Determined By The Circumstances Of A Particular Case

In this breach of contract case, Lehman and Assured dispute "whether the methodology Assured actually used to calculate its Loss was reasonable and applied in good faith." R.68. By adopting those standards of reasonableness and good faith, and by providing that they would be interpreted and applied according to New York law, Lehman and Assured agreed that any calculation of a termination payment would be evaluated, if necessary, through a fact-specific inquiry that takes into account the commercial context of the parties' agreement. Assured itself "does not dispute" that "'the question of what is reasonable may require consideration of the facts and surrounding circumstances in the case.'" Br. 33 (quoting R.65). As

Supreme Court correctly recognized, "this record" and "the circumstances of this case" evince sharp disagreements between the parties regarding Assured's reasonableness and good faith which preclude summary judgment. R.77, R.66.

Whether a party has breached its commitment to perform a contract "reasonably" is a fact-laden question that requires consideration of the circumstances surrounding the alleged breach. *See, e.g.*, *Guidance Enhanced Green Terrain, LLC v. Bank of Am. Merrill Lynch*, 146 A.D.3d 431, 434 (1st Dep't 2017) (holding, in a breach of contract case involving Lehman affiliates and an ISDA Master Agreement, that "[d]etermining whether it was 'reasonable' for plaintiff to [make a request], and if reasonable, for [defendant] to refuse that request, are fact-specific inquiries"). Such disputes routinely present triable issues not suited for determination as a matter of law. *See, e.g.*, *Good Hill Master Fund L.P. v. Deutsche Bank AG*, 146 A.D.3d 632, 636 (1st Dep't 2017) (trial held on whether party "acted in good faith and in a commercially reasonable manner"); *Samson Lift Techs., LLC v. Jerr-Dan Corp.*, 139 A.D.3d 534, 535 (1st Dep't 2016) (affirming denial of summary judgment due to "issues of fact as to whether any of the challenged conduct, individually or in the aggregate, constitutes a breach of Jerr–Dan's obligation under the amended license agreement to use 'reasonable commercial efforts'"); *Homayouni v. Paribas*, 241 A.D.2d 375, 378 (1st Dep't 1997) (where contract provided for payment of

"reasonable legal expenses," the court "properly denied summary judgment as to the reasonableness of the amount claimed and set the issue for trial").

Whether a party has fulfilled its contractual obligations "in good faith" is a similarly fact-specific inquiry under New York law. As this Court has recognized, because the "good faith" analysis "necessitates examination of a state of mind, [it] is not an issue which is readily determinable on a motion for summary judgment." *Credit Suisse First Boston v. Utrecht-Am. Fin. Co.*, 80 A.D.3d 485, 487 (1st Dep't 2011) (quoting *Coan v. Estate of Chapin*, 156 A.D.2d 318, 319 (1st Dep't 1989)). Trial is accordingly frequently required to determine whether a party failed to act in good faith as required by a contract's explicit terms. *See, e.g.*, *Federal-Mogul Corp. v. UTi, U.S., Inc.*, 146 A.D.3d 468, 469 (1st Dep't 2017) (reversing grant of summary judgment on breach of contract claim because "there is conflicting evidence as to whether plaintiffs … failed to negotiate in good faith"); *Terex Corp. v. Bucyrus Int'l, Inc.*, 94 A.D.3d 548, 550-51 (1st Dep't 2012) (reversing grant of summary judgment on breach claim premised on "whether defendant had engaged in good faith efforts to resolve the dispute").

In determining whether a party has complied with contractual obligations to act reasonably and in good faith, New York law endorses consideration of market practice. As the Court of Appeals has long recognized, where parties commit to act

in good faith or in a reasonable manner,[2] "the virtue of its lack of further particularization is that it invites consideration of accepted business practices as a guide." *Bankers Tr. Co. v. J.V. Dowler & Co.*, 47 N.Y.2d 128, 134 (1979); *see also id.* ("Customs and usages that actually govern the members of a business calling day-in and day-out not only provide a creditor with standards that are well recognized, but tend to reflect a practical wisdom born of accumulated experience."). Consideration of accepted industry practice is thus appropriate in assessing a breach of a reasonableness or good faith requirement "not for the improper purpose of interpreting or varying an agreement without ambiguity … but for the permissible purpose of providing guidelines for the unexplained term." *Hoag v. Chancellor, Inc.*, 246 A.D.2d 224, 230-31 (1st Dep't 1998).

In light of this precedent, Supreme Court correctly concluded that "the question of what is reasonable may require consideration of the facts and

[2] Assured appears to suggest (Br. 46, 49-50) that evidence of market custom and practice is relevant only where a contract imposes a standard of "commercial reasonableness," but not where a contract imposes a standard of "reasonableness." This Court's decision in *Hoag v. Chancellor, Inc.*, 246 A.D.2d 224 (1st Dep't 1998) makes plain that because a "reasonableness" requirement imposes an objective standard that requires consideration of the appropriate factual context, conduct under a commercial contract that imposes a requirement to act "reasonably" must be assessed in the specific context of the relevant market. *See id.* at 231 (noting that "industry norms may be appropriately considered" under contract requiring reasonable conduct); Restatement [Second] of Contracts § 228(b) (where contract does not otherwise specify degree of reasonableness required, standard of objective reasonableness is presumed to apply).

surrounding circumstances in the case" (R.65); even Assured "does not dispute this basic tenet" (Br. 33). Indeed, Assured's decision to cite no fewer than six sources of extrinsic evidence in support of its contractual arguments (*see* Br. 19, 28-29, 44-45, 47) underscores that whether Assured breached its obligation to "reasonably determine[Loss] in good faith" is a quintessential question of fact that cannot be resolved without weighing the competing evidence in the record following trial.

