
New York Supreme Court
Appellate Division—First Department

LEHMAN BROTHERS INTERNATIONAL (EUROPE)
(in Administration),

**Appellate
Case No.:
2023-03409**

Plaintiff-Appellant,

– against –

AG FINANCIAL PRODUCTS, INC.,

Defendant-Respondent.

**MOTION FOR LEAVE TO REARGUE, OR IN THE
ALTERNATIVE, LEAVE TO APPEAL TO THE
NEW YORK STATE COURT OF APPEALS**

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SUPREME COURT OF THE STATE OF NEW YORK
APPELLATE DIVISION, FIRST DEPARTMENT

LEHMAN BROTHERS INTERNATIONAL
(EUROPE) (IN ADMINISTRATION),

Plaintiff-Appellant,

-against-

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Defendant-Respondent

Appellate Division Case/Docket
No. 2023-03409

Originating Court
Index No. 653284/2011

**NOTICE OF MOTION FOR LEAVE
TO REARGUE, OR IN THE
ALTERNATIVE, LEAVE TO
APPEAL TO THE NEW YORK
COURT OF APPEALS**

PLEASE TAKE NOTICE that, upon the annexed affirmation of David S. Mader, dated April 15, 2024, and the Decision and Order of this Court dated March 14, 2024, attached as Exhibit A thereto; the accompanying Memorandum of Law; the Record on Appeal and briefs filed in the above-captioned matter; and all prior proceedings heretofore had herein, Plaintiff-Appellate Lehman Brothers International (Europe) (in administration) will move this Court, at a Term of the Appellate Division, First Department, to be held at the Courthouse thereof located at 27 Madison Avenue, New York, New York, on Wednesday May 1, 2024, at 10:00 a.m., or as soon thereafter as counsel can be heard, for (1) an order pursuant to CPLR 2221(d) and 22 N.Y.C.R.R. § 1250.16(d)(2) granting leave to reargue this Appeal, or (2) alternatively, an order pursuant to CPLR 5602(b)(1) and 22 N.Y.C.R.R. § 1250.16(d)(3) granting leave to appeal to the Court of Appeals from the aforesaid Decision and Order of this Court, on the ground that questions of law have arisen that should be reviewed by the Court of Appeals.

PLEASE TAKE FURTHER NOTICE that pursuant to CPLR 2214(b), answering papers and any notice of cross-motion with supporting papers, if any, are required to be served upon the undersigned at least seven (7) days prior to the return date of this motion.

Dated: New York, New York
April 15, 2024

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New York Supreme Court
Appellate Division—First Department

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**MEMORANDUM OF LAW IN SUPPORT OF MOTION FOR
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PRELIMINARY STATEMENT

Plaintiff-Appellant Lehman Brothers International (Europe) (in administration) (“LBIE”) respectfully submits this memorandum of law in support of its motion for leave to reargue or, in the alternative, leave to appeal to the New York Court of Appeals from the Decision and Order of this Court dated March 14, 2024 (NYSCEF No. 30) (the “Decision”).¹

The Decision—which involves the interpretation of “one of the most widely used forms of agreement in the world,” *Lomas et al. v. JFB Firth Rixson, Inc.*, [2010] EWHC 3372, ¶53, governing hundreds of trillions of dollars of financial derivatives, *JPMorgan Chase Bank, N.A. v. Godfrey Ltd. P’ship*, No. 602920/2008, 2012 WL 10007863, at *9 (Sup. Ct. N.Y. County July 16, 2012) (Kornreich, J.S.C.)—affirmed a Decision after Trial (Mader Aff. Ex. B) and subsequent Judgment (Mader Aff. Ex. C) of the Supreme Court, New York County (Crane, J.S.C.) awarding Defendant-Appellee AG Financial Products, Inc. (“AGFP”) damages and interest on counterclaims for breach of contract.

The Decision warrants reargument or leave to appeal. *First*, by affirming the Decision After Trial, the Decision departs from well-settled New York law—including prior rulings on summary judgment and interlocutory appeal *in this case*—

¹ A true and correct copy of the Decision with Notice of Entry is attached as Exhibit A to the Affirmation of David S. Mader, filed concurrently herewith (“Mader Aff.”).

that a contractual provision requiring performance of an obligation in a “reasonable” manner imposes an *objective* standard of reasonableness. Here, AGFP applied a valuation methodology that was inherently and admittedly *subjective*: it knowingly and intentionally disregarded all available market evidence, and instead assigned a termination value to the financial instruments at issue based solely on its own internal and subjective projections regarding their supposed worth. By blessing this completely unprecedented and entirely self-serving valuation, the Decision eviscerates the limits that New York law places on the discretion enjoyed by valuing parties in AGFP’s position, and it deprives counterparties and reviewing courts of the ability to challenge or test those valuations.

Second, by affirming the Decision After Trial, the Decision departs from well-settled New York law, as well as the uniform rulings of courts in other jurisdictions, that where, as here, a party purports to calculate Loss under an ISDA Master Agreement by reference to loss of bargain, the value of that bargain is properly measured or “cross-checked” by reference to market prices. Here, despite electing at the time of contract formation to calculate the termination value of the parties’ derivatives based on market prices, and despite expressly invoking the ISDA Master Agreement’s language permitting valuation based on loss of bargain, it is undisputed that AGFP adopted a valuation that wholly ignored market prices and other indicia of market value. By affirming the Decision After Trial and its ruling that market

prices were “irrelevant,” the Decision directly contradicts both well-settled principles of New York law and the uniform ruling of federal courts and courts in other jurisdictions interpreting the *exact same contract* to require a valuation consistent with market value.

By departing from well-settled New York law and the uniform approach of courts interpreting this globally important commercial contract, the Decision and the Decision After Trial undermine the consistency and predictability that are critical to the continued operation of the multi-trillion dollar financial derivatives market. As the global center of the financial industry, New York has a particular interest in ensuring that commercial contracts, including especially the ISDA Master Agreement, are interpreted correctly and in a manner that promotes stability and predictability. A failure by the courts of New York to reimpose limits on a valuing party’s discretion risks shifting the locus of this multi-trillion dollar industry overseas. In light of the global importance of the ISDA Master Agreement, and to ensure consistency with prior decisions of the Court of Appeals and the Appellate Division, reargument or leave to appeal is warranted.

STATEMENT OF ISSUES PRESENTED

Pursuant to 22 N.Y.C.R.R. § 1250.16(d), Plaintiff-Appellant states that it intends to raise the following questions of law on appeal to the Court of Appeals:

1. May a party subject to a contractual obligation to perform a valuation “reasonably” do so based on its own subjective view of value, notwithstanding prior rulings of this Court—including in this case—that an objective standard of reasonableness applies to a contractual provision requiring performance of an obligation in a reasonable manner?

2. May a party to an ISDA Master Agreement calculate Loss, as a fallback to Market Quotation and based on loss of bargain, without regard to and in an amount that differs materially from the market-derived value of the terminated derivatives, contrary to longstanding precedent that loss of bargain is measured by reference to market price, and “hornbook law” that the ISDA Master Agreement’s Market Quotation and Loss methodologies are intended to produce the same or broadly similar valuations?

STATEMENT OF FACTS

A. The ISDA Master Agreement

This case centers on the interpretation of the ISDA Master Agreement, a standard form contract published by the International Swaps and Derivatives Association. It is “probably the most important standard market agreement used in the financial world.” *Firth Rixson*, [2010] EWHC 3372, ¶53. It is estimated to govern more than 90% of all derivatives transactions, with the “vast majority” documented using the exact version at issue in this case. *In re Lehman Bros. Int’l Europe (in administration)*, [2016] EWHC 2417, ¶27. It has “been used over several decades as the basis for countless over-the-counter derivative transactions with a combined notional value of hundreds of trillions of dollars.” *Godfrey*, 2012 WL 10007863, at *9. Indeed, this case alone involves derivatives with a notional value of \$5.7 billion, which AGFP itself determined were worth \$438 million to LBIE in June 2009—an amount that, with interest, would entitle LBIE to a payment of more than \$1 billion, as opposed to the more than \$100 million it would ultimately owe AGFP if the Decision is upheld. *See* A8852.²

Because of its “prevalence and fundamental importance to the financial system,” *Godfrey*, 2012 WL 10007863, at *9, it is now “axiomatic that it should, as

² All citations to “A__” herein are references to the Appendix submitted in this Appeal, NYSCEF Nos. 4-21.

far as possible, be interpreted in a way that serves the objectives of clarity, certainty and predictability, so that the very large number of parties using it should know where they stand.” *Firth Rixson*, [2010] EWHC 3372, ¶53; see *Lehman Bros. Holdings Inc., et al. v. Intel Corp.*, No. 08-13555, 2015 WL 7194609, at *11 (Bankr. S.D.N.Y. Sep. 16, 2015) (same).

The ISDA Master Agreement allows parties to elect, at the time of contract formation, the manner in which their derivatives trades will be valued in the event of an early termination resulting from an Event of Default by one of the parties. *Intel*, 2015 WL 7194609, at *6; A7141-42. Here, the parties agreed that in the event of such an early termination, their derivatives would be valued in the first instance by reference to the ‘Market Quotation’ method, which assigns a value based on the market price of the derivatives as determined through a poll of derivatives dealers. A7160. They also agreed that if (as often happened) the strict requirements of the Market Quotation method could not be satisfied, the derivatives would instead be valued “as of” the date of termination according to the ‘Loss’ method. A7148. And they agreed that the valuation would be subject to the “Second Method” approach, A7160, a no-fault two-way payment provision that requires a non-defaulting party to make a termination payment to the defaulting party if an early termination results in a gain to the non-defaulting party—for example, by relieving the non-defaulting party “of the requirement to perform its obligations” under “a disadvantageous”

derivatives trade. *Peregrine Fixed Income Ltd. v. Robinson Dep't Store Public Co.*, [2000] EWHC Comm. 99, ¶¶29-30; A7141-142.

B. The Parties' Credit Default Swaps

Between August 2005 and May 2008, LBIE and AGFP entered into the 28 derivatives trades at issue here. These derivatives took the form of “credit default swaps” in which LBIE, as buyer, agreed to make a series of periodic fixed payments to AGFP, in return for AGFP’s promise to cover up to \$5.7 billion in shortfalls of principal and interest suffered by a referenced group of financial products, including securities backed by U.S. subprime mortgages, British residential mortgages, and risky “high yield” commercial loans. *See generally* A7208-587; A7598-600.

The onset of the financial crisis in 2008 materially increased the chance that those securities would suffer losses that AGFP would be required to cover. As Supreme Court (Friedman, J.)³ acknowledged on summary judgment, it could “not be disputed that, at the time of the terminations at issue, the financial crisis had significantly increased the prospect of shortfalls in timely interest and ultimate principal payments.” A74. As the risk of shortfalls grew, the derivatives became significantly more valuable to LBIE and became a correspondingly growing liability to AGFP; between June 2008 and June 2009, AGFP’s own accounting records

³ Justice Friedman presided over the case from 2012 until her retirement in 2020; the case was reassigned to Justice Crane for trial.

reflect that the value of the derivatives grew from \$216 million to \$438 million in LBIE's favor. A8848-52.

C. AGFP Terminates and Values the Swaps

In July 2009—ten months after LBIE's entry into bankruptcy administration, which constituted an Event of Default under the ISDA Master Agreement—AGFP chose to terminate the 28 CDS. A7588-7590. Because the parties had elected to value their swaps on a market basis, AGFP was required to solicit quotations from derivatives dealers representing the amount those dealers would be willing to either pay or receive to enter into a new transaction with AGFP “that would have the effect of preserving for [AGFP] the economic equivalent of” the terminated CDS. A7147-48. AGFP sought to do this by engaging a consulting firm to conduct an “auction” in September 2009. A6729. As was extremely common, the auction failed to generate any quotes. A6738; A2910. That failure did not mean the CDS had no value, as AGFP's own experts acknowledged. A3710-11. In fact, it was extremely common for the Market Quotation process to fail—an outcome the ISDA Master Agreement expressly contemplates and addresses. *Id.*; A7148.

Because it was unable to calculate a Market Quotation value, AGFP was then required to value the terminated CDS using the Loss methodology. “Loss and Market Quotation are intended to produce Early Termination Payments in broadly similar amounts when measuring the loss of payments or deliveries due after the

Early Termination Date,” as is the case here. *Intel*, 2015 WL 7194609, at *18. As Supreme Court held on summary judgment, “[i]t would make no sense to hold as a matter of law that, because the Market Quotation process was unsuccessful, [AGFP] was free to adopt a methodology that results in a termination payment completely divergent from the cost of replacing the Transactions.” A67.

Yet that is exactly what AGFP did. Just three weeks before the Early Termination Date, AGFP had looked to widely available public sources of market data—including daily prices published by market data vendor Markit—to value the trades for accounting purposes as being worth \$438 million to LBIE. A8852. Rather than use this market-based valuation, or even look to the underlying sources of market value information, AGFP instead calculated Loss on the basis of an entirely separate, subjective process by which its insurance company affiliate, AGC, set loss reserves for financial insurance products. A7594-95. No party to an ISDA Master Agreement has ever used such an insurance loss reserve process to calculate Loss. A1380; A385; A1951; A3696.

As ISDA itself has explained, “CDS are not insurance for numerous reasons,” including due to “differences in accounting, tax, bankruptcy and other regulatory treatment.” *Aon Fin. Prods. v. Societe Generale*, No. 06-1080, 2006 WL 1517230 (2d Cir. May 8, 2006) (Brief of Amicus Curiae). Contrary to Supreme Court’s mistaken belief, A78, AGFP is not an insurance company; in fact, insurance

regulations prohibited the insurance affiliate AGC from trading derivatives, A1698, A8845. Yet by applying a methodology that explicitly “does not apply to ... derivatives instruments,” A8860-61, AGFP purported to value the 28 CDS at issue based on the reserve amount that the insurer AGC would have taken had the CDS been insurance instruments subject to those different and inapplicable regulations.

For 26 of the CDS—covering *\$5.2 billion* in potential losses that AGFP would be required to cover—AGC interpreted the insurance regulations to mean that it was not required to take any insurance reserve at all. A1560-62. As a result, even though the termination of those 26 CDS relieved AGFP of its obligation to cover up to *\$5.2 billion* in losses that had indisputably become more likely to occur, AGFP purported to calculate the total value of its expected future payments for all of those 26 CDS to be \$0, while fully accounting for the tens of millions of dollars in payments LBIE would have been required to make over the remaining term of those swaps had they not been terminated. A7598-600.

