

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

-----X

LEHMAN BROTHERS INTERNATIONAL
(EUROPE) (in administration),

New York County Index No.
653284/2011
Justice Marcy S. Friedman

Plaintiff,

-against-

**VERIFIED ANSWER
AND COUNTERCLAIMS**

AG FINANCIAL PRODUCTS, INC.,

Defendant.

-----X

**VERIFIED ANSWER TO PLAINTIFF'S COMPLAINT
AND DEFENDANT'S COUNTERCLAIMS**

Defendant AG Financial Products Inc. ("Assured Guaranty"), by its undersigned attorneys, as and for its Answer to the Plaintiff's Verified Complaint, dated November 28, 2011 (the "Complaint"), respectfully states as follows:

NATURE OF THE ACTION

1. Assured Guaranty denies knowledge or information sufficient to form a belief as to the truth of the allegations in Paragraph 1, except admits and avers that Assured Guaranty and Lehman Brothers International (Europe) (in administration) ("Lehman International") are parties to the 1992 ISDA Master Agreement dated as of April 7, 2000 (the "Master Agreement") and the Schedule thereto (the "Schedule"), as amended on December 11, 2001 (together, the "Agreement"), and that Assured Guaranty and Lehman International entered into 37

Transactions, each of which was governed by the Agreement and by an individual Confirmation.¹

2. Assured Guaranty admits upon information and belief that Lehman International entered into administration in England on September 15, 2008. The remainder of the allegations in Paragraph 2 purport to state legal conclusions as to which no response is required. To the extent a response is required, Assured Guaranty respectfully refers the Court to the Agreement.

3. Assured Guaranty denies the allegations in Paragraph 3.

4. Paragraph 4 relates to Lehman International's first cause of action, which the Court dismissed on March 15, 2013, and therefore no response is required.

5. Paragraph 5 purports to state legal conclusions as to which no response is required. To the extent a response is required, Assured Guaranty denies the allegations in Paragraph 5.

6. Paragraph 6 purports to state legal conclusions as to which no response is required. To the extent a response is required, Assured Guaranty denies the allegations in Paragraph 6.

7. Assured Guaranty denies the allegations in Paragraph 7, except admits and avers that it sent Lehman International a statement pursuant to Section 6(d)(i) of the Master Agreement on October 16, 2009 (the "Statement of Calculations") setting forth that Lehman International owed Assured Guaranty \$24,799,972.85 with respect to the 28 Transactions terminated on July 23, 2009.

PARTIES

8. Assured Guaranty denies knowledge or information sufficient to form a belief as to the truth of the allegations in Paragraph 8.

9. Assured Guaranty admits and avers that it is incorporated in Delaware and maintains its principal place of business at 31 West 52nd Street, New York, NY 10019.

¹ Capitalized terms not defined herein shall have the meaning given to them in the Agreement.

JURISDICTION AND VENUE

10. Paragraph 10 purports to state legal conclusions as to which no response is required.

11. Paragraph 11 purports to state legal conclusions as to which no response is required.

FACTUAL ALLEGATIONS

12. Paragraph 12 purports to state legal conclusions as to which no response is required. To the extent a response is required, Assured Guaranty denies the allegations in Paragraph 12 and respectfully refers the Court to the Agreement, except admits and avers that Assured Guaranty and Lehman International are parties to the Agreement.

13. Paragraph 13 purports to state legal conclusions as to which no response is required. To the extent a response is required, Assured Guaranty respectfully refers the Court to the Agreement.

14. Paragraph 14 purports to state legal conclusions as to which no response is required. To the extent a response is required, Assured Guaranty respectfully refers the Court to the Agreement.

15. Paragraph 15 purports to state legal conclusions as to which no response is required. To the extent a response is required, Assured Guaranty respectfully refers the Court to the Agreement.

16. Paragraph 16 purports to state legal conclusions as to which no response is required. To the extent a response is required, Assured Guaranty respectfully refers the Court to the Agreement.

17. Paragraph 17 purports to state legal conclusions as to which no response is required. To the extent a response is required, Assured Guaranty respectfully refers the Court to the Agreement.

18. Paragraph 18 purports to state legal conclusions as to which no response is required. To the extent a response is required, Assured Guaranty respectfully refers the Court to the Agreement.

19. Paragraph 19 purports to state legal conclusions as to which no response is required. To the extent a response is required, Assured Guaranty respectfully refers the Court to the Agreement.