B. Assured Mischaracterizes The Decision Below And The Governing Legal Standard

Consistent with the legal principles set forth above, Supreme Court denied summary judgment as to Assured's calculation of Loss in light of, among other things, "market practice evidence" (R.69), "the significant discrepancy between the indicative bids and Assured's Loss calculation" (R.75), and the experts' disputes over "whether loss projections made for other business purposes constitute a reasonable basis for the measurement of Loss" and "the validity of Assured's assumptions in calculating Loss" (R.77). As Supreme Court properly recognized, each of these disputes is relevant to the dispositive question of "whether the methodology Assured actually used to calculate its Loss was reasonable and applied in good faith." R.68. On appeal, Assured offers two different arguments for ignoring this evidence, first suggesting (Br. 29-39) that Supreme Court improperly admitted parol evidence to alter unambiguous contract terms, and then faulting Supreme Court (Br. 43-50) for failing to give Assured a degree of deference in

performing its Loss calculation that has no basis in the Master Agreement or New York law. Neither of these arguments has any merit and neither provides any basis to reverse Supreme Court's decision below.

1. Supreme Court Found The Terms Of The Parties' Contract To Be Unambiguous

Assured wrongly suggests that Supreme Court considered extrinsic evidence of market practice in order to "add[] a new contractual requirement" to the definition of Loss (Br. 30) or "rewrite … unambiguous language in the contract" (Br. 32). Supreme Court did no such thing; instead, it expressly accepted Assured's argument that the Master Agreement "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" (R.68) and found that the Master Agreement is *not* ambiguous as to the Non-Defaulting Party's discretion to decide whether and how to consider market evidence—provided that discretion is exercised reasonably and in good faith (R.71). But as the Court correctly observed, in breach of contract actions no less than in myriad other circumstances, "the question of what is reasonable may require consideration of the facts and surrounding circumstances in the case." R.65; *see also Guidance Enhanced*, 146 A.D.3d at 434 ("fact-specific inquiry"). Finding a *factual* ambiguity "as to whether Loss, *under the circumstances of this case*, was 'reasonably determine[d]'" (R.66 (emphasis added)), Supreme Court concluded that evidence of "a uniform or highly consistent practice of calculating Loss in a

particular manner" is relevant and admissible not to vary the terms of the Master Agreement but instead as one "factor, among others, to be considered in assessing [Assured's] reasonableness and good faith in calculating Loss." R.71-72.

In deciding to consider this record evidence "not for the improper purpose of interpreting or varying an agreement without ambiguity, … but for the permissible purpose of providing guidelines for [an] unexplained term," Supreme Court quoted and followed this Court's precedent and instructions. R.66 (quoting *Hoag*, 246 A.D.2d at 231) (ellipses and alteration in original).[3] Assured's argument (Br. 33) that it was error to consider market practice and that its calculation was *per se* reasonable because it purports to quantify a "loss of bargain"—a conclusory assertion that by itself presents a disputed factual issue[4]—contradicts that precedent. This reading, which would render the Master Agreement's express textual requirements of reasonableness and good faith superfluous, must be rejected. *See, e.g.*, *Biotronik A.G. v. Conor Medsystems Ireland, Ltd.*, 117 A.D.3d 551, 553 (1st

[3] Assured's attempt (Br. 32-33) to distinguish *Hoag* on the ground that the Master Agreement provides a definition of Loss fails because neither that definition nor any other part of the contract provides guidelines by which reasonableness or good faith are to be assessed, instead committing that evaluation to the normal operation of New York law. *See* R.341; *Bankers Tr.*, 47 N.Y.2d at 134.

[4] Supreme Court expressly identified issues of fact regarding whether Assured's "payment model" constituted "a reasonable method for calculating Assured's loss of bargain," R.79-80, which Lehman disputes.

Dep't 2014) ("A contract should be read to give meaning and effect to each of its provisions.").

Similarly, because Supreme Court did not consider extrinsic evidence to vary contract terms but instead to assess whether triable issues existed as to Assured's breach of those terms, Assured's arguments regarding whether market practices are "notorious" (Br. 34-39) are not responsive to the actual ruling on appeal.[5] Even if Assured were correct that the parties must have "'contracted in reference' to a purported custom" for it to have relevance (Br. 35), Lehman's experts have testified that monoline insurers were aware of the market practice of considering market valuation when calculating Loss and regularly negotiated modifications to the Loss method when they wished to avoid a market-based calculation (*see, e.g.*, R.3821; R.3837-38), as Assured did for the nine trades that it terminated on a walkway basis in December 2008 (*e.g.*, R.119-20).

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[5] Assured's citation (Br. 34-35) of *Reuters Ltd. v. Dow Jones Telerate, Inc.*, 231 A.D.2d 337 (1st Dep't 1997) is particularly inapposite. In that case, the defendant cited market practices in an effort to avoid an express contractual obligation to "provide ... brokered prices" and "resist opposition by its customers to the [widespread dissemination] of their bids and other trading information," which the defendant had facially breached by "withholding large amounts of information." *Id.* at 452. Here, by contrast, Supreme Court properly recognized that evidence of established industry practice and contemporary market data are relevant and necessary in determining Assured's compliance with an express contractual term: "whether the methodology Assured actually used to calculate its Loss was reasonable and applied in good faith." R.68.

2. Assured's Proposed "Rationality" Standard Contradicts New York Law And The Terms Of The Parties' Contract

Assured has no more success in arguing (Br. 43-50) that Supreme Court should have required only that Assured's Loss calculation be "rational" and should therefore have excused Assured's inability to meet "an 'objective standard of reasonableness.'" Br. 43. Assured's proposed "rationality" standard has no basis in the text of the Master Agreement and, as Supreme Court correctly recognized, it "is overbroad and inconsistent with New York law." R.69 n.12. Supreme Court properly held Assured to the same *objective* standard that applies to any New York commercial contract imposing obligations of reasonableness and good faith.

