SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

LEHMAN BROTHERS INTERNATIONAL (EUROPE) (in administration),

Plaintiff,

- against –

AG FINANCIAL PRODUCTS, INC.,

Defendant.

Index No. 653284/2011

DEFENDANT'S REPLY MEMORANDUM IN FURTHER SUPPORT OF ITS MOTION FOR SUMMARY JUDGMENT

TABLE OF CONTENTS

Page

PRELIMINARY STATEMENT 1

ARGUMENT 4

I. ASSURED IS ENTITLED TO SUMMARY JUDGMENT DISMISSING COUNT THREE OF THE COMPLAINT BECAUSE LEHMAN INTERNATIONAL FAILS TO RAISE ANY MATERIAL FACTUAL DISPUTE THAT ASSURED CONDUCTED THE AUCTION IN GOOD FAITH 4

II. ASSURED IS ENTITLED TO SUMMARY JUDGMENT DISMISSING COUNT TWO OF THE COMPLAINT 6

A. Assured's Election To Determine Loss Based on Its "Loss of Bargain" Is Consistent With the Express Terms of the Loss Definition....................6

1. *Lehman International's Interpretation of Loss Ignores the Contractual Language* 6

2. *The So-Called "Cross-check" Principle Is Inapplicable* 8

3. *Purported Market Practice Evidence Cannot Be Used To Rewrite the Agreement* 9

B. There Is No Factual Dispute That Assured's Calculation of Its Loss of Bargain Meets the Contractual Requirements of Reasonableness and Good Faith 12

III. ASSURED IS ENTITLED TO SUMMARY JUDGMENT ON ITS COUNTERCLAIMS FOR BREACH OF CONTRACT AND FEES AND COSTS 15

CONCLUSION....................15

TABLE OF AUTHORITIES

Page(s)

Rules and Statutes

C.P.L.R. § 4547 8-9

Cases

AG Capital Funding Partners, L.P. v. State St. Bank & Trust Co.,
5 N.Y.3d 582 (2005) 10

Cohen PDC LLC v. Cheslock-Bakker Opportunity Fund, LP,
942 N.Y.S.2d 81 (App. Div. 1st Dep't 2012) 4

Eternity Global Master Fund Ltd. v. Morgan Guaranty Trust Co. of N.Y.,
375 F.3d 168 (2d Cir. 2004) 9

Fineman Family LLC v. Third Ave. N. LLC,
936 N.Y.S.2d 132 (App. Div. 1st Dep't 2011) 4

Fondazione Enasarco v. Lehman Bros. Fin. S.A.,
[2015] EWHC 1307 [Ch] 12-13

Hoag v. Chancellor, Inc., ... 10
677 N.Y.S.2d 531 (App. Div. 1st Dep't 1998)

Lehman Bros. Holdings Inc. v. Intel Corp.,
No. 08-13555 (SCC), 2015 WL 7194609 (Bankr. S.D.N.Y. Sept. 16, 2015) 8, 13

James v. Jamie Towers Hous. Co.,
743 N.Y.S.2d 85 (App. Div. 1st Dep't 2002) 7

Keiler v. Harlequin Enters. Ltd.,
751 F.3d 64 (2d Cir. 2014) 9

Law Debenture Trust Co. of N.Y. v. Maverick Tube Corp.,
595 F.3d 458 (2d Cir. 2010) 12

Matter of Midland Ins. Co.,
929 N.Y.S.2d 116 (App. Div. 1st Dep't 2011) 9

Nomura Asset Acceptance Corp. Alt. Loan Trust v. Nomura Credit & Capital, Inc.,
No. 653390/2012, 2014 N.Y. Misc. LEXIS 2905 (Sup. Ct. June 26, 2014) (Friedman, J.) 7

Portland Regency, Inc. v. RBS Citizens, N.A. 7-8
No. 2:12-CV-408-DBH, 2015 U.S. Dist. LEXIS 34771 (D. Me. Mar. 20, 2015)

SR Int'l Bus. Ins. Co. v. World Trade Ctr. Props., LLC,
467 F.3d 107 (2d Cir. 2006)........ 10

Trans-Packers Servs. Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA,
No. 651711/2010, 2014 N.Y. Misc. LEXIS 3656 (Sup. Ct. Aug. 11, 2014) (Friedman, J.) 9

