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

POST-TRIAL BRIEF OF AG FINANCIAL PRODUCTS INC.

TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	iv
PRELIMINARY STATEMENT	1
PROPOSED FINDINGS OF FACT	4
I. The Parties	4
II. The Bargain	6
A. Assured's CDS With LBIE Were Not On Standard Terms	6
B. Structural Protections In The Reference Obligations	8
C. Termination Provisions	9
III. LBIE's Default And Inability To Novate Lead To Termination	12
A. LBIE Defaults	12
B. LBIE Privately Recognizes The Transactions Have Limited Value To It	12
C. LBIE Attempts To Novate The Transactions But Finds No Takers	15
D. Anticipating Termination And Litigation, LBIE Solicits Indicative Bids	17
E. After LBIE's Failure To Novate, Assured Terminates The Transactions	19
F. Assured's Market Quotation Auction	20
IV. Assured's Calculation Of Its Loss	23
V. Broader Economic Conditions Relevant To Assured's Loss Calculation	30
A. Trading Prices Of Securities Were Dislocated During The Financial Crisis	31
1. Origins of the Financial Crisis	31
2. Illiquidity and Price Dislocation	32

Page

3. Early Signs of a Housing Market Recovery in 2009, as Dislocation Continues 35

B. Impact On The Monoline Industry 36

PROPOSED CONCLUSIONS OF LAW 39

VI. Burden Of Proof And Legal Standard 39

VII. Assured Followed The Contractual Language In Calculating "Its Loss" 40

VIII. Assured Did Not Breach The Agreement By Calculating Loss Without Reference To Market Prices 43

A. LBIE Failed To Prove The Existence Of A Uniform Market Practice Of Calculating Loss Based On Market Prices 44

1. The Say-so of LBIE's Experts Does not Prove There was a Uniform Market Practice 44

2. LBIE's Experts Admitted That Loss has not Uniformly Been Calculated as a Market Price—Including by Them 47

3. ISDA Materials, Treatises, and Industry Reports Further Disprove the Existence of LBIE's Purported Market Practice 50

4. LBIE's Other Evidence Also Falls Short of Proving a Uniform Market Practice 55

5. LBIE Failed to Prove That Assured Knew of LBIE's Purported Market Practice 56

B. Even If LBIE's Purported Market Practice Existed (Which It Didn't), It Was Reasonable For Assured To Depart From It Under The Circumstances 59

1. The Value of the Transactions to Assured was not Their Market Price 59

2. Reasonableness did not Require Assured to Defer to What Dislocated Market Prices Implied About Future Losses 61

Page

C. Assured's Good Faith Calculation Of Its Loss Was Reasonable And Reached A Reasonable Result 62

D. LBIE Failed To Establish It Is Entitled To Any Damages 67

IX. LBIE's Breach Entitles Assured To Recover Damages 73

A. Assured Performed Its Obligations Under The 1992 ISDA 73

B. LBIE's Breach Damaged Assured 73

C. Assured Is Entitled To Recover Its Legal Fees 74

CONCLUSION 75

TABLE OF AUTHORITIES

Page(s)

Cases

172 Van Duzer Realty Corp. v. Globe Alumni Student Assistance Ass'n, Inc.,
24 N.Y.3d 528 (N.Y. 2014) 73

Beecher v. Able,
435 F. Supp. 397 (S.D.N.Y. 1975) 41

Bethel v. New York City Tr. Auth.,
92 N.Y.2d 348 (1998) 39

Biestek v. Berryhill,
139 S. Ct. 1148, 203 L. Ed. 2d 504 (2019) 44

Boyce v. Soundview Tech. Grp., Inc.,
464 F.3d 376 (2d Cir. 2006) 41

Cassidy v. Highrise Hoisting & Scaffolding, Inc.,
89 A.D.3d 510 (1st Dep't 2011) 44, 45

CDO Plus Master Fund Ltd. v. Wachovia Bank, N.A.,
No. 07 CIV. 11078(LTS)(AJP), 2010 WL 3239416 (S.D.N.Y. Aug. 16, 2010) 75

Christiania Gen. Ins. Corp. of N.Y. v. Great Am. Ins. Co.,
979 F.2d 268 (2d Cir. 1992) 39-40

D'Amico Dry D.A.C. v. Nikka Fin., Inc.,
Civ. Action No. CV 1:18-00284-KD-MU,
2019 WL 2995922 (S.D. Ala. July 9, 2019) 75

D'Amico Dry D.A.C. v. Primera Mar. (Hellas) Ltd.,
433 F. Supp. 3d 576 (S.D.N.Y. 2019), *aff'd sub nom. d'Amico Dry d.a.c. v. Sonic Fin. Inc.*, 794 F. App'x 127 (2d Cir. 2020) 75

Deutsche Bank AG v. Ambac Credit Prods., LLC
No. 04 CIV. 5594(DLC), 2006 WL 1867497(S.D.N.Y. July 6, 2006) 45

Fort Worth Employees' Ret. Fund v. J.P. Morgan Chase & Co.,
301 F.R.D. 116 (S.D.N.Y. 2014) 41

Greene v. Xerox Corp.,
244 A.D.2d 877 (4th Dep't 1997) 44

Page(s)

In re Am. Home Mortg. Holdings, Inc.,
411 B.R. 181 (Bankr. D. Del. 2009) 41

In re Am. Home Mortg. Holdings, Inc.,
637 F.3d 246 (3d Cir. 2011)....................41

In re Lehman Bros. Holdings Inc.,
No. 08-13555 SCC, 2015 WL 7194609 (S.D.N.Y. Sept. 16, 2015)....................42

JPMorgan Chase Bank, N.A. v. Controladora Comercial Mexicana S.A.B. De C.V.,
No. 603215/08, 2010 WL 4868142 (Sup. Ct. N.Y. Cnty. Mar. 16, 2010) 41

L. Debenture Tr. Co. of N.Y. v. Maverick Tube Corp.,
595 F.3d 458 (2d Cir. 2010)....................44

Lehman Bros. Int'l (Europe) v. AG Fin. Prods., Inc.,
No. 653284/2011, 2013 WL 1092888 (Sup. Ct. N.Y. Cnty. Mar. 12, 2013) 12, 39

Lehman Bros. Int'l (Europe) v. AG Fin. Prods., Inc
No. 653284/2011, 2016 WL 392709 (Sup. Ct. N.Y. Cnty. Jan. 11, 2016)....................20

Lehman Bros. Int'l (Europe), In Administration v. AG Fin. Prods., Inc.,
No. 653284/2011, 2018 WL 3432593 (Sup. Ct. N.Y. Cnty. July 2, 2018) .... passim

Lion Oil Trading & Transp., Inc. v. Statoil Mktg. & Trading (US) Inc.,
Nos. 08 Civ. 11315 (WHP), 09 Civ. 2081 (WHP), 2011 U.S. Dist. LEXIS 24516 (S.D.N.Y Feb. 28, 2011) 44

Mass v. Melymont
No. SC2691/03, 2003 WL 23138786 (D.C.N.Y. Nassau Cnty. Dec. 23, 2003)....................44

Merrill Lynch Cap. Servs., Inc. v. UISA Fin.,
No. 09 CIV. 2324 (RJS), 2012 WL 1202034 (S.D.N.Y. Apr. 10, 2012), *aff'd*, 531 F. App'x 141 (2d Cir. 2013) 75

Nat'l Credit Union Admin. Bd. v. UBS Sec., LLC,
No. 12-2591-JWL, 2016 WL 7496106 (D. Kan. Dec. 30, 2016) 41

NECA-IBEW Health & Welfare Fund v. Goldman Sachs & Co.,
693 F.3d 145 (2d Cir. 2012)....................41

Pena v. City of New York,
161 A.D.3d 522 (1st Dep't 2018) 45

Sager v. Friedman,
270 N.Y. 472 (1936) 41

Page(s)

Trs. of Columbia Univ. in the City of N.Y. v. D'Agostino Supermarkets, Inc.,
36 N.Y.3d 69 (2020) 73

Wachovia Bank, Nat'l Ass'n v. VCG Special Opportunities Master Fund, Ltd.,
518 F. App'x 44 (2d Cir. 2013) 75

PRELIMINARY STATEMENT

The Court held a trial to answer one question: whether Assured "reasonably determined its Loss" after LBIE defaulted on the twenty-eight credit default swap transactions ("CDS") at issue.[1] The evidence at trial demonstrates the answer is "yes," Assured reasonably calculated its Loss in good faith. LBIE has not met its burden to prove otherwise.

Assured followed the terms of the parties' agreement. It calculated the value of "Loss" by solving for the "loss of bargain" it suffered as a result of LBIE's default,[2] and did so in a way that accounted for the actual economic bargain the parties reached and relevant market conditions at the time of the termination. The parties' economic bargain was straightforward: in exchange for fixed premium payments from LBIE, Assured agreed to make payments to LBIE to cover any shortfalls of principal or interest payments as they became due on the insured securities. Standard CDS are collateralized (meaning changes in the market prices of the insured securities can trigger an obligation to post collateral), but the non-standard CDS that Assured sold to LBIE were not, and there were no other terms that obligated Assured to make payments based on market price fluctuations. As a result, the value of the transactions to Assured depended on how the insured securities performed—not on market prices, which during periods of market dislocation (as was the case here) do not reliably predict actual performance.

As a monoline insurance company, Assured was in the business of projecting future losses on insured financial instruments, and had a rigorous process for doing so. Assured valued its terminated CDS with LBIE using the same process and models it employed in the regular course of its business to value all of its transactions. Using a well-established discounted cash

[1] *Lehman Bros. Int'l (Europe), In Administration v. AG Fin. Prods., Inc.*, No. 653284/2011, 2018 WL 3432593, at *15 (Sup. Ct. N.Y. Cnty. July 2, 2018) (hereinafter "D/O").
[2] JX-01 at 15 (1992 ISDA Master Agreement).

flow ("DCF") analysis, Assured determined it suffered an aggregate loss when LBIE defaulted because LBIE would have owed Assured more in unpaid premiums than Assured would have owed to LBIE to cover shortfalls in principal or interest payments when due. Specifically, Assured calculated that LBIE would have owed it $48,241,117.85 in unpaid premiums, and Assured would have owed LBIE $27,577,817.65 to cover shortfalls. Netting the two amounts resulted in LBIE owing Assured $20,663,300.20. This valuation was consistent with all the evidence at trial, including LBIE's own internal admissions at the time that the transactions had little to no real-world value and the fact that no one was willing to pay anything to take on LBIE's position in the transactions when LBIE tried to novate them or during Assured's well-designed and well-executed auction involving some of the most sophisticated financial institutions in the world.

LBIE's sole remaining claim at trial is that Assured acted unreasonably because the parties' agreement required Assured to calculate Loss using a theoretical market price based on data about the market prices of other securities. At summary judgment, LBIE's textual arguments were rejected, with the Court holding that the unambiguous language of Loss does not prohibit "a Non-Defaulting Party, like Assured, from calculating its Loss without reference to market prices."[3] LBIE was left to argue at trial that Assured's calculation was unreasonable because it departed from a purported uniform market practice of calculating Loss based on market prices (and, where no actual prices are available, by using a model to estimate a theoretical market price). But LBIE failed to prove that such a market practice even existed for transactions like those at issue here, let alone show that this purported market practice was universal, unvarying, and known to Assured. And, even if LBIE had done so, it failed to meet its

[3] *See* D/O at *12.

burden of proving that it was unreasonable for Assured to depart from this purported market practice during a period of severe market dislocation.

LBIE did not present a single example in which a theoretical pricing model was used to calculate Loss for transactions with economic terms similar to those here in a functioning market, let alone during a period of market dislocation. And the examples LBIE did point to consisted of confidential cherry-picked settlements it and its affiliates negotiated for transactions with materially different terms, including because they required the CDS sellers to post collateral and make settlement payments based on changes in the market prices of the insured securities. Lacking any systematic evidence or analysis, LBIE relied at trial on its experts' speculation and say-so to prove the existence of this purported market practice, but that cannot credibly or reliably support the claim. Notably, to the extent LBIE's experts had any experience calculating Loss, they had actually themselves departed from the purported market practice they claimed was universal and unvarying.

In short, the evidence overwhelmingly shows that, consistent with well-settled New York law, Assured's Loss calculation was objectively reasonable because it followed the contractual terms and took into account the relevant circumstances. The only common market understanding that existed at the time the transactions were terminated was that Loss is a broad indemnification provision that affords Non-defaulting Parties, like Assured, the flexibility to calculate Loss in light of the terms of the parties' bargain and any unique circumstances. Moreover, market practitioners, including LBIE's own experts and employees, understood that market prices do not reliably reflect the value of a security in times of market dislocation and illiquidity. In contrast to Assured's calculation, LBIE's litigation-driven model not only ignores the terms of the parties' contracts and the relevant circumstances, but would generate an unjustified windfall for

LBIE, and unfairly penalize Assured, which received no benefit from LBIE's default. For the reasons set out in detail below, Assured's calculation was reasonable, LBIE has failed to carry its burden to prove otherwise, and judgment should be granted in favor of Assured.

PROPOSED FINDINGS OF FACT

I. The Parties

Assured. Assured is a New York-based monoline insurer that sells credit protection on bonds, securities, and other financial obligations ("reference obligations") in two forms: financial guaranty and credit default swap.[4] AGC is a registered financial guaranty insurance company, and sells financial guaranty insurance directly to counterparties.[5] Defendant AGFP is a so-called "transformer entity" that was used by Assured to sell protection in credit default swap form.[6] AGFP was the contractual counterparty in the transactions with LBIE, but AGC, which is expressly identified as the Credit Support Provider for AGFP, was the real party in interest.[7]

Because Assured structured its CDS and its financial guaranties to offer the same protection, the underlying economics of both are materially the same: Assured guarantees the scheduled payments of interest and principal that investors receive on the reference obligations, and pays shortfalls, if any, as those payments come due.[8] In return, counterparties agree to make regular, fixed premium payments to Assured until the reference obligation matures, which may

[4] AX-70008 at 6-8 (Assured 2009 10-K). Defendant AG Financial Products Inc. (AGFP), together with its affiliate, Assured Guaranty Corp. (AGC), is referred to herein as "Assured." AGC is the New York-based and "Maryland-domiciled" "principal operating subsidiary" of Assured Guaranty Ltd., a Bermuda-domiciled holding company; *see also* Trial Tr. 2017:5-10 (Schozer), 2020:1-11 (Schozer).
[5] *See* Trial Tr. 1221:3-1222:2 (Rosenblum).
[6] *See id.* at 1225:10-1226:7 (Rosenblum).
[7] *See* JX-02 at 11 (1992 ISDA between LBIE and Assured); Trial Tr. 1225:10-1226:7 (Rosenblum), 2034:12-2035:4 (Schozer). The 1992 ISDA Master Agreement, Schedule, and Confirmations that Assured and LBIE entered into, which govern the 28 transactions at issue, is referred to herein as the "Agreement." Capitalized terms not defined in this brief have the meaning ascribed to them in the Agreement.
[8] *See* Trial Tr. 2841:4-2842:12 (Bailenson), 1221:3-11 (Rosenblum), 1221:23-1222:2 (Rosenblum); *see also* AX-70008 at 6 (Assured 2009 10-K).

take decades.[9] Assured earns a profit when it collects more in premium payments over the life of a transaction than it pays to cover shortfalls.[10] In deciding whether to sell credit protection on any given reference obligation, Assured uses an underwriting process to analyze the likelihood that it may have to make payments over the life of the transaction (i.e., the risk of the reference obligation failing to make scheduled payments).[11] Assured only sells protection when it determines that this risk is remote.[12] Where it sells protection, Assured monitors and analyzes potential losses on the reference obligations it insures through maturity as part of its surveillance process and, if a loss is expected, as part of its loss reserving process.[13] In short, projecting future losses is Assured's core expertise and is critical to how Assured manages its business.[14]

Lehman Brothers International (Europe) (in administration) ("LBIE"). LBIE, an international subsidiary of Lehman Brothers Holdings Inc. ("LBHI"),[15] was a broker-dealer that, among other things, bought and sold CDS.[16] On September 15, 2008, LBHI declared bankruptcy in the United States and LBIE entered administration in the United Kingdom.[17]

In LBIE's opening statement, counsel for LBIE said that its claims are overseen by neutral professionals who "are simply calling balls and strikes" and who "have no financial stake in the outcome of this case."[18] No such evidence was presented at trial.[19]

---

[9] *See* Trial Tr. 1223:21-1224:8 (Rosenblum), 3003:2-10 (Prager).
[10] *See id.* at 1223:21-1224:8 (Rosenblum).
[11] *See id.* at 1224:6-1225:6 (Rosenblum).
[12] *See* AX-70018 at 137 (Assured Q3 2009 10-Q); *see also* Trial Tr. 1224:6-1225:6 (Rosenblum).
[13] Trial Tr. 2109:17-2110:6 (Schozer), 2110:17-2111:9 (Schozer), 2868:13-2869:2 (Bailenson).
[14] *Id.* at 1236:21-1237:7 (Rosenblum), 2847:21-25 (Bailenson).
[15] LX-38 at 52 (LBIE March-Sept. 2009 Progress Report); Trial Tr. 382:19-22 (Viegas).
[16] *See, e.g.*, Trial Tr. 388:21-391:3 (Viegas).
[17] LX-38 at 52 (LBIE March-Sept. 2009 Progress Report); *see also* Trial Tr. 382:23-383:3 (Viegas).
[18] *See* Trial Tr. 11:10-13 (LBIE opening statement).
[19] In fact, the Court can take judicial notice that since 2014, LBIE's claims have been owned in significant part by two hedge funds, Elliott Management Corporation and King Street Capital Management. *See* PWC, Lehman Brothers International (Europe) – In Administration: Joint Administrators' Twenty-Fourth Progress Report, for the Period from 15 March 2020 to 14 September 2020 at 14 (Oct. 12, 2020), https://www.pwc.co.uk/business-recovery/administrations/lehman/lbie_24th_progress_report_12_oct_2020.pdf; PWC, Lehman Brothers International (Europe) – In Administration: Joint Administrators' Eighteenth Progress Report, for the Period from 15

II. The Bargain

At issue are 28 bespoke CDS between LBIE and Assured (the "Transactions") through which LBIE purchased credit protection from Assured on the senior tranches of various reference obligations.[20] Each reference obligation is an asset-backed security ("ABS"), which is a security whose payments are generated with cash from collateral assets.[21] Specifically, 14 of the Transactions reference UK residential mortgage-backed securities ("UK RMBS"), 11 reference collateralized loan obligations ("CLO"), one references a collateralized debt obligation ("CDO"),[22] and two reference baskets of twenty U.S. subprime RMBS (instead of a single security) that were included in the ABX 2006-02 and 2007-01 indexes ("ABX"). Each of the RMBS in the ABX baskets were composed primarily of mortgages originated in 2006.[23]

A. Assured's CDS With LBIE Were Not On Standard Terms

All of the Transactions shared the same key economic features, accurately described by one of LBIE's own employees as "non-standard."[24] The most important of these was that, in all cases, Assured agreed to provide protection only against the credit risk of the reference obligations, not against the risk of changes in their market prices. In other words, Assured was only required to pay actual shortfalls, if there were any, in interest and principal payments owed under the reference obligations, as those payments came due. This is sometimes referred to as a

---

March 2017 to 14 September 2017 at 37 (Oct. 9, 2017), https://www.pwc.co.uk/business-recovery/administrations/lehman/lbie-18th-progress-report.pdf; *see also* PWC, LB Holdings Intermediate 2 Limited – In Administration: Joint Administrators' Progress Report From 14 July 2020 to 13 January 2021 at 5 (Feb. 12, 2021), https://www.pwc.co.uk/business-recovery/administrations/assets/lbhi2-24th-report.pdf (LBHI2).

[20] *See* D/O at *1.

[21] Trial Tr. 65:7-11 (Rahl).

[22] The underlying security of the Piedmont CDO was fully paid off at the time of termination, and there is no meaningful dispute between the parties regarding the value of that Transaction. *See, e.g.*, *id.* at 843:3-5 (Bruce), 190:12-14 (Rahl).

[23] *See* JX-05 through JX-32 (confirmations); *see also* JX-08 (confirmation for ABX 2006-2); JX-15 (confirmation for ABX 2007-1); Trial Tr. 825:22-826:15 (Bruce).

[24] JX-67 at 4 (Valuation Memorandum) (noting that LBIE's contract exposure to AGO involved "non-standard documentation"); *see also* D/O at *1-2.

"pay-as-you-go" structure.[25] The Transactions did not provide for "physical" or "cash" settlement—which apply to most other CDS and expose a protection seller to changes in the market prices of the reference obligations.[26] Similarly, the Transactions did not require Assured to post collateral based on changes in the market prices of the reference obligations, which most CDS require.[27] Further, as with its financial guaranty insurance policies, Assured only sold CDS protection. Neither Assured nor AGFP "traded" CDS, as LBIE wrongly claims.[28] In addition, AGFP was thinly capitalized, had no employees, and no credit rating of its own.[29] As a result, the parties' economic arrangement depended on AGC (AGFP's Credit Support Provider) issuing a financial guaranty policy guaranteeing any payment obligations by AGFP, and that policy was expressly incorporated into the Agreement between LBIE and AGFP.[30]

Banks like LBIE typically traded CDS with standard economic terms. But, before the financial crisis, purchasing uncollateralized, "pay-as-you-go" credit protection from monolines on high-quality reference obligations was useful to banks because doing so allowed them to immediately recognize profits on related trading activity (through what is called "negative basis trades") or to reduce the amount of capital that regulations required them to hold, freeing up liquidity to invest elsewhere.[31]

---

[25] Trial Tr. 2112:22-2113:10 (Schozer) (explaining the UK RMBS contract), 2131:2-11 (Schozer) (the CLO transactions and CDO transaction were pay-as-you-go), 2163:22-2164:1 (Schozer) (the CDS on the ABX 2006-02 was pay-as-you-go), 2168:7-22 (Schozer) (the CDS on ABX 2007-01 was pay-as-you-go), 3003:2-24 (Prager) (discussing Assured's obligations under the CDS at issue here, noting the general obligation to make payments in event of credit defaults and principal at "legal final maturity").
[26] *Id.* at 2113:25-2114:13 (Schozer).
[27] *Id.* at 4256:18-25 (Bruce), 1028:23-24 (Bruce) ("[I]t's the normal practice of banks to post collateral.").
[28] *Id.* at 2035:5-2036:6 (Schozer) (Assured "couldn't have traded" in and out of CDS), 1226:11-13 (Rosenblum) ("Q. Did AGFP trade CDS? A. No. AGFP, much like AGC, did not trade in and out of the CDS market; it could not.").
[29] *See id.* at 2034:21-23 (Schozer) (AGFP had no employees), 1225:24-1226:7 (Rosenblum) (AGFP was "extremely thinly capitalized" and counterparties knew that AGFP would not be able to make payments due under its CDS contracts without the insurance policy from AGC), 2034:24-2034:25 (Schozer) (AGFP had no credit rating).
[30] JX-2 at 10 (1992 ISDA between LBIE and Assured); *see also* Trial Tr. 1225:24-1226:7 (Rosenblum).
[31] Trial Tr. 2071:3-18 (Schozer), 3484:4-11 (Pirrong); *see also id.* at 2044:3-7 (Schozer), 2051:15-24 (Schozer), 2611:8-12 (Cohn).