In arguing for a mere "rationality" standard, Assured relies on English cases applying English law. Br. 46-48 (citing *Lehman Bros. Spec. Fin. Inc. v. Nat'l Power Corp.*, [2018] EWHC 487 (Comm); *Fondazione Enasarco v. Lehman Bros. Fin. SA*, [2015] EWHC 1307 (Ch); and *Peregrine Fixed Income Ltd. v. Robinson Dep't Store Pub. Co. Ltd.*, [2000] EWHC 99 (Comm)). Assured cites no New York cases applying an "any rational basis" standard to contracts imposing an obligation of reasonableness, because, as Supreme Court observed, "substantial authority" establishes that under New York law such clauses are interpreted to impose a standard of *objective* reasonableness. R.65 (citing *MBIA Ins. Corp. v. Patriarch Partners VIII, LLC*, 842 F. Supp. 2d 682, 704-05 (S.D.N.Y. 2012) (applying New York law); *Christie's Inc. v. SWCA, Inc.*, 22 Misc. 3d 380, 383-84 (Sup. Ct. N.Y.

County 2008) (same); Restatement [Second] of Contracts § 228(b) (where contract does not otherwise specify, standard of objective reasonableness is presumed to apply)).

Assured, moreover, wrongly suggests (Br. 43) that the Bankruptcy Court for the Southern District of New York "endorsed and imposed" a rationality standard in *Lehman Bros. Holdings Inc. v. Intel Corp.*, 2015 WL 7194609 (Bankr. S.D.N.Y. Sept. 16, 2015). The word "rational" does not appear in *Intel*, and the court's actual ruling was that "selecting Loss to calculate an Early Termination Payment affords the non-defaulting party discretion and flexibility in selecting the means for calculating its Loss, *subject to such methodology being reasonable and in good faith*." *Id.* at *12 (emphasis added). Indeed, despite granting summary judgment to the calculating party (on a record both parties agreed did not present issues of fact, *see id.* at *3), the court specifically rejected "Intel's internal accounting valuation … for the Transaction" and Intel's citation of "internal Lehman email" as inadequate to support Intel's motion for summary judgment. *Id.* at *21, *23. Assured's preference for a rationality standard finds no support in a decision that never purported to apply such a standard and that rejected the exact type of evidence Assured cites in support of its calculations here.

Nor does the text or structure of the Master Agreement itself support Assured's argument. Where the Master Agreement intends to grant one party

unfettered discretion, it does so; for example, the Master Agreement confers the unqualified discretion to terminate a contract following an event of default (R.334), to transfer a transaction to a guaranteed affiliate (R.357), and to buy, retain, or sell the insured Reference Obligation (R.377-78). By contrast, the Master Agreement repeatedly imposes the requirement that other actions be "reasonable" in situations where the parties would expect to be judged against an objective standard informed by accepted business practices,[6] or taken in "good faith" in situations amenable to an abuse of discretion.[7]

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[6] *See, e.g.*, R.328 (any objection to a change of account must be reasonable); R.330 (demand for a document not explicitly required to be provided must be reasonable); *id.* (efforts to obtain and maintain necessary authorizations must be reasonable); R.334 (party facing a termination event must make all reasonable efforts to cure the termination by transferring its rights and obligations to an affiliate); R.335 (settlement amounts must be evidenced in reasonable detail and calculated on or as soon as reasonably practicable following termination); R.338 (fees and expenses recovered after enforcement action must be reasonable); R.342 (market quotations must be solicited on or as soon as reasonably practicable following termination); id. (decision to use Loss despite possibility of successful Market Quotation auction must be based on reasonable belief) R.344 (fair market value of unsettled obligations as of termination date must be determined reasonably); R.357 (objection to the other party's transfer of its rights and obligations must be reasonable).

[7] *See, e.g.* R.342 (documentation requirements for replacement transactions must be set in good faith); *id.* (date and time of Market Quotation auction must be decided in good faith); *id.* (dealers polled to determine a Market Quotation must be selected in good faith); R.359 (unascertained obligations must be estimated in good faith).

The text and structure of the Master Agreement likewise refute Assured's argument (Br. 47-48) that use of the term "*commercially* reasonable" in the 2002 ISDA Master Agreement introduced an objective standard of reasonableness that does not apply to the 1992 ISDA Master Agreement. In fact, the 1992 Master Agreement expressly provides that Loss is to be used where "a Market Quotation ... would not (in the reasonable belief of the party making the determination) produce a commercially reasonable result." R.342. If Loss allowed for the calculation of a subjectively "rational" but objectively commercially unreasonable termination amount, as Assured urges, there would be no reason to use it as a fallback measure where Market Quotation already generated an objectively unreasonable result. By directing use of Loss in such a circumstance, the Master Agreement makes clear that Loss, like Market Quotation, is evaluated on a standard of objective commercial reasonableness.

Finally, even if Assured's proposed "rationality" standard were not contradicted both by the text of the Master Agreement and by an extensive body of New York law, summary judgment would still be properly denied given outstanding questions of fact regarding whether Assured's conduct even met this lesser standard. Lehman has identified evidence of Assured's pledge not to make cash payments to Lehman under any circumstances (SR.8), its *ex ante* declaration that its Market Quotation process would fail (R.3502), and its decision to skew each of the major

economic forecasts in its Loss model to its own benefit in the weeks before it terminated the Transactions (R.1298, R.1312, R.1317). Moreover, Assured has not identified any other party to a 1992 ISDA Master Agreement that employed the Loss calculation methodology Assured employed here, and so even applying the (erroneous) English-law rationality standard Assured seeks to import here, it is disputed and unresolved whether Assured "arrive[d] at a determination which no reasonable [N]on-defaulting [P]arty could come to." Br. 48 (quoting *Nat'l Power*, [2018] EWHC 487 ¶ 75).