For the remaining two trades, covering *\$500 million* in losses on the popular and widely quoted ABX index of subprime housing securities, the insurance reserve model indicated that losses were likely to occur and that a reserve would have therefore been required. Yet rather than look to its own internal accounting records, which reflected a value for these two trades of *\$352.5 million in LBIE’s favor* just three weeks before the valuation date, A8852, AGFP instead projected that the ABX

CDS would suffer no more than \$24 million in losses (net of the roughly \$4 million LBIE would have owed AGFP had the trades not been terminated), A7598; A7604; A9302. That figure was not based on any contemporary market data; Supreme Court itself acknowledged that it was lower than the losses projected by anyone else at the time by “*hundreds of millions of dollars.*” A109 (emphasis added).

D. The Proceedings Below

LBIE filed suit against AGFP in November 2011 for breach of contract; AGFP subsequently brought counterclaims for breach of contract. A114, A139. In 2018, Justice Friedman, who presided over the case from 2012 until her retirement prior to trial in 2020, denied AGFP’s summary judgment motion with respect to AGFP’s Loss calculation. A51-75. Justice Friedman ruled that AGFP’s conduct was subject to “an objective standard of reasonableness,” and she rejected AGFP’s argument that its inability to value the trades using the Market Quotation method rendered market prices irrelevant or justified a valuation completely divorced from market value. A54-65, 67.

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

Trial was conducted before Justice Crane beginning in October 2021. In its Decision After Trial, issued on March 8, 2023, Supreme Court acknowledged that Justice Friedman had “found an issue for trial” because AGFP “did not use market prices in calculating its own loss” and thus that the issue to be tried was “whether Defendant AG Financial Products, Inc’s [] calculation of the ‘Loss’ on 28 Credit Default Swaps (‘CDS’) was objectively reasonable and made in good faith under the parties’ ISDA Master Agreement as of the July 23, 2009 termination date.” A76 (alteration in original) (citation omitted).

Yet rather than adhere to these prior rulings, Supreme Court erroneously ruled that market prices were “irrelevant” and that AGFP’s expressly subjective calculation, which gave no consideration to market practice or market value and which was demonstrably inconsistent with all contemporaneous projections by hundreds of millions of dollars, was “reasonable.” A107, A110. On that basis, Supreme Court entered judgment in favor of AGFP, requiring LBIE to pay AGFP more than \$100 million (inclusive of interest and fees) in connection with the termination of trades that, according to AGFP’s own internal valuation, were in fact worth hundreds of millions of dollars to LBIE. A16-18; A8852.

E. The Appeal of Supreme Court’s Judgment

Supreme Court entered Judgment on June 30, 2023. A14-18. LBIE appealed, raising three separate grounds for reversal: *first*, that Supreme Court erred in ruling that market values were “irrelevant,” App. Br. (NYSCEF Doc. No. 22) 28-42; *second*, that Supreme Court erred in failing to apply an objective standard of reasonableness, *id.* 42-49; and *third*, that Supreme Court erred in finding AGFP’s Loss calculation to be reasonable, *id.* 49-60.

The Court heard oral argument on February 21, 2024. By Decision and Order entered March 14, 2024, this Court affirmed the Judgment for the reasons set forth in the Decision After Trial, which this Court mistakenly characterized as being “based upon [Supreme Court’s] resolution of conflicting expert testimony.” Mader Aff. Ex. A (NYSCEF No. 30).

ARGUMENT

A motion for leave to appeal under CPLR 5602(b)(1) should be granted if “one or more questions of law have arisen which ... ought to be reviewed by the court of appeals.” N.Y. Const., art. VI, § 3(b)(4). This standard is satisfied when the appeal presents issues which are novel or of public importance, present a conflict with prior decisions of th[e] Court [of Appeals], or involve a conflict among the departments of the Appellate Division.” 22 N.Y.C.R.R. § 500.22(b)(4).

A motion to reargue should be granted when matters of fact or law have been

“overlooked or misapprehended,” CPLR 2221(d)(2), or the court “for some reason mistakenly arrived at its earlier decision.” *Mendez v. Queens Plumbing Supply, Inc.*, 39 A.D.3d 260, 260 (1st Dep’t 2007) (internal quotation marks omitted).

I. REARGUMENT OR LEAVE TO APPEAL IS WARRANTED AS TO THE APPLICATION OF AN OBJECTIVE STANDARD OF REASONABLENESS

AGFP was required to calculate Loss “reasonably.” A7147. There is “substantial authority that an objective standard of reasonableness applies to a contractual provision requiring performance of an obligation in a reasonable manner.” A54 (*citing MBLA Ins. Corp. v. Patriarch Partners VIII, LLC*, 842 F. Supp. 2d 682, 704-05 (S.D.N.Y. 2012); *Christie’s Inc. v. SWCA, Inc.*, 22 Misc. 3d 380, 383-84 (Sup. Ct. N.Y. County 2008); Restatement [Second] of Contracts, § 228). AGFP challenged this legal standard on interlocutory appeal, but this Court rejected that challenge and affirmed the applicability of an objective standard. A9358-9421, A9527-28.

As Supreme Court acknowledged, the objective standard of reasonableness requires that Loss be calculated in a “commercially reasonable” manner. A77; A79, A87; A98; *see* 4E N.Y. Prac., Com. Litig. in N.Y. State Courts §114:39 (4th ed.). This standard requires AGFP to calculate Loss in a manner that is consistent with “accepted business practices” that “actually govern the members of a business” and

thus “reflect a practical wisdom born of accumulated experiences.” *Bankers Tr. Co. v. J. V. Dowler & Co.*, 47 N.Y.2d 128, 134 (1979).

At trial, LBIE presented extensive and unrebutted evidence that standard market practice is to calculate Loss by reference to market values, including hours of expert testimony, A346-50, A918, A1191-97, A1355, A1365-67, A1857-58; direct evidence of how LBIE’s other derivatives counterparties valued their terminated trades, A808-09, A824-26, A832-46, A8507-18; SEC filings by AGFP’s own parent corporation acknowledging that AGFP might need to “make a mark-to-market payment” on early termination consistent with “market practice for derivative contracts,” A7770; and the affirmation by industry leaders including ISDA itself that “in determining close-out amounts market inputs should be used unless doing so would produce a commercially unreasonable result,” A7836.

None of AGFP’s experts offered any contrary opinions: one conceded that he was “not an expert in market practice for calculating Loss under an ISDA Master Agreement,” A4176-77; the second admitted that he was “not offering an opinion on whether the loss calculation was consistent with market practice under the ISDA Master Agreement,” A4640-41; and the third—ISDA’s former outside counsel—admitted that he advised market practitioners calculating Loss to “look at the market price,” A3696. Supreme Court’s conclusory assertion that LBIE had come “nowhere close” to demonstrating a uniform or highly consistent market practice

was not, therefore, “based upon its resolution of conflicting expert testimony,” as this Court mistakenly ruled. Mader Aff. Ex. A. (NYSCEF No. 30). Reargument or leave to appeal is warranted on that basis alone.

But even if LBIE had not established that Loss is calculated by reference to market value as a matter of ordinary market practice, that would have no bearing on whether AGFP’s *own* calculations were objectively reasonable. They were not. *First*, AGFP has never identified a *single* instance in which *any* ISDA party used an insurance reserve methodology to calculate Loss. Given that AGFP bore the burden of proof on its affirmative counterclaims, A77, its failure to establish the commercial reasonableness of its Loss calculation bars its recovery and mandates reargument or leave to appeal.

Second, in addition to being completely unprecedented, AGFP’s Loss calculation was also fundamentally and inherently *subjective*. For 26 of the 28 CDS, AGFP simply assumed that, because its insurer affiliate would not take a regulatory reserve, therefore the CDS would never suffer a loss that AGFP would have to cover. A1560-62, A7598-600. But AGFP’s insurer affiliate interpreted insurance regulations to require no reserve *even if future losses were possible*, as long as it determined—subjectively—that those losses were not more than 50% likely to occur. A1560-62. A *subjective* belief that losses are less than 50% likely to occur does not constitute an *objective* determination of the value of the CDS in light of the

possibility of loss. Nor did AGFP introduce any evidence supporting its subjective assumption that none of these 26 trades would suffer even a single dollar of loss, or call a single witness with first-hand knowledge of its valuation.

For the remaining two CDS, AGFP did purport to calculate the actual likelihood of loss as a basis for valuation, but once again that calculation was inherently subjective. As AGFP's own witnesses conceded at trial, its valuation was based on a series of assumptions regarding the future performance of the subprime mortgages underlying the CDS. A1686-87; A1706-07; A1722-23. Those assumptions were not based on contemporaneous data about the housing market; in fact in large part they were not based on any data at all. A1728-29; A1605-06; A1611-13; A1614-22; A9310; A1623-24.

Had AGFP used contemporary market assumptions, instead of its own assumptions, it would have projected losses directly in line with the observed market price—and with the market value it was recording for its own books. A9322; A8852. Instead, by adopting a series of subjective and self-serving assumptions, AGFP generated a Loss figure “hundreds of millions of dollars” lower than any other market participant was projecting at the time. A109. Supreme Court committed legal error in ruling that this massive discrepancy, directly attributable to AGFP's subjective approach and completely divorced from objective third-party measures of value, was “insufficient to amount to being legally unreasonable.” A109.

As ISDA’s former outside counsel testified at trial, “equipping Loss with the tests of reasonableness and good faith” was intended to “allow a diligent reviewing court the means to reign in any wild flights of calculational fancy.” A3720. Supreme Court’s failure to apply an objective standard of reasonableness represents a stark departure from well-established New York law, and it creates significant uncertainty for all parties to New York contracts requiring “reasonable” valuations, who have lost the critical safeguard provided by an objective standard. Reargument or leave to appeal is warranted to restore the protections that New York law requires.

II. REARGUMENT OR LEAVE TO APPEAL IS WARRANTED AS TO THE RELEVANCE OF MARKET PRICES

The ISDA Master Agreement allows a party to calculate Loss based on its “loss of bargain,” A7147, and that is what AGFP claims to have calculated here, A9416. New York law could not be clearer: loss of bargain is determined by reference to market price, which—as an *independent* assessment of value—provides the objective reference point that Supreme Court should have used to test the reasonableness of AGFP’s Loss calculation. Supreme Court’s ruling that market prices are “irrelevant” was plain legal error, as was this Court’s affirmance, warranting reargument or leave to appeal.

Loss of bargain damages measure “the difference between the contract price and the fair market value of the property at the time of the breach.” *White v. Farrell*, 20 N.Y.3d 487, 499 (2013) (quoting 25 Williston on Contracts § 66:80 (4th ed.)).

Where a party seeks compensation for “the deprivation of an item with a determinable market value, the market value at the time of the breach is the measure of damages.” *Cole v. Macklowe*, 64 A.D.3d 480, 480 (1st Dep’t 2009) (quoting *Sharma v. Skaarup Ship Mgt. Corp.*, 916 F.2d 820, 825 (2d Cir. 1990) (applying New York law)).

Supreme Court dedicated a significant portion of its Decision After Trial to a finding that financial markets were “dislocated,” supposedly rendering the readily available and observable market prices on the CDS at issue unreliable as a basis to calculate Loss. A84-87. But courts—including this Court—have held that market value remains relevant *even where prices cannot be directly observed*, and that “hypothetical market value based on expert testimony” serves the “objective that a party seeking recovery for breach of contract is entitled to be made whole as of the time of the breach.” *Credit Suisse First Bos. v. Utrecht-Am. Fin. Co.*, 84 A.D.3d 579, 580 (1st Dep’t 2011) (quotations omitted).

Supreme Court also suggested that market values were irrelevant because AGFP was entitled to determine “its Loss,” which Supreme Court interpreted to allow AGFP to adopt its own subjective valuation of the CDS based on its own idiosyncratic business interests. A107-08. But New York law is once again clear that loss of bargain damages “compensate the plaintiff for the ‘market value’ of the asset in contradistinction to any peculiar value the object in question may have had

to the owner.” *Schonfeld v. Hilliard*, 218 F.3d 164, 178 (2d Cir. 2000); *see also* *People v. Collier*, 22 N.Y.3d 429, 435 (2013) (one party’s “subjective interpretation of the agreement does not control”).

The bedrock principle that loss of bargain is measured by reference to market value has routinely been applied by courts interpreting the ISDA Master Agreement. *See Anthracite Rated Invs. (Jersey) Ltd. v. Lehman Bros. Fin. S.A.*, [2011] EWHC 1822 (CH) ¶117 (“It is precisely for the purpose of identifying the non-defaulting party’s loss of bargain that Market Quotation requires, and Loss permits, the use of quotations for replacement transactions.”). In fact, the principle that “Loss and Market Quotation are intended to produce Early Termination Payments in broadly similar amounts when measuring the loss of payments or deliveries due after the Early Termination Date” has hardened into “hornbook law” in cases applying the ISDA Master Agreement. *Intel*, 2015 WL 7194609, at *18; *see Anthracite*, [2011] EWHC 1822 (CH); *Britannia Bulk plc v. Pioneer Navigation Ltd.*, [2011] EWHC 692 (Comm.); *Peregrine*, [2000] CLC 1, 328.

Accordingly, although a non-defaulting party in AGFP’s position is entitled to some discretion—limited by the principles of commercial reasonableness and good faith—in choosing *how* to calculate Loss, that discretion does *not* extend to choosing *what* Loss is intended to measure. *See Lehman Bros. Fin. AG v. Klaus Tschira Stiftung GmbH*, [2019] EWHC 379 (Ch), ¶179 (“[W]hilst I accept that [the

determining party] had latitude and flexibility in choosing the method by which they should determine their Loss, I reject the suggestion that it was up to them to decide for themselves what Loss meant in the Master Agreements....”). And where, as here, the parties agree at inception that their derivatives will be valued by reference to market price through the Market Quotation method, with a fallback to Loss, it is uniformly established that Loss—however calculated—must aim to measure the replacement value of the terminated trades; after all, as Justice Friedman held on summary judgment, “[i]t would make no sense to hold as a matter of law that, because the Market Quotation process was unsuccessful, [AGFP] was free to adopt a methodology that results in a termination payment completely divergent from the cost of replacing the Transactions.” A67.

This principle is well illustrated by the *Devonshire* case, which Supreme Court misapplied in the Decision After Trial. When Barclays, acting as the non-defaulting party, was unable to use Market Quotation, it fell back to Loss, which it calculated on the basis of its ordinary-course accounting estimate of the market value of the derivatives. *Barclays Bank PLC v Devonshire Tr.*, 2011 ONSC 5008 (Can.) ¶¶378-81. The trial court rejected this approach, in part due to market dislocation on the valuation date, and ruled that Loss should instead be calculated based on a discounted cash-flow calculation, without any consideration of market value. ¶¶422-53, 432.

