STATE OF WISCONSIN CIRCUIT COURT DANE COUNTY

In the Matter of the Rehabilitation of:

Case No. 10 CV 1576

Segregated Account of Ambac Assurance Corporation

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

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Note: Assured Guaranty Re Ltd. appears without waiving its right to object to personal jurisdiction.

Dated May 9, 2011

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STATE OF WISCONSIN CIRCUIT COURT DANE COUNTY

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Assured Guaranty Re Ltd. ("AG Re") and Assured Guaranty Corp. ("Assured Guaranty") file this brief in opposition to the motion by the Wisconsin Commissioner of Insurance, Theodore K. Nickel, as court-appointed rehabilitator (the "Rehabilitator") of the Segregated Account (the "Segregated Account") of Ambac Assurance Corporation ("Ambac") to have the Court enjoin AG Re and Assured Guaranty from pursuing arbitration of a dispute with Ambac. Together, AG Re and Assured Guaranty are referred to as the "Assured Reinsurers."

SUMMARY OF ARGUMENT

This motion involves two reinsurance agreements with Ambac (the "Reinsurance Agreements") under which the Assured Reinsurers reinsure certain risks. The Reinsurance Agreements have not been allocated to the Segregated Account. They remain in Ambac's General Account, which is not subject to this proceeding. The Assured Reinsurers have disputes with Ambac over their obligations under these agreements. The Reinsurance Agreements provide that such disputes will be resolved by arbitration in New York, and the Assured Reinsurers seek arbitration of these disputes.

The Rehabilitator asserts that by seeking arbitration, the Assured Reinsurers violated the Order for Temporary Injunctive Relief entered by this Court on March 24, 2010 (the "Injunction"), later made permanent by Section 10.02 of the Plan of Rehabilitation (the "Plan") and paragraph 9 of this Court's January 24, 2011 Order confirming the Plan. The Rehabilitator takes that position even though:

- This Court lacks personal jurisdiction over AG Re, which has not appeared in this proceeding and does not do business in Wisconsin.
- The Injunction, by its terms, "does not apply to . . . contracts," like the Reinsurance Agreements, that "remain in [Ambac's] General Account."
- The Assured Reinsurers have not asserted any claims under any insurance policy or contract allocated to the Segregated Account.
- Neither provision of the Injunction relied on by the Rehabilitator enjoins a party from litigating or arbitrating a claim against Ambac under a contract that is not allocated to the Segregated Account.

In June 2010, the Rehabilitator's counsel advised the Assured Reinsurers that the Injunction did not affect their rights to arbitration because the Reinsurance Agreements:

> have not been allocated to the Segregated Account and therefore are not subject to the rehabilitation proceeding. Accordingly, *the temporary injunction granted by the rehabilitation court does not apply to enjoin any actions that Assured Guaranty or its affiliates may take under the reinsurance agreements (including* . . . provisions, or *demanding arbitration in accordance with the terms of the agreement).*

(emphasis added). In November 2010, the Rehabilitator's counsel confirmed that "general disagreements [under one of the Reinsurance Agreements] will remain subject to arbitration." The Rehabilitator's counsel was correct then, and is wrong now.

The Rehabilitator asks the Court not only to enjoin the Assured Reinsurers, but also to decide legal issues in dispute between them and Ambac. The Rehabilitator

contends that the Assured Reinsurers have lost their contractual rights to arbitrate disputes with Ambac because, for purposes of both a Wisconsin statute prohibiting certain arbitration clauses and provisions in the Reinsurance Agreements, a Chapter 645 proceeding against the Segregated Account is legally indistinct from a Chapter 645 proceeding against Ambac. That argument misconstrues the unambiguous statutory and contract terms, is belied by the Rehabilitator's own pre-dispute position that the Assured Reinsurers retained their arbitration rights, and is inconsistent with the Rehabilitator's and Ambac's assertions and this Court's determination that there are important differences between a proceeding against Ambac and proceeding against the Segregated Account.

A rehabilitation proceeding is not the proper vehicle for resolving these disputes. There is no legal basis for depriving the Assured Reinsurers of their rights to have their disputes with Ambac determined in a proper forum, according to that forum's rules and procedures.

If this Court does consider these contract disputes, it should reject the Rehabilitator's contentions that the Assured Reinsurers have no arbitration rights and are obligated to pay the amounts claimed by Ambac. On both issues, the Rehabilitator's position is that, for purposes of the Reinsurance Agreements, this proceeding against the Segregated Account is no different from a Chapter 645 proceeding against Ambac. That is an untenable interpretation of these contracts under New York law. Moreover, the Rehabilitator is estopped from making this argument because it is contrary to the position that he persuaded the Court to adopt in this proceeding.

FACTUAL BACKGROUND

A. The Assured Reinsurers and the Reinsurance Agreements

AG Re, an affiliate of Assured Guaranty, is a company organized under the laws of Bermuda, with its principal place of business in Bermuda. Affidavit of James M. Michener ("Michener Aff.") ¶ 3. AG Re does not do business in the United States, and it has not appeared in this proceeding. *Id*. Assured Guaranty is a Maryland corporation with its principal place of business in New York. *Id.* Assured Guaranty appeared in this proceeding last year in connection with the Court's approval of the settlement of an unrelated dispute. *Id.* ¶ 4.

In 2004, AG Re and Ambac entered into a reinsurance agreement, the Facultative Reinsurance Agreement (the "Facultative Agreement"). Under this agreement, AG Re agreed to reinsure a portion of certain insurance policies issued by Ambac and by Ambac Assurance UK Limited ("Ambac U.K."). Michener Aff. ¶ 6 & Ex. A. AG Re's dealings in connection with the Facultative Agreement have been with Ambac representatives at its headquarters in New York City, not in Wisconsin. Michener Aff. ¶ 6.

In 2003, Assured Guaranty and Ambac entered into a separate reinsurance agreement, the Second Amended and Restated Surplus Share Agreement (the "Surplus Share Agreement"). Pursuant to this agreement, Assured Guaranty agreed to reinsure a portion of certain insurance policies issued by Ambac. *Id.* ¶ 7 & Ex. B.

B. The Arbitration Agreements

In both Reinsurance Agreements, the parties agreed to submit to arbitration "any dispute or claim." Article 16 of the Surplus Share Agreement provides in part:

> Except as provided in ARTICLE 19 or in the event of the Company being subject to Proceedings, any dispute or claim arising out of this Agreement shall be submitted to arbitration in accordance herewith as a condition precedent to the commencement of any right of action hereunder. Arbitration shall be initiated by the delivery, by mail, facsimile, or other reliable means, of a written demand [f]or arbitration by one party to the other. The arbitration shall be held in New York, New York or such other place as the parties may mutually agree.

Michener Aff. Ex. B at 15. Article 15 of the Facultative Agreement is virtually identical, except that "is" replaces "being" in the first line and Article 15 adds that disputes arising out of the Facultative Agreement "including its formation and validity" must be arbitrated. Michener Aff. Ex. A at 12. Both agreements define "Proceedings" as "Proceedings . . . against the Company pursuant to Chapter 645 of the Wisconsin Insurance Code." *Id.* at 11; Michener Aff. Ex. B at 15.

C. The Rehabilitation Proceeding and the Injunction

On or about March 24, 2010, Ambac placed certain insurance policies that it had issued, including some that are reinsured under the Surplus Share Agreement or the Facultative Agreement, into the Segregated Account. Under Wis. Stat. § 611.24(3)(e), the Segregated Account is a separate insurer for purposes of proceedings under Chapter 645 of the Wisconsin Statutes. Neither Reinsurance Agreement has been allocated to the Segregated Account. Disclosure Statement Accompanying Plan of Rehabilitation, dated October 8, 2010 (the "Disclosure Statement" or "Discl. St.") [Tab 1], at 1; Michener Aff. ¶ 8. (References in the form "Tab __" refer to items in the Appendix of the Assured Reinsurers that is submitted with this brief.)

Throughout this proceeding, Ambac and the Rehabilitator have stressed that this is a rehabilitation of the Segregated Account, and is *not* a rehabilitation of Ambac. The Disclosure Statement broadcasts that point, and its importance, on page 1:

> NEITHER [AMBAC] NOR ITS GENERAL ACCOUNT, NOR ANY OF THE POLICIES, CONTRACTS, ASSETS, EQUITY OWNERSHIP INTERESTS AND RIGHTS OR LIABILITIES IN THE GENERAL ACCOUNT, IS IN REHABILITATION AS PART OF THE PROCEEDING OR OTHERWISE.

Discl. St. at 1 (capitalized as in original). In arguing for the entry of an order for rehabilitation, the Rehabilitator "emphasized . . . [that] this proceeding pertains solely to the Segregated Account," and noted that "[t]he Commissioner is not asking this Court to place the Ambac General Account into rehabilitation as part of this proceeding." Brief in Support of Entry of Order for Rehabilitation, dated Mar. 24, 2010, at 25.

The Rehabilitator made this a central theme at the March 24, 2010 hearing on the petition for rehabilitation and motion for an injunction. He described "a bright-line separation between what we're asking you to do as part of the rehabilitation proceeding as to the segregated account, not . . . tainting or affecting or spilling over into the affairs of the general account." Tr. of Hearing, Mar. 24, 2010 ("3/24 Tr.") 9:15-19. (A reference to "Tr." preceded by a date, *e.g.*, "11/15 Tr.," refers to a transcript of a hearing on that date.) The Rehabilitator told the Court:

> [W]e've made every effort to *divide the affairs and the court's jurisdiction between these two accounts* and the injunction that we'll get to in a minute scrupulously tries to avoid any concern that policyholders in the general account have that we're somehow trying to unfairly enjoin them. *It's directed solely at policies and issues which have been allocated to the segregated account* both directly and there are . . . subsidiaries which have also been allocated to the segregated account because a lot of the contracts

> that we've described in the briefing . . . are written through the subsidiaries.

Id. 18:17-19:3 (emphases added).

The Injunction provides that "the injunctive relief granted below *does not apply to policies or other contracts which remain in the Ambac General Account*. The injunctive relief specified below pertains to the Segregated Account, policies, contracts, assets and liabilities allocated to the Segregated Account." Injunction at 1 (emphasis added). That limitation is consistent with the provision in the Order for Rehabilitation that was entered on the same day: "[t]his proceeding . . . does not pertain to the policies, contracts, assets, equity ownership interests, and liabilities remaining in Ambac's General Account." Order for Rehabilitation, dated Mar. 24, 2010, ¶ 2.

D. Discussions with the Rehabilitator

After the entry of the Injunction, the Assured Reinsurers retained Debevoise & Plimpton LLP ("Debevoise") to advise them with respect to the Reinsurance Agreements. Michener Aff. ¶ 9; Affidavit of Alexander R. Cochran ("Cochran Aff.") ¶¶ 3, 5. Debevoise identified provisions of the Injunction that it believed were improper (including the prohibition against offsets in paragraph 7 of the Injunction in violation of § 645.56(1) of the Wisconsin Statutes, which requires that mutual debts and credits be set off), and prepared to file objections. Cochran Aff. ¶ 5. In May and June 2010, Debevoise sought confirmation from counsel for the Rehabilitator, Foley & Lardner LLP ("Foley"), that the Reinsurance Agreements were not allocated to the Segregated Account and that the Injunction did not apply to these agreements. *Id.* ¶¶ 6, 7. Foley advised

Debevoise that the Reinsurance Agreements remained in Ambac's General Account. *Id.* ¶ 6.

