STATE OF WISCONSIN CIRCUIT COURT DANE COUNTY

In the Matter of the Rehabilitation of:

Segregated Account of Ambac Assurance Corporation

Case No. 10 CV 1576

REHABILITATOR'S BRIEF IN SUPPORT OF MOTION TO ENFORCE INJUNCTION AGAINST ASSURED GUARANTY CORP. AND ASSURED GUARANTY RE LTD.

The Wisconsin Commissioner of Insurance, Theodore K. Nickel, as court-appointed Rehabilitator (the "Rehabilitator") of the Segregated Account ("Segregated Account") of Ambac Assurance Corporation ("Ambac"), files this brief in support of his motion to enforce this Court's injunction against Assured Guaranty Corp. ("AGC") and Assured Guaranty Re ("AGRe") (collectively, "Assured"), which reinsure certain exposures on policies allocated to the Segregated Account.

INTRODUCTION

On March 24, 2010, this Court issued an injunction (the "Injunction") to protect the claims-paying resources of the Segregated Account and to ensure the orderly administration of this proceeding. (*See* Injunction (Dkt. 9).) Among other things, the Injunction establishes this Court's exclusive jurisdiction over actions pertaining to Segregated Account policies or liabilities, to prevent the risk of competing litigation in other jurisdictions. (Injunction ¶ 1.) The Injunction also bars contractual counterparties from withholding payments owed to Ambac or the Segregated Account. (Injunction ¶ 7.) Finally, in recognition of the complex structure of this rehabilitation, the Injunction applies broadly to protect against a wide variety of legal and contractual actions that jeopardize claims-paying resources, whether those actions are taken

against the Segregated Account directly or against Ambac in connection with liabilities or other matters affecting the Segregated Account.

This Court has heard and fully addressed numerous timely objections to these and other provisions of the Injunction and the Plan of Rehabilitation (the "Plan"). Rather than raising its objections in this Court in a direct and timely fashion, as other interested parties have done, Assured has recently made belated challenges to the applicability of the Injunction and the Plan in a different forum (New York state court), to the detriment of policyholders and the administration of this proceeding. Specifically, in the past two weeks, Assured has refused to pay its proportionate share of Segregated Account liabilities under a reinsurance agreement, and has filed a petition in New York state court seeking to compel arbitration over whether it owes these sums at all.

These actions by Assured violate paragraphs 1 and 7 of the Injunction, as well as the terms of the underlying reinsurance agreements. The Rehabilitator therefore requests that this Court enter an order: (1) declaring that by refusing to pay its proportionate share of Segregated Account liabilities and by filing the petition to compel arbitration in New York state court, Assured has violated paragraphs 1 and 7 of the Injunction Order and has breached its reinsurance agreements with Ambac; (2) requiring Assured to immediately remedy these violations by satisfying all unpaid obligations under the reinsurance agreements and ceasing prosecution of the New York action to compel arbitration; and (3) declaring that any future failure of Assured to meet its obligations under the reinsurance agreements, including but not limited to payments related to liabilities discharged through the issuance of surplus notes, will violate the Injunction.

FACTUAL BACKGROUND

A. The Reinsurance Agreements

Numerous exposures in the Segregated Account are partially reinsured through agreements between Ambac and third-party reinsurers, including Assured. Recoveries on these reinsurance contracts add to the claims-paying resources of Ambac and the Segregated Account, partially offset diminutions in those resources due to the payment of claims, and serve as collateral for the Secured Note and the Aggregate Excess of Loss Reinsurance Agreement between Ambac and the Segregated Account. As of December 31, 2010, reserves ceded to reinsurers were approximately $180 million, reflecting the present value of estimated future claims with respect to reinsured policies allocated to the Segregated Account. The obligations of reinsurers, if enforced, would result in payments of these amounts over the life of the Plan as claims are satisfied by the Segregated Account, and form a material part of the claims-paying resources of the Segregated Account. As Assured has noted, the present dispute places potentially "tens of millions of dollars" of claims-paying resources in jeopardy. (Assured's Apr. 8, 2011 Petition to Compel Arbitration ("Petition") ¶ 30, attached to Apr. 15, 2011 Affidavit of Matthew R. Lynch ("Lynch Aff.") as Ex. 1.)

