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

LEHMAN BROTHERS INTERNATIONAL (EUROPE) (in administration),	Index No. 653284/2011
Plaintiff,	
- against -	
AG FINANCIAL PRODUCTS, INC.,	
Defendant.	

DEFENDANT'S MEMORANDUM IN SUPPORT OF ITS MOTION TO DISMISS THE FIRST AND THIRD CAUSES OF ACTION OF THE COMPLAINT

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Defendant AG Financial Products, Inc. ("Assured Guaranty") submits this Memorandum of Law in Support of Its Motion to Dismiss the First and Third Causes of Action of the Complaint of Plaintiff Lehman Brothers International (Europe) (in administration) ("Lehman International") under CPLR § 3211(a)(1) and (a)(7) for failure to state a cause of action and based on documentary evidence.

PRELIMINARY STATEMENT

This case involves an attempt by Lehman International, the London, England-based affiliate of Lehman Brothers Holdings Inc. (together with their affiliates, the "Lehman Group"), to exploit the temporary worldwide financial market disruption caused by the historic insolvency filings of the Lehman Group to obtain a windfall profit at the expense of Assured Guaranty, a New York-based insurer with whom it had long previously entered into 37 financial insurance contracts (together, the "Financial Insurance Contracts"). Because the contracts themselves unsurprisingly do not permit this type of unjust windfall, in two of the three Causes

of Action in the Complaint, Lehman International purports to augment its contractual rights based on an implied covenant of good faith and fair dealing. By this motion, Assured Guaranty seeks an order dismissing these claims because an implied covenant of good faith and fair dealing cannot be used to alter obligations and rights in a manner that is contrary to the express terms of the parties' agreements or as the basis for a claim that is simply duplicative of a breach of contract claim.

The First Cause of Action purports to be based solely on Assured Guaranty's termination of nine of the Financial Insurance Contracts in December 2008 (the "December 2008 Transactions") based on Lehman International's undisputed failure to deliver required trustee reports. Lehman International's claim is that Assured Guaranty breached an implied covenant of good faith and fair dealing by terminating the December 2008 Transactions (even though it is undisputed that the agreements explicitly authorized Assured Guaranty to take such action). The Second and Third Causes of Action both purport to be based solely on Assured Guaranty's calculation of the Settlement Amount, or closeout value of the transactions, following termination of the remaining 28 Financial Insurance Contracts in July 2009 (the "July 2009 Transactions") based on Lehman's continuing administration in a U.K. insolvency proceeding. Relying on the same group of alleged facts, the Second Cause of Action purports to be based on an alleged breach of contract and the Third Cause of Action purports to be based on another alleged breach of an implied covenant of good faith and fair dealing. Each of the causes of action purportedly based on the implied covenant of good faith and fair dealing fails on its face and should be dismissed as a matter of law.

First, Lehman International's assertion that Assured Guaranty's termination of the December 2008 Transactions breached the implied covenant of good faith and fair dealing (the

First Cause of Action) seeks to impose obligations upon Assured Guaranty that do not exist under, and are entirely inconsistent with, the terms of the parties' agreements. Each of the nine December 2008 Transactions involved Confirmations that expressly required Lehman International to deliver to Assured Guaranty trustee reports and other notices providing critical information regarding the reference obligations. Under each of the Confirmations for the December 2008 Transactions, Lehman International's failure to provide Assured Guaranty with such reports within 30 days of written notice by Assured Guaranty that it had not received them constituted contractually enumerated grounds to terminate the specific transaction governed by that Confirmation. It is undisputed that, with respect to each of the nine December 2008 Transactions: (a) Lehman International failed to provide Assured Guaranty with the monthly trustee reports required for at least the months of August, September and October 2008; (b) thereafter Assured Guaranty sent to Lehman International a "Notice of Failure to Deliver Reports," which identified these failures; and (c) Lehman International neither responded to the notices nor delivered the requested reports during the 30-day contractual Cure Period. Accordingly, following the expiration of the Cure Period, Assured Guaranty provided Lehman International with written notices of termination for each of the December 2008 Transactions as explicitly authorized by the contracts.

Lehman International's position that it should be awarded damages it supposedly suffered as a result of actions taken by Assured Guaranty that were specifically authorized by the very sophisticated parties to these agreements is nothing more than an impermissible attempt to use the implied covenant of good faith and fair dealing to erase the language of the agreements and to create rights and obligations inconsistent with their explicit terms. It is well-settled under

New York law that the duty of good faith and fair dealing cannot imply obligations inconsistent with the express terms of the parties' contract.