Vermont Teddy Bear Co. v. 538 Madison Realty Co.,
1 N.Y.3d 470 (2004) 7

Zuckerman v. City of N.Y.,
49 N.Y.2d 557 (1980)........ 6

Court Documents

First Am. Compl., Lehman Bros. Holdings Inc. v. LCOR Alexandria LLC, No. 13-01689 (SCC) (Bankr. S.D.N.Y. Dec. 5, 2014)........ 12

PRELIMINARY STATEMENT

To oppose dismissal of its claim that Assured breached the implied covenant of good faith and fair dealing in conducting the Market Quotation auction, Lehman International relies solely on the unsupported contention that there are material disputed facts concerning Assured's "good faith" when it sought actionable market quotes.[1] Yet Lehman International identifies no evidence that raises any question concerning Assured's good faith, and it fails to provide any expert testimony to support its nitpicking challenges to Assured's auction. The undisputed truth is that no one in the market was actually willing to step into Lehman International's shoes on the terminated Transactions and face Assured as a counterparty. This is confirmed by, among other things, the failure of Lehman International's own contemporaneous attempt to conduct a Market Quotation auction, as well as its failure to find any party to whom it could novate its positions in the months before Assured terminated the Transactions.

With respect to its breach of contract claim, Lehman International also fails to identify any triable issue as to whether it was "reasonable" for Assured (i) to choose the "loss of bargain" approach to determine its Loss and (ii) to employ the same rigorously vetted assumptions it used in the ordinary course of business in its loss models when calculating such Loss. Lehman International ignores the plain language of the Agreement in its contention that Assured was somehow operating under a "fundamental fallacy" when it exercised the discretion provided to it as the Non-defaulting Party to choose to calculate its Loss based on its "loss of bargain" – an approach explicitly authorized by the Loss definition. Assured plainly had the right not to adopt a damages approach based on non-existent market quotations. This is

[1] Capitalized terms not defined herein have the meaning set forth in Defendant's Memorandum in Support of its Motion for Summary Judgment ("Opening Brief") unless otherwise noted. Exhibits 1 through 92 referenced herein are attached to the Affirmation of Kimberly J. Brunelle in Support of Defendant's Motion for Summary Judgment, dated February 22, 2016. Exhibits 93 through 104 referenced herein are attached to the Affirmation of Kimberly J. Brunelle in Further Support of Defendant's Motion for Summary Judgment, dated May 9, 2016.

especially true because the Loss definition specifically says *even when such quotes are available* "a party may (but need not) determine its Loss by reference to quotations of relevant rates or prices from one or more leading dealers in the relevant markets." Lehman International is simply playing fast and loose with the Court when it quotes the definition of "Loss" in its Opposition Brief and omits (without any indication it is doing so) the above language in the Loss definition. See Opp'n Br. 6.

Lehman International is tilting at windmills when it asserts that Assured advocates "a different set of rules" because it is a monoline. Assured's business model and practices are relevant, however, in evaluating its approach to determining and calculating its loss of bargain. As an insurance company, Assured made money based on the difference between the premiums it received and the losses it paid out over the life of its insurance contracts, not based on their trading value. The approach Assured took to calculating its loss of bargain reflected this reality of Assured's business model and used the same loss models that Assured used in its ordinary course of business, including for generating the information used for regulatory reporting purposes. Lehman International's purported evidence of market practice in favor of a contrary approach is not only irrelevant and incompetent, but also does not include even a single example of a Non-defaulting Party making a payment to the Defaulting Party after a failed auction based on a computer-generated hypothetical replacement bid.

Finally, there is no basis for Lehman International's claim that Assured engaged in "chicanery." The only "chicanery" that has occurred here is Lehman International's attempt to leverage its own default and the resulting market disruption it helped cause into a windfall recovery. As the Non-defaulting Party, Assured is entitled to a remedy that puts it in the same position – no better and no worse – as if Lehman International continued to perform. As the

Defaulting Party, Lehman International is entitled to a recovery only if Assured obtained some real tangible value by virtue of the termination of the Transactions; in that case, Assured would be required by the parties' election of two-way settlement to turn over that value to Lehman International to avoid receiving a windfall. No such value has been identified; rather, it is undisputed that Assured suffered a loss roughly equal to its claim here.

