STATE OF WISCONSIN
COURT OF APPEALS
DISTRICT IV

In the Matter of the Rehabilitation of:

Segregated Account of Ambac Assurance Corporation

Ted Nickel and Office of the Commissioner of Insurance,

Petitioners-Respondents,

Ambac Assurance,

Interested Party-Respondent,

v.

Assured Guaranty Re Ltd. and Assured Guaranty Corp.,

Interested Parties-Appellants,

and

Access To Loans for Learning Student Loan Corporation, Aurelius Capital Management LP, Bank of America, N.A., Bank of New York Mellon, Bank Insureds, Countrywide Home Loans Servicing L.P., Customer Asset Protection Company ("CAPCO"), Depfa Bank, plc, Deutsche Bank National Trust Company, Deutsche Bank Trust Company Americas, Eaton Vance Management, Federal Home Loan Mortgage Corporation ("Freddie Mac"), Federal National Mortgage Association ("Fannie Mae"), Fir Tree Inc., Goldman Sachs & Co., Inc., HSBC Bank USA National Association, LVM Bondholders, Monarch Alternative Capital LP, King Street Capital Master Fund, Ltd., King Street Capital Management L.P., Knowledgeworks Foundation, Lloyds TSB Bank plc, Monarch Alternative

Dane County Case No. 10 CV 1576

Appeal No. _____

Capital LP, Nuveen Asset Management, One State Street LLC, PNC Bank, Restoration Capital Management LLC, Stonehill Capital Management LLC, Stone Lion Capital Partners LP, Treasurer of the State of Ohio, United States of America, U. S. Bank National Association, Wells Fargo Bank, N.A., Wells Fargo Bank, N.A. as Trustee for the LVM Bondholders, Wells Fargo Bank as Trustee for RMBS Certificate Holders, Wilmington Trust Company, and Wilmington Trust FSB,

Interested Parties.

Appeal From the June 14, 2011, Order of
the Dane County Circuit Court,
William D. Johnston, LaFayette County Circuit Court Judge, Presiding by Judicial Assignment Order

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PETITION FOR LEAVE TO APPEAL AND SUPPORTING MEMORANDUM OF THE ASSURED REINSURERS

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TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page

Cases

Statutes

Other Authorities

PETITION

In the alternative to the Notice of Appeal filed along with this petition, Assured Guaranty Re Ltd. ("AG Re") and Assured Guaranty Corp. ("Assured Guaranty" and, together with AG Re, the "Assured Reinsurers") petition the Court of Appeals, District IV, for leave to appeal from the order entered on June 14, 2011, in Dane County Circuit Court Case No. 10-CV-1576, the Honorable William D. Johnston presiding by judicial assignment, in favor of Ambac Assurance Corporation ("Ambac") and the Wisconsin Commissioner of Insurance, Theodore K. Nickel, as court-appointed rehabilitator (the "Rehabilitator"), and against the Assured Reinsurers, ordering the Assured Reinsurers to refrain from seeking arbitration of disputes with Ambac, to withdraw a petition to compel arbitration they had filed in New York state court, and to make certain monetary payments to Ambac. This would not be an appeal within Wis. Stat. § 752.31(2). This also would not be an appeal entitled to preference by statute.

SUMMARY OF ARGUMENT

As an initial matter, the Assured Reinsurers believe the June 14 order is final for purposes of appeal and accordingly have filed a notice of appeal from it. They file this petition out of an abundance of caution, in the event this Court may determine the June 14 order to be non-final. The Court need not consider this

petition if it determines that the June 14 order is a final document appealable as of right.

This appeal arises out of a dispute over the parties' contractual obligations under reinsurance contracts. At its core, the appeal concerns the effect of an injunction entered by a rehabilitation court on the rights and obligations of parties to a contract that does not involve a delinquent insurer.