Second, Lehman International's assertion that Assured Guaranty breached the implied covenant of good faith and fair dealing as a result of the calculation method it used in determining the amounts payable upon the termination of the July 2009 Transactions (the Third Cause of Action) is, at best, simply duplicative of Lehman International's breach of contract claim based upon the same conduct (the Second Cause of Action) and thus also fails as a matter of law. The parties' agreement gave Assured Guaranty, as the Non-defaulting Party, the right to calculate the closeout value of the July 2009 Transactions (the "Settlement Amount"). Depending on the outcome of that calculation a payment would be owed from or to the Non-defaulting Party. Lehman International has challenged the calculation made by Assured Guaranty, which showed that Lehman International owed Assured Guaranty a Settlement Amount of $24,799,972.85, and claims that if Assured Guaranty had performed this calculation using a different methodology and certain unspecified market data (neither of which are required by the parties' agreement), Assured Guaranty would owe Lehman International approximately $1.4 billion. See Verified Complaint, dated November 28, 2011 ("Compl."), ¶¶ 33, 37.

The essence of Lehman International's breach of contract claim is that, in performing its calculation of the Settlement Amount, Assured Guaranty failed to act "reasonably" and "in good faith." See Compl. ¶ 47. Both the substantive theory and factual allegations underlying Lehman International's Third Cause of Action for breach of the implied covenant of good faith and fair dealing are substantially identical to those underlying the breach of contract claim in its Second Cause of Action. Lehman International also seeks the same remedy with respect to the Second Cause of Action and the Third Cause of Action, namely, to

substitute its calculation of the Settlement Amount in place of the calculation done by Assured Guaranty. It is black letter New York law that a plaintiff may not maintain a claim for breach of the implied covenant of good faith and fair dealing where, as here, that claim is based upon the same factual allegations and seeks the same damages as the plaintiff's claim for breach of an express provision of the contract.

Finally, Assured Guaranty has not moved with respect to the Second Cause of Action for breach of contract because it believes that, in assessing such a claim, the Court would benefit from a factual record that cannot be presented in connection with a pleadings motion. To be clear, though, Assured Guaranty satisfied its contractual obligations in calculating the Settlement Amount – first, in seeking to obtain market quotations and, when market quotations proved unavailable, in calculating Loss:

- As the involvement and the reports of KPMG and Henderson Global Investments, which are referenced here for background, make manifest, Assured Guaranty conducted a robust auction process in an effort to obtain replacement counterparties for Lehman International in the 28 transactions.

- Assured Guaranty's Loss calculation, which was based on the approach Assured Guaranty took in valuing these obligations for purposes of determining its regulatory reserves, was consistent with the parties' agreement.

In contrast, the approach Lehman International suggests for calculating Loss is designed to procure for itself an unjustified windfall benefit from its own default. Lehman International creates out of whole cloth a supposed requirement that Assured Guaranty use unspecified "market data" in calculating "Loss," even though no such requirement is contained in the definition of "Loss" or appears anywhere else in the parties' agreements. In fact, the parties' Agreement, as defined below, specifically provides that the Non-defaulting Party "*may (but need not)* determine its Loss by reference to quotations of relevant rates or prices from one

or more leading dealers in the relevant markets." International Swap Dealers Association (ISDA) Agreement, dated April 7, 2000 ("Agreement") § 14 (Ex. 1) (definition of "Loss") (emphasis added).[1] Accordingly, the Court should not countenance Lehman International's efforts to rewrite the parties' agreement to erase its contractual obligations while imposing new obligations upon Assured Guaranty, under the guise of the implied covenant of good faith and fair dealing.

BACKGROUND

1. The Parties

Defendant Assured Guaranty is a New York-based company that provides insurance in the form of credit default swaps.

Plaintiff Lehman International is an international financial services firm and was the primary European broker-dealer for Lehman Brothers Holdings Inc. On September 15, 2008, Lehman International filed for insolvency protection and entered into administration in the U.K.

2. The Transactions and Assured Guaranty's Contractual Rights to Terminate

Beginning in 2005, the parties entered into 37 credit derivative transactions under which Lehman International purchased financial insurance from Assured Guaranty with respect to various reference bonds or securities. Compl. ¶ 1; id. ¶ 21 ("As contemplated by the Agreement, the parties entered into 37 Transactions governed by the Agreement....These Transactions referenced different underlying mortgage-backed securities and collateralized loan obligations."). In each transaction, Lehman International, as the protection buyer, agreed to make periodic premium payments to Assured Guaranty, and Assured Guaranty, as the protection seller, agreed to make a payment to Lehman International upon the occurrence of a credit event

[1] Unless otherwise noted, all exhibits referenced herein are attached to the affirmation of Rishi Zutshi, dated February 3, 2012 ("Zutshi Aff."). All capitalized terms not defined herein have the meaning ascribed to them in the Master Agreement, as defined below.

with respect to the reference obligation, i.e., if the obligor on the reference obligation failed to pay. See, e.g., Primus CLO Confirmation (Ex. 2). At the time the parties entered into the transactions, all of the reference obligations were highly rated (either AAA-rated or baskets of AA-rated) senior notes.[2]

Each of these transactions was "governed by a common contract between [Lehman International] and [Assured Guaranty] dated as of April 7, 2000, based on a template published in 1992 by the International Swaps and Derivatives Association ['ISDA'] (the 'Agreement,' which together with the 'Schedule' comprises the 'Master Agreement')." Compl. ¶ 1; see also Agreement (Ex. 1); Schedule (Ex. 3).[3] The Agreement contemplated that each transaction would be subject to an additional confirmation document (the "Confirmation"). See Compl. ¶ 21 ("Each Transaction was evidenced by a written confirmation."); Agreement § 1 (Ex. 1) (stating that the parties "anticipate entering into one or more transactions (each a 'Transaction') that are or will be governed by this Master Agreement, which includes the schedule (the 'Schedule'), and the documents and other confirming evidence (each a 'Confirmation') exchanged between the parties confirming those Transactions."). Each individual transaction was therefore governed both by the Agreement and Schedule and by its respective Confirmation.