On June 9, 2010, Debevoise lawyers discussed with Kevin G. Fitzgerald of Foley whether the Injunction affected the Assured Reinsurers' rights under the Reinsurance Agreements. *Id.* ¶ 7. In a June 11, 2010 email, Debevoise proposed topics for a discussion with Foley, including "[a]rbitration of a current dispute with respect to the calculation of ceding commissions pursuant to some of the Ambac/Assured reinsurance arrangements." *Id.* ¶ 7 & Ex. A. After a June 14, 2010 telephone discussion with Debevoise, *id.* ¶ 8, Mr. Fitzgerald stated the Rehabilitator's position in an email to Debevoise:

> [T]he reinsurance agreements between Ambac Assurance Corporation, as ceding company and affiliates of Assured Guaranty, as reinsurer, have not been allocated to the Segregated Account and therefore are not subject to the rehabilitation proceeding. Accordingly, the temporary injunction does not apply to enjoin any actions that Assured Guaranty or its affiliates may take under the insurance agreements (including . . . demanding arbitration in accordance with the terms of the agreement).

Id. ¶ 9 & Ex. B. Relying on the interpretation of the Rehabilitator's counsel, the Assured Reinsurers did not object to the Injunction. Michener Aff. ¶ 16.

After the Plan was filed on October 8, 2010, Debevoise sought to confirm that it would not be construed to limit the Assured Reinsurers' rights under the Reinsurance Agreements. Cochran Aff. ¶ 12. On November 5, 2010, Debevoise lawyers discussed that issue with Mr. Fitzgerald, and in an email later that day summarized their understanding of the Rehabilitator's position:

> [W]e just wanted to confirm your view that the plan of rehabilitation will not alter the contractual provisions of the reinsurance agreements between Ambac Assurance Corporation, as ceding company and affiliates of Assured Guaranty as reinsurer 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).

Id. ¶ 14 & Ex. C. In an email the next day, Mr. Fitzgerald confirmed, "Generally we agree with your summary" and acknowledged that "general disagreements will remain subject to arbitration (consistent with the contract)." *Id.* ¶ 15 & Ex. D.

Mr. Fitzgerald's November 6, 2010 email added a "caveat" about potential disputes over "underlying policy liabilities" for polices allocated to the Segregated Account. If the Assured Reinsurers wanted to step into Ambac's shoes and contest claims under those underlying policies, he pointed out, they would have to do so in this Court: "[t]he additional rights your client has under the insolvency clause (right to notice and to interpose a defense) necessarily must be exercised in the rehabilitation court, as this is where the underlying policy liability is located." *Id.* ¶ 16 & Ex. D. The email repeated this qualification: "disputes over claim liabilities (if the claims are in the Segregated Account) will need to be handled in the [rehabilitation] Court." *Id.*

Relying on Foley's statements, the Assured Reinsurers did not object to the Plan. Michener Aff. ¶ 16.

E. Confirmation of the Plan

The Rehabilitator moved for confirmation of the Plan and presented evidence at a five-day hearing. The evidence repeated that Ambac's General Account was a "separate

insurer," 11/17 Tr. 167:22-168:4, that held the majority of Ambac's policies, 11/18 Tr. 57:14-58:6, and that it was not in rehabilitation. 11/17 Tr. 127:16-23. The Commissioner and another official of the Office of the Commissioner of Insurance (the "OCI"), explained that the OCI's usual procedure would have called for a rehabilitation of Ambac. The Rehabilitator's evidence showed that the OCI decided not to bring such a proceeding in large part because a proceeding against Ambac would have satisfied conditions in, or "triggered," provisions of Ambac's contracts, to the benefit of other contract parties and to the detriment of Ambac and its policyholders:

> Typically, the approach by the Department has been to take the whole company into rehabilitation and then pull out the Segregated Account. In this situation we could not effectuate that without triggering covenants across the municipalities and commercial franchised businesses across the nation, and so in order to create the Segregated Account and sequester the rupturing of liabilities, we needed to work with the Board to have them create the Segregated Account as we put it into rehabilitation, and so it's something we could not do alone.

11/15 Tr. 141:1-11; *see also id.* at 143:17-19. Use of "the Segregated Account and its rehabilitation [rather] than . . . a full rehab[ilitation] or liquidation" of Ambac enabled the OCI to go forward under Chapter 645 while avoiding an occurrence that fell within contract terms that would have been triggered by a rehabilitation of Ambac. 11/16 Tr. 168:10-14; 11/15 Tr. 137:15-19; *see also id.* at 160:22-161:1.[1]

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[1] The Rehabilitator did not present these contract provisions to the Court, and the Assured Reinsurers have not seen them. The Injunction refers to the default provisions in the ISDA Master Agreement. Injunction at 6-7. Under the 1992 and 2002 versions of the ISDA Master Agreement, a default occurs when an entity "institutes or has instituted against it a proceeding seeking a judgment of insolvency or bankruptcy or relief under any bankruptcy or insolvency law or other similar law affecting creditors' rights." [Tabs 2 & 3].

On January 24, 2011, the Court granted the Rehabilitator's motion and entered a Decision and Final Order confirming the Plan ("Final Order"), which adopted the Rehabilitator's proposed findings of fact and conclusions of law. Citing the testimony presented by the Rehabilitator, the Court distinguished between "the rehabilitation of the Segregated Account [and] a full rehabilitation of all of Ambac." Final Order, Conclusions of Law ("COL"), ¶ 12; *see also* Final Order, Findings of Fact ("FOF"), ¶¶ 51-55, 59, 61, 63, 83, 106, 109, 136. OCI had determined, the Court noted, that "covenants and triggers" in Ambac's policies could be "pulled" if Ambac became "subject to a rehabilitation or liquidation proceeding," and it proposed the rehabilitation of the Segregated Account because it, unlike a rehabilitation or liquidation of Ambac, "would not trigger covenants and cause defaults" under Ambac's contracts. *Id.* ¶¶ 52, 54. Based on this distinction and the critical difference it made under Ambac's contracts, the Court decided that if it did not approve a Plan that placed only the Segregated Account in rehabilitation proceedings, a "full rehabilitation" of Ambac might be necessary, which would be detrimental to all policyholders. *Id.* ¶ 108.

The Court recognized that in other situations involving segregated accounts, the OCI "commenc[ed] rehabilitation of the insurer as a whole, then creat[ed] a segregated account and mov[ed] it out of rehabilitation to carry on a part of the insurer's business." *Id.* ¶ 61. The Court agreed with the Rehabilitator that "the opposite approach here – leaving the bulk of the insurer and its assets outside rehabilitation and rehabilitating a segregated account" was justified "due to the existence of the triggers in transactions insured by Ambac relating to delinquency proceedings and asset transfers." *Id.*

F. Surplus Notes

Under the Plan, holders of policies allocated to the Segregated Account will receive 25% of their permitted claim amounts in cash and 75% in surplus notes issued by the Segregated Account ("Surplus Notes"). Discl. St. at 26. Payments on Surplus Notes are contingent on approval by the Commissioner, who has "absolute discretion in determining whether to allow payments to be made on the Surplus Notes." *Id.* at 39.

G. The Contract Disputes

Ambac is entering into commutation agreements with holders of some of its policies that the Assured Reinsurers reinsure pursuant to the Reinsurance Agreements. In these settlements, some cash and some Surplus Notes are or will be delivered to the policyholders in satisfaction of Ambac's underlying insurance obligations. Michener Aff. ¶ 18. Ambac is demanding that Assured and AG Re pay, in cash, their reinsured portions of the cash payments and the principal amounts of the Surplus Notes. *Id*. ¶ 19. The Assured Reinsurers have paid their shares of the cash portions of these amounts. They do not believe, however, that the Reinsurance Agreements obligate them to pay cash to Ambac in the amount of their shares of the principal amounts of Surplus Notes. *Id*. ¶ 22. The Assured Reinsurers' payment obligations under the Reinsurance Agreements are in dispute. *Id*. ¶ 23.

H. Arbitration Demands

On April 7, 2011, Assured and AG Re demanded arbitration pursuant to Article 15 of the Facultative Agreement and Article 16 of the Surplus Share Agreement.

Michener Aff. ¶ 25. On April 8, 2011, Assured and AG Re filed a petition to compel arbitration in New York State court. *Id.* ¶ 26. This motion followed.

ARGUMENT

I. This Court Lacks Personal Jurisdiction Over AG Re.

A court's judgment or order can bind out-of-state persons only if the court has personal jurisdiction over them. *In re Termination of Parental Rights to Thomas J.R.*, 2003 WI 61, ¶ 2, 663 N.W.2d 734. Without such jurisdiction, a court's rulings do "not bind [an out-of-state person] personally, regardless of how familiar he may have been with the proceedings in the case." *Harley-Davidson, Inc. v. Selectra Int'l Designs, Ltd.*, 861 F. Supp. 754, 755 (E.D. Wis. 1994) (citing *Mid-Continent Wood Prods., Inc. v. Harris*, 936 F.2d 297, 301 (7th Cir. 1991)).

Absent waiver or consent,[2] a court lacks personal jurisdiction over a nonresident unless the nonresident is "subject . . . to jurisdiction under a Wisconsin long arm statute." *In re All-Star Ins. Corp.*, 110 Wis. 2d 72, 76, 327 N.W.2d 648 (1983). Courts can exercise such jurisdiction under special jurisdiction statutes. Wis. Stat. § 801.05(2). The only one of those statutes that could be relevant, Wis. Stat. § 645.04(5), governs in Chapter 645 proceedings. Both § 645.04(5) and the general long-arm statute set forth two requirements. First, the nonresident must be served pursuant to Wis. Stat. § 801.11. Second, there must be a substantive ground for personal jurisdiction. Wis. Stat.

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[2] In Article 18 of the Facultative Agreement, AG Re submitted to the jurisdiction of courts in the United States only if it failed to (a) pay an amount that it agreed was due, (b) arbitrate, or (c) pay an arbitration award. Michener Aff. Ex. A at 15.

§§ 801.05(1)-(11); 645.04(5)(a)-(c). The plaintiff or petitioner shoulders the burden of showing that these requirements are met. *FL Hunts, LLC v. Wheeler*, 2010 WI App 10, ¶ 7, 322 Wis. 2d 738, 780 N.W.2d 529. A plaintiff seeking to establish personal jurisdiction over a nonresident must show, in addition, that the court's exercise of such jurisdiction complies with the requirements of due process. *All-Star Ins.*, 110 Wis. 2d at 76; *Kopke v. A. Hartrodt S.R.L.*, 2001 WI 99, ¶ 22, 245 Wis. 2d 396, 629 N.W.2d 662.

There is no long-arm jurisdiction over AG Re. If there were, the exercise of such jurisdiction would not comport with due process because AG Re did not purposefully avail itself of the privilege of conducting activities in Wisconsin. As a result, the Injunction cannot bind AG Re, and the Court has no authority to grant the Rehabilitator's motion enjoining AG Re or deciding its contract rights.[3]

A. AG Re Has Not Been Served Pursuant to § 801.11.

Section 801.11 authorizes three ways to serve an insurer: (1) personally serving a summons on an officer, director or managing agent of the insurer, (2) leaving a summons with the person apparently in charge of the office of an officer, director or managing agent of the insurer, and (3) serving a summons on an "agent" (as defined in Wis. Stat. § 628.02) of the insurer and sending a copy by registered mail to the insurer's principal place of business within five days. Wis. Stat. §§ 801.11(5)(a), (d).