The Assured Reinsurers are party to reinsurance contracts (the "Reinsurance Agreements") with Ambac. Ambac's "Segregated Account" – but not Ambac itself – is being rehabilitated in the proceeding below. Ambac has entered into commutation agreements with the holders of some policies allocated to the Segregated Account. Under these agreements, the Segregated Account is paying the holders a combination of cash and non-cash "surplus notes." It is unclear when or whether those notes will be paid, because the Commissioner has absolute discretion in determining whether to allow any payments.

Ambac and the Rehabilitator contend that the Assured Reinsurers are contractually obligated to reimburse Ambac, with cash, for a proportionate share of the surplus notes' principal value. The Assured Reinsurers contend that they are not required to make these cash payments, because they would then be reimbursing Ambac for a loss it may never suffer.

The Reinsurance Agreements have arbitration provisions. The Assured Reinsurers served demands for arbitration on Ambac and then petitioned a New

York state court to compel arbitration according to the terms of the Reinsurance Agreements. The Rehabilitator and Ambac argue that this petition violated an injunction entered by the rehabilitation court. The Assured Reinsurers disagree, especially because the injunction explicitly "does not apply to policies or other contracts which" – like the Reinsurance Agreements – "remain in the Ambac General Account" rather than the Segregated Account subject to rehabilitation. The Assured Reinsurers interpret the injunction just as the Rehabilitator's own counsel did in an email he sent to the Assured Reinsurers in June 2010: the 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)."

Further, this appeal concerns how the Assured Reinsurers' contract dispute with Ambac should be litigated in the event that arbitration is not appropriate. The Rehabilitator asked the rehabilitation court to adjudicate the entire dispute itself, using motion procedure, rather than initiating a discrete action against the Assured Reinsurers. The Assured Reinsurers object both to the choice of forum and the truncated process, not least because the Rehabilitator failed even to establish the rehabilitation court's personal jurisdiction over AG Re.

On June 14, 2011, the rehabilitation court entered an order granting the Rehabilitator and Ambac all the relief they sought against the Assured Reinsurers. *See* Order Granting Rehabilitator's Mot. to Enforce Inj. Against Assured

Guaranty Corp. and Assured Guaranty Re Ltd. (the "Order") (App. 001-006).[1] The Order is substantively identical to a proposed order the Rehabilitator submitted along with his motion in April, before the rehabilitation court received any evidence or argument from the Assured Reinsurers. *Compare* Order (App. 001-006) *with* [Rehabilitator's Proposed] Order Granting Rehabilitator's Mot. to Enforce Inj. Against Assured Guaranty Corp. and Assured Guaranty Re Ltd. ("Rehabilitator's Proposed Order") (App. 008-013). The Order requires the Assured Reinsurers to refrain from seeking arbitration of disputes with Ambac, to withdraw their petition to compel arbitration in New York state court, and to make the cash payments insisted upon by Ambac and the Rehabilitator. *See* Order ¶¶ 12, 14 & pp. 5-6 ¶¶ 1-3 (App. 004-006). It also requires the Assured Reinsurers to pay, in cash, their proportionate share of surplus notes issued in connection with future settlements. *See id.* at 5-6 ¶ 3 (App. 005-006). The Order recognizes that future settlements will involve payment in non-cash surplus notes. *See id.* ¶ 7 (App. 003).

Again, the June 14 order is final. However, if the Court concludes that the June 14 order is non-final, it should grant this petition on the ground that immediate review of the Order will protect the Assured Reinsurers from substantial and irreparable injury and also will clarify further proceedings in the

[1] References to "App. __" refer to the pages in the Appendix to Petition for Leave to Appeal and Supporting Memorandum of the Assured Reinsurers.

rehabilitation action. The Assured Reinsurers have strong arguments on all issues that may be raised in this appeal. They are likely to show that the rehabilitation court erred in ordering the Assured Reinsurers to refrain from arbitrating disputes with Ambac, in adjudicating the contract dispute between the Assured Reinsurers and Ambac, and ultimately in ordering the Assured Reinsurers to pay Ambac a proportionate share of the "surplus notes" with cash. Delaying the appeal would expose the Assured Reinsurers to the risk of a substantial and irreparable injury because of the obvious risk that Ambac will be unable to reimburse the Assured Reinsurers for overpayments due to its deteriorated financial condition. Delaying the appeal also would mean a missed opportunity to clarify further proceedings in the rehabilitation action, which eventually will involve other settlement payments made in part with non-cash surplus notes.