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[2] Ratings for each of the relevant reference obligations are generally available at http://www.moodys.com/page/lookuparating.aspx or at http://www.standardandpoors.com/ratings/en/us/; see also, e.g., http://www.moodys.com/research/MOODYS-ASSIGNS-RATINGS-TO-NOTES-ISSUED-BY-STANFIELD-VEYRON-CLO--PR_113082 (assigning AAA rating, the highest possible, to notes referenced in one of the Financial Insurance Contracts).

[3] The 2000 Agreement was originally executed between Lehman International and ACE Capital RE Overseas Ltd. These parties then executed a novation under the Master Agreement on December 11, 2001, whereby Assured Guaranty assumed ACE Capital's rights and obligations under the Master Agreement. Compl. ¶ 12.

The Agreement provides that a party may terminate all transactions if any of the Events of Default enumerated in the Agreement occurs. See Agreement § 6(a) (Ex. 1). Among others, the filing of bankruptcy by Lehman International constitutes an Event of Default:

> ***Events of Default***. The occurrence at any time with respect to a party ... of any of the following events constitutes an event of default (an "Event of Default") with respect to such party: ...The party...seeks or becomes subject to the appointment of an administrator, provisional liquidator, conservator, receiver, trustee, custodian or other similar official for all or substantially all its assets.

Agreement § 5(a)(vii)(6) (Ex. 1); see Compl. ¶ 14. The Agreement further provides:

> ***Right to Terminate Following Event of Default***. If at any time an Event of Default with respect to a party (the "Defaulting Party") has occurred and is then continuing, the other party (the "Non-defaulting Party") may, by ... notice to the Defaulting Party specifying the relevant Event of Default, designate ... an Early Termination Date in respect of all outstanding Transactions [under the Master Agreement].

Agreement § 6(a) (Ex. 1); see also Compl. ¶ 15. In the event a party terminates all transactions based on an Event of Default, the Agreement provides that the Non-defaulting Party shall determine the amount of the termination payment, which depending upon the circumstances may be owed by the Defaulting Party to the Non-defaulting Party, or vice versa. See Agreement § 6(e) (Ex. 1); id. § 14 (Ex. 1); Schedule, Part 1(f) (Ex. 3).

In addition, certain of the Confirmations set forth "Additional Termination Events" – circumstances under which one or both of the parties could terminate the transaction specific to that Confirmation. For example, many of the transactions involved in this action – including each of the nine December 2008 Transactions – have Confirmations that expressly required Lehman International to deliver to Assured Guaranty trustee reports regarding the reference obligations at issue in the transaction. See, e.g., Primus CLO Confirmation § 8(a)(ii) (Ex. 2) ("Buyer [Lehman International] shall obtain and provide Seller [Assured Guaranty] with copies of all reports and other information relating to the Reference Obligation that the

Reference Entity, any collateral manager or servicer for the Reference Entity or the trustee with respect to the Reference Obligation is required to deliver to the holders of the Reference Obligation."). These reports provide critical information regarding the reference obligations without which Assured Guaranty could not properly monitor the performance of, or enforce rights in respect of, the securities for which it was providing insurance protection.

Further, the Confirmations for the December 2008 Transactions state that Lehman International's failure to provide Assured Guaranty with the trustee reports within 30 days of written notice by Assured Guaranty that it has not received them constitutes an Additional Termination Event – i.e., grounds for Assured Guaranty to terminate the specific transaction governed by that Confirmation. See, e.g., Primus CLO Confirmation § 8(a)(iii)(b) (Ex. 2). Specifically, each of these Confirmations provides:

> In the event that (x) Buyer [Lehman International] fails to promptly deliver any trustee or noteholder reports or other information to Seller [Assured Guaranty] as required under paragraph 8(a)(ii) of this Confirmation, (y) Seller [Assured Guaranty] gives written notice of such failure to Buyer [Lehman International], and (z) Buyer [Lehman International] does not cure such failure within thirty (30) days of effectiveness of such notice from Seller [Assured Guaranty] (the "Cure Period"), Seller [Assured Guaranty] may, within 30 Business Days of the end of such Cure Period, declare an Additional Termination Event to have occurred with respect to this Transaction and designate an Early Termination Date with respect thereto, with Buyer [Lehman International] as the sole Affected Party and this Transaction as the sole Affected Transaction.