Had there been a party who was actually willing to step into Lehman International's shoes and to pay real value for the privilege of doing so, Lehman International would have been entitled to receive such value, either as a result of Assured entering into a replacement trade (thereby maintaining its benefit of the bargain) and paying over to Lehman International the additional consideration it received, or by Assured paying a Termination Amount to Lehman International equal to what such party was actually willing to pay. It is not reasonably subject to dispute that no one was willing to pay to take over Lehman International's position. Lehman International has no right whatsoever to obtain at Assured's expense the value of a hypothetical replacement trade based on the output from complex computer models that bears no resemblance to what anyone in the real world would pay to step into Lehman International's shoes. In no way would having to make such a payment be consistent with Assured's contractual right to be put in the same position as if Lehman International fully performed; indeed, if Assured had to make a payment based on Lehman International's computer models, Assured would be approximately $435 million worse off today (even taking into account anticipated future losses) than if the Agreement continued. Assured is plainly entitled to summary judgment dismissing both of Lehman International's remaining claims and granting Assured judgment on its counterclaims.

ARGUMENT

I. ASSURED IS ENTITLED TO SUMMARY JUDGMENT DISMISSING COUNT THREE OF THE COMPLAINT BECAUSE LEHMAN INTERNATIONAL FAILS TO RAISE ANY MATERIAL FACTUAL DISPUTE THAT ASSURED CONDUCTED THE AUCTION IN GOOD FAITH

Lehman International does not dispute the extensive record evidence showing that Assured and its advisors, Henderson and KPMG, designed and conducted the Market Quotation auction in good faith, including by soliciting bids from ten leading dealers and by employing uniform bidding procedures that were consistent with market practice. See Opening Br. 11-13. Instead, Lehman International advances three unsupported nitpicking complaints, which fail to suggest that Assured acted in bad faith, let alone "raise a triable issue of fact" to withstand summary judgment. Fineman Family LLC v. Third Ave. N. LLC, 936 N.Y.S.2d 132, 134 (App. Div. 1st Dep't 2011) (dismissing implied covenant claim); see also Cohen PDC, LLC v. Cheslock-Bakker Opportunity Fund, LP, 942 N.Y.S.2d 81, 82 (App. Div. 1st Dep't 2012).

First, Lehman International misleadingly asserts that Henderson lacked "relevant experience" based on selective citation to a statement by Henderson's Head of Structured Products, Jim Irvine, that he had not previously conducted a Market Quotation auction under the ISDA Master Agreement. Lehman International omits the remainder of Mr. Irvine's testimony, which makes clear that he had designed and overseen no less than six auctions between 2008 and 2010, including for similar financial products.[2] Ex. 93, Irvine Dep. 33:14-35:15. In light of that experience, as well as Henderson's established reputation as a leading financial advisory firm, there is no basis on which any reasonable factfinder could conclude that Assured's retention of

[2] Lehman International also misleadingly states that Mr. Irvine had "no opinion as to whether the result of the auction satisfied the requirements of the Market Quotation provision." Opp'n Br. 29. While Mr. Irvine appropriately declined to express a legal opinion on whether the auction satisfied those requirements, he consistently testified that Henderson's design and execution of the auction met all the factual predicates necessary for the Court to reach such a conclusion. See Opening Br. 11-12. Nor has Lehman International identified a single aspect of the auction that failed to meet the contractual requirements.

Henderson somehow evidences bad faith. Ex. 38, Henderson Report at 33-34. This is confirmed by Lehman International's failure to put forward any expert testimony to challenge the conclusion reached by Assured's expert, Craig Pirrong, that the structure and design of the auction was reasonably calculated to increase the likelihood of its success.

Second, Lehman International complains – despite Assured soliciting bids from ten other leading dealers – that Assured did not make sufficient efforts to include Nomura in the auction. The documents Lehman International cites, however, do not suggest any bad faith by Assured, but rather merely show that, unlike the other ten potential bidders, Nomura did not have a pre-existing ISDA Master Agreement with Assured and was unable to negotiate an agreement in time to participate. See Ex. 94, Irvine Dep. 128:18-130:5. Further, contrary to Lehman International's speculation, the record confirms that Nomura's absence was immaterial: Just weeks before the auction, Lehman International itself had attempted to solicit actionable quotations from Juan Quintas, a Nomura trader who previously worked at Lehman International and knew the Transactions well because he had tried and failed to find parties willing to step into Lehman International's shoes, but Mr. Quintas explicitly refused to provide a firm bid to his former colleagues.[3] Ex. 65, J. Quintas Email, at 1. His refusal is consistent with the overwhelming record evidence that potential bidders declined to bid based largely on their "lack of appetite to purchase protection on the specific high-quality reference obligations at issue from a monoline insurer during the financial crisis." See Opening Br. 11-13.