B. Structural Protections In The Reference Obligations

The ABS referenced in the Transactions had many structural protections, which were an important factor in Assured's analysis of why the risk of future losses was remote.

US Subprime RMBS. *First*, the collateral supporting each RMBS consisted of a pool of individual mortgages, and "each of the mortgage loans [in the pool] represent[ed] only about 80 percent of the . . . initial value of the home."[32] This meant that "even if there were to be a default, before there [was] a loss to that loan, the value that was realized from selling the home would have to be at least 20 percent" lower than the purchase price for the collateral pool to lose value.[33] *Second*, the RMBS were over-collateralized—which means that the value of the mortgages in the pool was greater than the face value of the securities that were issued; for example, "if there were $100 million of loans that would have been placed into the pool, there may have been only [$]90 million or $95 million . . . of notes that were issued from the RMBS structure."[34] *Third*, the "average interest rate paid on the securities [was] going to be lower than the average interest rate on the mortgages."[35] The difference between those two interest rates—known as "excess spread"—generated an "extra cash flow [that was] available . . . to provide additional support for the RMBS securities."[36] *Fourth*, the RMBS had a tranche structure that provided further buffers against loss—the senior tranches, which is what Assured insured here, "would not suffer any losses until all of [the] junior tranches had suffered their losses entirely and had entirely been [written] down to zero."[37] *Finally*, the tranche structure also allowed for "rapid amortization," which meant that, "when certain early warning signs" occurred, "the cash

[32] *Id.* at 2996:11-16 (Prager).
[33] *Id.* at 2996:17-19 (Prager).
[34] *Id.* at 2997:7-10 (Prager).
[35] *Id.* at 2998:2-4 (Prager).
[36] *Id.* at 2998:4-11 (Prager).
[37] *Id.* at 2998:19-21 (Prager); *see also id.* at 820:12-821:6 (Bruce).

flow coming in start[ed] paying down [the senior tranche] . . . while losses [were] taken at the bottom."[38]

UK RMBS. In addition to having many of the same structural protections as the US RMBS, the UK RMBS had a "master trust structure."[39] This meant that there were "new loans coming into the pool at all times," providing "an opportunity on a regular basis to refresh and rebalance the pool level overcollateralization."[40] In addition, "reserve[] funds . . . were set up at initiation" containing "additional cash" that could be used to cover losses in the UK RMBS."[41]

CLOs. The CLOs at issue here were collateralized with corporate loans instead of mortgages.[42] These were "senior and generally secured loans" from corporate borrowers, meaning that if there was a default by the company, the lenders would be able to recover value from assets pledged by the company.[43] The CLOs also contained protections similar to those in the RMBS based on overcollateralization and tranche buffers.[44] And, because Assured insured the "super senior AAA" tranche of the CLOs, both the lower-rated tranches and the junior AAA tranches would have to be exhausted before the insured tranche experienced a dollar of loss.[45]

These structural features resulted in "a very highly risk protected structure" for each of the reference obligations in this case, which meant that even in a severely distressed market, the senior tranches of the ABS were unlikely to suffer significant losses.[46]

C. Termination Provisions

While each Transaction was documented separately, all were governed by a 1992 ISDA

[38] *Id.* at 2998:21-2999:2 (Prager).
[39] *Id.* at 2999:10-20 (Prager)
[40] *Id.* at 2999:21-3000:4 (Prager).
[41] *Id.* at 3000:5-10 (Prager).
[42] *Id.* at 3000:18-3002:4 (Prager).
[43] *Id.* at 3000:19-24 (Prager).
[44] *Id.* at 3000:25-3001:5 (Prager).
[45] *Id.* at 3001:6-13 (Prager).
[46] *Id.* at 3001:18-19 (Prager).

Master Agreement. When parties enter into a 1992 ISDA Master Agreement, they can choose which provisions will govern what payments will be owed in the event of early termination, selecting either "First Method" or "Second Method" and either "Market Quotation" or "Loss."[47] LBIE and Assured selected Second Method and Market Quotation.[48]

The choice between First and Second Method concerns the direction in which payments may be made: under the First Method, only the Defaulting Party may be required to make a payment to the Non-defaulting Party, whereas under the Second Method, either the Defaulting or Non-defaulting Party may be required to make a payment to the other.[49] Market Quotation and Loss are different methods for determining the value of the terminated transaction and the quantum of any payment to be made.[50]

Market Quotation requires the Non-defaulting Party to solicit quotations from "Reference Market-makers . . . for an amount, if any, that would be paid to such party (expressed as a negative number) or by such party (expressed as a positive number) in consideration of an agreement between such party . . . and the quoting Reference Market-maker to enter into a transaction (the 'Replacement Transaction')."[51] But, "[i]f fewer than three quotations are provided, it will be deemed that the Market Quotation . . . cannot be determined,"[52] and the Agreement instructs the Non-defaulting Party to calculate its "Loss" using any of the approaches enumerated in the Loss definition,[53] which in its entirety states:

> **"Loss" means**, with respect to this Agreement or one or more Terminated Transactions, as the case may be, and a party, the Termination Currency Equivalent of **an amount that party reasonably determines in good faith to be its total losses and costs (or gain, in which case expressed as a negative number)** in

---

[47] JX-01 at 9 (1992 ISDA Master Agreement).
[48] JX-02 at 4 (1992 ISDA between LBIE and Assured).
[49] JX-01 at 9-10 (1992 ISDA Master Agreement).
[50] *Id.*
[51] *Id.* at 15.
[52] *Id.* at 16.
[53] *Id.* at 15.

> connection with this Agreement or that Terminated Transaction or group of Terminated Transactions, as the case may be, **including any loss of bargain**, cost of funding or, at the election of such party but without duplication, loss or cost incurred as a result of its terminating, liquidating, obtaining or reestablishing any hedge or related trading position (or any gain resulting from any of them). Loss includes losses and costs (or gains) in respect of any payment or delivery required to have been made (assuming satisfaction of each applicable condition precedent) on or before the relevant Early Termination Date and not made, except, so as to avoid duplication, if Section 6(e)(i)(1) or (3) or 6(e)(ii)(2)(A) applies. Loss does not include a party's legal fees and out-of-pocket expenses referred to under Section 11. A party will determine its Loss as of the relevant Early Termination Date, or, if that is not reasonably practicable, as of the earliest date thereafter as is reasonably practicable. **A party may (but need not) determine its Loss by reference to quotations of relevant rates or prices from one or more leading dealers in the relevant markets**.[54]

As the Court concluded at Summary Judgment, there is "nothing in the text of the definition of Loss that explicitly mandates any particular calculation method."[55] Rather, "there is strong textual support for reading the definition of Loss [in the Agreement] as generally permitting non-defaulting parties . . . to select any methodology for calculating Loss, so long as such methodology is reasonable and in good faith."[56] Further, the Court held: "Given this plain and unambiguous language, the court cannot find that the Loss provision categorically prohibits a Non-Defaulting Party, like Assured, from calculating its Loss without reference to market prices. . . . the Loss provision could not be clearer in stating that a party 'may (but need not)' calculate Loss using market quotations of rates or prices. The phrase 'need not' is not a technical or specialized term which is, or could be, rendered ambiguous by evidence proffered by LBIE."[57] The Court went on: "The Loss provision thus by its terms affords the Non-Defaulting Party the discretion to make the determination as to whether use of market prices to calculate Loss is

---

[54] *Id.* (emphasis added).
[55] D/O at *12 (citation omitted).
[56] *Id.* (citation omitted).
[57] *Id.* at *12; *see also* § IX.B.

appropriate in a particular case."[58]

III. LBIE's Default And Inability To Novate Lead To Termination

A. LBIE Defaults

On September 15, 2008, LBIE filed for insolvency protection in the United Kingdom and entered into administration. PricewaterhouseCoopers ("PwC") was appointed to administer LBIE's estate.[59] As of that date, LBIE stopped making the agreed-upon fixed premium payments to Assured that were due under the Agreement.[60] LBIE's entry into administration, and its continuing failure to make payments due to Assured, constituted Events of Default under the terms of the Agreement and entitled Assured, as the "Non-defaulting Party," to decide whether and when to terminate the Transactions, and to calculate how much would be owed.[61]

B. LBIE Privately Recognizes The Transactions Have Limited Value To It

In October 2008, LBIE prepared a memorandum analyzing the value of the Transactions to LBIE (the "Valuation Memorandum").[62] Juan Quintas, a LBIE employee who was kept on by PwC because he was among LBIE's "most knowledgeable" traders,[63] prepared the Valuation Memorandum at the request of Eduardo Viegas,[64] who supervised the LBIE administration's fixed income division and whose job responsibilities included "understand[ing] the positions that LBIE was exposed to."[65] After sending an earlier draft to Viegas for his review, Quintas sent a revised draft on November 4, 2008 to Paul Copley, Viegas's superior and an eventual LBIE

---

[58] D/O at *12.
[59] Trial Tr. 383:1-22 (Viegas).
[60] JX-34 at 5 (Statement of Calculations); Trial Tr. 644:18-21 (Viegas).
[61] LBIE also defaulted on nine additional transactions with Assured, which Assured terminated in December 2008. The Court dismissed LBIE's sole claim related to those transactions in its March 12, 2013 decision, and those transactions were not at issue at trial. *Lehman Bros. Int'l (Europe) v. AG Fin. Prods.*, *Inc.*, No. 653284/2011, 2013 WL 1092888, at *4-5 (Sup. Ct. N.Y. Cnty. Mar. 12, 2013).
[62] *See* JX-67 (Valuation Memorandum); AX-30062a (Valuation Memorandum First Draft).
[63] Trial Tr. 573:24-574:7 (Viegas).
[64] JX-67 at 1 (Valuation Memorandum) (memorandum prepared "at the request of Eduardo [Viegas]").
[65] Trial Tr. 387:9-16 (Viegas), 388:15-20 (Viegas).

administrator,[66] and the three met to discuss it.[67]

The Valuation Memorandum analyzed several possible scenarios and concluded that "[t]he CDS Contract exposure to [Assured] is, in most scenarios, unlikely to generate cash for LBIE."[68] First, the Valuation Memorandum analyzed a "hold-to-maturity" scenario in which Assured, consistent with its business model, would simply continue to hold the Transactions and offset "losses [on the Transactions] versus the cumulative premium owed but not paid by LBIE."[69] Because of what the Valuation Memorandum called the "overall credit soundness of the short positions"—that is, the fact that the underlying reference obligations were not likely to suffer significant losses despite the then-ongoing financial crisis—the Valuation Memorandum estimated that the lifetime payments owed by Assured would only exceed the remaining premium payments by between $10 and $21 million.[70] The Valuation Memorandum noted that Assured had conveyed to LBIE a similar valuation and that Assured "expected bond losses [would be less than] expected premium to maturity on the whole portfolio . . . [and that] such premium will accrete to a higher amount tha[n] any losses they may have to pay."[71]

The Valuation Memorandum contrasted this with a market-based valuation. It observed that, *on paper*, then-current market prices of the reference obligations suggested that the Transactions could have been worth "in excess of $1bn in LBIE's favor,"[72] but concluded that their value was "significantly diminish[ed]" because "they [were not] . . . documented under standard CDS terms"—highlighting the "pay-as-you-go" terms and the lack of collateral posting

---

[66] *See* Copley Dep. Tr. 59:19-22, 26:24-27:5; Trial Tr. 582:6-17 (Viegas).
[67] *See* Copley Dep. Tr. 61:25-62:15.
[68] JX-67 at 4 (Valuation Memorandum); *see also* Trial Tr. 605:2-612:3 (Viegas).
[69] JX-67 at 2, 3 (Valuation Memorandum).
[70] *See id.* at 3-4.
[71] *Id.* at 3.
[72] *Id.* at 2.

described above[73]—and because contracting with Assured presented significant counterparty risk.[74] It described LBIE's worst-case scenario as the one in which Assured chose to hold the Transactions to maturity, because any potential value to LBIE would "be much smaller than [what LBIE] . . . could extract from any options that crystalli[z]ed, at least in part, the current MtM [mark-to-market] distress implied by the market for the CDS Contracts."[75] The Valuation Memorandum thus implicitly acknowledged the significant market dislocation between fundamental value (which is the term economists use to describe expectations about how the securities will perform) and market prices, which its upside case looked to exploit.[76]

The Valuation Memorandum also analyzed a scenario in which LBIE would assign the Transactions to another party. In that scenario, too, it concluded that the value of the Transactions would be "significantly diminish[ed]" because of Assured's counterparty credit risk and the Transactions' non-standard terms.[77] It explained that the appetite of other market participants to step into LBIE's shoes was "severely limited" by these factors.[78] Ultimately, the Valuation Memorandum concluded that, regardless of the scenario, the Transactions were "unlikely to generate cash for LBIE because of a combination of counterparty risk, non-standard documentation, and overall credit soundness of the short positions."[79]

LBIE expressed similar conclusions in several other internal memoranda and communications. For example, in December 2008, Francesco Cuccovillo, another of LBIE's

[73] *Id.* at 2; *see also* Trial Tr. 609:13-610:9 (Viegas).
[74] JX-67 at 2 (Valuation Memorandum).
[75] *Id.* at 3.
[76] *Id.* at 3; *see also* Trial Tr. 3139:8-3140:10 (Prager).
[77] JX-67 at 2 (Valuation Memorandum).
[78] *Id.*
[79] *Id.* at 4. Quintas also analyzed a third possible scenario, in which Assured and LBIE agreed to terminate the transactions at a cost to Assured. Quintas recognized that "[Assured wasn't] thrilled by this option," because it would reflect the mark-to-market value of the Transactions. *Id.* at 4.

"most knowledgeable" traders,[80] sent Viegas a slide deck assessing the value of the Transactions, in part based on discussions about novation with Steve Pearson, one of LBIE's Joint Administrators.[81] The slide deck reflected LBIE's continuing judgment that the Transactions had little to no value to it at the time, and reiterated the challenges LBIE faced in finding counterparties willing to step into its shoes.[82] That same month, Billy Radicopoulos, another LBIE trader, sent an email to Viegas similarly stating that the Transactions would be difficult to novate because of the "non-posting [of collateral] of the counterparty [Assured]" and that a market-based valuation of the Transactions "grossly exaggerates" their value.[83]

C. LBIE Attempts To Novate The Transactions But Finds No Takers

After LBIE's default, Assured considered three options: (1) do nothing, (2) terminate the Transactions, or (3) allow LBIE time to novate the transactions to another creditworthy counterparty, with Assured's consent.[84] Assured preferred to maintain its bargain, if possible, so it chose to allow time for novation,[85] and informed LBIE that it was "receptive to exploring that option."[86] Assured was "enthusiastic about [LBIE] assigning [the Transactions] to someone else,"[87] because doing so would have allowed Assured to collect premiums that LBIE was failing to pay,[88] so Assured would have consented to such a novation "[v]ery quickly."[89] The challenge,

---

[80] *See* Trial Tr. 573:24-574:7 (Viegas).
[81] AX-30009 at 1 (Cuccovillo Email to Viegas) ("[A]ttached is a presentation . . . that summarises the main features of the proposed 'Structural Assignment' transaction (already raised during the conversation with Steve P. the other day)."); *see also* AX-30010 (attached LBIE Slide Deck on Credit Exposure to Assured); Trial Tr. 654:8-17 (Viegas) (describing Steve Pearson's role in the LBIE administration).
[82] *See* AX-30010 at 3-5 (LBIE Slide Deck on Credit Exposure to Assured) (using the same language that was in the Valuation Memorandum).
[83] AX-30020 at 1 (Radicopoulos Email to Viegas); Radicopoulos Dep. Tr. 192:7-19.
[84] Trial Tr. 2172:8-15 (Schozer).
[85] *Id.*, 2184:22-2185:3 (Schozer), 2194:2-19 (Schozer).
[86] JX-61 at 1 (Pickering Email to Chow) (discussing LBIE–Assured position reconciliation).
[87] Trial Tr. 2194:19-20 (Schozer).
[88] *See* JX-67 at 3 (Valuation Memorandum) (Quintas noting that Assured would prefer novation because it would receive its premiums to maturity).
[89] Trial Tr. 2184:22-2185:3 (Schozer); AX-20034a at 43 (Assured "Insured Portfolio" Presentation) (informing ratings agency in October 2008 that Assured had "begun preliminary discussions with the UK administrator with

as LBIE acknowledged internally, was the non-standard terms of the Transactions (including a lack of collateral posting), as well as the counterparty credit risk involved in facing Assured.

Recognizing this challenge, LBIE designed a special financial structure, which it dubbed "Project Rioja," to "transform [its] monoline contract [with Assured] into a standard ISDA contract" that would be more "palatable" to market participants.[90] This structure involved creating a special purpose vehicle that would step into LBIE's shoes on the Transactions with Assured, while simultaneously issuing collateralized CDS with standard terms on the same reference obligations to a third-party purchaser.[91] LBIE described this structure as "[a]llow[ing] for the crystalli[z]ation of the mark to market value on CDS Contracts that have remote default risk," and it explained that "*LBIE will be cashing this money to the extent that* either [Assured] does not default, or *the [reference obligations] do not default* (or both) – and *this is a high probability scenario*."[92] In other words, LBIE reached the same view as Assured: that the reference obligations were unlikely to experience significant shortfalls. This admission is devastating to LBIE's attempt in this lawsuit to challenge that assessment as unreasonable.

In late 2008 and early 2009, LBIE tried to find counterparties interested in novation.[93] The only expression of interest came from Giancarlo Saronne, a former LBIE trader who had begun working at Nomura's London desk in November 2008.[94] Saronne was initially "very interested in the transaction[s],"[95] and Nomura signed a confidentiality agreement with LBIE to

regard to a possible negotiated settlement to either terminate the transactions or assign [the Transactions] to another counterparty").

[90] JX-62 at 4 (Cuccovillo Email to Saronne).

[91] AX-30010 at 6 (LBIE Slide Deck on Credit Exposure to Assured); JX-62 at 6 (Cuccovillo Email to Saronne).

[92] *See* AX-30010 at 8 (LBIE Slide Deck on Credit Exposure to Assured) (emphasis added); *see also* JX-62 at 4 (Cuccovillo Email to Saronne).

[93] *See* JX-60 (Cuccovillo Email Re: Nomura Confidentiality Agreement) (LBIE contacting Nomura in December 2008 regarding a confidentiality agreement in advance of novation discussions); Trial Tr. 535:2-20 (Viegas).

[94] Radicopoulos Dep. Tr. 69:12-19.

[95] JX-63 at 1 (Saronne Email to Administrators Re: Assignment of Transactions); Trial Tr. 537:9-19 (Viegas); JX-60 (Cuccovillo Email Re: Nomura Confidentiality Agreement).

move the process forward.[96] In January 2009, Quintas and Cuccovillo also left LBIE for Nomura.[97] But nothing came of LBIE's attempt to novate to Nomura.[98] And, at trial, LBIE offered no evidence of any other party expressing interest in the Transactions.[99]

D. Anticipating Termination And Litigation, LBIE Solicits Indicative Bids

In a June 2009 email, Paul Copley—who led the team that included Viegas, Quintas (before he moved to Nomura), and other LBIE traders tasked with valuing the Transactions[100]—told Pearson that the Transactions would only be worth "$10-15 m" even if LBIE could find a party interested in novation, based in part on concerns that Assured, as a monoline, "is nearly bust and is restructuring to survive."[101] He noted that LBIE had tried to market the Rioja "alternative," "but ha[d] not yet managed to get anyone to 'bite' on the idea."[102] In the same email, Copley described Assured as a "litigation candidate."[103]

Shortly before Assured terminated the Transactions, LBIE began trying to bolster its anticipated litigation position. Beginning on July 21, 2009, LBIE hurriedly threw together a plan to solicit bids that could later be used in litigation to challenge Assured's valuation.[104] LBIE first sought firm bids.[105] But as it became clear that no one would "give [LBIE] a firm quote," it pivoted, and, in the words of LBIE in-house attorney David Swanson, "just ask[ed] for [a] quote,

[96] *See* JX-63 at 2 (Saronne Email to Administrators Re: Assignment of Transactions) (acknowledging execution of the confidentiality agreement in late 2008).
[97] *See* Trial Tr. 536:3-9 (Viegas).
[98] *See id.* at 2193:10-22 (Schozer), 2203:19-20 (Schozer) (From Lehman's insolvency through July 2009, Schozer was not aware of any proposal from LBIE to novate or assign the Transactions.).
[99] *See id.* at 631:17-632:7 (Viegas) (testifying that he was not aware of any bank, broker-dealer, or monoline that was willing to step into LBIE's shoes on the Transactions).
[100] *See* Copley Dep. Tr. 59:15-60:16; Trial Tr. 572:10-574:2 (Viegas).
[101] AX-30013 at 1 (Copley Email to Pearson).
[102] *Id.*
[103] *Id*.
[104] *See* LX-73 at 1 (Porter Email to Unidentified Banks) (attaching the confirm documents for each trade with Assured).
[105] *See* AX-90019 at 1 (Email Chain Between Quintas at Nomura and Porter at LBIE) (Quintas: "[O]n the terms indicated below I won't quote. You are asking for firm bids."); Trial Tr. 683:17-23 (Viegas); Copley Dep. Tr. 148:20 ("We were seeking firm offers.").

without specifying firm or indicative," because, "[f]or purposes of challenging [Assured's] valuation, even indications should help."[106] In addition, LBIE provided incomplete, heavily redacted documentation about the Transactions, scrubbing any reference to Assured.[107]

Only three banks—Nomura, Citi, and JP Morgan Chase—agreed to provide indicative bids (and some provided only partial bids), and all included extensive caveats and conditions.[108] Nomura's indicative bid, which was provided by Quintas himself, stated that it did "not purport any degree of accuracy" in the prices it provided, which, it highlighted, were not "actionable" and were "not an offer or invitation to trade."[109] Nomura also explained (even though Quintas surely knew who the counterparty was from his work relating to valuation and novation of the Transactions at both LBIE and Nomura, including on Project Rioja[110]) that "the generic AAA and A counterparties assumed in the quotes are too broad an assumption, and therefore prices might differ substantially once we know the exact identity of our potential source of protection."[111] Citi and JP Morgan's partial indicative bids were also non-committal and came with a slew of qualifications.[112] John Miles at Citi wrote that "[a]ll bids are subject to a