ISSUES FOR REVIEW

(1) Did the rehabilitation court have personal jurisdiction over AG Re?

(2) Does the rehabilitation court's injunction enjoin the Assured Reinsurers from arbitrating a dispute about their contracts with Ambac, which have not been allocated to Ambac's Segregated Account?

(3) Is the Rehabilitator equitably estopped from arguing that the rehabilitation court's injunction enjoins the Assured Reinsurers from arbitrating a dispute about their contracts with Ambac?

(4) Under the McCarran-Ferguson Act, are the Assured Reinsurers'

rights under the Federal Arbitration Act reverse preempted?

(5) Does the rehabilitation court's injunction require the Assured Reinsurers to pay, in cash, a proportionate share of settlement payments made in non-cash surplus notes?

(6) Was the contract dispute between the Assured Reinsurers and Ambac, which regards two contracts not allocated to Ambac's Segegrated Account, properly raised by motion and adjudicated in the rehabilitation proceeding?

(7) Do the Reinsurance Agreements permit the Assured Reinsurers to demand arbitration of their contract dispute with Ambac?

(8) Do the Reinsurance Agreements require the Assured Reinsurers to pay, in cash, a proportionate share of payments made in non-cash surplus notes?

(9) To the extent it it was required to exercise its discretion, did the rehabilitation court err in adopting the Rehabilitator's proposed order nearly verbatim without providing its own reasoning?

STATEMENT OF FACTS

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 (App. 015). AG Re does not do business in the United States and did not appear in the rehabilitation proceeding

before the Rehabilitator filed a motion against it. *Id.* Assured Guaranty is a Maryland corporation with its principal place of business in New York. *Id.*

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. ¶ 5 & Ex. A (App. 015-016 & 023-042).

In 2003, Assured Guaranty and Ambac entered into a separate reinsurance agreement, the Second Amended and Restated Surplus Share Agreement (the "Surplus Share Agreement" and, together with the Facultative Agreement, the "Reinsurance Agreements"). Pursuant to this agreement, Assured Guaranty agreed to reinsure a portion of certain insurance policies issued by Ambac. *Id.* ¶ 7 & Ex. B (App. 016 & 044-073).

B. The Arbitration Agreements

In both Reinsurance Agreements, the parties agreed to submit "any dispute or claim" to arbitration. 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 (App. 058). Article 15 of the Facultative Agreement is virtually identical, except that "is" replaces "being" in the first line and adds that disputes arising out of the Facultative Agreement "including its formation and validity" must be arbitrated. *Id.* Ex. A at 12 (App. 034). Both agreements define "Proceedings" as "Proceedings . . . against the Company pursuant to Chapter 645 of the Wisconsin Insurance Code." *Id.* Ex. A at 11 & Ex. B at 15 (App. 033 & 058).

C. The Rehabilitation Proceeding and the Injunction

On or about March 24, 2010, Ambac placed certain insurance policies it had issued, including some that are reinsured under the Surplus Share Agreement or the Facultative Agreement, into the Segregated Account of Ambac Assurance Corporation (the "Segregated Account"). The Rehabilitator then placed the Segregated Account into rehabilitation under Chapter 645. *See* V. Pet. for Order of Rehabilitation (App. 074-088).

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.

See Disclosure Statement Accompanying Plan of Rehabilitation ("Discl. St.") (App. 182-270); Michener Aff. ¶ 8 (App. 016).