Finally, Lehman International's conclusory assertions that the bidding procedures

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[3] Indeed, while at Lehman International, Mr. Quintas, as the trader primarily responsible for valuing the Transactions, drafted an internal memorandum acknowledging that the true value of the Transactions was "a fraction of any estimate based on standard terms," and that appetite for these Transactions was "severely limited." Ex. 55, Assured Guarantee—LBIE Swap Exposure Valuation and Alternatives. The non-actionable bid he offered on behalf of Nomura in which he pretended not to know the identity of the counterparty to the trades was plainly an accommodation bid and is not entitled to any weight. See Ex. 64, Pirrong Rebuttal Report at 10-11.

caused "confusion" are also unsupported. Opp'n Br. 11, 29. Among the extensive communications involving Assured, Henderson and ten potential bidders, Lehman International cites to only two emails, neither of which suggests general confusion or any improper or collusive conduct by Assured. To the contrary, these emails simply appear to identify various reasons why two bidders were considering not submitting bids, including because they were unwilling to face Assured given the bespoke terms of the Transactions (e.g., "no collateral posting" by Assured). Pl.'s Ex. 31, BARC00000003.[4] In any event, Lehman International must demonstrate "by admissible evidence the existence of a factual issue," Zuckerman v. City of N.Y., 49 N.Y.2d 557, 560 (1980), and cannot rely on these emails as they are inadmissible hearsay as to which there has been no testimony.

II. ASSURED IS ENTITLED TO SUMMARY JUDGMENT DISMISSING COUNT TWO OF THE COMPLAINT

A. Assured's Election To Determine Loss Based on Its "Loss of Bargain" Is Consistent With the Express Terms of the Loss Definition

1. Lehman International's Interpretation of Loss Ignores the Contractual Language

Lehman International does not identify a single factual dispute relevant to deciding whether the Agreement permits Assured to determine its Loss based on its "loss of bargain," i.e., the amount necessary to place Assured in the same economic position it would have been in had Lehman International fully performed its obligations under the Agreement. See Opening Br. 16-20. The Court need look no further than the unambiguous text of the Agreement – which Lehman International conspicuously fails to address – to decide this question. The Loss definition expressly provides a non-exhaustive list of methods that the Non-defaulting Party may

[4] Exhibits attached to the Affirmation of James H.R. Windels in Opposition to Defendant's Motion for Summary Judgment, dated April 8, 2016, are referred to herein as "Pl.'s Ex."

choose to determine its Loss, including the "loss of bargain" approach that Assured used here. Ex. 7, Master Agreement § 14 ("Loss" definition). Critically, the final sentence of the definition expressly disclaims any requirement that Assured determine Loss "by reference to quotations of relevant rates or prices from one or more leading dealers in the relevant markets." Id.[5]

Lehman International's contention that Loss requires Assured to use a hypothetical pricing model supposedly derived from market quotes must be rejected, as well-settled New York principles of contractual interpretation establish that "courts may not by construction add or excise terms, nor distort the meaning of those used and thereby make a new contract for the parties under the guise of interpreting the writing." Vermont Teddy Bear Co. v. 538 Madison Realty Co., 1 N.Y.3d 470, 475 (2004); see also Nomura Asset Acceptance Corp. Alt. Loan Trust v. Nomura Credit & Capital, Inc., No. 653390/2012, 2014 N.Y. Misc. LEXIS 2905, at *29 (Sup. Ct. June 26, 2014) (Friedman, J.). The only case cited by Lehman International on general principles of contract interpretation confirms this point, holding that where "the alternative reading of the contract advocated by plaintiffs unreasonably creates multiple internal inconsistencies, there is no question of contract construction to be submitted to a jury." James v. Jamie Towers Hous. Co., 743 N.Y.S.2d 85, 88 (App. Div. 1st Dep't 2002).

Moreover, the principal case Lehman International cites for the proposition that the discretion afforded the Non-defaulting Party under the ISDA Master Agreement is "limited" does not help its position. Opp'n Br. 13. That case actually held that such discretion is limited only by the requirement that Loss must be "reasonably determine[d] in good faith," and that the Loss definition permits the Non-defaulting Party to "determin[e] what elements to include, or whether to refer to relevant rates from leading dealers." Portland Regency, Inc. v. RBS Citizens,

[5] Lehman International's own expert, Cynthia Parker, candidly testified in her deposition that the Loss definition, by its terms, "does not require" Assured to look to rates in the market to calculate Loss. Ex. 70, Parker Dep. 82:16.