20. Paragraph 20 purports to state legal conclusions as to which no response is required. To the extent a response is required, Assured Guaranty respectfully refers the Court to the Agreement.

21. Assured Guaranty denies knowledge or information sufficient to form a belief as to the truth of the allegations in Paragraph 21, except admits and avers that Assured Guaranty and Lehman International entered into 37 Transactions, each of which was governed by the Agreement and by an individual Confirmation, and which referenced mortgage-backed securities, collateralized loan obligations, or collateralized debt obligations.

22. Paragraph 22 relates to Lehman International's first cause of action, which the Court dismissed on March 15, 2013, and therefore no response is required.

23. Paragraph 23 relates to Lehman International's first cause of action, which the Court dismissed on March 15, 2013, and therefore no response is required.

24. Paragraph 24 relates to Lehman International's first cause of action, which the Court dismissed on March 15, 2013, and therefore no response is required.

25. Paragraph 25 relates to Lehman International's first cause of action, which the Court dismissed on March 15, 2013, and therefore no response is required.

26. Paragraph 26 relates to Lehman International's first cause of action, which the Court dismissed on March 15, 2013, and therefore no response is required.

27. Assured Guaranty denies the allegations in Paragraph 27, except admits and avers that it designated July 23, 2009 as the "Early Termination Date" for 28 Transactions based on Lehman International having been placed in administration, among other Events of Default.

28. Paragraph 28 purports to state legal conclusions as to which no response is required. To the extent a response is required, Assured Guaranty denies the allegations in Paragraph 28, except admits and avers that Assured Guaranty sent to Lehman International the Statement of Calculations on October 16, 2009.

29. Assured Guaranty denies the allegations in Paragraph 29 and respectfully refers the Court to the Statement of Calculations, except admits and avers that despite its diligent efforts to obtain quotations from Reference Market-makers during a two-week bidding period that concluded in September 2009, Assured Guaranty did not receive any final quotations and thereafter calculated the Termination Amount based on the Loss method as required under the Agreement.

30. Paragraph 30 purports to state legal conclusions as to which no response is required. To the extent a response is required, Assured Guaranty denies the allegations in Paragraph 30, and respectfully refers the Court to the Agreement.

31. Assured Guaranty denies the allegations in Paragraph 31.

32. Assured Guaranty denies the allegations in Paragraph 32, and respectfully refers the Court to the Statement of Calculations.

33. Assured Guaranty admits and avers that it sent to Lehman International the Statement of Calculations on October 16, 2009, and respectfully refers the Court to the Statement of Calculations.

34. Assured Guaranty denies the allegations in Paragraph 34.

35. Paragraph 35 purports to state legal conclusions as to which no response is required. To the extent a response is required, Assured Guaranty denies the allegations in Paragraph 35.

36. Assured Guaranty denies knowledge or information sufficient to form a belief as to the truth of the allegations in Paragraph 36.

37. Assured Guaranty denies the allegations in Paragraph 37.

**FIRST CAUSE OF ACTION
BREACH OF THE IMPLIED COVENANT OF GOOD FAITH AND FAIR DEALING -
DECEMBER 2008 TRANSACTIONS**

38. Assured Guaranty incorporates its responses to the foregoing paragraphs as if fully set forth herein.

39. Paragraph 39 relates to Lehman International's first cause of action, which the Court dismissed on March 15, 2013, and therefore no response is required.

40. Paragraph 40 relates to Lehman International's first cause of action, which the Court dismissed on March 15, 2013, and therefore no response is required.

41. Paragraph 41 relates to Lehman International's first cause of action, which the Court dismissed on March 15, 2013, and therefore no response is required.

42. Paragraph 42 relates to Lehman International's first cause of action, which the Court dismissed on March 15, 2013, and therefore no response is required.

**SECOND CAUSE OF ACTION
BREACH OF CONTRACT - JULY 2009 TRANSACTIONS**

43. Assured Guaranty incorporates its responses to the foregoing paragraphs as if fully set forth herein.

44. Paragraph 44 purports to state legal conclusions as to which no response is required. To the extent a response is required, Assured Guaranty admits that it and Lehman International are parties to the Agreement.

45. Assured Guaranty denies the allegations in Paragraph 45.

46. Assured Guaranty denies the allegations in Paragraph 46.

47. Paragraph 47 purports to state legal conclusions as to which no response is required. To the extent a response is required, Assured Guaranty denies the allegations in Paragraph 47.

48. Assured Guaranty denies that it breached the Agreement, and denies that Lehman International is entitled to any damages.

