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

LEHMAN BROTHERS INTERNATIONAL (EUROPE) (in administration),

Plaintiff,

v.

AG FINANCIAL PRODUCTS, INC.,

Defendant.

Index No. 653284/2011
Justice Melissa A. Crane

PLAINTIFF'S POST-TRIAL RESPONSE BRIEF

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I. PRELIMINARY STATEMENT

Over the past thirty years, thousands of CDS counterparties have terminated hundreds of thousands of CDS trades using "Market Quotation" and "Second Method" with a fallback to "Loss," the standard and familiar ISDA Master Agreement provisions that apply in this case. As AGFP's Post-Trial Brief ("AGFP Br.") (Dkt. 779) makes clear, there is no evidence in the record that any of those parties used subjective, internal loss reserves to calculate the payment that was due on termination. Even though this Court ruled that this case will be decided based on whether AGFP's conduct was ***objectively*** reasonable, and even though the First Department set this case for trial so that the Court could hear evidence of industry norms, AGFP remains unable to identify a single example of any other market participant ever using a loss reserve methodology. Not one.

Instead, AGFP sets out to deny that industry norms even exist. Thousands of different counterparties trade trillions of dollars of CDS, and they do so using standard ISDA Master Agreements precisely because uniformity and predictability are so crucial to the market's function. AGFP asks the Court to ignore this evidence altogether. According to AGFP, it is of no consequence that it was the ***only*** counterparty that sold LBIE credit protection on asset-backed securities that claimed it was ***owed*** millions of dollars. Every other protection seller on such trades calculated a payment to LBIE consistent with market prices. AGFP stands alone among the thousands of parties that have terminated CDS trades and the hundreds that did so facing LBIE after September 2008. Its unprecedented actions are exactly what an objectively reasonable calculation is designed to avoid. A ruling in AGFP's favor would disrupt settled expectations in the CDS industry.

AGFP's brief offers a litany of excuses for its unjustifiable failure to follow standard market practice, and every excuse fails on the law and the record at trial:

- AGFP claims that the parties' CDS trades "were not on standard terms." AGFP Br. at 6, 58. ***This is false***. The two ABX trades, which account for the bulk of the parties' dispute, required the same types of floating payments from AGFP, at the same time, in the same form as any other ABX trades. Tr. 1494:9-21 (Niculescu), 4118:4-13 (Bruce). The timing and form of payments under the CLO/CDO trades also matched industry standards. Tr. 1494:22-1495:11 (Niculescu). And the sole difference between the UK RMBS trades and market-standard trades was in *when* losses would have to be paid, Tr. 1492:10-1493:18 (Niculescu), a distinction that no evidence or logic suggests would materially change the basis for calculating Loss. The evidence at trial, including AGFP's internal documents, *e.g.* LX170, established that the market practice for dealing with non-standard terms is to adjust mid-market prices[1] to account for deviations, not to discard market values altogether.

- AGFP claims that "LBIE failed to prove the existence of a uniform market practice of calculating Loss based on market prices." AGFP Br. at 44. ***This is false***. As LBIE documented extensively at trial and in Section IV of the LBIE Post-Trial Brief ("LBIE Br.") (Dkt. 777), hundreds of counterparties, including dozens of counterparties terminating the same types of CDS trades based on the same contract language after the same LBIE default, uniformly used market prices to calculate Loss. Tr. 457:6-458:21, 473:24-475:13, 481:3-495:4 (Viegas). And the evidence further establishes *why* this uniform practice emerged, *why* its consistent application is necessary to a functioning market, and *why* it is the only approach that accurately reflects the value of CDS trades.

- AGFP claims that LBIE's experts "admitted under cross-examination that they had either calculated Loss differently, or seen others do so." AGFP Br. at 47. ***This is false***. In every instance AGFP cites, LBIE's experts testified that (unlike in this case) no market prices were available to calculate Loss, and recounted the great lengths they went to in order to replicate market values even in the absence of observable prices. *See infra* Section II.C.3.

- AGFP claims that Dr. Niculescu's calculations did not account for "the reduction in the price a buyer would pay for uncollateralized CDS protection from a monoline." AGFP Br. at 71. ***This is false***. Even putting aside the well-established legal principle that an ISDA counterparty cannot discount its obligations based on the chance it will not pay them, *Peregrine Fixed Income Ltd. v. Robinson Dep't Store Public Co.* [2000] EWHC 99 (Comm) [30] [Eng.], Dr. Niculescu addressed this issue head-on in his credit valuation adjustment analysis, using a market-standard approach to account for collateral, Tr. 1517:7-1518:14 (Niculescu). And, as Dr. Niculescu showed, even when every CVA assumption is made in AGFP's favor, a CVA-adjusted valuation still leaves the transactions worth hundreds of millions of dollars to LBIE. Tr. 1520:16-1521:18 (Niculescu).

- AGFP claims that "extreme dislocation in the markets" in July 2009 supported its approach. AGFP Br. at 30. ***This is false***. Dr. Niculescu presented the only admissible, reliable, and on-point market analysis at trial, which showed definitively that the ABX

[1] In the CDS industry, a "mid-market price" represents the mid-point between the price at which a derivatives dealer is willing to buy (the "bid") and the price at which the dealer is willing to sell (the "offer"). Tr. 879:20-21 (Bruce).

market was ***not*** dislocated in July 2009. LDX06-21; Tr. 1440:20-1441:23 (Niculescu). AGFP's experts provided no analysis to the contrary; the hearsay papers they point to are based on stale data and fail to show market dislocation in July 2009. *See infra* Section III.C.2. And AGFP has not identified any support for its view that supposed market dislocation—the existence of which AGFP could not establish at trial—justifies abandoning efforts to identify market value. In fact, the principal case cited by AGFP acknowledges that ***even if*** there is a dislocated market, a model-based valuation is still intended to determine a ***sale price***. *See In re American Home Mortgage Holdings, Inc.*, 411 B.R. 181, 192 (Bankr. D. Del. 2009).

- AGFP claims that "there were no market prices for comparable derivatives." AGFP Br. at 58. ***This is false***. As discussed in Section III.A, pricing data was available for all of the trades at issue. In fact, AGFP used this same data to determine that the 28 trades were worth $438 million in LBIE's favor as of June 30, 2009. LX170 (Tab "Q2 2009").

- AGFP claims that its affiliate, monoline insurer AGC, "was the real party in interest." AGFP Br. at 4. ***This is false***. AGFP, which is not an insurance company, is LBIE's counterparty in the governing contract and is the defendant in this case. JX-2 at 47; Dkt. 1. AGFP's attempt to conflate its identity with that of AGC, referring to them collectively as "Assured" throughout its brief, AGFP Br. at 4 n. 4, disregards legal significance of the two entities. The very reason for AGFP's existence is to participate in the CDS market, something AGC was prohibited from doing itself. Tr. 2032:10-2033:20 (Schozer); Tr. 1820:21-1821:9 (Adamidou); LX169 at 9, 17. AGFP entered the CDS industry to increase its revenues and profits; it cannot now disclaim the norms and standards of the industry by pointing to its corporate affiliations.

- AGFP claims its approach is "consistent with New York law on damages." AGFP Br. at 40. ***This is false***. New York law on damages requires using market values, not subjective views. *White v. Farrell*, 20 N.Y.3d 487, 494-96 (2013). This is specifically true in the case of calculating termination payments for CDS trades, both under New York law, *UBS Secs. LLC v. Highland Capital Mgmt., L.P.*, No. 50097/2009, NYSCEF Dkt. No. 641 at 20-21 (Sup. Ct. N.Y. Cty. Nov. 14, 2009), and under the law of other jurisdictions that have interpreted the same ISDA contracts, *Anthracite Rated Invs. (Jersey) Ltd. v. Lehman Bros. Finance S.A.*, [2011] EWHC 1822 [116-18] (Ch) [Eng.]. These decisions explain *why* objective market prices accurately reflect value: because financial instruments are bought and sold at a neutral midpoint, which reflects objective market consensus on the future value of the instrument. This is particularly vital for CDS trades subject to the two-way "Second Method" provision, which entitles the in-the-money party to the market value of the trades regardless of which party defaulted.

- AGFP claims that it "would have consented to … a novation 'very quickly.'" AGFP Br. at 15. ***This is false***. AGFP never committed to any novation and never participated in the search for a novation it claims to have wanted. Tr. 524:7-14, Tr. 525:21-526:9, 529:13-25, 544:14-18 (Viegas). Moreover, at trial AGFP successfully persuaded the Court to limit its inquiry into the possibility of a novation to an artificially truncated time period ending in April 2009. That cutoff date excluded evidence from immediately prior to the Early Termination Date showing that AGFP would not consent to a novation without material

amendments to the terms of the trades. Tr. 2452:4-2463:9; *see also* Dkt. 750 (Order on Motion 19). AGFP has opened the door to that evidence by expanding the relevant time period in its briefing, and the Court now can—indeed, must—consider the evidence demonstrating that AGFP actively frustrated LBIE's attempts to novate the trades.

- AGFP claims that the reason it did not enter new CDS trades on asset-backed securities in 2009 was that there was "no interest from counterparties." AGFP Br. at 19. ***This is false***. Trial established that the actual reason AGFP did not enter into such trades was that it was desperately seeking to reduce its exposure to these assets, even imposing risk limits that effectively prohibited it from replacing the LBIE trades. LX226; Tr. 1066:10-1070:25 (Bruce); 2362:19-2366:7 (Schozer). AGFP entered into no new CDS trades on asset-backed securities during this period and there is no evidence it even attempted to do so.

- AGFP claims that the September 2009 auction did not result in any bids because the CDS trades lacked "any value." AGFP Br. at 23. ***This is false***. The uncontradicted testimony at trial, from every witness who had ever participated in a Market Quotation process, was that the auction would have been recognizable to participants as a pricing exercise rather than a bona fide attempt to execute replacement trades. *See* Tr. 4213:2-14 (Bruce); Tr. 90:8-92:19 (Rahl); Tr. 1772:15-1773:8 (Niculescu); Tr. 2801:14-2802:6 (Cohn). The evidence established that such processes routinely failed, even for liquid instruments of undeniable value. In fact, if AGFP's interpretation of the auction result were correct, the Court would be required to reject AGFP's counterclaim: if the absence of any bid to pay to take LBIE's position indicated the CDS trades had no value to LBIE, the absence of any bid to take that same position in exchange for *being paid*—something bidders were expressly permitted to request (*see* AX-6003 at 31)—would also indicate the CDS trades had no value *to AGFP*.

- AGFP claims that LBIE "recognize[d] the Transactions ha[d] limited value to it." AGFP Br. at 12. ***This is false***. AGFP relies upon a hearsay document that was written nearly a year before AGFP terminated the trades, and which the Court previously discarded as having "little utility" since it simply represents the "impressions" of one of LBIE's former employees. Tr. 616:1-7 (Viegas). Further, AGFP's statement is belied by LBIE's repeated attempts to novate the trades—efforts stymied by AGFP—which would have realized the substantial value of these trades. Tr. 537:14-538:3, 541:23-542:18 (Viegas).

- AGFP claims that it provided "analysis" at trial that "showed there were no expected losses on 26 of the Transactions." AGFP Br. at 24. ***This is false***. No AGFP witness could or did testify competently about any of this purported "analysis," all of which was supposedly performed by non-witnesses, using models and systems that were never explained at trial. LBIE Br. at Sections II.G, V.A. For nearly all of these 26 CDS trades, AGFP never even attempted to introduce evidence of any analysis at trial, a fatal failure of proof that AGFP then tried but failed to paper over. Feb. 28, 2022 Hrg. Tr. 23:6-8 (excluding from evidence documents that AGFP sought to introduce after trial).

- AGFP claims that it employed a "rigorous process" for "projecting future losses." AGFP Br. at 1. ***This is false***. As LBIE showed in Section V.B of its Brief, AGFP's assumptions about future losses on the ABX trades—the only two trades for which AGFP provided any

evidence allowing the Court to examine its "rigorous process"—could not be rationalized even by rosy projections for the housing market and contradicted available data on the three primary drivers of value: defaults, loss severities, and prepayments. LBIE Br. at 48-61. At trial, AGFP's witnesses could not point to *any* relevant support for its assumptions about the future, instead pointing to sources like recollections of never-produced studies commissioned by other monolines in 2008 or non-testifying employees' supposed memories of housing prices in 2001, which bore no resemblance to the severity of the housing crisis at the relevant time. LBIE Br. at 58-60.

- AGFP claims that its subjective assumptions about the future "were consistent with those made by other market participants who engaged in similar analysis," and that it presented "extensive evidence at trial showing the reliability of [its] modeling," AGFP Br. at 26. ***This is false***. AGFP's subjective assumptions generated losses between $83 million and $224 million lower than the losses implied by the ratings agencies, which were acknowledged (including by AGFP and its experts) to have been too slow to recognize the scale of the financial crisis and too optimistic in their expectations for a recovery, and as much as $315 million lower than the losses projected by the bank research desks that were seen as the leading and most sophisticated analysts by market participants at the time. *See* LDX06-20; LDX10-6.

- AGFP claims that awarding LBIE the trades' market value "would generate an unjustified windfall." AGFP Br. at 3. ***This is false***. LBIE has been in administration since 2008, and the uncontradicted evidence at trial established that the administration's goal has always been to treat its creditors and debtors fairly, which required collecting payments when it was a buyer of protection and paying out when it was a seller. *See* LX92. If LBIE is unable to collect the value of these trades from AGFP, having honored its obligations to make payments as a protection seller on the same types of CDS trades with other counterparties, it will suffer a huge net loss. In fact it is AGFP, not LBIE, that seeks a windfall by terminating billions of dollars of risk—risk that exceeded AGFP's risk limits and which it sought to exit anywhere it could—and then demanding to be paid for terminating the trades that created this enormous risk. *See* Section V, *infra*. AGFP's claim that trades designed to protect LBIE against a decline in the value of the underlying securities ***moved in AGFP's favor*** in the midst of a once in a generation financial crises driven by declines in those same protected securities defies common sense and logic.

These shortcomings at trial, and others detailed in LBIE's Post-Trial Brief and below, show that AGFP did not act objectively reasonably when, in the middle of a once in a generation financial crisis, it valued 28 CDS trades that had undisputedly become materially more likely to require payment as assets. The evidence showed that LBIE, not AGFP, was in-the-money on these CDS trades when AGFP chose to terminate them. Under an objectively reasonable approach to Loss, AGFP owes LBIE $485 million based on market prices as of the Early Termination Date.

II. AN OBJECTIVELY REASONABLE CALCULATION OF LOSS MUST BE CONSISTENT WITH MARKET PRICES OR MARKET DATA

AGFP's brief makes clear that its fundamental request is for the Court to ignore how every prior calculation of a termination payment for a CDS trade has unfolded. In its legal arguments and its descriptions of the evidence, AGFP seeks to avoid being held to *any* standard, much less the objective reasonableness standard set forth by this Court and the First Department. AGFP is wrong on both the law and the facts, as trial established that a uniform market practice requires valuing terminated CDS trades consistent with available market prices or other market data.

A. The Court Has Already Ruled That The Objective Reasonableness Standard Requires Considering More Than AGFP's Subjective Views

It is law of the case "that an objective standard of reasonableness applies to a contractual provision requiring performance of an obligation in a reasonable manner," including the ISDA Master Agreement's definition of Loss. Dkt. 156 ("SJ Decision") at 22. AGFP claims that this standard asks "whether the actions taken by [AGFP] are consistent with what a reasonable Non-defaulting Party in [AGFP's] position would have done in light of the facts and circumstances facing [AGFP] at the time." AGFP Br. at 39. But AGFP has repeatedly argued that its "position" and the "facts and circumstances" facing it are unique to AGFP. *See, e.g.*, *id*. at 1 (referencing a "monoline" business model), 6 (referencing "bespoke" trade terms), 55 (referencing both). AGFP's attempt to turn an objective standard into a subjective one, informed only by AGFP's own concerns, purposes, and analyses, must fail. An objective standard reflects what a market participant without AGFP's idiosyncratic and subjective views would do—that is exactly what makes it objective. The Court previously rejected AGFP's attempt to argue for a more lenient standard of review, and should do so again. *See* SJ Decision at 26 n.12.

Both this Court and the First Department have been clear that the objective standard of reasonableness in this case requires consideration of practices in the CDS industry. The "market

practice evidence" that Justice Friedman cited in denying AGFP's request for summary judgment on the reasonableness of its Loss calculation expressly included the opinions of LBIE's experts (including specifically Ms. Rahl's description of and opinions regarding the framework by which Lehman counterparties settled thousands of terminated CDS trades), as well as Mr. Viegas's evidence regarding how other LBIE counterparties closed out similar trades, which was presented at trial in LX92. SJ Decision at 26-29. Given Justice Friedman's ruling that this evidence was relevant to show "a uniform or highly consistent practice of calculating Loss in a particular manner under similar circumstances," *id*. at 28, AGFP cannot now be heard to argue that the very same evidence is insufficiently "similar" to its own circumstances to warrant consideration. AGFP participated in the CDS industry under a uniformly used industry-wide contract, and it is that industry's norms—not insurance industry norms—that determine whether AGFP's Loss calculation was objectively reasonable.

B. AGFP Fails To Refute The Extensive Legal Precedent Requiring Loss And Damages To Be Calculated Using Available Market Prices Or Data

As LBIE demonstrated in Section III.B of its brief, New York courts have long recognized that where a breach "involves the deprivation of an item with a determinable market value, the market value at the time of the breach is the measure of damages." *Sharma v. Skaarup Ship Mgmt. Corp.*, 916 F.2d 820, 825 (2d Cir. 1990); *see also* *White*, 20 N.Y.3d at 494 ("'[T]he generally accepted measure of damages [for loss of bargain] is the difference between the contract price and the fair market value of the property at the time of the breach.'") (quoting 25 Williston on Contracts § 66:80 (4th ed.)).

In accord with this principle, courts interpreting the ISDA Master Agreement have regularly held that a calculation of Loss should be based on a market valuation. See *Lehman Bros. Special Financing Inc. v. Bank of Am., N.A.*, 553 B.R. 476, 485 (Bankr. S.D.N.Y. 2016) (Chapman,

J.) ("[A] termination payment is calculated using the mark-to-market value of the parties' swap positions, as calculated under Loss and using Second Method, meaning that a termination payment would be calculated based on the value of the Swap parties' positions at the time of the Early Termination Date.");[2] *The High Risk Opportunities Hub Fund Ltd. v. Lyonnais*, 2005 WL 6234513, *8 (N.Y. Sup. Ct. July 06, 2005) (determining Loss using the parties' internal market-based value for the trades); *Anthracite*, [2011] EWHC 1822 (Ch) [117] (when determining Loss, "the cost of … a replacement contract as at the breach date is likely to prove the most reliable yardstick for measuring the claimant's loss of bargain"); *Barclays Bank PLC v. Devonshire Trust*, [2013] ONCA 494 (Can Ont CA) ¶ 283 (holding that Loss should reflect "the cost of purchasing credit protection"); *Australia & New Zealand Banking Group Ltd. v. Société Générale*, [2000] CLC 833 (CA) [22] [Eng.] ("it is common ground that the Loss and Market Quotation bases aim at broadly similar results"); *Lehman Brothers Finance, S.A. v. Sal. Oppenheim Jr. & CIE. KGAA*, [2014] EWHC 2627 (Comm) [45] (where markets were closed on the Early Termination Date, determining Loss using the "replacement cost" of the transactions on the next trading day).