The Rehabilitator has not served AG Re with a summons, as required by § 801.11. When he mailed documents to AG Re, the Rehabilitator did not use a method

[3] Assured Guaranty has appeared in this proceeding, Michener Aff. ¶ 4, and does not contest the Court's jurisdiction over it. AG Re has made no appearance. *Id.* ¶ 3.

of service authorized by §§ 801.11(5)(a) and (d), and he acknowledged that mailing was not sufficient to establish jurisdiction.[4] In seeking approval of this form of notice, the Rehabilitator told the Court that "[f]or any discrete litigation in this matter . . . between the Commissioner and a single Interested Party or a reasonably small and identifiable number of Interested Parties, the Commissioner will effect service upon the adverse party or parties involved in accordance with Chapter 801 of the Wisconsin Statutes." Motion for Approval of Notice ¶ 4 (Mar. 24, 2010). The Rehabilitator seeks to initiate such "discrete litigation" against AG Re without effecting the service of process that he has recognized would be required to establish personal jurisdiction.

B. There Are No Substantive Grounds for Jurisdiction Under the General or Special Long-Arm Statutes.

Only two provisions in Wis. Stat. § 801.05 conceivably could apply here. Subsection 801.05(5)(a) applies to an action that "[a]rises out of a promise, made anywhere to the plaintiff or to some 3rd party for the plaintiff's benefit, by the defendant to perform services within this state or to pay for services to be performed in this state by the plaintiff." Subsection 801.05(10) applies to an "action which arises out of a promise made anywhere to the plaintiff or some 3rd party by the defendant."

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[4] The Rehabilitator sent to AG Re the notice of first-day filings and orders mailed to those deemed "interested parties" to this proceeding. Since then, notices have been limited to a legal notice in two newspapers and postings on the Rehabilitator's Website. *See* Mot. for Approval of the Form of Notice for the Rehabilitation Pet., First-Day Orders, and Subsequent Proceedings, dated Mar. 24, 2010 ("Motion for Approval of Notice"); dkt. 10, Order Approving Form of Notice (Mar. 24, 2010); *see also* dkt. 30, Joint Aff. of Service, p. 1-3 & Ex. E, p. 128 (Rehabilitator sent copies of four first-day filings and orders to AG Re by first-class mail).

Neither provision works here. This Chapter 645 proceeding arises from the Rehabilitator's assertions of the need to rehabilitate Ambac's Segregated Account, not from any promise by AG Re. Section 645.04(5)(b) could apply if AG Re had "written a policy of reinsurance for an insurer against which a rehabilitation or liquidation order [was] in effect when the action [was] commenced." The Segregated Account is a separate insurer for purposes of this proceeding, Wis. Stat. § 611.24(3)(e), and AG Re has not written reinsurance for that insurer. Therefore, § 645.04(5) does not apply.

C. Even If a Long-Arm Statute Did Apply, the Due Process Clause Would Preclude Jurisdiction.

The Due Process Clause permits jurisdiction only over persons with sufficient "minimum contacts" with the forum state, "such that the maintenance of the suit does not offend 'traditional notions of fair play and substantial justice.'" *Kopke*, 2001 WI 99, ¶ 24 (quoting *Int'l Shoe Co v. Washington*, 326 U.S. 310, 316 (1945)). These minimum contacts exist where a nonresident has "purposefully avail[ed] itself of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its laws." *Id.* (quoting *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 475 (1985)).

The party asking the court to exercise personal jurisdiction has the burden of showing sufficient contacts with the forum state to satisfy due process. *Kopke*, 2001 WI 99, ¶¶ 22-23 & n.7. To show that AG Re purposely availed itself of the privilege of conducting activities in Wisconsin, invoking the benefits and protections of its laws, the Rehabilitator would have to establish that AG Re took *affirmative* action directed at Wisconsin. *Asahi Metal Indus. Co. v. Superior Court*, 480 U.S. 102, 112 (1987). There

is no purposeful availment where, as here, the nonresident does not do business in the forum state, has no office or employees in the state, and has taken no other action to conduct business in the state. *Id.* at 112-13. Like the petitioner in *Asahi*, AG Re has not engaged in any action that is directed toward the forum state, and the exercise of personal jurisdiction over it would not comply with due process.

This conclusion is consistent with *All-Star Insurance*, where the Wisconsin Supreme Court held that personal jurisdiction complied with due process where the defendants had sent insurance applications to All-Star in Wisconsin and had made telephone calls to All-Star in Wisconsin for years, All-Star had performed its contract obligations entirely in Wisconsin, and the contract required the defendants to send monthly premium payments to All-Star in Wisconsin. *Id.* at 83. These activities established sufficient links between the defendants and Wisconsin to support the exercise of personal jurisdiction. *Id*. at 85.

Whereas All-Star was based in Wisconsin, Ambac has its principal office in New York. Request by the Office of the Wisconsin Commissioner of Insurance for Immediate Case Assignment of this Chapter 645, Wis. Stats., Insurance Delinquency Proceeding to the Honorable William D. Johnston, dated Mar. 24, 2010, ¶ 2. Whereas All-Star discharged its contract obligations solely in Wisconsin, Ambac did not. Whereas the defendants in *All-Star Insurance* had extensive contacts with All-Star in Wisconsin, AG Re's contacts with Ambac have been in New York. Michener Aff. ¶ 6. Whereas the defendants' contract required them to send premium payments to All-Star in Wisconsin,

AG Re makes payments to Ambac in New York, and the Facultative Agreement requires AG Re to send notices to Ambac in New York. Michener Aff. ¶ 6 & Ex. A at 15.

A contractual choice-of-law provision can be significant in the due process analysis. *Burger King*, 471 U.S. at 481-82. Purposefully availing oneself of the privilege of conducting activities in a state entails "invoking the benefits and protections of its laws." *Kopke*, 2001 WI 99, ¶ 24 (quoting *Burger King*, 471 U.S. at 475). Because the Facultative Agreement is governed by New York law, Michener Aff. Ex. A at 16, AG Re invoked the benefits and protections of New York law, not Wisconsin law.

II. The Injunction Does Not Enjoin the Assured Reinsurers from Arbitrating a Contract Dispute with Ambac.[5]

The Reinsurance Agreements are in the General Account of Ambac, and the Assured Reinsurers are not enjoined from exercising their rights under them. The Rehabilitator was correct when he advised the Assured Reinsurers, twice, that the Injunction did not deprive them of those rights, including their rights to arbitrate.

It is well established that injunctions must be construed strictly, "with close questions of interpretation being resolved in the defendant's favor." *3M v. Pribyl*, 259 F.3d 587, 598 (7th Cir. 2001). "Since . . . only those acts specified by [an] order will be treated as within its scope and . . . no conduct or action will be prohibited by implication, all omissions or ambiguities . . . will be resolved in favor of [the enjoined party]." 11A

[5] AG Re makes this argument, and the following arguments, for dismissal of the Rehabilitator's motion without waiver or prejudice to its position that the Court lacks personal jurisdiction over it.

Wright & Miller, Federal Practice & Procedure § 2955 (2011). This rule of strict construction is intended to "prevent unfair surprise" to parties charged with violating an injunction. *Schering Corp. v. Ill. Antibiotics Co.*, 62 F.3d 903, 906 (7th Cir. 1995). As the United States Supreme Court has observed, "basic fairness requires that those enjoined receive explicit notice of precisely what conduct is outlawed." *Schmidt v. Lessard*, 414 U.S. 473, 476 (1974).

The Wisconsin Supreme Court recognized this principle in *Wisconsin Central Railroad Co. v. Smith*, 52 Wis. 140, 8 N.W. 613, 614 (Wis. 1881): "an injunction order must be construed strictly in favor of the person charged with violating it." The Court expressed heightened concern that injunctions restraining parties from instituting or prosecuting proceedings be narrowly construed, observing that "[i]f a court of equity deems it proper in a given case to restrain a person from instituting or prosecuting a proceeding in the courts, it should do so in express words." *Id.* at 615.

Wisconsin law and fundamental fairness compel a reading of the Injunction that is limited to its express terms. This principle precludes the Rehabilitator from enlarging the scope of the Injunction by broadly interpreting its terms.

A. The Injunction Does Not Apply to Contracts in the General Account.

The Injunction clarifies at the outset that it does not affect parties whose contracts with Ambac remain in Ambac's General Account:

> Please note that, as explained in the Commissioner's motion, *the injunctive relief granted below does not apply to* policies or other *contracts which remain in the Ambac General Account.* The injunctive relief specified below pertains to the Segregated Account [and] policies, contracts, assets and liabilities allocated to the Segregated Account . . . .

Injunction at 1 (emphasis added). The Injunction has no exclusions from or qualifications to this broad exemption of contracts in the General Account. The Reinsurance Agreements fall within the "contracts" described unambiguously in this exemption since they "remain[ ] in the Ambac General Account."

The balance of the Injunction spells out ways in which the Court is enjoining actions directed to the property of the Segregated Account, including its insurance policies and assets. None of these provisions enjoins the Assured Reinsurers from arbitrating disputes with Ambac under contracts that have not been allocated to the Segregated Account. None of them purports to limit the Injunction's unqualified pronouncement that it does not apply to contracts in the General Account.[6]

B. The Rehabilitator's Motion for Entry of the Injunction Does Not Enjoin the Arbitration Sought by the Assured Reinsurers.

The Injunction was entered on the basis of written submissions and oral argument. Injunction at 1. The Rehabilitator's brief argued that injunctive relief was "necessary to

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[6] These provisions protect *the Segregated Account* from lawsuits (paragraph 1); restrain entities claiming secured or priority interests on *the Segregated Account's assets* from exercising rights to those assets (paragraph 3); prevent parties with policies and contracts allocated to *the Segregated Account* from terminating or asserting claims under those policies or contracts based on, among other things, the occurrence of a proceeding or non-payment (paragraph 4); prohibit parties with certain kinds of policies and contracts allocated to *the Segregated Account* from asserting certain kinds of claims, bringing lawsuits, or exercising control (paragraphs 5 and 6); and prevent parties from failing to pay premiums or other amounts owed to *the Segregated Account* or to the General Account in connection with policies or contracts allocated to *the Segregated Account* (paragraph 7). Paragraph 9 purports to explain how these provisions relate to specific kinds of policies and contracts that have been allocated to *the Segregated Account*.

prevent catastrophic destruction of policyholder value and to provide the Commissioner adequate time to transition this troubled insurer to the stability of a court-approved rehabilitation plan." Brief in Support of Motion for Temporary Injunctive Relief, dated March 24, 2010 ("Inj. Br."), at 1. The Rehabilitator described four kinds of harm that he was asking the Court to prevent:

- Parties with *policies or contracts allocated to the Segregated Account* might use ipso facto provisions in those contracts and policies to argue that the commencement of the rehabilitation proceeding enabled them to terminate those policies and contracts, or to assert rights under those policies and contracts that would lead to "enormous, inequitably inflated claims" *against the Segregated Account.* Inj. Br. at 2; *see also id.* at 9-10.

- Claimants *against the Segregated Account* might seek immediate payment of their claims, undercutting the Rehabilitator's efforts to institute an orderly claims process. *Id.* at 2-3, 10.

- Holders of *policies and contracts allocated to the Segregated Account* might cease their payments of premiums and other amounts due, effectively enabling them to obtain priority for their claims *against the Segregated Account.* *Id.* at 3, 10-11.

- The Rehabilitator would be exposed to lawsuits and interference with his task if the "[s]tandard first-day injunctive provisions found in all Wisconsin rehabilitation proceedings," such as "injunctions . . . against *lawsuits by Segregated Account policyholders outside this proceeding*" were not imposed. *Id.* at 3, 11.