**THIRD CAUSE OF ACTION
BREACH OF THE IMPLIED COVENANT OF GOOD FAITH AND FAIR DEALING -
JULY 2009 TRANSACTIONS**

49. Assured Guaranty incorporates its responses to the foregoing paragraphs as if fully set forth herein.

50. Paragraph 50 purports to state legal conclusions as to which no response is required. To the extent a response is required, Assured Guaranty admits that it and Lehman International are parties to the Agreement.

51. Paragraph 51 purports to state legal conclusions as to which no response is required.

52. Paragraph 52 purports to state legal conclusions as to which no response is required. To the extent a response is required, Assured Guaranty denies the allegations in Paragraph 52.

AFFIRMATIVE DEFENSES

Without assuming any burden of proof where such burden properly rests with the Plaintiff, and without waiving (and hereby expressly reserving) the right to assert any other defenses at such time and to the extent discovery establishes a basis therefor, Assured Guaranty hereby asserts the following affirmative defenses to the claims asserted in the Verified Complaint:

FIRST AFFIRMATIVE DEFENSE

53. The Verified Complaint fails, in whole or in part, to state a claim on which relief may be granted.

SECOND AFFIRMATIVE DEFENSE

54. The Plaintiff is not entitled to the relief it seeks under the Agreement.

THIRD AFFIRMATIVE DEFENSE

55. The Plaintiff's claims are barred because it has not suffered any injury or damages.

FOURTH AFFIRMATIVE DEFENSE

56. The damages claimed by Plaintiff are speculative, uncertain and/or contingent, and therefore are not recoverable.

FIFTH AFFIRMATIVE DEFENSE

57. The Plaintiff's claims are barred, in whole or in part, by the doctrines of unjust enrichment and unclean hands, including without limitation because the Plaintiff seeks inflated damages based on its own default.

SIXTH AFFIRMATIVE DEFENSE

58. The Plaintiff's claims are barred, in whole or in part, by its failure to minimize and mitigate damages.

SEVENTH AFFIRMATIVE DEFENSE

59. The Plaintiff's claims are barred, in whole or in part, by the doctrines of laches, waiver, and estoppel.

EIGHTH AFFIRMATIVE DEFENSE

60. The Plaintiff's claims are barred because the damages it seeks would constitute an unenforceable penalty.

NINTH AFFIRMATIVE DEFENSE

61. Before commencing this action, Lehman International did not provide notice as required under the Agreement to Assured Guaranty that a Settlement Amount was allegedly owed by Assured Guaranty to Lehman International. Lehman International therefore is not entitled to recover interest under the Agreement, and it is also thus independently barred from recovering interest under the doctrines of laches and waiver.

RESERVATION OF RIGHTS

62. Assured Guaranty gives notice that it intends to rely upon any other claim or defense that may become available or appear during the pre-trial proceedings, based upon evidence developed in discovery or otherwise, and reserves the right to amend this Verified Answer to assert any such claims or defenses.

COUNTERCLAIMS

Assured Guaranty, by its undersigned counsel, as and for its counterclaims, upon knowledge as to matters in which it was directly involved and upon information and belief as to all other matters hereby alleges as follows:

NATURE OF THE COUNTERCLAIMS

63. These counterclaims are for breach of contract and attorneys' fees.

64. Assured Guaranty and Lehman International are parties to the Agreement (i.e., the 1992 ISDA Master Agreement dated as of April 7, 2000, and the Schedule thereto, as amended on December 11, 2001). The counterclaim for breach of contract relates to the 28 Transactions entered into by the parties under the Agreement that Assured Guaranty properly terminated in July 2009 based on Lehman International's insolvency (the "July 2009 Transactions"). In October 2009, Assured Guaranty notified Lehman International that it owed Assured Guaranty \$24,799,972.85 with respect to the terminated July 2009 Transactions. Lehman International has failed to make payment in breach of its contractual obligations. By its counterclaim for attorneys' fees, Assured Guaranty seeks to recover all fees and costs incurred in connection with this action.

JURISDICTION AND VENUE

65. This Court has jurisdiction over Counterclaim Defendant Lehman International under N.Y. C.P.L.R. §§ 301 and 302(a) and General Obligations Law § 5-1402 and under Section 13(b) of the Master Agreement, as modified by Part 4(j) of the Schedule.

66. Venue is proper in New York County under N.Y. C.P.L.R. §§ 501 and 509 and General Obligations Law § 5-1402 and under Section 13(b) of the Master Agreement, as modified by Part 4(j) of the Schedule.