AGFP fails to refute the longstanding principle that damages should be assessed based on market pricing. Instead, AGFP cites cases that ***actually support LBIE's position***. AGFP primarily relies on *In re American Home Mortgage Holdings, Inc.*, 411 B.R. 181 (Bankr. D. Del. 2009) for the proposition that in a dysfunctional market, a discounted cash flow valuation is appropriate.

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[2] AGFP cites *Lehman Bros. Holdings Inc. v. Intel Corp.* for the proposition that Loss provides the Non-Defaulting Party with discretion to calculate Loss without reference to market prices. AGFP Br. at 41-42. But *Intel* is distinguishable, since i) it involved Lehman's failure to deliver securities and not a CDS trade termination, ii) Intel was seeking restitution-based damages, and iii) the ISDA Agreement in that case did not select Market Quotation as the primary calculation methodology. *In re Lehman Bros. Holdings Inc.*, 2015 WL 7194609, at *6, 8, 22-23 (Bankr. S.D.N.Y. Sept. 16, 2015). Moreover, Judge Chapman, who decided *Intel*, later recognized in *Bank of America* that a Loss calculation for terminated CDS based on loss of bargain rather than restitution *should* be based on mark-to-market value. *Bank of America*, 553 B.R. at 485.

AGFP Br. at 41 n. 276. But AGFP fails to mentions that the court in that case went on to hold that regardless of whether the market in question was functional, "***[e]very valuation methodology has as its goal the determination of value***, which, by definition, means ***the sale price of the asset***." 411 B.R. at 192 (emphasis added). The court also observed:

> Financial professionals have established a variety of methodologies to determine the value of assets that are not readily valued by reference to a market. These include, among others, the [discounted cash flow] analysis, the comparable company analysis and the comparable transaction analysis. ***No matter which methodology is used the purpose remains the same—to determine as accurately as possible what the sale price would be, i.e., price discovery***.

Id. (emphasis added). This stands in stark contrast to AGFP's methodology, which it admits was ***not*** intended to determine the sale price of the CDS. *See* Tr. 2524:14-16 (Schozer) (AGFP did not use observable market data for its internal model); Tr. 1088:4-1091:25, 1097:16-1098:21 (Rosenblum). Instead, AGFP used its self-serving assumptions to determine an entirely subjective loss reserve valuation designed to predict what the transaction would be worth if held to maturity many years in the future and totally at odds with market pricing on the day of termination.

AGFP cites *NECA-IBEW Health & Welfare Fund v. Goldman Sachs & Co*., 693 F.3d 145 (2d Cir. 2012) for the proposition that the price of a security and its value are not equivalent. AGFP Br. at 41 n. 276. But this case involves Section 11 of the Securities Act, and in particular the statutory meaning of "price" and "value" under the damages provision of 15 U.S.C. § 77k(e). 693 F.3d at 165. It has nothing to do with the valuation of CDS under an ISDA Agreement. That said, the case is not helpful for AGFP. The court notes that "valuing illiquid assets is an important (and routine) activity for asset managers, an activity typically guided by Statement 157 of the Financial Accounting Standards Board ('FAS 157')." *Id.* at 167. The court described the valuation inputs in FAS 157:

> Under the "fair value hierarchy" established by FAS 157, ***the highest priority "input" for valuing assets and liabilities is quoted prices in active markets for***

> ***identical assets or liabilities***. FAS 157 at 12. If such "Level 1" inputs are not available, "Level 2" inputs, such as quoted prices for similar assets or liabilities in active markets, should be used. Id. at 12–15. And if "Level 2" inputs are not available—such as when there is "little, if any, market activity for the asset or liability at the measurement date"—"unobservable" "Level 3" inputs, such as model assumptions that take market participant assumptions into account, should be used. Id. at 15.

NECA-IBEW, 693 F.3d at 167 n. 16 (emphasis added). This hierarchy is nearly identical to the "hierarchy of inputs" described by Mr. Bruce at trial. . LDX04-7; Tr. 867:11-869:10. As Mr. Bruce demonstrated, Level 1 or Level 2 inputs were available in July 2009 for *all* of the CDS trades at issue. Tr. 899:7-18, 900:18-902:9, 907:13-910:4 (Bruce). There was no justification for AGFP to resort to a Level 3 (or worse) valuation methodology.

Market Prices for Same or Similar Transactions Were Available to AGFP in July 2009

Level		ABX	CDS on UK RMBS	CDS on CLOs
1	**Market Price of Instrument**	• Observable prices • **Dealer runs** • **Markit end-of-day composites**	• Observable prices • **Markit mid-market spreads for same CDS**	• Observable prices
2	**Market Price of Similar Instrument**	• Observable prices of constituent CDS or RMBS	• Observable prices of similar CDS or same/similar reference RMBS • **Markit mid-market spreads for nearly identical CDS**	• **Observable prices of similar CDS or same/similar reference CLOs** • **Benchmark CLO Indices (e.g., JPMorgan)**
3a	**Market Assumption-Based Model**	• Model with market inputs	• Model with market inputs	• Model with market inputs
3b	**Non-Market Assumption-Based Model**	• Model with non-market inputs	• Model with non-market inputs	• Model with non-market inputs

JX-040-0011—JX-040-0016 (Bruce Rpt. ¶¶ 38-58)

LDX04-9

LDX04-9; Tr. 912:17-914:7 (Bruce).

AGFP also cites *Beecher v. Able*, 435 F. Supp. 397 (S.D.N.Y. 1975), a forty-seven-year-old Section 11 case that predates the CDS market and the ISDA Agreement. There, the court acknowledged a potential difference between "realistic value" and "market price" for corporate

debentures "where the public is either misinformed or uninformed about important factors relating to the [corporation's] well being." *Id.* at 404. Here, AGFP did not establish that the public or the derivatives market was "misinformed or uninformed" about the CDS contracts at issue in 2009, such that the market price would be unreliable. Moreover, the court in *Beecher* determined that the market price *did* in fact reflect realistic value, and used it "as a starting point" in valuing the debentures. *Id.* at 405-406. AGFP, by contrast, disregarded market prices entirely. Like the rest of AGFP's cited cases,[3] this case does not refute, but instead supports, the extensive body of case law holding that market prices are the proper measure of damages and Loss.

C. AGFP Fails To Refute The Existence Of A Uniform Industry Practice Of Calculating Loss Using Available Market Prices Or Data

Section IV.A of LBIE's Post-Trial Brief collected the overwhelming evidence that the settled norm, practice, and expectation in the CDS industry—and therefore, under New York law, the objectively reasonable approach—was to determine Loss by reference to available market prices or other market data. *See* LBIE Br. at 29-39. This evidence included testimony from every witness at trial that had previously valued a CDS trade or calculated Loss;[4] testimony regarding how dozens of counterparties valued terminated CDS after LBIE's default;[5] documentation from terminations of asset-backed CDS trades facing LBIE and other Lehman entities;[6] industry

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[3] AGFP also relies upon two *Daubert* decisions, both of which—to the extent they are even relevant—support LBIE's case. AGFP Br. at 41 n. 277; *see National Credit Union Admin. Board v. UBS Securities, LLC*, 2016 WL 7496106 at *5 (D. Kan. Dec. 30, 2016) (holding that a security may have value even where "it trades in an illiquid market"); *Fort Worth Employees' Ret. Fund v. J.P. Morgan Chase & Co.*, 301 F.R.D. 116, 130 (S.D.N.Y. 2014) (holding that the use of market prices or third-party pricing benchmarks is standard industry practice in securities valuation).

[4] *E.g.*, Tr. 98:2-99:18, 122:2-123:1 (Rahl); Tr. 866:3-9; 971:15-17 (Bruce); Tr. 1812:18-24, 1829:4-1829:6, 1832:16-1833:6 (Adamidou); Tr. 1533:13-1534:2 (Niculescu).

[5] *E.g.*, Tr. 443:14-20, 457:6-458:21, 473:24-475:13, 481:3-495:4, 565:2-566:6 (Viegas).

[6] *E.g.*, LX92; LX35 at 11-12, 42; Tr. 1463:18-1464:19 (Niculescu).

publications, including those authored by AGFP's own witnesses;[7] and even AGC's SEC filings.[8]

For years, AGFP has sought to exclude all of this evidence, and for years both this Court and the First Department have rejected the attempt. At summary judgment, AGFP argued that LBIE's evidence could not show industry practice, and Justice Friedman rejected the argument. SJ Decision at 18-22, 24-28. On appeal, AGFP argued the same, and the First Department rejected the argument. Dkt. 354. Moving *in limine* before the trial, AGFP argued the same thing again, and this Court rejected the argument. Dkt. 745. It is the law of the case that LBIE's proffered evidence is admissible evidence of commercially reasonable practices in the derivatives industry.

Now, after trial and after failing to exclude this evidence, AGFP dedicates much of its brief to criticizing it. As discussed below, AGFP has no *alternative* evidence suggesting that any industry participant ever relied on a loss reserve model to calculate Loss for a terminated CDS trade. But even setting aside the absence of any affirmative support for AGFP's conduct, AGFP's critiques fail to dislodge the industry consensus that LBIE repeatedly established at trial.

1. The "Fixed And Invariable" Standard Does Not Apply—Yet LBIE Met This Standard Regardless

As a preliminary matter, AGFP is simply wrong when it improperly asks the Court to ignore evidence of market practice unless the Court finds it to be "fixed and invariable in the industry." AGFP Br. at 44. While the evidence of industry norms set forth at trial, in Section IV.A of LBIE's post-trial brief, and below meets that standard, AGFP's request is wrong as a matter of law. AGFP sources this standard from *Law Debenture Trust Co. v. Maverick Tube Corp.*, 595 F.3d 458 (2d Cir. 2010), which does not address identifying industry norms for the purpose of evaluating objective reasonableness, but instead relates to circumstances in which contractual

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[7] *E.g.*, Tr. 2779:25-2780:16 (Cohn); JX-64 at 137.

[8] *E.g.*, JX-57 at 58; LX169 at 6-7; LX159 at 3.

language is ambiguous because "the parties have used terms that are specialized," words that "convey no meaning to those who are not initiated into the mysteries of the craft." *Id*. at 466; *see also id*. at 469 (dispute over meaning of "common stock"). *Law Debenture* is inapposite, because this case does not require interpretation of an ambiguous contract term, as AGFP itself has conceded. *See, e.g.*, Hearing Tr. Feb. 28, 2022 at 82:5-23 (Court asking whether "you think [the contract] is ambiguous," and Mr. Zutshi answering "We do not, your Honor."); *see also* 79:3-16.

Contrary to AGFP's suggestion, LBIE has not presented evidence of industry practice in order to modify the terms of the ISDA Master Agreement, but rather to provide necessary context to the standard of objective reasonableness against which AGFP's conduct must be judged. In her summary judgment decision, Justice Friedman expressly noted the difference between using custom and practice evidence to resolve an ambiguity in the meaning of words (which is subject to the "fixed and invariable" standard) and using evidence of industry norms to measure the objective reasonableness of a party's conduct (which is not). SJ Decision at 23 (citing *Hoag v. Chancellor*, 246 A.D.2d 224, 230-31 (1st Dep't 1998)). The First Department cited the exact same authority in affirming Justice Friedman. Dkt. 354. AGFP's argument that evidence cannot be considered for the purposes of measuring objective reasonableness unless it varies the meaning of specialized terms in a contract is contrary to the specifically-affirmed law of the case.

2. LBIE's Other Counterparties Calculated Loss Consistent With Market Prices

At trial, LBIE presented first-hand factual evidence demonstrating that market practice was to value terminated CDS trades using available market prices or market data. This proof came in the form of direct evidence showing that LBIE's counterparties on the types of CDS at issue here valued those trades consistent with market prices. *See* LX92. In addition, all of the major players in the CDS market looked to market prices when valuing their trades facing Lehman's US

affiliates. *See* LX35. It is nearly impossible to imagine more on-point evidence of how participants in the industry acted in the exact situation facing LBIE and AGFP on the 28 trades at issue. Justice Friedman acknowledged this fact when concluding that this very evidence could show "a uniform or highly consistent practice of calculating Loss in a particular manner under similar circumstances." SJ Decision at 28; *see id*. (specifically relying on the evidence contained in LX92); *id*. at 27-28 (same as to evidence contained in LX35). AGFP's demand that this Court disregard all of this directly probative evidence must be rejected.

The evidence in LX92 reflects the termination payments that 76 different counterparties[9] submitted to LBIE to terminate 606 CDS trades referencing asset-backed securities, just like the trades at issue here. Whether they were net sellers or net buyers of credit protection from LBIE, and whatever their business model or subjective views about the future, *all* of these dozens of counterparties recognized that a termination value should reflect and approximate market price.[10] This is clear evidence that these counterparties shared the same consensus view as LBIE's witnesses—that Loss should reflect a mark-to-market valuation.

Of LBIE's counterparties with CDS on ABS positions, AGFP is the only one to have calculated a net payment to itself where it was the seller of protection. LX92; LBIE Br. at 29-31. Even for the two trades where AGFP correctly recognized that it owed money—the ABX trades—the magnitude of AGFP's deviation from market practice was unprecedented. For 171 ABX trades terminated by LBIE's other counterparties, LBIE and its counterparties differed by less than 1% in their calculation of the amount owed by the seller of protection ($992 million versus $986

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[9] Notably, LBIE's other monoline-affiliated counterparty, FGIC, does not appear on the spreadsheet because FGIC successfully negotiated a "walk-away" provision that allowed it to terminate its LBIE trades without calculating a termination payment. Tr. 501:1-502:3 (Viegas).

[10] Tr. 457:6-458:21, 473:24-475:13, 481:3-495:4 (Viegas); LX92 (Tab "Ctpy Values").

million).[11] By comparison, there is a whopping 93% difference between LBIE's market-based value of the ABX trades in this case ($328 million) and AGFP's reserve-based valuation of those same trades ($24 million). LDX04-13, LDX06-26 to 27. AGFP was an extreme outlier amongst LBIE's counterparties in its failure to determine Loss consistent with market prices.

AGFP's attempts to distinguish the hundreds of trades in LX92 on the basis of trade characteristics fail both factually and legally for the reasons discussed in Section III.C, *infra*, and its other critiques are confused. LX92 has a *trade-by-trade* valuation at termination assigned by the determining, Non-defaulting Party, and it is offered for that purpose; any other details about a "larger resolution" between LBIE and the counterparties was excluded at trial *at AGFP's insistence*. Tr. 413:3-414:9; 421:2-13; 430:19-433:25 (Viegas) (explaining that the minimal content in LX92 arguably related to dispute resolution was redacted in response to AGFP's objections). And while AGFP claims that "there is no evidence of what calculation methodology was used for any transaction," AGFP Br. at 56, the actual evidence is the opposite: LX92 lists the contractual methodology the counterparty applied for every trade. *See* LX92 Tab "Ctyp Values," Col. N & O). The consistently minor differences between counterparty's values, however derived, (Col. I) and LBIE's mark-to-market values (Col. J) are decisive evidence of uniform practice in terminating CDS trades using and by reference to market prices.

Likewise, LX35, the Lehman Derivatives Claims Settlement Framework, adopts a valuation procedure for terminated derivative trades "starting with the mid-market price" and then "allow[ing] for a set of standardized bid offer adjustments, depending on the type of instrument being examined." Tr. 946:19-947:11 (Bruce). Crucially, every witness questioned about LX35

[11] LX92 at tab "Ctpy Values," column H filtered for "ABX". This analysis compares the amounts owed by protection sellers in column I (counterparty valuation) versus the amounts in column J (LBIE valuation).

agreed that it did not represent a novel approach to valuing CDS, but instead reflected ***pre-existing*** market practice. *See* Tr. 947:12-16 (Bruce) ("[T]he settlement framework follows my opinion of market practice, that is you start with the mid-market value of the instrument concerned."); Tr. 1463:18-1464:19 (Niculescu) (recognizing the adjustments in the framework as "the market standard"). How other participants in the CDS industry agreed to value terminated trades after Lehman's default is, of course, evidence of the industry norms that were in place when AGFP calculated Loss after terminating its own trades following the same default (and indeed long before that termination).[12] Here, AGFP determined the mid-market value to be $438 million on June 30, 2009, broadly consistent with LBIE's determination of $498 million on July 23, 2009, but unlike any other counterparty AGFP disregarded this mid-market value in favor of a highly subjective reserve calculation that was massively favorable to it. LX170 (Tab "Q2 2009); LDX06-48.

3. Expert Testimony Established That Loss Should Be Consistent With Available Market Prices

At trial, LBIE's expert witnesses testified that the market practices reflected in LX92 and LX35 were entirely consistent with industry practices generally. AGFP's claim that those witnesses took contrary positions in prior work is based on a mischaracterization of both the norms at issue and the facts of this and prior cases. In each of the examples AGFP highlights, LBIE's experts sought to approximate the replacement value of CDS trades for which no market prices were available, not even for closely-related instruments. As explained below, LBIE's experts

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[12] Dr. Niculescu testified that LX35, the derivatives framework, was used across the derivatives industry (not solely by "big banks") and reflected market practice as of Lehman's default (not as of 2011). Tr. 1463:20-23 (Niculescu) ("[T]he derivatives claim framework … was a public document that, in my experience, was referred to many times certainly by virtually all of my clients in the post-2008 period."); Tr. 1464:9-19 ("[I]t was a very diligent effort put together by well-informed people in late 2008/2009 time frame, it became public, it was used uniformly, in my experience, so there was an element of equity in everybody using it.").

testified that in each such instance (i) comparable market prices were unavailable (which is not true in this case and inconsistent with AGFP's own ability to calculate the mid-market value); (ii) the experts used neutral, third-party projections rather than one party's subjective assumptions (which is not what AGFP did in this case); and (iii) the goal of their cash flow modeling was to approximate an unobservable market value (which AGFP concedes was not its goal here).

Far from vindicating AGFP, the *Devonshire* case reveals the strength of the industry expectation that CDS trades are terminated based on market values at the time of termination. As reflected in the Court of Appeal for Ontario's decision, *Barclays Bank PLC v. Devonshire Trust*, [2013] ONCA 494 (Can Ont CA)[13], and as Ms. Rahl testified, the *Devonshire* case arose where two CDS counterparties agreed to a "seventeen-month standstill" on their CDS trades, then both sought to terminate the trades. Tr. 248:5-18 (Rahl); *Devonshire*, [2013] ONCA 494 ¶¶ 53-58, 65-77. During that standstill, "liquidity calls, collateral calls, and stop-loss features were suspended," but if they had been active then those features would have "effectively capped the real value of the CDSs to Barclays on termination at the amount of the posted collateral in place at any particular time." [2013] ONCA 494 ¶¶ 270-71. In these unique circumstances, the court ruled, it was neither "in good faith" nor "a commercially reasonable result" to value the CDS in the markets at the *end* of the standstill, when they would have terminated far earlier, and on far more favorable terms, but for the standstill. *Id.* ¶ 268.