II. SUPREME COURT PROPERLY IDENTIFIED TRIABLE ISSUES AS TO WHETHER ASSURED SELECTED ITS VALUATION METHODOLOGY AND CALCULATED THE TERMINATION PAYMENT REASONABLY AND IN GOOD FAITH

In addition to accurately identifying the fact-intensive standard by which reasonableness and good faith are measured under New York law, Supreme Court correctly applied that standard in ruling that questions of fact remain as to whether Assured breached its obligations in this case. Here, multiple unresolved issues of fact separately and independently require trial. Assured chose to value the Transactions using a methodology it had never seen used for this purpose (*e.g.*, R.3855-56, R.3863, R.3869, R.3876) and that was at odds with industry consensus about the goals of the Loss calculation (*e.g.*, R.3837). Further, Assured's idiosyncratic methodology relied upon subjective economic forecasts and assumptions (*e.g.*, R.77 n.16) that significantly diverged from market consensus

(*e.g.*, R.1288-97, R.1306-08, R.1316-17) and which Assured had adjusted in its favor in the month before it terminated the Transactions (*e.g.*, R.1297-30, R.1312, R.1314-17). As Supreme Court ruled, the parties' sharp and well-founded dispute over the reasonableness and good faith of each of these choices precludes summary judgment.

A. Triable Issues Exist As To Whether Assured Selected Its Methodology Reasonably And In Good Faith

1. Assured's Decision To Ignore Market Value Altogether Raises Triable Issues

Supreme Court correctly recognized that there are triable issues as to whether Assured acted unreasonably or in bad faith when it decided to ignore all market pricing information and to calculate Loss based solely on its own internal and subjective "payment model." R.68-72. Making specific reference to the evidence Lehman submitted indicating "a uniform or highly consistent practice of calculating Loss in a particular manner under similar circumstances" (R.71)—including evidence of practices among ISDA Master Agreement users generally (*e.g.*, R.3099) and monoline insurers specifically (*e.g.*, R.3833-45), both prior to (*e.g.*, R.3815-32) and following (*e.g.*, R.3410-13) Lehman's default—Supreme Court properly concluded that trial is required to determine "whether the methodology Assured actually used to calculate its Loss was reasonable and applied in good faith" (R.68).

On appeal, as below, Assured wrongly argues (*e.g.,* Br. 17-21, 34-39) that Lehman's evidence should not be considered sufficient to raise triable issues of fact, either because of its alleged irrelevance[8] or its alleged unreliability. Assured's argument that only monoline insurers' practice and business models are relevant to assessing its reasonableness ignores both that this very position is disputed (*e.g.*, R.3818-20) and that Lehman's experts[9] addressed exactly that industry (*e.g.*, R.3815-25, R.3833-51). These arguments are the subject of the experts' disagreement, not a basis for ignoring either party's evidence on summary judgment. *See, e.g.*, *Shillingford v. N.Y.C. Transit Auth.*, 147 A.D.3d 465, 465 (1st Dep't 2017) ("[P]laintiff's expert merely disagreed with defendants' expert's methodology and conclusions, presenting a battle of the experts for the jury to resolve."); *Ezra v. Life*

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[8] Assured contests (Br. 35-36) the relevance of post-2008 market practice, arguing that such evidence should not be used to vary the terms of the contract. As discussed above, *supra* at 30-32, that is not the purpose for which Supreme Court considered such evidence. *See* R.72 ("departure … from standard industry practice is a factor, among others, to be considered in assessing the reasonableness and good faith in calculating Loss"). Assured's failure to show that *any* of the dozens of other market participants that calculated Loss in response to the same default and in the same market adopted Assured's approach (R.3410-13) is plainly relevant to determining whether Assured selected that methodology reasonably and in good faith.

[9] Assured challenges the competence of two of Lehman's experts, both "senior executives at two other monoline insurers," to opine on "custom and practice" among monoline insurance companies with respect to valuation of credit derivatives (Br.38), but such an argument—fact-laden and contested as it is—must be resolved in pre-trial motion practice or by the fact-finder, which in this case is Supreme Court itself.

Ins. Co. of N. Am., 298 A.D.2d 267, 267 (1st Dep't 2002) ("The divergence of opinion expressed by the parties' experts precludes summary judgment."). As Supreme Court recognized, the parties sharply dispute the strength and import of the market practice evidence in the record, and accordingly the reasonableness and good faith of Assured's Loss calculation, measured against market practice, cannot be decided on summary judgment. *See, e.g. Hoag*, 246 A.D.2d at 230.

In any case, Assured's attacks on the relevance and quality of Lehman's evidence are not only meritless but further underscore the necessity for a trial to resolve the substantial factual disputes between the parties. Contrary to Assured's argument (Br. 19) that Lehman has not presented evidence of custom and practice regarding Loss calculations by monoline insurers specifically, two of Lehman's experts—the only experts who have actually been employed by a monoline—have opined that monolines understood that Loss would be "calculated on a mark-to-market basis unless the monoline negotiated a different calculation." R.3821; *accord* R.3837-38. The record indicates that where monoline insurers wanted the freedom to calculate a payment on default without reference to market prices, they negotiated for that privilege by including "walkaway" provisions that replaced Loss with alternative measures. R.3840-41. Indeed, Assured itself modified the terms of some of its ISDA Master Agreements with third parties to override Loss on default. *See* SR.35-38 (revised "Payments on Early Termination" provision). It even

modified the terms of some of the transactions it executed *with Lehman* to provide for "walkaway" valuation in certain circumstances. *E.g.*, R.119-20. But it did not renegotiate or otherwise alter its termination payment obligations with respect to the Transactions at issue. At most, Assured's reliance on its status as a monoline insurer, and its arguments regarding the supposed impact that status should have on its termination payment obligations, raise issues of fact for trial.