The Ontario Court of Appeals *reversed*, ruling that the trial court “demonstrated a misunderstanding of the loss of bargain component of Loss.” *Barclays Bank PLC v Devonshire Tr.*, 2013 ONCA 494 (Can.), ¶282. The appellate court explained that by failing to “take account of the *market-implied* estimate of projected losses” reflected in market prices, the trial court had failed to “value the loss of bargain in relation to the CDS.” *Id.* at ¶283. In light of market dislocation on the valuation date, the appellate court approved the use of a “normalized” market value based on market prices in earlier, non-dislocated periods. *Id.* at ¶¶286-89.

Here, Supreme Court expressly relied on the overturned trial court decision in *Devonshire*. A100-02. The decision of the appellate court in *Devonshire*—consistent with a well-established body of law arising out of decisions in New York and England—reflects the rule that, in circumstances like those here, Market Quotation and Loss are intended to solve for the same thing: the market value of the terminated derivatives. Given that AGFP itself valued the trades as being worth \$216 million *to LBIE* in June 2008—before the period of supposed market dislocation, A8848—and because it “[can]not be disputed that, at the time of the terminations at issue, the financial crisis had significantly increased the prospect of shortfalls in timely interest and ultimate principal payments,” A74, AGFP’s valuation of the trades as being worth tens of millions of dollars *to AGFP* was manifestly unreasonable.

By ruling that market prices were “irrelevant” to AGFP’s calculation of Loss, and by entering judgment in AGFP’s favor on the basis of a Loss calculation that made no attempt to solve for market value, Supreme Court committed reversible legal error, and this Court’s affirmance therefore warrants reargument or leave to appeal.

CONCLUSION

For the foregoing reasons, this Court should grant Plaintiff-Appellant reargument or, in the alternative, leave to appeal.

Date: April 15, 2024

Respectfully submitted,

By: Andrew J. Rossman

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SUPREME COURT OF THE STATE OF NEW YORK
APPELLATE DIVISION, FIRST DEPARTMENT

LEHMAN BROTHERS INTERNATIONAL
(EUROPE) (IN ADMINISTRATION),

Plaintiff-Appellant,

-against-

AG FINANCIAL PRODUCTS, INC.

Defendant-Respondent

Appellate Division Case/Docket
No. 2023-03409

Originating Court
Index No. 653284/2011

**AFFIRMATION OF DAVID S.
MADER IN SUPPORT OF MOTION
FOR LEAVE TO REARGUE, OR IN
THE ALTERNATIVE, LEAVE TO
APPEAL TO THE NEW YORK
COURT OF APPEALS**

David S. Mader, being duly sworn, declares under penalty of perjury that:

1. I am a partner in the law firm of Quinn Emanuel Urquhart & Sullivan LLP, 51 Madison Avenue, 22nd Floor, New York, NY 10010, counsel for Plaintiff-Appellant in the above-captioned matter.

2. I submit this Affirmation in support of Plaintiff-Appellant's motion for leave to reargue or, in the alternative, to appeal from the Court's Decision and Order dated March 14, 2024.

3. I have attached to this Affirmation true and correct copies of the following:

Exhibit A – Decision and Order of the Court, dated March 14, 2024, Leave to Reargue or Appeal From Requested, with Notice of Entry. Index No. 653284/2011 NYSCEF No. 879.

Exhibit B – Decision After Trial of the Honorable Melissa A. Crane, J.S.C., dated March 8, 2023. Index No. 653284/2011 NYSCEF No. 790.

Exhibit C – Judgment of the Court, dated June 30, 2023, Appealed From, with Notice of Entry. Index No. 653284/2011 NYSCEF No. 830.

I affirm this 15th day of April, 2024, under the penalties of perjury under the laws of New York, which may include a fine or imprisonment, that the foregoing is true, and I understand that this document may be filed in an action or proceeding in a court of law.



David S. Mader

EXHIBIT A

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

NOTICE OF ENTRY

PLEASE TAKE NOTICE that attached hereto is a true and correct copy of the Decision and Order of the Supreme Court, Appellate Division, First Judicial Department in the above-captioned action, dated March 14, 2024, and duly entered in the office of the Clerk of the Supreme Court of the State of New York, Appellate Division, First Department, on March 14, 2024.

Dated: March 14, 2024
New York, New York

CLEARY GOTTlieb STEEN &
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Supreme Court of the State of New York

Appellate Division, First Judicial Department

Webber, J.P., Oing, González, Kennedy, Shulman, JJ.

1845 LEHMAN BROTHERS INTERNATIONAL (EUROPE) Index No. 653284/11
(in Administration), Case No. 2023-03409
Plaintiff-Appellant,

-against-

AG FINANCIAL PRODUCTS, INC.,
Defendant-Respondent.

Quinn Emanuel Urquhart & Sullivan LLP, New York (Andrew J. Rossman of counsel),
for appellant.

Cleary Gottlieb Steen & Hamilton LLP, New York (Roger A. Cooper of counsel), for
respondent.

Judgment, Supreme Court, New York County (Melissa A. Crane, J.), entered June
30, 2023, dismissing plaintiff’s remaining cause of action after a bench trial and
awarding defendant/counterclaim plaintiff \$20,663,300.20, plus interest, unanimously
affirmed, with costs.

We affirm for the reasons set forth in Supreme Court’s well-reasoned decision.

“In a nonjury trial, the decision of the fact-finding court should not be disturbed
upon appeal unless it is obvious that the court’s conclusions could not be reached under
any fair interpretation of the evidence” (*Watts v State of New York*, 25 AD3d 324 [1st
Dept 2006] [internal quotation marks omitted]). Here, there is no basis to disturb the
trial court’s determination, which is based upon its resolution of conflicting expert
testimony.

We have considered plaintiff's remaining arguments, including that the trial court's decision after trial is inconsistent with our decision on summary judgment (*see* 168 AD3d 527 [1st Dept 2019]), and find them unavailing.

THIS CONSTITUTES THE DECISION AND ORDER
OF THE SUPREME COURT, APPELLATE DIVISION, FIRST DEPARTMENT.

ENTERED: March 14, 2024



Susanna Molina Rojas
Clerk of the Court

EXHIBIT B

**SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY: COMMERCIAL DIVISION**

PRESEN HON. MELISSA A. CRANE

PART 60

Justice

-----X

LEHMAN BROTHERS INTERNATIONAL
(EUROPE) (IN ADMINISTRATION)

INDEX NO. 653284/2011

Plaintiff,

DECISION AFTER TRIAL

- v -

AG FINANCIAL PRODUCTS, INC.,

Defendant.

-----X

The trial in this case tasked the court to determine which valuation (if either) in a series of terminated credit default swaps (CDS), involving 28 reference securities (the “Securities” or “Transactions”) under an ISDA Master Agreement was correct. The summary judgment decision in this case, *Lehman Bros. Intl. (Europe) v AG Fin. Products, Inc.* (60 Misc 3d 1214(A) [Sup Ct, NY County 2018] [Friedman, J.] [S/J Decision], *affd* 168 AD3d 527 [1st Dept 2019]), held “a Non-Defaulting Party's Loss (however calculated) should generally be within the range of what the market would pay for a replacement transaction. If a Non-Defaulting Party's calculation of Loss is not within that range, a genuine question may be raised as to whether the Non-Defaulting Party's calculation of loss was reasonable” (S/J Decision at *14). Thus, because the non-defaulting party here, AG Financial Products, Inc. (**Assured**), did not use market prices in calculating its own loss, the S/J Decision found an issue for trial.

That issue is, as plaintiff Lehman Brothers International Europe (**LBIE** or plaintiff) succinctly describes:

“whether Defendant AG Financial Products, Inc’s [] calculation of the ‘Loss’ on 28 Credit Default Swaps (‘CDS’) was objectively reasonable and made in good faith under the parties’ ISDA Master Agreement as of the July 23, 2009 termination date”

(Plaintiff’s Post Trial Opening Br. [EDOC 777] at 6)].

Whether a specific valuation methodology is commercially reasonable and correctly applied is a mixed question of fact and law (*In re Am. Home Mtge. Holdings, Inc.*, 411 BR 181, 193 [Bankr D Del 2009], *affd but criticized* 637 F3d 246 [3d Cir 2011]).

The contract between the parties derives from a template known as the 1992 version of the ISDA (International Swap Dealer's Association) Master Agreement. Under the ISDA Master Agreement, "Loss" includes the amount a party "reasonably determines in good faith to be its total losses and costs ... including any loss of bargain" (JX-1 at 15 [Definition of "Loss"]).

The parties have disagreed about how to calculate Assured's "Loss" to such an extent that LBIE claims it is owed \$485 million dollars, whereas Assured claims it is owed over \$20 million dollars. This is a discrepancy of over \$500 million dollars. As the court stated in its decision on the burden of proof dated March 1, 2022 (EDOC 774), LBIE bears the burden of proof to establish that Assured's calculation was unreasonable, and also, for the purposes of damages, the reasonableness of its own calculation. Assured bears the burden of proof on its defenses and counterclaims.

The trial in this case took place over a 5-week period in November 2021. Post-trial briefing concluded during the summer of 2022. The parties stipulated that the court could conduct the trial virtually given the Covid-19 pandemic. The court applauds both teams of attorneys who did a fantastic job educating the court about this highly complex financial arrangement and valuation. When this trial first started, the court was skeptical about how, given such a large discrepancy, Assured's calculation could ever be reasonable. As the trial progressed, however, there was a growing realization that the marriage of catastrophic, historical financial circumstances with bespoke contractual terms, along with strong structural protections in the Securities, lent itself to the conclusion that at least LBIE's calculations were not reasonable.

Given this growing realization, because LBIE had the burden of proof to show its own damages calculation was reasonable and that Assured's calculations were not reasonable, the court allowed LBIE to present a rebuttal case. Now, even with the benefit of that rebuttal case, and extensive post trial briefing, the court's growing realization has crystallized to conclusion. LBIE's valuation, that relied entirely on market prices its experts constructed for this litigation, was insufficient to meet LBIE's burden to prove its own calculations were reasonable. Not only did LBIE fail to demonstrate the existence of a uniform market practice to calculate "Loss"

based on market prices, but it did not even show that market prices were available around the time of the valuation date, July 23, 2009. At that point in time, the markets were so disrupted that accurate market prices were non-existent.

Not that market prices would be relevant anyway. Once the auction failed, the ISDA Master Agreement allowed Assured to value its Loss in any reasonable manner and specifically stated that Assured “need not” consider market prices in that calculation. Assured is a monoline insurer.¹ It did not trade in CDS the way an investment bank would. Assured made its money from the premiums it received for the protection it provided. Also, Assured did not insure the value of the Transactions. It insured their payment flow as payments became due. Therefore, market prices were not even relevant to determining Assured’s “Loss” – the only “Loss” under consideration.

What would have been important to projecting the payments Assured might have had to pay out was the default rate of the mortgages in the mortgage pools underlying the Transactions. To determine that default rate, Assured relied on data from Intex involving those very mortgages. Assured also took into consideration market conditions, such as seasoning and government programs. It took into consideration the significant structural protections inherent in the Transactions, both on the pool and individual loan level. Assured came up with a 28% default rate on the ABX trades and 0% default rate on the others.

Assured, as a monoline insurance company, was in the business of projecting risk. It used the same model that its surveillance and loss reserve groups used in the regular course of Assured’s business to estimate the losses on the Transactions. Unlike the banks, who had an incentive to sell as many of these securities as possible for investment purposes, Assured was operating as an insurer for their payment flow. Thus, for Assured, accurate modeling was critical to enter into these CDS. Otherwise, Assured could be left holding the bag with catastrophic results.

¹ A monoline insurer provides “only financial guarantee insurance, and not property, casualty, life, health, or disability insurance” (*Aurelius Capital Master, Inc. v MBIA Ins. Corp.*, 695 F Supp 2d 68, 71 [SDNY 2010]; see also *Pacific Life Ins. Co. v US Bank Natl. Assoc.*, 2022 WL 11305628, *6 n 10 [SDNY Oct 19, 2022] [“Monoline insurance is a form of credit enhancement that involves purchasing insurance to cover losses from any defaults.”] [citations omitted]).

In calculating the Loss here, Assured followed the ISDA Master Agreement's contractual terms and considered all relevant circumstances. Accordingly, Assured has carried its burden to demonstrate that its valuation was commercially reasonable and in good faith.

I. WITNESSES

This trial involved extensive expert testimony. LBIE's witnesses were primarily experts: (1) Graham Bruce, Chief Executive at Ainigma Group, who testified about the market practice for valuing derivatives; (2) Leslie Rahl, the Founder and Managing Partner of Capital Market Risk Advisors, who testified about whether Assured's application of the "Loss" provision in the 1992 ISDA Master Agreement in determining the "Settlement Amount" was commercially reasonable; (3) Evy Adamidou, a Consultant on risk management, regulatory compliance, portfolio evaluation and restructuring, and valuation, who testified about market practice in relation to the 1992 ISDA Agreement; and (4) Dr. Peter Niculescu, a Partner at Capital Market Risk Advisors, who was LBIE's valuation expert. In addition, Dr. Eduardo Viegas, a Director at PriceWaterhouseCoopers, appointed to act as a public fiduciary overseeing LBIE's administration, primarily testified about events related to LBIE's attempts at novation and receipt of indicative bids.

Assured's experts were: (1) Joshua Cohn, Managing Principal of JBHS LLC, who testified about the history of the relevant contractual provisions and market practice for Loss calculations; (2) Dr. Craig Pirrong, Professor of Finance at the University of Houston, who testified primarily about market conditions at the time of valuation, July 23, 2009, and provided rebuttal testimony criticizing Professor Niculescu's valuation; and (3) David Prager, Managing Director at Goldin Associates, LLC, who was Assured's valuation expert. In addition, Assured called Benjamin Rosenblum – Chief Actuary at Assured; Michael Schozer – Former President at Assured during the relevant time period; and Rob Bailenson – Chief Financial Officer at Assured.

II. FINDINGS OF FACT

Plaintiff LBIE, a broker-dealer, purchased credit protection from Assured, a monoline insurer, on the 28 reference Securities/Transactions mentioned earlier. The deal involved an arrangement whereby LBIE would make premium payments to Assured in return for Assured covering shortfalls of principal or interest as they became due on the Securities. This, in turn,

depended on whether the obligors within the pools of mortgages underlying the Securities paid or not. It is critical that, for the most part, Assured guaranteed payments **over the life of these Transactions** (*see* LBIE Response Brief [EDOC 782] at 38 [“(Assured) is right that the trades at issue were pay-as-you-go trades”]; *see also* JX-67 [internal LBIE memorandum recognizing that “(Assured) does not have to pay for principal losses as they occur (i.e. when the losses in the portfolio exceed the available credit enhancement for the relevant reference obligation), but rather at the legal final maturity of the assets when such principal payments are legally due”]).