Despite those unique and non-comparable circumstances in *Devonshire*, when Ms. Rahl valued Loss using, among other things, a discounted cash flow projection, she did not rely on one party's subjective views about the future, as AGFP suggests. Instead, she calculated expected losses based on projections from "independent third-parties." Tr. 105:1-106:1 (Rahl). Moreover,

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[13] *Available at* www.ontariocourts.ca/decisions/2013/2013ONCA0494.pdf.

although these independent projections suggested only $12,000 in expected future payments from her client for realized losses, Ms. Rahl added $254 million in risk premium to her valuation, "which is what you have to do to get a market price." *Id.*[14]

After the trial court valued the CDS using only the $12,000 expected loss figure, ignoring the $254 million in risk premium, the Court of Appeal for Ontario reversed this ruling, holding that it "demonstrated a misunderstanding of the loss of bargain component of Loss." [2013] ONCA 494 ¶ 282. In words that equally describe AGFP's methodology, the appellate court held that "by rejecting the normalized risk premium component of Ms. Rahl's opinion, the trial judge valued the likely loss to be suffered in the underlying portfolios; he did not value the loss of bargain in relation to the CDS." *Id.* ¶ 283. *Devonshire* thus stands for the proposition that even where a standstill requires a Loss calculation to factor in conditions prior to termination, the purpose of calculating Loss is still to find not "the likely loss to be suffered," but instead "the loss of bargain in relation to the CDS," *id.*, which requires using third-party inputs in any cash flow projection and adding a market-derived risk premium "to get a market price." Tr. 105:1-106:1 (Rahl).

The same is true for Dr. Niculescu's calculations in the Solstice matter, which "relate[d] to a market price" "as closely as [he] could make them." Tr. 1767:1-1768:15 (Niculescu). In that case, unlike this one, "[t]here were no market prices available," even on related instruments. *Id.* Even still, Dr. Niculescu did not rely on his own (or his client's) subjective assumptions about the future but instead "project[ed] the performance … using the assumptions that other market participants were making." *Id.*; *see also* Tr. 1727:14-1728:8 (Niculescu) (explaining that he has

[14] "Risk premium" is the difference between the risk-free rate of return (assuming the investment will perform exactly as predicted) and the expected rate of return (based on market participants 'risk-based valuation). *See, e.g.*, James Chen, *Market Risk Premium*, Investopedia (May 30, 2022) *available at* https://www.investopedia.com/terms/m/marketriskpremium.asp.

used forecasting when "you have absolutely no market data available"; then "you have no option; you have to forecast using market assumptions and you have to discount back using a relevant market risky discount rate. That would be a Level-3-style valuation."). Had AGFP likewise incorporated the assumptions of leading market participants, it would have valued just the two ABX trades alone at more than $288 million in LBIE's favor. LDX06-21. Like *Devonshire*, the Solstice matter illustrates the lengths to which market participants will go to calculate a market price even where one is not immediately observable, and neither case provides any support for a party using its own subjective assumptions about the future as the basis for a termination payment.

Mr. Bruce's experience with Ambac also supports LBIE and contradicts AGFP. During the Ambac settlement, the parties recognized that in the event of an ISDA termination the "mark-to-market" value of the trades would be used. AX50039 at 33. Ambac's CDS on CDO trades were valued using a cash-flow model because ***market prices for the trades were unavailable***; CDOs were no longer trading. Tr. 935:10-16 (Bruce).[15] As Mr. Bruce explained when discussing the "hierarchy of inputs" for derivatives valuation, model-based pricing is permissible *only if* better sources of value, such as market prices for the same or similar instruments, are not available, and model-based values must still use assumptions consistent with market participant expectations.

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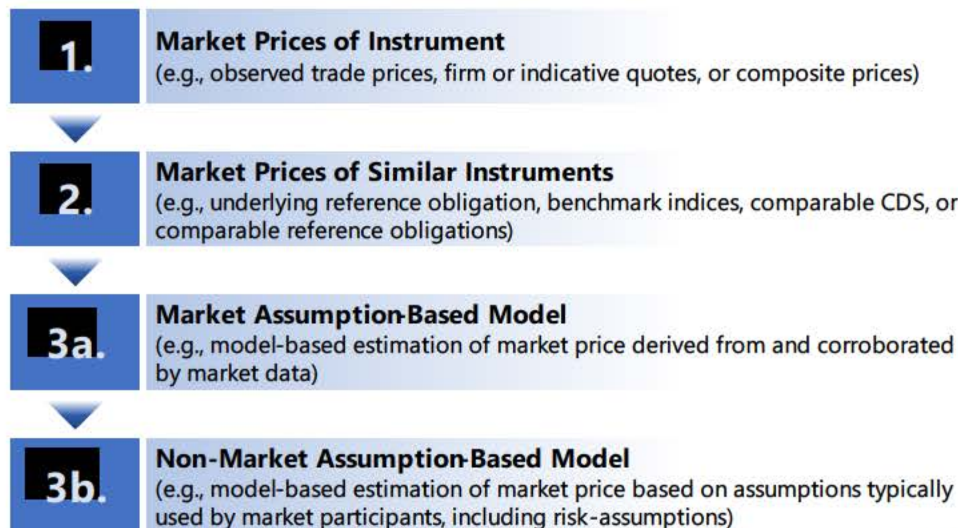
[15] Ambac's loss reserves were not "incorporated in any way into the models" used to value these CDS trades. Tr. 935:17-20 (Bruce).



LDX04-7. In contrast to the Ambac situation, market prices were either directly observable or readily determined for the trades here. *See* Section III.A. There was no justification to resort to a Level 3 valuation, the least reliable approach, when Level 1 and 2 inputs were available.[16]

4. <u>LBIE's Experts Provided Ample Support For Their Testimony Regarding Uniform Industry Practice</u>

Contrary to AGFP's pejorative labeling, the evidence presented by LBIE's experts at trial establishing the uniform primacy of market prices when calculating Loss was not based on "say so" but on decades of personal experience and substantial documentary evidence. At trial, each of LBIE's experts presented his or her qualifications and the basis for his or her testimony before being duly qualified as an expert and permitted to offer opinion testimony, often with AGFP's

[16] The Ambac example also undermines any attempt to discount AGFP's liabilities based on the possibility that AGFP would not pay them when due. Even for a truly insolvent organization like Ambac, with whom no party would trade, it was never suggested that its sales of credit protection should be discounted to account for counterparty credit risk. Tr. 941:14-942:4 (Bruce). Instead, Ambac paid billions on these trades. AX50039 at 31-34.

express agreement and recognition of the propriety of their testimony. *See* Tr. 60:23-61:11 (Rahl) (Ms. Bensman: "We're not challenging Miss Rahl's market experience. … Not to her expertise in the derivatives market."); Tr. 816:2-9 (Bruce) (Mr. Dassin: "Not [any issue] to his qualifications."); Tr. 1385:8-10 (Niculescu) (Mr. Zutshi: "We're not [challenging Dr. Niculescu as an expert], Your Honor."); Tr. 1820:1-10 (Adamidou) (Court admitting as expert witness "as to the understanding and practice in the market"). AGFP's belated challenge to the foundations of expert testimony the Court has already admitted comes far too late and is unfounded.

AGFP's suggestion that an expert witness's only role is to recite survey results into the record is contrary to New York law. It is well established that "actual experience" in a field can qualify experts to offer opinions supported by their "skill, training, knowledge and experience." *Price ex rel. Price v. N.Y.C. Housing Auth.*, 92 N.Y.2d 553, 559 (1998). That is the basis on which the Court admitted LBIE's experts, and it is supported by the record.

Ms. Rahl served on ISDA's board, has personally entered into, traded, valued, and terminated derivatives, and has further worked on roughly "a hundred separate terminations" involving "the termination of tens of thousands of transactions." Tr. 56:17-20, 59:15-62:16, 129:19-130:5 (Rahl). Mr. Bruce was the only witness to trade CDS in 2009 and oversaw numerous CDS terminations, including negotiations over the treatment of CDS between monoline affiliates and banks. Tr. 810:13-813:18, 924:13-925:24 (Bruce). Ms. Adamidou had thirty years of experience with credit derivatives, including extensive experience specifically terminating CDS trades between monolines and others at market prices and negotiating termination provisions. Tr. 1806:18-1808:19, 1812:18-24, 1832:16-1833:6 (Adamidou). And Dr. Niculescu, in addition to his academic credentials, drew on decades of leading roles at CDS market participants and personal involvement with over 20 closeouts involving the valuation of approximately 50,000 terminated

derivatives trades. Tr. 1384:7-1385:7, 1529:18-1530:1, 1530:20-1531:8 (Niculescu). The First Department has held that experts' opinions "grounded in relevant experience" form a proper basis for testimony "on the material issue of industry custom and practice," *Greene v. Simmons*, 13 A.D.3d 266, 266 (1st Dep't 2004), and this is precisely such a case—as the Court already ruled.

AGFP's untimely and incorrect redefinition of the proper basis for expert testimony is ironic given its own proffer of Mr. Cohn, a lawyer who has never traded or valued CDS and did not examine how any other counterparties "assigned valuations on early termination of derivatives of the type at issue here." Tr. 2597:10-2600:22 (Cohn). It strains credulity for AGFP to portray a witness who refused to testify about the advice he gave any client or even whether a single client ever followed that advice, who forthrightly admitted that he "only [had his] recollection of the circumstances" in 2009 to go on, and who had ***never calculated Loss***, *see id.*, as the "only expert witness with the experience to speak credibly to how the market understood Loss." AGFP Br. at 46. Doing so one page after faulting LBIE's actual market participant witnesses for relying on "their personal experiences" rather than surveys that Mr. Cohn also did not produce, *id.* at 45, renders AGFP's attempts to avoid evidence of industry practice hollow. Moreover, Mr. Cohn's testimony is impeached by his own contemporaneous explanation of industry practice in early 2009, where he shared many of LBIE's positions. *See* AX-90199 at 5.[17]

5. AGFP Knew Uniform Industry Practice Was To Use Market-Based Prices When Terminating ISDA Trades

AGFP argues that it was not aware of a market practice to value terminated derivatives on

[17] The Court excluded this exhibit—and all of Mr. Cohn's testimony relating to the interpretation of the ISDA Master Agreement—at the evidentiary hearing. *See* Hearing Tr. Feb. 28, 2022 at 82:5-24. AGFP's decision to nonetheless invoke Mr. Cohn's opinions in their brief should lead the Court to revisit this decision and admit AX-90199 as both impeachment evidence and evidence of custom and practice.

a market basis, but it cites the ***exact document*** proving its awareness. AGFP Br. at 56-57 (citing JX-57). This market practice was so well-known that AGFP's parent company AGL acknowledged it in its 2008 10-k filing with the Securities and Exchange Commission ("SEC"):

> If a credit derivative is terminated, the Company could be required to make ***a mark-to-market payment*** as determined under the ISDA documentation. . . . The process for determining the amount of such payment is set forth in the credit derivative documentation and ***generally follows market practice for derivative contracts***.

JX-57 at 58.

AGFP now argues that this statement only applied to situations where its counterparties terminated, AGFP Br. at 57, but that is an attorney creation. A plain reading of this disclosure reveals no such distinction. Indeed, such a distinction would not make sense, since a "market practice for derivative contracts," which AGL recognized and warned would apply to its CDS trades, necessarily applies to the derivatives market ***as a whole***.

AGFP fails to address LX169, another public statement to regulators that recognized the difference between AGC's "core financial guaranty business" and its "CDS business," and stated that the former was "not subject to the risk of destabilizing mark-to-market termination payments" while, for CDS trades, the "risk of mark-to-market termination payments exist." LX169 at 4, 7.

AGFP's internal documents not only fail to support its attorneys' argument that different rules apply to different counterparties, they flatly disprove it. When AGC told its Board of Directors in May 2008 that one of the principal differences between CDS and financial guaranty policies is that, in CDS, "***mark-to-market may apply***," it made expressly clear that this was true *no matter which counterparty defaulted*. LX159 at 4 (emphasis added). The presentation specifically separates when a CDS trade is "terminable by monoline" and when one is "terminable by counterparty," and lists "mark-to-market" as the payment mechanism in ***both*** situations. *Id.*

Attribute	Credit Default Swap	Financial Guaranty Policy

…

Terminable by monoline:	Generally only if the counterparty defaults. Mark-to-market may apply.	No.
Terminable by counterparty:	Generally only if the FP Company and/or its credit support provider (i.e., the related monoline) defaults (e.g., fails to pay, becomes insolvent etc.). Mark-to-market is likely to/may apply. The FP Company may also agree to allow early termination upon payment of a make-whole.	Generally no.

LX159 at 4 (highlighting added). Before it was convenient for litigation, AGFP recognized that mark-to-market termination payments would be required when *any* counterparty terminated a CDS trade on standard terms like those here. This is precisely why other monoline affiliates, including those run by Mr. Schozer, insisted on different termination provisions—and why the standard terms foreclose AGFP's calculations. Tr. 1862:11-1865:10 (Adamidou) (noting Schozer's insistence "that the monoline, Ambac, would have to eliminate all provisions from the standard ISDA agreement that could potentially generate mark-to-market exposures"); LX20 at 4, 14. The Court should reject AGFP's self-serving and convoluted attempt to rewrite history.

6. The Publications Cited By AGFP Recognize Uniform Industry Practice

AGFP's attempt to find favor in out-of-court statements from ISDA, academics, attorneys, and others only throws the absence of any prior support for using loss reserves as a basis to terminate CDS trades into starker relief. AGFP cites the "breadth," "flexibility," and "inclusion of 'loss of bargain'" of the Master Agreement's Loss definition (AGFP Br. at 51) without recognizing the implications from the fact that industry participants have taken this broad, flexible, "loss of bargain" provision and consistently applied it as a market-value concept—just as New York law dictates for "loss of bargain" in contract cases. *See, e.g.*, *White*, 20 N.Y.3d at 494.

AGFP asks the Court to rely on Mr. Cohn's parol description of how "the newly-inserted reasonableness requirement" "arose," which would be error under any circumstance and

particularly so here, where it is law of the case, affirmed by the First Department, that the actual meaning of this term is that "an objective standard of reasonableness applies," and as such "industry norms may be appropriately considered." SJ Decision at 29; Dkt. 354.

AGFP's brief parades snippets of hearsay treatises written by lawyers rather than practitioners. While these treatises discuss the "discretion" afforded the Non-defaulting Party, they recognize that this discretion is limited to *how* a party reaches a market-based termination amount, not whether market value is the goal in the first place. For example, the Gooch & Klein treatise could hardly be clearer that an out-of-the-money party such as AGFP should pay LBIE upon termination, and that this principle is fundamental to the derivatives industry:

> The value of a derivatives transaction to each of the parties ***moves with changes in the price or level of the underlying asset*** … Generally speaking, ***if a derivatives transaction is closed out early, the party for whom the transaction is out of the money will be required to pay compensation***, often referred to as 'breakage,' to the other party.
>
> The view of OTC derivatives as assets or liabilities—as in-the-money or out-of-the-money—is fundamental not only to the calculation of damages and other close-out settlement amounts but also to many of the legal, regulatory and business frameworks within which the parties to derivatives operate.

AX-90023 at 34 (emphasis added); *see* AX-90021 (Firth Treatise) at 211 (while a pricing model may be used when market prices are unavailable, "***the value generated by the model must be an accurate estimate of the price that would be negotiated by a willing buyer and a willing seller***") (emphasis added); AX-90024 (Durham Treatise) at 31 ("[T]o the extent that prices and rates can be obtained from third parties, it is advisable to include such quotations in the loss calculations.").

The evidence at trial demonstrated that valuing CDS trades on the basis of market values, particularly at termination, is indeed "fundamental" to the industry. AX-90023 at 34. In the CDS market, "LBIE took both positions, being a seller and a buyer at the same time," and after its default the administration's mandate "was to treat [all the counterparties] fairly and in a consistent

manner." Tr. 390:25-391:3, 392:3-8 (Viegas); LX92. Objective market pricing is the guiding principle for such fairness. Defaulting parties such as LBIE cannot be expected to pay millions in losses to protection buyers based on market prices, only to have protection sellers such as AGFP choose to ignore market data and pay nothing. Market-based termination payments advance uniformity and fairness, while AGFP's subjective, self-serving valuation cannot.

D. AGFP Fails To Identify A Single Prior Instance Of Using A Loss Reserve Model To Calculate Loss

Absent from AGFP's brief, and absent from the trial record, is any evidence that participants in the CDS market ever contemplated, much less endorsed, the use of an affiliate's subjective loss reserve as a basis for valuing terminated CDS trades. Hundreds of counterparties have terminated tens of thousands of CDS trades by reference to market prices, and not one has been identified as ever having done so using an insurance company's loss reserve methodology.

The plain fact that AGFP cannot identify any prior market precedent for its Loss calculation not only supports LBIE's claim but also undermines AGFP's counterclaim. AGFP's brief relies heavily on the Court's ruling that LBIE bears the burden on its affirmative claim, while ignoring the Court's simultaneous ruling that AGFP bears the burden of proof on its counterclaim. A counterclaim for breach of contract requires the defendant to establish the "essential elements of a breach of contract cause of action," namely "the existence of a contract, the [defendant's] performance pursuant to the contract, the [plaintiff's] breach of his or her contractual obligations, and damages resulting from the breach." *Maspeth Fed. Savings & Loan Assoc. v. Yeshiva Kollel Tifereth Elizer*, 197 A.D.3d 1253, 1254 (2d Dep't 2021).

Accordingly, to recover on its counterclaim, AGFP bears the burden of proving its own "performance pursuant to the contract"—most crucially, its performance of its obligation to "reasonably determine[] in good faith … its total losses and costs (or gain, in which case expressed

as a negative number) in connection with this Agreement." JX-1 at 9, 15. Just as the Court has ruled that LBIE cannot recover without affirmatively proving AGFP's breach of this obligation, AGFP cannot recover on its counterclaim without affirmatively proving its performance. *See, e.g.*, *Billy Chi. Ltd. v. Chi. China Tour, LLC*, 176 A.D.3d 566, 567 (1st Dep't 2019) (affirming dismissal of breach of contract counterclaim where defendant failed to perform its own obligations); *Perry v. McMahan*, 164 A.D.3d 1486, 1487 (2d Dep't 2018) (same). The burdens are mirror images.