Similarly, Assured's argument (Br. 23-25, 37, 40-42, 53-54) that the failure of its Market Quotation auction conclusively demonstrates the unavailability of market-based pricing information erroneously assumes that bids submitted in an auction conducted according to restrictive conditions nearly two months after termination are the only source of market-based reference pricing information. That is plainly not the case, as reflected in both the indicative quotations obtained by Lehman (R.1183-92) and in the various other market-based indicators of value upon which Lehman's experts rely (*e.g.* R.3165-66 (computing mid-market values from available sources of market information); *see* R.3822 ("If no quotes are available in the market, a party would try to obtain other evidence of market prices to establish its loss, including through soliciting indicative quotes. This is standard market practice in the derivatives market.")). The fact that the Market Quotation measure uses the *average*, rather than the best, of the received quotes is further evidence that the drafters of the 1992 ISDA Master Agreement contemplated the use of indicative

quotations; if all received quotations were necessarily executable, using anything but the best received price would misprice the transaction. And quotations, whether firm or indicative, are not the only form of market data available. The Transactions all referenced underlying securities or indices from which market-based valuations could readily be derived. *See* R.1723-24. Given this evidence, Lehman has at the very least identified genuine fact issues that the fact-finder will need to resolve in determining whether Assured's decision not to consider *any* market information in its Loss calculation was reasonable and in good faith. *See* R.69.

Assured only further substantiates the propriety of denying summary judgment by citing (Br. 12-16, 53) to its own extrinsic evidence—including internal Lehman e-mails *pre-dating* the termination of the Transactions, and correspondence between Lehman and an affiliate *years after* that termination—to argue that Lehman should not be permitted to question the reasonableness of Assured's valuation methodology. As Supreme Court properly recognized, the parties sharply dispute the meaning, context, and importance of the very materials Assured cites. R.80. For example, in citing a 2011 email reflecting negotiations between Lehman and its affiliate regarding inter-affiliate trades designed to mirror the Transactions, Assured fails to note that Lehman's negotiation position with its affiliate was specifically intended to mirror Assured's own litigation position (in an attempt to keep Lehman from facing payment liability to its affiliate without receiving payment from

Assured), and thus it does not independently support that valuation's validity. R.1815. In fact, evidence cited by Assured (Br.16) makes clear that Lehman viewed these intra-affiliate trades as a "very large … payable" from the protection seller to the protection buyer. R.1822-23. Nor does Assured disclose that Lehman and its affiliate ultimately assigned hundreds of millions of dollars of market value to the Transactions, just as Lehman does now. R.4063.[10] Once again, these pieces of record evidence do not provide a basis for summary judgment, but instead raise further disputed issues of fact requiring resolution at trial.[11]

Finally, Assured's argument (Br. 50-52) that the reasonableness of its Loss calculation can be determined on summary judgment in light of general principles of damages law fails for the simple reason, acknowledged by Supreme Court (R.78-79), that a Second Method termination payment in the 1992 ISDA Master Agreement is *not* a form of damages upon a contract breach. It is instead a method

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[10] Assured cites other materials (*e.g.*, Br. 12-15) that it claims demonstrate that Lehman has previously adopted Assured's approach to the valuation of the Transactions, but those materials in fact reflect an approach to valuation—adjusting the market value of the Transactions to account for unique contractual terms and for Assured's creditworthiness—that is entirely consistent with the market-based calculation performed by Lehman's expert. *Compare* R.1077-78 and R.1088-89, *with* R.1768-82.

[11] *See Intel*, 2015 WL 7194609, at *23 ("Lehman's internal 'view' of the proper measure of … Loss is not an undisputed fact," and "[e]ven if it were undisputed, it would not be probative of the reasonableness of [the] calculation of Loss for purposes of [summary judgment].")

for determining the value of derivatives upon termination, as evidenced by the fact that a Second Method valuation, in a "fundamental departure" from common law damages, may constitute a "payment owed from the non-defaulting party to the defaulting party." *Intel*, 2015 WL 7194609 at *19; *see* R.336. Assured therefore cannot rely on damages law to justify its own departure from accepted practices in the specific context of an ISDA Loss calculation.[12] Moreover, even if the Court accepted Assured's request to replace the contract's valuation provisions with common-law damages principles, there would *still* be no basis for summary judgment, because as Supreme Court recognized, "Assured has failed to show on this motion that its methodology was consistent with such law." R.39; *see, e.g.*, *Cole v. Macklowe*, 64 A.D.3d 480, 480 (1st Dep't 2009) (where a contract breach results in "the deprivation of an item with a determinable market value, the market value at

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[12] Indeed, *Anthracite Rated Investments (Jersey) Ltd. v. Lehman Bros. Finance SA*, [2011] EWHC (Ch) 1822 (Eng.), on which Assured relies to support its invocation of damages principles (Br. 52 n.19), held precisely the opposite: "The termination payment formulae under Section 6(e) are not to be equated with, or interpreted rigidly in accordance with, the quantification of damages at common law for breach of contract. … This is, in particular, because the Second Method works both ways, and may lead to a close-out payment due to the defaulting party." *Id.* ¶ 116[3]; *see also id.* ¶ 117 ("the cost of such a replacement contract as at the breach date is likely to prove the most reliable yardstick for measuring the claimant's loss of bargain"). As noted, *supra* at 22, 31, Supreme Court identified issues of fact regarding whether Assured's "payment model" constituted a reasonable method of calculating its loss of bargain, which Lehman disputes.

the time of the breach is the measure of damages") (internal quotation marks omitted).

2. The "Cross-Check Principle" Raises Triable Issues

Supreme Court found complementary support for its conclusion that fact issues preclude summary judgment in the "cross-check principle," a test developed by English courts construing and applying the same 1992 ISDA Master Agreement executed by the parties here. R.72-75. Observing that the Master Agreement uses Loss where the parties have selected the Market Quotation measure but a Market Quotation value "cannot be determined or would not ... produce a commercially reasonable result" (R.342), the English courts concluded that "the Market Quotation and Loss clauses aim at broadly similar, although by their nature not always precisely the same, results." *Australia & New Zealand Banking Group Ltd. v. Société Générale*, [2000] CLC [CA] 833, ¶ 15 [Eng.]. Accordingly, the "outcomes derived from one may be usefully tested by way of cross-check by reference to the other." *Anthracite*, [2011] EWHC [Ch] 1822, ¶ 116[1]. As one court has observed:

> Given that the definition of the Settlement Amount [which a non-defaulting party is required to calculate under the Market Quotation measure] expressly contemplates that, if a Market Quotation cannot be determined or would not produce a commercially reasonable result, the fallback position will be a calculation of Loss, it would be very odd if the two payment measures were not intended to achieve broadly the same result ....