In 2003, Ambac and AGC entered into a Second Amended and Restated Surplus Share Reinsurance Agreement (the "AGC Agreement"), which reinsured a portion of Ambac's policy exposures. (*See generally* AGC Agreement, Lynch Aff. Ex. 2.) The next year, AGRe entered a Facultative Reinsurance Agreement (the "AGRe Agreement") with Ambac, in which it also reinsured a share of Ambac's policy exposures. (*See generally* AGRe Agreement, Lynch Aff. Ex. 3.) Under each of these agreements, Ambac has continued to pay premiums to Assured since the commencement of rehabilitation. In exchange, Assured is "liable for its proportionate share

of the risk associated with each [reinsured] Policy, including all Losses arising under the Policies[.]" (AGRe Agreement Art. 5; *see also* AGC Agreement Art. 1, 2.A, 4.).

B. Assured's Involvement in the Rehabilitation Proceeding

In March 2010, the Rehabilitator commenced this rehabilitation proceeding. In the Verified Petition, the Rehabilitator noted that the Plan of Rehabilitation would call for the payment of policy obligations "in the form of a cash/note split, with a percentage of the claim paid in cash immediately and the remainder paid in interest-bearing surplus notes." (Dkt. 1 ¶ 12(c).) Less than a week later, Assured was served notice of the rehabilitation and the Injunction. (Dkt. 30 at Exs. A, C, E.)

AGC subsequently appeared in this rehabilitation proceeding. Specifically, its counsel entered an appearance at the June 23, 2010 hearing to approve a settlement between the Segregated Account and AGC, among other parties, in which AGC received a settlement payment in the form of $65 million in cash and $50 million in surplus notes.[1] (Dkt. 260, June 23, 2010 Tr. at 22:9-10.) AGC was thus aware that commutation transactions involving obligations allocated to the Segregated Account would be paid in the form of a cash/note split.

The Rehabilitator filed his proposed Plan of Rehabilitation on October 8, 2010, and immediately served it upon AGC. (Dkt. 475 at Ex. D.) As discussed in the March 2010 Verified Petition, the proposed Plan called for payment of Segregated Account policy claims in a mix of cash and notes and stated that:

- "Such payment of Cash and the issuance of Surplus Notes . . . shall constitute *full and complete payment* and settlement of such Policy Claim." (Dkt. 461 § 4.04(c) (emphasis added).)

[1] The settlement was unrelated to Assured's role as reinsurer of certain Segregated Account liabilities.

- "Notwithstanding the . . . satisfaction of Permitted Policy Claims with Surplus Notes in lieu of Cash, [Ambac] shall be entitled to recover the full amount all recoveries, reimbursements and other payments[.]" (*Id.* § 4.04(g).)

This Court approved the Plan, including the above-quoted provisions, on January 24, 2011. (Dkt. 692.)

From the date this rehabilitation commenced through the present, Assured has lodged no objections in this Court to any terms of the Plan, including the payment provisions in Section 4.04 of the Plan. Nor did Assured appeal from this Court's January 24 Plan confirmation order.

C. Communications between the Rehabilitator and Assured

In addition to entering an appearance in the rehabilitation proceeding, counsel for Assured made a number of inquiries to the Rehabilitator regarding the effect of the Injunction and the Plan on the reinsurance agreements. Specifically, on November 5, 2010, shortly before the Plan confirmation hearings, Assured wrote the Rehabilitator (through counsel) as follows:

> . . . Without attempting to summarize everything we discussed on the call, we just wanted to confirm [the Rehabilitator's] view that the plan of rehabilitation will not alter the contractual provisions of the reinsurance agreements between Ambac . . . and affiliates of Assured Guaranty . . . or *enjoin any actions* that Assured Guaranty or its affiliates may take under such reinsurance agreements (including exercising contractual netting and set-off provisions, or demanding arbitration in accordance with the terms of such reinsurance agreements).

(Lynch Aff., Ex. 4 (emphasis added).)