(emphases added). At the March 24, 2010 hearing, the Rehabilitator repeated these reasons for seeking an injunction to protect the Segregated Account. 3/24 Tr. 21-25.

The Assured Reinsurers' efforts to arbitrate raise none of these concerns. They are not trying to augment claims against the Segregated Account – they have no such claims. They are not bringing claims against the Segregated Account in a manner inconsistent with the Plan. They are not stopping premium payments due under policies

or contracts allocated to the Segregated Account. They are not suing the Rehabilitator or otherwise interfering with the administration of the Segregated Account.

At the March 24, 2010 hearing, the Rehabilitator defined the limit on the relief he sought: "there is a bright-line separation between what we're asking [the Court] to do as part of the rehabilitation proceeding as to the [S]egregated [A]ccount, not you know, tainting or affecting or spilling over into the affairs of the general account." *Id.* at 9:15-19. Ambac made the same point in response to motions opposing a settlement:

> The starting point in addressing the need for Court approval is the incontestable fact that the polices that are subject to the CDS Settlement are in the General Account, not the Segregated Account. *Only the activities of the Segregated Account are subject to review by this Court*. Except as constrained by the Cooperation Agreement . . . *it is business as usual for the General Account policies*.

Ambac Br. in Opposition to Various Motions, dated May 20, 2010, at 22 (emphasis added) (citation omitted). Consistent with the "bright line separation," the Injunction does not affect the Reinsurance Agreements.

C. Paragraph 1 of the Injunction Does Not Enjoin the Assured Reinsurers from Arbitrating Their Disputes with Ambac.

The Rehabilitator argues that paragraph 1 of the Injunction enjoins the Assured Reinsurers from arbitrating disputes under the Reinsurance Agreements because any such dispute "relates to" policies allocated to the Segregated Account. Rehabilitator's Brief in Support of Motion to Enforce Injunction Against Assured Guaranty and AG Re, dated Apr. 15, 2011 ("Rehab. Br."), at 9. That breadth is not in the language of paragraph 1 nor is it consistent with the basis on which the Injunction was sought or entered.

In March 2010, The Rehabilitator argued that the Court had authority to "impose injunctions prohibiting commencement or prosecution of litigation against an insolvent insurer while rehabilitation efforts are on the way." Inj. Br. 8-9, quoting *In re Rehab. of Frontier Ins. Co.,* 870 N.Y.S.2d 144, 146 (N.Y. App. Div. 2008). The Rehabilitator explained that he was seeking "the standard first-day types of protections . . . protecting the entity from direct lawsuits, protecting lawsuits against the rehabilitator and his employees and the like" 3/24 Tr. 21:9-13. He said nothing about enjoining actions against Ambac to resolve disputes under contracts that were not allocated to the Segregated Account, and he never suggested that the Injunction would cross the "bright line separation between what we're asking you to do as part of the rehabilitation proceeding . . . [and] the affairs of the general account."

Because of the unusual nature of this rehabilitation proceeding, "protecting the entity from direct lawsuits" required an injunction extending beyond actions and proceedings brought against the Segregated Account. Holders of policies or contracts allocated to the Segregated Account could bring lawsuits, directed toward those policies or contracts, that were nominally against Ambac. To provide "protect[ion] from direct lawsuits" of that kind against the Segregated Account, the Injunction needed to proscribe some actions and proceedings that nominally would be against Ambac. It would not be appropriate or consistent with the Rehabilitator's position to enjoin actions and proceedings against Ambac beyond those that would be in substance directed against, or brought under policies or contracts allocated to, the Segregated Account. Accordingly, paragraph 1 enjoins actions and proceedings against Ambac that are "in respect of . . .

policies . . . contracts or liabilities allocated to the Segregated Account." The arbitration that the Assured Reinsurers seek to bring is "in respect of" contracts in Ambac's General Account, and not within the reach of paragraph 1.

Contrary to the Rehabilitator's assertion, Rehab. Br. 9, paragraph 1 does not enjoin all proceedings against Ambac that "relate[ ] to" Segregated Account policies and contracts. Paragraph 1 does not reach actions and proceedings against Ambac by holders of policies or contracts in the General Account, to which the Injunction expressly does not extend.[7] That is the only reasonable interpretation of paragraph 1. Any other reading would nullify the Injunction's express exemption of such contracts, wipe out the "bright line" that the Rehabilitator described, extend the Injunction well beyond what the Rehabilitator told the Court he needed or was seeking in March 2010, and violate the principle of strict construction of injunctions.

The Assured Reinsurers' disputes are with Ambac, not the Segregated Account. Paragraph 1 does not enjoin the Assured Reinsurers from arbitrating those disputes.

D. Paragraph 7 Does Not Enjoin the Assured Reinsurers from Arbitrating Their Disputes with Ambac.

The Rehabilitator's contention that paragraph 7 of the Injunction enjoins the Assured Reinsurers from not paying the amounts that Ambac says are due under the Reinsurance Agreements mischaracterizes those disputed amounts as "payments . . .

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[7] The Rehabilitator also notes that the Assured Reinsurers' non-payment of amounts claimed by Ambac "adversely impacts the claims paying resources of the Segregated Account." Rehab. Br. 10. That is true of every issue or dispute that affects Ambac's financial condition. The fact that a claim may affect Ambac does not bring it within the Injunction.

owed to . . . the Ambac General Account . . . in connection with policies . . . allocated to the Segregated Account." Inj. Br. 12-13.

The Rehabilitator sought this provision to prevent holders of policies and contracts allocated to the Segregated Account from using non-payment to obtain priority for their claims against the Segregated Account. *Id.* at 3, 11 (relief sought "to require counterparties to continue to pay the premiums they owe on the policies allocated to the Segregated Account and to make the payments due on contracts insured by the policies in the Segregated Account"). As he said at the hearing, "it's to require policyholders to keep paying their premiums" to avoid "a situation where the policyholders say, [']Oh, my goodness, the company has been put into the or at least the segregated account into liquidation, I'm going to stop making my premium payments.[']" 3/24 Tr. 24:7, 24:9-12.

Applying paragraph 7 to payments sought by Ambac under the Reinsurance Agreements effectively would nullify the provision that the Injunction "does not apply to policies or other contracts which remain in the Ambac General Account," and would be inconsistent with the "bright line" that the Rehabilitator said was being drawn.[8]

Even apart from that, the Rehabilitator's attempt to use paragraph 7 to thwart the Assured Reinsurers' arbitration against Ambac has two fatal flaws. First, the Assured

[8] The last sentence of paragraph 7 confirms that it relates to attempts to set off or withhold payment on policies allocated to the Segregated Account: "A party's withholding or set-off of premiums or payments owed under or in connection with any of the aforementioned documents may result in the future disallowance or decrease of such party's claims." The purpose of paragraph 7 is to prevent the disruption of payments due under policies and contracts allocated to the Segregated Account.

Reinsurers dispute that these amounts are "owed" to Ambac. These disputed amounts are unlike the "owed" insurance premiums covered by paragraph 7. The timing and amounts of those premiums are stated in policies or schedules that were agreed to before this proceeding began. There are no such agreed-to amounts owed by the Assured Reinsurers. Nothing in Chapter 645 empowers the Court or the Rehabilitator to declare these contested amounts to be "owed" to Ambac. Second, these disputed amounts are owed to Ambac "in connection with" the Reinsurance Agreements – not "in connection with" policies allocated to the Segregated Account. The Rehabilitator's effort to exploit arguable vagueness in his own drafting to expand the Injunction to payments to Ambac under contracts in the General Account is inconsistent with the stated reasons for and the scope of the Injunction (including its exclusion of contracts remaining in Ambac's General Account), and irreconcilable with the "bright-line separation . . . not . . . tainting or affecting or spilling over into the affairs of the general account." 3/24 Tr. 9:15-19. Payment of these amounts is the subject of a dispute with Ambac, not an obligation to the Segregated Account under paragraph 7.[9]

[9] The Rehabilitator quotes a portion of § 4.04(g) of the Plan, apparently to suggest that it gives Ambac a right to recover these amounts. Rehab. Br. 5. That provision merely preserves Ambac's rights under any Policy (defined in §1.48 as certain policies allocated to the Segregated Account) or "related underlying . . . contract(s) governing the priority or distribution of cash recoveries or delivery of assets." The Reinsurance Contracts are not policies or contracts covered by § 4.04(g).

E. The Rehabilitator Is Equitably Estopped from Arguing for an Expansive Reading of the Injunction.

Because the Assured Reinsurers relied on Foley's advice that their rights under the Reinsurance Agreements were not affected by the Injunction or the Plan, the Rehabilitator is equitably estopped from arguing that the Injunction bars the Assured Reinsurers from seeking arbitration of their disputes with Ambac under those agreements.

Equitable estoppel requires the following elements: "(1) action or non-action, (2) on the part of one against whom estoppel is asserted, (3) which induces reasonable reliance thereon by the other, either in action or non-action, and (4) which is to his or her detriment." *Milas v. Labor Ass'n of Wis., Inc.*, 214 Wis. 2d 1, 11-12, 571 N.W.2d 656 (1997). Each element is present here. First, Foley's statements constituted "action" for purposes of equitable estoppel. *See*, *e.g.*, *George v. Wis. Mut. Ins. Co.*, 2011 WI App 1, ¶ 8, 330 Wis. 2d 832, 794 N.W.2d 926 (insurer judicially estopped from denying coverage based on statement to policyholder that premium had been paid). Second, these statements were made on behalf of the Rehabilitator. Third, the statements induced the Assured Reinsurers' reasonable reliance in deciding not to object to the Injunction or the Plan. Michener Aff. ¶ 12. Fourth, the Assured Reinsurers' relied to their detriment on these statements since they (or Assured Guaranty, which previously had appeared) could have used those objections to clarify their rights, avoiding this motion.

In an attempt to disavow these clear statements of his position, the Rehabilitator buries the June 2010 email in a footnote and distorts the November 2010 email. Rehab. Br. 5-6 & 6 n.2. He accuses the Assured Reinsurers of taking the June 2010 email "out

of context." *Id.* at 6 n.2. The accompanying affidavits present that context. The Assured Reinsurers were concerned that the Injunction might be construed to affect their rights under the Reinsurance Agreements, including their arbitration rights. Their lawyers asked for clarification, and Foley assured them that the Injunction did not affect those rights. Cochran Aff. ¶¶ 5-10 & Ex. B. After the Plan was filed, they asked about its effect on the Reinsurance Agreements, and Foley said there would be none, apart from the mechanism for contesting claims against "underlying policy liabilities" in the Segregated Account. *Id*. ¶¶ 12-18 & Ex. D.

The Rehabilitator tries to distort the "caveat" in Mr. Fitzgerald's November 2010 email into a statement that any "dispute involv[ing] liabilities related to claims that had been allocated to the Segregated Account" would have to be brought before this Court. Rehab. Br. 5-6. That is not what Mr. Fitzgerald said. If he had said that, he would not have "[g]enerally . . . agreed" with the Debevoise email summarizing the Rehabilitator's position – he would have rejected it. Finally, the Rehabilitator chides the Assured Reinsurers for not expressing disagreement at the confirmation hearing. *Id.* at 6. But the Assured Reinsurers had no disagreement with the position that was stated in Foley's emails. Michener Aff. ¶ 12; Cochran Aff. ¶ 18.