The Securities fall into three categories:

- 1) Two ABX trades. These were two series of RMBS² trades that US subprime mortgage loans payments would fund. These particular RMBS trades were on the “ABX index.” This index measures the overall value and performance of the subprime residential mortgage market. Market data vendor Markit Partners (Markit) created and maintained the ABX index. In general, the ABX series were subdivided into rated “tranches.” Tranches with higher ratings had less of an investment return, but also less risk. LBIE bought protection for “last cash flow” AAA Tranches of the 06-2 and 07-1 series. The level of tranche at issue would not suffer losses until more junior tranches had been wiped out (Prager Tr. at 2998, Bruce Tr. at 820-821). Pools of US subprime loans that had originated in 2006 backed these tranches (Bruce Tr. at 825-826). Markit published official prices for the ABX trades at the close of every trading day (LX114; LX 133; *but see* Prager Tr. 3028-3029 [explaining that Markit does not reflect actual market prices, but that it reflects “mid market quotes” or “an indicative number”]).
- 2) CDS on UK RMBS (UK RMBS) trades: These 14 trades reference nine securities backed by five pools of residential mortgages that originated in the United Kingdom. Markit also regularly published prices for the mortgage-backed securities underlying these trades throughout 2009. These funds were similar in risk level to the ABX trades mentioned above (Prager Tr. 2999), with the additional protection of a “master trust structure” ensuring new loans were coming in all the time (*id.*), as well as a reserve fund to cover losses (*id.* at 3000).

² A residential mortgage backed security (RMBS) is, more or less, a bond that makes payments generated by a pool of residential mortgages. As borrowers make payments, they are distributed to investors according to the seniority of their investment.

- 3) 11 CDS on CLO (CLO) trades: These trades reference “collateralized loan obligations” or CLOs. These are pools of high yield loans, such as business loans, to small- and mid-sized companies that use assets, such as equipment, as collateral. The tranches at issue on these trades were “super senior AAA,” which again meant that the lower tranches would have to be wiped out before the “super senior” level suffered any loss (Prager Tr. 3001).

As the S/J Decision described, three agreements governed the Transactions at issue: (1) the aforementioned ISDA Master Agreement (JX-1 [EDOC 182]), (2) a schedule to that Master Agreement (EDOC 183) and (3) a negotiated confirmation for each Transaction (*see e.g.* EDOCS 184-211). Unlike most other CDS transactions, the CDS here did not require the posting of collateral (*see* AX-90030 at 6 [ISDA Collateralization Practices Market Review 2010] [reporting that 97% of credit derivatives are collateralized]). The transactions also did not call for physical settlement upon termination whereby the protection seller pays the face value of the asset to the buyer and the buyer delivers the reference asset to the seller.

A. LBIE Defaults Leaving Assured with the Right to Terminate and Calculate the Termination Payment

Because LBIE entered into letters of Administration and then bankruptcy on September 15, 2008, Assured was entitled to declare an event of default under section 5[a][vii][6] of the ISDA Master Agreement (JX-1). Section 6(a) of the ISDA Master Agreement authorized Assured, as the non-defaulting party, to terminate the Transactions (*id.*). Assured did terminate, but not until July 23, 2009, ten months later. Also, as the non-defaulting party, Assured had the right to calculate the termination payment (*id.*, § 6[e][i][3]). The parties had previously elected to use “Market Quotation and Second Method” to calculate that termination payment.

The Market Quotation method required Assured to seek quotations from leading dealers in the relevant market, known as “Reference Market-makers.” These quotations were to represent:

“an amount, if any, that would be paid to [Assured] (expressed as a negative number) or by [Assured] (expressed as a positive number) in consideration of an agreement between such party ...and the quoting Reference Market-maker to enter into a transaction (the ‘Replacement Transaction’) that would have the effect of preserving for [Assured] the economic equivalent of any payment or delivery ... by the parties under Section 2(a)(i) in respect of such Terminated Transaction or group of Terminated Transactions [i.e., under the applicable Confirmation(s)] that

would, but for the occurrence of the relevant Early Termination Date, have been required after that date . . . ”

(*id.*, § 14 [“Market Quotation” Definition]). The ISDA Master Agreement states that, “[i]f fewer than three quotations are provided, it will be deemed that the Market Quotation in respect of such Terminated Transaction or group of Terminated Transactions cannot be determined” (*id.*).

B. Assured Conducts the Auction Properly

In accordance with its responsibilities under the ISDA Master Agreement, following its declaration of an event of default, Assured engaged the assistance of Henderson Global Investors, Ltd. (Henderson), to conduct an auction so that it could satisfy the ISDA Market Quotation process. Henderson contacted 11 potential bidders in advance of the auction that took place on September 16, 2009. **Not one bid was received.** The S/J Decision found the auction had been conducted properly (60 Misc 3d 1214(A) at *7 [Sup Ct, NY County 2019] [“Henderson was a qualified advisor and . . . the auction was designed to satisfy the Market Quotation requirement.”]). The Appellate Division, First Department affirmed this holding (*see Lehman Bros. Intl. v AG Fin. Prod., Inc.*, 168 AD3d 527, 528 [1st Dept 2019]).

C. Even Before the Auction, Perhaps Anticipating a Lack of Bids, LBIE Tried to Obtain Some Semblance of a Market Price.

1. Novation

It is undisputed that, even before the failed auction, LBIE tried for months to novate the transactions (i.e., find someone willing to step into LBIE’s shoes). There were no takers. LBIE contends that the failure to novate was Assured’s fault. What unknown amount a third party may or may not have paid to step into LBIE’s shoes is too speculative to consider. Regardless, novation is not really relevant, and is not a factor in this decision, because the contract between the parties only called for the auction as a valuation exercise. Assured was under no obligation to value via a novation once that auction failed.

2. Indicative Bids

LBIE also points to three “indicative” (i.e., nonbinding) bids that their witness, Dr. Viegas, called “market color” and “indicative market data of where these transactions, these underlyings would be trading at that stage on termination date” (Viegas Tr. at 562-563). However, not one company was actually willing to make a binding offer (*see e.g.* LX 74, LX

74A). For example, LX 74A describes hesitation on the part of Citibank and JP Morgan, because LBIE did not reveal the counterparty (Assured). Even Nomura, the only entity to provide a true indicative bid, who must have known Assured was the counterparty,³ was unwilling to make a firm offer.

Moreover, Nomura's indicative bid is full of disclaimers: "This is not investment advice of any kind and we do not purport any degree of accuracy in these levels." Mr. Quintas qualifies the indicative bid for Nomura even further: "please bear in mind that these are not firm protection bids from Nomura, and that none of these prices are actionable. This is not an offer or an invitation to trade" (LX 74).

More troubling statements appear in LX 74, the first page of which is an internal LBIE email from Andrew Porter to Viegas, dated July 30, 2009. LX 74 contains language reflecting that the solicitation of indicative bids may have been some attempt by LBIE to influence other banks (many of whom may have been in the same perilous boat as LBIE), to make any bid, so that LBIE could then argue for a market price valuation: "any color is good color to us and [Pearce at JP Morgan] is lobbying for them [his US trading team] to at least put a number on it even if it is zero" (*id.*). Apparently, the "US Trading Team" at JP Morgan was hesitant to make an indicative bid, because that bid would be "completely inaccurate without knowing who they face" (*id.*). Whether the conversation Porter relates actually took place as described is somewhat irrelevant. What does concern the court is the import by a LBIE employee [Andrew Porter] that "any color is good color . . . **even if it is zero.**" Why would LBIE not care if the bid was literally "zero"? This raises the concern that LBIE's goal, with respect to the indicative bids, was to make these trades seem as worthless as possible to then be able to collect the most from Assured in a lawsuit.

Additional evidence in the record supports that LBIE only sought the indicative bids to bolster its litigation position against Assured. AX 30013 is a June 2009 internal LBIE email from Paul Copley, who led the LBIE team involved with valuing the transactions with Assured. Copley wrote that "MTM [mark to market]⁴ is theoretically c\$1bn," but that because "AGR

³ The same person who put together Nomura's bid, Juan Quintas, used to work with Viegas at LBIE.

⁴ "Mark-to-market" is an accounting method by which the holder of an asset "adjusts the value of that asset on its balance sheet each period to reflect its fair market value . . . Mark-to-market accounting

[Assured] is a monoline insurer which is nearly bust and is restructuring to survive,” even if LBIE could novate the transactions, they would only be worth “c\$10-15m,” and that because they could not get anyone to “bite” on the idea of sharing the credit charge, they were considering Assured as a “litigation candidate” (AX 30013 at 1). It was shortly after calling Assured a “litigation candidate” that LBIE solicited bids.

Clearly, LBIE wanted those bids for litigation purposes. On July 22, 2009, the day before Assured terminated the transactions, David Swanson, another internal LBIE employee, who was expecting Assured “to terminate today,” writes that “[f]or purposes of challenging their [Assured’s] valuation, even indications should help, and this is what we have to rely on in other circumstances where we are reconstructing the market prices after the event” (*see* AX 30030). Finally, it stands to reason that, if one of these banks really wanted these Transactions, it would have bid at the auction.

Therefore, these “indicative” bids do not reflect anything more than LBIE’s attempt at bolstering its litigation position. For this reason, and because they are literally nonbinding, indicative bids are of limited utility to try to place a market price on the transactions at issue in this case. They are also irrelevant. As discussed *infra*, this is because, once the auction failed, Assured (1) could value in any reasonable manner, (2) the ISDA Master Agreement specifically states that Assured “need not” consider market prices, and (3) market prices were not relevant to determining Assured’s “Loss,” which is the only “Loss” to consider. Therefore, relying on non-binding bids does not seem reasonable or relevant.

D. The Evidence at Trial Demonstrated Extreme Market Dislocation in General and for the Specific Financial Instruments in this Case

As LBIE’s experts have acknowledged, the financial crisis that led to the demise of plaintiff, as well as others, was a meltdown of a magnitude not seen since the Great Depression (*see e.g.* Bruce Tr. at 863). There was substantial evidence at trial that the markets were dislocated, with trading values on these Securities substantially lower than their actual worth (Pirrong Tr. at 3487-3488, 3532; Niculescu Tr. at 1641 [agreeing that a decline in prices could be

better represents the current market value of the asset[] on a company's balance sheet than does [its] historical date-of-purchase cost” (*Ironworkers Local 580--Joint Funds v Linn Energy, LLC*, 29 F Supp 3d 400, 409 [SDNY 2014]).

due to lack of liquidity]; *see also* AX 90199 [article by Assured’s testifying expert, Josh Cohn, dated January 2009, entitled “*Bruised, but Best in Show*,” describing the market at the time as “distorted” and “troubled”]). Cohn’s article also notes the difficulty in determining the termination amount during periods of market disruption: “Certainly, in the troubled markets of late, many NDPs [non-defaulting parties] have found it difficult or impossible to get reliable quotes from dealers” and that “[i]n a distorted market, finding an accurate means of calculating damages may be difficult” (AX 90199; *see also* Firth, *Derivatives Law and Practice* [2021] [AX 90021] at 211⁵ [“Where there is no available market for a replacement transaction . . . it may not be possible to establish the Loss by reference to the market price.”]; *Anthracite Rated Invs. (Jersey) Ltd. v Lehman Bros. Finance S.A.* [2011], EWHC 1822 (Ch) [Eng.] at ¶ 84 [“*Anthracite*”] [noting “the valuation and liquidity difficulties affecting hedge fund portfolios” in 2009]).

The trial evidence demonstrated that the 2008-2009 market was in free fall due to lack of liquidity, deleveraging and the exiting of traditional investors from the market (*see e.g.* AX 90196 [3/23/2009 report from the US Department of Treasury describing the “[n]egative [e]conomic [c]ycle. . . where declining asset prices have triggered further deleveraging, which has in turn led to further price declines”]; *see also* Prager Tr. at 3025 [describing negative economic cycle]). Reflecting the roiling markets, Markit, upon which plaintiff so heavily relies, fell by a third during 2008-July 2009, because there were far fewer market participants (Prager Tr. at 3030-3031). That major market participants left the market, also compounded the lack of liquidity for these financial instruments (AX -90196; *see also* Prager Tr. at 3026, 3141-3151; Bruce Tr. at 854).

The Bank of England certainly believed at the time that illiquidity and uncertainty pervaded the market (AX -50072 at 13-15 [BOE October 2008 report]).⁶ That the US Federal Reserve continued to extend its liquidity programs into the middle of 2009 is evidence that the markets remained illiquid into 2009 (*see* AX 90196 [US Dept. of Treasury Press release]).

⁵ LBIE has objected to the use of the Firth treatise on hearsay grounds, but its own expert, Leslie Rahl, relied on it.

⁶ LBIE complains that the BOE reports are hearsay but has staked its position on Markit, which is reflected in the BOE report. Nevertheless, the BOE report is admissible to show that the BOE thought markets were dislocated.

Remarkably, even LBIE's own expert, Leslie Rahl, in a strikingly similar case, *Barclay's Bank PLC v Metcalf & Mansfield* (2011 CarswellOnt 9183 [Can. Ont. Sup Ct]) ("*Devonshire*"), described market dislocation in early 2009 as "severe" and attributable to "extreme illiquidity, and risk premiums [that] were historically very high and much higher than the true credit losses that were reasonably predicted at the time" (AX 90027 at 18, 21 [Rahl *Devonshire* rebuttal]). Rahl also recognized that "[m]any market participants, accountants, the financial press, and even the US Congress recognized the extraordinary divergence and questioned the appropriateness of mark-to-model during a crisis" (AX -90026 at 32 [Rahl's expert report in *Devonshire*]).

LBIE insists that the markets were not dislocated. However, this position flies in the face of the bulk of the evidence, reality, and its own expert's opinion in *Devonshire*.

Despite the grim market that existed for the Securities at the time, the evidence at trial also demonstrated a glimmer of hope. By June 2009, month-to-month housing prices rose for the first time in more than two years and delinquency rates began to drop (Prof. Niculescu Tr. at 1543-1544; Case Shiller US National Home Price Index [AX-90198] [showing rising housing prices between May and June 2009]; Moody's August 2009 report at 1 [AX 50044] [stating "housing indicators are stabilizing"]). By July 2009, market observers, such as Standard & Poor's (S&P), projected that real estate prices would start to stabilize in the first half of 2010 (S&P July 2009 report at 6 [AX 50031]); *see also* Prager Tr. at 3013-3014 [noting that housing prices began to recover in June 2009]). Even Markit, upon which LBIE so heavily relies, reported that, as of July 23, 2009, conditions were improving (*see* LX-136 at 1 [Markit, The European ABS Market A Week in Review: 15-23 July 2009]). At trial, there was evidence to suggest that at least some of the recent recovery in housing prices was due to the advent of government programs earlier in the year to assist homeowners with loan modifications and refinancing, including HAMP and HARP (Prager Tr. at 3014).