Britannia Bulk Plc. (in liquidation) v. Pioneer Nav. Ltd., [2011] EWHC [Comm] 692, ¶ 44 [Eng.]. In England this principle has "hardened into hornbook law," *Anthracite*, [2011] EWBC [Ch] 1822, ¶ 116 [1], and the rule has been cited favorably by the court overseeing LBHI's bankruptcy when applying New York law, *see Intel*, 2015 WL 7194609, at *16 (describing the cross-check principle as "well-reasoned").

Consistent with this approach, New York courts use the same principle of applying an alternative valuation measure to test the reasonableness of the measure actually selected. *See, e.g.*, *Penn Central Transp. Co. v. City of New York*, 42 N.Y.2d 324, 331 (1977) (approving the use of "alternative bases of valuation ... as a basis for determining the reasonableness of return"); *Brown-Conte Equities, Inc. v. Bd. of Assessors of Nassau Cty.*, 121 A.D.2d 629, 629 (2d Dep't 1986) ("the court's correlation of income approach valuation and market approach valuation were warranted by the particular evidence before it"). Similarly, federal courts applying New York law look to alternative valuation methodologies to test the reasonableness of a party's proposed valuation. *See, e.g.*, *In re Menorah Cong. & Rel. Ctr.*, 554 B.R. 675, 694-95 (Bankr. S.D.N.Y. 2016) (when a model relies on challenged assumptions, "it is worthwhile to consider an alternative valuation methodology as a reality check"); *In re Lyondell Chem. Co.*, 567 B.R. 55, 104 (Bankr. S.D.N.Y. 2017) (crediting expert's valuation analysis that was "more consistent with the views of the financing banks, management, and industry experts at the time").

Here, Lehman has identified both fact evidence (in the form of contemporaneous indicative quotations) and expert evidence (in the form of a market-based Loss calculation) establishing that a market-based valuation of the terminated Transactions generates a value that is significantly different from Assured's subjective "payment model"-based Loss calculation. R.1183-92, R.1713-61. As Supreme Court properly recognized, the discrepancy between these market-based valuations and Assured's proposed figure raises a triable question regarding the reasonableness of Assured's methodology and result. R.35.

Assured cannot support its assertion that the cross-check principle applies when the determining party uses Market Quotation but not when it calculates a Loss. Br. 39-40. Nothing in the caselaw developing and applying the cross-check principle suggests it is inapplicable where (as here) a market-based calculation is used to determine whether a party's subjective Loss determination is unreasonably divorced from market expectations. To the contrary, the cross-check principle reflects the textual relationship between Market Quotation and Loss, in which the latter serves as a fallback if the former cannot be calculated. Nothing in the contract suggests that the parties intended the valuation of a particular financial instrument to vary wildly based on whether third parties elect to bid for replacement transactions, and the operation of these provisions should not be considered in strict isolation from one another. *See, e.g.*, *Australia & New Zealand Banking Grp.*, [2000] CLC [CA]

833, ¶ 15 ("It is now common ground that the Market Quotation and Loss clauses aim at broadly similar, although by their nature not always precisely the same, results.").[13]

Assured's further contention (Br. 40) that the cross-check principle is inapplicable because its Market Quotation auction failed to produce any bids is inconsistent with its concession that the formal Market Quotation process can fail even in liquid market conditions. *See* R.74. It also presupposes that bids received in a formal Market Quotation process are the only available source of market pricing information, which is simply not true—as Lehman has demonstrated in this case, both by submitting quotations it solicited from derivatives dealers (R.1183-92), and by submitting expert evidence reflecting a market-based valuation of the Transactions using a variety of market inputs (R.1713-61).

Assured also wrongly argues (Br.41) that the indicative quotations Lehman obtained are not a reliable proxy for executable prices, and it attacks the credibility of one of the traders who provided indicative quotes (*id.* 41-42), but the weight and reliability of fact evidence and the credibility of witnesses are both matters for the fact-finder at trial. *See, e.g.*, *New Rainbow Heaven LLC v. Wesco Ins. Co.*, 163

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[13] Nor do Assured's frequent references (*e.g.*, Br. 2-4, 16, 27) to its entitlement to recover its "loss of bargain" under Loss justify disparate outcomes, as the parties explicitly agreed that Market Quotation, and not Loss, would define and quantify "the loss of bargain" if it could be ascertained. R.336.

A.D.3d 439, 440 (1st Dep't 2018). Similarly, Assured's unsupported claims (Br. 17-18, 23, 37, 41) that Lehman's expert's market valuation is unreliable or unduly subjective are arguments about "possible infirmities in the analysis," and thus "go to the weight the evidence is to be accorded at trial," rather than provide any basis for summary judgment. *Nonnon v. City of New York*, 88 A.D.3d 384, 398 (1st Dep't 2011). At most, the failure of Assured's Market Quotation auction raises an issue of fact regarding the availability of market pricing information for the terminated Transactions that precludes summary judgment.

3. The Market Context Surrounding The Termination Raises Triable Issues

Supreme Court also rightly denied summary judgment based on what it described as the "context surrounding Assured's termination of the transactions." R.41. As the court explained, it "cannot be disputed" that at termination, "the financial crisis had significantly increased the prospect of shortfalls," such that evidence in the record at least arguably "demonstrates that ratings agencies and Assured itself believed, by January 2009, that the Transactions were 'deeply in the money to [Lehman].'" R.41-42. The court went on to rule that "[w]hile there may be legitimate explanations for Assured's calculation of a termination payment to itself ... the context surrounding the termination of the Transactions raises a genuine issue of fact as to the reasonableness and good faith of Assured's calculation of its Loss." R.42.