Both AGFP's counterclaims and its critiques of LBIE's market practice evidence thus fail because the witnesses at trial, from both sides, were unanimous. Ms. Rahl had "never observed using an expected loss as a metric for Market Quotation with fall-back to Loss on a CDS." Tr. 122:7-8. Mr. Bruce had "never seen an insurance regulatory reserve approach used for valuing a derivative for any purposes whatsoever." Tr. 971:15-971:17. Dr. Niculescu testified that using AGFP's loss reserve model to calculate Loss was "unprecedented." Tr. 1443:1-22. Mr. Rosenblum "didn't take into consideration whether the loss reserve calculation was or was not an appropriate calculation for determining termination amounts under an ISDA Master Agreement" and "had no opinion about what would be the appropriate approach." Tr. 1088:5-25. Mr. Schozer "was never involved in a Loss calculation" before this case and had "never seen how someone else calculated Loss under an ISDA." Tr. 2277:24-2278:10. Mr. Cohn had "not been involved" in "how any other monoline addressed early termination of derivatives under a 1992 ISDA Master Agreement" and had not "examined how any other ISDA counterparty, other than a monoline, assigned valuations on early termination of derivatives of the type at issue here." Tr. 2599:21-2600:10. Mr. Prager admitted he was "not an expert in market practice for calculating Loss under an ISDA Master Agreement," something he had never done himself. Tr. 3180:6-3181:1. And Mr. Pirrong admitted that he was "not offering an opinion in this case as to the reasonableness or good

faith of AGFP's loss calculation," and "not offering an opinion on whether the loss calculation was consistent with market practice under the ISDA Master Agreement." Tr. 3586:20-3587:6.

The market practice evidence at trial was thus entirely one-sided: LBIE presented evidence that hundreds of participants in the CDS industry had calculated CDS termination payments using available market prices and by calculating replacement values where no prices were available, while AGFP failed to present a single example of any party calculating Loss using a loss reserve model, or even a discounted cash flow model that reflected the Non-defaulting Party's subjective assumptions about the future. "In determining whether conduct is objectively reasonable, industry norms may be appropriately considered," *Hoag*, 246 A.D.2d at 231, and in this trial the extensive industry evidence compels a single conclusion: an objectively reasonable calculation of Loss must be consistent with available market prices or market data. It cannot be based on subjective, self-serving and idiosyncratic assumptions about the ultimate value of the trades at maturity.

III. AGFP'S EXCUSES FOR CONTRADICTING UNIFORM MARKET PRACTICE HAVE NO SUPPORT IN THE TRIAL RECORD OR THE LAW

As a fallback, AGFP argues that even if trial established a uniform standard for the termination of CDS trades and calculation of Loss, then "it was reasonable for [AGFP] to depart from it under the circumstances." AGFP Br. at 59. Every excuse for this "departure" is meritless.

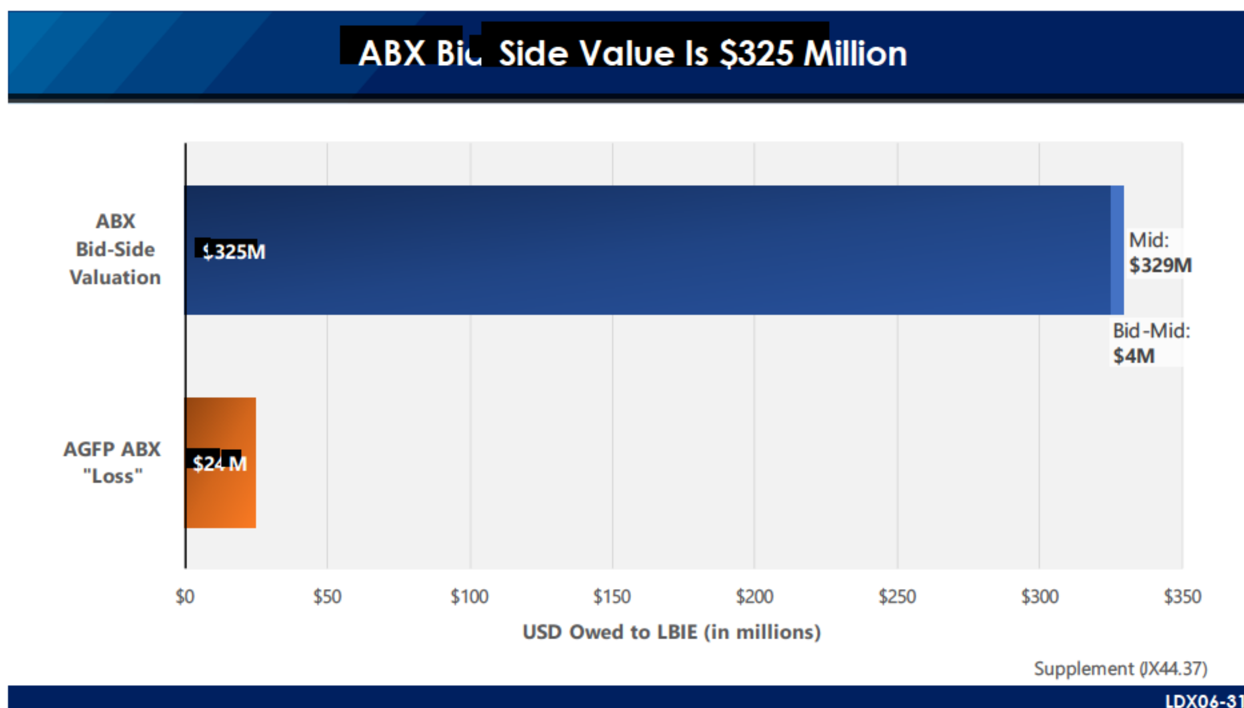
A. AGFP's Subjective Loss Calculation Contradicted Available Market Prices

AGFP does not dispute that its Loss calculation bore no resemblance to objective market prices. Nor could it. LBIE introduced extensive expert and documentary evidence establishing the mid-market value of the trades as of the Early Termination Date. *See, e.g.*, LBIE Br. at 42-45. AGFP's own expert, Mr. Prager, *accepted this valuation* when proposing adjustments to Dr. Niculescu's Loss calculation. ADX03-19. The pricing evidence admitted at trial established three key facts that are devastating to AGFP's case: (i) market prices were available for each of the

trades at issue, (ii) AGFP's Loss calculation massively undervalued these trades, and (iii) AGFP violated the "cross-check" principle by calculating a Loss inconsistent with market prices.

1. The ABX Trades Were Worth At Least $325 Million

Trial established that there was an active market for the ABX on July 23, 2009, and that prices for these trades were available to AGFP. *See, e.g.*, LX355 at 22 (AGFP Q3 2009 Mark-to-Market Memo) ("the ABX Index is still an actively traded and published Index"). This data included the Markit index, which showed the mid-market values of the ABX each day. Tr. 871:9-872:9, 896:2-22 (Bruce).[18] Dr. Niculescu used the Markit prices to determine that the ABX trades at issue were worth ***$325 million in LBIE's favor*** as of July 23, 2009. LX114; LDX06-31.[19]



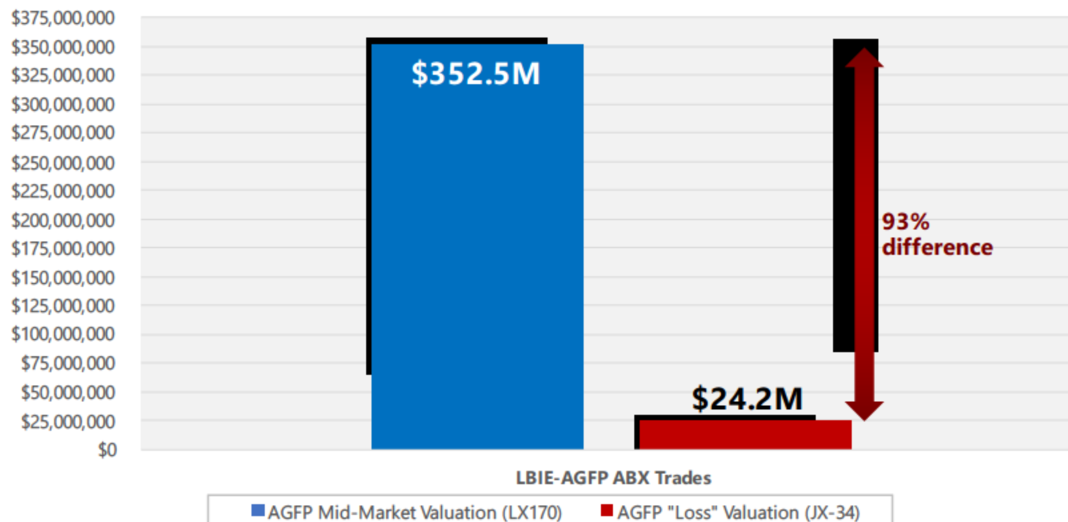
[18] Another pricing source available on July 23, 2009 were "dealer runs," emails sent by broker-dealers who wished to buy and sell CDS on ABX. Tr. 870:16-871:8, 873:25-874:6 (Bruce).

[19] As discussed in LBIE's opening post-trial brief, LBIE is relying upon the bid-side valuation of the trades (the side more favorable for AGFP) because evidence showed it was market practice to include bid-offer adjustments in Loss calculations. LBIE Br. at 44-45.

In the ordinary course, AGFP used the *exact same* Markit index to value its ABX trades. Repetto Dep. Tr. 80:11-23, Tr. 896:17-22 (Bruce); LX114. At trial, LBIE introduced a spreadsheet showing AGFP's ordinary course valuation of the LBIE trades on a quarterly basis between June 2008 and June 2009. *See* LX170; Tr. 1352:20-1354:24 (Rosenblum). Unsurprisingly, AGFP's internal valuation of the ABX trades matched the valuation found in the Markit index. *Compare* LX170 (AGFP's mid-market marks for the LBIE trades) *with* LDX04-13 (the Markit-based valuation of the ABX trades over time). As discussed below in Section III.C, AGFP made no adjustment to the value of these trades based on allegedly "non-standard" terms, because these trades were completely standard.

As of June 30, 2009, AGFP valued the ABX trades at ***$352 million in LBIE's favor***, more favorable for LBIE than Dr. Niculescu's $325 million valuation as of July 23, 2009. LX170 (Tab "Q2 2009"); LDX06-23. LX170. Yet when it came time to calculate the value of these trades under the ISDA Agreement, AGFP disregarded this valuation. Using a loss reserve methodology inappropriate for valuing derivatives,[20] AGFP valued the ABX trades at just $24 million to LBIE. The difference between AGFP's ordinary course valuation and its Loss calculation is massive:

[20] *See* JX-51 (FAS 163) at 3-4, 11 (stating the accounting standards for financial guaranty insurance contracts do not apply to derivative instruments).



These are contradictory valuations on the same exact trades, with the same counterparties, approximately three weeks apart. Neither valuation includes a CVA adjustment. Tr. 4185:13-19 (Bruce). The key difference between AGFP's valuation of the ABX trades at $352.5 million as of June 30, 2009 and $24.2 million as of July 23, 2009—a ***$325 million difference***—is that the latter valuation was designed to minimize AGFP's payment to LBIE after termination. When AGFP was at risk of having to make a mark-to-market payment under the ISDA Agreement, it discarded its mark-to-market valuation methodology and used a self-serving, subjective valuation instead.

2. <u>The UK RMBS Trades Were Worth At Least $76 Million</u>

At trial LBIE also established that there was an active market for CDS on UK RMBS trades. AGFP acknowledged internally that dealers were "still selling protection on asset classes within Assured Guaranty's CDS portfolio." LX355 at 21; Tr. 833:13-17 (Bruce). Mid-market prices for CDS on UK RMBS were published by Markit:

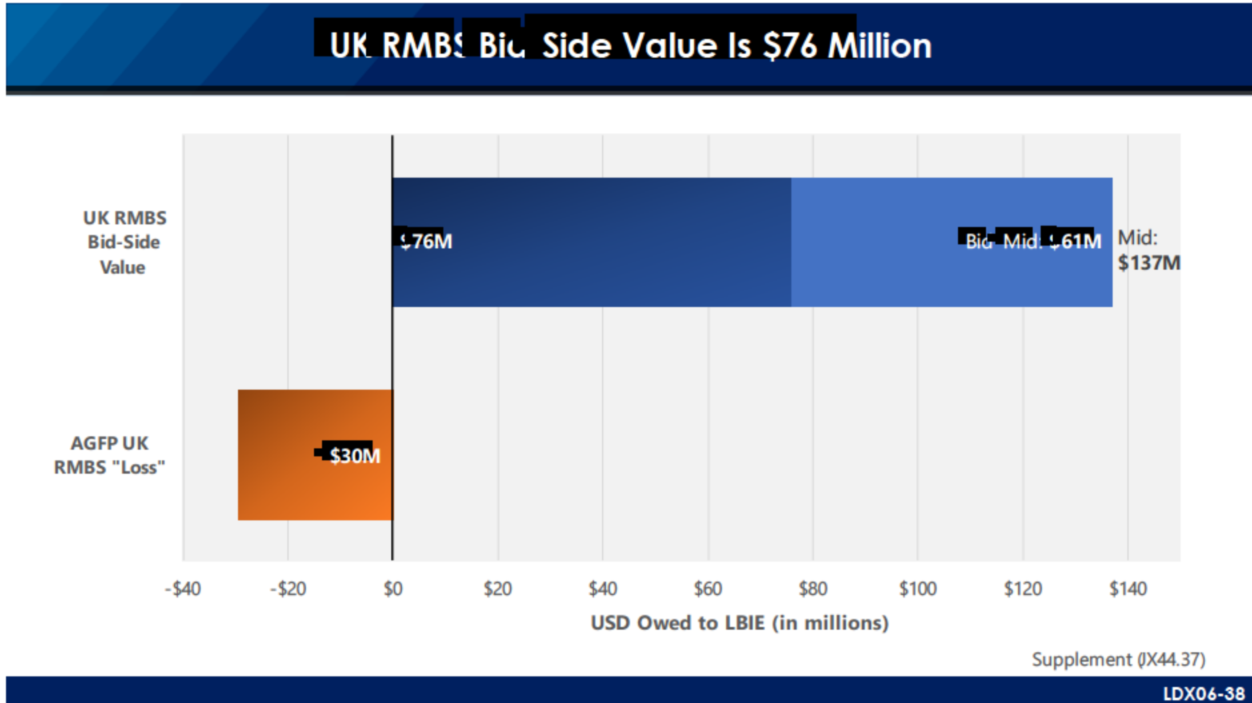
European CDS of ABS AAA (Source: Markit European CDS of ABS Service)							
Deal Name	Series	Class	Currency	Isin	Levels	Duration	WAL
Arkle Master Issuer plc Series 2006-2	2006-2	3A2	EUR	XS0277508692	175	1.66	1.87
Delphinus 2006-I B.V.	2006-1	A	EUR	XS0256323972	160	2.22	2.53
Permanent Master Issuer plc Series 2007-1	2007-1	3A	EUR	XS0288090342	220	2.32	2.66
Gracechurch Mortgage Financing plc 2007-1	2007-1	3A2	EUR	XS0302999064	170	2.51	2.76
Holmes Master Issuer PLC Series 2007-1	2007-1	3A2	EUR	XS0292750253	170	1.81	2.00
Granite Master Issuer plc Series 2007-2 Notes	2007-2	3A2	EUR	XS0298974840	9 + 50dm	2.83	1.91

LX136 at 2 (Markit: The European ABS Market July 15-23, 2009); Tr. 900:9-904:14 (Bruce).

AGFP had access to this same pricing source, and used it to value its UK RMBS trades in the ordinary course. Tr. 906:21-907:4 (Bruce); *see* LX355 at 13. Dr. Niculescu used Markit's published levels as of July 23, 2009 to determine that the UK RMBS trades were worth $76 million in LBIE's favor. LDX06-38. AGFP's internal valuation of the trades as of June 30, 2009 was $47.8 million in LBIE's favor. LX170 (tab "Q2 2009").[21]

As with the ABX trades, AGFP ignored available market prices and its own internal marks when it calculated its Loss for the UK RMBS trades. Using a completely subjective methodology that its own witnesses have been unable to explain or defend, AGFP decided that the UK RMBS trades were worth $30 million ***in AGFP's favor***. *See infra* Section IV.B. This was over $77 million below AGFP's internal valuation, and over $100 million below Dr. Niculescu's valuation.

[21] AGFP's internal memos suggest that its mark-to-market methodology applied an unusual adjustment for "funding cost" and "bank profit," which likely accounts for the discrepancy between AGFP's valuation and Dr. Niculescu's. *See* LX355 at 24-27; Tr. 2943:4-20 (Bailenson).



This upside-down valuation bears no resemblance to any objective data. AGFP simply decided that LBIE should have to pay all future fixed premiums owed on the (now terminated) CDS, but that AGFP would never have to pay a dime in losses despite a global economic crisis.

3. <u>The CLO Trades Were Worth At Least $96 Million</u>

LBIE demonstrated at trial that there was an active CLO market in 2009, and that prices were available through sources such as JPMorgan. LX135 at 1, 38-51; Tr. 907:13-908:8, 910:5-912:2 (Bruce).

US HY CLO*

Date	AAA	AA	A	BBB	BB
WAL	6-8	7-10	8-10	9-11	10-12
2/19/09	500	25	10	8	8
2/26/09	550	25	10	8	8
3/5/09	550	25	10	8	8
3/12/09	550	25	10	8	8
3/19/09	550	25	10	8	8
3/26/09	550	25	10	8	8
4/2/09	600	25	10	8	5
4/9/09	600	25	10	8	5
4/16/09	600	25	10	8	5
4/23/09	600	25	10	8	5
4/30/09	600	25	10	8	5
5/7/09	800	25	10	8	5
5/14/09	800	25	10	8	5
5/21/09	750	35	15	8	5
5/28/09	750	35	15	8	5
6/4/09	700	45	20	8	5
6/11/09	650	55	30	12	5
6/18/09	600	55	30	12	5
6/25/09	600	55	30	12	5
7/1/09	600	55	30	12	5
7/9/09	600	55	30	12	5
7/16/09	600	55	30	12	5
7/23/09	600	55	30	12	5

LX135 at 38 (JPMorgan Global ABS/CDO Weekly Market Snapshot – July 24, 2009).