Nevertheless, although real estate prices were starting to recover, the prices for the financial instruments based on this real estate remained dislocated (Prager Tr. at 3028 [noting that there was still concern about the economy and dislocation in the financial markets]; *id.* at 3145-3146 [noting that "current prices for ABX.HE indexes are inconsistent with any reasonable assumption for mortgage default rates"]; *see also id.* at 3150-3152; Pirrong Tr. at 3391 [noting

that “the government still believed that there was dislocation in the trading markets through the middle of 2009”).

LX 137, part of an ABX index, demonstrates dislocation for the very transactions at issue in this case. As Prof. Pirrong testified (Tr. at 3568), this document shows market dislocation because “rather curiously is that the higher quality . . . is giving you by far the most bearish indication of what is going to happen to housing prices” when housing prices were actually rising. In other words, the ABX Index is showing lower pricing on RMBS in the face of rising housing prices. There should NOT be an inverse correlation between the housing values and the value of the RMBS. One of the reasons, perhaps the main reason, RMBS prices remained dislocated is because of liquidity problems that “did not resolve quickly” and “extended into 2009” (Niculescu Tr. at 1641; *see also* AX 90196 [US Treasury Press Release describing continued negative economic cycle]). As Prof. Prager testified, because of this lack of liquidity, the US Federal Reserve extended liquidity programs into the middle of 2009 (Prager Tr. at 3026, 3030, 3141-3151; *see also* AX 90196 [US Treasury Press Release]).

It was during this extreme dislocation, in September 2009, that the auction failed to produce a single bid. The failed auction is strong evidence that the market remained dislocated for the very financial instruments that are the subject of this case. Again, both this court and the Appellate Division, First Department have found, on summary judgment, nothing wrong with the way Assured and Henderson conducted that auction.

E. Loss Method

Because the auction had failed to produce any bid, much less the requisite three, the ISDA Master Agreement authorized Assured to use an alternative “Loss” method to calculate the termination payment. The Loss method comes into play when a Market Quotation “cannot be determined or would not (in the reasonable belief of the party making the determination) produce a commercially reasonable result” (ISDA Master Agreement [“Settlement Amount (b)” Definition])

The ISDA Master Agreement defines “Loss” in pertinent part, as:

“an amount [the Non-Defaulting 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] group of Terminated Transactions ..., including any

loss of bargain, cost of funding or, at the election of such party but without duplication, loss or cost incurred as a result of its terminating, liquidating, obtaining or reestablishing any hedge or related trading position (or any gain resulting from any of them)”

(*id.* [“Loss” Definition]).

The Loss method requires that a Non-Defaulting Party “determine its Loss as of the relevant Early Termination Date, or, if that is not reasonably practicable, as of the earliest date thereafter as is reasonably practicable,” and expressly states that “[a] party may (**but need not**) determine its Loss by reference to quotations of relevant rates or prices from one or more leading dealers in the relevant markets” (*id.* [emphasis added]).

This exception exists because market value is NOT necessarily loss of bargain for the non-defaulting party (*see Anthracite, supra*, ¶ 127 [(“It is by no means axiomatic that, in relation to derivatives, one party’s loss approximates to the other party’s gain.”)]). And this is particularly so, as the above discussion demonstrates, when markets are distorted, as they were here.

F. How Assured Calculated Its Own Loss

It is undisputed that Assured did not try to determine its Loss by reference to dealer quotations. Nor did it have to because the auction failed to produce a single bid. Rather, Assured netted the premium payments LBIE would have owed over the life of the transactions against the amounts Assured projected it would have had to pay to cover expected shortfalls in interest and principal (*see JX-34 at Bates page AG 00074397*). The premiums are a fixed amount so there is no real dispute as to that number. Where the parties’ views diverge is with respect to the projected shortfalls on the underlying securities.

LBIE proclaims that no one knows how Assured calculated its loss, but this is not really correct. Assured’s methodology is contained in JX-71, a presentation to Assured’s Audit Committee, dated October 30, 2009, entitled “Third Quarter Loss Projections.” Although this presentation involves all of Assured’s CDS, this document reflects that Assured primarily used a projected default rate, and then calculated in a prepayment rate and loss severities to establish their overall projections. Assured ran four different scenarios (JX-71). As Ben Rosenblum, Assured’s Chief Actuary testified, the most important factor out of them all was the default rate

(Rosenblum Tr. at 1246, 1259, 1266-1269). With respect to the default rate, Assured projected that defaults would decline to levels consistent with historical norms by 2012 (*id.* at 1370).

For Assured, a monoline insurer in a highly regulated industry, accurate modelling was essential to its risk management.⁷ Accordingly, Assured used a similar methodology that it used in its underwriting process to project its losses here (*see* AX 20006 at 4 [Underwriting memo for ABX 2006-2]; JX-65 at 5 [Underwriting memo for ABX 2007-1]). This same methodology was also used to monitor the credit quality of the Transactions over time (*see* AX 70008 at 23-24 [Assured 2009 10-K]) and to determine regulatory reserves for the quarter ending September 30, 2009 by [Assured's] Credit Support Provider, Assured Guaranty Corp. (Prager Tr. at 3040; Rosenblum Tr. at 1126-1127; Schozer Tr. at 2213; AX 20005 at 2 [Frederico Report to Assured Board]). Mr. Schozer testified that there would be no other way of calculating loss that would have been consistent with Assured's business (Tr. at 2213-2217).

The regulatory reserve process that utilized the same methodology was: (1) independent and (2) subject to multiple layers of oversight. A Reserve Committee, comprised of senior executives of Assured, determined assumptions, loss scenarios and probability weights that it believed to be reasonable based on past assumptions and current market information (Rosenblum Tr. at 1237-1238). Then, an Audit Committee would review and approve what the Reserve Committee determined (Rosenblum Tr. 1238-1242). Assured's senior directors, its Chief Actuary, and its independent auditor, PriceWaterhouseCoopers (PwC), comprised the Audit Committee).

LBIE does not dispute that PwC audited the loss reserve assumptions and issued an opinion for Assured. The record does not appear to contain that opinion. However, testimony from Mr. Rob Bailenson, the CFO for Assured, implied that PwC approved Assured's methods. Mr. Bailenson testified that after an audit for year 2009, PwC "would agree with the assumptions and they issued an unqualified opinion for the company" (Bailenson Tr. at 2873). One would think that PwC would have raised a concern somewhere if they had found a problem with Assured's methodology (*see* Rosenblum Tr. at 1286 ["(A)s a practical matter given the

⁷ Assured, as a monoline insurer, was in the very business of assessing risk. Assured's September 2007 underwriting memo for these transactions, from before the financial crisis, noted that Assured was well protected with respect to these Securities (*see e.g.* AX 20004 at 19-20).

challenges from (PwC) and our board, it would have been difficult to under report your expected losses.”)].

1. ABX

On the two ABX trades, Assured determined that its payments to LBIE to cover shortfalls would have exceeded the amount of premium payments, and that it therefore would have owed LBIE approximately \$27.5 million. In reaching this conclusion, Assured used actual performance data for the specific RMBS at issue from Intex, an industry standard platform. The data on Intex would have included such items as how many borrowers were delinquent, how many were in default, and the loss severities on the defaulted loans.⁸ LBIE does not challenge the reliability of Intex or its widespread use in the industry. Even one of LBIE’s own exhibits, a Credit Suisse report, relied on Intex data (*see* LX 263 [Excel spreadsheet tab 2, “Intex Ticker”]). LBIE’s experts also recognized the importance of Intex to the industry (*see* Adamidou Tr. at 1951 [recognizing that Intex was used in developing complicated models]; Niculescu Tr. at 1722-1725 [describing Intex as a “data library” used often for modelling]; Bruce Tr. at 937 [noting that Intex “was the market standard one from modeling CDOs with RMBS and other constituents”]).

Armed with the Intex data, Assured then utilized models that its surveillance and loss reserve groups used to estimate expected losses for all of its transactions referencing similar securities (JX 34 at 5 [Assured’s statement of calculations dated October 16, 2009]; Rosenblum Tr. at 1287-1288). Specifically, using the Intex data, Assured tried to determine: (1) how many borrowers in the relevant RMBS pools would default on their mortgages; (2) how many would prepay; and (3) loss severity⁹ (*see* Rosenblum Tr. at 1233-1234, 1246-1249). Assured came up with a default rate of 28% for ABX.

⁸ Rosenblum (Tr. at 1213) describes Intex’s data as coming from “trustee reports [that] have data about foreclosures. That information is then added . . . into Intex which is the standard industry modelling tool that most people use to model mortgage backed securities.” Explaining how it worked, Rosenblum described “so, after data [is] uploaded into Intex, assumptions are layered on. So again, if we’re talking about loss severity, you would put the loss severity curve into Intex. And then Intex is looking at . . . homes that default at each specific period of time . . . and it applies the loss severity at that point in time” (*id.*).

⁹ As the term implies, “loss severity” determines how severe the losses on the mortgages would be. In this context, the loss severity depends on how much the bank would recover once it sells the foreclosed upon property (*see* Prager Tr. at 3004 “severity is essentially the difference between a loan price and the sale price that’s ultimately recovered”).

Assured then took this rate and determined how defaults, prepayment and loss severity would evolve over time. In determining this evolution, Assured took into consideration market factors that: (1) the severity of the downturn in the housing market that had begun in 2007 was finally beginning to stabilize by July 2009; (2) government intervention to stabilize the housing market would be successful (Rosenblum Tr. at 1373-1374); and the recession was over, though the “bad period” would continue “up to 2012” (Prager Tr. at 3079).

2. Seasoning/Burnout

Continuing to evaluate utilizing actual performance data from Intex, Assured also took into consideration a circumstance common to large mortgage pools known as “burnout” or “seasoning” (*see* JX 71, at 0024-25 [Assured Guaranty Third Quarter 2009 Loss Projections discussing seasoning/burnout]). Burnout occurs because, within a pool of mortgages, those who are likely to default typically do so in the first few years of owning a home. By contrast, borrowers who are able to stay current on their mortgage payments for the first few years statistically have a lower likelihood of defaulting. As a result, the default rate in pools of mortgages decreases over time (Rosenblum Tr. at 1269-1270; Prager Tr. At 3066-3067). Then, Assured assumed that, because of the economic stresses that many borrowers faced during 2008, burnout would be even more pronounced and, accordingly, those borrowers who had managed to stay current on mortgages through 2012 were even less likely to default in later years (Prager Tr. at 3344-3345).¹⁰

LBIE, through Professor Niculescu, reasoned that when home values drop below that of the mortgage, homeowners walk away from their mortgage payments, and that therefore a drop in housing prices would lead to defaults. While walking away may make financial sense for a business loan, it does not for a home loan. This is because people need to live somewhere and likely would prefer making payments on an underwater house to homelessness or moving somewhere perhaps less desirable.

¹⁰ Assured waited for ten months from LBIE’s bankruptcy before terminating the Transactions. By doing so, Assured was able to wait out the market a bit until things were looking up. This waiting had the consequence of lowering its liability to LBIE, because its projections could then utilize the more positive data that developed. To the extent the claim was not already dismissed at the summary judgment stage, LBIE has not argued at trial that this waiting period was in bad faith, or the termination date should have been earlier. Rather, it is undisputed that the termination date is July 23, 2009.

Thus, Assured continued to project historically high default rates in its model for a period of 24-27 months, while reasoning (as it turns out, correctly) that over time, the percentage of defaulting borrowers would eventually return to levels more consistent with historical norms (JX 71 at 23-25 [forecasting that “the CDR plateau would begin improving 24 months from now, which is after the currently delinquent loans” would have liquidated]; *see also* Rosenblum Tr. at 1169). To project over long periods of time was consistent with the contractual arrangement between the parties whereby Assured was only to cover as payments became due over the life of the Transactions. Assured settled on a default rate of 28%.

3. The Predictions from the Ratings Agencies Were Close to Assured’s Predictions and more Credible than Predictions from the Banks

Assured was not alone in its assumptions. For example, the ratings agency, Moody’s, made similar predictions based on the same factors, including that government bailout plans would engender loss mitigation (*see* AX50083 at 1, 7 [Moody’s March 5, 2009 Report entitled “Subprime RMBS Loss Projection Update, March 2009”]). Like Assured, Moody’s reduced its loss projections forecasts for vintage year 2006 to 30%, in large part due to “[p]otential government-sponsored modification programs” (*id.* at 7; *see also id.* at 8, 12). For certificates rated B2 or higher, like those at issue here which were AAA, Moody’s predicted these were “likely to be paid off in full under expected conditions” (*id.* at 13).

Other ratings agencies made similar predictions. On July 6, 2009, Standard & Poor’s, that had previously been more optimistic than Moody’s, revised its default projections for subprime RMBS to 32% (*see* AX 50031 at 4), a number close to Moody’s 30%. However, unlike Moody’s, S&P did not appear to weigh the government bailout programs as a significant ameliorating factor. Fitch, another ratings agency, concluded a higher default rate of 39%, but did not disclose its methodology at all (*see* LX 367).

It is true that, as LBIE points out, Moody’s subsequent August 13, 2009 report (AX 50044) discusses how the slow start of the Obama Administration’s Home Affordable Modification Program (HAMP) plus the “large overhang of foreclosures” had the effect of delaying a rise in home prices (*id.* at 2). Moody’s ultimately concluded that the process to limit foreclosures would “take longer than initially expected (*id.* at 3). Moody’s also noted that “[c]urrent performance trends are tracking the projections we (previously) made for sub-prime, Alt-A and Option ARM pools” but that loss severity was coming in higher than it had previously

projected (*id.* at 7). Nevertheless, more important, in this document, Moody's stated that housing prices were stabilizing and to expect the trough by mid-2010 (AX 50044 at 1). This is actually earlier than when Assured predicted the market would begin to recover. It is only LBIE's model that predicted housing prices would remain depressed, perhaps for decades (Prager Tr. at 3078 [describing Dr. Niculescu's model at 60% of his initial default rate all the way to 2020]).

LBIE's fallback position is that the earlier report (Moody's March 2009 report) used stale data. However, Standard & Poor's projections are nearly the same and their report is from July 6, 2009, extremely close in time to the July 23, 2009 valuation date Assured had to use. Moreover, Moody's did not change its loss estimates in its August 2009 report from its March 2009 report (AX 50044 at 9).