Assured concedes (Br. 54-55) that the change in market value of the Transactions "could potentially be relevant to determining Lehman['s] loss of bargain if Assured had defaulted," but claims that it is "irrelevant to Assured's Loss" because (it argues) "Assured did not guarantee such 'market prices' ...." Assured is wrong: by agreeing to a "Second Method" two-way termination payment methodology, and by failing to substitute an alternative "walk-away" payment provision or otherwise amend its payment obligations upon termination (as it had for other transactions), Assured did in fact assume the risk and responsibility of having to make a payment *to Lehman* based on the value of the trades "as of the Early Termination Date," regardless of the identity of the defaulting party. In fact, Assured has expressly acknowledged in its filings with securities regulators that the "[r]isk of mark-to-market termination payments exists" for its credit default swap business. R.4034. Assured's determination "not ... to take any action that would result in a net cash payment to Lehman" (SR.8) thus raises another triable issue of fact as to its good faith in calculating the payment due under Second Method.

Indeed, contrary to its claims (Br. 21), it is Assured, not Lehman, that seeks a windfall here. While the parties dispute the degree to which Assured's declining creditworthiness would actually affect the market price of the Transactions (*see* R.3716-34, R.3801-04), it is clear that the deteriorating financial health of Assured and other monoline insurance companies was due directly to their failure to properly

understand and prepare for the real and significant risks they faced as a result of their credit default swap trading activity.[14] Assured's deteriorating creditworthiness is thus further evidence that the market rejected the optimistic economic forecasts and loss assumptions Assured used to reserve against its future payment liabilities. Yet Assured now claims it acted reasonably and in good faith as a matter of law when it used those same forecasts and assumptions in a Loss calculation that somehow results in Lehman having to pay Assured $23 million for credit default swaps that were worth hundreds of millions of dollars *to Lehman* when Assured voluntarily terminated them in July 2009. As Supreme Court correctly observed (R.42), Assured will have an opportunity to try to justify this result at trial; at the very least it raises questions that are sufficient on their own to warrant denial of summary judgment.

B. Triable Issues Exist As To Whether Assured Employed Reasonable And Good-Faith Assumptions In Its Calculation

Supreme Court was also correct to recognize (R.77-78) that even if Assured's *choice* of methodology could be determined to have been reasonable and in good

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[14] *See, e.g.* FIN. CRISIS INQUIRY COMM'N, Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States (Government Printing Office, 2011), at 276-78 (explaining, under chapter sub-heading "Monoline Insurers: We Never Expected Losses," how the failure of monoline insurers to account and reserve for their credit default swap-related exposure resulted in a practice of keeping "razor-thin capital" against much larger derivatives-related liabilities that in turn resulted in the downgrading of credit ratings on the monolines themselves).

faith as a matter of law (it cannot), questions of fact about Assured's *application* of that methodology separately and independently preclude summary judgment. The subjective assumptions Assured used in its model were far more optimistic than the market's contemporary projections, contradicted by observed data, and adjusted by Assured in its own favor in the weeks before they were used to calculate Loss, all of which call Assured's reasonableness and good faith into question. Supreme Court was correct to deny summary judgment on this basis as well.

Assured purported to calculate Loss by adding the value of past fixed payments owed by Lehman to the present value of the future fixed payments Lehman would have been required to pay over the lifetime of the Transactions, and then subtracting the present value of "the floating payments Assured expected to pay to Lehman International based on future shortfalls in principal or interest payments." Br. 16. In performing this calculation, Assured subjectively assumed that its floating payments "would not exceed approximately ½ of 1% of insured principal," based on the loans' characteristics and "a series of assumptions" provided by Assured itself. R.261 (Assured's experts' description of model). Lehman strongly disputes the accuracy and reliability of these assumptions.

Supreme Court noted that Assured itself has described its modeling of loss reserves—the approach it used to calculate Loss under the Master Agreement—as "an inherently subjective process involving numerous estimates, assumptions and

judgments by management." R.77 n.16 (quoting Assured's 2007 Form 10-K). In this case, each of the three critical assumptions for projecting Assured's future payments—default rate (i.e., the rate of default among the loans underlying the reference securities), loss severity (i.e., the magnitude of the loss experienced on loans that did default), and prepayment rate (i.e., the rate of prepayment on the loans underlying the reference securities)—was severely flawed and uniformly contradicted by other market participants' contemporaneous predictions.[15] Moreover, the record evidence shows that Assured had adjusted each one of these assumptions dramatically in its favor in July 2009, during the depths of the financial crisis and just before it used the new figures to calculate its supposed Loss. R.3746-48. Assured's assumptions raise, at minimum, genuine issues of material fact in this case.[16]

Default rate. From the time Lehman and Assured executed the ABX Transactions to the time Assured terminated them, the quality of the residential mortgage-backed securities underlying the ABX Transactions fell drastically: by

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[15] Assured's own expert has previously opined that the fact "[t]hat third parties have independently estimated losses is highly relevant to an assessment of the appropriateness of [a monoline insurer's] loss reserve projections." R.4147.

[16] Assured's experts defended the reasonableness of Assured's assumptions and calculations exclusively by citing assumptions and data related to the parties' two ABX Transactions (*see* R.259-64; R.273); accordingly, Lehman's expert critiqued those specific assumptions (*see* R.1199), which are the focus of the following paragraphs.