See, e.g., Primus CLO Confirmation § 8(a)(iii)(b) (Ex. 2).[4] In the event Assured Guaranty terminates based on Lehman International's failure to provide trustee reports, no termination payment is calculated under Section 6(e) of the Agreement. Instead, the relevant Confirmations require Lehman International to pay an "Accrued Fixed Payment Amount," which "means, as of any Early Termination Date, the accrued and unpaid Fixed Payments under the Transaction for

[4] The nine confirmations that provide Assured Guaranty with the right to terminate under these circumstances are attached to the Zutshi Aff. as Exs. 2, 4-11, and the relevant provisions of each are substantively identical.

the period from and including the [premium payment date] immediately preceding the Early Termination Date to but excluding the Early Termination Date, plus any Unpaid Amounts payable to Seller [Assured Guaranty] and outstanding on the Early Termination Date." See, e.g., Primus CLO Confirmation § 8(a)(iii)(b) (Ex. 2); Zutshi Aff. Exs. 4-11; see also Compl. ¶ 25.

3. Assured Guaranty Terminates Nine of the 37 Transactions in December 2008 Based on Lehman International's Undisputed Failure to Deliver Reports

It is undisputed that Lehman International failed to provide Assured Guaranty with trustee reports for at least the months of August, September and October 2008 for the securities referenced in the nine December 2008 Transactions.[5] See, e.g., Compl. ¶ 4.

In compliance with the terms of the applicable Confirmations, "[o]n November 13, 2008, ... [Assured Guaranty] sent to [Lehman International] [a] 'Notice of Failure to Deliver Reports'," Compl. ¶ 23, which explained that "[Lehman International] [had] failed to provide [Assured Guaranty] with [certain specified] monthly trustee reports relating to the reference obligations" with respect to the nine December 2008 Transactions. Id.; see also, e.g., Primus CLO Confirmation § 8(a)(iii)(b) (Ex. 2) ("written notice" requirement).[6] Lehman International neither responded to Assured Guaranty's notice nor delivered the requested reports during the 30-day Cure Period. See, e.g., Primus CLO Confirmation § 8(a)(iii)(b) (Ex. 2). Following the expiration of the Cure Period, "[o]n December 23, 2008, on the basis of [Lehman International's] failure to provide the reports, [Assured Guaranty] sent to [Lehman International] notices of termination for the December 2008 Transactions, declaring the occurrence of an

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[5] Additionally, with respect to seven of the December 2008 Transactions, Lehman International also failed to provide the monthly trustee reports for July 2008.

[6] Although it is undisputed that Assured Guaranty provided written notice of Lehman International's failure to produce the requisite reports, copies of those notices are provided for the Court's convenience as Ex. 12 to the Zutshi Aff.

Additional Termination Event (as defined in the confirmations documenting these Transactions)." Compl. ¶ 25; see also Notices of Termination (Ex. 13).

As Lehman International recognizes, "[p]ursuant to Section 8(a)(iii)(B) of the confirmations of the December 2008 Transactions, upon the occurrence of an Additional Termination Event, ... [Lehman International] ... owe[d] to [Assured Guaranty] an 'Accrued Fixed Payment Amount,' which consists of the accrued and unpaid premiums that [Lehman International] owes to [Assured Guaranty] as of the Early Termination Date. Thus, no amount (other than amounts due and not paid) is payable by either party in respect of the termination of the December 2008 Transactions." Compl. ¶ 25; see also Primus CLO Confirmation § 8(a)(iii)(b) (Ex. 2).

4. Assured Guaranty Terminates the Remaining 28 Transactions in July 2009 Based on Lehman International's Ongoing Administration

"On September 15, 2008, [Lehman International] entered into administration in England. As a result, the terms of the Agreement allowed [Assured Guaranty] to terminate the Transactions under the Agreement and calculate a net amount to be paid by one party to the other." Compl. ¶ 2; see also Agreement § 6(a) (Ex. 1); id. § 5(a)(vii)(6) (Ex. 1) (providing that party becoming "subject to the appointment of an administrator, provisional liquidator, conservator, receiver, trustee, custodian or other similar official for it or for all or substantially all its assets" constitutes an Event of Default). As long as this Event of Default continues, Assured Guaranty is entitled to terminate the entire Agreement. Agreement § 6(a) (Ex. 1) ("If at any time an Event of Default . . . has occurred and is then continuing, the [Non-defaulting Party] may . . . designate . . . an Early Termination Date in respect of all outstanding Transactions.").[7]

[7] It is undisputed that Lehman International has remained in administration in the U.K. since the date of its initial filing in September 2008, and remains so today.

On July 23, 2009, Assured Guaranty notified Lehman International that it was terminating all 28 outstanding transactions based on Lehman International having been placed in administration, among other Events of Default. See Compl. ¶ 27 ("On July 23, 2009, [Assured Guaranty] sent to [Lehman International] a notice designating an Early Termination Date under the Agreement ... stat[ing] that [Lehman International's] order of administration ... constituted an Event of Default under the Agreement."); Notice of Termination for all Transactions (Ex. 14).