[106] AX-30030 at 1 (Swanson Email to Merriman); *see also* Trial Tr. 671:14-17 (Viegas).
[107] LX-73 (Porter Email to Unidentified Banks) (containing documents LBIE sent to potential bidders where it redacted Assured's name from the confirms with a sharpie); *see also* Trial Tr. 560:11-16 (Viegas), 3510:19-3511:8 (Pirrong) ("[E]very indication of who the counterparty would be has been excised [from the confirms].").
[108] *See* LX-74 (Porter Email to Viegas Re: Indicative Bids) (compiling all indicative bids received).
[109] *Id.* at 2; *see also* Trial Tr. 3514:4-17 (Pirrong).
[110] *See* Trial Tr. 686:14-687:5 (Viegas); JX-67 (Valuation Memorandum); JX-55 (Quintas Email to LBIE Re: Project Rioja).
[111] LX-74 at 2 (Porter Email to Viegas Re: Indicative Bids); *see* Trial Tr. 3514:4-3515:7 (Pirrong) (explaining that the indicative bid was not a reliable source of information about the value of the Transactions because "[c]ounterparty risk really matters. And getting a number that . . . cannot take into account that . . . counterparty risk is not a reliable indication of the value of [the Transactions]"). It is reasonable to assume that Quintas was aware of who the counterparty was at the time he offered the indicative bid on behalf of Nomura. *See id.* at 686:14-687:8 (Viegas).
[112] LX-74 at 6, 8 (Porter Email to Viegas Re: Indicative Bids); *see also* Trial Tr. 3515:20-3516:2 (Pirrong) (explaining that JP Morgan's email to LBIE meant that even if all other caveats were satisfied, JP Morgan still "was only willing to take a piece of [the Transactions]"), 3516:16-23 (Pirrong) (explaining that Citi only made bids on some of the Transactions, notably not placing any bids on the ABX transactions).

satisfactory counterparty and variety of internal approvals within Citigroup."[113] Similarly, James Pearce at JP Morgan wrote that "[the indicative bids] are contingent on us knowing and agreeing [to the] counterparty and getting legal to check [that] confirmations are in line with what J.P. Morgan uses."[114] After receiving JP Morgan's email, LBIE discussed internally that JP Morgan was "putting up a little resistance as they believe[d] anything the[y] indicate will be completely innacurate [sic] without knowing exactly who they face."[115]

E. After LBIE's Failure To Novate, Assured Terminates The Transactions

While Assured had been "hopeful" following LBIE's bankruptcy that LBIE could novate the Transactions,[116] months passed without success.[117] By June 2009, Assured thought the likelihood of another party taking over LBIE's positions on the Transactions was low because "there were a lot of stresses on a lot of monolines and so . . . banks [did not want] to add a lot more exposure to monolines."[118] Assured also knew firsthand that there was a lack of market appetite to purchase new CDS from monolines with similar non-standard terms.[119] In the first half of 2009, Assured saw no interest from counterparties to do new CDS on CLOs, CDOs, or U.S. and U.K. RMBS.[120] The Transactions also continued to raise internal and external issues because: (i) Assured was not collecting any premiums from LBIE,[121] and (ii) the Transactions

---

[113] LX-74 at 9 (Porter Email to Viegas Re: Indicative Bids); *see* Trial Tr. 689:14-690:7 (Viegas), 3517:20-3518:10 (Pirrong). John Miles later declined to bid on the Transactions during the Market Quotation auction. *See* AX-40001 (Citibank Email to Henderson); Trial Tr. 3525:7-8 (Pirrong) (noting that Citi did not submit a bid at the auction).
[114] LX-74 at 6 (Porter Email to Viegas Re: Indicative Bids); *see* Trial Tr. 692:14-23 (Viegas), 3516:3-3516:15 (Pirrong) (explaining that JP Morgan was telling LBIE that "they have to know [the counterparty] in order to tell what [the Transactions] are really worth and what they would be really willing to pay").
[115] LX-74 at 1 (Porter Email to Viegas Re: Indicative Bids).
[116] Trial Tr. 2192:5-6 (Schozer).
[117] *See id.* at 2193:10-22 (Schozer), 2203:19-20 (Schozer).
[118] *Id.* at 2197:2-19 (Schozer).
[119] *See* LX-56 at 2 (Assured Structured Finance June 2009 Report); Trial Tr. 2198:8-2200:10 (Schozer) (discussing LX-56: ". . . it says there was no business in that sector"), 2197:2-19 (Schozer).
[120] *See* LX-56 at 2 (Assured Structured Finance June 2009 Report) (YTD Financial Summary Chart).
[121] *See* Trial Tr. 2182:13-2183:1 (Schozer) (discussing AX-20018 (Schozer Email to Assured Colleagues), which described the principal risks in not terminating the Transactions with LBIE).

reflected a "fairly large notional exposure" for Assured, leading to "ongoing questions from rating agencies and other constituencies" about why Assured still had significant exposure to LBIE.[122] Accordingly, after giving LBIE eight months to novate, Assured engaged LBIE in settlement negotiations in June 2009.[123] When they proved unsuccessful, Assured delivered a notice of termination on July 23, 2009 (the "Early Termination Date").[124]

F. Assured's Market Quotation Auction

Following its notice of termination, Assured engaged Henderson Global Investors Ltd. ("Henderson") to design and execute an auction of the Transactions as required under the ISDA Market Quotation process.[125] Assured selected Henderson, "one of the major fund complexes in the U.K.," because it had the experience and capability to run a formal auction and was "a very important player in the markets" that would be taken seriously by potential bidders.[126] As Mr. Schozer explained at trial, Assured's goal in conducting the auction was to "get live bids . . . for prices at which people will really trade, because that's the only time you actually have a value; the value of any financial instrument is what people actually will pay cash for."[127]

After conducting broad market outreach, Henderson invited twelve major financial institutions to participate in the auction (either directly, or on behalf of their clients).[128] The auction was timed to avoid August, when many in Europe take vacation, and to avoid conflicts

---

[122] *Id.* at 2203:14-2204:6 (Schozer) (explaining why Assured eventually decided to terminate the Transactions).
[123] *See Lehman Bros. Int'l (Europe) v. AG Fin. Prods., Inc.*, No. 653284/2011, 2016 WL 392709, at *1-2 (Sup. Ct. N.Y. Cnty. Jan. 11, 2016).
[124] *See* JX-33 (Termination Notice).
[125] D/O at *3.
[126] Trial Tr. 2206:14-2208:22 (Schozer).
[127] *Id.* at 2206:20-23 (Schozer), 2207:4-7 (Schozer) (Henderson was "hired to actually conduct an auction and . . . execute on the sale of those assets . . . and the sale would establish . . . what the value was.").
[128] AX-60003 at 5-6, 32 (Henderson Report); *see* Irvine Dep. Tr. 63:17-21 ("[W]e concentrated our efforts on the largest investment banks, who themselves would have had a whole variety of potential risk-taking clients, hedge funds, distressed funds, . . . buyers of distressed assets."); AX-40004 at 1 (Credit Suisse Email to Henderson) ("[W]e . . . went out to clients to see what interest we could generate.").

with other auctions and less favorable days of the week.[129] Eleven of twelve invitees executed confidentiality agreements, which identified Assured as the counterparty to the transactions;[130] eight entered the data room that contained detailed information about the Transactions;[131] and three executed the bidding procedures letter.[132] The Henderson Report describes in detail how the auction was conducted,[133] but those specifics are omitted here because, at summary judgment, this Court held that LBIE had failed to challenge "in any material respect" Professor Pirrong's opinion that "the structure and design of the auction was reasonably calculated to increase the likelihood that the Market Quotation process would be successful."[134]

The auction was conducted in London on September 16, 2009.[135] Mr. Schozer, then President of Assured, flew to London in order to be ready to "execute the transaction" in the event that a bid was received.[136] Ultimately, none of the auction participants submitted bids.[137] All but one told Henderson why they chose not to bid, or not to participate at all:

- BNP Paribas said that it had "simply no appetite to increase our exposure to monolines."[138]
- JP Morgan Chase said that it did not "currently have credit appetite to buy protection

[129] Irvine Dep. Tr. 66:14-67:25.
[130] AX-60003 at 6 (Henderson Report). The twelfth institution, BNP Paribas, declined to execute a confidentiality agreement. *Id.* at 5.
[131] *Id.* at 8.
[132] *Id.* at 8.
[133] *Id.* at 11.
[134] D/O at *6-7 (rejecting as speculative and unsupported LBIE's contentions that (1) Henderson lacked necessary experience; (2) Assured's requirement that auction participants have an existing ISDA Master Agreement in place with Assured frustrated the Market Quotation process; (3) confusion as to which ISDA Master Agreement would govern the Transactions discouraged bids; and (4) Assured's retention of discretion to accept or reject bids discouraged bids).
[135] D/O at *3; Trial Tr. 2367:11-13 (Schozer) (confirming that Schozer was "in London for the auction").
[136] *See* Trial Tr. 2209:24-2210:4 (Schozer), 2367:1 (Schozer) ("I was in London in order to hit a bid.").
[137] D/O at *3.
[138] AX-40005 at 1 (BNP Paribas Email to Henderson). With respect to this and the subsequently discussed emails, the Court allowed Plaintiff to present evidence of emails it received from banks regarding indicative bids LBIE received in July 2009 with respect to the valuation of the LBIE-Assured transactions. *See, e.g.*, Trial Tr. 562:1-563:25. In order to "complete[] the narrative," *id.* at 3524:21 (Pirrong), the Court allowed Defendant to present evidence that banks, even some of the same banks that submitted indicative bids to LBIE, declined to bid in Assured's Market Quotation auction.

from AGFP on this portfolio of AAA ABS and CDOs."[139]

- Morgan Stanley said that it had "very limited appetite to source or intermediate protection on an uncollateralized basis."[140]
- UBS said that it was "unable to obtain internal Credit approval to face AG on bought cds protection."[141]
- Credit Suisse said that it had "no principal axe for this trade" and "had little success" generating client interest "given the nature of the underlying and the end monoline."[142]
- HSBC said that it chose to "pass" in part because the ABX trades would be "difficult to exit," noting that "ABS CDS markets remain[] relatively illiquid under current market conditions;" and because it could not effect a negative basis trade.[143]
- Citibank said that they "had a number of clients very interested in buying protection on quite a few of the line items that were auctioned, but none of them were prepared to step into the existing contracts and face Assured Guaranty [due] to counterparty risk."[144]
- RBS said that it was "unable to get through the required approvals . . . in time to participate in the auction," but did not specify why.[145]
- Nomura said that it was not "able to turn around an ISDA fast enough."[146]
- Barclays did not provide an explanation to Henderson,[147] but internally stated it would "politely pass" including because "we arent looking to add AGO/AGFP exposure."[148]
- Deutsche Bank indicated that "they want[ed] to utilize what limited lines they have to monolines on a 'strategic' basis."[149]

As the Court previously held: "Assured's inability to obtain bids from counterparties willing to enter into replacement contracts 'was a result of a lack of appetite in the market for these products.'"[150] The most sophisticated financial institutions in the world were invited to

---

[139] AX-40006 at 1 (JPMC Email to Henderson).
[140] AX-40007 at 1 (Morgan Stanley Email to Henderson).
[141] AX-40003 at 1 (UBS Email to Henderson).
[142] AX-40004 at 1 (Credit Suisse Email to Henderson).
[143] AX-40002 at 1 (HSBC Email to Henderson). Prior to emailing Henderson, HSBC also informed Henderson that its decision not to participate related to the reference credits not suiting its book and an inability to find clients to bid. LX-412 at 1 (Email Between Henderson and Assured). LX-412 presents a second hand summary of HSBC's position, whereas AX-40002 is an email directly from HSBC and should be credited accordingly.
[144] AX-40001 at 1 (Citibank Email to Henderson).
[145] AX-40010 at 1 (RBS Email to Henderson).
[146] AX-40009 at 1 (Nomura Email to Henderson).
[147] AX-40011 at 1 (Barclays Email to Henderson).
[148] LX-411 at 1 (Barclays Internal Email).
[149] AX-20028 (Henderson Internal Email).
[150] D/O at *5 (citing Pirrong Initial Report).

participate and analyzed the actual (unredacted) documentation of the Transactions,[151] but not one bidder was willing to pay any amount to enter into LBIE's shoes.[152] If the Transactions had any value, bidders would have realized that value by making a firm bid.[153]

Because no market quotations were obtained, Assured could not proceed under the Market Quotation provision and was required to fall back to the Loss provision.[154]

IV. Assured's Calculation Of Its Loss

The financial consequence of LBIE's default for Assured was that it would no longer receive premiums from LBIE over the life of the Transactions and no longer had to make floating payments in the event of any interest or principal shortfalls.[155] As a result, Assured calculated its loss of bargain by calculating the net present value of these two payments streams (*i.e.*, premium payments and floating payments).[156] Assured's calculation of the first payment stream was straightforward because the premium amounts were contractually fixed.[157] Specifically, Assured determined that the present value of the premiums LBIE would have paid Assured from the Early Termination Date through the end of the life of the Transactions was \$35,191,751.62.[158] LBIE had also already failed to pay \$13,049,366.23 in premiums as of the Early Termination Date, resulting in a total amount owed by it to Assured of \$48,241,117.85.[159]

To calculate the second payment stream, the present value of the floating payments, Assured used the same regular-course-of-business models that its surveillance and loss reserving

---

[151] *See* Trial Tr. 3530:1-4 (Pirrong) (discussing efforts of auction participants).
[152] *See* AX-60003 at 3 (Henderson Report).
[153] Trial Tr. 3529:16-3530:10 (Pirrong).
[154] *See* JX-01 at 15 (1992 ISDA between LBIE and Assured).
[155] Trial Tr. 2211:9-24 (Schozer).
[156] JX-34 at 4 (Statement of Calculations); Trial Tr. 2211:9-24 (Schozer).
[157] JX-34 at 4 (Statement of Calculations).
[158] *Id.*
[159] *Id.* at 4-5.

groups use to estimate expected losses for all of its transactions.[160] Assured's analysis, including detailed modeling by the surveillance group, showed there were no expected losses on 26 of the Transactions (all of the UK RMBS, CLO, and CDO transactions), which continued to be investment-grade during the financial crisis.[161] This conclusion was consistent with the extensive structural protections in these securities, described above, and with Assured's prior underwriting analysis, which showed that Assured would not incur a single dollar of loss on the UK RMBS, unless "home prices . . . [had] declined and losses . . . [were] more severe than it ever had been experienced in the UK market including [during] the bombing of London and the economic fallout around those times," or on the CLOs, unless losses were "two times [historic] averages on the corporate loan losses."[162]

Assured originally projected no losses on the ABX transactions,[163] but its updated analysis in 2009, which took into account developments in the housing market and the performance of the mortgages, had determined there was the potential for losses. As such, these transactions were elevated to Mr. Rosenblum, Assured's Chief Actuary, for the calculation of

---

[160] *Id.* at 5; *see also* Trial Tr. 2213:3-17 (Schozer) ("Q. How did Assured decide to use this methodology? A. . . . I don't think there was a decision per se. I mean, we're a—we're a regulated insurance company, we have certain ways we calculate things and we have to treat this transaction the same as we treat all other transactions. . . . Q. In your view, was there . . . any other way to do the calculation that it would have been consistent with the economics of the transaction for Assured? A. No. Q. Was there any other way to do it that would have been consistent with Assured's business? A No."); AX-20005 at 2 (Frederico Report to Assured Board Re: Aug 2009) ("We completed the auction of our terminated swap positions with Lehman. This auction was a required step in the termination process. We received no bids as we anticipated and now, per the contract, will assess losses on any of the terminated swaps per our loss model.").

[161] *See* JX-34 at 8-10; AX-20020 (AMMC CLO Class A1R Spreadsheet); AX-20038 at 1 (Assured International RMBS Portfolio Email); Trial Tr. 1295:11-1300:20 (Rosenblum) (discussing surveillance runs for the CLO and CDO Transactions), 1300:21-1301:6 (Rosenblum), 1303:2-1310:24 (Rosenblum) (discussing surveillance runs for the UK RMBS Transactions).

[162] Trial Tr. 3001:23-3002:4 (Prager); *see also id.* at 2094:5-2095:5 (Schozer), 2119:2-2120:15 (Schozer); AX-20004 at 2 (Assured Sept. 2007 Underwriting Memo) (noting that Assured was protected between 1.66 and 2.84 times against the worst case historic losses experienced by the UK residential mortgage market in the late 1980s); AX-10001 at 2, 5-6 (Ballyrock CDO Underwriting Memo).

[163] *See* AX-20006 (Underwriting Memo for ABX 2006-2), JX-65 (Underwriting Memo for ABX 2007-01); Trial Tr. 1224:6-1225:6 (Rosenblum) (describing Assured's zero-loss standard for underwriting credit protection).

expected losses.[164] To do so, Assured used the same methodology it used for calculating expected losses on all transactions referencing similar securities (US subprime RMBS).[165] Assured's model—which was run on the industry-standard Intex platform—relied on three key parameters: (1) how many borrowers in the relevant RMBS pools would default on their mortgages (represented as the cumulative default rate or CDR), (2) how many would prepay (represented as the prepayment rate), and (3) how severe losses on mortgages in default would be (represented as the loss severity).[166] In each case, Assured set these inputs based on actual market data for the specific RMBS at issue—which was available through Intex.[167]

Assured then had to apply its judgment to determine how defaults, prepayment and loss severity would evolve over time.[168] In doing so, Assured took into account relevant market conditions, including the severity of the downturn in the housing market that had begun in 2007 and the many indications that the housing market was beginning to stabilize, including based on unprecedented government intervention by the Obama administration.[169] Specifically, Assured continued to use historically high default rates in its model based on then-current observed data for a period of between 24-27 months, and determined that, over time, each of the parameters in its model would eventually return to normalized historical levels.[170] Based on this modeling, Assured calculated that the present value of the expected losses on the two ABX transactions would total $27,577,817.65, which it would have been required to pay LBIE.[171] Subtracting this amount from the $48,241.117.85 in unpaid and future premiums owed by LBIE, resulted in a

[164] Trial Tr. 1287:19-1288:2 (Rosenblum) (noting that the "expected losses for the ABX transactions in this case . . . were assessed [using] . . . the same scenarios that [they] ran for the rest of [their] subprime transactions").
[165] *See id.* at 1287:19-1288:14 (Rosenblum).
[166] *See id*. at 1321:19-1322:1 (Rosenblum).
[167] *See id*. at 1233:17-1234:7 (Rosenblum).
[168] *See id.* at 1287:1-15 (Rosenblum).
[169] *See id.* at 1255:5-1259:10 (Rosenblum).
[170] *See id.* at 1169:4-17 (Rosenblum).
[171] *See* JX-68 (Column S, Rows 172-173); *see also* Trial Tr. 1288:16-1292:6 (Rosenblum).

Loss calculation of $20,663,300.20 owed by LBIE to Assured.[172] This is the economic loss that Assured suffered as a result of LBIE's default as of the Early Termination Date.

There was extensive evidence at trial showing the reliability of Assured's modeling. First, the judgments that Assured made about how to model losses over time were consistent with those made by other market participants who engaged in similar analysis, including Moody's and Standard & Poor's.[173] Both expressed the view that housing prices would stabilize in the first half of 2010, consistent with Assured's modeling.[174] Similarly, Moody's, which provided extensive disclosure regarding its methodology, explicitly discussed how seasoning and government programs would curtail the severity and duration of losses.[175] Additionally, the expected losses that Assured calculated for the ABX transactions closely tracked the contemporaneous expected loss calculations published by Moody's and Standard & Poor's for US subprime RMBS of the same vintage: Assured projected 28% lifetime collateral losses, while Moody's projected 30% and S&P 32%.[176]

Second, Assured's models were regularly used for multiple business purposes. Assured relied on the same models: (1) in its underwriting process, where accurate modeling was critical to its decision to enter into new transactions;[177] (2) after entering into transactions, to monitor their credit quality and determine which transactions required increased surveillance or remedial

[172] JX-35 at 2 (Letter Correcting Statement of Calculations). The original statement of calculations, JX-34, contained an inadvertent transposition error, which Assured notified LBIE of in July 2019. *See id.*; Trial Tr. 1290:22-1291:22 (Rosenblum), 1360:14-1362:6 (Rosenblum).
[173] Trial Tr. 3347:19-3349:15 (Prager).
[174] AX-50031 at 5 (S&P Report); AX-50044 at 2 (Moody's Aug. 2009 Report).
[175] *See* AX-50083 at 6, 7 (Moody's March 2009 Report); Trial Tr. 3066:17-3067:2, 3339:18-3342:24, 3346:16-3348:10 (Prager).
[176] Trial Tr. 3080:18-3081:5 (Prager); AX-50083 at 1 (Moody's March 2009 Report); AX-50031 at 4 (S&P July 2009 Report).
[177] AX-20006 at 4 (Underwriting Memo for ABX 2006-2); Trial Tr. at 2144:24-2145:3 (Schozer) (describing loss projection methods included in underwriting memo); JX-65 at 5 (Underwriting Memo for ABX 2007-01); Trial Tr. 2156:15-24 (Schozer) (explaining expected loss process done in connection with underwriting).

action;[178] (3) to determine its regulatory loss reserves for its entire portfolio, including "literally hundreds of transactions" unrelated to this dispute;[179] (4) as the basis for its financial reporting to investors;[180] and (5) as the basis for reporting required by its insurance industry regulators.[181] Additionally, Assured used the same models for loss mitigation purposes,[182] including purchasing RMBS on which Assured had written protection where the trading prices were dislocated and did not reflect expected losses projected by its models.[183] Assured had a strong incentive to calculate losses as reasonably and accurately as possible because those calculations affected so many critical aspects of its business. In its reporting, for example, losses would eventually have to be disclosed, and delays in doing so would undermine Assured's credibility with investors and regulators.[184] And it would have made no economic sense for Assured to have used its loss reserve models in connection with purchasing RMBS if it believed the models underestimated expected losses.

Third, because Assured's expected loss methodology was critical to its business, it was

---

[178] AX-70008 at 23-24 (Assured 2009 10-K).

[179] Trial Tr. 3040:10-12 (Prager), 1126:15-1127:10 (Rosenblum), 2213:3-17 (Schozer); AX-20005 at 2 (Frederico Report to Assured Board) ("We received no bids, as we anticipated, and now, per the contract, will assess losses on any of the terminated swaps per our loss model.").