Even if the Court decides that an element of equitable estoppel has not been established, Foley's statements would be grounds for denying the Rehabilitator's motion. As noted above, injunctions are construed strictly, with any "close questions of interpretation being resolved in [the Assured Reinsurers'] favor." *3M v. Pribyl*, 259 F.3d 587, 598 (7th Cir. 2001). If the applicability of the Injunction to the Assured Reinsurers'

rights to arbitrate were clear enough to grant the Rehabilitator's motion, his counsel would not have interpreted it in exactly the opposite way.

III. The Wisconsin Statute Abrogating Arbitration Provisions Does Not Apply to the Reinsurance Agreements, Leaving No Basis for Reverse Preemption.

The Rehabilitator's motion goes beyond seeking a ruling under the Injunction. Without explaining why this Court can or should determine the rights of the Assured Reinsurers to arbitration of their disputes with Ambac, he contends that the arbitration agreements cannot be enforced because (a) Wis. Stat. § 645.04(3) so provides, Rehab. Br. 11, and (b) the Federal Arbitration Act ("FAA") is reverse preempted under the McCarran-Ferguson Act, 15 U.S.C. §§ 1011-15. Rehab. Br. 10-11. Both arguments are based on a misreading of the Wisconsin statute. Although § 645.04(3) does invalidate some arbitration agreements, it does not affect those in the Reinsurance Agreements. It provides, "[a]n 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." (emphasis added).

"[S]tatutory interpretation begins with the language of the statute," and that "language is given its common, ordinary, and accepted meaning." *State ex rel. Kalal v. Circuit Court for Dane Cnty.*, 2004 WI 58, ¶ 45, 271 Wis. 2d 633, 681 N.W.2d 110 (internal quotation marks and citation omitted). The Rehabilitator asserts that Wisconsin law nullifies arbitration agreements in all "disputes involving the delinquent insurer," Rehab. Br. 11, but that is not what § 645.04(3) says. On its face, it affects only arbitration agreements *in contracts with insurers in delinquency proceedings.*

The Segregated Account is "subject to a delinquency proceeding" within the meaning of § 645.04(3), making arbitration provisions in contracts with the Segregated Account unenforceable. But the arbitration agreements at issue are in contracts *with Ambac*, which is not "subject to a delinquency proceeding" within the meaning of § 645.04(3) in the "common, ordinary, and accepted meaning" of those words: "NEITHER [AMBAC] NOR ITS GENERAL ACCOUNT . . . . IS IN REHABILITATION AS PART OF THE PROCEEDING OR OTHERWISE." Discl. St. at 1. Arbitration agreements with Ambac are not affected by § 645.04(3).

Because § 645.04(3) does not prohibit arbitrations of disputes under the Reinsurance Agreements, the Rehabilitator's reverse preemption argument, Rehab. Br. 10-12, fails. Under the McCarran-Ferguson Act, "No Act of Congress shall be construed to . . . supersede any law enacted by any state for the purpose of regulating the business of insurance." 15 U.S.C. § 1012. Federal law is preempted under the McCarran-Ferguson Act only where (1) a federal statute "specifically relates to the business of insurance," (2) a state statute was enacted "for the purpose of regulating the business of insurance," (3) and application of the federal statute would "impair, interfere, or supersede" that state statute. *U.S. Dep't of Treasury v. Fabe*, 508 U.S. 491, 500-01 (1993) (applying test for determining whether the McCarran-Ferguson Act reverse preempts a federal law) (internal quotation marks and citations omitted); *see also McKnight v. Chi. Title Ins. Co., Inc.*, 358 F.3d 854, 857-59 (11th Cir. 2004).

Reverse preemption under McCarran-Ferguson must be based on a state insurance law that is inconsistent with federal law (here, the FAA). There is no such Wisconsin

law. Enforcing the FAA against Ambac, which is not "an insurer that is subject to a delinquency proceeding," would not invalidate, impair or supersede § 645.04(3). The Rehabilitator is incorrect when he says that the Injunction can provide the basis for reverse preemption. Rehab. Br. 10. The Injunction is not a state law, and cannot serve as the "particular *state law* that regulates the business of insurance" for purposes of the McCarran-Ferguson Act. *Am. Heritage Life Ins. Co. v. Orr*, 294 F.3d 702, 708 (5th Cir. 2002) (emphasis added). The cases cited by the Rehabilitator do not apply reverse preemption based on a court order. Rehab. Br. 10-11.[10]

Taking a broader view of reverse preemption, the Rehabilitator asserts that "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." Rehab. Br. 10. McCarran-Ferguson does not provide that *any* state law regulating the business of insurance reverse preempts federal law. "The test under McCarran-Ferguson is not whether a state has enacted statutes regulating the business of insurance, but whether such state statutes will be invalidated, impaired, or superseded by application of federal law." *Miller v. Nat'l Fid. Life Ins. Co.*, 588 F.2d 185, 187 (5th Cir. 1979). Where a state law prohibits arbitration clauses in all insurance contracts, that law reverse preempts the FAA because compelling arbitration under the FAA directly conflicts with the

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[10] In these cases, reverse preemption stemmed from state statutes that the courts relied on in enjoining arbitrations, not the injunctions themselves. *See Davister Corp. v. United Republic Life Ins. Co.*, 152 F.3d 1277, 1281 (10th Cir. 1988); *Munich Am. Reins. Co. v. Crawford*, 141 F.3d 585, 593-95 (5th Cir. 1998); *Stephens v. Am. Int'l Ins. Co.*, 66 F.3d 41, 45-46 (2d Cir. 1995).

prohibition on arbitration. *E.g.*, *McKnight*, 358 F.3d at 74 (Georgia arbitration act explicitly excepting "any contract of insurance" from arbitration reverse preempts FAA) (quoting Ga. Code Ann. § 9-9-2(c)); *Stephens*, 66 F.3d at 45-46 (Kentucky liquidation statute rendering all arbitration clauses unenforceable during liquidation reverse preempts FAA). Wisconsin law contains no such ban, and the limited prohibition in § 645.04(3) does not apply here.

Moreover, reverse preemption under McCarran-Ferguson cannot apply to the Facultative Agreement because its arbitration agreement is subject to a treaty, the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 3 (the "New York Convention"). The New York Convention applies to that arbitration agreement because (a) a party to the dispute, AG Re, is not a U.S. citizen, (b) the agreement is part of a commercial contract, and (c) the United States and Bermuda are parties to the New York Convention.[11] Article II(3) of the New York Convention requires courts to enforce arbitration agreements in international commercial transactions. Congress implemented the New York Convention under Chapter 2 of the FAA, 9 U.S.C. §§ 201-08. According to the United States government, however, Article II of the New York Convention is a self-executing treaty provision. Brief for the United States as Amicus Curiae at 8, *La. Safety Ass'n of Timbermen-Self Insurers Fund v. Certain Underwriters at Lloyd's, London*, 131 S. Ct. 65

[11] The United States has ratified the New York Convention. The United Kingdom has ratified it and extended it to Bermuda. United Nations Treaty Collection, Status, Convention on the Recognition and Enforcement of Foreign Arbitral Awards. [Tab 4].

(2010) (No. 09-945) ("U.S. Br.") [Tab 5]. Article II therefore "automatically ha[s] effect as domestic law," independent of the FAA. *Medellin v. Texas*, 552 U.S. 491, 504 (2008). Because McCarran-Ferguson reverse preemption reaches only "Acts of Congress" and Article II has effect other than by an act of Congress, there can be no reverse preemption. U.S. Br. at 13. Courts are obligated to enforce international arbitration clauses under the New York Convention, regardless of state insurance laws that limit arbitration rights.

A number of courts have concluded that, even where there is a contrary state insurance law, McCarran-Ferguson has no impact on arbitration agreements under Article II of the New York Convention. The Fifth Circuit enforced an arbitration agreement that conflicted with Louisiana insurance law, observing that "Congress did not intend the term 'Act of Congress,' as used in the McCarran-Ferguson Act, to reach a treaty such as the Convention." *Safety Nat'l Cas. Corp. v. Certain Underwriters at Lloyd's, London*, 587 F.3d 714, 724 (5th Cir. 2009); *see also Goshawk Dedicated Ltd. v. Portsmouth Settlement Co.*, 466 F. Supp. 2d 1293, 1304 (N.D. Ga. 2006); *Antillean Marine Shipping Corp. v. Through Transp. Mut. Ins., Ltd.,* No. 02-22196-Civ., 2002 WL 32075793, at *3 (S.D. Fla. Oct. 31, 2002); *but cf. Stephens*, 66 F.3d at 45.

Enforcing arbitration agreements that come within the New York Convention is consistent with the rule that the public policy favoring enforcement of such agreements is "even stronger in the context of international business transactions." *David L. Threlkeld & Co. v. Metallgesellschaft Ltd (London)*, 923 F.2d 245, 248 (2d Cir. 1991); *see also Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 629-31 (1985). In the view of the United States government, refusals to enforce such agreements would

"subvert federal efforts to deal comprehensively and uniformly with enforcement of arbitration agreements in the international commercial context." U.S. Br. at 17.

IV. The Parties' Contract Disputes Are Not Properly before This Court.

The Assured Reinsurers and Ambac – an insurer that is not in rehabilitation – disagree over (a) whether the Assured Reinsurers are obligated to pay the amounts sought by Ambac under the Reinsurance Agreements, and (b) whether that contract dispute is subject to arbitration. The Rehabilitator asks this Court to decide these contract disputes and to "declare that [the] Assured [Reinsurers have] violated [their] contracts with Ambac," Rehab. Br. 13. There are ways in which such disputes are properly decided, and courts (or arbitration panels) in which they are properly decided. They do not include a motion in a Chapter 645 rehabilitation proceeding of the Segregated Account.

A. There Are Appropriate Fora and Procedures for Deciding the Disputes Between Ambac and the Assured Reinsurers.

The Assured Reinsurers believe their contract disputes with Ambac should be arbitrated because of the arbitration agreements in the Reinsurance Agreements, and Ambac disagrees. The resolution of this disagreement is a "threshold determination." *U.S. Bulk Carriers, Inc. v. Arguelles*, 400 U.S. 351, 362 (1971). There are procedures under federal and New York State law for making that kind of determination. 9 U.S.C. § 4; N.Y. C.P.L.R. § 7503(a). In asking this Court to make that threshold determination, the Rehabilitator has not complied with those clear-cut procedures.

The Assured Reinsurers have invoked the appropriate procedures for making this threshold determination by bringing a petition to compel arbitration in a New York State

court – just over a mile from Ambac's headquarters. The parties designated New York as the source of governing law and as the site for their arbitrations, Michener Aff. Ex. A at 12, 16, Ex. B at 15, 19, making that court a logical choice. As the Wisconsin Supreme Court has noted, "the plaintiff's choice of a forum should rarely be disturbed unless the balance is strongly in favor of the defendant." *U.I.P. Corp. v. Lawyers Title Ins. Corp.*, 264 N.W.2d 525, 528 (Wis. 1978) (internal quotation marks and citation omitted). The New York courts should decide whether the parties are obligated to arbitrate.

If the Assured Reinsurers prevail on this threshold issue, there will be an arbitration, in which a panel of three arbitrators will "determine all procedural matters." Michener Aff. Ex. A at 12, Ex. B at 15-16. This Court has no authority to determine what procedures will apply in an arbitration. If Ambac prevails, these disputes should proceed in a court with personal jurisdiction over the defendants, and the parties should have the rights and responsibilities of litigants in that as-yet-undetermined court. If the Assured Reinsurers are required to litigate, they probably would choose to do so in New York. If Ambac brings litigation, it will face significant hurdles in obtaining personal jurisdiction over AG Re in any federal or state court.