Upon termination, the Agreement provides the Non-defaulting Party with the exclusive right to calculate the Settlement Amount. In calculating the Settlement Amount, the Non-defaulting Party must first use the Market Quotation method. See Schedule, Part 1(f) (Ex. 3) ("For the purpose of Section 6(e) of [the] Agreement, Market Quotation and the Second Method will apply.") (underlined in original); Agreement §6(e)(i)(3) (stating that termination amount shall be "determined by the Non-defaulting Party").[8] The Market Quotation method requires the Non-defaulting Party to solicit quotations from Reference Market-makers in order to determine a market value for the terminated transactions. Agreement § 14 (Ex. 1). In effect, Reference Market-makers are asked to indicate what they would pay or require to be paid in order to step into the shoes of the Defaulting Party (here, Lehman International) in a materially identical replacement transaction facing the Non-defaulting Party (here, Assured Guaranty) and referencing the same underlying security or basket of securities as the terminated transaction.

Here, Assured Guaranty engaged the assistance of KPMG, a major international accounting firm, and Henderson Global Investors, one of Europe's largest and most preeminent

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[8] Specifically, Section 6(e)(i)(3) of the Agreement provides that the amount payable shall be "equal to (A) the sum of the Settlement Amount (determined by the Non-defaulting Party) in respect of the Terminated Transactions and the Termination Currency Equivalent of the Unpaid Amounts owing to the Non-defaulting Party less (B) the Termination Currency Equivalent of the Unpaid Amounts owing to the Defaulting Party. If that amount is a positive number, the Defaulting Party will pay it to the Non-defaulting Party; if it is a negative number, the Non-defaulting Party will pay the absolute value of that amount to the Defaulting Party."

investment advisors, to advice on the development of a bidding process. Following the advice of KPMG and Henderson Global Investors, Assured Guaranty then established a robust bidding procedure to obtain quotes for each replacement transaction, and ultimately solicited quotations from a dozen market participants during a two-week bidding period that concluded in September 2009. Despite its diligent efforts to obtain quotations from Reference Market-makers, Assured Guaranty did not receive any final quotations. See Report from Henderson Global Investors and Report from KPMG (Exs. 15-16).

When, as was the case here, a "Market Quotation cannot be determined or would not (in the reasonable belief of the party making the determination) produce a commercially reasonable result," the Agreement specifically requires the Non-defaulting Party to use an alternative Loss methodology, i.e., "an amount that party reasonably determines in good faith to be its total losses and costs (or gain, in which case expressed as a negative number) in connection with . . . [the] group of Terminated Transactions." Agreement § 14 (Ex. 1); see also Compl. ¶ 20. Consistent with the Agreement, Assured Guaranty therefore calculated the Settlement Amount based on the Loss methodology, determining the amount it believed in good faith to be its total losses, costs, and gains with respect to all 28 remaining transactions. On October 16, 2009, notified Lehman International of its closeout calculations and proposed Settlement Amount.

ARGUMENT

Rule 3211(a)(7) of the CPLR provides that a court shall dismiss a complaint when "the pleading fails to state a cause of action." Similarly, Rule 3211(a)(1) provides that a court shall dismiss a cause of action when documentary evidence refutes the plaintiff's allegations and establishes a defense as a matter of law. While the court must generally presume that the facts alleged in a complaint are true, "[t]he interpretation of an unambiguous contract is a question of

law for the court, and the provisions of a contract addressing the rights of the parties will prevail over the allegations in a complaint." Taussig v. Clipper Grp., L.P., 13 A.D.3d 166, 167 (1st Dep't 2004) (dismissing claim); see also 150 Broadway N.Y. Assocs. v. Bodner, 14 A.D.3d 1, 5(1st Dep't 2004) ("[W]here a written agreement . . . unambiguously contradicts the allegations supporting [the] breach of contract, the contract itself constitutes documentary evidence warranting the dismissal of the complaint pursuant to CPLR 3211(a)(1)."). Additionally, where parties to a contract are "sophisticated, counseled commercial entities," courts will enforce contracts according to their plain terms and not rewrite them. See Flag Wharf, Inc. v. Merrill Lynch Capital Corp., 40 A.D.3d 506, 507(1st Dep't 2007).

I. LEHMAN INTERNATIONAL'S FIRST CAUSE OF ACTION FOR BREACH OF THE IMPLIED COVENANT OF GOOD FAITH AND FAIR DEALING BASED ON ASSURED GUARANTY'S TERMINATION OF THE DECEMBER 2008 TRANSACTIONS FAILS TO STATE A CLAIM

Lehman International does not – because it cannot – dispute any of the following facts, which demonstrate that Assured Guaranty acted within its contractual rights when it terminated the December 2008 Transactions:

(i) the Confirmations governing the nine December 2008 Transactions require Lehman International to provide trustee reports regarding the reference obligations to Assured Guaranty and provide that Lehman International's failure to provide Assured Guaranty with those reports within 30 days of written notice by Assured Guaranty that it has not received them constitutes an Additional Termination Event – i.e., grounds for Assured Guaranty to terminate the specific transaction governed by that Confirmation, see, e.g., Primus CLO Confirmation §§ 8(a)(i) - (iii);