N.A., No. 2:12-CV-408-DBH, 2015 U.S. Dist. LEXIS 34771, at *21, n.18 (D. Me. Mar. 20, 2015). This is consistent with Intel, the only other U.S. case interpreting the Loss definition cited by Lehman International, which also explicitly holds that it is well within a party's discretion not to use market quotations in determining Loss. See Lehman Bros. Holdings Inc. v. Intel Corp., No. 08-13555 (SCC), 2015 WL 7194609, at *11 (Bankr. S.D.N.Y. Sept. 16, 2015).[6]

2. The So-Called "Cross-check" Principle Is Inapplicable

In its attempt to avoid the plain meaning of the Loss definition, Lehman International invokes the so-called "cross-check" principle. The notion that Loss and Market Quotation "should achieve broadly the same result," Opp'n Br. 16 – which is not a legal principle that any U.S. court has ever applied – by definition has no relevance here because the Market Quotation auction yielded no result. Although citing this principle, Lehman International actually attempts a bait-and-switch by suggesting that rather than comparing Assured's Loss calculation against actual market quotes (which is impossible since there were none), the Court should compare it against the non-actionable accommodation bid Lehman International solicited or the amount generated by its litigation expert's hypothetical pricing model. This suggestion not only directly contradicts the final sentence of the Loss definition, but it has never been adopted by any court based on the "cross-check" principle (or any legal principle for that matter).

In any event, the reasonableness of both Assured's methodology and results can be "cross-checked" based on their consistency with Lehman International's own methodology and results. Lehman International put forth the same methodology as Assured to determine a zero valuation for the identical back-to-back transactions with its affiliate LBSF. See Ex. 86, L. Summerfield Email. Contrary to Lehman International's argument, CPLR § 4547 does not

[6] None of the non-U.S. cases cited by Lehman International, see Opp'n Br. 13, reject the principle that a Non-defaulting Party may determine Loss based on its loss of bargain.

preclude the Court from considering evidence of settlement negotiations regarding a claim between Lehman International and a third party. In fact, controlling case law establishes that such evidence is admissible where, as here, "it is offered to refute [a party's] claims by showing that [the party], in other proceedings, utilized the [] methodology it seeks to challenge . . . in this proceeding." Matter of Midland Ins. Co., 929 N.Y.S.2d 116, 121 (App. Div. 1st Dep't 2011). Lehman International also reached a result similar to Assured's Loss calculation in its own 2009 internal analysis, in which its current Joint Administrator concluded that the Transactions have little to no value to Lehman International. See Ex. 85, P. Copley Email.

3. Purported Market Practice Evidence Cannot Be Used To Rewrite the Agreement

Lehman International concedes that a court should only resort to extrinsic evidence "to assess ambiguity" in the governing contract. See Opp'n Br. 15. Lehman International fails, however, to identify any ambiguity in the Loss definition on the issue of whether Assured was entitled to use a "loss of bargain" approach, which the definition plainly allows.[7] Ex. 7, Master Agreement § 14 ("Loss" definition). In the face of this unambiguous language, all of Lehman International's purported market practice evidence is irrelevant, as it is well-settled that "when parties set down their agreement in a clear, complete document, their writing should . . . be enforced according to its terms," Trans-Packers Servs. Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA, No. 651711/2010, 2014 N.Y. Misc. LEXIS 3656, at *5 (Sup. Ct. Aug. 11, 2014) (Friedman, J.), and that "industry practice may not be used to vary th[ose] terms." Keiler v. Harlequin Enters. Ltd., 751 F.3d 64, 69 (2d Cir. 2014).[8]

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[7] Lehman International misleadingly cites Eternity Global Master Fund Ltd. v. Morgan Guaranty Trust Co. of N.Y., 375 F.3d 168, 173 (2d Cir. 2004), to suggest that the court found ambiguity in the ISDA Master Agreement generally, when in fact that case addressed potential ambiguity in a provision of the ISDA Master Agreement that is not at issue here, i.e., the definition of restructuring events. Id. at 178-79.

[8] Lehman International cites several cases that considered market practice evidence in evaluating whether a party fulfilled a duty to act reasonably. Those cases have no relevance to the question of contract interpretation presented

Furthermore, evidence of custom and usage can only be considered if it is established that "the term in question has a fixed and invariable usage" and "the party sought to be bound was aware of the custom, or that the custom's existence was so notorious that it should have been aware of it" when the contract was entered. SR Int'l Bus. Ins. Co. v. World Trade Ctr. Props., LLC, 467 F.3d 107, 134 (2d Cir. 2006). Lehman International's purported market practice evidence is not only irrelevant, but is also incompetent because it fails on multiple levels to meet these exacting standards.