PARTIES

67. Counterclaim Plaintiff Assured Guaranty is a Delaware corporation. Its principal place of business is 31 West 52nd Street, New York, NY 10019.

68. Upon information and belief, Counterclaim Defendant Lehman International entered into administration under the laws of England and Wales on September 15, 2008. Its principal place of business is 25 Canada Square, London, United Kingdom, E14 5LQ.

BACKGROUND

The Agreement Between Assured Guaranty and Lehman International

69. Lehman International and ACE Capital Re Overseas Ltd. (“ACE”) entered into a 1992 ISDA Master Agreement and Schedule thereto dated as of April 7, 2000. On December 11, 2001, Lehman International, ACE, and Assured Guaranty (which was at the time known as AGR Financial Products Inc.) agreed to amend the Master Agreement and Schedule and to assign all of ACE’s rights and obligations under the Agreement to Assured Guaranty.

70. Between 2005 and 2008, Assured Guaranty and Lehman International entered into 37 Transactions under which Lehman International purchased financial insurance from Assured Guaranty with respect to various reference bonds or securities. In each of the Transactions, Lehman International, as the protection buyer, agreed to make periodic premium payments to Assured Guaranty, and Assured Guaranty, as the protection seller, agreed to make a payment to Lehman International upon the occurrence of a credit event with respect to the reference obligations.

71. Each of these Transactions was governed by the Agreement and by an individual Confirmation. Section 6(a) of the Master Agreement provides that either party may terminate all transactions if any of the Events of Default enumerated in the Agreement has occurred and is continuing. The filing of bankruptcy by Lehman International constitutes one such Event of

Default. In the event a party terminates all transactions based on an Event of Default, the Agreement provides that the Non-defaulting Party shall determine the amount of the termination payment, which depending upon the circumstances may be owed by the Defaulting Party to the Non-defaulting Party, or vice versa (the “Termination Amount”).

Termination of 28 Transactions in July 2009

72. Lehman International entered administration on September 15, 2008.

73. On July 23, 2009, Assured Guaranty notified Lehman International that it was terminating all 28 then outstanding Transactions based on Lehman International having been placed in administration, among other Events of Default, and designated July 23, 2009 as the Early Termination Date.

74. Upon termination, the Agreement provides the Non-defaulting Party with the exclusive right to calculate the Termination Amount in respect of any terminated Transactions. Under the Agreement, in calculating this amount, the Non-defaulting Party must first use the Market Quotation method. The Market Quotation method requires the Non-defaulting Party to solicit quotations from Reference Market-makers in order to determine a market value for the terminated transactions. In effect, Reference Market-makers are asked to indicate what they would pay or require to be paid in order to step into the shoes of the Defaulting Party (here, Lehman International) in a materially identical replacement transaction facing the Non-defaulting Party (here, Assured Guaranty) and referencing the same underlying security or basket of securities as the terminated transaction.

75. Assured Guaranty engaged Henderson Global Investors, one of Europe’s largest and most preeminent investment advisors, to advise on the development of a bidding process and implement that process. With the assistance of Henderson Global Investors, Assured Guaranty

established a robust bidding procedure to obtain quotes for each replacement transaction, and ultimately solicited quotations from a dozen market participants during a two-week bidding period that concluded in September 2009. Despite its diligent efforts to obtain quotations from Reference Market-makers, Assured Guaranty did not receive any final quotations.

76. Under the Agreement, if a Market Quotation cannot be determined or would not produce a commercially reasonable result (in the reasonable belief of the Non-defaulting Party), then the Non-defaulting Party must use the Loss methodology. Loss is defined in Section 14 of the Master Agreement as “an amount that party reasonably determines in good faith to be its total losses and costs (or gain, in which case expressed as a negative number) in connection with . . . [the] group of Terminated Transactions.”

77. Consistent with the Agreement, Assured Guaranty therefore calculated the Termination Amount based on the Loss methodology, determining the amount it believed in good faith to be its total losses, costs, and gains with respect to July 2009 Transactions. Specifically, Assured Guaranty calculated its Loss for each such Transaction by subtracting the expected aggregate Floating Payments (i.e., the payments Assured Guaranty calculated it would owe Lehman International based on Assured Guaranty’s determination of the likelihood of a credit event occurring with respect to the reference obligations) from the present value of Fixed Amounts (i.e., the premium payments owed by Lehman International to Assured Guaranty) which would have come due after the Early Termination Date. Assured Guaranty then added to this amount the aggregate Fixed Amounts that were due and unpaid as of the Early Termination Date.