B. These Disputes Should Not Be Resolved in the Rehabilitation Proceeding for the Segregated Account.

The Rehabilitator offers no reason why this Court, as part of its supervision of a Chapter 645 rehabilitation, can or should resolve contract disputes between Ambac and the Assured Reinsurers. He does not acknowledge the incongruity of putting these issues before this Court when neither he nor the Segregated Account is a party to the disputes.

Aside from that, adjudicating these kinds of issues would be inconsistent with the role of a court supervising a Chapter 645 rehabilitation. Ambac described that role when it opposed a motion to intervene and conduct discovery. Ambac Br. in Opp'n to LVM Bondholders' Mot. Challenging Allocation of LVM Bond Policy to Segregated Account, dated June 30, 2010, at 17. In denying the motion, the Court quoted Ambac:

> A rehabilitation proceeding is not an adversarial litigation designed to adjudicate the diverse and divergent interests of each policyholder. It is a formal remedial measure to "rehabilitate the business of a domestic insurer." Wis. Stat. §645.32(1). Accordingly, rehabilitation is "a very flexible procedure" that is "regarded as a management rather than a legal task. . . . [The Rehabilitator] must act under the supervision of the court, of course, but the court's control should be liberal, not strict, and should be provided without cumbersome procedures." Wis. Stat. Ann. §645.32 cmt. Therefore, in relying on Wis. Stat. §803.09(1), the LVM Bondholders ignore the critical difference between ordinary, adversarial litigation and a rehabilitation proceeding.

July 16, 2010 Order at 7. The Rehabilitator now brings to the Court "adversarial litigation" that is even farther removed from its "management task" in this proceeding.

The Rehabilitator's effort to have the Court decide these issues overlooks the effect of a Chapter 645 rehabilitation on "adversarial litigation." The Plan prescribes how claims against policies allocated to the Segregated Account must be asserted. Plan at 26-29. But the Assured Reinsurers are not pursuing claims against the Segregated Account. They are seeking arbitration to determine their obligations to Ambac. Nothing in Chapter 645 provides that such issues can be decided in this proceeding.

The bringing of a rehabilitation proceeding does not insulate a delinquent insurer like the Segregated Account from litigation, or centralize all its litigation in the rehabilitation court. Because the rehabilitator needs some breathing room "to obtain

proper representation and prepare for further proceedings," Wis. Stat. § 645.34(1), Wisconsin courts are required to stay pending actions to allow the rehabilitator time to take those steps, but not to transfer them to the rehabilitation court. Similarly, Wis. Stat. § 645.34(1) requires the rehabilitator to seek stays in litigation outside Wisconsin where necessary, but does not require the rehabilitator to seek to have it brought before the rehabilitation court. The Official Comment adds that the rehabilitator can seek to stay litigation, but that would be for the limited purpose articulated in § 645.34(1): to give the rehabilitator time "to obtain proper representation and prepare for further proceedings."

By contrast, in a liquidation proceeding under Chapter 645, "all actions and all proceedings against the insurer whether in this state or elsewhere shall be abated and the liquidator shall not intervene in them." Wis. Stat. § 645.49(1). As the drafting comments explain, "[n]ormally it is preferable that actions against an insurer be terminated when the liquidation begins, to be succeeded by the statutory claims procedure." Laws of Wisconsin (1967) ch. 89, p. 265. The Official Comment to § 645.34(1) sums up this difference between the two forms of proceedings: "The rehabilitator should not be permitted to escape actions and proceedings instituted against the insurer − if he needs to do that the insurer should be liquidated, not rehabilitated." Laws of Wisconsin (1967) ch. 89, p. 251.

Having chosen a rehabilitation proceeding instead of a liquidation, the Rehabilitator should follow the rules applicable to a rehabilitation. Those rules confirm that a rehabilitation court should not decide these contract disputes between Ambac and the Assured Reinsurers.

C. The Rehabilitator's Position Would Deprive the Assured Reinsurers of Their Due Process Rights to Adequate Procedures.

The Rehabilitator asks the Court to decide these contract disputes without the procedures that ordinarily would accompany litigation of such a dispute – *e.g.*, pleadings, motions to dismiss, discovery, motions for summary judgment, and a trial. Although the parties opted out of the litigation process when they entered into arbitration agreements that "reflect[ed] the parties' preference for non-judicial dispute resolution, which may be faster and cheaper," *AT&T Broadband, LLC v. Int'l Bhd. of Elec. Workers*, 317 F.3d 758, 762 (7th Cir. 2003), that is the process they should revert to if the arbitration agreements are held by the New York courts to be unenforceable.

If required to litigate these issues, the Assured Reinsurers would be entitled under the Fourteenth Amendment to a proceeding that comports with due process of law. *See generally Mathews v. Eldridge*, 424 U.S. 319, 333 (1976) ("The fundamental requirement of due process is the opportunity to be heard 'at a meaningful time and in a meaningful manner.'") (quoting *Armstrong v. Manzo*, 380 U.S. 545, 552 (1965)); *Swaim v. Moltan Co.*, 73 F.3d 711, 720 (7th Cir. 1996) (due process requires service of process) (citing *Mullane v. Cent. Hanover Bank & Trust Co.*, 339 U.S. 306 (1950)). For this Court summarily to adjudicate these contract disputes, with no basis for deciding them in this proceeding and without subjecting this dispute to procedures designed for adjudicating such disputes, would deprive the Assured Reinsurers of their due process rights.

V. The Rehabilitator Is Wrong on the Merits.

The Rehabilitator argues that (1) these disputes are not subject to arbitration and (2) the Assured Reinsurers owe Ambac the amounts that Ambac claims. Rehab. Br. 2, 17. Under governing New York contract law, the dispositive question on each issue is this: Is there a "proceeding under Chapter 645 . . . against Ambac?" There is no such proceeding, and that answer resolves both issues in favor of the Assured Reinsurers.

The Rehabilitator's position is that, for purposes of provisions in the Reinsurance Agreements, there is no distinction between a Chapter 645 proceeding against Ambac and this rehabilitation proceeding against the Segregated Account. That is incorrect. Moreover, the Rehabilitator's position is inconsistent with the position on which he has based this proceeding, and which he has convinced the Court to adopt, that this is a critically important distinction in construing Ambac's contracts.

A. Because Ambac Is Not Subject to a Chapter 645 Proceeding, the Arbitration Agreements Remain in Effect.

Because reverse preemption is inapplicable, the arbitration agreements are subject to the FAA, 9 U.S.C. §§ 1 *et seq.*, as well as New York contract law. Michener Aff. Ex. A at 16, Ex. B at 19. The FAA reflects a federal policy favoring arbitration: "In enacting [the FAA], Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration." *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984); *see United Steel, Paper & Forestry, Rubber, Mfg., Energy, Allied Indus. & Servs. Workers Int'l Union v. TriMas Corp.*, 532 F.3d 531, 536 (7th Cir. 2008)

(interpreting contract to "comport with the federal policy in favor of arbitration").[12] Last month, the U.S. Supreme Court confirmed that policy and stressed that arbitration agreements have the status of contracts:

> We have described [Section 2 of the FAA] as reflecting both a "liberal federal policy favoring arbitration," and the "fundamental principle that arbitration is a matter of contract." In line with these principles, courts must place arbitration agreements on an equal footing with other contracts.

AT&T Mobility LLC v. Concepcion, No. 09-893, 563 U.S. __, slip op. at 4-5 (Apr. 27, 2011) (internal citations omitted).

1. The exception to the arbitration agreement is not in effect.

The virtually identical arbitration agreements in the Reinsurance Agreements are broad arbitration agreements, under which the parties subjected all disputes to arbitration. Michener Aff. ¶¶ 5, 7, Ex. A at 12, Ex. B at 15. "Where the arbitration clause is broad, there arises a presumption of arbitrability and arbitration of even a collateral matter will be ordered if the claim alleged implicates issues of contract construction or the parties' rights and obligations under it." *Louis Dreyfus Negoce S.A. v. Blystad Shipping & Trading Inc.*, 252 F.3d 218, 224 (2d Cir. 2001) (internal quotation marks and citations omitted). The Rehabilitator relies on an exception to these broad arbitration agreements, but does not acknowledge that where there "is a broad arbitration clause, providing for only a narrow exception, a court should compel arbitration unless there is positive,

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[12] Under Section 2 of the FAA, "A written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2.

unambiguous assurance that the dispute is within that narrow exception." *Roso-Lino Beverage Distribs., Inc. v. Coca-Cola Bottling Co.*, 749 F.2d 124, 126 (2d Cir. 1984).

The exception relied on by the Rehabilitator reads: "Except . . . in the event of [sic] the Company is subject to Proceedings." The capitalized words are defined in the agreements. In the Facultative Agreement, "Company" is defined as "Ambac [U.K.], a UK insurance company . . . and, together with [Ambac] as the context requires." Thus, "Company" means either Ambac U.K. alone, or that entity *and* Ambac. Michener Aff. Ex. A at 1. In the Surplus Share Agreement, "Company" is defined as Ambac. Michener Aff. Ex. B at 1. "Proceedings" is defined in both Reinsurance Agreements as follows: "Proceedings against the Company pursuant to Chapter 645 of the Wisconsin Insurance Code." Michener Aff. Ex. A at 11, Ex. B at 15. When the exception is read together with these unambiguous definitions, the result is free of ambiguity. The arbitration agreement in the Surplus Share Agreement does not apply when there is a proceeding against Ambac under Chapter 645, and the arbitration agreement in the Facultative Agreement does not apply when there are proceedings against Ambac U.K. and Ambac under Chapter 645.

Under both federal and New York law, the arbitration agreements are subject to ordinary rules of contract construction. *Stone v. Doerge*, 328 F.3d 343, 345 (7th Cir. 2003); *In re Salvano v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 85 N.Y.2d 173, 182 (1995). Under New York law, "[t]he best evidence of what parties to a written agreement intend is what they say in their writing. Thus, a written agreement that is complete, clear and unambiguous on its face must be enforced according to the plain meaning of its

terms." *Greenfield v. Philles Records, Inc.*, 98 N.Y.2d 562, 569 (2002) (internal quotation marks and citations omitted). Where an "agreement on its face is reasonably susceptible of only one meaning, a court is not free to alter the contract to reflect its personal notions of fairness and equity." *Id.* at 569-70; *See also In re Matco-Norca, Inc. v. Matz*, 802 N.Y.S.2d 707, 708 (N.Y. App. Div. 2005). The exceptions are complete, clear and unambiguous. The Rehabilitator does not contend otherwise.

The Rehabilitator ignores the inconvenience that the Facultative Agreement unambiguously requires a proceeding against Ambac U.K., and treats that portion of the exception to arbitration as a nullity. The Rehabilitator's position under the Facultative Agreement should be rejected on that basis alone.