[180] AX-70008 at 23-26, 96-97, 160 (Assured 2009 10-K); *see also* AX-70006 at 34-35, 48-49 (Assured Q2 2009); JX-50 at 68 (Assured Q2 2009 10-Q) (Assured used "stressed loss assumptions" to reflect its view of the "maximum probable deterioration likely to occur on these transactions."); Trial Tr. 2836:4-2838:10 (Bailenson) (discussing use in connection with regulatory filings and according to statutory requirements), 2862:16-18 (Bailenson) ("We were explaining to the reader that these non-GAAP measures were the most appropriate measure that investors should look at when evaluating the underlying economics of the company.").

[181] LX-244 at 14 (Assured Annual Statement filed with Maryland regulator (FY 2009)); Trial Tr. 2836:4-2838:10 (Bailenson) (discussing use in connection with regulatory filings and according to statutory requirements), 2935:13-22 (Bailenson) (discussing filing with Maryland regulators).

[182] Trial Tr. 3041:10-21 (Prager) ("[I]n 2008, 2009, 2010 understanding your losses were very important to what further business decisions you would make.").

[183] *Id.* at 1284:7-1285:21 (Rosenblum) ("[I]f we saw a bond that we insured in the market, in many cases it was a good economic play, it was a good opportunistic economic play to go ahead and purchase that bond . . . . We used the same loss reserve assumptions to figure out if it was a good economic play for us to purchase those bonds as we used – as we used in a loss reserve analysis."), 2859:8-2861:3 (Bailenson).

[184] *Id.* at 3045:7-16 (Prager) ("[A]t end of the day the number will be what the number will be. The actual cash flows will bear out, and if you miss then you are going to have to keep adjusting and eventually have to take the loss.").

subject to multiple layers of internal and external review.[185] That process began with "a large Surveillance Department" that continuously worked on loss projections.[186] Additionally, each quarter, Assured's Reserve Committee updated its loss reserve models in light of recent market developments.[187] The Reserve Committee consisted of the most senior, experienced personnel at Assured, including its CEO, CFO, Chief Surveillance Officer, Chief Accounting Officer, Chief Actuary, and General Counsel.[188] The updated model was then reviewed by the Audit Committee of Assured's Board of Directors.[189] Without the Audit Committee's approval, Assured could not file its 10-K.[190] Finally, Assured's independent auditor, PwC, also conducted an audit of the loss reserve assumptions and issued an opinion for the Company.[191] The strength of Assured's loss reserving model was critical to its success through the financial crisis.[192]

---

[185] *Id.* at 1237:8-1239:20 (Rosenblum) (describing the role of the surveillance department, the reserve committee, the audit committee, and independent auditors in the loss reserves process), 1239:21-1241:3 (Rosenblum) (describing the Reserve Committee's process), 3042:1-2 (Prager) ("There were a lot of controls that were in place, internal and external, management level and board level."), 3041:7-10 (Prager) ("One [of the benefits] is the number of layers of checks and balances and control to make sure it was isolated from bias and to make sure it was properly reflective of economic output.").

[186] *Id*. at 1217:14-1218:1 (Rosenblum).

[187] AX-70008 at 23-24 (Assured 2009 10-K); Trial Tr. 1213:8-20 (Rosenblum) ("Q. What data was Assured looking at to make determinations about expected losses for the ABX transactions? A. 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. . . . And then, above that, we layered in our—anything else we could see in the market that we thought was useful."), 3042:1-7 (Prager) (explaining role of surveillance group), 1214:20-24 (Rosenblum) (explaining Reserve Committee's consideration of assumptions), 1236:4-10 (Rosenblum) (explaining use of scenarios and scenario weighting), 1275:4-20 (Rosenblum) (discussing interplay of loss assumptions and scenarios).

[188] *Id.* at 1237:20-1238:9 (Rosenblum) (testimony as to committee members).

[189] *Id.* at 1238:23-1239:5 (Rosenblum) ("So the audit committee is a group of—from our board who are typically—are frequently senior retired insurance executives or other people, an ex-auditor. And their job, again, on behalf the board, is to look at the reserves, among other financial data that we present to them, and challenge it and see that they can agree that, with the numbers and the judgments we made, because, again, we can't file our annual financials, our 10-K, without them agreeing it's appropriate."), 1242:25-1243:12 (Rosenblum) (further describing role of Audit Committee).

[190] *Id.*

[191] *Id.* at 1242:4-24 (Rosenblum) (describing PwC's involvement with the quarterly review process), 3042:19-23 (Prager) ("And so PWC would have come in and tested this so you have layer, upon layer, upon layer of review and quality control and testing."), 2873:5-9 (Bailenson) ("[O]bviously at this time loss reserves were a significant estimate, very important that it was reviewed appropriately. And so they would review it on that quarterly basis and determine that it was appropriate."), 2873:10-15 (Bailenson) ("It was a full audit . . . They would agree with the assumptions and they issued an unqualified opinion for the company.").

[192] *Id.* at 2028:6-10 (Schozer).

Finally, the methodology Assured used to calculate Loss was consistent with how it described the value of its CDS transactions in the extensive disclosures it filed as a publicly-traded, regulated insurance company.[193] Assured repeatedly made clear that its economic obligations under its CDS transactions were limited to protecting against shortfalls in interest and principal payments on the reference obligations as they came due.[194] While Assured was required under GAAP accounting rules to "mark to market" its CDS contracts, these calculations were "not meaningful at all" to its business, and Assured explained to its investors that they were not a measure of economic loss.[195] Mark-to-market calculations could reflect fluctuations in the market price of a reference obligation or in Assured's credit spread, rather than "the underlying economics" of the CDS transaction.[196] And because Assured could not trade out of its CDS positions, it could not realize any mark-to-market gain or loss.[197] Further, the GAAP rules required Assured to factor into its calculations a counterparty's cost to hedge the risk of non-performance by Assured, which involved incorporating Assured's own credit spreads (measuring its credit risk).[198] This too had nothing to do with actual credit losses on insured securities. For

---

[193] *Id.* at 2836:21-2838:10 (Bailenson) (discussing Assured's reporting obligations).
[194] *Id.* at 2841:23-2842:12 (Bailenson), 3012:11-15 (Prager) (explaining that economic obligations under a CDS are "really identical, if not identical to those under a financial guaranty policy" because both are "credit risk product[s]"), 1221:23-1222:2 (Rosenblum), 1223:10-17 (Rosenblum) (explaining that insurance protection in CDS form worked the same way as financial guaranty protection because for both "our obligation and our policy was to pay shortfalls of principal and interest when due"), 64:4-13 (Rahl) (discussing fixed payments as the payment that a protection buyer pays for protection in a credit default swap and floating payment as the amount the protection seller is on the hook for).
[195] *Id.* at 2848:1-12 (Bailenson); *see also* AX-70008 at 72 (Assured 2009 10-K) (noting that, although Assured was "required to mark-to-market certain derivatives[,]" marking-to-market, net changes in fair market value of derivatives, have "no cash flow effect"), 118 ("Changes in the fair value of the Company's credit derivatives that do not reflect actual or expected claims or credit losses have no impact on the Company's claims paying resources, rating agency capital or regulatory capital positions."). Notably, for counterparties that would hold their contracts to maturity, Assured was "precluded" from booking its positions mark-to-market. Trial Tr. 2846:9-17 (Bailenson).
[196] *See* Trial Tr. 2852:13-18 (Bailenson); *see also* AX-70008 at 72 (Assured 2009 10-K) ("Accordingly, the Company's GAAP earnings will be more volatile than would be suggested by the actual performance of its business operations and insured portfolio."), 118 ("The gain or loss created by the estimated fair value adjustment will rise or fall based upon estimated market pricing and may not be an indication that ultimate claims.").
[197] Trial Tr. 2862:19-2863:8 (Bailenson).
[198] *Id.* at 2876:9-2877:9 (Bailenson).

these reasons, Assured directed investors to use non-GAAP valuation methodologies based on its expected loss model (such as operating income or adjusted book value) when "evaluating the underlying economics of the company" rather than mark-to-market calculations.[199] For example, Assured explained: "[t]he operating income measure adjusts net income to remove effects of certain fair-value adjustments relating to dislocation in the market and any fair value adjustments where the Company does not have the intent or the ability to realize gains or losses."[200] Analysts and ratings agencies covering Assured agreed, and used those non-GAAP measures when evaluating the company.[201] In any event, even in its GAAP financials, Assured recognized a loss of approximately $20 million as a result of terminating the Transactions.[202]

Assured provided a statement to LBIE setting out its Loss calculation on October 16, 2009.[203] LBIE did not make payment, and instead sued Assured in November 2011.[204]

V. Broader Economic Conditions Relevant To Assured's Loss Calculation

There was extensive evidence at trial that during the financial crisis, many securities (including the US subprime RMBS referenced in the ABX transactions at issue here) were trading at prices substantially lower than their fundamental value. This extreme dislocation in the markets further supported Assured's decision to calculate Loss using a DCF analysis, which tracked the parties' actual economic obligations under the contracts, rather than by using a model

[199] *Id.* at 2861:19-2862:18 (Bailenson).
[200] AX-70008 at 96 (Assured 2009 10-K); Trial Tr. 2861:10-2863:18 (Bailenson).
[201] Trial Tr. 2866:9-12 (Bailenson); AX-50012 at 33 (S&P Global Bond Insurance Book 2007) (explaining that the concept of mark-to-market accounting under FASB No. 133, "insofar as it relates to the financial guarantee insurance industry, has introduced an element of earnings volatility that has little bearing on either the likelihood of a potential claim or the or the intrinsic earnings power of a bond insurer . . . . Unlike other financial sectors for which FASB No. 133 may be more relevant, bond insurers' contracts are not traded, and there is no business intention to realize gains. . . . We believe that the insurers' loss reserves are the more appropriate indicators of potential claims . . . .").
[202] *See* AX-20033 (Assured Summary of Transactions with LBIE) (in the Q2 2009 tab, determining the mark-to-market value of the 28 transactions to be $19,821,946 in Assured's favor); *see also* Trial Tr. 1318:4-1320:11 (Rosenblum).
[203] JX-34 (Statement of Calculations).
[204] Compl., D.I. 1 (Nov. 28, 2011) ("Compl.").

based on those dislocated market prices, like the one created by LBIE's litigation experts. The extent and causes of this market dislocation, as well as other economic conditions relevant to the value of the Transactions, are described below.

A. Trading Prices Of Securities Were Dislocated During The Financial Crisis

1. Origins of the Financial Crisis

In the early 2000s, the U.S. housing market experienced a sustained boom period, with rising home prices and low interest rates driving increased borrowing.[205] This fueled tremendous activity in the financial markets, and from 2000 through 2007, the global issuance of ABS ballooned from about $100 billion to nearly $700 billion; the vast majority were RMBS.[206] At the same time, CDS were being written on RMBS and other ABS, and the "derivatives market just continued to grow."[207] But, in the spring of 2007, home prices began to decline, setting off the worst financial crisis since the Great Depression.[208] The 2007 decline in home prices triggered "cascading" failures and a "downward spiral" in the financial markets: falling asset prices caused banks and other investors to start selling assets; increasing supply depressed prices further; some traditional investors exited the market altogether, reducing overall liquidity; this pushed prices down even further, resulting in fire sales;[209] this triggered further declines in asset prices, which spurred yet more selling.[210]

These events "dramatically reduced" the willingness of market participants to buy, or

[205] *See* AX-50022 at 34 (Financial Crisis Inquiry Report).
[206] *See* Trial Tr. 3488:13-21 (Pirrong).
[207] *Id.* at 2700:9 (Cohn).
[208] *Id.* at 863:6-8 (Bruce).
[209] *Id.* at 3023:19-20 (Prager), 3447:3-4 (Pirrong) ("[F]ire sales typically depress prices and they can depress prices by a lot.").
[210] For example, banks observing falling asset prices then said, "my balance sheet is going down again and I have to sell some more," triggering yet more fire sales. "And this cycle continues to repeat." Trial Tr. 3025:12-14 (Prager), 3146:3-9 (Prager) (describing the potential impact of short selling on ABX pricing), 3147:11-15 (Prager) ("Short position is a bet against something…[It] could be a bet against the actual security…[or] against the financial sector[,] and against the residential real estate sector more broadly.").

even hold, RMBS or other similar ABS.[211] The crisis raised serious doubts for investors and traders about the value of many of these assets and introduced uncertainty about the best way to determine that value. Specifically, the market-wide drop in asset prices revealed to participants that the models they had been using to value RMBS and CDS on RMBS had "a very stylized and abstract way of modelling correlations" that ultimately proved unreliable.[212] The depth of the financial crisis thus "made people more aware of and [averse] to model risks, less likely to trust the value they got out of their models."[213] And investors' loss of confidence in their own models further reduced their appetite to purchase RMBS, pushing down prices even more.[214]

2. Illiquidity and Price Dislocation

During this time, "the markets became very illiquid."[215] Niculescu admitted that "one of the unique aspects of the financial crisis was that liquidity stresses did not resolve quickly" and "extended into 2009."[216] To address the crisis, the U.S. Federal Reserve was "still extending its liquidity programs" in the middle of 2009.[217] The liquidity crisis was compounded by the collapse of some major market participants (Lehman, Bear Stearns)[218] and by the departure of others from the market (Merrill Lynch).[219] Even market participants that remained solvent were "continuing to exit the subprime market and subprime RMBS,"[220] as evidenced by the sharp decline in the number of dealers providing ABX pricing indications to MarkIT, which fell by a

[211] *Id.* at 3532:23-3533:2 (Pirrong).
[212] *Id*. at 3494:10-12 (Pirrong).
[213] *Id*. at 3494:22-3495:2 (Pirrong).
[214] This problem was most acute (and investor appetite most impaired) when the correlations that needed to be modeled were particularly complex. *See id.* at 3502:4-15 (Pirrong).
[215] *Id.* at 3487:25 (Pirrong).
[216] *Id*. at 1641:11-16 (Niculescu).
[217] *Id.* at 3026:22-23 (Prager), 3141:11-17 (Prager), 3151:20-25 (Prager); AX-90196 (U.S. Department of the Treasury Press Release Regarding Private Partnership Investment Program)
[218] Trial Tr. 3026:14-15 (Prager) ("[I]n March of 2008 . . . Bear Stearns fails."); *see also id.* at 854:9-25 (Bruce) (testifying about the collapse of Bear Stearns and Lehman).
[219] *Id.* at 1583:19-1584:1 (Niculescu).
[220] *Id.* at 3391:4-10 (Prager).

third during the period from 2008 to July 2009.[221]

LBIE's experts have asserted that 2009 trading prices are the best evidence of how the market believed the ABS referenced in the Transactions would perform in the future. But that was not the consensus view at that time (or ever). To the contrary, reports published by government entities and other neutral market observers at the time found that ABS were trading at steep discounts because of illiquidity and the other market conditions described above. For example, in its April 2008 Financial Stability Report, the Bank of England reported that "[m]any credit markets are dislocated . . . which has led to large discounts for illiquidity and uncertainty in some markets,"[222] and that ABX prices in particular "point either to very severe outcomes for credit losses or, more plausibly, embody large discounts for illiquidity or uncertainty."[223] The Bank explained that future losses implied by then-current market prices of US subprime mortgages were more than twice as large as the Bank's independent estimate of future losses, which it attributed to "the fact that market prices have fallen for reasons other than expectations of increased credit losses."[224] As a result, the Bank warned "that using a mark-to-market approach to value illiquid securities could significantly exaggerate the scale" of ultimate losses.[225]

Six months later, in the October 2008 Financial Stability Report, the Bank of England returned to the subject of price dislocation. Providing "updated" analysis "to account for the

---

[221] ADX03-10 (ABX Depth); Trial Tr. 3030:7-31:6 (Prager) ("There are fewer [market] participants . . . [T]raditional [market] makers are just not there. There are few of them not showing up even to put up a quote.").
[222] AX-50008 at 5-6 (BOE April 2008 Report).
[223] *Id.* at 6 (BOE April 2008 Report) (noting that the prices of the ABX index's AAA tranches "appear to be particularly out of line with credit fundamentals," illustrated on the same page by Chart 5); *see also* Trial Tr. 3532:10-12 (Pirrong) ("[O]ne of the things that can cause a divergence between fundamental value . . . and price is illiquidity.").
[224] AX-50008 at 17-19 (BOE April 2008 Report) (again noting that "The difference between actual and model-implied prices is notably greater for the AAA ABX indices"); *see also id.* at 23 (describing the prices for the ABX index AAA tranches as "dominated by illiquidity and uncertainty premia").
[225] *Id.* at 19 (BOE April 2008 Report).

deterioration in the US housing market since the April *Report*," it again concluded that market-implied losses were significantly larger than projected credit losses, and reiterated that mark-to-market valuations "continue to reflect significant premia for uncertainty . . . and illiquidity."[226] Six months after that, in March 2009, the Bank for International Settlements published a working paper that reported a similar conclusion: "[r]isk appetite and market liquidity risk seem to account for a sizeable part of observed variation in ABX returns," while "fundamentals," such as housing loan delinquencies, did not explain ABX price movements.[227] LBIE's expert witness, Leslie Rahl, too, described market dislocation in early 2009 as "severe," which she attributed 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."[228]

The price dislocation observed during the financial crisis was so widespread and extreme that, as LBIE's own expert Rahl has written, "[c]onsensus opinion about the appropriateness of various valuation techniques was being debated and reassessed in 2008 and 2009."[229] For example, a controversy developed around mark-to-market accounting rules, which require certain assets to be valued by reference to market prices (or, where no market prices are available, by reference to models designed to generate theoretical market prices—"mark-to-model").[230] During this time, "[m]any market participants, accountants, the financial press, and

---

[226] AX-50072 at 13-15 (BOE Oct. 2008 Report); *see also* AX-50009 at 1 (BIS Sept. 2008 Working Paper) ("[D]eclining risk appetite and heightened concerns about market illiquidity have provided a sizeable contribution to the observed collapse in ABX prices since the summer of 2007.").
[227] AX-50019 at 17-18 (BIS March 2009 Working Paper) (also noting that this effect was most pronounced for the AAA and AA indices).
[228] AX-90027 at 18, 21 (Rahl Devonshire Rebuttal).
[229] AX-90026 at 98 (Rahl Devonshire Report).
[230] Trial Tr. 1312:15-21 (Rosenblum) ("Assured Guaranty's approach to calculating its mark was to say: I got paid some amount of money when I entered the transaction. Given how the market has changed and given how the transaction may have changed . . . what would I get paid if I had to re-underwrite the transaction again[?]"); AX-50022 at 255 (Financial Crisis Inquiry Report) ("As market prices dropped, 'mark-to-market' accounting rules required firms to write down their holdings to reflect the lower market price.").

even the US Congress recognized the extraordinary divergence [of market prices from fundamental value] and questioned the appropriateness of mark-to-model during a crisis."[231] Indeed, at trial, Rahl admitted that she was aware that "Lehman itself argued to the SEC in August 2008 that it should be excused from having to use mark-to-market accounting for certain debt securities because it intended to hold them to maturity."[232]

3. Early Signs of a Housing Market Recovery in 2009, as Dislocation Continues

By mid-2009, after massive government intervention designed to "assist homeowners with modifications and refinancing," the first signs of recovery in the housing market appeared.[233] In June 2009, month-over-month housing prices rose for the first time in more than two years.[234] Delinquency rates began to drop.[235] By July 2009, neutral market observers, such as Standard and Poor's, were projecting that "residential real estate prices [would] start to stabilize in the first half of 2010."[236] But, as before, the financial markets continued to lag the housing market, with prices for ABS remaining dislocated through at least mid-2009.[237]

LBIE's experts have asserted that this dislocation no longer existed by July 2009. But again, there was no such consensus. "The [US] government still believed that there was dislocation in the trading markets through the middle of 2009," as evidenced by statements by Chairman Bernanke and actions by the Federal Reserve and the Treasury.[238] Academic

---

[231] AX-90026 at 33 (Rahl Devonshire Report); *see also* AX-90027 at 26-34 (Rahl Devonshire Rebuttal) (appending public criticisms of mark-to-market accounting given price dislocation caused by the financial crisis from Wells Fargo, Deutsche Bank, UBS, Barclays, Bank of New York Mellon, and others).
[232] Trial Tr. 193:21-194:2 (Rahl).
[233] *Id.* at 3014:9-17 (Prager) (describing HAMP and HARP); *see also* ADX03-6 (ABX Depth).
[234] *See* Trial Tr. 1543:14-1544:5 (Niculescu) (agreeing that home prices had stopped falling in May of 2009 and were increasing heading into July); AX-90198 (Case-Shiller US National Home Price Index).
[235] Beginning in January and through August 2009, "[y]ou could see the thirty-day [delinquency] rates are coming down . . . . And then you see the same thing with the 60 to 90s [day delinquency rates] coming down." Trial Tr. 3021:11-15 (Prager).
[236] AX-50031 at 6 (S&P July 2009 Report).
[237] Trial Tr. 3028:11-14 (Prager), 3150:3-3152:14 (Prager).
[238] *Id.* at 3391:15-25, 3026:21-3027:4 (Prager) (referencing ADX03-9).

researchers also reported similar observations. In October 2009, two UC Berkeley professors published a paper comparing fundamental loss projections to market-implied losses (based on prices through June 30, 2009) and concluded that "current market prices of ABX.HE are inconsistent with any reasonable assumptions for future default rates, and, moreover, are uncorrelated with changes in the realized credit experience of the underlying loans."[239]

B. Impact On The Monoline Industry

The financial crisis materially affected the monoline industry.[240] Many monolines had insured the relatively riskier (below AAA) tranches of asset-backed securities that had significant losses during the crisis; similarly, many insured CDOs of asset-backed securities that suffered significant losses because the CDOs often bundled the lower-rated mezzanine tranches of mortgage securities, and those mortgage securities in turn may have bundled riskier alt-A or subprime mortgage loans.[241] These monolines had to pay out large amounts under the financial guaranty or CDS contracts they had written.[242]

As a result, several monolines approached insolvency and ultimately were forced into restructuring. Ambac, one of the largest monolines, began experiencing significant financial stress in late 2008,[243] and by late 2009, it was on the verge of insolvency.[244] Ambac ultimately

[239] AX-50056 at 25 (Bear's Lair 2009); *see also id.* at 4 (explaining that, in fact, "there is *no* default rate high enough to support observed prices").
[240] *See* Trial Tr. 1228:22-23 (Rosenblum) ("[I]n the runup to the financial crisis, all the monoline industry came under stress.").
[241] *See id.* at 2274:15-22 (Schozer) ("[T]he other area where the catastrophic losses were—were in the CDOs of ABS. And those were catastrophic because those were securitizations of the mezzanine, meaning Double B, for example, rated mortgage product."), 3787:7-13 (Pirrong) (discussing how some mortgage-backed securities and other related asset-backed securities were toxic assets that had higher value prior to the crisis), 1954:4-18 (Adamidou) (discussing CIFG's termination of 12 billion dollars' worth of toxic CDOs), 1069:4-6 (Bruce) (stating that alt-A loans are "between prime and subprime" in credit quality).
[242] *See, e.g.*, *id.* at 1228:22-1229-8 (Rosenblum) (describing "toxic[ity]" during financial crisis of CDO on higher-risk, lower-performing securities), 1954:4-18 (Adamidou), 1995:6-1996:17 (Adamidou) (discussing CIFG's "financial difficult[ies]" caused by "CDS on toxic CDOs").
[243] *See* AX-50039 at 15-16 (Ambac Disclosure Statement to Wisconsin Regulators).
[244] Trial Tr. 1031:21-1032:2 (Bruce).

negotiated a settlement with several major counterparty banks on June 7, 2010.[245] Similarly, CIFG underwent restructuring in 2008 and ceded a significant portion of its portfolio to Assured in January 2009,[246] and by 2010, FGIC, another monoline, had also entered rehabilitation and bankruptcy.[247] Insurance regulators also stepped in to stem monoline losses.[248] Regulators ordered failing monolines Syncora, Ambac, and FGIC, which had been placed in rehabilitation, to cease making payment on claims to any creditor.[249] Similarly, in some instances, regulators ordered the subordination of structured products claims to municipal claims on public policy grounds, which meant that certain claims might not get paid at all.[250] These actions by regulators generated uncertainty for some counterparties, including dealer banks that were counterparties to CDS transactions with monolines, about whether their contracts would be enforceable and recoverable in the event of actual losses on the insured securities and, as a result, about the value of CDS contracts with a monoline.[251]

These developments had several important effects on Assured. First, concerns about the riskiness of monolines impacted Assured's credit ratings. In November 2008, Moody's downgraded Assured's credit rating from Aaa to Aa2,[252] and, in May 2009, it announced that it was again placing Assured on downgrade watch.[253] In July 2009, Standard & Poor's revised its outlook on Assured from stable to negative.[254] Over this same period, Assured's credit spreads

[245] *See* AX-50039 at 33 (Ambac Disclosure Statement to Wisconsin Regulators).
[246] *See* AX-70008 at 29 (Assured 2009 10-K); Trial Tr. 3124:7-8 (Prager).
[247] *See* Trial Tr. 3121:24-3122:17 (Prager), 3320:14-25 (Prager)
[248] *See id.* at 3122:18-3125:21 (Prager).
[249] *Id.* at 3121:24-3122:17 (Prager), 3122:20-24 (Prager), 3124:8-12 (Prager).
[250] *See id.* at 3125:8-21 (Prager).
[251] *See id.* at 3124:22-3125:25 (Prager) (describing the challenges that bank CDS counterparties faced in recovering payments from defaulting monolines as a result, in part, of regulator actions).
[252] *See* JX-57 at 57 (Assured 2008 10-K).
[253] *See* Trial Tr. 2443:22-24 (Schozer).
[254] AX-70008 at 57 (Assured 2009 10-K).

widened to historic levels and remained significantly wider than pre-crisis levels in July 2009.[255]

Second, by early 2009, demand for CDS protection on ABS sold by monolines, including Assured, had largely disappeared.[256] This was driven by the concerns about the value of monoline CDS contracts, the disappearance of the dealer banks' interest in regulatory capital trades or negative basis trades, and the increased costs of hedging monoline exposure.[257] LBIE introduced no evidence at trial of parties purchasing CDS protection on the reference obligations from Assured or any other monoline in 2009.