78. On October 16, 2009, pursuant to Section 6(d)(i) of the Master Agreement, Assured Guaranty sent Lehman International its Statement of Calculations setting forth these

calculations in detail and notifying Lehman International that it owed Assured Guaranty \$24,799,972.85 (the “July 2009 Termination Amount”) in respect of the July 2009 Transactions. Lehman International has failed to pay the July 2009 Termination Amount to Assured Guaranty.

FIRST COUNTERCLAIM

Breach of Contract

79. Defendant repeats and realleges Paragraphs 63 through 78 as though fully set forth herein.

80. The Agreement and the Confirmations thereunder are valid, binding and enforceable contracts between Assured Guaranty and Lehman International.

81. Assured Guaranty properly terminated 28 Transactions in July 2009 based on Lehman International’s entry into administration, which constituted an expressly enumerated ground for termination under the Agreement. Despite its good faith efforts, Assured Guaranty was unable to determine the Termination Amount for these Transactions using the Market Quotation method. As required under the Agreement, Assured Guaranty consequently used the Loss method to calculate the amount it believed in good faith to be its total losses, costs, and gains in respect of the 28 terminated Transactions, determining that it was owed \$24,799,972.85 by Lehman International.

82. Lehman International has breached the Agreement by failing to pay the amount due and owed to Assured Guaranty under the Agreement in respect of the July 2009 Transactions, despite Assured Guaranty’s demand that it do so.

83. As a result of Lehman International’s breach of the Agreement, Assured Guaranty has suffered damages and is entitled to a money judgment against Lehman International in an amount to be determined.

SECOND COUNTERCLAIM

Attorneys' Fees and Costs

84. Defendant repeats and realleges Paragraphs 63 through 78 as though fully set forth herein.

85. The Agreement and the Confirmations are valid, binding and enforceable contracts between Assured Guaranty and Lehman International, which Lehman International has breached. Section 11 of the Master Agreement entitles Assured Guaranty to an award of reasonable out-of-pocket expenses, including reasonable attorneys' fees, incurred in connection with the enforcement and protection of its contractual rights or the early termination of any Transaction.

86. Assured Guaranty has been forced to incur out-of-pocket expenses, including attorneys' fees and costs, in connection with this action because of Lehman International's failure to comply with the terms of the Agreement.

87. Assured Guaranty is thus entitled to an award of attorneys' fees, costs, and all other litigation expenses.

PRAYER FOR RELIEF

WHEREFORE, Assured Guaranty demands judgment against Lehman International as follows:

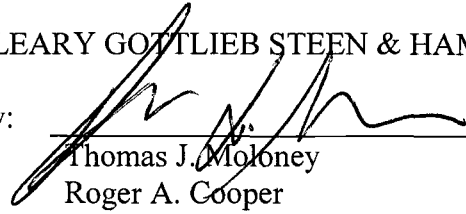
- (a) Dismissing the Verified Complaint against it with prejudice;
- (b) Awarding Assured Guaranty damages in an amount to be determined;
- (c) Awarding attorneys' fees and costs; and
- (d) Granting such other legal and equitable relief as the Court deems just and proper.

Dated: New York, New York
April 22, 2013

Respectfully submitted,

CLEARY GOTTLIEB STEEN & HAMILTON LLP

By:



Thomas J. Moloney
Roger A. Cooper

One Liberty Plaza
New York, New York 10006
Telephone: (212) 225-2000
Facsimile: (212) 225-3999

Attorneys for AG Financial Products Inc.

VERIFICATION

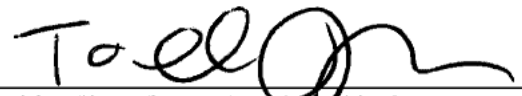
STATE OF NEW YORK)

: ss. :

COUNTY OF NEW YORK)

Todd Julian, being duly sworn, deposes and says:

I am an in-house Counsel for AG Financial Products Inc. I have read the foregoing answer and counterclaims, and verify that I know the contents thereof to be true, except as to matters stated to be alleged upon information and belief, and as to those matters, I believe them to be true.



Todd Julian, for and on behalf of
AG FINANCIAL PRODUCTS INC.

Sworn to before me this 22nd day of April, 2013



Notary Public

JOSEPH M. FURNARI
Notary Public, State of New York
No. 01FU6046586
Qualified in Westchester County
Commission Expires August 14, 2014