Throughout the rehabilitation proceeding, Ambac and the Rehabilitator have stressed that the proceeding 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 (App. 194) (capitalized as in original).

On March 24, 2010, the rehabilitation court entered an Order for Temporary Injunctive Relief. *See* Order for Temp. Inj. (the "Injunction") (App. 271-286). 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 (App. 271) (emphasis added). This limitation is consistent with a provision in the Order for Rehabilitation 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 ¶ 2 (App. 287).

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 (App. 017); Affidavit of Alexander R. Cochran ("Cochran Aff.") ¶¶ 3, 5 (App. 291-92). Debevoise identified provisions of the Injunction that it believed were improper and prepared to file objections. Cochran Aff. ¶ 5 (App. 292). 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 (App. 292-293). Foley advised Debevoise that the Reinsurance Agreements remained in Ambac's General Account. *Id.* ¶ 6 (App. 292-293).

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 (App. 293). After a June 14, 2010 telephone discussion with Debevoise, *id.* ¶ 8 (App. 293), 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 (App. 293-294 & 312). Relying on the interpretation of the Rehabilitator's counsel, the Assured Reinsurers did not object to the Injunction. Michener Aff. ¶ 16 (App. 018-019); Supplemental Affidavit of James M. Michener ("Supplemental Michener Aff.") ¶¶ 3 & 10-11 (App. 369, 371-372); Affidavit of Michael E. Wiles ("Wiles Aff.") ¶ 15 (App. 378-379); Affidavit of Wolcott B. Dunham, Jr. ("Dunham Aff.") ¶ 14 (App. 407-408).

After the Rehabilitator filed a Plan of Rehabilitation on October 8, 2010, Debevoise sought to confirm that it too would not be construed to limit the Assured Reinsurers' rights under the Reinsurance Agreements. Cochran Aff. ¶ 12 (App. 294). 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 (App. 294-295 & 328). In an email the next day, Mr. Fitzgerald confirmed that the Assured Reinsurers retained their contractual rights to arbitrate, stating "[g]enerally we agree with your summary" and acknowledging that "general disagreements will remain subject to arbitration (consistent with the contract)." *Id.* ¶ 15 & Ex. D (App. 295 & 348).

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 the rehabilitation 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. (App. 295 & 348)

Mr. Fitzgerald's "caveat" related to provisions in the Reinsurance Agreements' insolvency clauses allowing the Assured Reinsurers to interpose, in a delinquency proceeding, "any defense or defenses that it deems available to [Ambac] or its liquidator, receiver or statutory successor." Michener Aff. Ex. A, art. 14 (App. 033); *id.* Ex. B, art. 15 (App. 058). It did not relate to any provision

in the Reinsurance Agreements concerning the Assured Reinsurers' liability to Ambac as a reinsurer of settled claims.

Relying on Foley's statements, the Assured Reinsurers did not object to the Plan. Michener Aff. ¶ 16 (App. 018-019).

E. Surplus Notes

Under the Plan of Rehabilitation, 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 (App. 219). 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 (App. 232).

F. The Contract Disputes

As part of the rehabilitation of the Segregated Account, Ambac entered into commutation agreements with holders of some of its policies that the Assured Reinsurers reinsure under the Reinsurance Agreements. Under these commutation agreements, some cash and some Surplus Notes were or will be delivered to the policyholders in satisfaction of the underlying insurance obligations. Michener Aff. ¶ 18 (App. 019). Ambac demanded that the Assured Reinsurers pay, in cash, their reinsured portions not only of the cash payments but also of the principal amounts of the Surplus Notes. *Id.* ¶ 19 (App. 019). The

Assured Reinsurers paid their shares of the cash payments. They asserted, however, that the Reinsurance Agreements do not obligate them to pay cash to Ambac in the amount of their shares of the Surplus Notes' principal unless and until those notes are actually paid. *Id.* ¶ 22 (App. 020).