In any event, the exception to both arbitration agreements is inapplicable because there is no proceeding under Chapter 645 against Ambac. The Rehabilitator has made that clear many times. In opposing an emergency motion for injunctive relief, he presented an affidavit stating that "OCI's statutorily mandated interest in protecting the best interests of policyholders generally, and the public, would be disserved by needlessly subjecting the vast majority of Ambac's sound policies to rehabilitation." Affidavit of Roger A. Peterson, dated May 19, 2010 ("Peterson Aff."), ¶ 9(a)(v). In a brief to the Wisconsin Court of Appeals, the Rehabilitator stated that "Ambac is not in the above-captioned Segregated Account rehabilitation proceeding." Br. in Support of Motion to Dismiss RMBS Movants' Purported Appeal of Right of Trial Court's Non-Final Denial of Temporary Injunctive Relief, dated June 1, 2010, at 1. In a letter to the Securities and Exchange Commission on behalf of the Segregated Account, Foley represented that "The

Rehabilitation does not include Ambac Assurance, its general account or [Ambac Financial Group, Inc.]." Letter from Steven R. Barth (Nov. 11, 2010), at 1 [Tab 6].[13]

Ambac adamantly has maintained that there is no Chapter 645 proceeding against it. In response to motions filed by various parties opposing a settlement between Ambac and certain CDS parties, it asserted, "Only the activities of the Segregated Account are subject to review by this Court. Except as constrained by the Cooperation Agreement . . . it is business as usual for the General Account policies." Ambac Br. in Opposition to Various Motions, dated May 20, 2010, at 22. In a submission to the Wisconsin Court of Appeals, it stated that "[o]nly the Segregated Account is in rehabilitation. The remainder

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[13] *See also*, *e.g.*, Br. in Opposition to Wells Fargo's Motion to Modify Temporary Injunction Order and to Intervene, dated June 10, 2010, at 4 ("OCI determined that placing Ambac as a whole into a rehabilitation proceeding would trigger material damages to the detriment of all policyholders."); Br. in Opposition to the LVM Movants' Various Motions, dated June 30, 2010, at 12 (potential adverse consequences "clearly presented a rational basis for choosing to establish and rehabilitate the Segregated Account in lieu of commencing the rehabilitation of Ambac as a whole"); Rehabilitator's Consol. Br. in Opp'n to All Motions Scheduled for Hearing on Sept. 9, 2010, dated Aug. 17, 2010, at 5 ("Blindly swinging the sledgehammer of a full-blown rehabilitation or liquidation of Ambac, as Movants implicitly suggest as their preferred alternative, would not better serve the purpose of '[e]quitable apportionment of any unavoidable loss.'"); Commissioner's Consolidated Brief to the Court of Appeals of Wisconsin, dated Nov. 18, 2010, at 18 ("OCI opted to utilize a more surgical approach: to rehabilitate a Segregated Account, . . . subject to rehabilitation under Wis. Stat. § 645.31 *et seq.*, which was comprised of Ambac's most troubled policies, while leaving Ambac's stable General Account outside the rehabilitation proceeding."); *id.* at 48 ("[T]he policies that were commuted in the Bank Settlement were not allocated to the Segregated Account (and therefore were not subject to the rehabilitation proceedings) . . . ."); Br. in Support of Motion to Remand by the Rehabilitator, dated Dec. 17, 2010, at 10 ("[T]he rehabilitation of the Segregated Account carried substantial benefits for Ambac's policyholders, creditors, and the public and avoided potentially catastrophic harms that could have resulted from a full rehabilitation of Ambac.").

of Ambac's business, also referred to as the 'General Account,' is not in rehabilitation." Ambac Br. in Opposition to RMBS Investors' Renewed Emergency Motion Seeking an Injunction Pending Appeal, dated June 1, 2010, at 4. In a "Questions and Answers" section of the "Investor Relations" section of its website, Ambac took the position that "only the Segregated Account is in rehabilitation," that "[t]he General Account, which is also referred to simply as [Ambac], retains all obligations of [Ambac] which [have] not been allocated to the Segregated Account," and that the Rehabilitator "has taken control of the Segregated Account and not [Ambac]." Questions and Answers Addressing Recent Actions Taken by the Wisconsin Regulator (as of Nov. 19, 2010) [Tab 7].

The exception in the arbitration agreements themselves, before importing the definitions, refers to "the Company being subject to Proceedings." The Rehabilitator seems to prefer that phrasing, Rehab. Br. 11-12, but these words produce the same result: neither Ambac nor Ambac U.K. is "subject to" a rehabilitation proceeding. Both the Rehabilitator and Ambac have used that formulation in explaining that there is no such proceeding. *See* Commissioner's Consolidated Brief to the Court of Appeals of Wisconsin, dated Nov. 18, 2010, at 17 ("*If Ambac were subjected to a rehabilitation proceeding*, however, lenders might have ceased funding those issuers' financing facilities or special-purpose entities or required those issues to divert operating income to make accelerated securities payments. . . .") (emphasis added)); Affidavit of Cathleen J. Matanle, Managing Director of Ambac, dated May 20, 2010 ("Matanle Aff."), ¶ 25 ("[I]f the proposed settlement is not consummated and the Ambac General Account *becomes*

the subject of rehabilitation proceedings, there are additional consequences to Ambac, its policyholders and the public." (emphasis added)).

There is no rehabilitation proceeding against Ambac. Under the plain meaning of the arbitration agreements, the exception argued by the Rehabilitator does not apply. He certainly cannot provide the required "positive, unambiguous assurance" that they do.

2. The Rehabilitator's arguments are meritless.

The Rehabilitator argues that, even though there is no "Proceeding against Ambac," the exception applies for two reasons. Rehab. Br. 11-12. First, he says, the Assured Reinsurers' position "ignores the rationale" for this exception: "it would be inappropriate to commence arbitration regarding reinsured liabilities that are already subject to the jurisdiction of a rehabilitation court." *Id.* at 11. Second, he says that "the fact that the rest of Ambac remains outside the rehabilitation should have no bearing on whether [the parties'] dispute is arbitrable." *Id.* at 12.

Both contentions are meritless. The Rehabilitator's purported rationale for the exception does not appear in the Reinsurance Agreements. The Assured Reinsurers have a different view of the rationale: where Ambac is in a Chapter 645 proceeding, giving the Commissioner an option to reject or enforce arbitration agreements under Wis. Stat. § 645.04(3), the exception levels the playing field by removing that one-sided option. That rationale applies if, and only if, there is a Chapter 645 proceeding against Ambac. There is no need to decide this difference over what rationale underlies the exception. Such arguments based on "a party's uncommunicated subjective intent cannot supply the ultimate meaning." *SR Int'l Bus. Ins. Co. v. World Trade Ctr. Props., LLC*, 467 F.3d

107, 125 (2d Cir. 2006) (applying New York law). Under governing New York law, an argument based on the Rehabilitator's unarticulated view of the rationale for the unambiguous exception has no force.

Because there is no Chapter 645 proceeding against Ambac (or against Ambac U.K.), the exception does not apply. The arbitration agreements are enforceable.

3. Judicial estoppel bars the Rehabilitator from arguing that there is no distinction between rehabilitations of Ambac and of the Segregated Account.

The Rehabilitator has shown that the decision to put only the Segregated Account, and not Ambac, into a Chapter 645 rehabilitation was taken deliberately. The principal reason was that a rehabilitation proceeding against Ambac would have had potentially serious consequences because of provisions in Ambac's contracts:

> [M]any of the transaction documents relating to obligations Ambac insures include "triggers" that permit counterparties to declare defaults, accelerate payments, and take other actions that would create additional material losses to the detriment of all policyholders if subjected to a formal delinquency proceeding. . . .
>
> . . . .
>
> OCI and Ambac estimated that the collateral damage associated with [commercial asset-backed securities] could exceed $1 billion in additional claims against Ambac alone.

Commissioner's Consolidated Brief to the Court of Appeals of Wisconsin, dated Nov. 18, 2010, at 16-17 (internal citations omitted).

A managing director of Ambac made the same point:

> In the event of a rehabilitation of Ambac's General Account, billions of dollars in par amount of insured obligations would be adversely affected which, in turn, would have a detrimental effect on the amounts available to

> pay all policyholders, including those allocated to the Segregated Account. It would also adversely affect the public at large.

Matanle Aff. ¶ 26. Dunkin' Brands, Inc. ("DBI"), an Ambac policyholder, expressed the same concern: "If the issuer of the Ambac policy were subject to a delinquency proceeding, it would have significant negative implications on DBI's financing structure." Affidavit of Kate Lavelle, Executive Vice President and Chief Financial Officer, Dunkin' Brands, Inc., dated May 17, 2010, ¶ 8.

The OCI selected, and the Rehabilitator defended, this unusual form of proceeding in order to take advantage of the *difference* between a rehabilitation of Ambac and a rehabilitation of the Segregated Account. According to the rehabilitator, a Chapter 645 rehabilitation against Ambac would have been a significant event under numerous contract provisions, and the triggering of those provisions would have benefited Ambac's contract parties and disadvantaged Ambac. The Rehabilitator urged the Court to confirm a plan based on a rehabilitation of the Segregated Account, rather than a rehabilitation of Ambac and a liquidation of either the Segregated Account or Ambac, because any other approach would have led to "the pulling of default triggers" – that is, contract parties would have claimed that the rehabilitation or liquidation of Ambac had effects under their contracts that the Rehabilitator sought to avoid. Rehabilitator's Proposed Findings of Fact Supporting the Plan, dated Nov. 29, 2010 ("Proposed Findings"),¶ 55 (rehabilitation of Ambac); *see id*. at ¶ 57 (liquidation of Ambac), ¶ 59 (liquidation of Segregated Account). The Rehabilitator said that OCI had "found that numerous Ambac policies

included 'triggers' that could be 'pulled' upon being subject to a rehabilitation or liquidation proceeding." *Id.* ¶ 52. *See also id.* ¶¶ 55, 57.

Because the rehabilitation was limited to the Segregated Account, the Rehabilitator explained, parties to contracts and policies with Ambac would be unable to use the rehabilitation to invoke the provisions that would be triggered by a rehabilitation or liquidation of Ambac:

> Recognizing that a full rehabilitation or liquidation would have triggered covenants across almost all policies and caused other adverse consequences and collateral damages, OCI determined that a segregated account approach would have the most beneficial outcome for all policyholders.

Id. ¶ 60. The Rehabilitator told the Court that, by configuring the Chapter 645 proceeding as a rehabilitation of only the Segregated Account, thereby not triggering these contract provisions, "Policyholders in the General Account and the Segregated Account are advantaged by the Segregated Account rehabilitation approach." *Id.* ¶ 63. As a result, he said, "the Plan provides all policyholders with a more favorable future outcome in regard to their claims than they would have received had OCI chosen to place Ambac in a general liquidation or rehabilitation proceeding." Rehabilitator's Proposed Conclusions of Law Supporting the Plan, dated Nov. 29, 2010, ¶ 13.

Thus, the Rehabilitator's argument for the Court's approval of the Plan rested on the proposition that, under many of Ambac's contracts, there was a legally decisive distinction between a rehabilitation of Ambac and a rehabilitation of the Segregated Account, and that the latter would leave Ambac's contract parties unable to invoke the rights that *would* be triggered by a rehabilitation of Ambac.

In granting the motion to confirm the Plan, the Court adopted the Rehabilitator's findings and conclusions. The Court decided that a rehabilitation of Ambac would have triggered provisions in Ambac contracts, whereas a rehabilitation of the Segregated Account would not, and rested its decision to confirm the Plan on that legal distinction. FOF ¶¶ 51-55, 59, 60, 63, 106, 109, 135; COL ¶ 12. Endorsing the Rehabilitator's position that the Plan should be approved because it avoided making Ambac the subject of the rehabilitation proceeding, the Court concluded:

> [T]he basis demonstrated by OCI and the Rehabilitator for pursuing the rehabilitation of the Segregated Account rather than a full rehabilitation of Ambac and its roughly 15,000 policyholders . . . was rational, prudent and in the interests of all of the policyholders and creditors of Ambac's General and Segregated Accounts and the public generally.