Finally, as a result of the financial crisis, Assured paid out significant amounts on insured securities, mostly under financial guaranty contracts that insured riskier, non-AAA tranches of ABS.[258] With respect to its CDS business, however, Assured had mostly sold protection on the highest-rated AAA tranches of securities, and not on the types of CDOs that proved to be the most toxic for other monolines.[259] As a result, by summer 2009, Assured was poised to emerge from the financial crisis as the "market leader" in the monoline industry.[260] In July 2009, Assured acquired FSA, a larger monoline that, like Assured, had avoided writing CDS on CDOs

---

[255] *See* Trial Tr. 1107:2-1109:9 (Rosenblum) (" . . . And so, it is plausible, at that period of time [6/30/09], with our spreads at historically wide levels. . . ."), 2882:5-11 (Bailenson) ("Assured Guaranty's credit spreads were relatively wide to historical norms in 2008 and 2009."); *see also* AX-70008 at 255 (Assured 2009 10-K) ("In 2009, AGC's and AGM's credit spreads narrowed, however they remained relatively wide compared to pre-2007 levels.").

[256] *See* Trial Tr. 1229:23-24 (Rosenblum) ("So by 2009 we could not sell our protection anymore. While our ratings were quite high . . . ."), 2197:2-7 (Schozer), 2199:18-2200:8 (Schozer) (describing the lack of new CLO, CDO or RMBS business in June 2009).

[257] *See id.* at 2381:1-7 (Schozer) ("[T]his was the negative-basis trade business, and that business kind of evaporated because the demand by the banks for that kind of disappeared."), 2197:12-19 (Schozer), 3161:12-3162:20 (Prager), 3506:10-16 (Pirrong), 3543:7-3544:13 (Pirrong).

[258] *See* AX-70008 at 117-18 (Assured 2009 10-K) ("Losses incurred on credit derivatives in 2009 was primarily due to losses in trust preferred securities ("TruPS") and U.S. RMBS sectors."), 129-30 ("The Company insures two types of second lien RMBS, those secured by home equity lines of credit ("HELOCs") and those secured by CES ["closed-end second"] mortgages . . . . The performance of the Company's HELOC and CES exposures deteriorated beginning 2007 and throughout 2008 and 2009 . . . .").

[259] *See* Trial Tr. 1229:1-8 (Rosenblum) ("And Assured Guaranty had made a critical decision early on that we were not going to write a product called CDO of ABS . . . And those proved very toxic in the financial crisis, because losses—very large losses emerged.").

[260] *See* AX-70008 at 29 (Assured 2009 10-K).

of asset-backed securities.[261] In addition, as of July 2009, Assured had maintained its relatively higher credit ratings,[262] reflecting its status as the largest and strongest surviving monoline.

PROPOSED CONCLUSIONS OF LAW

VI. Burden Of Proof And Legal Standard

LBIE's only remaining claim in this action is that Assured's calculation of its Loss constituted a breach of contract.[263] The Court has ruled that, as the Plaintiff, LBIE bears the burden of establishing its breach of contract claim, meaning that LBIE "bears the burden of establishing Assured's unreasonableness and also, for the purposes of damages, the reasonableness of its own damages' calculation."[264] Assured, on the other hand, bears the burden of proof with respect to its defenses and counterclaims.[265]

Assured's determination of its Loss is assessed under an "objective standard of reasonableness."[266] This standard requires that the Court consider whether the actions taken by Assured are consistent with what a reasonable Non-defaulting Party in Assured's position would have done in light of the facts and circumstances facing Assured at the time.[267]

---

[261] Trial Tr. 1152:12-14 (Rosenblum), 1229:9-20 (Rosenblum); AX-70008 at 201 (Assured 2009 10-K).
[262] *See* AX-70008 at 57 (Assured 2009 10-K) ("On July 1, 2009, S&P published a research update in which it affirmed its AAA counterparty credit and financial strength ratings of AGC."), 118 ("While AGC's and AGM's credit spreads have substantially narrowed during 2009, they still remain at levels well above their historical norms.").
[263] *See* Compl. at 14; *Lehman Bros. Int'l (Europe) v. AG Fin. Prods., Inc.*, No. 653284/2011, 2013 WL 1092888, at *6 (Sup. Ct. N.Y. Cnty. Mar. 12, 2013) (dismissing LBIE's claim of breach based on Assured's termination of certain transactions in December 2008); D/O at *19 (dismissing LBIE's claim of a violation of the implied covenant of good faith and fair dealing and dismissing LBIE's breach of contract claim to the extent based on the design and execution of Assured's Market Quotation auction); *see also* Feb. 28, 2022 Hr'g Tr. 64-65 (characterizing LBIE's claim as a "simple breach of contract").
[264] Order Determining Burden of Proof and Various Evidentiary Issues at 1, D.I. 774 (March 1, 2022) ("Burden of Proof Order"); Feb. 28, 2022 Hr'g Tr. 4-5.
[265] *Id.*
[266] D/O at *11.
[267] *See, e.g.*, *Bethel v. New York City Tr. Auth.*, 92 N.Y.2d 348, 356 (1998) (stating that the objective reasonable person standard "'provides sufficient flexibility, and leeway, to permit due allowance to be made for all of the particular circumstances of the case which may reasonably affect the conduct required'"); *Christiania Gen. Ins. Corp. of N.Y. v. Great Am. Ins. Co.*, 979 F.2d 268, 275-76 (2d Cir. 1992) (in a case construing a reinsurance contract, assessing whether defendant insurer satisfied its obligation to give "prompt notice," which the court

VII. Assured Followed The Contractual Language In Calculating "Its Loss"

Assured followed the language of the Agreement in calculating "its loss" reasonably and in good faith.[268] There is no dispute that: (1) LBIE defaulted; (2) Assured then had the right to terminate the Agreement; (3) after terminating, Assured conducted a well-designed and well-executed Market Quotation auction in good faith; (4) when that auction resulted in no bids, Assured turned to the "Loss" provision of the Agreement to determine its Loss by calculating its "loss of bargain"; and (5) the Agreement specifically states that Assured, as the Non-defaulting Party, was not required to use market prices to determine its Loss.[269]

The Agreement defines Loss as the amount that Assured (as the Non-defaulting Party) "reasonably determines in good faith to be its total losses and costs . . . including any loss of bargain."[270] Assured followed this language in determining its Loss, by calculating its "loss of bargain" as a result of LBIE's default, consistent with the ISDA User Guide's description of Loss as "a general indemnification provision" for the Non-defaulting Party.[271] Specifically, Assured did so by netting the fixed premium payments it expected from LBIE over the lifetime of the Transactions against its expected losses on the Transactions (which were calculated based on its regular-course-of-business models).[272] This approach put Assured "back in the same situation [it] would have been in had Lehman not defaulted,"[273] just as Loss allowed it to do.

Assured's calculation of its Loss using a "loss of bargain" approach is also consistent with New York law on damages. Under New York law, "[t]he measure of damages which flows

---

construed as notice "within a reasonable time after the duty to give notice has arisen," from the perspective of "a reasonable insured in defendant's position" and based on an "objective evaluation of facts known to insured").

[268] JX-01 at 15 (1992 ISDA Master Agreement).

[269] *See* D/O at *2-3, *6; JX-01 at 15 (1992 ISDA Master Agreement).

[270] *See* JX-01 at 15 (1992 ISDA Master Agreement).

[271] JX-72 at 35 (1992 ISDA User's Guide).

[272] *See* JX-34 at 4-5 (Statement of Calculations).

[273] Trial Tr. 2211:1-24 (Schozer).

from a breach of contract is the difference between the value of what has been received under the contract and the value of what would have been received if the contract had been performed according to its terms."[274] "[D]amages for breach of contract should put the [non-breaching party] in the same economic position he would have occupied had the breaching party performed the contract."[275] Further, courts have recognized that "the value of a security may not be equivalent to its market price," particularly in a dislocated market.[276] In a dislocated market, a discounted cash flow analysis (DCF) is a "generally accepted method for valuing an asset."[277]

As discussed in § II.C, this Court concluded at summary judgment that "there is strong textual support for reading the definition of Loss [in the Agreement] as generally permitting non-defaulting parties . . . to select any methodology for calculating Loss, so long as such methodology is reasonable and in good faith,"[278] and that "[t]he Loss provision . . . affords the Non-Defaulting Party the discretion to make the determination as to whether use of market prices to calculate Loss is appropriate in a particular case."[279] Similarly, in *Lehman Bros. Holdings Inc.*

---

[274] *Sager v. Friedman*, 270 N.Y. 472, 481 (1936).
[275] *Boyce v. Soundview Tech. Grp., Inc.*, 464 F.3d 376, 384, 391 (2d Cir. 2006) (applying New York law).
[276] *NECA-IBEW Health & Welfare Fund v. Goldman Sachs & Co*., 693 F.3d 145, 165 (2d Cir. 2012) (overturning district court decision which improperly "conflated the price of a security and its 'value'" and holding that the value of the security at issue was not equivalent to the market price at the time of sale); *see also In re Am. Home Mortg. Holdings, Inc*., 411 B.R. 181, 190 (Bankr. D. Del. 2009) (acknowledging that "if [a] market is currently disrupted or dysfunctional it would not fairly reflect the potential sale price of an asset" such that the best indication of value would be found using another methodology such as a DCF analysis); *Beecher v. Able*, 435 F. Supp. 397, 404-405 (S.D.N.Y. 1975) (recognizing that market price was not "conclusive evidence of value" but "merely some evidence of value" and widespread agreement "that realistic value may be something other than market price . . . ").
[277] *Nat'l Credit Union Admin. Bd. v. UBS Sec., LLC,* No. 12-2591-JWL, 2016 WL 7496106, at *5 (D. Kan. Dec. 30, 2016) (rejecting the argument that the value of derivatives must be determined by reference to market prices, and holding that a DCF analysis was a reasonable alternative method of determining their value); *see also Fort Worth Employees' Ret. Fund v. J.P. Morgan Chase & Co*., 301 F.R.D. 116, 130 (S.D.N.Y. 2014) (finding modeling expected cash flows to be "industry practice" in securities valuation); *In re Am. Home Mortg. Holdings, Inc.*, 411 B.R. at 192 (recognizing DCF analysis as one of a "variety of methodologies [used by financial professionals] to determine the value of assets that are not readily valued by reference to market"); *In re Am. Home Mortg. Holdings, Inc*., 637 F.3d 246, 257 (3d Cir. 2011) (holding that "when the market is dysfunctional and the market price does not reflect an asset's worth [one should] turn to other determinants of value" and that a DCF method was a commercially reasonable way to determine value).
[278] D/O at *11.
[279] *Id*. at *12.

v. Intel Corp., the court observed that there is "no single 'correct' methodology for calculating Loss," which is why "non-defaulting parties are afforded discretion in choosing a method to calculate Loss, so long as such calculation is ultimately performed 'reasonably and in good faith.'"[280] LBIE's claim that Assured's "loss of bargain" approach was unreasonable, because the only reasonable way for Assured to determine its Loss on the Transactions was to rely on market prices,[281] is therefore contrary to the Court's decision and *Intel*. In addition, the trial answered a related question raised by the Court based on the limited record then before it at summary judgment: "how, if a replacement transaction was available to [Assured], a calculation of Loss which fails to account for that availability" would be reasonable?[282] There was no evidence presented at trial of a replacement transaction being available to Assured, and the trial record now clearly establishes that Assured's only obligation under the Agreement was to conduct a Market Quotation auction,[283] which it fulfilled.

In its pre-trial briefing,[284] its opening statement,[285] and through the testimony of its expert Evy Adamidou at trial, [286] LBIE argued that if Assured wanted to calculate its Loss without reference to market prices, it should have "substituted [Loss] with . . . a 'walkaway' or a 'make-whole'" provision in the Agreement.[287] This argument tries to avoid the language of the parties' Agreement by focusing on language and contractual provisions not at issue in this case, and

---

[280] *In re Lehman Bros. Holdings Inc.*, No. 08-13555 SCC, 2015 WL 7194609, at *19 (S.D.N.Y. Sept. 16, 2015). This conclusion is consistent with the history and purpose of the Loss provision, which was designed to give significant discretion to the Non-defaulting Party. *See* § IX.A.
[281] *See, e.g.*, Pl.'s Pre-Trial Br. at 1-2, D.I. 741 (May 24, 2021) ("Pl.'s Pre-Trial Br.").
[282] D/O at *18.
[283] JX-01 at 15-16 (1992 ISDA Master Agreement), JX-02 at 4 (1992 ISDA between LBIE and Assured).
[284] *See* Pl.'s Pre-Trial Br. at 24.
[285] *See* Trial Tr. 28:24-29:10 (LBIE opening statement).
[286] *See, e.g.*, *id.* at 1828:22-1829:5 (Adamidou), 1859:3-1859:9 (Adamidou), 1861:8-18 (Adamidou), 1876:13-20 (Adamidou) (arguing that Assured needed to negotiate walkaway or make-whole provisions to avoid calculating Loss with respect to market prices).
[287] *See id.* at 28:24-29:10 (LBIE Opening Statement).

undermines (rather than supports) LBIE's claims. If LBIE wanted to prevent Assured, as the Non-defaulting Party, from calculating its "Loss" by solving for its "loss of bargain" without using market inputs—as the language in the Agreement specifically provides[288]—LBIE should have bargained for different contractual language that required use of market inputs. LBIE may challenge how Assured exercised its discretion, but it is law of the case that Assured had discretion in how to calculate its Loss.[289] In short, Assured followed the language of the parties' actual Agreement, as opposed to the agreement that LBIE retroactively wishes it had.

VIII. Assured Did Not Breach The Agreement By Calculating Loss Without Reference To Market Prices

After this Court held that the Agreement granted Assured the discretion to calculate its Loss without reference to market prices,[290] the sole question for trial became whether Assured exercised its discretion reasonably and in good faith—"whether Loss, under the circumstances of this case, was 'reasonably determine[d].'"[291] At trial, LBIE contended that the universal and unvarying market practice was to calculate Loss based on market prices, and that under *no* circumstances is it reasonable to depart from that practice and calculate Loss as Assured did.[292] But LBIE failed to prove that any such market practice existed or that, had such a market practice existed, it would have been unreasonable for Assured to depart from it. Consequently,

---

[288] JX-01 at 15 (1992 ISDA Master Agreement).
[289] *See* D/O at *11-12; Trial Tr. 24:3-5 (LBIE Opening Statement) (arguing that Assured's Loss calculation "fundamentally, was unreasonable," because it did not use market prices).
[290] D/O at *12.
[291] *Id.* at *11, *14 ("Where, as here, evidence is submitted that there <u>may be</u> a uniform or highly consistent practice of calculating Loss in a particular manner <u>under similar circumstances</u>, and the Non-Defaulting Party deviates from that practice, that deviation raises a genuine question of fact as to the Non-Defaulting Party's reasonableness or good faith in calculating Loss.") (emphasis added).
[292] *See*, *e.g.*, Trial Tr. 12:14-22 (LBIE Opening Statement) ("Assured stands alone, in this courtroom and in the marketplace, in asserting to the Court that it should be able to decide its own value for these trade ignoring market data."), 24:3-15 (LBIE Opening Statement) ("[W]hat we're going to show the Court is that AGFP's valuation fundamentally . . . was unreasonable and not in good faith because they ignored observable market prices, they relied on the subjective model."), 2010:12-14 (Counsel for LBIE) ("[W]hat's missing is the use of contemporaneous market values from--from their calculation. That is the uniform market standard.").

LBIE has not carried its burden to show that Assured acted unreasonably.[293]

A. LBIE Failed To Prove The Existence Of A Uniform Market Practice Of Calculating Loss Based On Market Prices

To prove an industry custom or practice modified the Agreement and required Assured to calculate Loss based on market prices—despite the express contractual language to the contrary—LBIE must meet an exacting standard. LBIE must prove that the custom is "fixed and invariable in the industry in question," "established, and not casual, uniform and not varying, general and not personal, and known to the parties."[294] LBIE cannot meet its burden merely through the say-so of a handful of individuals. "Before a claimed industry standard is accepted by a court as applicable to the facts of a case, the expert must do more than merely assert a personal belief that the claimed industry-wide standard existed at the time the design was put in place."[295] LBIE has not come close to meeting this high burden.

1. The Say-so of LBIE's Experts Does not Prove There was a Uniform Market Practice

LBIE failed to put forward reliable expert evidence capable of supporting its assertion about custom and practice in the CDS market as a whole. Courts typically look to surveys to support claims about large populations,[296] and the Court should require that here given the diversity of the market.[297] By 2008, the CDS market had grown exponentially, and CDS were

---

[293] Burden of Proof Order at 1.
[294] *Law Debenture Tr. Co. of N.Y. v. Maverick Tube Corp.*, 595 F.3d 458, 466 (2d Cir. 2010).
[295] *See Cassidy v. Highrise Hoisting & Scaffolding, Inc*., 89 A.D.3d 510, 511 (1st Dep't 2011).
[296] *See*, *e.g.*, *Biestek v. Berryhill*, 139 S. Ct. 1148, 203 L. Ed. 2d 504 (2019) (private market data survey used to support a vocational expert's testimony about the availability of certain jobs in the economy); *Lion Oil Trading & Transp., Inc. v. Statoil Mktg. & Trading (US) Inc.*, Nos. 08 Civ. 11315 (WHP), 09 Civ. 2081 (WHP), 2011 U.S. Dist. LEXIS 24516 (S.D.N.Y) (market survey used as evidence of the market practices of crude oil traders in pricing shortfall volume under specific conditions); *Greene v. Xerox Corp.*, 244 A.D.2d 877, 877 (4th Dep't 1997) (labor market survey data used to support vocational rehabilitation expert's testimony about plaintiff's earning capacity); *Mass v. Melymont*, No. SC2691/03, 2003 WL 23138786 (D.C.N.Y., Nassau Cnty. Dec. 23, 2003) (survey of 130 car repair shops used to prove the fair and reasonable market rate for body work).
[297] LBIE's experts have experience in conducting such surveys, and have specifically surveyed this market in the past. *See* Trial Tr. 133:10-12 (Rahl) ("Q. Your firm, CMRA, your consultant firm, has conducted market surveys,

being bought and sold around the world by a diverse range of market participants including banks, hedge funds, insurers, government agencies and entities, corporations, energy/commodity firms, pension funds, wealthy individuals, and monolines,[298] leading to "great[] variance in philosophy and activity."[299] Indeed, another case involving a dispute about CDS market practice discussed the fact that "industry practices for transactions between two dealers would not necessarily mirror those for transactions involving a non-dealer."[300] No one had a bird's-eye-view of the entire market, because derivatives were traded "over the counter"—in private, bilateral transactions.[301] Yet LBIE's experts did not conduct any surveys or studies of this complex and opaque market, nor did they identify any existing market survey or study supporting their assertions.[302]

Instead, LBIE's experts extrapolated their personal experiences to the entire market, and asserted that *no* market participants had different practices. But their anecdotes are not data about the market as a whole, and their speculative testimony should be rejected.[303] Not only that, but the experience they rely on is the wrong experience. All of LBIE's experts had their formative industry experiences at banks, where they traded CDS in order to profit based on

---

though, before; hasn't it? A. Yes, it has."), 1598:11-12 (Niculescu) ("Q. CMRA has conducted market surveys in the past; right? A. On various risk-related topics, yes.").

[298] *See* AX-90033 at 5 (ISDA Margin Survey 2010); LX-232 at 3 (ISDA Margin Survey 2009); Trial Tr. 2610:5-23 (Cohn).