Because the ratings agencies had a much lower valuation than the one LBIE's experts contrived for this litigation, LBIE casts aspersions on the ratings agencies. According to LBIE, the ratings agencies had a notorious conflict of interest because they were in the business of selling ratings and too much pessimism would "drive issuers to take their business to a competitor agency willing to shade its projections" (Niculescu Tr. at 3841; *see also id.* at 3845-3846). LBIE, therefore, urges the court to consider projections from the banks, rather than from the ratings agencies.

But the estimates from the bank reports are suspect. The losses they project are hundreds of millions of dollars larger than those of the ratings agencies. LBIE encourages the court to use, in particular, the projected rate from Barclays' Bank. Barclays' projection was 67% (*see* LX 137 [ABX weekly recap from Barclay's Capital dated July 27, 2009]).

Barclays' projections are quite dubious. Not only is the loss percentage projection more than twice as high as the ratings agencies, but, as LX 137 discloses on page 5, "[o]n September 20, 2008, Barclays Capital Inc acquired Lehman Brothers' North American investment banking, capital markets and private investment management business." Therefore, by the time it issued this report on July 27, 2009, Barclay's could easily have known Lehman N.A.'s related entity, LBIE, was facing Assured on the Transactions. Barclay's, therefore, may have had an incentive to project huge losses so that LBIE could recover as much as possible from Assured, LBIE's monoline. Prof. Niculescu's projections, that rely so heavily on the default rate from a bank that had inherited Lehman North America, are suspect as well and seem designed simply to make

LBIE's losses as high as possible without regard to a true projection. Compare Barclays' projections to those of Goldman Sachs, which had not purchased a part of Lehman. Goldman Sachs (AX 50084 at page 20) was forecasting losses on the 2006 vintage subprime collateral at between 18.2-27%. This is even lower than Assured's forecast.

There is also evidence that bank reports in general might not be objective (*see e.g.* LX 119 at 0013 [JP Morgan report dated July 9, 2009] ["Research strategists routinely consult with JP Morgan Trading desk personnel in formulating views, opinions and recommendations in preparing research Therefore, this research may not be independent from the proprietary interests of JP Morgan trading desks."]).

Thus, it stands to reason that, at that time of extreme market disruption, the banks had every incentive to make the outlook for the Transactions seem as dire as possible in order to set the stage to collect more from their monoline insurers. Meanwhile, the ratings agencies had come under extreme disapprobation for failing to predict the financial crisis (*see* LX 266 at 6-7 [Memorandum from J. Levinson of US SEC, dated October 2, 2008, re: Meeting with representatives from Assured to discuss Release No 57907, and attached slides from Assured]; AX 50022 at 241 [Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States, January 2011] [concluding that "the credit rating agencies abysmally failed"]; AX 50093 [Moody's CEO's Statement to the SEC, dated April 15, 2009]).¹¹

The ratings agencies were aligned with neither the banks nor the monolines. They had nothing to gain from putting forth a biased viewpoint on the crisis involving RMBS. Instead, given prior mistakes and the "loss of confidence in the credit ratings industry" (AX 50093 at 1), it was terribly important for the prognostications of the ratings agencies to be correct. Perhaps this is why, unlike the banks, the ratings agencies, by and large, disclosed the methodology behind their projections (*see also* AX 50093 [April 2009 testimony of Moody's CEO to the SEC describing measures it had implemented to "enhance the quality, independence, and transparency of ratings," including "increasing the transparency of rating agencies' performance, methodologies and quantitative models" and "addressing conflicts of interest"]).

¹¹ Prof. Pirrong testified that the ratings agencies took a lot of criticism at the time for using flawed models (Tr. 3495-3496).

Accordingly, the court finds that information at the time, from ratings agencies like Moody's and Standard and Poor's, to be more reliable than prognostications from the investment banks that undoubtedly were already in litigation or were contemplating litigation against their monoline insurers. Assured's rate aligns with Moody's 30% rate and S&P's 32% rate (*see* Prager Tr. at 3095 ["I wouldn't expect them to be equal, but in terms of order of magnitude, it shows me that they are thinking about things in very similar ways."]).

4. Structural Protections

The Transactions for which Assured protected the cash flow had significant structural protections. For example, with respect to the ABX trades, LBIE bought protection for "last cash flow" AAA Tranches of the 06-2 and 07-1 series. As discussed previously, this high level of tranche would not suffer losses until more junior tranches had been wiped out. According to Dr. Prager, that is why Assured could project 28% lifetime collateral losses on the ABX. As Dr. Prager explained:

"The structural protections are working here. The structural protections are designed to create just this scenario. Where there are losses and the losses are incurred and suffered at other levels within the structure and before they get to the AAAs and if everything works according to plan, they never get to the AAAs"

(Prager Tr. at 3104).

With respect to the rest of the transactions, the UK RMBS and the CLO's, Dr. Prager explained the significance that these transactions held on to their AAA rating in 2009:

"even though some transactions had started to see deterioration and increased risks and these particular transactions were not seeing that increased risk and made it through the depths of the housing market and the depths of the recession and were moving towards the other side still maintaining that AAA rating"

(*id.* at 3107).

Again, the tranches at issue on these trades were "super senior AAA" which again meant that the lower tranches would have to be wiped out before the "super senior" level suffered any loss (*id.* at 3001).

There were additional protections on the individual mortgage level underlying the ABX trades. As Dr. Prager testified, "each of the mortgage loans here represent only about 80% of the value, the initial value of the home. So even if there were to be a default, before there is loss to

that loan, the value that was realized from selling the home would have to be at least 20% where it was sold” (*id.* at 2996). There were also protections at the “pool level.” Dr. Prager testified that there was an additional level of equity and over collateralization at the pool level from mixing mortgage notes, and that, on average, the FICO score was closer to 625 and could be considered “near prime,” as opposed to “subprime” (*id.* at 2996). Also, there was protection because of “excess spread,” where the funds take in more in interest (Prager gave the example of 5%) than they are paying out in interest (Prager used an example of 4%). This excess spread of 1% “provides additional support for the RMBS securities” (*id.* at 2998).

Dr. Prager described an even greater “equity cushion” for the UK RMBS (*id.* at 2999) and discussed additional protection from the UK RMBS’ “master trust structure,” whereby new loans and new collateral constantly enter the pool (*id.* at 2999-3000). Finally, Dr. Prager testified that there were even further protections for the UK RMBS at issue because “overcollateralization at the pool level was about ten percent and then there were also reserved funds that were set up at initiation where there was additional cash set aside in order to cover the loans” (*id.* at 3000). Dr. Prager testified that there were similar structural protections in the CLOs (*id.* at 3000-3001).

5. Assured’s Result

Based on its modeling, and again, using Intex data for the very securities at issue, Assured calculated losses in favor of LBIE of \$27,577,817.65. Subtracting this amount from the \$48,241,117.85 in unpaid premiums that LBIE would have owed, the loss calculation was in Assured’s favor at \$20,663,300.20.

Using its discounted cash flow analysis and projections used across its business, Assured calculated that it would owe nothing on the UK RMBS, CLO, and CDO trades because there would ultimately be no losses (*see* JX 34 [Assured’s statement of calculations dated October 16, 2009]). During the crisis, these transactions remained investment grade (Rosenblum Tr. at 1309-1310 [“We’re so far removed from a loss emerging that it is very difficult to imagine a loss coming out and assigning a real probability that this would occur to Assured.”])).

Mr. Rosenblum testified that the surveillance runs that he performed for these assets showed no losses (*see id.* at 1296-1299) because Assured assumed a conservative stress case of a 5.4% base loss rate (historically the losses were .1 percent or less) (*see* AX 20020, tab 4). This, according to Rosenblum, combined with the senior tranche status of the layer, for which Assured

provided protection, meant no losses: “We have a base case loss of 5.4 percent, and our credit enhancement is 11.7 percent. So, in other words, losses would have to double to get to any—to—and then it still wouldn’t attach to our layer” (*id.* at 1309).

Again, Assured ran its data through Intex, an industry standard platform for modelling cashflow models. And, again, like the ABX, the data was for the exact transactions at issue. Therefore, in calculating how these transactions were going to perform, Assured looked at actual performance data. As Mr. Rosenblum testified:

“for all our transactions that attracted loss reserves, particularly in the RMB—in the mortgage-backed securities space, the first place we looked at is the actual performance data of the transaction. That’s really the most important piece in some ways is: How are the borrowers in the transaction performing? Are they going delinquent? Are they—are their homes being liquidated? If so, what loss severities? Do prepayments exist? And that is really the starting place for looking at it. And then, above that, we layered in out—anything else we could see in the market that we thought was useful”

(*id.* at 1213).

Thus, Assured utilized the same practices that it employed in its general course of business in determining how the Securities were likely to perform. In doing so, it took into account the relative strength of the underlying instruments, including their senior position in the pool, the improving market conditions, and significant structural protections. It also used data for the very securities at issue from Intex, a recognized industry platform. The default rate it came up with is close to the default rate from Moody’s and S&P (see Prager Tr. 3344, testifying that Moody’s and Assured’s default rates were not materially different).

III. LEGAL FRAMEWORK

It bears repeating that, because the auction had failed, Assured was entitled to calculate utilizing the “Loss” method. Again, the definition for “Loss” under the contract between the parties is:

“an amount [the Non-Defaulting 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] group of Terminated Transactions ..., including any loss of bargain, cost of funding or, at the election of such party but without duplication, loss or cost incurred as a result of its terminating, liquidating, obtaining or reestablishing any hedge or related trading position (or any gain resulting from any of them).”

Again, under the ISDA Master agreement “A party may (but need not) determine its Loss by reference to quotations of the relevant rates or prices from one or more of the leading dealers in the relevant markets.”

In general, “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” (*In re Lehman Bros. Holdings Inc v Intel Corp.*, 2015 WL 7194609 at *12 [Bankr SDNY Sept. 16, 2015] [*Intel*]; see also *Barclays Bank PLC v Devonshire Trust*, [2013] OJ No 3691, ¶ 268 [Can Ont] [CA] [holding that “the ISDA Master Agreement requires a Non-Defaulting Party's calculation of Loss to be reasonable and made ‘in good faith.’ It must also produce a commercially reasonable result”]). The court in *Intel* has described loss method as “an express alternative to the rigid methodology and procedure of . . . Market Quotation” (*Intel, supra* at *11).

Certain cases have endorsed the concept that “Loss and Market Quotation are, although different formulae, aimed at achieving broadly the same result, so that outcomes derived from one may be usefully tested by way of cross-check reference to the other” (*Anthracite Rated Invs. (Jersey) Ltd. v Lehman Bros. Finance, S.A.*, 2011 EWHC 1822 (Ch) [Eng.] at ¶ 116 [1-2]). Nevertheless, “there may be circumstances in which the Market Quotation measure would not operate satisfactorily” (*Peregrine Fixed Income Ltd. v Robinson Dep’t Store Public Co. Ltd.*, [2000] CLC 1, 328 [Eng.] [“*Peregrine*”]).

Commentary to the ISDA Master Agreement confirms that “Loss” is supposed to be flexible, involves more than what a Market Quotation exercise would take into consideration, but still may take into account market prices. The “User's Guide to the 1992 ISDA Master Agreements” states:

“Under the 1992 Agreements a payment on early termination can be viewed as consisting of the following three components: (i) payments for obligations which became payable or deliverable but which were not paid or delivered prior to the Early Termination Date, (ii) payments for obligations which would have been payable or deliverable prior to the Early Termination Date if all conditions to payment or delivery (such as the absence of any Event of Default) had been satisfied or if the Early Termination Date had not been designated and (iii) payments for the future value of the Terminated Transactions or the Agreement, as the case may be.... Amounts referred to in clause (iii) are included in the

definition of ‘Market Quotation’. Amounts referred to in clauses (i) - (iii) are encompassed within the definition of ‘Loss.’”

Thus, “Loss” is clearly broader than “Market Quotation” and, to some degree, payments for the future replacement value of the transactions may be included in the calculation of “Loss” (see *Bank of New York Mellon Tr. Co., N.A. v Solstice ABS CBO II, Ltd.*, 2012 WL 13070212, at *7 [SDNY Mar. 28, 2012] [“The User's Guide thus confirms that both the definitions of “Market Quotation” and “Loss” include calculations of the future value of the Transaction”]). For instance, in *CDO Plus Master Fund Ltd. v. Wachovia Bank, N.A.* (2011 WL 4526132 [SDNY Sept. 29, 2011]), the court approved Wachovia’s estimate because it was able to acquire a quotation and two indications from Reference Market-makers (*id.* at *2; see also *Brittania Bulk PLC [in liquidation] v Pioneer Nav. Ltd.* [2011] EWHC 692 (Comm) [“(I)t would be very odd if the two payment measures [i.e. loss and market quotation] were not intended to achieve broadly the same result.”]).

Nevertheless, there are many times, especially during occasions of market disruption, when applying the two valuation measures causes extremely divergent results. (see e.g. *Devonshire, Anthracite Rated Invs. (Jersey) Ltd. v Lehman Bros. Finance S.A.* [2011] EWHC 1822 (Ch) [Eng.] at ¶¶ 16-17 [both these cases involved the same time period as that involved in this case]).

The ISDA Master Agreement anticipates times when a market quotation will diverge sharply from other valuation methods by stating that a non-defaulting 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” (see also *Lehman Bros. Holdings Inc. v Intel Corp.*, 2015 WL 7194609, *11 (Bankr SDNY Sept. 16, 2015) [interpreting exact same loss provision and holding it is within a party's discretion not to use market quotations in determining Loss]). The ISDA Master Agreement also specifically states that, even if there were relevant market quotations, the non-defaulting party need not take them into consideration where to do so “would not (in the reasonable belief of the party making the determination) produce a commercially reasonable result” (ISDA Master Agreement [JX 1 at 16] [Definition of “Settlement Amount” (b)]).

Thus, under the ISDA Master Agreement, the non-defaulting party “need not” consider market prices, especially where to do so would render the Termination amount “commercially unreasonable.” By limiting the use of market prices, ISDA thereby contemplates a situation, like

the one here, where market prices are completely divorced from value. In addition, ISDA's "Loss" provision is flexible enough to take into account all types of "loss of bargain," even Assured's, which had nothing to do with market prices.

Where reference to market prices does not always lead to a commercially reasonable result, courts favor a valuation that does not use market prices. "If a market price is unavailable or the market is disrupted or dysfunctional, one must use a different method [than market prices]" (*In re Am. Home Mtge. Holdings Inc.*, 411 BR 181, 190-193 [Br Del 2009], *affd* 637 F3d 246, 257 [3d Cir 2011] [finding that the "commercially reasonable determinant of value" for measuring damages was "discounted cash flow method" where there was no dispute that the "mortgage market was dysfunctional on the acceleration date"]).