G. Arbitration Demands and Litigation in the Rehabilitation Court

On April 7, 2011, the Assured Reinsurers demanded arbitration pursuant to Article 15 of the Facultative Agreement and Article 16 of the Surplus Share Agreement. Michener Aff. ¶ 25 (App. 021). On April 8, they filed a petition to compel arbitration in New York State court. *Id.* ¶ 26 (App. 021). On April 18, the Rehabilitator moved the rehabilitation court for an order requiring the Assured Reinsurers to refrain from arbitrating disputes with Ambac, to withdraw their petition to compel arbitration, and to pay in cash their shares of the Surplus Notes' principal value. *See* Notice of Mot. and Mot. to Enforce Inj. Against Assured Guaranty Corp. and Assured Guaranty Re Ltd. ("Rehabilitator's Mot.") (App. 432-433).

The Rehabilitator did not serve a summons or complaint on either of the Assured Reinsurers before filing its motion on April 18. However, after receiving the Assured Reinsurers' brief in opposition, in which AG Re raised the objection of lack of personal jurisdiction, the Rehabilitator attempted to serve an unauthenticated copy of a document labeled a "summons" on AG Re. The

Rehabilitator served this unauthenticated summons, unaccompanied by a complaint, on an in-house attorney for Assured Guaranty who has never worked for AG Re. *See* Supplemental Br. of Assured Guaranty Re Ltd. and Assured Guaranty Corp. in Opp'n to Rehabilitator's Motion to Enforce Inj. at 2-3 (App. 436-437); Affidavit of Service by Eric A. James ¶¶ 2, 5 (App. 442-443); Affidavit of William Duffy ¶¶ 2-4, 7-8 (App. 444-446).

ARGUMENT

For the reasons set forth in Part I below, the Order is final and appealable by right. Even if the Order were not final, however, an interlocutory appeal would be appropriate. As explained in Part II below, immediate appellate review would protect the Assured Reinsurers from substantial and irreparable injury and would clarify further proceedings in the rehabilitation action.

I. THE ORDER IS FINAL AND APPEALABLE AS OF RIGHT; THIS MOTION IS FILED IN THE ALTERNATIVE IN AN ABUNDANCE OF CAUTION.

A judgment or order is final for purposes of appeal if it "disposes of the entire matter in litigation as to one or more of the parties." Wis. Stat. § 808.03(1). To meet this requirement, the judgment or order must either "explicitly dismiss[] the entire matter in litigation as to one or more parties" or "explicitly adjudg[e] the entire matter in litigation as to one or more parties." *Tyler v. The Riverbank*, 2007 WI 33, ¶ 17, 299 Wis. 2d 751, 728 N.W.2d 686. In this case, the Order is

final because it explicitly adjudges the entire matter in litigation as to the Assured Reinsurers.

The Order does this on its final two pages, where it explicitly orders all the relief sought by the Rehabilitator in his motion against the Assured Reinsurers. *See* Order at 5-6 (App. 005-006). This relief covers the Assured Reinsurers' obligation to pay their proportionate share of Surplus Notes issued in connection with future settlements, not just the Surplus Notes already issued. *See id.* at 5-6 ¶ 3 (App. 005-006). In ordering this relief, the rehabilitation court disposed of the only matters in litigation as to the Assured Reinsurers. Neither the Rehabilitator nor Ambac has filed any other motions against the Assured Reinsurers. Nor have the Assured Reinsurers joined any motions pending before the rehabilitation court. There is nothing left for the Assured Reinsurers to do in the rehabilitation court.

Consistent with *Tyler*, the Order does more than "merely address[], or decid[e], substantive issues" raised by the Rehabilitator's motion. *See Tyler*, 299 Wis. 2d 751, ¶ 17. The Order's first five pages, which set forth the rehabilitation court's findings of fact and conclusions of law, address and decide substantive issues. *See* Order ¶¶ 1-17 (App. 001-005). The Order's final section then goes beyond a resolution of substantive factual or legal issues, granting the relief sought against the Assured Reinsurers and making the Order a final document.