COL ¶ 12. [14]

The Rehabilitator's arguments and the Court's conclusions are directly contrary to the position that the Rehabilitator takes in support of this motion, where the effect of a rehabilitation proceeding against Ambac would be beneficial to his position. *See* Rehab.

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[14] Earlier in this proceeding, the Rehabilitator had persuaded the Court of the same distinction in Ambac's contracts. In denying the motions of policyholders to enjoin a settlement between Ambac and several large financial institutions, the Court stated:

> [E]stablishing and rehabilitating the Segregated Account, while leaving Ambac's general account outside the rehabilitation proceeding and subject to continuing regulatory oversight – addressed Ambac's clear need for rehabilitation of certain troubled segments of its business while eliminating most of the drawbacks of a full rehabilitation.

May 27, 2010 Findings of Fact and Conclusions of Law Regarding Motions of Certain RMBS Policyholders and Certain LVM Bondholders ("May 27, 2010 Findings of Fact and Conclusions of Law"), ¶ 25.

Br. 15. Judicial estoppel prohibits the Rehabilitator from arguing this inconsistent argument. Judicial estoppel precludes a party from arguing a position where "(1) a party against whom estoppel is sought presents a later position that is 'clearly inconsistent' with the earlier position; (2) the facts at issue are the same in both cases; and (3) the party to be estopped convinced the first court to adopt its position." *State v. White*, 2008 WI App 96, ¶ 15, 312 Wis. 2d 799, 754 N.W.2d 214.[15] As the Wisconsin Court of Appeals has noted, "Judicial estoppel is a doctrine that is aimed at preventing a party from manipulating the judiciary as an institution." *State v. Miller*, 2004 WI App 117, ¶ 31, 274 Wis. 2d 471, 683 N.W.2d 485. The Seventh Circuit has likewise observed that judicial estoppel "is intended to protect the courts from being manipulated by chameleonic litigants who seek to prevail, twice, on opposite theories." *Levinson v. United States,* 969 F.2d 260, 264 (7th Cir. 1992) (internal quotation marks omitted).

By his 180º turn on this issue, the Rehabilitator is engaging in the kind of gamesmanship that judicial estoppel prevents. He should be estopped from taking the plainly inconsistent position that there is a Chapter 645 proceeding against Ambac for purposes of contract provisions that are triggered by such proceedings.

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[15] The fact that the "first court" that adopted the Rehabilitator's position is the same court before which he now argues an inconsistent position is of no consequence. Judicial estoppel is generally applicable where "a party assumes a certain position in a legal proceeding and succeeds in maintaining that position" and "thereafter assume[s] a contrary position." *United States v. Krankel*, 164 F.3d 1046, 2053 (7th Cir. 1998) (citations and internal quotations omitted).

4. The Rehabilitator's position is contrary to his own pre-dispute interpretation of the arbitration agreements.

The Rehabilitator's position is legally untenable for another reason. In June and November 2010, before there was a dispute about the parties' arbitration rights, the Rehabilitator agreed with the Assured Reinsurers that the Injunction and the Plan did not affect either side that "demand[ed] arbitration in accordance with the terms of the agreement)," and that "general disagreements will remain subject to arbitration (consistent with the contract)." Cochran Aff. ¶¶ 9, 15 & Ex. B, D. The Rehabilitator's position now – that these arbitration agreements have been inoperative since March 24, 2010 – flies in the face of his own pre-dispute interpretation.

Insofar as there is any ambiguity in the exception to the arbitration agreements, the Rehabilitator's "practical interpretation . . . for any considerable period of time before it comes to be the subject of controversy is deemed of great, if not controlling, influence," *Old Colony Trust Co. v. City of Okla.*, 230 U.S. 100, 118 (1913). Under New York law, "the parties' course of performance under the contract is considered to be the 'most persuasive evidence of the agreed intention of the parties.'" *Fed. Ins. Co. v. Ams. Ins. Co.*, 691 N.Y.S.2d 508, 512 (N.Y. App. Div. 1999) (internal citation omitted); *accord Coliseum Towers Assocs. v. Cnty. of Nassau*, 769 N.Y.S.2d 293, 296 (N.Y. App. Div. 2003); *Ocean Tr. Line, Inc. v. Am. Phil. Fiber Indus., Inc.*, 743 F.2d 85, 90-91 (2d Cir. 1984). The interpretation that Foley clearly stated, when the goal was to seek clarification and a common understanding rather than prevail in a dispute, constitutes that kind of "persuasive evidence."

B. The Assured Reinsurers' Payment Obligations Do Not Include the Amounts of Surplus Notes.

The Rehabilitator contends that the Assured Reinsurers owe the amounts sought by Ambac because of the insolvency clauses in the Reinsurance Agreements. Like the exception to the arbitration agreements, the insolvency clauses are unambiguous. They apply when there is a Chapter 645 proceeding against Ambac (or against Ambac and Ambac U.K.). Because there is no such proceeding, the insolvency clauses are not in effect.

1. The Assured Reinsurers' obligation is to "follow the settlements" by Ambac.

One of the fundamental tenets of a reinsurer's payment obligations is the "follow the settlements" doctrine. Subject to certain exceptions, a reinsurer is obligated to pay its proportionate share of a settlement entered into by the entity it is reinsuring, whether the settlement is beneficial or burdensome. *See generally N. River Ins. Co. v. ACE Am. Reins. Co.*, 361 F.3d 134, 139-40 (2d Cir. 2004). This reinsurance law doctrine is reflected in Article 5 of the Facultative Agreement and Article 6 of the Surplus Share Agreement. Michener Aff. Ex. A at 6, Ex. B at 10.

The commutations underlying the disputes between Ambac and the Assured Reinsurers are settlements with holders of policies that have been allocated to the Segregated Account, in which the policyholders agree to release their policy rights in exchange for payments by the Segregated Account. The Assured Reinsurers have not objected to those settlements so far. Consistent with the doctrine of following of settlements, the Assured Reinsurers believe their payment obligations should follow the

payments made by the underlying insurer. Insofar as a payment is made in cash (or cash equivalents), the Assured Reinsurers have offered to pay their reinsurance portion in cash. Michener Aff. ¶ 19. Insofar as payment is made in Surplus Notes, the Assured Reinsurers believe their obligations to follow these settlements are satisfied either by payment of their shares in Surplus Notes or by payment of their shares on those Surplus Notes, if and when such payments are made on the Surplus Notes.

Ambac contends that the Assured Reinsurers should pay the principal amount of Surplus Notes in cash, even though there is no certainty as to whether, or when, those notes will be paid and no contention that the Surplus Notes have a value equal to or approximating their principal amounts. Rehab. Br. 12-18. If the Assured Reinsurers were to pay their share of a $10,000 loss for each $10,000 principal amount of Surplus Notes that is paid, they would not be following Ambac's fortunes. They would be paying far more than their proportional share of the expense incurred in these settlements – just as they would be if they paid their share of $10,000 for delivery of a $10,000 note payable when the Milwaukee Brewers win the World Series, or a $10,000 note payable when the Milwaukee Braves win the World Series.

2. The insolvency clauses do not apply.

The Rehabilitator's position on the Assured Reinsurers' payment obligations is based solely on the insolvency clauses in Article 14 of the Facultative Agreement and Article 15 of the Surplus Share Agreement. Rehab. Br. 13-17. There are several reasons why this argument misapprehends these contractual provisions, and those will be presented in the appropriate forum. (The Rehabilitator is incorrect when he surmises that

the Assured Reinsurers would not contest Ambac's claims if Ambac were in rehabilitation. *Id.* at 15.) A short, and complete, answer to the Rehabilitator's position is that the insolvency clauses are not in effect.

The insolvency clauses apply if there are "Proceedings against the Company pursuant to Chapter 645 of the Wisconsin Insurance Code." Again, "Company" is defined as Ambac (or, in the Facultative Agreement, as Ambac and Ambac U.K.). Michener Aff. Ex. A at 1, Ex. B at 1. The insolvency clauses unambiguously require a "Proceeding against Ambac [or Ambac U.K. and Ambac] pursuant to Chapter 645," and under New York law that language is enforced according to its terms. Again, the key question is whether there is a Chapter 645 proceeding against Ambac. The answer is clear, even in lower case: "Neither [Ambac] nor its General Account is in rehabilitation," Discl. St. at 1 (capitalization altered). The insolvency clauses do not apply.

3. The Rehabilitator's attempts to rewrite the insolvency clause should be rejected.

The Rehabilitator's arguments hinge primarily on ignoring the express terms of the insolvency clauses in favor of the Rehabilitator's opinion of how they should be construed. Rehab. Br. 14-17. That approach is inconsistent with governing New York law. The Rehabilitator's argument that the Segregated Account is treated as a separate "insurer" under Chapter 645, *id.* at 15-16, undermines his position. There are two insurers. There is a Chapter 645 proceeding against one of these separate insurers (the Segregated Account), and there is no such proceeding against the other (Ambac). In the world of Chapter 645, to which the insolvency clauses expressly refer, a Chapter 645

proceeding against the Segregated Account is not a proceeding against Ambac, any more than a Chapter 645 proceeding against a "separate insurer" like Wisconsin Mutual Life Insurance Co. would be a Chapter 645 proceeding against Ambac.[16]

The Rehabilitator's effort to argue from the "plain language" of the insolvency clauses, *id.* at 15, falls flat. This argument is built on the proposition that the words "against the Company" can be ignored because the Rehabilitator deems the other contract language "more relevant." *Id.* The Assured Reinsurers agree that there are "Proceedings . . . pursuant to Chapter 645 of the Wisconsin Insurance Code." There have been such proceedings against many Wisconsin insurers. But there is no such proceeding against the "Company," as unambiguously defined in the Reinsurance Agreements. New York law does not permit an unambiguous contract term to be made ambiguous by ignoring a word or phrase, no matter how inconvenient that word may be. *E.g.*, *Wallace v. 600 Partners Co.*, 86 N.Y.2d 543, 548 (N.Y. 1995). Courts "may not write into a contract conditions the parties did not insert by adding or excising terms under the guise of construction." *In re Matco-Norca, Inc.*, 802 N.Y.S.2d at 709. All the words in a contract

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[16] The Rehabilitator cites *In re Segregated Acct.*, No. 10-cv-778-bbc, 2011 WL 956855 (W.D. Wis. Jan. 14, 2011), but that decision has no bearing on the plain language of the insolvency clauses. There, the United States sought to remove a dispute over the "allocat[ion] to [Ambac's] segregated account" of certain tax liabilities and this Court's injunction prohibiting it "from initiating any type of lawsuit in regard to Ambac's potential federal tax liabilities . . . *against the segregated account* or any subsidiary of Ambac whose stock or other form of ownership interest were allocated to the segregated account, to Ambac, to any subsidiary of Ambac or the rehabilitator." 2011 WL 956855 at *3 (emphasis added). The dicta quoted by the Rehabilitator arose in that context, a situation within the scope of the rehabilitation proceeding. The Assured Reinsurers' contract disputes fall outside that scope.

count, and those words include "against the Company." There is no Chapter 645 proceeding "against Ambac."

4. The Rehabilitator is judicially estopped from making this argument.

Having persuaded the Court that the distinction between "Proceedings against Ambac pursuant to Chapter 645" and a rehabilitation against the Segregated Account had critical legal significance under Ambac's contracts, the Rehabilitator is judicially estopped from arguing that there is no such distinction.

CONCLUSION

For the reasons stated in this brief, the Rehabilitator's motion should be denied.

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Note: Assured Guaranty Re Ltd. appears without waiving its right to object to personal jurisdiction.