First, the organization that speaks for the industry, ISDA, has explicitly rejected Lehman International's one-size-fits-all view of market practice and taken the position that the Loss definition grants wide discretion to the Non-defaulting Party in calculating Loss in both its 1992 User Guide and in court filings, see Opening Br. 18-19, which are clearly better evidence of ISDA's official views than the single remark by an employee plucked from comments made at a symposium, on which Lehman International attempts to rely, see Opp'n Br. 2-3, 20-21. Additionally, Lehman International itself took the position that its back-to-back transactions with LBSF should be valued *using the same approach that Assured used, yielding a near identical value*. In explaining why the market-based approach was invalid, Lehman International's lead negotiator, Lisa Summerfield, specifically stated that "no market participants were willing or able to provide a valuation of these positions," Ex. 86, L. Summerfield Email; she did not even attempt to justify her position by referring to the parties' side letter, contrary to Lehman

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here, where the contract expressly permits Assured to follow the approach it chose and disavows any requirement to follow the approach Lehman International advocates. See Opp'n Br. 14-15. Indeed, Hoag v. Chancellor, Inc., on which Lehman International relies, reaffirms that industry practice is not permitted "for the improper purpose of interpreting or varying an agreement without ambiguity." 677 N.Y.S.2d 531, 535 (App. Div. 1st Dep't 1998). Moreover, Lehman International erroneously asserts that the Court of Appeals rejected this well-settled principle in AG Capital Funding Partners, L.P. v. State St. Bank & Trust Co., when in fact it merely held that such evidence could be used for a different purpose at the pleading stage, namely to support an independent allegation that a third party, Davis Polk, had assumed and breached an extra-contractual duty. 5 N.Y.3d 582, 593-94 (2005).

International's post hoc rationalization. See Opp'n Br. 24-25. Further, Lehman International confirmed in its interrogatory responses that the global settlement agreement "did not attribute specific values to the Back-to-Back transactions either individually or in the aggregate," Ex. 95, Def.'s Third Set of Interrogs. No. 23, nor did it attempt to do so in its reports to its creditors, see Ex. 96, Joint Admins.' Seventh Progress Report at 20-21. Thus, the self-serving deposition testimony by Ms. Summerfield in response to her counsel's question that she subjectively viewed the settlement as attributing significant value to the back-to-back transactions carries no weight.

Second, Lehman International's own expert, Leslie Rahl, testified in another matter that a Non-defaulting Party was not required – and should not even be permitted – to use a market-based model (similar to the one used here by Lehman International's expert, Peter Niculescu) for pay-as-you-go derivatives transactions given the market conditions in 2009. Not only did Ms. Rahl testify that the use of cash flow projections was the most appropriate means of determining Loss in those circumstances, but she also specifically noted that Barclays and many other financial institutions used that methodology. Ex. 97, Rahl Rebuttal Report at 19-20, Barclays PLC v. Devonshire Trust; Ex. 98, Rahl Report at 9, Barclays PLC v. Devonshire Trust.[9] Nor can Lehman International rely on the testimony of its purported experts, Evy Adamidou and Cynthia Parker, for market practice evidence regarding the calculation of Loss since both testified that they have had no experience calculating a settlement amount under the Loss provision. See Ex. 99, Parker Dep. 69:25-70:4; Ex. 100, Adamidou Dep. 46:17-47:8.

Third, Lehman International's self-serving declaration referencing a number of close-outs with other counterparties since 2008 is legally irrelevant because, as noted above, market practice evidence that postdates the execution of the Transactions could not have been

[9] Because Ms. Rahl was offering an opinion on behalf of the Defaulting Party, she also included a "normalized risk premium" in her calculation "to be conservative," id. at 11, which would more fully reflect the additional cost the Non-defaulting Party would incur to replace the position in a normal market.