Market prices leading to a commercially unreasonable valuation is especially likely during periods of severe market disruption where reliable market prices may not exist. Courts have therefore made distinctions between market prices and the value of an instrument during times of market disruption (*see National Credit Union Admin. Bd. v UBS Sec., LLC*, 2016 WL 7496106, at *5 [D. Kan. Dec. 30, 2016] ["The lack of a market does not necessarily mean, however, that the OTCs had no value to NCUA-Liq, and indeed, the possibility of future income suggests that the OTCs did have some value."]). The *National Credit* court also questioned why a discounted cash flow model would not be appropriate in times of illiquid markets (*id.*).

A valuation during the same time period of severe market disruption as that involved here is exactly what occurred in the closely analogous Canadian case of *Barclays Bank, PLC v Devonshire Trust* (2011 CarswellOnt 9183 [Ca. Ont. Sup. Ct J.] [*Devonshire Trial Decision*], *affd in part, revd in part Barclays Bank PLC v Devonshire Trust*, 2013 CarswellOnt. 11271 [Ca. Ont. CA] [2013] [*Devonshire Appellate Decision*]). Like here, the parties operated under the identical ISDA provisions regarding "Loss" and there was a huge discrepancy in valuations. Barclays claimed to have suffered a loss of \$1.2 billion [2011 *Devonshire Trial Decision* at ¶ 5). Meanwhile, Devonshire claimed Barclays was entitled to, at most, \$12,000 (*id.* at ¶ 143). Devonshire, like Assured here, "sold Barclays protection against the possibility of credit defaults" (*id.* at ¶ 115), while Barclays, like LBIE, paid Devonshire a monthly premium for this protection (*id.* at ¶ 15). Like the Transactions in this case, the assets in the portfolio in *Devonshire* were "super senior" (*id.* at ¶ 20), meaning the risk of loss was relatively low.

Importantly, like here, Devonshire tried, but was unable to obtain, any quotation from any market participant (*id.* at ¶ 335).

The timing in *Devonshire* is critically similar to the timing here. The valuation date in *Devonshire* was January 13, 2009, while the valuation date here is July 23, 2009. In addition, both here and in *Devonshire*, the valuation date was removed from the actual date of default. In *Devonshire*, there was a 17-month standstill (*id.* at ¶ 369). Here, Assured terminated the Transactions 10 months after Lehman declared bankruptcy. Again, LBIE does not argue that this gap was improper.

The *Devonshire* trial judge rejected Barclays' \$1.2B valuation. Noting the disruption in the market in 2009 due to extreme illiquidity, and the failure to obtain any market quotation from the auction, the court rejected Barclays' attempt to recreate market prices via their proprietary model:

“It makes little sense, in my view, for a party to say there is no identifiable market price, because no one will make a firm bid, i.e. there is no market for the swap, and so we will use some construct to come up with a price as if there were a market and call that construct the market value of our loss. That would be making an assumption that there was a functioning market, and **if there is no functioning market, I see no basis to construct one**. The definition of loss certainly does not indicate that in its language”

(*id.* at ¶ 403 [emphasis added]).

In reaching this conclusion, the court noted the extreme market disruption that existed in 2009:

“In this case, the ABCP market in January 2009 had been frozen and in turmoil for seventeen months and the collapse of Lehman Brothers and other financial institutions had caused the worst financial crisis in the market in 2008 since at least the 1930s”

(*id.* at ¶ 415).

The *Devonshire* Appellate Court also recognized these tumultuous circumstances. The *Devonshire* Appellate Court credited Leslie Rahl's view (**LBIE's expert here**) that:

“a number of events leading up to January 2009 had changed the economics of the CDSs and created what she [Rahl] viewed as temporarily aberrant risk premiums for CDSs in general: (i) the 17-month Standstill Agreement, an unprecedented factor in addressing issues surrounding the calculation of Early Termination payments under an ISDA Master Agreement; (ii) the 2008 financial

crisis, which led to extreme illiquidity in the market; and (iii) the temporary, but extraordinary, illiquidity in the market around January 2009”

(*Devonshire Appellate Decision* at ¶ 238).

Instead, the trial judge accepted Devonshire's expert's opinion that a discounted cash flow method of valuation was reasonable under the circumstances. Those circumstances included accepting the evidence that the market in early 2009 was highly illiquid (*Devonshire Trial Decision* at ¶ 409). Relying on this model, the trial judge valued Barclays' Loss at \$12,000 but reduced it to \$0 based on mitigation. In arriving at this value, the trial judge declined to adopt Devonshire's expert's view that the \$12,000 figure should be increased by a \$264 million risk premium.

Although the *Devonshire* Appellate Court would go on to reverse the calculation of Barclays' Loss, because Devonshire had not included a standardized risk premium, this circumstance is irrelevant. Here, we are not calculating LBIE's Loss (Barclays' equivalent),¹² but rather Assured's Loss (Devonshire's equivalent). The calculation of Devonshire's Loss was not appealed. The critical importance of the *Devonshire Appellate Decision* to this case is that decision affirmed the rejection of Barclays' market-based valuation because of the financial meltdown that existed at the end of 2008-beginning of 2009:

“Particularly given the events that occurred during the intervening 17-month period, including the 2008 financial crisis, the extreme illiquidity in the market, and the temporarily aberrant risk premiums that existed in January 2009, the operation of the Standstill Agreement rendered Barclays' model-based valuation of Loss commercially unreasonable. In normal circumstances, the special features of the swaps (including the liquidity feature, the stop-loss feature, and the limited-recourse provision) effectively capped the real value of the CDSs to Barclays on termination at the amount of the posted collateral in place at any particular time. In effect, Barclays' use of its model-based valuation was an attempt to shift the entire consequences of failing to achieve a restructuring during the Standstill on to Devonshire.

Moreover, as the *Devonshire* trial judge found, as of January 2009, there was simply no willing buyer and no willing seller for the CDSs at any price approximating that produced by Barclays' model. The significant inflation in risk premiums during the Standstill Period had caused the model-based value of the

¹² In *Devonshire*, the court undertook to calculate the Loss for both parties, rather than just one, for reasons not relevant here.

CDSs to increase beyond any realistic estimate of their underlying real worth, taking account of their special features”

(*Devonshire Appellate Decision* at ¶¶ 271-272 [emphasis added]).

None of LBIE’s cases discuss what happens when the markets are so dislocated that there are no market bids from which to derive a quotation. *Devonshire* addresses the exact situation involved here, i.e., the absence of an operating market during 2009. Those decisions, both trial level and appellate, dealt with a proffered valuation based on contrived market prices versus a valuation based on cash flows and involved an even greater difference than the valuations in this case. Yet, given the illiquidity and dislocated market, the court rejected Barclays’ valuation based on theoretical market prices.

IV. ANALYSIS

LBIE failed to prove the existence of a uniform market practice of resorting to market prices to determine “Loss,” much less Assured’s Loss, which had nothing to do with market prices. By putting all its eggs in the market price basket, LBIE has failed to show both that Assured’s valuation was unreasonable, and that its own valuation, whereby its was owed more than \$450 million, was reasonable. Meanwhile, Assured’s valuation was reasonable and calculated in good faith.

A. There was No Uniform Market Practice

As explained earlier, under the ISDA contract, because the auction had failed to produce a single bid Assured did not have to try to determine its Loss by reference to dealer quotations. Instead, Assured used a discounted cash flow analysis whereby it netted the premium payments LBIE would have owed over the life of the transactions against the amounts Assured would have had to pay to cover expected shortfalls in interest and principal on the Securities.

As already discussed, the premium amounts are not disputed. LBIE takes issue with the amounts Assured calculated to cover expected shortfalls. LBIE’s primary argument is that Assured’s calculation was unreasonable because it departed from what LBIE sees as a uniform market practice of calculating Loss based on market prices. Where no actual market prices are available, LBIE contends that it is industry practice to develop a model to estimate theoretical market prices using available market prices or data. LBIE then advocates for the use of the theoretical valuation its experts composed for this litigation.

LBIE came nowhere close to proving a uniform market practice to value utilizing only market prices. LBIE never explains away cases, such as *Devonshire*, where the court soundly rejected a valuation based on theoretical market prices for similar securities during the same time period of market disruption at issue in this case. Moreover, a review of the evidence reveals that, particularly at times of extreme market disarray, there was no consensus on valuation methods, because prices became divorced from value (*see Bear's Lair* 2009, AX 50056 at 25-26 [finding “that current market prices of ABX.HE are inconsistent with any reasonable assumptions for future default rates” such that there is “serious doubt on the current practice of using these securities to mark portfolios of subprime mortgages to market”]; BOE Oct. 2008 Report, AX-50072 at 11; BIS March 2009 Working Paper, AX-50019 at 19 [identifying factors that “may limit the usefulness of ABX price quotes for valuation purposes and as indicators of future write downs and losses by ABX investors” and stating that “default-related losses on subprime MBS instruments . . . may ultimately turn out to be significantly lower than recent ABX prices would seem to imply”]; Cohn, “*Bruised but Best in Show*,” AX 90199 [(I)n a distorted market, finding an accurate means of calculating damages may be difficult.”]; *see also Anthracite Rated Invs. (Jersey) Ltd. v Lehman Bros. Finance S.A.* [2011] EWHC 1822 (Ch) [Eng.] at ¶ 84 [noting “the valuation and liquidity difficulties affecting hedge fund portfolios” in 2009]; Firth Derivatives Law and Practice [2021], AX 90021 at 211 [“Where there is no available market for a replacement transaction, it may not be possible to establish Loss by reference to market price.”]).

Even some of LBIE’s own experts have utilized different valuations in other cases. For example, in *Devonshire*, that again involved an ISDA Master Agreement containing the same definition for “Loss,” Leslie Rahl, LBIE’s own expert, did not rely on prevailing market prices (*see* AX 90026 at 8 [Rahl expert report in *Devonshire*]). Instead, she factored in many of the same circumstances that Assured used here, including the disrupted market conditions in 2009, and came up with a normalized risk premium that did not rely on market prices. In *Devonshire*, Rahl noted that in January 2009, the disparity between a cash flow valuation and a mark-to-model valuation was quite large and was “**the subject of much debate**” (*see Devonshire Trial Decision* ¶ 239 [emphasis added]). The “subject of much debate” implies the opposite of a uniform market practice.

In addition, Professor Niculescu, LBIE’s primary valuation expert, performed a valuation similar to what Assured performed here in *Bank of New York Mellon Tr. Co., N.A. v Solstice ABS*

CBO II, Ltd. (910 F Supp 2d 629 [SDNY 2012]; see also *Bank of New York Mellon Tr. Co., N.A. v Solstice ABS CBO II, Ltd.*, 2012 WL 13070212, at *7 [SDNY Mar. 28, 2012]), albeit under circumstances far different and perhaps without real disagreement as to methodology. Nevertheless, this circumstance undercuts LBIE's argument that there was a standard practice. Indeed, Dr. Niculescu explained that he used this analysis in *Solstice* because "there were no market prices available" and because the "swap in question . . . was not tradeable, it was embedded in a particular structure, it was unique These were bespoke and non-tradeable" (Tr. at 1767-1768). But the Transactions here involved bespoke (monoline specific) terms and were not tradeable, as the lack of bids at the auction demonstrates.

Also, LBIE never explains how this purported uniform industry practice could have possibly worked in the first half of 2009 given the extreme dislocation in the market and the extreme illiquidity. It was these circumstances that led the *Devonshire* court to reject Barclays' valuation based on market prices. Nor does LBIE explain how a uniform industry practice of resorting to market prices could ever work to approximate Assured's Loss as a monoline insurer that insured payments over the life of the Transactions. LBIE did not cite to a single case where a court used a theoretical pricing model to calculate Loss for transactions with economic terms similar to those here.

As discussed earlier, LBIE's attempts at novation and the indicative bids LBIE obtained are irrelevant (see discussion, *infra*). So, too, is the evidence of private settlements with other monoline insurers. There is no evidence those insurers protected the same AAA level securities,¹³ under the same terms, such as pay as you go, lack of collateralization, etcetera. More importantly, LBIE does not point to any monoline settlement where the monoline was not the defaulting party, such that it was the counterparty of the monoline whose loss was being calculated. Here, Assured, a monoline, is the non-defaulting party and therefore it is Assured's Loss that needs to be calculated, not LBIE's.

Finally, LBIE's settlements with other entities, who were NOT monoline insurers and that had contracts with materially different terms, are irrelevant. Although these other entities,

¹³ To the contrary, other monolines insured far riskier tranches of asset backed securities (Rosenblum Tr. at 1229).

including other investment banks, may have settled based on what they may have viewed as market prices (we do not really know), it does not mean Assured's calculations were unreasonable, especially as many of the others involved collateralized CDS and involved physical settlement, making them irrelevant to the court's analysis. The Transactions here were not collateralized and did not involve physical settlement.

B. LBIE's Speculative Model Constructed Hypothetical Market Prices

LBIE continues that, even if there were not a uniform practice, Assured's Loss calculation contradicted available market prices and was therefore wrong. To prove its point, LBIE interposed a valuation model, that Dr. Niculescu created out of whole cloth, that attempted to calculate a hypothetical market price based on various pricing proxies.

Despite Dr. Niculescu's detailed and interesting valuation, it has no application to the real world at the time. Rather, the evidence at trial demonstrated a total lack of a market for the securities at issue in this case. That LBIE's experts had to create market prices through increasingly speculative projections reflects this lack. That no market participant bid at the auction is strong evidence that there was no market and no way of pricing these Transactions.

This case is on all fours with *Devonshire* in all relevant respects. In *Devonshire*, the Appellate Court rejected Barclays' valuation based on market prices because "Barclays' use of its model-based valuation as of January 13, 2009 produced a commercially unreasonable result (*Devonshire Appellate Decision* at ¶ 285). The *Devonshire Appellate Decision* found Barclays' valuation to be commercially unreasonable because:

"[a]pplying quite different market circumstances 17 months later, in circumstances where liquidity calls, collateral calls and stop-loss features were suspended in the intervening period, departs from the original intent of the ISDA Master Agreement. Particularly given the events that occurred during the intervening 17-month period, including the 2008 financial crisis, the extreme illiquidity in the market, and the temporarily aberrant risk premiums that existed in January 2009, the operation of the Standstill Agreement rendered Barclays' model-based valuation of Loss commercially unreasonable. . . In effect, Barclays' use of its model-based valuation was an attempt to shift the entire consequences of failing to achieve a restructuring during the Standstill on to *Devonshire*. Moreover, as the trial judge found, as of January 2009, there was simply no willing buyer and no willing seller for the CDSs at any price approximating that produced by Barclays' model"

(*Devonshire Appellate Decision* at ¶ 272).