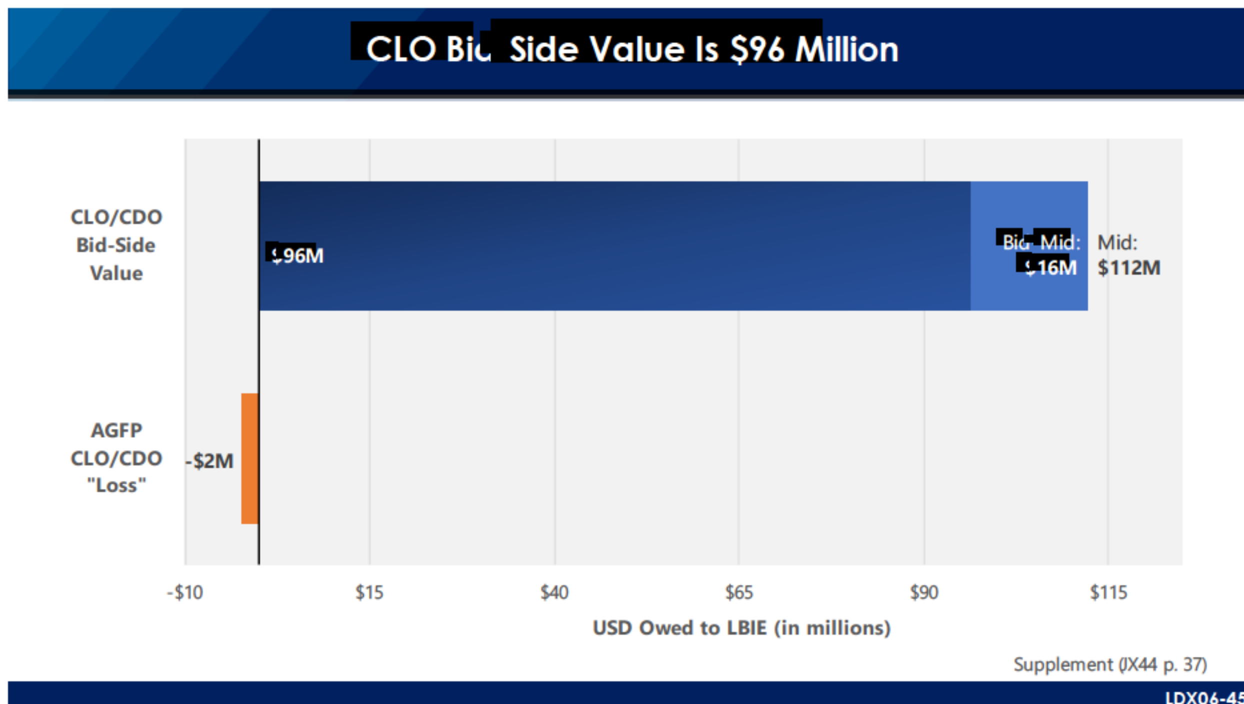
AGFP's own documents confirm that this was the same pricing source that AGFP used to value its CLO positions in the ordinary course:

> [W]e are using the JPMC Benchmark for High Yield Cash Flow CDOs/CLOs to mark our Cash Flow CDO/CLO portfolio. According to our pricing team and Blackrock, ***this market index is the most accurate market benchmark for HY Cash Flow CDO's /CLO's and, as previously stated, has been used consistently in the past by the Company to value these transactions***.

LX355 at 7 (emphasis added); *see also* Tr. 911:23-912:2 (Bruce). Dr. Niculescu used the JPMorgan benchmark to determine the CLO positions were worth $96 million to LBIE. LDX06-45. AGFP valued these trades at $37.6 million in LBIE's favor as of June 30, 2009. LX170.

As with the ABX and UK RMBS trades, AGFP chose not to use its market-based, ordinary course valuation for the CLO trades. Instead, it summed up the amount of future premiums it believed LBIE owed, and then jumped to the unsupported and inconsistent conclusion that these

trades would *never* experience losses that AGFP would owe to LBIE. *See infra* Section IV.B. As a result, AGFP came up with a Loss valuation of $2 million in its favor.



4. <u>The Disparity Between Market Prices And AGFP's Loss Calculation Confirms That AGFP Acted Unreasonably</u>

In interpreting the ISDA Agreement, Justice Friedman recognized based on the well-established "cross-check" principle that "[AGFP's] Loss (however calculated) should generally be within the range of what the market would pay for a replacement transaction. If [AGFP's] calculation of Loss is not within that range, a genuine question may be raised as to whether [AGFP's] calculation of loss was reasonable." SJ Decision at 30. As laid out above, LBIE presented documentary and expert evidence establishing that the current market value of these trades was at least ***$485 million in LBIE's favor*** as of the Early Termination Date. LBIE Br. at 42-45, 73-74. This was consistent with AGFP's own internal valuation of the trades of ***$438 million in LBIE's favor*** as of June 30, 2009. LX170 (tab "Q2 2009"). AGFP's self-serving Loss

calculation ***of $20.7 million in its own favor***,[22] based on entirely subjective, self-serving, and unsupported assumptions, bears no resemblance to the value of a replacement transaction.[23]

AGFP failed to introduce ***any*** evidence establishing that "the price of a replacement transaction [was] impossible to estimate for purposes of applying the cross-check principle." SJ Decision at 30. Nor could it, given that it used market data to estimate the value of these trades in the ordinary course. LX170. AGFP's Loss calculation violates the cross-check principle and represents a breach of AGFP's duty to act objectively reasonable.

B. AGFP's Claim That LBIE Believed The Trades Had Little Value Is Based On Unreliable Hearsay

AGFP cites a series of unreliable hearsay documents in support of its argument that LBIE agreed with AGFP's valuation. AGFP Br. 12-15, 17 (referencing JX-67, AX-30010, AX-30013). None of these documents reflected LBIE's valuation of the trades, none of the authors of these documents were available for cross-examination at trial, and they should all be disregarded.

First, AGFP claims that JX-67, which it calls LBIE's "Valuation Memorandum," supports AGFP's valuation and methodology. AGFP Br. at 12-15. Not so. This was a one-off memo from November 2008 that presented the initial opinions of Juan Quintas following and reflecting discussions with AGFP. *See generally* JX-67. The document contains critical errors that undermine its reliability. For example, the memo states that "the CDS Contracts were not documented under standard ISDA confirmation terms." JX-67 at 2. But this is not accurate. As Dr. Niculescu and Mr. Bruce explained, the ABX and CLO trades were documented under

[22] These figures incorporate $13 million in Unpaid Amounts. JX-34 at 12.

[23] While AGFP now suggests that its CVA-adjusted valuation of the trades supports its Loss calculation, AGFP Br. at 30, LBIE demonstrated at trial that even AGFP admitted its CVA methodology led to nonsensical results. LX355 at 26; Tr. 329:3-331:9 (Rahl); 1316:22-1317:17, 1347:23-1352:2 (Rosenblum); 2953:9-2954:7 (Bailenson); 4262:11-18 (Bruce).

standard terms. Tr. 1494:9-1495:11 (Niculescu), 4118:4-19 (Bruce). In addition, the memo fails to mention that many of the CLO trades contained ratings triggers that made the trades more valuable to LBIE.

The Court already observed that JX-67 was "of little utility" since it merely represented "Mr. Quintas' impressions." Tr. 616:1-7 (Viegas). Consistent with the Court's view, Mr. Viegas testified that JX-67: (i) is not a type of document that the LBIE administration ordinarily produced when assessing how to handle counterparty disputes; (ii) was worked up in October 2008, nine months before the Early Termination Date and nearly a year before AGFP calculated Loss; (iii) was not based on analysis of the actual trade documents, and reflects a mistaken understanding of the terms of the trades; (iv) is based on undisclosed assumptions by Mr. Quintas; and (v) was never signed off on by Mr. Viegas or any of Mr. Quintas' superiors. Tr. 581:9-582:1, 620:23-621:1, 753:13-16, 754:24-755:22, 760:5-16 (Viegas). The Court should grant this document no weight, consistent with its stated intention at trial.

The Francesco Cuccovillo presentation produced at AX-30010 is largely a cut-and-paste from JX-67, and should be similarly disregarded. The Paul Copley email produced at AX-30013 was never introduced at trial, and its author could not recall the basis for the email at his deposition. Copley Dep. 123:22-126:8. As unreliable hearsay, it should also carry no weight.

C. AGFP's Claim That The Features Of These CDS Trades Permitted AGFP To Discard Market Practice Contradicts AGFP's Own Internal Documents

AGFP's conclusory claim that the at-issue trades "were not on standard terms" is entirely unsupported with respect to the ABX and CLO trades and lacks context for the UK RMBS trades. These trades were executed on overwhelmingly market-standard terms, and where they were not (only in the case of the UK RMBS trades), any changes are properly reflected as an adjustment to the mid-market value of the trades (as Dr. Niculescu calculated). The trade terms did not give

AGFP license to adopt a wholly different calculation of Loss that discarded market practice. As the witnesses who had previously calculated Loss after a CDS termination agreed, "the market practices are across asset classes." Tr. 60:12-16 (Rahl). AGFP's arguments regarding trade characteristics are thus both incorrect and irrelevant.

While AGFP is right that the trades at issue were pay-as-you-go trades, *see* AGFP Br. at 6-7, that is not a non-standard or notable characteristic: pay-as-you-go was the market-standard for CDS referencing the ABX index, CLOs, and UK RMBS. Tr. 69:7-14 (Rahl); 1615:22-1616:24 (Niculescu).

Despite the labels AGFP uses, its brief does not actually dispute that the at-issue ABX trades featured standard contract terms for ABX trades. The at-issue ABX trades called for the exact same floating payments, in the exact same form, on the exact same schedule, as any other CDS referencing ABX. AGFP Br. at 6-7 (failing to contend otherwise); Tr. 1494:4-21 (Niculescu) ("[T]he ABX trades were standard contract trades," so "it was very straightforward to value them."). AGFP likewise does not dispute that the CLO trades between LBIE and AGFP featured standard pay-as-you-go contract terms for CLO trades. AGFP Br. at 7 n. 25; Tr. 1494:22-1495:11 (Niculescu) ("[T]he CDS referencing CLOs in this case [as] compare[d] to the standard payment terms for a CDS on CLO . . . were standard").

As for the UK RMBS trades, these also featured standard pay-as-you-go terms. AGFP Br. at 7 n.25 (citing Schozer testifying to the same). The only difference with the UK RMBS trades was that the stream of payments AGFP was liable to pay LBIE over time differed slightly from the stream of payments typically called for in CDS on UK RMBS trades. Tr. 1492:10-1493:18 (Niculescu). Yet this difference was not unique or unprecedented, but instead a difference whose price impact was easily calculated time and again: by LBIE and AGFP when they executed the

trades; by AGFP when it marked the trades to market each quarter; and by Dr. Niculescu in performing his valuation. *Id.* (explaining that LBIE estimated this documentation difference reduced the value of the UK RMBS trades by 20% at their inception and that Dr. Niculescu estimated it reduced the value by 20% as of July 23, 2009); LX170 (Tab "Q2 2009") (AGFP's own market-price valuation of the UK RMBS as of June 30, 2009).

Unable to credibly contest that these trades were executed on terms standard for these products (ABX and CLO) or easily susceptible to standard pricing adjustments (UK RMBS), AGFP resorts to other irrelevant claims to cast these trades as outliers. AGFP Br. at 6-7. For example, AGFP suggests that the absence of collateralization should impact the valuation of the trades. AGFP Br. at 7. That is incorrect. Collateral is designed to reduce counterparty credit risk, Tr. 75:5-24 (Rahl), which is irrelevant as a matter of law. LBIE Br. at 26-28. Evidence at trial established that the lack of collateral does not affect the value of terminated trades, because it was not market practice to include a CVA when terminating trades. Tr. 931:1-17 (Bruce). Moreover, AGFP has admitted that its own creditworthiness does not affect the performance of the CDS. AGFP Br. at 29. The lack of collateral simply means that between these two parties there is no pre-funded collateral account to cover the bulk of any termination payment. Even if the lack of collateral and AGFP's creditworthiness were relevant, Dr. Niculescu calculated that the 28 trades would still be worth $249 million in LBIE's favor. LDX06-48, 49.

Finally, AGFP's discussion of the supposedly non-standard terms of the at-issue trades is notable for what it omits. Nowhere does AGFP contend that the supposedly non-standard nature of these trades made market prices indeterminable. AGFP Br. at 6-7; Section III.A *supra*. Nor could AGFP offer such a contention, given that it calculated market pricing for these trades in the ordinary course of its business reflecting that, at mid-market, they were worth over $400 million

in LBIE's favor. LX170. Nor does AGFP offer any argument that CDS trades with characteristics like those in the 28 trades at issue are subject to any different market practices in the calculation of Loss. The uncontradicted evidence is that they are not. *See, e.g.*, Tr. 98:2-13 (Rahl) (testifying that she had never "been involved in a matter where a party disputed whether loss, when calculated as a fallback from a failed market quotation, should reach a market-based result," including "in terminations of trades documented under pay-as-you-go forms").

D. AGFP's Claim That Market Conditions In July 2009 Permitted It To Discard Market Practice Has No Support In The Law Or The Record

AGFP repeatedly cites purported "price dislocation" as a defense of its unprecedented Loss calculation. *See* AGFP Br. at 32-35, 61-62. AGFP's arguments on this point are illogical, legally irrelevant, and contradicted by the record, which established that market prices on the CDS trades at issue and closely related instruments were widely available, and indeed regularly applied by AGFP, at the time. *See, e.g.*, LX170. And AGFP's claim that "trading prices were dislocated" if they "did not reflect expected losses projected by its models," AGFP Br. at 27, reveals both factual and legal errors. As a matter of fact, as explained further below, prices were *not* dislocated in July 2009; neutral third-party projections of future losses on the assets underlying the CDS trades matched the market price. And as a matter of law and logic, there is no reason that a disconnect between market price and expected future losses—a disconnect that AGFP never proved—would change the well-established practice of basing CDS termination payments on available market prices. There was no evidence at trial that market data could be entirely disregarded when calculating Loss during allegedly "dislocated" markets. AGFP's suggestion that market prices were dislocated because they did not match its own subjective loss projection assumptions is inconsistent with the law of the case that the termination value must be determined in an objectively reasonable manner.

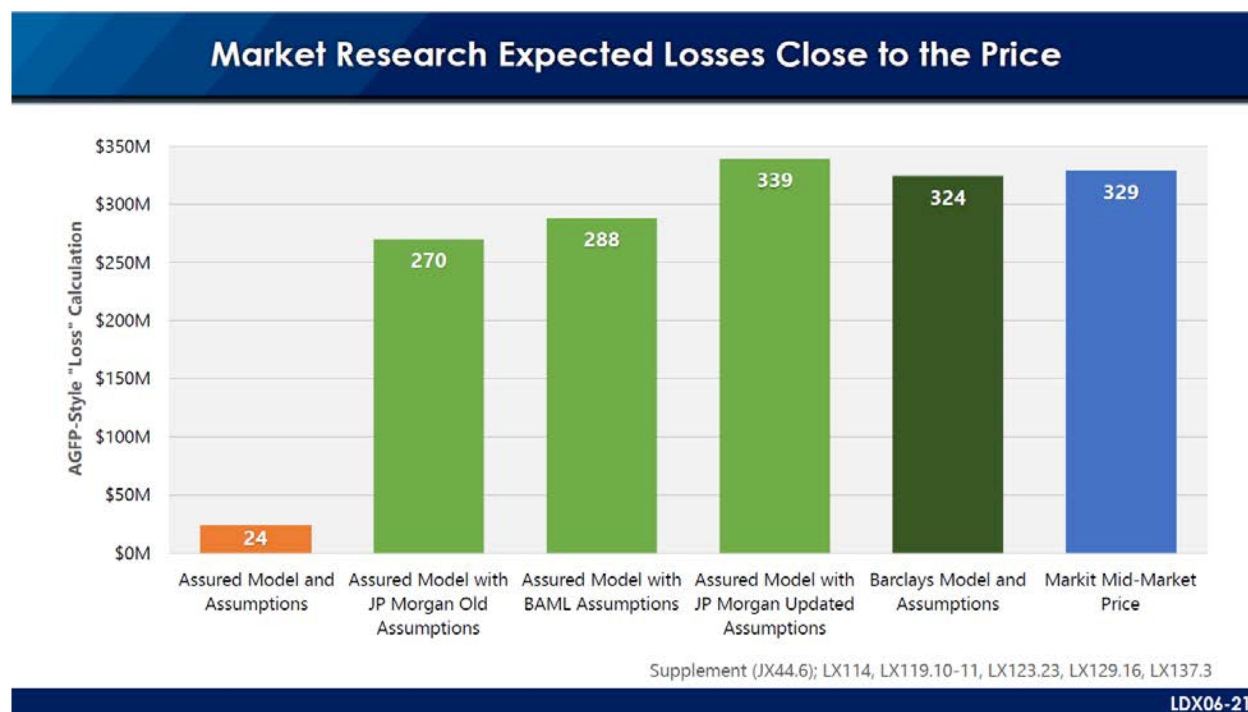
1. In July 2009, Market Prices For The 28 CDS Trades At Issue Were Determinable, Including By AGFP Itself

It cannot be disputed that market prices for these CDS trades were determinable throughout 2009—as discussed above, AGFP determined them. *See, e.g.*, LX170 (Tab "Q2 2009") (AGFP's June 2009 mid-market valuation of the trades). At trial, AGFP elicited extensive testimony about *adjustments* to the mid-market prices that Dr. Niculescu identified, but no one disputed that mid-market prices for the ABX trades, in particular, were readily determinable using a spreadsheet from Markit or dealer runs from July 23, 2009. LX114; LX133; ADX03-19; Tr. 1450:9-17 (Niculescu); Tr. 3028:25-3029:10, 3301:12-3305:1 (Prager). The supposed "market dislocation" AGFP invokes did not make market prices for these trades indeterminable.

2. The Evidence At Trial Refuted AGFP's Analysis-Free Assertion Of Market Dislocation

AGFP's arguments fail on the facts because markets *were not* dislocated. The only analysis presented at trial regarding the relationship between market prices and market views of projected losses for the ABX as of July 23, 2009 was a careful study conducted by Dr. Niculescu, detailed in his supplemental expert report, presented on demonstrative LDX06-21, and discussed at length during his testimony. Tr. 1440:19-1441:23; 1728:9-1729:15; 3926:3-3927:18 (Niculescu) (explaining his analysis and that he performed the dislocation study that Dr. Pirrong proposed but did not perform). Dr. Niculescu explained that the readily available, easily determinable mid-market price for the ABX trades was $329 million. Tr. 1446:13-24; 1450:1-12 (Niculescu); LDX06-27. That figure came directly from a Markit spreadsheet and was confirmed by dealer runs sent to customers on July 23, 2009. LX114; LX133; LX135 at 15-16; Tr. 1448:8-1450:25 (Niculescu). Dr. Niculescu then analyzed the ABX losses projected using AGFP's model but populated with assumptions published by independent, highly-regarded research groups at Bank of America, JP Morgan, and Barclays as of termination. Tr. 1433:16-1442:11 (Niculescu). He

found that these research groups were projecting losses of approximately $270 million to $339 million on the two ABX trades. *Id.*; Tr. 3879:11-3880:3 (Niculescu) ("Barclays was saying there was absolutely no dislocation. It was saying the market place nailed exactly – almost exactly a price very, very close to their projected losses."). As shown below, there was little if any "dislocation" between market price (the blue bar) and market participants' contemporaneously projected losses (in green).



During trial, in response to questions from the Court and testimony from Mr. Prager, Dr. Niculescu augmented this analysis by calculating ABX projected losses based on reports from S&P and Fitch, and found that their projected losses were $107 million and $248 million, respectively. LDX10-6; Tr. 3895:12-3897:18 (Niculescu).[24] Taking the average across all of these third-party projected losses gives an estimated loss projection of $262 million on the ABX trades,

[24] Dr. Niculescu also calculated projected losses for Moody's based on a report it published in March 2009, but as discussed at Section IV.D, this report was irredeemably stale by July 2009.

equal to fully 80% of the market price of $329 million. Thus, there was no large gap or significant dislocation between projected losses and market prices. Whereas objective sources projected losses equal to 80% of the price (with the most-reputable and best-resourced source projecting even higher losses), AGFP projected losses equal to only 7% of the price. The true "dislocation" was between AGFP's self-serving assumptions and the consensus views of other market analysts.