[299] *See* Trial Tr. 2611:17-2612:6 (Cohn).

[300] *See, e.g., Deutsche Bank AG v. AMBAC Credit Prod., LLC*, No. 04 CIV. 5594 (DLC), 2006 WL 1867497, at *8 n.10 (S.D.N.Y. July 6, 2006).

[301] *See* Trial Tr. 126:16-127:14 (Rahl) (acknowledging that because CDS transactions were over-the-counter and bilateral, only the parties to a given transaction would have information about that transaction); *see also id.* at 74:13-20 (Rahl) (describing how she never inquired into a counterparty's business model when running a trading desk, and that it would have been impractical to do so).

[302] *See id*. at 133:13-15 (Rahl) (confirming she did not conduct a market survey), 1598:2-3 (Niculescu) (confirming same), 1955:15-18 (Adamidou) (confirming same), 997:4-13 (Bruce) (confirming same).

[303] *See Pena v. City of New York*, 161 A.D.3d 522, 523 (1st Dep't 2018) (finding an expert's opinion insufficient when "unsupported by reference to any authority, standard, or other corroborating evidence"); *Cassidy*, 89 A.D.3d at 511.

market price movements.[304] Even if banks value CDS based on market prices, that is not evidence of a uniform market practice for valuing all CDS solely in that way, particularly after the default of a counterparty. Bruce had no direct experience at all in closing out a credit default swap after a counterparty default.[305] Rahl did, but never with a termination under a 1992 ISDA Master Agreement where a monoline was the Non-defaulting Party.[306] Adamidou, LBIE's only witness who had worked at a monoline, also admitted that she had no such experience.[307] And Niculescu, the only LBIE witness who had ever valued a derivative transaction for a monoline, admitted that he had performed a DCF valuation, just as Assured did here.[308]

In contrast, Assured's expert Cohn was the only expert witness with the experience to speak credibly to how the market understood Loss. His work with ISDA led him to interact with a large and diverse set of market participants. He discussed the Loss provision with them extensively because of (i) his role in drafting the 1987 and 1992 ISDA Master Agreements, (ii) his involvement with the Counterparty Risk Management Policy Group ("CRMPG"), which was focused on standardizing market practices, and (iii) his being "tapped" by ISDA "to participate" in "the public rollout" of the Master Agreement. In this "teaching capacity," he gave "presentations on the Master Agreement, explaining it to the rest of the market" and answering their questions about Loss, from 1992 "into 2012 or 2013."[309] Based on that experience, he testified that Loss provides market participants with "a universe of possibility" for valuing

[304] *See* Trial Tr. 58:15-60:16, 127:18-128:1 (Rahl) (describing her experience at Citibank, which pre-dated the invention of CDS), 810:13-811:10 (Bruce), 812:11-22 (Bruce) (describing his experience Commerzbank, Standard Bank of South Africa and consulting for UBS), 1381:5-1382:22 (Niculescu) (describing his experience at Goldman Sachs), 1806:22-1807:19 (Adamidou) (describing her experience at Lehman Brothers and Chase).
[305] *Id*. at 998:24-999:2 (Bruce) (Q. "[Y]ou don't have any direct experience with respect to credit default swaps, closing them out upon a counterparty default; right? A. No. That is correct.").
[306] *Id*. at 130:15-18 (Rahl) (Q. "So is it the case that this is the first experience you've had of a termination under a 1992 ISDA Master Agreement where a monoline is the nondefaulting party? A. Yes.").
[307] *See id*. at 1812:5-1817:19 (Adamidou).
[308] *Id*. at 1384:20-24 (Niculescu), 1585:19-1586:6 (Niculescu).
[309] *Id*. at 2605:20-2606:2 (Cohn), 2651:7-16 (Cohn).

terminated derivatives transactions,[310] and that the market never understood Loss solely as a measure of replacement value, or as equivalent to Market Quotation, as LBIE contends.[311]

2. LBIE's Experts Admitted That Loss has not Uniformly Been Calculated as a Market Price—Including by Them

LBIE's expert evidence also failed to prove that, even had the purported market practice existed, it was fixed and invariable. Despite asserting that there was a universal practice—without exception—to calculate Loss as a market price,[312] Rahl, Niculescu, and Bruce admitted under cross-examination that they had either calculated Loss differently, or seen others do so. (Adamidou did not, because she had no relevant experience at all).[313]

Rahl submitted an expert valuation opinion on behalf of CMRA (her consultancy with Niculescu) in the *Devonshire* case, in which she rejected a mark-to-model-based approach in favor of calculating Loss based on an adjusted DCF projection that diverged from then-current market prices.[314] In *Devonshire*, as here, a dealer bank (Barclays) had purchased CDS protection from an atypical counterparty (Devonshire);[315] those transactions were documented under a 1992 ISDA; the CDS were terminated early during the financial crisis; valuation proceeded under the Loss provision after Market Quotation failed; and the parties' dispute was over the

[310] *Id.* at 2639:11-15 (Cohn).
[311] *See, e.g.*, *id*. at 2734:1-8 (Cohn) ("Q. At the time that Assured entered into and then terminated the CDS transactions at issue . . . [w]as there a uniform market understanding that loss was solely a measure of replacement value? A. No."), 2637:9-19 (Cohn), 2652:13-17 (Cohn), 2698:20-2699:4 (Cohn).
[312] *See id.* at 129:4-9 (Rahl) ("Q. Is it your testimony that the only reasonable way to calculate [L]oss under a 1992 ISDA Master Agreement is to base that calculation on market prices? A. When that calculation is a fall-back to market quotation, yes."), 922:16-18 (Bruce) ("So in my experience, the market practice—and I can't recall ever having a dispute around this in the market—is to start with the mid-market price."), 1443:14-22 (Niculescu) ("I think that there's been a universal understanding and universal application that when a market price is available, even if Market Quotation fails, that the fallback to Loss needs to be based on that market price . . . I've never seen or heard anybody ignoring a market price when it was available."). In regards to Adamidou, we are unable to point to conduct by her contradicting her opinions because she simply lacks experience relevant to this matter.
[313] *See id*. at 1812:5-1817:19 (Adamidou).
[314] *See generally* AX-90026 (Rahl Devonshire Report); AX-90027 (Rahl Devonshire Rebuttal). Assured is not taking a position on whether Rahl's calculation in the Devonshire case generated a reasonable value for the CDS at issue.
[315] Devonshire was a special-purpose trust designed to hold CDS to maturity; like Assured, it did not trade in and out after entering into a CDS transaction. *See* AX-90026 at 5 (Rahl Devonshire Report).

reasonableness of the valuation.[316] Using the same kind of mark-to-model approach as Niculescu has offered here, Barclays (the Non-defaulting Party) calculated its Loss as of January 2009 at $1.2 billion.[317] Rahl opined in 2010 that Barclays' "mark-to-model calculation" was inappropriate, writing that "[o]ur opinion as market practitioners is that it is unreasonable in the unique circumstances following the standstill blindly to apply a mark-to model that depends on illiquid CDS prices in the midst of the largest crisis of illiquidity since the 1930s."[318] She was referring to the financial crisis, which she explained had caused "extraordinary illiquidity, uncertainty in valuations and high risk premiums," with the result that "[t]he markets were not functioning effectively" in January 2009, the date used for the Devonshire valuation.[319] Consequently, because "the market was detached from fundamental considerations of loss,"[320] Rahl concluded that "actual loss projections provided a better indicator of long-term expected performance and value than did market pricing."[321] Because Barclays—which traded CDS and valued them based on that business model—was the non-defaulting party whose Loss was being measured, Rahl added a risk premium to her "actual loss projections" in order to "get to a market price."[322] But Rahl "normalized" the risk premium that she used to eliminate the price distortions she observed in the financial markets, and rejected the "dramatically" different result produced by Barclays' unadjusted market-price-based model.[323] In other words, even in a case where a dealer bank that traded CDS was calculating its Loss, Rahl used a DCF approach (as

---

[316] *See* Trial Tr. 231:5-234:4 (Rahl). There are, of course, also many differences between the two cases, but they concern the particular economics of the transactions at issue and other points of lesser significance.
[317] *Id*. at 234:21-25 (Rahl).
[318] AX-90026 at 8 (Rahl Devonshire Report).
[319] *Id.* at 94.
[320] *Id.* at 106. *See also id*. at 14 (The fact that the CDS market in January 2009 was highly illiquid "biases the mark-to-model value of the swap in Barclay's favor and exaggerates the dichotomy between the mark-to-model and the projected real-world cash-flows in this transaction.").
[321] *Id.* at 106.
[322] Trial Tr. 105:12-14 (Rahl).
[323] AX-90026 at 106 (Rahl Devonshire Report).

Assured has here) to value terminated CDS, and (despite an adjustment to reflect the bank's business model) arrived at a value that was orders of magnitude less than what was implied by actual market prices available to her at the time.

Rahl's actions in Devonshire are evidence that market practitioners understood Loss to be flexible and to permit various methodologies, including DCF valuations.[324] Before she was retained by LBIE, Rahl said so herself: "it is standard practice when there is no developed market to use 'actuarially derived, rather than market observed, input parameters.' If there is no market, there is no alternative and such a methodology is accepted market practice."[325]

Niculescu has also calculated a termination payment under a 1992 ISDA Master Agreement without reference to market prices. As noted above, in the Solstice matter, MBIA (a monoline) hired Niculescu "to perform a calculation of value of" a terminated CDS.[326] There, as here, the market quotation process had failed and the parties defaulted to Loss.[327] There were "no market prices available" and the transactions "were bespoke and non-tradeable."[328] In those circumstances (akin to those faced by Assured in this case), Niculescu calculated Loss by determining the future cash flows of the swap.[329] This action fatally undermines his trial testimony that "the way to [calculate a commercially reasonable value for derivatives transactions] is to determine the price that a 'disinterested third-party' would pay or receive in a competitive market to step into Lehman's shoes."[330]

Bruce also has experience with CDS valuations based on fundamental loss projections

---

[324] *See* Trial Tr. 329:14 (Rahl) (describing her valuation in Devonshire as "totally unique, something I haven't seen before").
[325] AX-90027 at 19 (Devonshire Rebuttal Report); *see also id.* at 20 (explaining that "many financial institutions used" cash flow-based "fundamental valuations").
[326] *See* Trial Tr. 1586:12-13 (Niculescu); *see id.* 1766:12-18 (Niculescu).
[327] *See id*. at 1587:1-9 (Niculescu).
[328] *Id*. at 1768:16-20 (Niculescu).
[329] *See id*. at 1587:10-13 (Niculescu).
[330] *Id.* at 1584:13-15 (Niculescu).

(rather than on market or model-based methodologies) that undermines the credibility of his trial testimony about market practice. At Commerzbank, Bruce was "heavily involved in the restructuring and commutation of CDS transactions with Ambac," a monoline insurer, "verg[ing] on insolvency."[331] As part of that process, BlackRock (the independent appraiser) and the Wisconsin Commissioner of Insurance (Ambac's regulator) sought to determine the value of Ambac's CDS on CDOs.[332] For this, BlackRock generated three loss scenarios, each of which used a DCF model.[333] Bruce affirmed that this approach was consistent with market practice[334] and that "BlackRock is obviously . . . one of the world's largest asset management companies."[335] BlackRock's use of fundamental loss projections is further evidence of what market practice actually was.

LBIE's parent LBHI has even taken the position in another litigation that its counterparty's calculation of Loss "was not commercially reasonable because [the counterparty] purposefully failed to take into account the [terminated transaction]'s value based on the present value of the net discounted cash flows to maturity."[336] This, too, shows a lack of consensus.

3. ISDA Materials, Treatises, and Industry Reports Further Disprove the Existence of LBIE's Purported Market Practice

A wide array of industry materials also contradicts LBIE's market practice argument.

ISDA materials. From the beginning, the market has consistently understood that Loss is a simple provision that provides broad and flexible indemnification for the Non-defaulting

---

[331] *Id*. at 925:10-11 (Bruce), 1031:14-1032:2 (Bruce).
[332] *See id*. at 933:20-936:2 (Bruce).
[333] *See id*. at 1034:19-1035:3 (Bruce).
[334] *See id*. at 1037:6-9 (Bruce).
[335] *Id*. at 942:19-943:1 (Bruce).
[336] Second Am. Compl. ¶ 96 , *Lehman Bros. Holdings Inc., v. LCOR Alexandria L.L.C.*, No. 13-01689 (SCC) (Bankr. S.D.N.Y. August 14, 2015), D.I. 37; *see also id.* ¶ 41 ("'Loss' means a reasonable and good faith determination of [the counterparty's] total loss or gain as a result of the early termination; in other words, it includes the gain or loss to [the counterparty] based on the present value of the net discounted cash flows to maturity from the terminated [transaction].").

Party. At trial, Cohn described how the Loss provision evolved from its first incarnation as "Indemnification" in ISDA's 1985 Swaps Code to its final form in the 1992 Master Agreement.[337] Throughout, the core features of Loss—its breadth, its flexibility, and the inclusion of "loss of bargain"—remained unchanged, as did the market's understanding. Indeed, the 1985, 1986, and 1987 versions were largely identical.[338] The 1992 Master Agreement had more differences; it followed innovation in new types of derivatives and "explosive growth in the market,"[339] which drove demand for a "much broader agreement . . . contemplating unknown market diversity."[340] Accordingly, it kept unchanged "the core . . . indemnification principle" that gives Loss its breadth and flexibility.[341] But, because the 1992 Master Agreement elevated Loss to a principal payment measure,[342] there "was an awful lot of discussion of Loss" among the drafters,[343] after which the provision was supplemented by new examples of presumptively appropriate measures of damages in addition to loss of bargain,[344] as well as the statement 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," added to avoid the appearance that Loss either forbade or required parties to engage in a "diminished version of Market Quotation."[345] The only change in the 1992 version that arguably narrowed Loss was the newly-inserted reasonableness requirement, which arose from "a desire to bound [Loss] without

[337] *See* Trial Tr. 2607:18-2639:15 (Cohn), 2613:4-5 (Cohn).
[338] AX-50062 at 23 (1985 Swaps Code); AX-50064 at 39-40 (1986 Swaps Code); AX-50065 at 12 (1987 ISDA Master Agreement); Trial Tr. 2622:2-4 (Cohn) (In the 1986 version, Indemnification "hardly changed at all."), 2627:13-23 (Cohn) (explaining that the differences between the 1986 and 1987 provisions were insubstantial).
[339] Trial Tr. 2629:7-11 (Cohn).
[340] *Id.* at 2630:11-14 (Cohn).
[341] *Id.* at 2634:6-13 (Cohn).
[342] AX-50001 at 9 (1992 ISDA Master Agreement).
[343] Trial Tr. 2633:3-10 (Cohn).
[344] *See* AX-50001 at 15 (1992 ISDA Master Agreement); Trial Tr. 2632:16-2637:3 (Cohn).
[345] AX-50001 at 15 (1992 ISDA Master Agreement); Trial Tr. 2636:8-2637:3 (Cohn).

suppressing its flexibility and its utility."[346]

Rahl called ISDA "the voice of the derivatives industry."[347] ISDA has never used its voice to support the understanding of Loss put forward by LBIE. On the contrary, over decades, ISDA has consistently explained that Loss is a flexible measure, coextensive with the broad principle of indemnification. In its guides, ISDA invariably described the provision as a "general indemnity" for the Non-defaulting Party.[348] And ISDA's guide to the 1992 Master Agreement specifically stated that the "definition of 'Loss' has also been expanded from the 1987 Agreement," confirming that it retained its full original breadth.[349] More recently, in 2015 ISDA submitted an amicus brief in the *Intel* case in which it again explained, citing its 1992 Guide, that the Loss provision, "carefully crafted as an alternative to Market Quotation, to allow flexibility,"[350] is a measure "guided solely by good faith reasonableness and open to a universe of calculation methods."[351] There is no reason to doubt that the market accepted and shared this understanding.[352]

Treatises. Leading treatises also show a lack of uniform market practice for calculating Loss. First, each of the several treatises Rahl relied on as support for her opinion that Loss is a

---

[346] Trial Tr. 2634:19-2635:5 (Cohn).
[347] *Id*. at 72:13-17 (Rahl).
[348] AX-50063 at 6 (Guide to 1985 Swaps Code); AX-50064 at 13 (1986 Swaps Code); AX-50066 at 12 (Guide to 1987 ISDA Master Agreement). *See also* Trial Tr. at 2629:2-4 (Cohn) (Q. "[H]ad ISDA's understanding [o]f loss changed with the advent of the 1987 Master Agreement? A. No."). ISDA also commented that "many ISDA members have a preference for 'Indemnification' as a fall-back because of its simplicity." AX-50064 at 14 (1986 Swaps Code).
[349] AX-50002 at 35 (Guide to 1992 ISDA Master Agreement); Trial Tr. 2637:13-15 (Cohn) ("Q. Did the market understand [L]oss to have narrowed in the 1992 ISDA from the 1987 version? A. No. On its face it expanded.").
[350] ISDA's Amicus Brief in Support of Def. Intel Corp.'s Mot for Summ. J., ECF No. 57-1, *Lehman Bros. Holdings Inc. v. Intel Corp. (In re: Lehman Bros. Holdings Inc.)*, Case No. 13-1340-scc (Bankr. S.D.N.Y. Jan. 20, 2015). The Court may take judicial notice of a filed amicus brief. *See* Trial Tr. 2655:7-10. ISDA has repeatedly drawn a distinction between Loss and the market-based and replacement-value-focused Market Quotation methodology. For example, in the introduction to the revised 1986 Code, ISDA explained (consistent with its 1985 Guide) that Agreement Value contemplates the price of a "replacement transaction," whereas Indemnification "allows the parties to calculate damages on the basis of a general indemnity." AX-50064 at 12-13 (1986 Swaps Code).
[351] *Id.* at 19.
[352] Trial Tr. at 2616:21-2617:12 (Cohn).

replacement value concept that requires a market-price-based calculation actually contradicts that claim.[353] Like ISDA, the treatises explain Loss as a "general indemnification approach."[354] They contrast it with the "replacement transaction" concept of Market Quotation,[355] emphasizing that Market Quotation and Loss have a "basic difference in the approach to valuation."[356] The Firth treatise explains that difference by contrasting Market Quotation's focus on "price" with Loss's focus on "value."[357] And nothing in these treatises supports Rahl's claim that Loss has a different meaning when it is the fallback to Market Quotation.[358]

The treatises also affirm that reasonableness under the 1992 ISDA does not inflexibly require the use of market data.[359] Indeed, speaking directly to the circumstances present in this case, the Firth treatise states that, when calculating Loss, "[w]here there is no available market

---

[353] *Id*. at 136:5-9 (Rahl) (quoting her deposition); AX-90021 at 211 (Firth Treatise) ("Where there is no available market for a replacement transaction (or a series of replacement transactions), it may not be possible to establish the Loss by reference to the market price."); AX-90023 at 49 (Gooch & Klein, 2002) ("The Loss approach permits, but does not require, a party to determine its Loss 'by reference to quotations of relevant rates or prices from one or more leading dealers in the relevant markets.'"); AX-90024 at 24 (Durham Treatise) ("Loss is a more subjective measure of the value of the transaction and a more subjective determination of the early termination amount because it represents the losses suffered by the non-defaulting party or non-affected party which may be unique to that party.").

[354] AX-90023 at 49 (Gooch & Klein, 2002) (also noting that in 1992, Loss was only "slightly modified" from the 1987 version); *see also* AX-90022 at 11, 16 (Gooch & Klein, 1993) (explaining that Loss "is a general indemnification provision and designed to result in compensatory damages for the actual loss of bargain that would be incurred as a result of early termination.").

[355] *Id.* at 12; AX-90023 at 54 (Gooch & Klein, 2002) ("[M]arket participants have largely abandoned [Formula-like approaches] in favor of general indemnification clauses *or of various alternatives* that call for quantifying damages by reference to what the market would charge or pay to enter into replacement transactions.") (emphasis added).

[356] AX-90023 at 56 (Gooch & Klein, 2002); *see also* AX-90021 at 202 (Firth Treatise) ("Whereas the Market Quotation provisions provide a precise mechanism for determining the financial effect of any close-out, where 'Loss' is selected the methodology to be used is not prescribed.").

[357] AX-90021 at 236 (Firth Treatise).

[358] Trial Tr. 148:9-12 (Rahl) ([W]hen questioned on a treatise's three bullet explanation on the use of Loss, Ms. Rahl was asked: "Q. Miss Rahl, there is no fourth bullet point here for [L]oss if it is a fallback after market quotation; right? There are only three? A. There are only three bullets."), 2638:8-19 (Cohn) ("[Loss is] exactly the same provision" when chosen as a standalone provision as it is when chosen as a fallback to Market Quotation.).

[359] AX-90024 at 47 (Durham Treatise) ("[I]f the determining party believes in good faith that consideration of these market sources would yield a commercially unreasonable result, it is not required to utilize or consider market data in determining the close-out amount."); AX-90021 at 236 (Firth Treatise) (The Loss provision "gives the determining party a discretion as to the methodology that should be used to ascertain what it has lost or gained as a result of the termination."). LBIE tried to make hay out of snippets from a conceptual discussion in a different part of the 2002 Gooch & Klein treatise, *see, e.g.*, Trial Tr. 298:11-300:7 (Rahl), but that separate section, which focuses on market trading of derivative transactions, does not address Loss at all.

for a replacement transaction . . . the use of quotations (whether firm or indicative) or valuations of the cost of a replacement transaction is *inappropriate*."[360]

At trial, LBIE took the position that Assured's calculation was unreasonably subjective.[361] But, as the Durham treatise relied on by Rahl explains, "Loss is a more subjective measure of the value of the transaction and a more subjective determination of the early termination amount because it represents the losses suffered by the non-defaulting party which may be unique to the party."[362]

Industry reports. Rahl and Bruce also relied on the 1999 Counterparty Risk Management Policy Group report, parts of which focus on measures of value at termination, including Loss and Market Quotation.[363] It too shows the absence of any industry-wide consensus on how to value terminated transactions, writing that "achieving . . . harmonization to standard industry close-out procedures could take considerable time."[364] That no such consensus developed later is reflected in the Policy Group's 2008 report, which notes that the subject of close-out methodology led to "lively discussion" of the market's "competing views," which the Policy Group was still attempting "to reconcile" in order to create a "consistent industry-wide approach" to closeout methodology.[365]

[360] AX-90021 at 211 (Firth Treatise) (emphasis added).
[361] *See, e.g.*, Trial Tr. 2009:12-19 (Counsel for LBIE) ("[O]n the question of whether what Assured did was unreasonable, I think self-evidently shows and is evidence sufficient to show that it was quite unreasonable. He applied the wrong standard, it was a subjective standard . . . .").
[362] AX-90024 at 24 (Durham Treatise).
[363] Trial Tr. 161:17-20 (Rahl), 812:14-15 (Bruce); *see also* AX-50013 (CRMPG I). Like the treatises, a later Policy Group reports reflects the understanding that Loss and Market Quotation are different from one another. AX-50006 at 104 (CRMPG II) ("The Policy Group recognize[d] that each of the three ISDA methodologies [Market Quotation, Loss, and Close-out] has certain strengths and weaknesses that depend on, among other factors, the characteristics of the underlying product and prevailing market conditions.").
[364] AX-50013 at 48 (CRMPG I).
[365] JX-64 at 135 (CRMPG III) ("The subject of the methodology used to execute close out by a non-defaulting counterparty in the event of a default by one or more counterparties has been a subject of lively discussion in CRMPG III, just as it was in CRMPG II and CRMPG I."), 138 (acknowledging the existence of "competing views" in the market about different close-out valuation methodologies).