(ii) Lehman International failed to provide Assured Guaranty with trustee reports required under the Confirmations for the December 2008 Transactions for at least the months of August, September and October 2008, see Compl. ¶ 4;

(iii) Assured Guaranty notified Lehman International of this failure in writing, see Compl. ¶ 23 ("On November 13, 2008, . . . [Assured Guaranty] sent to [Lehman International] [nine] 'Notices of Failure to Deliver Reports' which alleged that with respect to [the December 2008 Transactions], [Lehman International] failed

to provide [Assured Guaranty] with monthly trustee reports relating to the underlying reference obligations.");

(iv) Lehman International failed to respond to Assured Guaranty's written notice or otherwise cure its failure to provide the required reports during the 30-day cure period, see Compl. ¶ 24 (conceding that Lehman International neither provided the reports nor responded to Assured Guaranty's requests for the reports, and arguing instead that Assured Guaranty should have attempted to "obtain[] these reports from other sources");

(v) Assured Guaranty subsequently sent Lehman International notices of termination for the nine December 2008 Transactions, see Compl. ¶ 25 ("On December 23, 2008, on the basis of [Lehman International's] failure to provide the reports, [Assured Guaranty] sent to [Lehman International] notices of termination for the December 2008 transactions, declaring the occurrence of an Additional Termination Event . . ., and designating December 24, 2008 as the Early Termination Date."); and

(vi) Assured Guaranty calculated the "Accrued Fixed Payment Amount" based on "the accrued and unpaid premiums that [Lehman International] owe[d] to [Assured Guaranty]" as set forth in the Confirmations. Compl. ¶ 25.

Because it cannot allege a breach of the contractual agreements, Lehman International argues instead that Assured Guaranty was precluded from exercising its express contractual right to terminate the December 2008 Transactions because "[h]ad [Assured Guaranty] wanted the reports for commercial or risk management purposes, . . . it could have obtained them from other sources, including the trustee, or it could have requested them directly in the context of the ongoing negotiations." Compl. ¶ 41. Put simply, Lehman International asks this Court simply to erase the requirement in the parties' contracts that Lehman International provide the trustee reports as well as the parties' agreed-upon contractual remedy if Lehman International failed to take corrective action after receiving 30 days' notice of a failure to produce such reports. There is no language in the parties' agreements that suspends the parties' rights and obligations under these provisions if the trustee reports can theoretically be obtained from another source or during any period of time when the parties are supposedly discussing the

"possible novation of [these agreements]." See id.[9] Nor is there any merit to Lehman International's suggestion that Assured Guaranty was required to provide oral notice of Lehman International's failure to produce the reports in addition to the formal written notice that indisputably was provided to, and received by, Lehman International; the Agreement expressly requires Assured Guaranty to provide *written* notice, which indisputably occurred. See Primus CLO Confirmation § 8(a)(iii)(b) (Ex. 2); Agreement § 12(a) (Ex. 1).

Lehman International's position is thus nothing more than an impermissible attempt to use the "implied covenant of good faith and fair dealing to read into the agreement obligations at odds with the express contractual rights of the parties." UBS AG v. Cournot Fin. Prods., LLC, No. 10-cv-494 (GBD), 2010 WL 3001884, at *2 (S.D.N.Y. July 26, 2010); see also Havell Capital Enhanced Mun. Income Fund, L.P. v. Citibank, N.A., 84 A.D.3d 588, 589 (1st Dep't 2011) ("[T]he duty of good faith cannot imply obligations inconsistent with the express terms of [an] agreement."). Indeed, if the Court were to adopt the position urged by Lehman International, it would render meaningless the reporting requirements, the requirement that Assured Guaranty provide written notice of any such failure, the 30-day cure period and Assured Guaranty's express right to terminate in the event of Lehman International's failure to cure. See Phoenix Capital Invs. LLC v. Ellington Mgmt. Grp., L.L.C., 51 A.D.3d 549, 550 (1st Dep't 2008) ("We adhere to the well-established principle that the implied covenant of good faith and fair dealing will be enforced only to the extent it is consistent with the provisions of the contract.

[9] Lehman International's implicit acknowledgement that prior to its default, it was focused on its obligations under these agreements makes its decision to ignore its obligations under these contracts appear to be a deliberate choice or, in any event, an even less excusable failure. Notably, there is no claim by Lehman International that it registered any objection when it received the December 2008 notice of an Additional Termination Event (it did not), and even now Lehman International does not argue the notice was ineffective nor does it seek to restore these contracts.

. . . [To rule otherwise] would unjustifiably frustrate the expectations of the parties as made explicit in the contract.").