"known to the parties" at the time they entered into the Agreement. Law Debenture Trust Co. of N.Y. v. Maverick Tube Corp., 595 F.3d 458, 466 (2d Cir. 2010) (citing Belasco Theatre Corp. v. Jelin Prods., Inc., 59 N.Y.S.2d 42, 46 (App. Div. 1st Dep't 1945)). Moreover, the declaration does not even purport to disclose the actual methodologies used by counterparties, and one need look no further than the rampant litigation by various Lehman affiliates in the wake of their insolvency to see the true range of approaches that their counterparties have employed. See, e.g., Intel, 2015 WL 7194609, at *10 (upholding Loss determination based on initial transaction costs); First Am. Compl. at ¶ 29, Lehman Bros. Holdings Inc. v. LCOR Alexandria LLC, No. 13-01689 (SCC) (Bankr. S.D.N.Y. Dec. 5, 2014) (Lehman affiliate alleging that Loss should be determined "based on the present value of the net discounted cash flows to maturity").[10]

B. There Is No Factual Dispute That Assured's Calculation of Its Loss of Bargain Meets the Contractual Requirements of Reasonableness and Good Faith

Lehman International has not disputed that the governing legal standard, as set forth in the Enasarco and Intel decisions, requires the Court to uphold Assured's calculation of its loss of bargain so long as there is any rational basis for that calculation. See Opening Br. 21-22. Similarly, Lehman International does not dispute that Assured determined its Loss by using the same discounted cash flow methodology that it used to calculate losses for multiple business, accounting, and regulatory purposes in the ordinary course, and that this methodology underwent rigorous review both internally and externally. Id. That undisputed fact alone more than satisfies the rational basis test and thus precludes Lehman International from further challenging the reasonableness of Assured's Loss calculation. See Fondazione Enasarco v. Lehman Bros.

[10] Lehman International quotes a handful of irrelevant statements by Assured employees, see Opp'n Br. 23, which merely acknowledge the noncontroversial fact that, if Assured were hypothetically to default on a transaction under an ISDA Master Agreement, its counterparty would typically be entitled to calculate the amount due on termination (e.g., by conducting a Market Quotation auction). None of these statements even address how such a determination would be made if a Market Quotation auction failed to generate bids, let alone suggest that the ISDA Master Agreement precludes a Non-defaulting Party from determining Loss based on its loss of bargain.

Fin. S.A. [2015] EWHC 1307 (Ch) ¶ 53; Intel, 2015 WL 7194609, at *10.

Without providing any legal basis for doing so, Lehman International implicitly invites the Court to apply a more exacting standard of review and to scrutinize each of the individual inputs that Assured used as part of its ordinary course loss projections. The Court should decline this invitation as it is not only unsupported by law, but also fundamentally inconsistent with the plain language of the Agreement and the overarching commercial objectives of the ISDA regime. As Professor Jeffery Bruce Golden, one of the principal drafters of the 1992 ISDA Master Agreement, has explained, the Loss definition is intended to provide a "contractual privilege for the non-defaulting party to make its own determination, and . . . the situations when a court would interfere with the exercise of that contractual discretion would be extremely limited." Ex. 74, Golden Report ¶ 41. Professor Golden explained that "mitigating the risk of fact-specific disputes and the attendant risk of protracted litigation" was a central "commercial objective . . . in drafting the ISDA standard-form documents." Id. ¶ 38.

In any event, Lehman International's complaints about Assured's methodology for calculating its Loss are meritless. The total losses that Assured projected at the time of Termination are consistent with other contemporaneous projections, most notably Lehman International's own internal projections of minimal expected losses on the Transactions. See e.g., Ex. 85, P. Copley Email, supra at 9; Ex. 86, L. Summerfield Email, supra at 10, 13; Ex. 55, Assured Guarantee—LBIE Swap Exposure Valuation and Alternatives, supra at n. 3; see also Opening Br. 14, 28-30. Additionally, contemporaneous analysis by Standard & Poor's that Dr. Niculescu reviewed but chose not to include in his purported table of comparisons predicted collateral losses on the subprime ABX similar to what Assured did. Compare Ex. 101, S&P Ratings Direct Article, at 4, with Ex. 68, Niculescu Rebuttal Report, ¶ 342 & Ex. 62.

Similarly, even if the Court were to engage with this legally improper line of inquiry, Lehman International has not set forth any valid criticism of the individual inputs that Assured used in its Loss model. For example, Lehman International has criticized Assured's inputs for the loss severity rate as overly optimistic, see Opp'n Br. 26; however, as Assured's expert, David Prager, explained in his initial report, Assured used loss severity rates that were consistent with those used by Syncora and Ambac, the only monolines that publicly reported their loss severity assumptions. See Ex. 4, Goldin Report ¶ 56, App. I. Furthermore, Lehman International's criticism that the prepayment rates used by Assured "understated the extent of projected losses on the ABX transactions," Opp'n Br. 27, demonstrates the peril of the Court permitting this type of nitpicking. In fact, despite Lehman International's unfounded suggestion to the contrary, the higher prepayment rate that Assured used had the effect of increasing (not decreasing) its loss projections. See Ex. 104, Prager Dep. 86:14-87:25, 89:25-90-13.[11]