In a November 6 response, counsel for the Rehabilitator made clear that, to the extent that the dispute involved liabilities related to claims that had been allocated to the Segregated Account, the proper forum for resolving those disputes was this Court (rather than through arbitration):

> Generally we agree with your summary, but there is *one caveat*. The additional rights your client has under the insolvency clause

> (right to notice and interpose a defense) necessarily must be exercised in the rehabilitation court, as that is where the underlying policy liability is located. Again, setoff is not affected, and general disagreements will remain subject to arbitration (consistent with the contract), but *disputes relative to claim liabilities (if the claims are in the Segregated Account) will need to be handled in the Rehab Court*. Let me know if you have any questions.

(*Id.* (emphasis added).) At the time, Assured did not assert that payment in the form of a cash/note split would relieve it of its obligations to pay its proportionate share of losses on Segregated Account exposures. Nor did Assured do anything to challenge or even question the Rehabilitator's clarification.[2] Assured had ample time to raise any disagreement it had about the Rehabilitator's position in the subsequent Plan confirmation hearings, or before the Court issued its January 24, 2011 order confirming the Plan.

Assured also worked with the Rehabilitator and Ambac to formulate the Ceded Reinsurance Guidelines to establish its rights upon implementation of the Plan. The Ceded Reinsurance Guidelines, which were filed with this Court on March 18, 2011 (Dkt. 780), set out detailed operating procedures to be followed regarding reinsurance claims under the Plan.

[2] Assured's New York Petition also references an earlier June 15, 2010 e-mail from the Rehabilitator's counsel, which made a general statement regarding the inapplicability of the Injunction Order to reinsurance agreements, which had not been allocated to the Segregated Account. (Petition ¶ 42.) However, Assured reads this earlier e-mail out of context. Specifically, the November 6, 2010 email from the Rehabilitator's counsel clarified that there is a distinction between "general disagreements," which were "subject to arbitration (consistent with the contract)," and which were described in the June 15 email, and specific "disputes relative to claim liabilities (if the claims are in the Segregated Account)," which had to be handled in this Court. Moreover, Assured cannot contend that it relied on the June 15 e-mail, because (1) it sought clarification on November 5 about the scope of the Injunction Order and the Plan as it related to the arbitration clause in the reinsurance agreements and (2) Assured has had the Rehabilitator's November 6 answer in hand for the last five months, during which time Assured took no additional actions in this Court.

D. Assured's Refusal to Honor Its Obligation to Contribute to the Claims-Paying Resources of the Segregated Account

Despite having participated in the rehabilitation proceeding, and having communicated with the Rehabilitator regarding the effect of the Injunction and the Plan on the reinsurance agreements, Assured now refuses to honor its reinsurance obligations on Segregated Account exposures—at least to the extent that the Rehabilitator has discharged those liabilities by the issuance of surplus notes. Thus, for any given claim paid or resolved by the Segregated Account through a combination of cash and surplus notes, which is a defining feature of the Plan, Assured apparently contends that it must pay only for the cash component of its reinsurance obligation.

Assured first informed the Rehabilitator of its position last month. On March 14, 2011, the Rehabilitator and Ambac reached a settlement (the "Northstar Settlement") with the holder and beneficiaries of Segregated Account policy number AB0632BE (the "Northstar Policy"), whereby the policy was terminated in exchange for a one-time payment of $7 million ($4 million in cash and $3 million in surplus notes). Assured reinsured the policy under the AGC Agreement and therefore was liable to Ambac for a 6.66667 percent share of the $7 million settlement, which amounted to $446,667.[3]

On March 22, 2011, counsel for AGC informed Ambac that Assured did not consider the issuance of surplus notes to give rise to a reinsured "loss" within the meaning of its reinsurance agreement, and therefore AGC would not reimburse any portion of the Northstar Settlement that was to be paid in surplus notes unless and until the notes are paid in cash. (Lynch Aff. Ex. 5.) On March 31, 2011, counsel for the Rehabilitator sent a response to AGC stating that the Rehabilitator believed that Assured was responsible for its full proportionate share of the loss

[3] Under their reinsurance agreements, AGC and AGRe are obligated to contribute their proportionate share toward settlements of reinsured policy obligations. (AGC Agreement, Art. 5; AGRe Agreement, Art. 4.) Such settlements are "unconditionally binding" on Assured. (AGC Agreement, Art. 11.B; AGRe Agreement, Art. 10.B.)