July 2009, 85% of the underlying securities were rated below investment grade, more than 20% of the mortgage pool was in default, and another 46% were either seriously delinquent or in foreclosure. R.1204-08. All of these measures were deteriorating further at the time, with delinquency rates and defaults increasing while home prices fell. R.1311. Nonetheless, in July 2009 Assured substantially *lowered* its assumed default rates (and thereby reduced its own predicted payouts) and applied its new figures in calculating its Loss against Lehman. R.1312. The results were out of step with the market and dramatically more optimistic than the forecasts of broker-dealers, rating agencies, and other monoline insurers. R.1306-08. For example, Assured assumed that only 28% to 42% of current loans would ever default, while other firms predicted 67% to 79%; Assured also predicted that 15% of the mortgages *already in foreclosure* in July 2009 would somehow never default, a view other market participants logically rejected. *Id.*

Loss severity. As of July 2009, observed loss severity (the percentage of the value of a loan that was lost upon default) for the two ABX indices replicated by the ABX Transactions was 74%. R.1281. This actually observed rate was already worse than the most "pessimistic scenario" in Assured's internal models, which forecast only a 70% loss rate on defaults. R.4191-92 (internal Assured second quarter 2009 reserve memo). Despite an observed market reality that already exceeded its model's worst-case scenario, Assured adjusted its loss severity predictions

downward in July 2009 (and thus predicted less payout by Assured), assuming an 85% chance that the rate would fall to 40% by 2012 and assuming a worst-case rate of 50% by 2014. R.1282, R.1297-1300. Because loss severity is largely driven by sales prices following foreclosure, Assured's assumptions effectively predicted a massive increase in home values over the three years following 2009. R.1286. The market (including other monoline insurers) rejected Assured's assumptions, uniformly predicting that home prices would continue to fall, resulting in projected loss severities of 67% to 76% going forward—far higher than the 40% to 50% that Assured assumed. R.1288-97.

Prepayment rate. As of July 2009, the combination of a high number of underwater loans and an unavailability of new subprime refinancing loans had driven voluntary prepayment rates (the proportion of mortgages that paid off their principle ahead of schedule) for the mortgages underlying the ABX Transactions below 2%. R.1313. Nonetheless, in July 2009 Assured increased its predicted prepayment rate dramatically (and thereby reduced its projected default payments), assuming that in the *worst-case* scenario the prepayment rate would improve five-fold to 10% within three years. R.1314-17. Other market participants predicted (as Assured had previously predicted) that prepayment rates would remain below 4%. R.1316-17.

These overly optimistic assumptions, each one skewed heavily in Assured's favor, had a multiplicative effect when combined. R.1320-23. Compared to the rest of the market, Assured assumed that fewer loans would remain at risk in the pool (due to its unreasonably high assumed prepayment rate), that fewer of the loans that did remain would require a shortfall payout (due to its unreasonably low assumed default rate), and that those payouts that were required would be lower (due to an unreasonably low assumed loss severity measure).

Rather than defend the substance of its assumptions, Assured asks this Court (Br. 56), illogically and improperly on summary judgment, to "infer" that none of these consensus-defying predictions changed the outcome of its calculations. In fact, the proper inference to draw on its motion for summary judgment is precisely the opposite—that *Assured's* failure to offer this alternative calculation establishes that any such calculation would be in Lehman's favor and would impeach Assured's Loss figure. *See Suri v. Grey Global Grp., Inc.*, 164 A.D.3d 108, 116 (1st Dep't 2018) ("[I]f there is any evidence in the record from any source from which a reasonable inference could be drawn in favor of the nonmoving party, summary judgment is improper.").

Moreover, Lehman's experts *do* expressly opine that the "combination of overly low default rates, overly low loss severities and overly high prepayment rates" resulted in "extraordinarily low estimates for losses" in Assured's calculation

model. R.1329. The record supports this conclusion: the day after Assured's termination, Barclays reported expected principal losses of between 68% and 75% on the indices replicated by the ABX Transactions, which would have equated to $359 million in losses. R.1231. The order-of-magnitude difference between this third-party estimate and Assured's projected $23 million in present value losses on the same Transactions (R.843) demonstrates the materiality of Assured's assumptions and the major questions remaining about their reasonableness and good faith. Indeed, Assured's own expert has testified that assumptions underpinning a similar model were misleading, unreliable, and unreasonable, and has admitted that independent loss estimates like those Lehman's experts have adduced are "highly relevant to an assessment of the appropriateness of loss reserve projections." R.4147.

Finally, Assured's repeated attempts (Br. 17-18, 56) to defend its assumptions and calculation by listing the payments it would, in hindsight, have been required to make to date is both legally irrelevant and wrong as a matter of fact. The Master Agreement required Assured to calculate Loss "as of" the Early Termination Date it selected (R.341), and subsequent market developments—which were necessarily unknown to Assured at the time—cannot establish whether Assured "reasonably

determine[d] in good faith" its loss or gain in 2009.[17] Moreover, as to the ABX Transactions that account for the large bulk of the parties' dispute in dollar terms, Assured's assumptions and predicted loss have proven incorrect: loss severity rose to 80% by May 2015 (R.1300-01) compared to Assured's worst-case assumption of 50% (R.1297-1300); prepayment rates averaged less than 3% between July 2009 and May 2015 (R.1319) compared to Assured's worst-case assumption of 10% (R.1314-17); and Assured's payments just through May 2015 would have totaled $44 million, far more than the $23 million that Assured assumed it would have to pay over the *lifetime* of the ABX Transactions—which would not have matured until 2035 at earliest (R.397, 433), and as to which most of the notional loan amount remains outstanding and subject to further loss (R.1235).

Supreme Court was thus correct to rule that triable issues remain as to the reasonableness and good faith of Assured's calculation, just as they separately and independently remain as to the reasonableness and good faith of Assured's choice of methodology. Whether Assured breached its contractual obligations is properly resolved by a full presentation of competing evidence, and Supreme Court did not err by requiring the parties to prove their case at trial.

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[17] For a similar reason, Assured's argument (Br. 18, 37) that the value of credit derivative transactions as of July 2009 can be measured by whether they in fact paid out over the next decade under different market conditions is fundamentally flawed; the *ex ante* value of an insurance contract is not properly measured by the amount the insured party goes on to recover in claims.

CONCLUSION

The Decision and Order should be affirmed insofar as it denied in part Assured's motion for summary judgment.

Date: October 31, 2018

Respectfully submitted,

By: *[signature]*

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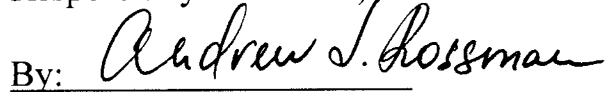
By: 

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