Finally, as shown in the chart below, Assured's calculations have proven remarkably accurate, and far more accurate than the predictions by Lehman International's expert, Dr. Niculescu.[12] Lehman International suggests that, in addition to the actual losses incurred to date, the Court should also consider Assured's current projected losses; however, Lehman International has improperly inflated these numbers by failing to discount the figures to

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[11] Lehman International attempts to support its criticisms by misrepresenting testimony by Assured's expert, Jay Goldin, in a prior matter, ABN Amro Bank N.V. v. Eric Dinallo. Lehman International fails to mention that this matter did not concern a determination of Loss, but rather the New York State Department of Insurance's consideration of MBIA's proposed transformation. In that context, Mr. Goldin analyzed whether the assumptions used by MBIA to calculate the adequacy of its solvency cushion provided an appropriate basis for effectively rewriting the terms of its existing contracts with policy-holders. See Ex. 102, Goldin Dep. 109:15-24; Ex. 103, Goldin Dep. 119:21-121:4.

[12] Lehman International's expert, Ms. Rahl, has previously endorsed precisely this type of analysis, explaining that "one way to think about whether the mark-to-model approach or the cash-flow approach is more appropriate under the circumstances is to look at what has happened . . . and which valuation methodology was more accurate when back-tested with knowledge of subsequent events." See Ex. 98, at 94. Of course, such back-testing is only relevant as a "ballpark" check of reasonableness. Lehman International, which has not paid premiums on these contracts for the last eight years, is not actually entitled to be reimbursed for such losses. Nor could Assured adjust its Loss calculation in its favor if losses had turned out to be slightly less than it projected.

2009 levels. See Opp'n Br. 28. After correcting for this mistake, Assured's actual losses plus currently projected losses total $62 million, or roughly 1% of the $5.7 billion of insured notional principal. Assured's original loss estimate of $23.4 million thus remains within one percentage point of total accuracy. In stark contrast, Dr. Niculescu's Loss calculation reflects losses of $497.5 million,[13] which overstates the current actual and projected losses by more than 800%.

Comparison of Parties' Loss Projections to Actual Losses (in millions)[14]					
Total Notional	**Lehman International's Internal Projected Losses**	**Assured's Projected Losses** (as of Termination)	**Lehman International's Expert's Loss Calculation**	**Actual Losses** (as of March 2015)	**Additional Projected Losses** (as of March 2015)
$5,676	$0	$23.4	$497.5	$34.6	$27.8

III. ASSURED IS ENTITLED TO SUMMARY JUDGMENT ON ITS COUNTERCLAIMS FOR BREACH OF CONTRACT AND FEES AND COSTS

For the reasons stated above, there can be no material factual dispute that Assured reasonably and in good faith calculated its Loss in connection with the Transactions. Assured is therefore entitled to summary judgment on its counterclaim for breach of contract with an award of damages in the amount of $24,799,972.85 plus interest, and its counterclaim seeking attorneys' fees and costs in an amount to be later determined by this Court.

CONCLUSION

For the foregoing reasons, Defendant respectfully requests the Court grant Defendant's Motion for Summary Judgment in its entirety.

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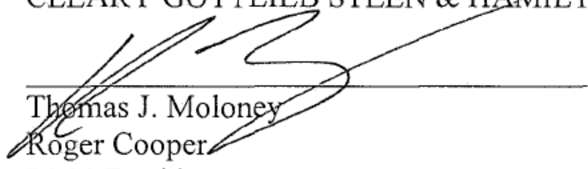
[13] Dr. Niculescu concedes that his hypothetical model valuation would have to be reduced substantially to account for the cost of purchasing protection against the risk of Assured's default, and thus calculates a Loss value of $213.7 million (excluding unpaid premiums Lehman International owed to Assured). Ex. 82, Niculescu Report ¶¶ 17, 26, Erratum (Changes in text ¶ 1).

[14] All amounts are shown in present value dollars as of the Early Termination Date in 2009. See Ex. 86, L. Summerfield Email (Lehman International's Internal Projected Losses); Ex. 40, Statement of Calculations (Assured's Projected Losses); Ex. 82, Niculescu Report (Lehman International's Expert's Loss Calculation); Pl.'s Ex. 56, ABX Check.xlsx (Actual Losses, Additional Projected Losses).

May 9, 2016

Respectfully submitted,
CLEARY GOTTLIEB STEEN & HAMILTON LLP



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