incurred in the Northstar Settlement, including the portion of the settlement paid in surplus notes. (Lynch Aff. Ex. 6.) The letter demanded that Assured remit the full $446,667 owed under its reinsurance agreement. (*Id.*)

Assured did not make full payment. Instead, on April 7, 2011, AGC and AGRe sent letters to Ambac demanding arbitration over the disputed claim and "the scope of [their] reinsurance obligations" to Ambac. (Lynch Aff. Exs. 7, 8.) The arbitration demand letters indicate that Assured believes that the portion of claims or settlements paid in interest-bearing surplus notes do not constitute "losses" within the meaning of their reinsurance agreements and that Assured will not pay them. (*Id.*) Because the Plan calls for payment of all policy claims on a cash-note split basis, Assured's position (if maintained) would deprive Ambac of significant claims-paying resources.

The next day, before receiving any response to their arbitration demand letters, Assured filed a petition in New York Supreme Court to compel Ambac to arbitrate. (*See generally* Petition.) That petition is scheduled for a hearing before the New York state court on May 6, 2011.

ARGUMENT

I. ASSURED HAS VIOLATED PARAGRAPH 1 OF THE INJUNCTION

A. The Injunction Bars Assured From Seeking to Compel Arbitration Relating To Claims Pertaining to Segregated Account Policies

The success of the rehabilitation requires the orderly and consistent prevention of opportunistic avoidance of contract obligations by counterparties, and the existence of a single, comprehensive forum for the resolution of all disputes. Judge Crabb recently acknowledged the importance of these purposes, in the context of the United States Internal Revenue Service's attempted removal of its disputes to federal court:

> In many respects, the state rehabilitation proceedings and the supplemental injunction are similar to federal bankruptcy proceedings and the automatic stay that goes into effect in bankruptcy. Insurance companies are barred from using bankruptcy to reorganize; their only remedy is a state court rehabilitation proceeding. As in bankruptcy, the efficacy of a rehabilitation proceeding is dependent upon the court's ability to stay actions by creditors that will interfere with the court's ability to manage the proceeding. When a claimant is affected by the stay, the claimant challenges the effect in the bankruptcy court and if the result is unfavorable, it appeals. The claimant does not file a separate proceeding in a separate court to determine whether the stay should apply, as the United States has done in this case.

In the Matter of the Rehabilitation of Segregated Acct. of Ambac Assurance Corp., No. 10-cv-778-bbc, 2011 WL 956855, at *9 (W.D. Wis. Jan. 14, 2011) ("*In re Segregated Acct.*").

Consistent with this purpose, paragraph 1 of the Injunction provides:

> All persons and entities are enjoined and restrained from commencing or prosecuting any actions, claims, lawsuits or other formal legal proceedings . . . against Ambac . . . in respect of the Segregated Account or policies (including financial guarantee insurance policies and surety bonds), contracts or liabilities allocated to the Segregated Account. . . . This Court has exclusive jurisdiction over any such actions, claims or lawsuits.

(Injunction ¶ 1.)

Paragraph 1 of the Injunction plainly applies to Assured's arbitration demand and its New York state court petition to compel arbitration. *First*, Assured's filing of a petition to compel Ambac to arbitrate constitutes the commencement of an "action[], claim[], lawsuit[] or other formal legal proceeding[] . . . against Ambac."

Second, the present dispute relates to a "policies . . . allocated to the Segregated Account," including the Northstar Policy (and all other Assured-reinsured Segregated Account policies, if Assured maintains this same position going forward). The dispute pertains to the scope of Assured's obligations when payments are partially made in the form of surplus notes. Under the Plan, the surplus note payment mechanism applies specifically to policies in the

Segregated Account. Moreover, the effect of Assured's refusal to pay reinsurance claims on such policies adversely impacts the claims paying resources of the Segregated Account and diminishes the collateral of its Secured Note from Ambac. Thus, the present dispute is "in respect of the Segregated Account or policies . . . allocated to the Segregated Account."

B. Assured's Asserted Reasons For Violating The Injunction Should Be Rejected As A Matter Of Law

In its petition to compel arbitration filed in New York, Assured contends that the reinsurance agreements provide for arbitration of this dispute, and the Federal Arbitration Act favors enforcement of such agreements. These contentions are unavailing, however, because this Court's Injunction supersedes this contractual arrangement as well as any conflicting federal law.