The contractual terms, the gap in time between the event of default and termination, the market dislocation, and the failed auction that led the *Devonshire* court to reject Barclays' valuation are all present in this case. Thus, as the court did in *Devonshire*, this court rejects LBIE's contention that there was a standard industry practice to use market prices when the market itself was in total disarray, such that the auction for the very Securities at issue did not receive even one bid. At bottom, there just was no market to generate prices. The theoretical prices that LBIE's experts come up with are just that – theoretical. Like the *Devonshire* court concluded, if there is no market for the securities, and dislocation divorces prices from value, then there is no basis upon which to construct a market.

C. Market Prices Were Irrelevant to Assured's "Loss of Bargain"

Even if there were a market, the ISDA Master Agreement did not require Assured to calculate Loss using available market prices or data: “[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” (ISDA Master Agreement at 15 [“Loss Definition”] [emphasis added]). Rather, the ISDA Master Agreement allowed Assured to calculate its loss in any commercially reasonable manner (*see Intel*, 2015 WL 7194609, at *11 [Bankr SDNY Sept. 16, 2015]).

Moreover, Assured's “Loss” had nothing to do with market prices because Assured is a monoline insurer. Unlike LBIE, it was not in the business of trading and making a profit on the Securities. Its income derived from the premiums minus what it would have to pay to cover payment shortfalls in the Securities. Because Assured had an obligation to cover shortfalls over the life of the Securities, what mattered in calculating Assured's Loss was the rate of defaults of the underlying loans feeding these Securities, not the market value of the instruments. Therefore, the worth of the Transactions in the market is utterly irrelevant to Assured's Loss.

A theme running through some of the legal decisions is that market quotation and Loss are supposed to reach broadly the same result (*see e.g. Peregrine; Anthracite; the S/J Decision*). However, it is not at all clear to this court why this should be the case. Nothing in the 1992 ISDA Master Agreement directs this. After all, we are measuring the “loss of bargain” of a non-defaulting party who had a completely different role than its counterparty. Here, LBIE's valuation, a contrived proxy for market quotation, actually puts Assured in a worse position than if the Transactions had not been terminated. Assured would be required to make a huge payment

to LBIE in one lump sum, rather than paying over time. It would have no replacement transaction and would have lost the cash flow from the premiums. How then does LBIE's valuation measure the loss of bargain to Assured, the non-defaulting party? If Assured's method, which relies heavily on projected defaults, is applied, it simply receives the cash flow it would have received had the Transactions not been terminated. Therefore, LBIE misses the point in asserting that LX 355, an internal Assured document meant to comply with FAS 157, and LX 170, reflecting certain calculations for Assured's GAAP accounting, is proof that Assured had no problem obtaining market prices for its own internal purposes. Assured was to calculate its own loss of bargain, not LBIE's. LX 355 was for a completely different purpose. LBIE keeps forgetting that once the auction failed, Assured was entitled to resort to Loss methodology that "NEED NOT" utilize market prices.¹⁴ These valuations were for another purpose, i.e., to comply with GAAP for reporting obligations.

Thus, LBIE's valuation was commercially unreasonable under the circumstances. Because Assured insured the payment flow of the Transactions, not their market value, the Loss to Assured depended on how the Transactions actually performed. This in turn depended on the rate of default of the underlying loans, NOT on the market prices for the Transactions. LBIE's valuation is therefore irrelevant to Assured's Loss and actually puts Assured in a worse position than had the Transactions never terminated.

D. Assured's Valuation

Having put all its eggs in the market price basket, LBIE is left to quibble with Assured's discounted cash flow valuation. As explained earlier, Assured used actual market data for the specific Transactions at issue, available through Intex, an industry standard platform, to come up with a default rate of 28%. From there, Assured calculated that it would owe LBIE about \$27 Million on the ABX transactions and nothing on the rest.

For example, LBIE complains that the information from Intex that Assured used was stale because it was based on data from the second half of 2008 and, therefore, Assured's

¹⁴ If the court considers LX 355 and 170, then, in all fairness, it should also consider LBIE's valuation memo demonstrating that trades were worth nothing to LBIE due to the pay as you go structure (JX-67). However, all these documents are unnecessary to the conclusion the court reaches today.

liquidation rate was inaccurate.¹⁵ However, as Rosenblum, Assured's Chief Actuary, explained, the liquidation rate is merely an outcome of Assured's initial default rate. This, as Rosenblum testified, was based on current performance data reflecting actual delinquencies as of 2009 (Tr. at 1265-1268). Moreover, it stands to reason that liquidation rates do not change much over time, because that rate depends largely on how fast a bank can foreclose (*id.* at 1259).

LBIE also complains that Assured's loss severity curve of 70% was too low. However, the record demonstrated that Assured's calculation was smack in the middle of the other potential rates. For example, JP Morgan and Moody's reported using lower rates (Prager Tr. at 3065-3068). Meanwhile, plaintiff's expert, Dr. Niculescu, unreasonably picked the absolute highest loss severity rate of 75% among all the market participants. Professor Niculescu also looked back too far at the falling housing market. While the housing market had been falling consistently since 2006, Dr. Niculescu ignored that housing prices were showing signs of recovery by mid-2009 (*see e.g.* Case Schiller report [AX 90198]; Moody's August 2009 report [AX 50044]). He also projected losses all the way to 2020. This was unrealistic (*see* Prager Tr. at 3019 [testifying this period was significantly longer "even though it was already known the recession was over"]).

LBIE complains that just about everyone else, including the ratings agencies, had liquidation and default rates higher than Assured. Remember, Moody's had a default rate of 30%, S&P had a default rate of 32%, and Fitch had a default rate of 39%, compared to Assured's default rate of 28%. This discrepancy is significant in that a couple of percentage points makes a difference of hundreds of millions of dollars. However, the discrepancy is insufficient to amount to being legally unreasonable (Prager Tr. at 3344 [testifying that Moody's and Assured's default rates were not materially different]). This is because the valuations here are subject to projections based on assumptions about how the market would perform. Assured made the assumptions that the housing market would recover by 2012 and that most of the borrowers who were going to default had already done so (seasoning). In reaching these conclusions, Assured relied on actual market information from Intex, an industry standard platform, as to how the very Securities at issue were performing at the time. Thus, Assured made reasonable assumptions as to how the

¹⁵ The default rate is the percentage of the asset class that defaults, and the liquidation rate is percentage recovered (*see* Rosenblum Tr. at 1159-1160).

loans would perform in the future, based on that data and taking into consideration how these pools of mortgages performed historically.

Assured also took into consideration that these instruments had significant structural protections, largely due to their senior tranche, AAA status. There were further structural protections at the individual mortgage level that Assured also took into account, including that most of the loans covered only 80% of the home value, such that that 20% could be recovered in a foreclosure. On the pool level, Assured took into account protections, such as excess spread. Finally, Assured also took into account that the non-ABX trades maintained investment grade status throughout the crisis.

Under the ISDA agreement between the parties, once the auction failed, Assured was well within its rights to calculate using the Loss method, without resorting to market prices. Assured was to calculate its own loss, NOT LBIE's. To calculate its own loss, Assured merely used the same models it used throughout its business. The projections it made relied on reasonable assumptions that many others in the market had made. Assured took into account data from Intex for the specific Transactions at issue and also took into account the significant structural protections inherent in them. Thus, Assured demonstrated *prima facie* that its calculations were reasonable and in good faith.

LBIE never addresses the structural protections that Assured's experts discussed at trial. All LBIE asks for at the end of its opening brief (EDOC 777 at 74) is that this court alternatively average the highest default rates from certain banks (including Barclays' inflated number), throwing in Fitch and S&P's numbers to round it out. Predictably, LBIE does not include the lowest 30% default rate from Moody's that was so close to Assured's 28%. In the 11 years this case has been pending, LBIE never asked for this alternative valuation. Instead, it staked its position on unreasonably high numbers that bore no relation to reality. This does nothing to refute Assured's *prima facie* showing that the 28% was reasonable, even though Assured's rate was somewhat lower than rates from Moody's and S&P. It was ultimately reasonable to assess a default percentage slightly lower than the ratings agencies, because of the structural protections inherent in these instruments about which Assured's experts testified. Because LBIE never adequately addressed the structural protections on these securities, it failed to rebut Assured's *prima facie* showing, despite Assured's default rate being slightly lower than the rates from the

ratings agencies. The court has considered LBIE’s remaining contentions and finds them unavailing.

Accordingly, after trial, the court finds in favor of Assured. The parties are to attend a conference on March 20, 2023, at 11:00 a.m. over Microsoft Teams, to discuss next steps, including entry of judgment and calculation of attorney’s fees.

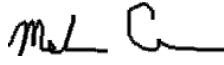
<u>3/8/2023</u> DATE	 HON. MELISSA A. CRANE, J.S.C.			
CHECK ONE:	<input type="checkbox"/>	CASE DISPOSED	<input type="checkbox"/>	NON-FINAL DISPOSITION
	<input type="checkbox"/>	GRANTED	<input type="checkbox"/>	GRANTED IN PART
	<input type="checkbox"/>	DENIED	<input checked="" type="checkbox"/>	OTHER

EXHIBIT C

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

NOTICE OF ENTRY

PLEASE TAKE NOTICE that attached hereto is a true and correct copy of the Judgment in the above-captioned action entered by the Clerk of the County of New York on June 30, 2023.

Dated: June 30, 2023
New York, New York

CLEARY GOTTLLIEB STEEN &
HAMILTON LLP

/s/ Roger A. Cooper

Lev L. Dassin

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VIA NYSCEF

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T: 212-849-7000

*Attorneys for Plaintiff Lehman Brothers
International (Europe) (in administration)*

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

-----X
LEHMAN BROTHERS INTERNATIONAL (EUROPE)
(in administration),

Plaintiff,

- against -

AG FINANCIAL PRODUCTS, INC.,

Defendant.
-----X

Index No. 653284/2011

~~PROPOSED~~ **JUDGMENT**

Plaintiff Lehman Brothers International (Europe) (in administration) (“Plaintiff”), having commenced this action on November 28, 2011, by filing a Summons and Verified Complaint (“Complaint”); and Defendant AG Financial Products, Inc. (“Defendant”), having filed a Verified Answer to Plaintiff’s Complaint and Defendant’s Counterclaims on April 22, 2013; and Plaintiff having filed a Verified Reply to Defendant’s Counterclaims on May 13, 2013;

This Court having entered a Decision/Order on March 12, 2013, dismissing the first cause of action of the Complaint for Breach of the Implied Covenant of Good Faith and Fair Dealing, which was the sole claim concerning the termination of the December 2008 Transactions,¹ and thus dismissing all Plaintiff’s claims with respect to the December 2008 Transactions;

This Court having entered a Decision/Order on July 2, 2018, dismissing the third cause of action of the Complaint for Breach of the Implied Covenant of Good Faith and Fair Dealing with respect to the July 2009 Transactions and the second cause of action of the Complaint for Breach

¹ Capitalized terms used by otherwise not defined herein shall have the meanings ascribed to them in the Complaint.

of Contract with respect to the July 2009 Transactions solely to the extent that it is based upon Assured's conduct in connection with the Market Quotation Auction; and

This matter having been tried over a five-week period beginning on October 18, 2021 and ending on November 19, 2021, and upon further proceedings on February 28, 2022, and upon post-trial briefing submitted on April 22, 2022 and upon further post-trial briefing submitted on June 21, 2022, and upon further proceedings on May 9, 2023; and Plaintiffs, having appeared by its attorneys, Quinn Emanuel Urquhart & Sullivan, LLP, and Defendant, having appeared by its attorneys, Cleary Gottlieb Steen & Hamilton LLP; and this Court having heard the testimony and received evidence and after due deliberation thereon, issued a Decision After Trial dated March 8, 2023, finding that Plaintiff's only remaining Second Cause of Action with respect to the July 2009 Transactions should be dismissed and that Defendant is entitled to judgment on its counterclaim against Plaintiff in the amount of \$24,623,630.06, exclusive of interest and attorneys' fees, costs and disbursements;

NOW, it is **ORDERED, ADJUDGED AND DECREED**, that Plaintiff's Second Cause of Action and all other remaining claims with respect to the July 2009 Transactions and all Plaintiff's defenses are dismissed; and it is

FURTHER ORDERED, ADJUDGED AND DECREED, that Defendant, AG Financial Products, Inc., with offices at 1633 Broadway, 23rd Floor, New York, NY 10019, shall have judgment pursuant to the dismissal of the first cause of action against Plaintiff, Lehman Brothers International (Europe) (in administration), with offices at Regus Level 5, Tower 42, 25 Old Broad Street, London EC2N 1HN, in the amount of \$3,960,329.86, plus interest thereon at the rate of ~~nine percent (9%) compounded daily from December 24, 2008~~ / eight percent (8%)

simple from September 15, 2008] through the date this judgment is entered in the sum of

4,649,958.03

\$ _____; and it is

FURTHER ORDERED, ADJUDGED AND DECREED, that Defendant shall have judgment on its counterclaim against Plaintiff in the amount of \$20,663,300.20, plus interest

thereon at the rate of ~~nine percent (9%) compounded daily from July 23, 2008~~ eight percent

(8%) simple from September 15, 2008] through the date this judgment is entered in the sum of

24,261,545.02

\$ _____; and it is

FURTHER ORDERED, ADJUDGED AND DECREED, that the total award and pre-judgment interest is \$ 53,535,123.11, with post-judgment interest accruing on that sum at the rate

of ~~nine percent (9%) compounded daily~~ / eight percent (8%) simple], from the date this

judgment is entered until the date payment of this judgment is complete; and it is

FURTHER ORDERED, ADJUDGED AND DECREED, that the total judgment as of the date hereof is \$ 53,535,123.11, and Defendant shall have immediate execution thereon; ~~and it~~

is *The clerk is directed to enter judgment accordingly.*

~~**FURTHER ORDERED, ADJUDGED AND DECREED**, that Defendant shall be awarded all reasonable out-of-pocket expenses incurred by Defendant related to this litigation, including attorney's fees and any costs of collection, and that the calculation of such expenses, including any applicable interest, is severed from this judgment and shall be determined in a separate judgment.~~

[Signature]
Hon. Melissa A. Crane, J.S.C.

5-17-2023

30 th Jun. 2023
Date

FILED
Jun 30 2023
NEW YORK
COUNTY CLERK'S OFFICE

Milton Adair Tonglong
Clerk

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

~~PROPOSED~~ JUDGMENT

11 653284

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FILED AND
DOCKETED
Jun 30 2023
AT 11:02 A M
N.Y. CO. CLK'S OFFICE

User Name: Rishi Nachiketa Zutshi

Firm Name: CLEARY GOTTLIEB STEEN & HAMILTON LLP

Address: 1 Liberty Plz, New York, NY 10006

Phone: (212) 225-2085 Service E-mail: rzutshi@cgsh.com