Tellingly, Lehman International does not assert a claim for breach of contract based on Assured Guaranty's termination of the December 2008 transactions, and for good reason: it is beyond dispute that Assured Guaranty was well within its express contractual rights to terminate the December 2008 Transactions based upon Lehman International's undisputed failure to produce the trustee reports when required or to cure that failure within 30 days of Assured Guaranty's notice of its failure to do so. Instead, Lehman International asks this Court to invoke the implied covenant of good faith and fair dealing in order to rewrite those obligations. But it is black letter New York law that "[n]o obligation [of good faith and fair dealing] can be implied . . . which would be inconsistent with other terms of the contractual relationship." Murphy v. Am. Home Prods. Corp., 58 N.Y.2d 293, 304 (1983); see also Sabetay v. Sterling Drug, Inc., 69 N.Y.2d 329, 329 (1987) (dismissing breach of the implied duty of good faith claim); Cohen v. Nassau Educators Fed. Credit Union, 37 A.D.3d 751, 751 (2d Dep't 2007) (dismissing breach of implied covenant of good faith and fair dealing claim where "the documentary evidence clearly showed that the [defendant] was authorized to terminate the [contract]").

This limitation applies with particular force in contractual disputes between sophisticated parties arising out of derivatives transactions, and courts routinely dismiss claims that a party breached the implied covenant of good faith and fair dealing by exercising its express contractual rights under an ISDA Master Agreement. See U.S. Bank Nat'l Ass'n v. Ables & Hall Builders, 696 F. Supp. 2d 428, 445 (S.D.N.Y. 2010) (rejecting breach of implied covenant claim based on counterparty's declaration of an Additional Termination Event under an ISDA

Master Agreement); UBS AG v. Cournot Fin. Prods., LLC, No. 10-cv-494 (GBD), 2010 WL 3001884, at *2 (S.D.N.Y. July 26, 2010) (dismissing breach of implied covenant claim based on alleged violation of an "implicit [term] in the ISDA Master Agreement"); Duration Mun. Fund, L.P. v. J.P. Morgan Sec. Inc., 25 Misc. 3d 1203(A), at *9 (Sup. Ct. N.Y. County 2009) (dismissing claim for breach of implied duty of good faith under C.P.L.R. 3211(a)(7)).

The recent decision in U.S. Bank is instructive. Alleging facts similar to those alleged by Lehman International with respect to the December 2008 Transactions, the defendants in U.S. Bank asserted a counterclaim against the plaintiff bank for breach of the implied covenant of good faith and fair dealing based on the bank's declaration of an Additional Termination Event under an ISDA Master Agreement. As the court explained in rejecting the defendants' counterclaim:

> When the Bank declared an Additional Termination Event and charged a payment upon early termination, the Bank was exercising its rights under the contract. The implied covenant "does not extend so far as to undermine a party's general right to act on its own interests." Defendants may not employ the covenant as a means of forcing the Bank to forbear from exercising its contractual rights.

U.S. Bank , 696 F. Supp. 2d at 445 (citation omitted). Similarly, this Court should reject Lehman International's attempt to create an implied duty that would deprive Assured Guaranty of its express contractual termination rights.

II. LEHMAN INTERNATIONAL'S THIRD CAUSE OF ACTION FOR BREACH OF THE IMPLIED COVENANT OF GOOD FAITH AND FAIR DEALING BASED ON ASSURED GUARANTY'S TERMINATION OF THE JULY 2009 TRANSACTIONS FAILS TO STATE A CLAIM

It is well settled that a "breach of [the implied duty of good faith and fair dealing] is merely a breach of the underlying contract," Fasolino Goods Co. v. Banca Nazionale del Lavoro, 961 F.2d 1052, 1056 (2d Cir. 1992) (citation omitted), and that "New York does not recognize a separate cause of action for violation of the implied covenant of good faith and fair

dealing." Cohen v. Nassau Educators Fed. Credit Union, 12 Misc. 3d 1164(A), at *4 (Sup. Ct. N.Y. County 2006), aff'd 37 A.D.3d 751 (2d Dep't 2007). "[T]he implied covenant of good faith and fair dealing [i]s properly dismissed as duplicative of [a] breach-of-contract claim [where] both claims arise from the same facts and seek the identical damages . . . ." Amcan Holdings, Inc. v. Canadian Imperial Bank of Commerce, 70 A.D.3d 423, 426 (1st Dep't 2010); see also Eternity Global Master Fund Ltd. v. Morgan Guar. Trust Co. of N.Y., No. 02-cv-1312 (LMM), 2002 WL 31426310, at *4 (S.D.N.Y. Oct. 29, 2002) (granting motion to dismiss breach of implied covenant claim because plaintiff asserted duplicative breach of contract claim based on ISDA Master Agreement); UBS AG v. Cournot Fin. Prods., LLC, No. 10-cv-494 (GBD), 2010 WL 3001884, at *2 (S.D.N.Y. July 26, 2010) (same). As the court in Fin. One. Pub. Co. Ltd. v. Lehman Bros. Special Fin., Inc., 215 F. Supp. 2d 395, 395 (S.D.N.Y. 2002), explained, "a plaintiff may not maintain a good faith and fair dealing claim where that claim is based upon the same factual allegations and seeks the same damages as the plaintiff's claim for breach of an express provision of the contract." Id. (dismissing breach of implied covenant of good faith and fair dealing claim asserted against Lehman Brothers Special Financing, Inc. ("LBSF"), an affiliated Lehman entity, on ground that it was duplicative of breach of contract claim based upon the terms of an ISDA Master Agreement concerning calculations of termination payments).[10]