First, the Federal Arbitration Act is inapplicable. By operation of the McCarran-Ferguson Act, 15 U.S.C. § 1012, state law regulating the business of insurance reverse-preempts any conflicting federal law that is not specifically directed at insurance, including the Federal Arbitration Act. Paragraph 1 of the Injunction applies state law regulating the business of insurance:

> In this case, Wis. Stat. ch. 645 vests jurisdiction in the state rehabilitation court over matters related to the rehabilitation of an insurer. Wis. Stat. § 645.04. The state court has authority to enjoin any action that may interfere with the proceedings or "lessen the value of the insurer's assets or prejudice the rights of policyholders, creditors or shareholders, or the administration of the proceeding." Wis. Stat. § 645.05. These sections of chapter 645 relate specifically to regulating the business of insurance.

In re Segregated Acct., 2011 WL 956855, at *5.

Injunctions establishing the exclusive jurisdiction of the state rehabilitation court over all disputes pertaining to the rehabilitation and/or the insurer reverse-preempt the Federal Arbitration Act. *See Davister Corp. v. United Republic Life Ins. Co.*, 152 F.3d 1277, 1281 (10th Cir. 1998) (holding that state insurance law reverse-preempted federal arbitration law by virtue

of the McCarran-Ferguson Act, 15 U.S.C. § 1012, and refusing to enforce an arbitration provision because "[a]llowing a putative creditor to pluck from the entire liquidation proceeding one discrete issue and force arbitration contrary to the blanket stay entered by the [liquidation] court would certainly impair the progress of the orderly resolution of all matters involving the insolvent company"); *Munich Am. Reinsurance Co. v. Crawford*, 141 F.3d 585, 593-95 (5th Cir. 1998) (same); *Stephens v. Am. Int'l Ins. Co.*, 66 F.3d 41, 45 (2d Cir. 1995) (same).

Second, any purported contractual right to demand arbitration is subordinate to both the express terms of the Injunction and Wisconsin insurance law, neither of which permits the enforcement of arbitration clauses in disputes involving the delinquent insurer absent the consent of the Rehabilitator. As Wis. Stat. ch. 645 makes clear,

> An arbitration provision of any contract with an insurer that is subject to a delinquency proceeding under subch. III is not enforceable unless the receiver elects to accept arbitration. Only the court that has jurisdiction of the delinquency proceeding may entertain, hear or determine any matter that otherwise would be subject to an arbitration provision.

Wis. Stat. § 645.04(3).

Finally, consistent with Wisconsin law, the Assured reinsurance agreements provide that the initiation of an insurance delinquency proceeding renders the arbitration clause inapplicable. (*See* AGC Agreement, Art. 16; AGRe Agreement, Art. 15.) Specifically, both agreements provide for arbitration "[*e*]*xcept* ... in the event of the Company *being subject to Proceedings*." (*Id.* (emphasis added).) Assured attempts to avoid this exception by arguing that "the Company" means Ambac, which is not "subject to" rehabilitation. This argument ignores the rationale for this exception to the arbitration clause, *i.e.*, that it would be inappropriate to commence arbitration regarding reinsured liabilities that are already subject to the jurisdiction of a rehabilitation court. Here, Assured seeks to arbitrate its obligations as to policies allocated to the

Segregated Account and thus subject to this Court's jurisdiction. The fact that the rest of Ambac remains outside rehabilitation is completely irrelevant to the parties' dispute, and should have no bearing on whether such dispute is arbitrable.

In sum, Assured's demand for arbitration and its petition to compel arbitration filed in New York state court violate paragraph 1 of the Injunction, Wisconsin law and the terms of the reinsurance agreements.

II. ASSURED HAS VIOLATED PARAGRAPH 7 OF THE INJUNCTION

Although the confirmed Plan provides that the Segregated Account shall pay its obligations through a combination of cash and surplus notes, Assured contends that it is required to pay only pay its proportionate share of claims and settlements of Segregated Account policies that are paid in cash, and is not required to pay its proportionate share of any amounts in respect of the surplus notes unless and until payments are made on those notes. (Petition ¶¶ 22-30.)