The only principles around which the 2008 Policy Group was able to coalesce were "(1) commercial reasonableness; (2) duty of good faith; and (3) fair dealing."[366] In addition, the 1999 report recommends that flexibility "should be a common industry standard,"[367] and emphasizes that any "enhancements" to existing documentation "should not reduce the flexibility to value transactions *without third-party inputs*."[368]

4. LBIE's Other Evidence Also Falls Short of Proving a Uniform Market Practice

LBIE also attempts to prove the existence of the purported market practice through two irrelevant documents: the Lehman Derivatives Claims Settlement Framework (LX-35), and the Viegas Spreadsheet (LX-92b). Neither supports LBIE's claims. The Framework was a settlement agreement with certain large dealer banks; it did not include any monoline insurers, did not purport to address transactions like the bespoke ones at issue in this case, and did not even purport to reflect what the market as a whole understood about Loss—to which the Framework makes no reference.[369] Moreover, the Settlement Framework was confidential until 2011.[370] As this Court recognized, a document like this that was unavailable to Assured at the time it calculated Loss cannot have any relevance to the reasonableness of its calculation.[371]

The Viegas Spreadsheet suffers from the same defects. Like the Framework, it was not available to Assured in 2009.[372] And, like the Framework, it pertains to different kinds of transactions than those at issue here, rendering it irrelevant: the evidence at trial showed that

---

[366] JX-64 at 135 (CRMPG III).
[367] AX-50013 at 13 (CRMPG I).
[368] *Id.* at 48 (emphasis added).
[369] *See* LX-35 at 42 (Lehman Settlement Framework) (listing "Big Bank Counterparties"), 9-25 (Framework Valuation Approach); Trial Tr. 1025:22-1026:2 (Bruce) (confirming no insurance company or other corporate counterparties in Framework), 1030:20-1031:5 (Bruce) (noting banks' standard practice of posting collateral).
[370] *See generally* LX-35 (Lehman Settlement Framework) (confidentiality restrictions branded on each page).
[371] *See* Trial Tr. 1467:13-19 ("THE COURT: . . . If this derivatives claim framework is from 2011 and the—Judge Friedman said we can't use hindsight and the Appellate Division affirmed that, then why am I looking at this?").
[372] *See id.* at 711:18-25 (Viegas) (describing how his declaration and supporting spreadsheet were prepared in 2015 in connection with this lawsuit).

nearly all of the transactions reflected in it were collateralized and called for physical settlement.[373] Thus, because "[t]he economics [of these transactions] are different" than those at issue in this case, the amounts at which they were settled are completely irrelevant to whether Assured acted reasonably.[374] Most importantly, there is no evidence of what calculation methodology was used for any transaction—and the inferences that LBIE draws from the final totals are unreliable in the extreme.[375] For example, Viegas admitted that, in some cases, the final amounts recorded for a transaction are one part of a larger negotiated compromise of multiple transactions.[376] And, there is no way to tell for any particular transaction whether or not it was part of such a larger resolution, nor when it was terminated, nor whether it was collateralized or accompanied by a credit support annex, nor how pre-termination payments were to be made.[377] Finally, the Viegas Spreadsheet is also misleading, because it reflects only cherry-picked information about settled transactions, excluding all transactions that remained disputed, creating the false appearance that Assured's dispute with LBIE is an outlier.[378]

5. LBIE Failed to Prove That Assured Knew of LBIE's Purported Market Practice

In addition to failing to prove there was a uniform market practice of calculating Loss as a market price, LBIE also failed to carry its burden of proving that Assured knew of that

[373] *See id*. at 3130:15-3131:10 (Prager) (explaining that 44 out of the 46 ISDA agreements produced by LBIE referenced collateral postings, and noting that 19 of the 20 confirmations that LBIE produced called for physical settlement); *see also* AX-50076 (LBIE Produced Master Agreements and Confirms) (summarizing the data that Prager discussed).
[374] Trial Tr. at 3131:16 (Prager).
[375] *See* LX-92b (Unique "Ctpy List" tab, column H and "Ctpy Values" tab, column O noting "no info" for how the counterparty determined Loss).
[376] *See*, *e.g.*, Trial Tr. 735:18-25 (Viegas) ("Q. You're saying, there may be trades beyond what's accounted for in this spreadsheet that were part of Lehman's assessment of whether the counterparty's valuation was consistent with Lehman's valuation? A. Yes, because they were not trades related to ABS and CDS, and I think . . . even yesterday I said . . . that we've done this analysis on a counterparty-aggregated basis.").
[377] *See id.* at 717:9-720:1 (Viegas) (agreeing that "a CDS transaction could provide different options for how the protection seller makes payment in the ordinary course of the transaction before it's terminated," and agreeing that no such "contractual details [are] indicated elsewhere in this document").
[378] *See* LX-38 at 20 (2013 Progress Report); Trial Tr. 742:19-743:15, 747:2-748:9 (Viegas) (testifying regarding claims against LBIE and unaccepted offers by LBIE due to differences in valuation methodology and approach).

purported market practice. To the contrary, Schozer, Assured's President from 2003–09 (before which he worked on the swaps desk at Barclays, then at Ambac),[379] explained, based on his experience and the language of the Agreement, that he understood that Loss simply operated "to put a non-defaulting party back into the position they would have been in but for the default."[380]

LBIE presented at trial snippets of documents that it claimed showed Assured's awareness of a purported market practice.[381] Understood in context, none of those documents support LBIE's claim. First, LBIE pointed to language extracted from a 10-K, but in reality, the disclosure addressed what might happen if Assured's *counterparties* "exercised their right to terminate" their CDS if Assured defaulted.[382] If that were to occur, those counterparties would calculate a settlement payment, and Assured explained that "[t]he process for determining the amount of such payment is set forth in the credit derivative documentation and generally follows market practice for derivative contracts," adding that, in that situation, "the Company could be required to make a mark-to-market payment as determined under the ISDA documentation."[383] Assured has never argued that another party could not calculate Loss based on market prices, or that if a counterparty entered into a transaction replacing Assured (under market quotation) that Assured could not be required to make a market-based payment. Thus, explaining that a counterparty "could" in certain circumstances calculate a settlement amount using a mark-to-market methodology is entirely consistent with Assured's position and is not evidence of a universal market practice in all cases.

---

[379] *Id*. at 2016:24-2017:4 (Schozer), 2021:19-2024:3 (Schozer).
[380] *Id*. at 2080:24-2082:12 (Schozer) ("Q. And what was your understanding at the time of what that would mean if there was no Market Quotation and then Assured had to use loss? A. Well, in that case we would go back to--and, as it says quite explicitly in the language--you know, the benefit of our bargain.").
[381] *See* LDX01-7 (LBIE Opening Demonstrative) (quoting JX-57 at 84 (Assured 2008 10-K)).
[382] JX-57 at 84 (Assured 2008 10-K) ("For example, if AGC's rating were downgraded to A+, under market conditions at December 31, 2008, if the counterparties exercised their right to terminate their credit derivatives . . . ").
[383] *Id*. at 84.

Second, LBIE also argued that the mark-to-market calculations that GAAP accounting rules required Assured to perform demonstrated Assured's awareness of the purported market practice.[384] But Assured never stated that these accounting requirements had any connection to market practice for valuing its CDS, nor is there any such connection. To the contrary, Assured made clear that those GAAP calculations were "[c]ompletely irrelevant" to the actual value to Assured of its derivative transactions.[385] This fact was also widely understood.[386] Moreover, Assured was equally clear that its mark-to-market numbers were entirely hypothetical and there were no market prices for comparable derivatives (due in part to the non-standard terms of Assured's CDS), explaining that "[w]e do not typically exit our credit derivative contracts and there are not quoted prices for our instruments or similar instruments" and therefore "[t]here is no exit market or actual exit transactions."[387] It further explained that generating these numbers was challenging, which limited their reliability, because of illiquidity in the relevant markets.[388]

Third, LBIE also showed Mr. Schozer a set of slides, which included a slide comparing CDS to financial guaranty policies, trying to suggest that this showed Assured knew it might have to calculate Loss based on a mark-to-market calculation.[389] But as Mr. Schozer stated, he understood the reference to "mark-to-market" to mean Second Method/Market Quotation.[390]

---

[384] *See* AX-70008 at 72 (Assured 2009 10-K) ("The Company is required to mark-to-market certain derivatives that it insures, including CDS that are considered derivatives under GAAP.").
[385] Trial Tr. 2036:20 (Schozer); JX-57 at 101 (Assured 2008 10-K) ("Changes in the fair value of our credit derivative contracts do not reflect actual claims or credit losses[.]"); AX-70007 at 78 (Assured Q3 2008 10-Q) (same).
[386] AX-50012 at 81 (S&P Global Bond Insurance Book 2007) ("Revenue for Assured Guaranty Ltd. and all bond insurers, is unnecessarily volatile due to FASB 133, which requires certain credit derivatives to be marked to market, notwithstanding the fact that the bond insurers do not trade these instruments and ultimately the mark will 'zero out' in the very large majority of instances in view of the typically strong underlying rating of the credit.").
[387] JX-57 at 101 (Assured 2008 10-K) ("We do not typically exit our credit derivative contracts and there are not quoted prices for our instruments or similar instruments."), 195-96 ("There is no exit market or actual exit transactions. Thus, our exit market is a hypothetical one based on our entry market . . . . There is a very limited market in which to verify the fair values developed by the Company's model.").
[388] *Id*. at 196.
[389] *See id.* at 2336:22-2337:19 (Schozer), 2342:4-2343:24 (Schozer).
[390] *Id*. at 2560:14-16 (Schozer).

And he explained that it was correct to connect these terms, even where Assured's counterparty defaults, because under Market Quotation "if the counterparty defaults . . . if that trade gets transferred over to somewhere else, we're left in the same position, because if it's transferred for cash, we get cash, we send the cash to the counterparty" and that cash amount is what the market would pay.[391] That is to say, according to Mr. Schozer, the slide merely reflected the undisputed point that Market Quotation is a mark-to-market or market price concept. But that says nothing about what Loss requires or that Assured was aware of a market practice for calculating Loss.

In sum, all these statements fall far short of meeting LBIE's burden to prove Assured's awareness of a uniform market practice for Loss.

B. Even If LBIE's Purported Market Practice Existed (Which It Didn't), It Was Reasonable For Assured To Depart From It Under The Circumstances

Even if LBIE had managed to prove the existence of a market practice to calculate Loss as a price (which it has not), LBIE has not met its burden to prove that, under the circumstances of this case, it was unreasonable for Assured to depart from that practice.

1. The Value of the Transactions to Assured was not Their Market Price

The contractual language explicitly identifies *Assured's* loss of bargain as the relevant measure of Loss. Whether Assured's calculation was reasonable and made in good faith therefore turns on the value of the Transactions *to Assured*. For that, market prices are irrelevant: Assured is not a bank or a hedge fund, and it does not trade CDS, profit from market price movements, nor offer CDS on terms that tie its payment obligations to market prices.[392] This is also reflected in the terms of the Transactions, which did not require Assured to post collateral or make payments based on fluctuations in market prices. Because Assured holds to

[391] *Id*. at 2563:1-5 (Schozer).
[392] *See* Trial Tr. 2867:11-22 (Bailenson), 1223:10-20 (Rosenblum).

maturity the CDS it sells, the value to it of the CDS is the sum of all of the fixed premium payments that Assured expects to receive, less the sum of any floating payments that Assured expects to make to cover actual losses.[393] Had LBIE not defaulted, Assured would have realized the net value of those two payment streams at the maturity of the Transactions; market price movements in any direction would have had no effect on the profit or loss to Assured.[394] Likewise, had the market quotation auction resulted in a bid, the amount paid by the bidder would have passed to LBIE, and Assured would have remained "flat," collecting its fixed premiums from the new counterparty, and making whatever floating payments came due.[395] This is the benefit Assured bargained for when it entered into the Transactions with LBIE.

It was reasonable for Assured to follow the contractual language and calculate the benefit of *its* bargain and value the transactions from its perspective; nothing in the Agreement required it to estimate the value of the transactions to its defaulting counterparty. Nor was there any market consensus that the Agreement required Assured to ignore the actual economic terms of its CDS.[396] Market prices of CDS with different terms are irrelevant to the value of the CDS *in this*

---

[393] *Id*. at 2031:24-2032:9, 2211:10-18 (Schozer) ("[T]he benefit of our bargain is there are a fixed and a floating leg, and, so, the value of any financial instrument is the present value of the cash flow streams of that financial instrument. And, so, we have a present value of receivable, in terms of premium, and a present value of expected payments, in terms of payments that would be made to the beneficiary of our policy."); *see also* JX-57 at 127 (Assured 2008 10-K) ("The Company's credit derivative exposures . . . are contracts that are generally held to maturity.").

[394] Trial Tr. 2037:4-7 (Schozer) ("Because we're never trading out of them, we would never be crystalizing gains or losses anyhow. So you're holding to maturity and you're earning, you know, premium income during the life of the transaction.").

[395] *See id*. at 2180:18-2181:6 (Schozer) ("[I]f Lehman were to transfer it to Goldman and let's say that swap was worth $100 million, well, Goldman would pay us and we would pass that money to Lehman. While 100 million walked in and walked out of our accounts, it was not a net payment . . . So we're actually indifferent to what is the . . . executable market price of that swap . . . because we collect whatever that money is from new counterparty and pass it on to old counterparty.").

[396] AX-90024 at 24 (Durham Treatise) ("Loss is a more subjective measure of the value of the transaction and a more subjective determination of the early termination amount because it represents the losses suffered by the non-defaulting party or non-affected party which may be unique to that party."); AX-90021 at 236 (Firth Treatise) (describing "the Loss methodology under the 1992 ISDA Master Agreement [as giving] the determining party a discretion as to the methodology that should be used to ascertain what it has lost or gained as a result of the termination"); AX-90022 at 11 (Gooch & Klein, 1993) (noting that damages under Loss include "the value (if any) of the loss of the bargain to the non-defaulting party"); AX-90023 at 49 (Gooch & Klein, 2002) ("Early drafting

case to Assured.[397]

2. Reasonableness did not Require Assured to Defer to What Dislocated Market Prices Implied About Future Losses

LBIE has also argued that it was unreasonable for Assured to use loss projections in its calculation that were different from the projected losses that then-current market prices implied. Not only is that argument wrong for the reasons already stated, but it fails to account for the circumstances in the markets at the time of Assured's calculation. As explained in § V.A.2, , at that time, the financial markets remained fundamentally dislocated. Not only was there no consensus that then-current market prices reflected actual value, but numerous neutral market observers—including the Bank of England and the Bank of International Settlements—looked at market prices, including the ABX, and noted that those prices implied future losses that were grossly in excess of even the most pessimistic predictions (e.g., a *100%* default rate), and concluded that they reflected the impacts of illiquidity and short-selling rather than a collective judgment about actual value or likely future losses.[398] Rahl drew the same conclusion in her Devonshire report. There, she explained (with respect to a Loss calculation performed earlier in 2009) that "when the market was detached from fundamental considerations of loss due to extraordinary illiquidity, actual loss projections provided a better indicator of long-term expected performance and value than did market pricing."[399] She further opined that she "considered [a

approaches thus left it to the party claiming damages to . . . show why the amount claimed was in fact the amount necessary to put the party in as good a position as it would have been in if the transaction had not been closed out.").

[397] Notably, LBIE's parent recognized (and argued to the SEC) that market prices were not necessarily appropriate to measure the value of a security being held to maturity. Trial Tr. 193:21-25 (Rahl).

[398] *See* AX-50072 at 11 (BOE Oct. 2008 Report); AX-50019 at 19 (BIS March 2009 Working Paper) (identifying factors that "may limit the usefulness of ABX price quotes for valuation purposes and as indicators of future writedowns and losses by ABX investors" and that "default-related losses on subprime MBS instruments . . . may ultimately turn out to be significantly lower than recent ABX prices would seem to imply"); AX-50056 at 1 (Bear's Lair 2009) ("[W]e find that current prices for the ABX.HE indices are inconsistent with any reasonable assumption for mortgage default rates, and that ABX.HE price changes are only very weakly correlated with observed changes in the credit performance of the underlying loans in the index.").

[399] *See* AX-90026 at 106 (Rahl Devonshire Report).

discounted cash-flow approach to Loss] commercial[ly] reasonable[] based on what others have done in a similar circumstance."[400]

Moreover, the market prices that LBIE pointed to were not even those of the reference obligations, but rather for different securities with different terms; even in a functioning market, those market prices would have little to no relevance in determining the value of a CDS facing Assured.[401] And there were no market prices at all for the Transactions themselves: LBIE failed to novate the Transactions, and Assured received no bids in its auction.[402]

LBIE has not provided a single example of an entity that found itself in the same circumstances as Assured—a monoline with CDS terms like those here, with a counterparty default in an illiquid market—that calculated its Loss based on market prices of the reference obligations. And LBIE has not proven that it was unreasonable for Assured to have calculated Loss the way that it did.

C. Assured's Good Faith Calculation Of Its Loss Was Reasonable And Reached A Reasonable Result

Unable to prove the existence of a market practice that required Assured to calculate Loss based on market prices, LBIE has also attacked the reasonableness of the calculations that Assured performed. The evidence at trial showed that those attacks are unfounded and that Assured used a methodology that was highly reliable, including because it was used in the regular-course for multiple business purposes, extensively vetted internally and externally, took into account relevant market data, and reached a result consistent with those reached by the rating agencies—which provided the most independent and transparent assessments of the

---

[400] AX-90027 at 4 (Rahl Devonshire Rebuttal).
[401] *See* Trial Tr. 1591:12-16 (Niculescu) ("Q. But you weren't able to find actual market prices at which the relevant CLOs traded; isn't that right? A. Again, as you say, these are transactions that are performed over the counter, so I had to resort to a well known index. So you are correct."), 1605:18-20 (Niculescu) ("Q. And you said that those CDS have some different terms than the Assured CDS on U.K. RMBS in this case, right? A. That is true, yes.").
[402] *See* § III.C, III.F.

expected performance of the securities referenced in the Transactions here.

The record is clear that Assured used its regular-course-of-business models to determine its Loss. Assured's core expertise as an insurance company is in modelling future losses, and its expected loss models were used for multiple, business-critical functions, including underwriting new transactions, monitoring and managing its transactions, determining its regulatory loss reserves for all transactions, reporting to stockholders and regulators, and even evaluating whether to purchase RMBS for mitigation purposes.[403] As a result, Assured had every incentive to ensure its models were reasonably accurate because the use of unreliable models would have threatened the viability of its entire enterprise. Had Assured's expected loss models been overly optimistic, it would not have been able to effectively manage its exposures, it would have faced significant risk as a regulated, public company, and it would have risked overpaying on its purchases of RMBS.[404] As Mr. Schozer confirmed at trial, "[there] was [no] . . . other way to do the [Loss] calculation that . . . would have been consistent with the economics of the transaction for Assured" and no "other way to do it that would have been consistent with Assured's business."[405]

In addition, because of the importance of calculating expected losses for all of its transactions across its business, Assured had robust modeling in place, informed by its experience and the expert judgments of its specialists, with multiple safeguards and independent checks (including benchmarking against projections made by others), to ensure that its loss projections were reliable.[406] To calculate the value of the Transactions, Assured used the results generated by this established, proven process, which was regularly reviewed by its Board and

[403] *See supra* § IV.
[404] *Id.*
[405] Trial Tr. 2213:10-17 (Schozer).
[406] *See supra* § IV.

vetted by its independent auditor, PwC. It was plainly reasonable for Assured to use these established models, which were subject to many levels of review internally and externally,[407] rather than constructing an entirely new, one-off model, as LBIE's expert has done for the purposes of litigation.

The evidence also shows that Assured's expected loss models appropriately took into account actual performance data for each of the reference obligations, which reflected the most current information on how many borrowers were delinquent, how many were in default, the severity of the losses on defaulted loans and the level of prepayment. That actual market data, which reflected the effects of the recession on the housing market and individual borrowers, formed the starting point for Assured's modeling of US subprime RMBS losses. In addition, Assured had to make judgments about how defaults would evolve over time. In doing so, Assured again considered relevant market data, including the fact that the housing market "was starting to see signs of a recovery" in 2009,[408] that home prices were predicted to stabilize in 2010,[409] that government programs unveiled by the Obama Administration earlier in the year to assist homeowners with loan modifications and refinancing, including HAMP and HARP, were starting to have a positive impact by June 2009,[410] and that effects of "burnout" (a significant portion of borrowers who were most likely to default having already done so) meant that the borrowers who had survived years of recession and continued to stay current on their mortgages were less likely to default in the future.[411]

LBIE's argument that it was objectively unreasonable for a person in Assured's shoes to

---

[407] *Id.*
[408] Trial Tr. 3031:3 (Prager), 3034:2-8 (Prager), 3071:10-12 (Prager) ("There is a lot of data here to show you that the market is stabilizing and that goes to both factors, both to default rate and to loss severity.").
[409] *See supra* § IV.
[410] *Id*. at 3014:7-23 (Prager), 3021:1-21 (Prager).
[411] *Id*. at 3066:17-3067:2 (Prager) (describing burnout effect).

arrive at these judgments not only ignores this market data, but also ignores that two neutral and objective market observers—Moody's and S&P—reached very similar judgments.[412] Like Assured, these rating agencies formed the view that home prices would stabilize by 2010 and accounted in their modeling for factors, like seasoning and government intervention that would reduce losses over time.[413] The reasonableness of Assured's modeling is also confirmed by the fact that Assured's projected losses for the ABX transactions were very similar to the losses projected by Moody's and S&P for the same vintage of US subprime RMBS.[414]

LBIE has pointed to opaque reports published by the research desks of a few banks that appeared to be making different predictions about future losses than Assured, but that is not sufficient to prove that Assured acted unreasonably in relying on its own expertise and established processes. First, Niculescu provided no basis to conclude that the particular bank reports he chose were representative of a market consensus view at the time. To the contrary, there were multiple examples of him cherry-picking figures from reports when favorable to his position and excluding relevant figures from reports when they were unhelpful to his argument.[415] Most tellingly, in discussing benchmarks against which to compare Assured's loss projections for the subprime RMBS in the ABX transactions, Niculescu conveniently omitted the contemporaneous lifetime loss projections published by Moody's and S&P, despite himself having repeatedly cited to Moody's and S&P for various other purposes in his expert reports.[416] As noted above, those omitted projections, were closely aligned with Assured's.