Here, the substantive factual allegations underlying Lehman International's Third Cause of Action for breach of the implied covenant of good faith and fair dealing are identical in

[10] In Fin. One. Pub. Co. Ltd. v. Lehman Bros. Special Fin., Inc., 215 F. Supp. 2d 395 (S.D.N.Y. 2002), shortly before terminating the ISDA Master Agreement based on the plaintiff's insolvency, LBSF acquired debts owed by the plaintiff to another Lehman affiliate which it then purported to offset against the termination payment it owed the plaintiff. The plaintiff alleged that LBSF had acquired the debt instruments in bad faith and asserted claims for breach of contract and breach of the implied covenant of good faith and fair dealing. See id. at 398-99. The court dismissed the plaintiff's breach of the implied covenant of good faith and fair dealing claim, holding that a plaintiff "cannot assert a breach of contract and a breach of good faith and fair dealing claim redundantly." Id. at 403.

all material respects to those underlying its breach of contract claim. Lehman International's good faith and fair dealing claim with respect to the July 2009 Transactions relies on two core allegations, namely that Assured Guaranty (i) "acted to bypass the parties' selection of Market Quotation to measure the termination payment" and (ii) "attempted to exploit its invented 'flexible' Loss methodology to claim a termination payment from [Lehman International]." Compl. ¶ 52. Yet these are the very same allegations Lehman International articulates in support of its breach of contract claim only seven paragraphs earlier. See Compl. ¶¶ 45, 46 ("[Assured Guaranty] breached its obligations under the Agreement by deciding before even terminating the transactions to bypass Market Quotation, the agreed-upon payment methodology selected by the Parties in the Agreement . . . [and] proceeded to improperly calculate Loss without reference to any market information.").

Similarly, Lehman International alleges that Assured Guaranty's "delayed" request for quotations and use of "burdensome bidding procedures" support both its breach of the implied covenant of good faith and fair dealing claim, Compl. ¶ 52, and its breach of contract claim. Compl. ¶¶ 28-29; see Havell Capital, 84 A.D.3 at 588 (finding "the claim for breach of the implied covenant of good faith, which arose from the same facts . . . duplicative of the [breach of] contract claim"). Specifically, Lehman International disputes that Assured Guaranty sought quotations "as soon as reasonably practicable following the occurrence of an Early Termination Date" (per Section 6(a) of the ISDA Agreement) and that Assured Guaranty properly concluded under the terms of the contract that "Market Quotation cannot be determined" (per the definition of "Settlement Amount" in the Agreement). But those claims can be addressed under the express terms of the parties' contract. The separate allegation of a supposed breach of "good faith and fair dealing" adds nothing to these claims: this is precisely a

case in which Lehman International's "claim for breach of the duty of good faith implied in contracts is nothing more than a restatement of its breach of contract claim." Eternity Global Master Fund Ltd., No. 02-cv-1312 (LMM), 2002 WL 31426310, at *4 (dismissing claim for breach of implied covenant of good faith and fair dealing as duplicative of breach of contract claim).

Likewise, Lehman International seeks the same remedy with respect to the Third Cause of Action and the Second Cause of Action; namely, to substitute – in contravention of the plain terms of the Agreement – its own closeout calculations in place of Assured Guaranty's closeout calculations. Compare Compl. ¶¶ 43-48 with Compl. ¶¶ 49-52. New York law is clear that a claim for breach of the implied covenant of good faith and fair dealing must be dismissed where, as here, the damages sought based upon that claim are "intrinsically tied to the damages allegedly resulting from a breach of the contract." Hawthorne Group, LLC v. RRE Ventures, 7 A.D.3d 320, 323 (1st Dep't 2004) (dismissing breach of implied covenant of good faith claim).

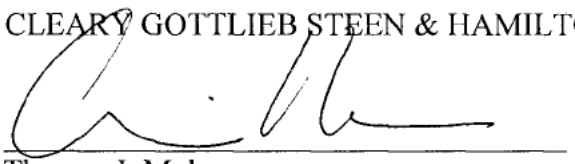
CONCLUSION

For the foregoing reasons, the Court should dismiss the First and Third Causes of Action in the Complaint pursuant to CPLR §§ 3211(a)(1) and (a)(7).

Dated: February 3, 2012

Respectfully submitted,

CLEARY GOTTLIEB STEEN & HAMILTON LLP



Thomas J. Moloney
Christopher P. Moore
One Liberty Plaza
New York, New York 10006
Telephone: (212) 225-2000
Fax: (212) 225-3999

Counsel to AG Financial Products, Inc.