Dr. Niculescu's analysis is further supported by testimony from Mr. Bruce, who testified on rebuttal that the market was not dislocated in 2009. Tr. 4139:2-4139:13, 4144:9-14, 4145:8-4146:1 (Bruce). Mr. Bruce was the only witness on either side who was trading CDS on ABX, UK RMBS, and CLOs in 2009, and who thus had direct firsthand knowledge of conditions in that market at that time. Tr. 810:13-813:18, 827:5-9, 833:13-835:2, 922:13-922:22 (Bruce).

AGFP's experts performed *no analysis* to rebut Dr. Niculescu's exacting study showing there was no ABX market dislocation as of July 23, 2009. AGFP Br. at 30-36, 61. Nor did AGFP's witnesses offer any reliable testimony disputing Mr. Bruce, the only witness at trial who traded ABX in 2009. AGFP instead directs the Court to unsubstantiated testimony, Ms. Rahl's report in the *Devonshire* case, and inadmissible hearsay documents that are stale in any event. AGFP Br. at 32-36, 61-62. None withstand scrutiny or undermine Dr. Niculescu's work.

First, AGFP tries to argue that prices were dislocated in mid-2009 based on vague statements by its own experts, but these opinions are of no value due to their lack of underlying analysis or support. *See, e.g.*, AGFP Br. at 35 (asserting that ABS prices were dislocated in 2009, but citing testimony from Mr. Prager that does not even mention market prices). Of AGFP's experts, only Dr. Pirrong is an economist with training analyzing market prices. Notably, the only testimony AGFP cites from Dr. Pirrong on this topic is a statement that: "the markets became very illiquid." AGFP Br. at 32. In the first instance, illiquidity does not establish dislocation; rather,

while Dr. Pirrong explained the analysis he would conduct to assess dislocation, he never conducted that analysis (only Dr. Niculescu did) and the analysis is not to simply look at illiquidity. Tr. 3566:24-3567:14 (Pirrong). Moreover, Dr. Pirrong's comment was made in reference to a hearsay report relating to *the second half of 2007 and beginning of 2008*. Tr. 3487:25 (Pirrong) (addressing AX-50008 at 5). As discussed below, that (inadmissible) report is irrelevant given its timeframe; moreover, commenting on a chart discussing liquidity during a different time frame is not offering an opinion that the markets at issue here were dislocated as of July 23, 2009.

As for Mr. Prager, he is a restructuring expert who never traded CDS, was not active in the CDS markets in July 2009, and undertook no analysis of dislocation in those markets in connection with his expert work in this case. Tr. 3181:2-4, 3187:22-6 (Prager). Nonetheless, AGFP relies heavily on its characterizations of his *ipse dixit* testimony to try to persuade this Court that the relevant markets were dislocated. *See* AGFP Br. at 32-33, 35. In reality, most of Mr. Prager's comments broadly supported Dr. Niculescu's views. Mr. Prager agreed, as a general matter, that "September 2008 is the crescendo, really" when markets faced significant strain and that by "July of 2009, these events we're talking about in September of '08, that the results of those had eased[.]" Tr. 3026:15-3027:2 (Prager).[25] Mr. Prager also agreed that in July 2009 "[t]he markets [were] starting to recover" and reflected only "some dislocation." Tr. 3027:3, 3028:11-14 (Prager). These concessions are all consistent with Mr. Bruce's testimony and Dr. Niculescu's analysis showing that, by July 2009, the ABX market was functioning well. Tr. 826:18-826:22, 853:13-853:24, 4139:2-4139:13 (Bruce); LDX06-21. It is also consistent with AGFP's own view that the ABX market was active and liquid. *See supra* Section III.A.1.

[25] These vague comments are based largely on Mr. Prager's timeline, ADX03-9, which he presented without any source material references, leaving LBIE no meaningful ability to examine the context surrounding, supporting, or disproving its *ipse dixit* assertions.

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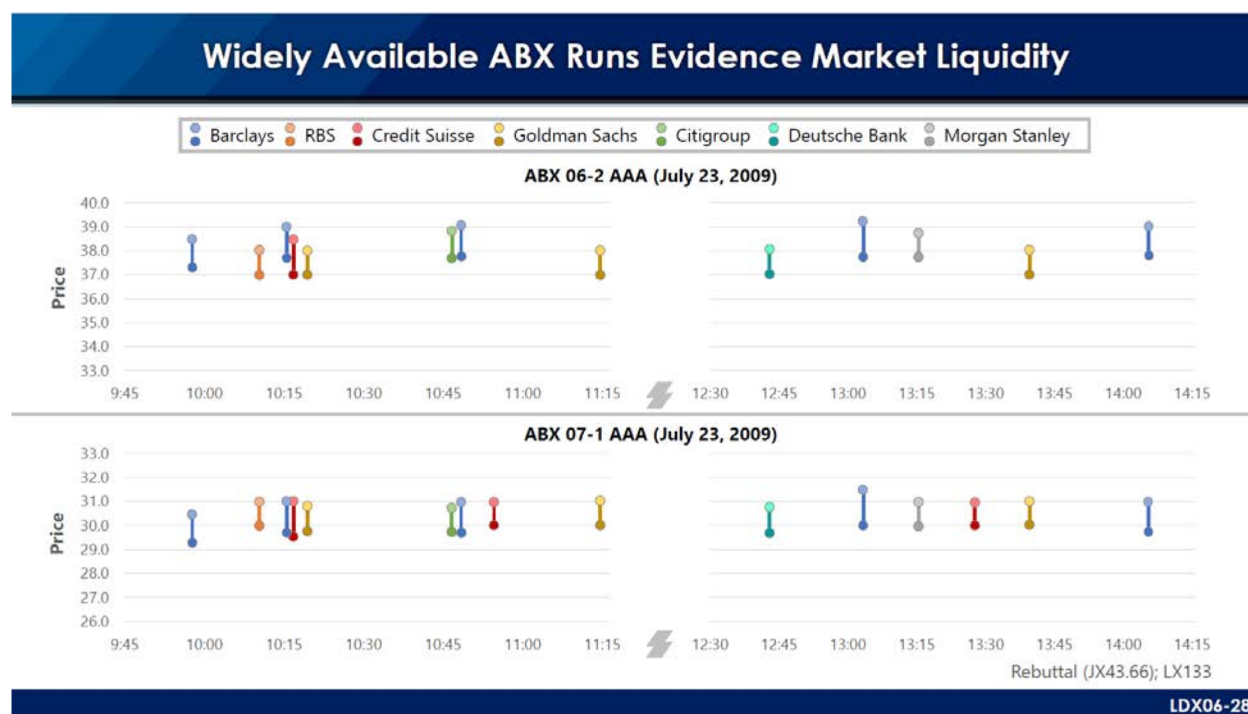
The only specific claim Mr. Prager offered relating to ABX market dislocation as of July 2009 was that because fewer banks chose to submit end-of-day marks to Markit, "market makers are just not there." Tr. 3031:5 (Prager). This claim, based on records of a technical process at Markit, is wrong. As LX133 showed, and Dr. Niculescu summarized in LDX06-28, market makers *were* there: at least seven market makers made ABX markets for customers on July 23, 2009. The decline in submissions to Markit that Mr. Prager referenced was a result of dealer consolidation; it did not change the size of the available market. Tr. 3301:12-3305:1 (Prager) (conceding the same and that sufficient dealers remained according to Markit's rules).[26]



Second, AGFP cites Leslie Rahl's statements in her *Devonshire* expert report that "the market was detached from fundamental considerations of loss." AGFP Br. at 61. These statements are from an entirely different case, involve a different time period, different types of trades, and a

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[26] Three contributors to the Markit composite (Bear Stearns, Merrill Lynch, and Lehman Brothers) were either acquired by other banks or went bankrupt during this time.

17-month standstill unlike anything occurring in this case. *See* Section II.C.3, *supra*. They are unrelated to the ABX market in July 2009, and cannot support departing from industry norms.

Finally, AGFP spends five pages of its brief discussing hearsay articles that it argues prove that markets were dislocated. AGFP Br. 33-36, 61 (discussing AX-50008, AX-50009, AX-50019, AX-50056, AX-50072). This is improper. The Court ruled that these articles *could not be used* to prove market dislocation, because they are rank hearsay. Rather, the Court ruled that the *only* permissible use for these articles is as an attempt to rebut LBIE's proof of a market consensus on how to calculate Loss. Feb. 28 Hrg. Tr. 31:14-18 (ruling on AX-50056 "I do think they come in for the issue that there was a lack of consensus in the market . . . that is fair because LBIE is really pushing that Assured deviated from the industry standard. But they're not coming in for the calculations."); *id.* at 44:12-15 (applying the same ruling to AX-50008, AX-50009, AX-50019, and AX-50072).[27] This ruling at the post-trial hearing was also fully consistent with the Court's ruling at trial barring Dr. Niculescu from testifying about any of these documents because the Court was "not going to consider" them. Tr. 3922:4-3926:2 (Niculescu).

Even if the Court were to credit these documents in any respect, they do not show that the ABX market was dislocated on July 23, 2009, for the simple reason that the data and/or loss projection assumptions each used were stale and unreliable by the Early Termination Date:

- **Bank of England Reports (AX-50008** and **AX-50072)**: The Bank of England Financial Stability Reports were published in April and October 2008, and say nothing about ABX market dislocation in July 2009. AGFP's own expert agreed that market conditions

[27] AGFP attempts to avoid this conflict by misrepresenting the "consensus" at issue. As the Court recognized, LBIE argues that AGFP deviated from the industry-standard consensus regarding *how to calculate Loss*. In an effort to use these documents, AGFP gins up a different so-called "consensus" relating to *market dislocation*. *See* AGFP Br. at 33. ("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)."). This is a bait and switch. AGFP's evidence is irrelevant to the only consensus that the Court and LBIE have argued matters: market practice in calculating Loss.

changed significantly over mere months at this time. Tr. 3026:15-3027:2 (Prager). Moreover, as AGFP mentions, the Bank used its own "estimate of future losses" in the calculations it undertook. AGFP Br. at 33. But both reports reveal the Bank used assumptions from *2005*, which were far out of date by 2008, let alone 2009. AX-50008 at 6, 19, 23, 24; AX-50072 at 12. As discussed at trial and illustrated in LDX10-4, reliable researchers at this time updated assumptions regularly and changed them significantly over time. Tr. 3846:18-3848:10 (Niculescu) ("one of the hallmarks of resourcing is how frequently they update their forecasts . . . you update it monthly"); LDX10-4 (showing S&P's and JP Morgan's respective projected losses rose by about half between February and July 2009). Years-old projected loss estimates cannot be relied upon. Finally, Mr. Bruce testified that the Bank of England was not a reliable source for analysis regarding the U.S. subprime market, and even if its analysis were accurate and up to date., the ABX trades would still be worth $260 million to LBIE. Tr. 4139:10-24, 4143:23-4145:7 (Bruce).

- **Fender/Scheicher Analysis (AX-50009** and **AX-50019)**: These documents, two versions of the same analysis by researchers Indo Fender and Martin Scheicher, were published in September 2008 and March 2009, but analyze data from mid-2006 to mid-2008. AX-50009 at 12; AX-50019 at 30-31 (sample covers "20 July 2006 to 10 June 2008"). Again, data from one to three years earlier cannot inform market dislocation on July 23, 2009.

- **Bear's Lair (AX-50056)**: This article by two researchers at U.C. Berkeley was published after the Early Termination Date, in October 2009. Notwithstanding its publication date, this study is both stale and fundamentally incorrect. The authors' methodology centered on using data "from 2006-2008 . . . to infer the market's expectations of future defaults." *Id.* at 3. Whereas Dr. Niculescu located research reports showing precisely what S&P, Fitch, Barclays, JP Morgan, and BAML ***actually*** expected as of July 2009, and compared those expectations to observed prices on that day, LDX06-21, these researchers ***guessed*** market participants' expectations based on data from years prior. Trial proved that they guessed wrong: for instance, while they guessed that the market was expecting "a prepayment rate of 25% per year," trial showed that ***not even AGFP*** expected prepayment rates that high, and most expected them to be far lower at around 2%. LDX06-16. Likewise, the Bear's Lair researchers claimed that a 66% loss severity was "a value well below anything ever observed in the U.S. mortgage markets," when, in fact, loss severities had exceeded 66% since late fall 2008 and ***even AGFP*** expected them to remain elevated in the future. LDX06-8, LDX06-15. The inadmissible hearsay in Bear's Lair supports dislocation only if you first assume—incorrectly—that conditions were far better than even AGFP, the most optimistic voice in the room, believed them to be. Without those demonstrably false assumptions, the article has nothing to say about market dislocation.

In sum, the only reliable analysis before the Court of dislocation in the at-issue markets is Dr. Niculescu's. He found that ABX market prices were not dislocated, but were instead closely related to expectations of projected losses as of July 23, 2009. No one has offered any credible rebuttal to that careful, thorough work.

3. AGFP Identified No Evidence Suggesting That The Manner Or Purpose Of Calculating Loss Differs In Dislocated Markets

In addition to failing to prove any relevant price dislocation, AGFP also failed to prove that any such dislocation would justify its off-market calculation of Loss. New York law does not hold that, in dislocated markets, the benefit of the bargain on a financial instrument changes from one that is based on market prices to one that is based on subjective inputs. Instead, as Justice Friedman held in an analogous case involving CDS valuation, "[i]t is well-settled that 'where the breach involves the deprivation of an item with a ***determinable*** market value, the market value at the time of the breach is the measure of damages.'" *UBS Secs.*, No. 650097/2009, NYSCEF Doc. No. 641, at 20 (quoting *Sharma*, 916 F.2d at 825 (emphasis added)). If market prices are determinable—and as discussed above, even AGFP's own materials show they were, *see* LX170—then standard market practice and prevailing case law call for the use of market prices. *See* LBIE Br. Sections III.B, IV.A.

Critically, the "well-settled" legal rule that market prices should be used to estimate damages does not exist only because market prices provide indicia of expected losses. Rather, this legal rule exists because market price itself is what the law seeks to measure. Only market price provides an objective measure of where market participants have reached agreement regarding future performance of a particular trade, whereas each market participant's personal view of expected performance will differ. *See* *Boyce v. Soundview Tech. Grp., Inc.*, 464 F.3d 376, 388 (2d Cir. 2006) (observing that market prices "must represent not only the seller's viewpoint, but also the buyer's, since value in the market place reflects both influences" (quotation omitted); *see also* *United States v. Cartwright*, 411 U.S. 546, 551 (1973) (endorsing "the price at which the property would change hands between a willing buyer and a willing seller" as the best estimate of value).

Because determinable market prices are the dictated measure of damages, they remain

appropriate even if they diverge from a market participant's expected losses. *Sharma*, 916 F.2d at 825-26 (as between expected losses and market prices, market price "is the measure of damages"). In other words, even if determinable market prices were "dislocated" relative to subjective expectations of loss, damages would still be measured by prices, not subjective expectations. The case law cited by AGFP confirms this simple principle. *See American Home*, 411 B.R. at 192 (holding that even where markets are dislocated, "the purpose remains the same—to determine as accurately as possible what the sale price would be, i.e., price discovery").

E. AGFP's Claim That It Supported Novation Is Demonstrably False

AGFP also cites the fact that no replacement transaction resulted from LBIE's efforts to find a partner for novation as grounds to permit AGFP's departure from industry norms when calculating Loss. AGFP Br. at 15-17, 19-20. This cynical argument rests entirely on AGFP's so-far successful exclusion of evidence that shows that AGFP *cut off those novation efforts*. When the Court reviews the entire record, including LX61 (Dkt. 548), which was not admitted but which AGFP's Brief requires be considered, the novation story establishes AGFP's desperation to get out of the risk on its CDS trades with LBIE, not any willingness to re-enter that risk in the market.

At trial, it was undisputed that AGFP never "provide[d] a consent, a binding consent to novate the trades," Tr. 524:7-9 (Viegas), and that AGFP's decision to terminate nine trades on the basis of missing trustee reports, without requesting those reports from the administration employees AGFP was dealing with each day, "raise[d] serious concerns whether or not [AGFP was] serious about [novating the remaining trades]." Tr. 512:4-12 (Viegas). AGFP's neglect of, and indeed outright hostility to, a three-party process that could have kept the trades (and their risk) on AGFP's books contradicts any suggestion that AGFP viewed those trades as desirable.

In seeking to support the opposite account, AGFP makes a demonstrably false representation that should cause the Court to revisit its exclusion of the emails that tell the end of

the novation story. In its brief, AGFP quotes Mr. Schozer's testimony to make the bald assertions that it "would have consented to such a novation 'very quickly'" and that "nothing came of LBIE's attempt to novate to Nomura." AGFP Br. at 15, 17. The documentary evidence from July 2009 establishes that neither of these claims is true. *See* Dkt. 548 (LX61 – Not Admitted). At trial, AGFP persuaded the Court to exclude this evidence, even after eliciting testimony from Mr. Schozer about his purported "enthusiasm" for a novation, by claiming that his testimony had been "limited to that time period" "from the beginning of January, the beginning of 2009, through March 2009"—thereby, according to AGFP, not opening the door to evidence showing AGFP taking the exact opposite position in July 2009. Tr. 2454:19-2455:18 (Colloquy). Whatever the merits of this temporal gerrymander at trial, AGFP's post-trial briefing abandons it, and instead flatly claims, without qualification, that AGFP "would have consented to such a novation," but that no progress was made. In light of AGFP's position, and because LBIE "did not proffer the [email] to show an offer of compromise or an admission made in compromise negotiations," but instead to explain the responsibility AGFP bears for the absence of a potential novation, the Court can and should consider evidence that AGFP told LBIE it would ***not*** "have consented," much less done so with "enthusiasm." *See* *Sage Realty Corp. v. Ins. Co. of N. Am.*, 34 F.3d 124, 128 (2d Cir. 1994) (affirming admission of settlement discussion not offered to show evidence of compromise).

AGFP's conduct in connection with LBIE's efforts to find a third-party novation partner is of a piece with AGFP's broader participation in the CDS markets in 2009. AGFP wanted to eliminate, not replace, its exposure to the securities underlying its trades with LBIE, and it enacted new risk management and risk reduction policies that are directly contrary to its claims that it would have been "enthusiastic about LBIE assigning the Transactions to someone else." AGFP Br. at 15; *see, e.g.*, LX226 at 8 (September 2008 risk limit barring *any* new exposure to ABX or

UK RMBS); LX206 at 8 (disclosure of resources AGC expended getting subprime risk off its books). At best for AGFP, it did *nothing* to help find a novation, a choice that contradicts any claim that the CDS trades were valuable assets but fits alongside the overwhelming evidence that the trades were dangerous liabilities AGFP was desperate to avoid. *See infra*, Section V.C.

F. AGFP's Claim That The Absence Of Bids In Henderson's Auction Indicates An Absence Of Value Has No Evidentiary Or Logical Support

AGFP once again implores the Court to find that because the Henderson auction failed in September 2009, that somehow the trades had no value as of July 2009. AGFP Br. at 22-23. The Court previously rejected this argument:

> It would make no sense to hold as a matter of law that, because the Market Quotation process was unsuccessful, Assured was free to adopt a methodology that results in a termination payment completely divergent from the cost of replacing the Transactions. The parties appear to agree that Market Quotation auctions often fail to produce replacement transactions, even in liquid markets. . . . The failure of the Market Quotation auction in this case does not necessarily mean that Assured was unable to replace the Transactions in the market, or that the price of a replacement transaction is impossible to estimate for purposes of applying the cross-check principle.