---

[412] *Id.* at 1145:21-1146:1 (Rosenblum) ("I think it's fair to say that all rating agencies would agree that their estimates are . . . conservative").
[413] *See supra* §§ IV, V(A)(3).
[414] *See supra* § IV.
[415] Trial Tr. 1558:14-1566:23, 3957:22-3975:14 (Niculescu) (Moody's and S&P reports with projected losses were not included in Niculescu's rebuttal report and were lower than the figures that were included), 3930:8-3934:7 (Niculescu) (Moody's and S&P reports were frequently cited in Niculescu's reports for other propositions).
[416] Trial Tr. 1558:14-1566:23 (Niculescu).

Relatedly, in stark contrast to the Moody's reports, which provide extensive disclosure of its methodology, the bank reports that LBIE relies on contain little to no information about the methodology each bank used or the judgments they made.[417] As a result, it is impossible to assess whether those banks' models are reliable at all, much less to conclude they represent the only reasonable approach that could be used under the circumstances. In addition, the limited information included in those reports indicates that the bank projections Niculescu selected were actually using market prices as their starting point and working backwards to arrive at the future loss projections that those prices implied.[418] But using dislocated market prices for this purpose would grossly overstate expected losses, because those prices actually reflect illiquidity and the other market stresses that existed during the financial crisis. This was the precise conclusion reached by numerous government bodies and respected academics at this time.[419] And the bank reports that LBIE tries to rely on actually confirm how severely dislocated market prices of the relevant ABS were. For example, a Barclays "ABX Weekly Recap" from July 2009 contains a chart showing that indicative prices quoted for each of the four vintages of the ABX index implied that each would be subject to a dramatically different housing price appreciation rate.[420] Because housing prices appreciate at one rate, this divergence is powerful evidence of ABX

[417] *Id*. at 1579:8-13 (Niculescu) ("Q. All right. Now, you were just testifying about what you thought JPM would have been doing in their model. But it's true that you don't know what JPM was doing in their model; right? A. They didn't provide that model to me; instead I have Assured's plateau model."), 3371:25-3372:9 (Prager) (describing lack of disclosure of methodology in JP Morgan report (LX-119)), 4001:5-8 (Niculescu) ("Q. Looking at this page, there's no other information that JP Morgan provides about what other parameters it's using in these models, is there? A. Not that I see.").
[418] LX-137 at 2 (Barclays ABX Weekly Recap) (referring to "marked-implied losses"); Trial Tr. 3364:16-22 (Prager) ("It's a market implied loss. In other words, it's a number that would have taken the price that we saw on the prior page and, you know, tried to layer that on and figure out—assuming some—here it has a—the risk-free rate is showing me one and a half—very low discount rate and just translating it into loss projections."), 3578:14-16 (Pirrong) ("We saw the Barclay's document earlier which basically explicitly said that those were market-based market-implied measures of expectations.").
[419] *See supra* § V(A)(2).
[420] LX-137 (Barclays ABX Weekly Recap) at 2.

price dislocation at the time.[421] In short, LBIE failed to establish a consensus that market prices in July 2009 were unaffected by illiquidity and reliably reflected fundamental value, and as a result its reliance on these bank reports also fails.

In any event, many of Niculescu's nit-picking complaints regarding specific aspects of Assured's regular-course models are based on apples-to-oranges comparisons or are otherwise misleading. For example, Niculescu compared *lifetime* roll rates in a JP Morgan report to Assured's *two-year* roll rates, without disclosing that he was doing so.[422] Similarly, Niculescu attacked Assured's judgments about the timing of an expected recovery in the housing market as overly optimistic, but he omitted from the demonstrative that he prepared for the Court relevant data showing housing price improvements in June 2009.[423]

In sum, the evidence at trial shows that there was no single uniform method for determining whether there would be future losses on the Transactions and no single "correct" answer as to what those losses might be. Assured had an established model for projecting losses that relied on actual data and reasoned judgments made by its internal experts and extensively vetted, which was broadly similar in approach and output to the modeling published by at least the rating agencies. LBIE failed at trial to identify any reason why it would have been objectively unreasonable for a person in Assured's position to rely on such a model.

D. LBIE Failed To Establish It Is Entitled To Any Damages

LBIE also failed to establish at trial that it suffered any recoverable damages. As the

[421] Trial Tr. 3568:18-3569:21 (Pirrong).
[422] *Id*. at 1790:14-1791:4 (Niculescu) ("Q. So my question to you is: You used the two-year liquidation rates for Assured in this table, right? A. Yes. Q. And you compared them to lifetime liquidation rates in the middle column for "J.P. Morgan," right? A. Yes . . . Q. Do you note in your report here that the J.P. Morgan rates that you're using are J.P. Morgan's lifetime liquidation rates? You don't, right? A. No.").
[423] *See* Trial Tr. 1542:3-1544:19 (Niculescu) (discussing how Niculescu left out home prices for June 2009 to July 2009 in his demonstrative, LDX-06, despite being aware that Assured had access to such information when determining its Q3 2009 loss reserves).

Defaulting Party, to recover damages under the Agreement, LBIE must not only prove that Assured's Loss calculation was unreasonable (which LBIE failed to do for the reasons set forth above), but LBIE must also prove that Assured actually received a gain by terminating the Transactions. If, and only if, Assured received a gain as a result of LBIE's default, Assured would be required by Second Method to pay that gain over to LBIE.[424] But, as discussed above, the evidence at trial showed that, by every reasonable measure, Assured incurred a loss of approximately $20 million, not a gain, when it terminated the Transactions.[425] LBIE and its experts largely ignored that evidence. Instead, LBIE seeks a windfall of hundreds of millions of dollars based on a hypothetical damages model created by Niculescu solely for this lawsuit. Niculescu's model is legally irrelevant because it fails to show that Assured actually received a gain by terminating the Transactions, and it is also fundamentally unreliable.

First, the hypothetical "market price" of the Transactions generated by Niculescu's litigation-driven model bears no relation to any gain realized by Assured. This is demonstrated by the fact that his calculation cannot be reconciled with the extensive real-world evidence that no one was willing to pay Assured even a dollar to step into LBIE's shoes on the Transactions. Niculescu testified that his model was trying to calculate the price that "a disinterested third-party would pay or receive in a competitive market to step into LBIE's shoes as AGFP's counterparty with respect to the transactions."[426] But the evidence at trial showed that LBIE attempted to novate the Transactions for many months, and that Assured conducted a good-faith, well-designed auction to find bidders. In each case, many of the most sophisticated financial institutions in the world had the opportunity to bid and chose not to do so.[427] It is inconceivable

[424] *See supra* § II.C.
[425] *See supra* § IV.
[426] Trial Tr. 1701:6-14 (Niculescu).
[427] See *supra* § III.C-F.

that if these institutions believed the Transactions were worth hundreds of millions of dollars, as Niculescu's model suggests, they would have passed on those opportunities.[428] The only reasonable conclusion to draw from this evidence is that the Niculescu's approach was *not* generally accepted by market participants and that his model failed to account for important factors that affected the real-world value of the Transactions. Neither the parties' agreement nor New York law allows a Defaulting Party to substitute its litigation expert's mathematical thought-experiment for evidence of an actual gain by the Non-defaulting Party.

Another critical flaw in Niculescu's model is that it fails to adequately account for the non-standard terms of the Transactions. A threshold challenge that Niculescu faced in trying to put forward a valuation based on market prices was that there were no market prices available for CDS with the same economic terms as the Transactions, let alone for CDS protection sold by a monoline. Niculescu conceded at trial that he could not base the model on actual transactions because there were none.[429] As a result, he used a series of proxies based on prices and other data related to entirely different CDS or securities and applied a series of adjustments based on his own subjective assumptions and judgments. For example, Niculescu could not find any market prices for CDS on the CLOs at issue here, or even for the referenced CLOs.[430] So, he used pricing data for an index of CLOs (which, he admitted, included lower-rated CLOs and may

[428] Trial Tr. 2215:23-2216:1 (Schozer) ("I think that the auction illustrated that there wasn't a bid by any kind of trading counterparty."), 3174:18-20 (Prager) ("What I could tell you, if there had been $230 million of potential value it's much more likely that somebody would have come in and say I'll pay something for that."), 3573:1-11 (Pirrong) ("If those prices actually represent the prices that these participants were willing to pay . . . then taking Dr. Niculescu's argument as an empirical prediction, his prediction would be, as if these dealers that are indicated by green checks and the dealer one cited by LBIE's expert column, they should have been willing to bid something close to his numbers at the auction. They had the opportunity to do so and they did not.").
[429] E.g., *id*. at 1591:1-5 (Niculescu) ("I do not dispute that [I was not able to get prices for CDS transactions on these CLOs].").
[430] *Id*. at 1591:12-16 (Niculescu) ("Q. But you weren't able to find actual market prices at which the relevant CLOs traded; isn't that right? A. Again, as you say, these are transactions that are performed over the counter, so I had to resort to a well known index. So you are correct.").

not have contained any of the referenced CLOs), made assumptions about how to interpolate a price for AAA CLOs like those relevant here, and tried to estimate a price for CDS on those CLOs using data related to CDS on junk bonds (an entirely different asset class).[431] Unsurprisingly, Niculescu could not point to a single survey or any other robust empirical evidence to show that market participants generally accepted or used his approach of layering proxies upon proxies and adjustments upon adjustments to approximate the value of CDS with highly customized terms like the Transactions here. [432]

Relatedly, Niculescu made no attempt to test his subjective modeling adjustments against the real-world evidence of how LBIE priced or valued the Transactions. For example, the pricing data that Niculescu used as his initial proxy for valuing the CDS on UK RMBS was based on "benchmark CDS" that did not contain pay-as-you-go terms, unlike the Transactions in this case.[433] The fact that Assured was only obligated to pay shortfalls as they came due, which in some cases might be decades into the future, reduced the price that a buyer would pay for that protection. Evidence that LBIE itself produced in this lawsuit shows that it paid premiums for a CDS on UK RMBS with standard terms that were four times larger than the premiums it paid for pay-as-you-go CDS protection from Assured on the same reference obligation.[434] But Niculescu

---

[431] *Id*. at 1592:1-15 (Niculescu) (referencing calculation method for spread on bond), 1593:19-23 (Niculescu) ("Q. And the indicative spread in the J.P. ~ [sic] Morgan publication, that included both senior Triple-A tranches and also junior Triple-A tranches. That's what you testified to earlier? A. Yes. That is my understanding."), 1593:5-7 (Niculescu) ("Q. And, in the report that you rely on, they don't disclose what specific CLOs are in the index; right? A. No."), 1593:24-1594:1 (Niculescu) ("Q. And the senior Triple-A tranches are less risky than the junior Triple-A tranches; right? A. Yes."), 1595:4-6 (Niculescu) ("Q. So you had to estimate what the spread was for the senior Triple-A CLOs; right? A. Yes.").

[432] *Id*. at 1597:19-23 (Niculescu) ("Q. Dr. ~ [sic] Niculescu, you didn't conduct a survey of market participants to see whether they took the same steps that you just testified about to determine how much to pay for a CDS on one of the CLOs at issue; right? A. No.").

[433] *Id*. at 1615:4-9 (Niculescu) ("Q. Now, Dr. Niculescu, you agree with me that the reason you were doing this exercise to come up with the difference between the benchmark CDS and the Assured CDS was because there were different terms, different obligations that the parties had undertaken under the contracts; right? A. Yes."); *id.* 1618:25-1617:8 (Niculescu).

[434] Trial Tr. 1610:11-21 (Niculescu, 1612:11-1614:8 (Niculescu), 1663:8-17 (Niculescu); *see also* AX-30063 (Email From Tipping Re: CDS Mtm Estimates) and AX-30063a (attached trade blotter); Fraser Ker Dep. Tr. 148:17-154:9.

chose to make only a small adjustment to the prices of those benchmark CDS to reflect the difference in terms.[435] And he conceded that he did not make any attempt to reconcile the adjustments in his model with this real-world evidence.[436]

LBIE also failed to establish that Niculescu's model adequately accounts for the reduction in the price a buyer would pay for uncollateralized CDS protection from a monoline. At that time, the monoline industry as a whole was under stress, market participants were trying to decrease their monoline exposure, and banks no longer had the same accounting or regulatory capital rationales for purchasing CDS protection from a monoline.[437] Niculescu ignored the extensive evidence that there was no appetite among third-parties to step into LBIE's shoes and face Assured in the Transactions. Instead, he computed a CVA that merely accounts for the cost to the buyer of hedging the risk that the protection seller might not be able to make pay-as-you-go payments in the future.[438] Although Niculescu purported to use a "market standard model" that had been used for decades,[439] he could not point to a single example of a market participant using his approach to price how much it would pay for CDS protection on highly-rated ABS from monolines during the financial crisis, let alone a consensus on its use.

This is hardly surprising given that LBIE introduced no evidence that anyone was willing

---

[435] *Id*. at 1663:5-16 (Niculescu) (conceding that Dr. Niculescu reduced the mid-market value of the UK RMBS by about 20% despite the fact that, in another transaction, Lehman paid "approximately four times as much premium to Swiss Re as it was to Assured").

[436] *Id*. at 1609:22-1610:1 (Niculescu) ("Q. Now, for example, did you look to see how your model would perform to predict the difference between the price of a benchmark CDS and the Assured CDS at the time that the parties entered into these transactions? A. I did not go back and do a retrospective performance."), 3158:9-22 (Prager) (explaining that Niculescu could have back tested his calculations to confirm their purported accuracy, but did not).

[437] *See supra* § V.B.

[438] LBIE separately seeks to inflate its damages calculation by approximately $300 million by arguing that it should not be required to make any deduction for the counterparty risk associated with facing Assured on the Transactions. But, in addition to the many factual and legal flaws in LBIE's claim already discussed, this argument is directly contradicted by LBIE's own experts, who testified (1) that market practice requires Loss to be calculated based on the cost of a replacement transaction, and (2) that the price of a replacement transaction "depend[s] on the counterparty." Trial Tr. 139:24-140:1 (Rahl); *see also id*. at 1584:7-1584:24 (Niculescu).

[439] *Id*. at 3905:3-22 (Niculescu).

to purchase CDS protection from monolines in 2009. That absence of demand is consistent with the recognition that actual market participants were keenly aware of model risk by 2009 and unwilling to stake real money based on models, like Niculescu's, that had proven to be unreliable during the financial crisis.[440] The general concerns about modeling complex correlations discussed above were particularly pronounced in the context of CDS protection issued by monolines on highly-rated ABS because of "wrong-way" risk—the risk that it would take an economic meltdown even worse than the financial crisis for the ABS to experience significant losses and that the monoline would be unlikely to survive such a scenario (including because all the CDS it wrote would likely also suffer losses under such extreme circumstances). The absence of any consensus supporting use of Niculescu's model is demonstrated by the fact that Jon Gregory, a leading economic expert on CVA, concluded in August 2008, based on these modeling concerns, that the "traditional approach of assessing counterparty risk [for a monoline] is highly questionable."[441]

Finally, even if LBIE had proven that Assured's Loss calculation was unreasonable and that the Agreement required use of a model that calculates theoretical market prices for the terminated Transactions (and it has not), LBIE's claimed damages would be an unenforceable penalty because the hypothetical damages claim produced by Niculescu's model is speculative and counterfactual and bears no relation to the lack of any actual damages LBIE suffered. Accordingly, should the Court hold that LBIE has established it is entitled to damages, Assured reserves the right, consistent with the Court's ruling at trial, to submit evidence showing that the windfall LBIE seeks here is grossly disproportionate to its lack of actual damages because the

---

[440] *See supra* § V(A)(1).
[441] AX-50050 at 10 (2008 Jon Gregory article).

actual losses on the Transactions were in fact largely consistent with Assured's projections.[442]

IX. LBIE's Breach Entitles Assured To Recover Damages

LBIE's failure to pay the amounts it owes under the Agreement was a breach of LBIE's contractual obligations and entitles Assured to recover its damages. Assured is also entitled to recover the legal fees and costs that it incurred in enforcing its rights under the Agreement.

A. Assured Performed Its Obligations Under The 1992 ISDA

Assured performed all of its obligations as set forth in the Agreement. *First,* after LBIE defaulted, and Assured terminated the Agreement, Assured satisfied its obligations under the Market Quotation provision by holding an auction designed to secure firm bids from any interested party.[443] No party was interested.[444] This Court already concluded in its Summary Judgment decision dismissing LBIE's claim related to the auction that "LBIE fail[ed] to raise a triable issue of fact as to Assured's good faith in the design and execution of the Market Quotation auction."[445] *Second,* when the auction resulted in no bids, Assured again followed the Agreement and determined the Loss that it suffered as a result of LBIE's default and the termination of the Agreement. It did so by calculating its own "loss of bargain," one of the approaches that the Agreement expressly contemplates, and provided a reasonably detailed statement of calculations to LBIE showing how it made its calculations.[446]

B. LBIE's Breach Damaged Assured

LBIE breached the Agreement when it first entered bankruptcy and stopped paying

---

[442] *See Trs. of Columbia Univ. in the City of N.Y. v. D'Agostino Supermarkets, Inc*., 36 N.Y.3d 69, 71 (2020) (affirming lower court's decision that liquidated damages provision should be struck because damages sought were grossly disproportionate to the actual harm suffered due to the breach); *172 Van Duzer Realty Corp. v. Globe Alumni Student Assistance Ass'n, Inc.*, 24 N.Y.3d 528, 537 (2014) (reversing the trial court's judgment for barring defendant from presenting evidence showing that the damages award was disproportionate to plaintiff's actual losses).
[443] *See* D/O at *7; *see also supra* § III.F.
[444] *See* AX-60003 (Henderson Report).
[445] D/O at *7.
[446] *See supra* § VII; JX-34 (Statement of Calculations).

premiums, and then again when it failed to pay Assured the Termination Amount that Assured calculated. LBIE claims it was excused from making the payment because Assured did not calculate the Termination Amount reasonably and in good faith, but as shown at trial and explained above, LBIE has failed to meet its burden of proving this.[447] In addition, LBIE also breached the Agreement by failing to make payment of the unpaid premiums it owed to Assured with respect to the nine CDS that Assured terminated in December 2008. This Court dismissed LBIE's sole claim with respect to those transactions in 2013, and LBIE has not asserted any other basis to avoid payment. As a result, Assured is entitled to damages in the amount of $20,633,300.20, plus interest.[448]

C. Assured Is Entitled To Recover Its Legal Fees

Assured's second counterclaim is for recovery of its attorneys' fees, costs, and all other litigation expenses that it was forced to incur to protect its rights under the Agreement and defend against LBIE's claims.[449] Assured is entitled to recover these expenses pursuant to Section 11 of the 1992 ISDA Master Agreement, which provides that "A Defaulting Party will, on demand, indemnify and hold harmless the other party for and against all reasonable out-of-pocket expenses, including legal fees and Stamp Tax, incurred by such other party by reason of the enforcement and protection of its rights under this Agreement or any Credit Support Document to which the Defaulting Party is a party or by reason of the early termination of any Transaction, including, but not limited to, costs of collection."[450]

"Attorneys' fees provisions in ISDA Master Agreements are enforceable under New

---

[447] *See supra* §VIII.
[448] The Court has already ruled that "Plaintiff has to establish Assured's unreasonableness." (Feb. 28, 2022 Hr'g Tr. 5:13-14). However, even if LBIE were to argue that Assured has an obligation to prove the reasonableness of its Loss calculation in connection with its counterclaim, Assured has clearly met that burden for all of the reasons set forth above in § VII.
[449] Verified Answer to Pl.'s Compl. and Def.'s Countercls. ¶¶ 84-97, D.I. 37 (Apr. 22, 2013).
[450] JX-01 at 12-13 (1992 ISDA Master Agreement).

York law."[451] Courts routinely award Section 11 fees to the prevailing party in litigation concerning an ISDA Master Agreement.[452]

LBIE chose not to pay Assured the amounts owed under the Agreement and instead to file this lawsuit. LBIE, as the Defaulting Party, is obligated to indemnify Assured for the reasonable costs and fees incurred by Assured in connection with this litigation. Assured is prepared to provide the necessary calculations and information as the Court directs.

CONCLUSION

For the reasons set out above, the Court should enter judgment in favor of Assured.

---

[451] *Merrill Lynch Cap. Servs., Inc. v. UISA Fin.*, No. 09 CIV. 2324 (RJS), 2012 WL 1202034, at *24 (S.D.N.Y. Apr. 10, 2012), *aff'd*, 531 F. App'x 141 (2d Cir. 2013).

[452] *See Wachovia Bank, Nat'l. Ass'n v. VCG Special Opportunities Master Fund, Ltd.*, 518 F. App'x 44, 45 (2d Cir. 2013) (upholding award of Section 11 fees to the prevailing party); *D'Amico Dry D.A.C. v. Primera Mar. (Hellas) Ltd.*, 433 F. Supp. 3d 576, 578 (S.D.N.Y. 2019), *aff'd sub nom. d'Amico Dry d.a.c. v. Sonic Fin. Inc.*, 794 F. App'x 127 (2d Cir. 2020) (same, including post-judgment costs of collection); *CDO Plus Master Fund Ltd. v. Wachovia Bank, N.A.*, No. 07 CIV. 11078(LTS)(AJP), 2010 WL 3239416, at *5 (S.D.N.Y. Aug. 16, 2010) (same); *JPMorgan Chase Bank, N.A. v. Controladora Comercial Mexicana S.A.B. De C.V.*, No. 603215/08, 2010 WL 4868142 (Sup. Ct. N.Y. Cnty. Mar. 16, 2010) (same); *d'Amico Dry d.a.c. v. Nikka Fin., Inc.*, Civ. Action No. CV 1:18-00284-KD-MU, 2019 WL 2995922, at *3 (S.D. Ala. July 9, 2019) (same).

Dated: New York, New York

April 22, 2022

Respectfully submitted,

CLEARY GOTTLIEB STEEN & HAMILTON LLP

/s/ Roger A. Cooper

Lev L. Dassin
Roger A. Cooper
Rishi Zutshi
Lina Bensman
One Liberty Plaza
New York, New York 10006
T: 212-225-2000
F: 212-225-3999

Counsel to AG Financial Products Inc.