However, Assured's position again is barred by the Injunction. Paragraph 7 of the Injunction provides:

> All persons and entities are enjoined and restrained from withholding or failing to pay or setting-off premiums or other payments (including without limitation recoveries[and] reimbursements) owed to . . . the Ambac General Account under or in connection with policies or contracts allocated to the Segregated Account[.]

In short, contractual counterparties cannot withhold payments owed to Ambac or the Segregated Account "in connection with policies or contracts allocated to the Segregated Account."

Assured's refusal to pay a portion of its reinsurance obligations falls squarely within this prohibition. It has withheld its share of settlement payments owed to Ambac, or that would be owed absent the rehabilitation and Ambac's present financial condition, to the extent they are made in surplus notes. All of the reinsurance payments at issue are "in connection with policies

or contracts allocated to the Segregated Account," and the Plan contemplates that surplus notes will be used to pay the holders of other Segregated Account policies.

The sole basis provided by Assured for refusing to honor its obligations is the fact that such claims and settlements are paid in part in surplus notes. Partial payment of claims through surplus notes is a crucial component of the Plan. Absent the issuance of surplus notes pursuant to the Plan, Assured would presumably have no dispute over its obligations to make reinsurance payments in full. As this Court previously recognized in rejecting arguments by Segregated Account policyholders seeking to withhold premium payments owed to Ambac, Paragraph 7 of the Injunction bars Assured from using this proceeding as a basis to escape those obligations. (*See* Oct. 26, 2010 Decision and Order (Dkt. 489), at 12 ("Movants seeking [to amend] Paragraph 7 of the Injunction wish to be authorized to cease contributing to Ambac's liquid claims paying resources without any consequence to them. This has an affect on all policyholders . . . [and] violates the Injunction.").)

III. THE REINSURANCE AGREEMENTS DO NOT PERMIT ASSURED TO WITHHOLD PAYMENTS

Separate and apart from its violation of the Injunction, Assured's position—that the reinsurance agreements do not require it to pay any amounts in respect of the surplus notes until cash payments are made on those notes—is contrary to the plain language of the reinsurance agreements. Therefore, this Court should also declare that Assured has violated its contracts with Ambac.

A. The Insolvency Clause In The Reinsurance Agreements Forecloses Assured's Attempt To Avoid Its Payment Obligations

Both reinsurance agreements include an "insolvency clause" that contemplates: (1) the possibility of a rehabilitation proceeding; and (2) a rehabilitation plan or other order of the Rehabilitation Court or Rehabilitator requiring the insurer to make payments in some manner

other than cash. Specifically, the reinsurance agreements contain the following insolvency clause, which closely tracks paragraph 7 of the Injunction:

> In the event of the insolvency of the Company or of Proceedings (as defined below) against the Company pursuant to Chapter 645 of the Wisconsin Insurance Code (hereinafter "Proceedings"), *the reinsurance under this Agreement shall be payable to the Company (or its manager) or to its liquidator, receiver or statutory successor*, on the basis of *the liability of the Company under Policies reinsured without diminution* because of the insolvency of or Proceedings against the Company, or because the liquidator, receiver or statutory successor of the Company *has failed to pay all or any part of a claim.*

(AGC Agreement, Art. 15; AGRe Agreement, Art. 14 (emphasis added).) Thus, this insolvency clause requires Assured to satisfy its obligations based on the "liability" of Ambac in full (*i.e.*, "without diminution"), even if the Rehabilitator "has failed to pay all or any part of a claim."

Using the Northstar Policy as an illustration, the full "liability" of Ambac that Assured is required to pay is 6.66667 percent of the $7 million Northstar Settlement, or $446,667. The Rehabilitator's payment of cash and notes in a commutation transaction effectively accelerates and discharges all future liability arising from this policy. Thus, the insolvency clause requires Assured to honor its obligation *in full*, even if there has only been partial cash payment of a claim.

Given the clarity of the insolvency clause in the agreements, Assured is left to argue that: (1) the reinsurance agreements define "Company" to mean "Ambac"; and (2) the insolvency clause is inapplicable because Ambac's Segregated Account is in rehabilitation rather than Ambac as a whole. (Petition ¶¶ 39-40).) As discussed below, Assured's interpretation of the insolvency clause is riddled with flaws.