SJ Decision at 30.[28] It should reject it again.

AGFP's argument contradicts the structure and purpose of the ISDA Master Agreement. The contract requires that AGFP fall back to Loss if the Market Quotation process fails. JX-01 at 16. It does not state or imply that in that case, the trades are worth nothing. *Id*; Tr. 2804:14-2805:2 (Cohn). Nor would this make any commercial sense. As witnesses on both sides agreed, requests for prices under Market Quotation frequently fail and are often viewed as a "pricing exercise,"

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[28] In its brief, AGFP incorrectly states that the Court "held" that "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.'" AGFP Br. at 22 (citing SJ Decision at 8-9). But the Court's opinion was simply describing AGFP's position by quoting excerpts from Professor Pirrong's expert report; this was not the Court's holdings nor a finding of fact.

deterring potential participants from spending time valuing trades that will not execute. *See* Tr. 4213:2-14 (Bruce); Tr. 90:8-92:19 (Rahl); Tr. 1772:21-1773:8 (Niculescu); Tr. 2801:14-2802:7, 2803:24-2804:5 (Cohn); Tr. 3618:2-3619:19 (Pirrong); Tr. 478:5-478:15 (Viegas); LX92.

AGFP cites a series of rejection emails to Henderson, AGFP Br. at 21-22, but these documents are hearsay and should be given no weight. None of the auction participants were cross-examined at deposition or trial, and there is no reason for the Court to infer that the statements provided to Henderson were true. Indeed, the most reliable of these hearsay documents shows that the emails were intended to placate Henderson and mask a lack of desire to participate in a pricing exercise. *See* LX411 at 1 (Barclays Internal Email). In that email, a Barclays trader privately wrote that "[AGFP] might just be fulfilling their 'market quotation' obligations under their existing (terminated 23 July 09) LBIE ISDA," and suggested that Barclays should "[keep] a positive tone" in its correspondence with Henderson and "politely pass" so as "not to taint any relationship" with Henderson and AGFP. *Id.* This same participant also explained why a bidder would not waste their time bidding: "AGFP has no commitment to accept any bids (therefore submitting very low bids 'just in case we get hit' may not make sense either)." LX411 at 1; *see also* Tr. 3644:21-3645:9 (Pirrong).[29]

Moreover, AGFP's argument is fatal to its counterclaim. The auction procedures expressly permitted bidders to quote not only an amount they would *pay* to enter the trades (which AGFP would owe LBIE) but also an amount they would *charge* to enter the trades (which LBIE would owe AGFP). AX-60003 (Henderson Report) at 21-22. Just as no bidder offered to pay to take LBIE's position, no bidder offered to take LBIE's position if it were paid to do so. Under AGFP's

[29] AGFP's witness, Professor Pirrong, conceded that regardless of what they wrote in their emails, the eleven banks who signed the auction confidentiality letter showed a willingness to face AGFP as a CDS counterparty. Tr. 3611:9-3613:12 (Pirrong).

argument, there is no way to square this result with AGFP's counterclaim demand for tens of millions of dollars. If the failure of the Market Quotation process means the trades are worth nothing (it does not), then the trades must be worth *nothing*.

CDS markets can change rapidly, and an absence of pricing evidence from a pricing auction cannot determine value two months earlier. *See* *UBS Secs.*, No. 650097/2009, NYSCEF Dkt. No. 641 at 29 (Friedman, J.) (rejecting results of CDS auction 11 days after breach in favor of $470 million mark-to-market valuation as of the date of breach). The only relevance of the Market Quotation auction is that it failed, requiring AGFP to conduct an objectively reasonable and good faith Loss calculation. The auction is otherwise irrelevant to the value of the trades.

G. AGFP's Claim That Its Poor Credit Should Lessen Its Liabilities Is Legally Incorrect and Contrary To Market Practice

AGFP argues that its poor credit entitles it to a $300 million deduction in any market valuation of the trades. AGFP Br. at 71 n. 438. It is no surprise that AGFP relegates this argument to a footnote, because it contradicts settled law. As explained in LBIE's opening brief, a party's creditworthiness is irrelevant to a determination of contract damages, and specifically to the valuation of derivatives following early termination under the ISDA Master Agreement. LBIE Br. at 26-28; *see, e.g.*, *Am. List Corp. v. U.S. News & World Report, Inc.*, 75 N.Y.2d 38, 44-45 (1989); *Peregrine Fixed Income Ltd.*, [2000] EWHC 99 [30]. AGFP cites no cases in support of its contrary contention that a credit valuation adjustment is permitted under New York law or any prior decision interpreting an ISDA Master Agreement.

Even if the law were ambiguous or unsettled—and it is not—there is no evidence that credit-based adjustments are consistent with industry custom and practice. AGFP misrepresents the testimony of Ms. Rahl and Dr. Niculescu, both of whom testified that they were not aware of any market practice of including a CVA in a Loss calculation. Tr. 326:9-326:21 (Rahl); Tr.

1512:18-1513:2 (Niculescu). Mr. Bruce, who traded CDS in 2009, testified that he had never seen anyone incorporate a CVA into the value of a terminated trade. Tr. 931:1-931:17 (Bruce) ("the CVA calculation is extraneous to the value of the transaction itself"). He also testified that when the Ambac trades were settled, the parties did not incorporate a CVA even though Ambac was close to bankruptcy and the trades were uncollateralized. Tr. 941:8-943:20 (Bruce).

AGFP admits in its brief that its own credit risk "had nothing to do with actual credit losses on insured securities." AGFP Br. at 29. AGFP is correct that its own creditworthiness did not affect the performance of the trades. For this reason, their value should not be discounted as a result of AGFP's credit standing in 2009. AGFP did not incorporate a CVA into its Loss calculation, and it has provided no legal or factual basis to justify the inclusion of such an adjustment. Tr. 324:12-324:16 (Rahl); Tr. 933:11-933:13 (Bruce).

H. AGFP's Claim That Its Business Model Permitted AGFP To Discard Market Practice Improperly Conflates Different Entities

AGFP's brief also repeatedly cites the monoline insurance business model and AGFP's intention to hold its trades to maturity as a basis to justify its departure from industry norms. *See, e.g.*, AGFP Br. at 7, 29. While it persistently and intentionally conflates AGFP, the counterparty to the contract and the defendant in this case, with other entities including Assured Guaranty Corp. and Assured Guaranty Ltd., it ultimately must acknowledge that AGFP was "a so-called 'transformer entity'" that existed exclusively "to sell protection in credit default swap form." AGFP Br. at 4 & 4, n.4. AGFP identifies no precedent suggesting that a company can enter and profit from a market and then escape being held to standards in that market by claiming it was affiliated with, guaranteed by, companies in a different industry.

The testimony at trial from both expert and fact witnesses established that a consistent CDS market practice not only exists but plays a major role in the proper functioning of the industry in

which LBIE and AGFP executed their trades, both before and after the financial crisis. Ms. Rahl testified that the uniformity that followed from "ISDA's publication of standardized documents or contracts" "significantly" drove both "growth in the use of derivatives" and "liquidity" in the CDS market, and that until this case she had never heard anyone suggest that "the parties' business models would play [a role] in how the standard terms get implemented." Tr. 72:18-74:20 (Rahl). Similarly, Mr. Viegas testified that in fulfilling the administration's "mandate" to "crystallize the debtors, collect those debts in an organized manner, quantify the creditors in a fair manner and distribute the money accordingly," it did not "make any difference to [the] determination [of CDS values] what the nature of the counterparty's business was." Tr. 391:20-392:2, 500:10-15 (Viegas). Instead, "the principle most of all was treating everybody consistently," which meant, across all counterparties, following "the fundamental principle … that if counterparty submitted a value that was in accordance to the market practices based on market data, [LBIE] would have accepted." Tr. 392:3-8, 435:2-10 (Viegas).

This evidence of the importance of upholding market expectations buttresses prior rulings from this Court and others about the importance of interpreting the ISDA Master Agreement consistently across time, jurisdictions, and counterparties. At summary judgment, Justice Friedman ruled that "consideration of industry custom" is "particularly appropriate in a case like this, in which the parties have chosen to structure their transactions using the ISDA Master Agreement." SJ Decision at 21 n.10. The Court recognized that this dispute, like others involving this standard, industry-wide contract, "has the potential, through principles of stare decisis, to affect thousands of non-parties and millions of transactions in jurisdictions around the globe governed by precisely the same language." *Id*. The "principal drafter of the ISDA Master Agreement" that Justice Friedman cited for this conclusion has advocated that interpretations of

this contract must "have regard not only to industry terminology, customs and practices in the general sense, but also to the legislative history of the document itself *as well as how market participants have historically dealt with the provisions and concepts in question*." Dkt. 323 at 5 (Jeffrey Golden, *Interpreting ISDA Terms*, 9 Capital Markets Law Journal 299, 302 (2014)).

Other courts have similarly noted that disputes governed by the ISDA Master Agreement, "probably the most important standard market agreement used in the financial world," should "be interpreted in a way that serves the objectives of clarity, certainty and predictability." *Anthracite*, [2011] EWHC 1822 (Ch) ¶ 114; *see also Lomas v. JFB Firth Rixson*, [2010] EWHC 3372 (Ch) ¶ 53 [Eng.] (same); *In re Lehman Bros. Hldgs. Inc.*, 2015 WL 7194609 at*11(same). Those goals and expectations are incompatible with an approach under which the same standardized contract is interpreted or applied differently on the grounds that a particular user of that contract views itself as outside the market defined by the rest of its users.

Ultimately, AGFP entered into an ISDA Master Agreement, and its attempt to distinguish away every bit of industry evidence as inapplicable to its business model is nothing more than a request for "judicial interpretation of the ISDA Master Agreement in a vacuum, without any consideration of industry practice"—exactly what Justice Friedman warned "could lead to results that frustrate, rather than promote, ISDA's—and the parties'—objectives of certainty and market stability." SJ Decision at 21-22 n.10. The Court should continue to reject AGFP's request that the objective reasonableness of its Loss calculation be determined without considering the rest of the industry, and should instead follow the guidance that Justice Friedman previously cited:

> [I]f a market participant is taking a position that has never been taken previously in the long history of the ISDA Master Agreement, and there is clear evidence of market participants having consistently taken a different position on the same or similar facts, that is usually a very good indication that the participant's position is contrary to the industry's understanding of how the provision in question is meant to operate.

Dkt. 323 at 5 (Golden, *Interpreting ISDA Terms*, 9 Capital Markets Law Journal at 302).

IV. AGC'S SUBJECTIVE LOSS RESERVE MODEL IS AN OBJECTIVELY UNREASONABLE BASIS FOR AN ISDA LOSS CALCULATION

A. AGC's Subjective And Self-Interested Loss Reserve Model Is Fundamentally Unsuited To Calculate Loss On CDS Trades

At trial, there was no dispute that the loss reserve figures that AGFP relied on to calculate Loss under the ISDA Master Agreement were generated in accordance with the accounting standard FAS 163, under which "an insurance company is allowed to use its own subjective assumptions when determining expected losses." Tr. 1118:1-5 (Rosenblum). There was similarly no dispute that the subjective values generated under FAS 163 could *not* be used to value or account for credit default swaps, which instead had to be accounted for "under FAS 157," which "requires that the CDS be marked on a mark-to-market basis." Tr. 1115:7-13 (Rosenblum); JX-51 at 3-4, 11, 12, 47 (stating that FAS 163 does not apply to derivative instruments such as credit default swaps). That CDS trades must be valued using objective market prices, on a mark-to-market basis, was common ground among LBIE's experts, *e.g.* Tr. 1051:10-23 (Bruce), AGFP's fact witnesses, *e.g.*, Tr. 1115:7-13 (Rosenblum), the accounting guidelines themselves, *e.g.* JX-52 at 4 (FAS 157: "The guidance in this Statement applies for derivatives"), and AGC's public disclosures to investors, *e.g.*, AX70008 at 119.

AGFP knew the difference between these standards—and knew which one would favor AGFP when calculating Loss. Months after AGFP had terminated the trades, but weeks before it calculated the Loss figure that led to this lawsuit, AGFP employees exchanged spreadsheets that demonstrated that the loss reserves for these trades was nowhere close to AGFP's mid-market valuation of the same trades. LX242 (Tab "Summary," *compare* Col. AB ("FAS 163 Reserve") *with* Col. AD ("Base MTM")). Thus, long before it submitted its purported Loss calculation, AGFP had in hand the comparison between using AGC's subjective loss reserves under FAS 163,

which would show only $9.9 million in reserves for these trades as of June 30, 2009, and it mid-market values under FAS 157, which would reveal that the trades were hundreds of millions of dollars in LBIE's favor as of that same date. *Id.* AGFP chose to use the figures calculated under a subjective standard that it knew did *not* apply to CDS trades. These figures turned a liability measured at nearly half a billion dollars into a supposed asset AGFP could demand to be paid for.

At trial, AGFP's witnesses not only failed to identify any precedent for this choice, *see* Section II.D, *supra*, they could not provide any explanation for how the choice was made in the first place. *See, e.g.*, Tr. 2491:9-23 (Schozer) (claiming AGFP held no meetings on choice of methodology for Loss calculation). AGFP repeatedly noted that it had not previously made a calculation like this one, and admitted that it had not hired an experienced third party to perform, audit, or even consult on this process. Tr. 1092:18-21 (Rosenblum); Tr. 2281:11-17 (Schozer). This stood in stark contrast to AGFP's prior conduct in hiring third parties "to supply it with values on its derivatives trades," Tr. 1092:1-5 (Rosenblum), and to perform its Market Quotation auction on these trades because "[t]hat is something which other firms do but something we don't do." Tr. 2208:4-5 (Schozer). AGFP relied on experienced third parties to guide or assist with valuations and calculations outside of its normal competency—except when deciding to defy industry convention by applying its own subjective loss reserve model to calculate Loss. This led to a grossly off-market calculation in its favor, rather than the hundreds of millions in LBIE's favor that any objectively reasonable calculation would require.

B. AGFP Has No Competent Evidence For The Loss Calculation On 26 Of The 28 Trades

As shown in Section V.A of LBIE's Post-Trial Brief, AGFP utterly failed, both at trial and throughout this litigation, to provide any competent evidence that could support its Loss calculation for the 26 CDS trades that referenced UK RMBS or CLO/CDO securities. No AGFP

witness conducted the analysis of these trades that AGFP relied on to generate a presumption that not one of them would ever suffer a single dollar of losses. *See* Tr. 1133:20-1134:10 (Rosenblum); Tr. 2250:21-23 (Schozer); Tr. 2907:23-25 (Bailenson). There was not a single word of testimony explaining how AGFP's Surveillance Department collected data about these 26 trades, how it created or tested any models it might have run on the trade characteristics it assigned to the 26 trades, or how it arrived at the assumptions it made about future defaults, market moves, or payouts—as the Court inquired, no AGFP witness knows "what they actually did." Tr. 1136:11-13 (Rosenblum). This complete failure of evidence necessarily prevents AGFP from meeting the burden it bears on its counterclaim seeking tens of millions of dollars from LBIE. Dkt 774.

AGFP attempts to breeze past this gaping hole in the record with a single sentence about "Assured's analysis" on page 24 of its brief, which it attempts to support in a single footnote, number 161. The evidence AGFP points to is damning in its insufficiency.

- **JX-34** is a Statement of Calculations on which AGFP has placed a conclusory "0" under "Expected Floating Amounts 26 times over; there is no "analysis."
- **AX-20020** is a May 2009 spreadsheet that, on its face, appears to show the projected results for a *single* CDS trade referencing a CLO. Because AGFP only ever introduced the exhibit through Mr. Rosenblum, who played no part in its creation, *see* Tr. 1297:24-1298:10 (Rosenblum), it offers effectively no evidentiary value. There is no evidence in the record of how or why any particular assumptions were adopted in this "analysis," how and whether those assumptions differed from or aligned with the assumptions used to project ABX losses, or even how AGFP populated the characteristics of this trade.
  - Moreover, AX-20020 is the *only* spreadsheet of its kind for *any* CLO transaction, as the Court properly precluded AGFP from seeking to paper over its evidentiary failures with evidence never even used at trial. Feb. 28, 2022 Hrg. Tr. 23:6-8.
- **AX-20038** is a September 2009 email from one non-witness to another, and a spreadsheet attached to the email that appears to include detail from UK RMBS trades. However, none of the figures in this spreadsheet are *projections* detailing AGFP's purported "analysis" about the future. Instead, this document shows only *historical* facts about these trades, and a single column of "Base Case Expected Loss %" without any explanation of the assumptions used, whether other "Cases"

were run, etc. Neither Mr. Rosenblum nor any other AGFP witness created this exhibit or even remembered seeing it in 2009. Tr. 1306:5-9 (Rosenblum).

Finally, AGFP cites Mr. Rosenblum's testimony at pages 1295-1310 of the trial transcript, a series of questions in which he provided conclusory answers about AX-20020 and AX-20038, two documents he played no role in creating. Mr. Rosenblum provided this testimony after the Court had already cut through his speculation about what the Surveillance Group "would have" done by asking him "What about what they actually did? Do you know the answer?" which elicited a flat "No" in response. Tr. 1136:8-14 (Rosenblum). AGFP's reliance on testimony from a witness with an admitted complete lack of relevant personal knowledge as to most of the evidence of its "analysis" reveals the fundamental absence of any such "analysis" in the record and in this case.

C. Cash Flow Models Must Use Independent Third-Party Projections, Not Subjective And Irrational Internal Assumptions

The evidence at trial also condemned AGFP's Loss calculation by establishing that, where market prices cannot or should not be used to calculate Loss (neither of which is the case here), market practice requires the use of a discounted cash flow model based on third-party projections about the future, not assumptions from the Non-defaulting Party. That was Ms. Rahl's testimony with respect to the *Devonshire* case, where she "looked to independent third-parties" to "create the projections that went into that discounted cash flow model." Tr. 105:18-23. That was Dr. Niculescu's testimony with respect to the Solstice matter, where he "project[ed] the performance of … various asset-backed securities using the assumptions that other market participants were making." Tr. 1767:13-16. That was Mr. Bruce's testimony with respect to the Ambac matter, where the "model outputs … were conducted by the independent appraiser," while "Ambac's insurance loss reserves" were not "incorporated in any way into the models." Tr. 935:4-20.

And it was even Mr. Prager's testimony with respect to the Syncora matter, where an independent third-party, Blackrock, "was brought in … to do the cash flow modeling" for valuing

CDS, rather than using a monoline's internal and subjective loss reserves. Tr. 3117:13-23.

The trial record does not contain a single prior instance, from any type of party in the CDS market, of using internal, subjective projections, rather than neutral, unbiased projections, to calculate Loss. And, as discussed in the next section, using *any* third-party projections in place of AGFP's outlier views about the future would have required a major payment to LBIE. It was only by using both a discounted cash flow methodology and its own consensus-defying assumptions that AGFP was able to gin up a demand for payment from LBIE. As detailed at length in Section V.B of LBIE's Post-Trial Brief, AGFP's approach contradicted contemporaneous performance data, was irrational on its face, and yielded results diametrically opposed to those calculated by others. LBIE Br. at 48-69. If the court were to rule in favor of AGFP's unprecedented approach, it would invite the moral hazard of counterparties calculating Loss in the same self-serving way that AGFP did, thereby disrupting the settled expectations of derivatives counterparties across the globe.

D. AGFP's Models Were Not "Very Similar" To Other Models, Which In Reality Projected \$83 Million To \$315 Million More Losses

AGFP attempts to portray its loss projections for the ABX trades as "very similar" to those published by others in the market by focusing on two of the ratings agencies. AGFP Br. at 62-65. As discussed below, ratings agencies actually projected losses that were more than *seven times larger* than the losses calculated by AGFP's loss reserve model. And the more credible bank research desks projected even more losses than the ratings agencies, and again far more than AGFP did. No contemporaneous projections of the future—none—were "very similar" to AGFP's unreasonably rosy view.

As an initial matter, trial disproved AGFP's baseless claim, offered without citation to the record, that the ratings agencies offered unbiased estimates of expected performance. AGFP Br.

at 62-63. As detailed in LBIE's opening brief, *see* LBIE Br. at 70, the ratings agencies had strong financial incentives to—and did—under-project losses, resulting in the higher ratings their customers sought. As Dr. Pirrong put it, the ratings agencies were "always the last to know." Tr. 3674:23-3675:20 (Pirrong). As the Congressional Oversight Panel put it, their models "involved excessively rosy assumptions about the quality of the underlying mortgages, ignoring the fact that these mortgages (especially subprime mortgages) were far riskier than ever before and were in fact becoming steadily riskier year by year." LX438 at 43. As the Financial Crisis Inquiry Commission put it, "the credit rating agencies abysmally failed in their central mission to provide quality ratings . . . the rating agencies placed market share and profit considerations above the quality and integrity of their ratings." AX-50022 at 241. And as AGC itself put it to the SEC, "the [rating] agencies clearly underestimated, by large margins, the potential severity and correlation of [RMBS and other] transactions . . . [and] were seriously deficient." LX266 at 7. The Court could not ask for a more universal rejection of AGFP's un-cited contention that the ratings agencies were viewed as "independent and transparent." AGFP Br. at 62-63.

What trial actually established is that the research desks connected with leading banks provided independent, unbiased, and universally respected analysis. LBIE Br. at 61-62, 69-70. As Dr. Niculescu testified, and no AGFP witness refuted, the bank research groups had all the right incentives to produce research useful to clients with trading positions on both sides of the market. *Id.* Dr. Niculescu, using research reports published within two weeks of the Early Termination Date, concluded that Barclays, Bank of America, and JP Morgan all projected losses equating to an average of $305 million on the two at-issue ABX trades, ranging from a high of $339 million using assumptions derived from JP Morgan's most up-to-date model, to a low of $270 million using assumptions from an older JP Morgan model, with Barclays and Bank of America in

between. LBIE Br. Section V.D; LDX06-21. In other words, on average the bank research groups projected losses on the ABX almost *thirteen times greater* than AGFP projected.

In its brief, AGFP does not contest that bank research groups were well-respected and regularly relied upon for their quality analysis. AGFP does not contest that, while monolines were structurally biased because they ran "one-way" books in which they only sold protection, the banks ran "flat" books with even exposure to buys and sells of protection, and in any event directed their research to bank clients with positions on both sides of the market. Tr. 3863:13-3866:1 (Niculescu) ("[T]he firm's clients . . . are interested in that research being as accurate as possible. If they suspect there is a bias or taint, your reputation would be damaged and you won't have a client base that listens to your research anymore."). And AGFP does not contest that Dr. Niculescu's calculations of the bank research departments' expected losses are sound. AGFP Br. at 65-66.

Instead, AGFP disputes the usefulness of the research reports by arguing they are "opaque" and by falsely contending that these reports "used market prices as their starting point." *Id.* These are red herrings. The Court can rely on the bank research reports because they are the type of report relied upon in the marketplace, including by AGFP itself. *See* JX-71 at 21, 33-35 (AGC's reserve committee considered banks research reports); Tr. 1194:4-22 (Rosenblum) (confirming that AGC's board and auditors analyzed how its reserves compared to bank projections). The Court need only open the reports from Bank of America (LX123) and JP Morgan (LX119) to see that they contain immense detail regarding the factors considered. Tr. 1729:22-1732:18 (Niculescu) ("everybody was fully aware of what was going on in modifications, and they had been going on for a while and were being studied"). And while the exact document Barclays published contemporaneously with the Early Termination Date (LX137) was brief, Barclays' general processes and publications made clear that it considered government programs and all

available information that would have impacted its forecasts. Tr. 3881:2-23 (Niculescu) ("Of course you consider all available information that would potentially affect your forecast.").

As for the claim that Barclays' loss projections "work[e]d backwards" from the price to expected losses, AGFP Br. at 66, that is simply wrong. As Dr. Niculescu explained at trial, AGFP points to the wrong page of Barclays' report in trying to support this argument: Barclays does show market-implied losses *on page 2*, but the projected losses that Dr. Niculescu used in his analysis are *on page 3*; the projected losses on page 3 are not based on market prices, but rather on Barclays' own assumptions and projections. *Compare* AGFP Br. at 66, notes 418 and 420, *with* Tr. 3877:12-3879:10 (Niculescu) (explaining Mr. Prager was simply "confused").

The similarity of the loss figures on these two pages does not show that Barclays "work[e]d backwards" from the market price to derive its loss projections, but rather that the market price on July 23, 2009 overwhelmingly reflected expectations regarding future losses on the ABX. Tr. 3879:11-3881:1 (Niculescu) ("the markets are seeing . . . no evidence of dislocation"). This was not a dislocated market, but rather a market in which losses were expected to be incredibly high, even after accounting for people's desires to stay in their homes, for government programs, and for expectations that the housing market would begin to bottom out within a year or two. Tr. 3881:2-23 (Niculescu); LBIE Br. at 67-68.

Even if the Court is inclined to disregard the bank research reports and look to the ratings agencies, beset as they were by undisputed conflicts of interest favoring optimism, they still projected far more losses than AGFP as of July 23, 2009. As summarized in LDX10-4 below, none of the ratings agencies produced reports that were ABX-specific or as closely contemporaneous as the reports produced by Barclays and Bank of America. The ratings agencies also did not produce reports that provided the same metric as AGFP, the actual dollar losses

projected on the ABX tranches at issue; Barclays was the only third party that provided that directly analogous calculation.

Projected ABX-related Collateral Losses From Available Reports

PROJECTED LOSS SHOWN AS A PERCENT OF **CURRENT** BALANCE

Entity	As of Date	Projection	ABX-Specific?	Source
Barclays	July 24, 2009	67%	X	LX137-3, LX263
Assured	July 23, 2009	36%	X	JX43-135
BofA	July 23, 2009	67%	X	LX123-23
JP Morgan	July 9, 2009	65% / 74%	--	LX119-11, LX263
S&P	July 6, 2009	44%	--	AX50031-4, LX263
Fitch	June 12, 2009	60%	--	LX367
Moody's	March 5, 2009	41%	--	AX50083-1, LX263
JP Morgan	February 25, 2009	41% / 49%	X	AX50089-1 to 2, LX263
S&P	February 6, 2009	32%	--	AX-50090-2, LX263
Goldman	June 6, 2008	30%	X	AX50084-24, LX263

LDX10-4

S&P and Fitch did, however, produce reports that each provided projected losses to the underlying mortgage pool as a percent of current or original balance and that were dated within six weeks of the Early Termination Date. While less precise than the analysis Dr. Niculescu performed using more detailed information from Bank of America and JP Morgan, Dr. Niculescu was able translate the loss projections from S&P's and Fitch's percentage losses into dollar losses at the relevant ABX tranche level. Tr. 3895:12-3897:18 (Niculescu). Dr. Niculescu concluded that S&P's projected mortgage pool losses of 32% of original balance or 44% of current balance amounted to $107 million of projected tranche-level losses. LDX10-3, 4, 6. He concluded that Fitch's projected mortgage pool losses of 39% of original balance or 60% of current balance

amounted to $248 million of projected tranche-level losses. *Id.*; LBIE Br. at 72.[30] AGFP has not challenged these calculations in any respect. *See, e.g.*, Tr. 3270:7-15 (Prager) (declining to offer an alternative calculation of the ratings agencies' implied tranche-level losses).

Dr. Niculescu's calculations show that S&P projected losses about 350% larger than those AGFP projected and that Fitch projected losses about 930% larger. LDX10-6. In its brief AGFP ignores the Fitch projection entirely, failing to mention it even once in 75 pages. It characterizes S&P's projection, which is *$83 million larger than AGFP's*, as "closely track[ing]" and "very similar" to its own. AGFP Br. at 26, 65; *see also* Tr. 3094:23-3095:22 (Prager) (similarly calling S&P's projection "very similar" to AGFP's). In reality, neither S&P's projections nor Fitch's "confirm[]" the "reasonableness of Assured's modeling" in any respect—an $83 to $224 million divergence cannot be papered over as within the bounds of reasonable variation. *Id* at 65.

AGFP also points to the Moody's report. Again, Moody's projection was not "very similar"; rather, it amounted to $66 million, nearly three times and $42 million more than AGFP's projection. LDX10-6. But more importantly, the Moody's projection, published on March 5, 2009, was far out of date by July 23, 2009. A review of the progression of projections shown in LDX10-4 reveals why this is so problematic. For instance, in February and early March 2009, Moody's was actually more pessimistic than S&P, and aligned with JP Morgan. By July 2009, however, JP Morgan and S&P had both updated their projections to be substantially higher based on data observed since early 2009. Moody's had not yet done so. Consequently, any reasonable observer estimating projected losses as of July 23, 2009 would not have looked to Moody's

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[30] Dr. Niculescu also addressed the differences between Fitch on the one hand and S&P on the other. As he testified, "Fitch had resourced this effort fairly significantly at the time to a greater extent than S&P and Moody's." Tr. 1746:20-22 (Niculescu)

estimates from March 2009.[31] Tr. 3859:13-15, 3884:5-3885:8, 3896:17-20 (Niculescu) (explaining that Moody's updated projections only once per year and "was out of date").

The losses projected by the ratings agencies not only fail to confirm the reasonableness of AGFP's projections, they further undermine AGFP's projections. Combined with the projections from research groups at the dealer banks, the rating agency projections reveal that every one of the independent contemporaneous sources shown to the Court at trial projected losses that were, on average, $238 million larger than AGFP's projections.

V. AGFP GAINED HUNDREDS OF MILLIONS OF DOLLARS FROM TERMINATING THE CDS TRADES

AGFP argues that LBIE's market-based damages would "generate an unjustified windfall for LBIE, and unfairly penalize Assured, which received no benefit from LBIE's default." AGFP Br. at 3-4, 68, 72. This argument has no basis in law or fact. AGFP reduced its exposure to potentially massive losses when it terminated the trades, reaping a huge benefit to itself while simultaneously denying LBIE the hundreds of millions of dollars to which it is entitled.

A. AGFP Improperly Seeks To Introduce Hindsight Evidence

Once again, AGFP has disregarded this Court's rulings by relying on irrelevant and inadmissible hindsight evidence. AGFP Br. at 72-73. AGFP's repeated attempts to influence the Court's decision by discussing unspecified, unexamined, unreliable, and legally irrelevant evidence that was never allowed at trial is improper. As this Court and others have held, contract damages are to be assessed at the time of breach, and not years later using hindsight. *See* SJ

[31] AGFP points to a Moody's publication from August 2009—a month after the Early Termination Date—but that publication expressly acknowledges that Moody's earlier projections had been based on assumptions regarding the housing market that had proven inaccurate and unduly optimistic, and it acknowledged that Moody's had simply not yet updated its projections. AX-50044 at 2, 7, 9-10 (acknowledging loss severities were proving worse than projected and that earlier projections were based on home-price projections that were out of date by August 2009).

Decision at 36, Tr. 2668:10-2669:1 (Colloquy); *Sharma*, 916 F.2d at 826.

B. LBIE Is Seeking Compensatory Damages, Not A Windfall Or Punitive Damages

LBIE is not seeking a "windfall." Instead, it is seeking compensatory damages that, under New York's common law, "return the plaintiff, as nearly as possible, to the position it would have been in had the wrongdoing not occurred[.]" *E.J. Brooks Co. v. Cambridge Sec. Seals*, 31 N.Y.3d 441, 444 (2018). Here, the "wrongdoing" was AGFP's failure to reasonably and in good faith calculate its Loss. Had AGFP not breached the contract, it would have owed LBIE a Settlement Amount of approximately $485 million.

AGFP fails to cite any cases holding that compensatory damages calculated as of the date of breach are a "windfall." *See* *BNP Paribas v. Wockhardt*, [2009] EWHC 3116 (Comm) [Eng.] at [38] ("The effect of the [ISDA close-out] provisions is not that either party receives a windfall but that both receive the benefit (or disbenefit) of the unperformed transactions comprising their agreement crystallized at an earlier point in time (of the Non Defaulting party's choosing)."). The only party seeking a windfall is AGFP, which has abused its role as the Non-defaulting Party in its attempt to eliminate a nearly half-billion dollar obligation to LBIE.

AGFP incorrectly argues that LBIE's requested damages would "unfairly penalize Assured, which received no benefit from LBIE's default." AGFP Br. at 3-4. No court has ever held that the Loss provision in the ISDA Master Agreement, which seeks to compensate the parties for their actual losses as a result of termination, is a penalty provision. In fact, *every* court to address the issue has upheld the ISDA Master Agreement against such a challenge. *See, e.g.*, *Drexel Burnham Lambert Prod. Corp. v. MCorp*, 1991 WL 165941, at *3 (Del. Super. Ct. Aug. 13, 1991); *Drexel Burnham Lambert Prod. Corp. v. Midland Bank PLC*, 1992 WL 12633422, at *2 (S.D.N.Y. Nov. 10, 1992); *Brookfield Asset Mgmt., Inc. v. AIG Fin. Prod. Corp.*, 2010 WL

3910590, at *15-17 (S.D.N.Y. Sept. 29, 2010); *BNP Paribas,* [2009] EWHC 3116 at [32].

C. AGFP Experienced A Massive Gain When It Terminated The Trades

Even if it were relevant whether a breaching counterparty benefitted from its breach of contract, the record shows that AGFP benefitted *immensely*. Trial established what Justice Friedman has already recognized "cannot be disputed": that "at the time of the terminations at issue, the financial crisis had significantly increased the prospects of shortfalls in timely interest and ultimate principal payments on the Underlying Securities." SJ Decision at 38; *see also, e.g.*, Tr. 2275:11-12 (Schozer) ("the expected losses on all mortgage products worsened during that period"). Because AGFP was on the hook for paying those shortfalls if and when they came to pass, eliminating these liabilities was a massive gain to AGFP that the ISDA Master Agreement required be paid over to LBIE. AGFP's actions confirm that fact and refute AGFP's ongoing attempts to suggest that it viewed these trades as assets it had lost.

If AGFP believed that the CDS credit protection contracts it sold LBIE on subprime mortgage securities and corporate loans were profitable assets in July 2009, it could have kept the trades live and taken that risk. Better yet, it could have sold more CDS protection and potentially made billions of dollars if its predictions were correct. Instead, AGFP chose to do the opposite, terminating these trades and declining to try to sell to anyone else the type of CDS it had traded with LBIE. Despite AGFP's central claim in this litigation—that sales of credit protection on mortgage-backed securities or corporate loans made before the financial crisis were profitable assets in July 2009, not dangerous liabilities—AGFP "did not enter into any CDS in those asset classes in this period," and admitted at trial that "we weren't in the -- that market for ABX." Tr. 2373:22-2374:4, 2287:21-24, 2379:9-12 (Schozer). It is impossible to square AGFP's claim to have suffered a "Loss" by terminating these trades with AGFP's actual conduct, in which it avoided such risks altogether for the entirety of 2009. AGFP's own actions establish that it did

not actually believe these trades were valuable assets in July 2009.

AGFP's recognition that credit protection on mortgage- and loan-securities was a liability is reflected not just in AGFP's market behavior, but in its express company policies. In September 2008—contemporaneous with LBIE's default, and months before AGFP finally terminated its trades—AGC revised its company risk limits, drastically reducing the allowable exposure to the very assets at issue in this case. LX226 at 8. The limit for assets including UK RMBS was cut by two thirds, from $2.2 billion to $750 million, and the limit for US subprime assets, including the ABX trades, was dropped from $2.2 billion to ***zero***. *Id.* These changes were drastic efforts to address a central risk that AGFP admits had "materially affected the monoline industry," AGFP Br. at 36, and had generated "larger than expected losses in [AGC's] insured RMBS portfolio," leading the company to "ma[k]e the mitigation of RMBS losses a high priority" and "put[] significant resources toward this effort." LX206 at 8.

Under the risk limits in place in July 2009, AGFP could not enter into a single ABX trade, at any price, without special approval from the Risk Committee. Tr. 2365:15-21 (Schozer). Mr. Schozer's claims to have been ready to accept any bids received on the day of Henderson's September auction (*see* Tr. 2209:24-2210:4 (Schozer)) were unaccompanied by any testimony suggesting that anyone at AGFP sought, much less obtained, this Risk Committee approval. In fact, there is not a single documented communication within AGFP of any kind seeking an exception to these risk limits. Instead, the record is clear that AGFP left itself an express means to avoid trading, even if any party *had* bid. Tr. 2368:10-15 (Schozer) (AGFP retained right not to trade in auction). AGFP cannot square its internal, company-wide and year-long decision to avoid mortgage-backed assets with its claim that it would have accepted the exact same type of trades through the Market Quotation auction or novation. Nor does AGFP explain why it enacted so

many policies to avoid and eliminate CDS trades that its Loss calculation casts as valuable assets. The evidence shows that AGFP enjoyed a gain when it terminated these trades.

AGFP benefited substantially when it terminated the 28 trades at issue. It removed approximately $6 billion in risk from its books at the height of the Great Recession, avoiding any possibility that it would have to pay the hundreds of millions of dollars in shortfalls that the market expected. The Loss provision requires that AGFP pay LBIE the market value of this gain.

VI. AGFP IS NOT ENTITLED TO ATTORNEY FEES

Because AGFP breached the contract by failing to calculate Loss reasonably and in good faith, it is not entitled to attorney fees or interest. *See, e.g.*, *25 East 83 Corp. v. 83rd Street Associates*, 213 A.D.2d 269, 269 (1st Dept. 1995) ("It is settled that only a prevailing party is ordinarily entitled to attorney's fees."). LBIE reserves the right to oppose any award of attorney fees or interest, and requests the right to submit full briefing on the issues in post-judgment proceedings.

VII. CONCLUSION

For the foregoing reasons, Plaintiff Lehman Brothers International (Europe) (in administration) respectfully requests that the Court enter judgment in its favor in the amount of $485 million, with an award of pre-judgment interest pursuant to CPLR § 5001.

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Respectfully submitted,

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