First, Assured's interpretation of the insolvency clause is contrary to the obvious intent in reinsurance agreements in general and the insolvency clause in particular. Specifically, the

purpose of the insolvency clause is to prevent reinsurers from avoiding their contractual obligations based on the initiation of a delinquency proceeding in which Ambac may be directed not to pay claims or other liabilities entirely in cash. Tellingly, Assured does not, and cannot, contend that the insolvency clause would permit it to avoid making full payments if all of Ambac were in rehabilitation. Stated another way, there is no legitimate reason why Assured would agree to satisfy its obligations in full relating to Ambac policy losses if Ambac as a whole were in a Chapter 645 proceeding, but would not agree to satisfy its obligations in full relating to the *same exact* Ambac policy losses if Ambac's Segregated Account, to which the policies in question were allocated, were in a Chapter 645 proceeding. In either case, Assured has received the benefit of its bargain (in the form of the payment of premiums), and is reinsuring exposures related to the same policies issued by Ambac.

It should make no difference that the Rehabilitator has limited this rehabilitation only to certain policies and liabilities for which rehabilitation is necessary, rather than through the rehabilitation of Ambac as a whole. Assured improperly seeks a windfall to which it is not entitled under the governing documents and which is flatly contrary to the overarching purpose of this rehabilitation.

Second, Assured's interpretation is contrary to the plain language of the agreements. Assured focuses on the definition of the word "Company," but the more relevant language in the insolvency clause is the reference to "*Proceedings* against the Company *pursuant to Chapter 645 of the Wisconsin Insurance Code*." Wis. Stat. ch. 645 governs insurer rehabilitation and liquidation proceedings. Section 645.03(1)(f) defines "insurer" for purposes of Chapter 645. Wis. Stat. § 645.03(1)(f). Section 611.24(e) provides that a segregated account created by a company "shall be deemed an insurer within the meaning of s. 645.03(1)(f)." Wis. Stat.

§ 611.24(e). Thus, the reference to "proceedings . . . pursuant to Chapter 645" in the insolvency clause of the agreements encompasses proceedings against the Company itself, as well as segregated accounts of the Company, which are both treated as "insurers" under Chapter 645. *See In re Segregated Acct.*, 2011 WL 956855, at *6 ("*Although the segregated account is deemed to be a separate insurer for purposes of rehabilitation, it is not actually a separate corporation from Ambac. Indeed, the whole point of the rehabilitation is to rehabilitate Ambac Assurance Corporation*. . . . Allowing the United States to proceed against Ambac or any of the affiliates and subsidiaries [outside the Rehabilitation Court] would amount to pulling out the linchpin that secures the entire enterprise.") (emphasis added); *id.* (rejecting a "narrow view of the rehabilitation proceeding" as permitting actions against Ambac directly as unreasonably formalistic); Jan. 24, 2011 Decision and Order (Dkt. 692) (noting Ambac's responsibilities for administering and adhering to the Plan under the Rehabilitator's guidance, Ambac's ultimate liability for payments on Segregated Account claims, and the Rehabilitator's continuing contractual and regulatory control mechanisms over Ambac). The policy exposures at issue reside in the Segregated Account, and there is no question that Chapter 645 proceedings against that "corporation *within* a corporation," Wis. Stat. Ann. § 611.24 cmt. (emphasis added) are underway as permitted by Chapter 645. Thus, a plain reading of the insolvency clause in the context of Chapter 645 encompasses this dispute.

Assured's New York petition also suggests that, if the parties' agreements had intended the insolvency clause to cover segregated accounts, they could have spelled that out more explicitly. (Petition ¶ 40.) However, given the broad reference to Chapter 645, this argument actually weighs against Assured. Had the parties intended different treatment depending on the particular type of rehabilitation conducted, they could have stated so expressly. They did not.

Instead, they included a general insolvency clause that encompasses the particular form of rehabilitation chosen by the Rehabilitator.

For all of these reasons, a Chapter 645 proceeding against Ambac's Segregated Account, which holds the reinsured exposure at issue, is a Chapter 645 proceeding "against the Company" for purposes of the insolvency clause in the agreements. (AGC Agreement, Art. 15; AGRe Agreement, Art. 14.) That insolvency clause bars Assured from withholding the payments it has refused to pay.

B. Assured's Argument That It Is Not Liable For "Losses" Until They Are Paid In Cash Is Contrary To The Plan Of Rehabilitation And The Plain Language Of The Reinsurance Agreements

Even if the Court held that neither the Injunction nor the insolvency clause applies under these facts, Assured *still* is not permitted to withhold payments. Under the agreements, Assured is liable for its proportionate share of losses arising under the Policies. (AGC Agreement, Art. 1, 2.A, 4; AGRe Agreement, Art. 5.) "Loss[es]" include:

> the amount of liability paid or to be paid by the Company with respect to claims, losses, [or] liabilities . . . including, without limitation, any settlements or compromises of disputed claims arising under any Policy and any other liabilities resulting from a restructuring or refinancing of the risks associated with any Policy[.]

(AGC Agreement, Art. 5; AGRe Agreement, Art. 4 (emphasis added).)

Presumably, Assured will take the position that payments made in surplus notes are not liabilities "paid or to be paid," and therefore do not constitute "[l]osses" for which Assured is immediately liable for its proportionate share. That position is incorrect, for at least two reasons.

First, that position requires is at odds with the Plan, which Assured has not challenged. As explained above, the Plan establishes that distribution of a combination of cash and surplus notes "constitutes full and complete payment and settlement of [a] Policy Claim," "regardless of

the existence of any provision in [a] Policy or any other underlying instrument(s) or contract(s) that would require, or that contemplates, the discharge of the obligations of the Segregated Account through the payment of Cash." Plan §§ 4.04(c), (d). Therefore, an obligation paid in surplus notes is a claim that is "paid," regardless of any contractual provisions or interpretations to the contrary.

Despite having full notice and an opportunity to raise objections or concerns regarding this Plan language, Assured did not appear at the Plan confirmation hearings, did not express concerns regarding the import of this language, and has never sought to challenge it until the events giving rise to this Motion. Assured is therefore barred from raising this post-confirmation challenge to Section 4.04 of the Plan.

Second, even under Assured's incorrect position that the issuance of surplus notes does not constitute a claim "paid," the liability covered by such interest-bearing notes would constitute a claim "to be paid" under the reinsurance agreements. Indeed, the notes are an express promise to make future cash payments. While the Rehabilitator has discretionary control over the timing and amount of cash payments under the notes, neither the Plan nor the notes provide any mechanism by which Ambac or the Rehabilitator can unilaterally extinguish the Segregated Account's obligation to make such payments. Assured's present contention—that it has no reinsurance liability unless and until surplus notes are paid in cash—would render the "to be paid" language of the reinsurance agreement meaningless, in contravention of black-letter law regarding contract construction. *See Columbus Park Corp. v. Dep't of Housing Preserv. & Dev.*, 598 N.E.2d 702, 708 (N.Y. 1992) ("[A] construction which makes a contract provision meaningless is contrary to basic principles of contract interpretation[.]"); *Goebel v. First Fed. Sav. & Loan Ass'n*, 83 Wis. 2d 668, 680, 266 N.W.2d 352, 358 (1978) ("[C]ourts must avoid a

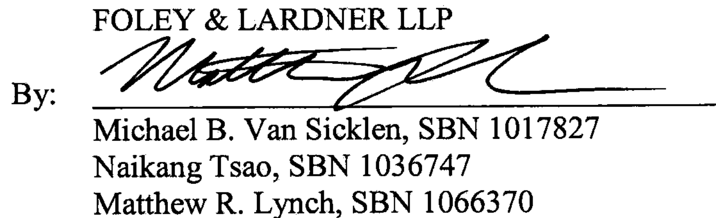
construction which renders portions of a contract meaningless, inexplicable or mere surplusage.").

CONCLUSION

For the reasons stated, the Rehabilitator's motion should be granted, and an order should be entered, declaring that AGC and AGRe have violated paragraphs 1 and 7 of the Injunction, declaring that AGC and AGRe have breached their reinsurance agreements with Ambac, and requiring AGC and AGRe to satisfy all unpaid obligations under the reinsurance agreements, including but not limited to payments related to the issuance of surplus notes.

Dated this ____ day of April, 2011

FOLEY & LARDNER LLP

By: 

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