The only reason the Order might appear to be non-final is that it does not comply with *Tyler*'s requirement that a final judgment or order should state on its face that it is final for the purpose of appeal. *See Tyler*, 299 Wis. 2d 751, ¶ 25. But the omission of this statement does not turn a final document into one that is non-final. *Tyler* recognized that circuit courts would issue some final documents without a statement of finality and instructed the court of appeals to construe such documents "liberally in favor of preserving the right to appeal." *Id.* ¶ 26. Here, construing the Order in favor of the Assured Reinsurers' right to appeal means acknowledging that the Order is final and appealable as of right.

Noteworthy is the fact that this case is not the first in which this Court has considered a final order from the rehabilitation proceeding that lacked a statement of finality. The Court concluded that the rehabilitation court's May 27, 2010 order was a final document for purposes of appeal. *See* June 18, 2010 Ct. App. Order (App. 447-451). That earlier order, like the Order here, did not state on its face that it was a final document. *See* Findings of Fact and Conclusions of Law Regarding Mots. of Certain RMBS Policyholders and Certain LVM Bondholders (App. 452-468).

Also noteworthy is that the Rehabilitator apparently agrees that the Order is final. Counsel for the Rehabilitator recently filed and served a § 806.06(5) Notice of Entry of Order Granting Rehabilitator's Motion to Enforce Injunction Against Assured Guaranty Corp. and Assured Guaranty Re Ltd. The

Rehabilitator's notice states that the Order "is final as to the interests of the Assured Reinsurers in this ongoing rehabilitation proceeding."

II. EVEN IF THE ORDER IS NOT FINAL, THIS COURT SHOULD GRANT THE ASSURED REINSURERS LEAVE TO APPEAL FROM IT.

An interlocutory appeal is appropriate when immediate review will materially advance the termination of the litigation or clarify further proceedings, will protect a party from substantial or irreparable injury, or will clarify an issue of general importance in the administration of justice. Wis. Stat. § 808.03(2). Immediate review in this case both would protect the Assured Reinsurers from substantial and irreparable injury and would clarify further proceedings in the rehabilitation action.

A. An Immediate Appeal Will Protect the Assured Reinsurers from Substantial and Irreparable Injury.

If the Assured Reinsurers pay Ambac in cash now for their share of payments made in Surplus Notes, they will risk losing that cash if this Court determines, in a later appeal, that the Assured Reinsurers should not have been compelled to pay it. The possibility that Ambac will be unable to repay the Assured Reinsurers down the road is very real. Ambac's financial condition indisputably is poor, which is why the Rehabilitator created the Segregated Account and initiated the rehabilitation proceeding. *See* V. Pet. for Order of Rehabilitation ¶¶ 5-8 (App. 076-077). Further, if the Order is not final for purposes of appeal, it is unclear when a final order will be entered. The Assured

Reinsurers could even be forced to wait until the entire rehabilitation proceeding has concluded. That could take a long time, during which the Assured Reinsurers would be compelled to make additional cash payments that could prove unrecoverable after an appeal from the document terminating the rehabilitation.

The Assured Reinsurers also are likely to need repayment from Ambac after an appeal, because their appeal is likely to succeed. *See* Michael S. Heffernan, *Appellate Practice and Procedure in Wisconsin* (5th ed. 2011) § 94(B) ("most important criterion for determining whether an [interlocutory] appeal should be granted . . . is whether the petition for leave to appeal shows a substantial likelihood of success on the merits."). The Assured Reinsurers are likely to succeed on the merits of all the issues they may raise on appeal, as demonstrated below:

1. The Rehabilitation Court Lacked Personal Jurisdiction Over AG Re.

The rehabilitation court made *no* findings or conclusions of law relating to the issue of personal jurisdiction. *See* Order (App. 001-006). The Assured Reinsurers argued that the Rehabilitator failed to serve Ag Re pursuant to Wis. § 801.11, that no substantive grounds for jurisdiction exist under any long-arm statute, and that the Due Process Clause precludes jurisdiction in any event. *See* Brief of Assured Guaranty Re Ltd. and Assured Guaranty Corp. in Opp'n to Rehabilitator's Motion to Enforce Inj. ("Assured Reinsurers' Br. in Opp'n") at

14-18 (App. 491-495). The Rehabilitator argued that the rehabilitation court had jurisdiction under Wis. Stat. § 645.04(5), which expressly relates to jurisdiction over certain persons "served pursuant to s. 801.11," yet still denied that he had any obligation to serve AG Re pursuant to § 801.11. *See* Rehabilitator's Reply in Support of Mot. to Enforce Inj. Against Assured Guaranty Corp. and Assured Guaranty Re Ltd. ("Rehabilitator's Reply Br.") at 16, 19-21 (App. 550, 553-555). The rehabilitation court declined even to address the jurisdiction issue in its order.

2. The Injunction Does Not Enjoin the Assured Reinsurers from Arbitrating Their Contract Dispute with Ambac.

When initiating the rehabilitation proceeding, the Rehabilitator defined the limit of 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." Mar. 24, 2010 Tr. at 9:15-19 (App. 558). Accordingly, the Injunction explicitly states that it "*does not apply* to policies or other contracts which remain in the Ambac General Account." Injunction at 1 (App. 271) (emphasis added). It is undisputed that the Assured Reinsurers' contracts with Ambac remain in the Ambac General Account and that the parties' dispute concerns the Assured Reinsurers' rights and duties under these General Account contracts. The rehabilitation court thus erred in concluding that this dispute is one "in respect of the Segregated Account or policies (including

financial guarantee insurance policies and surety bonds), contracts or liabilities allocated to the Segregated Account." Order ¶ 11 (App. 003-004) (quoting Injunction ¶ 1).

The rehabilitation court also erred in expanding the Injunction's scope beyond its stated intent. The Wisconsin courts have long held that "an injunction order must be construed strictly in favor of the person charged with violating it," *Wisconsin Central Railroad Co. v. Smith*, 52 Wis. 140, 8 N.W. 613, 614 (1881). Yet the rehabilitation court construed the Injunction expansively to apply far beyond its intended scope. In seeking the Injunction, the Rehabilitator explained that the Injunction was needed to prevent *Segregated Account policyholders and contract counterparties* from terminating their policies or contracts, seeking immediate payment of their claims against the Segregated Account, ceasing payments of premiums or other amounts they owed on Segregated Account policies, or initiating lawsuits concerning their Segregated Account policies. *See* Br. in Supp. of Mot. for Temp. Inj. Relief at 2-3, 9-11 (App. 562-563, 569-571). The Assured Reinsurers are not Segregated Account policyholders or contract counterparties and thus lie outside the Injunction's intended scope.

Moreover, the Rehabilitator's counsel himself confirmed the Injunction's scope in emails to the Assured Reinsurers. In June 2010, counsel for the Rehabilitator told the Assured Reinsurers that the 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)." Cochran Aff. ¶ 9 & Ex. B (App. 293-294 & 312). Later, he represented a second time that, with an exception not applicable here, disagreements about the Reinsurance Agreements would "remain subject to arbitration (consistent with the contract)." *Id.* ¶ 15 & Ex. D (App. 295 & 348). Thus, before changing his mind a few months ago, even the Rehabilitator understood that the Injunction does not enjoin actions taken under the Reinsurance Agreements.

3. The Rehabilitator Is Equitably Estopped from Arguing that the Injunction Enjoins the Assured Reinsurers from Arbitrating Their Contract Dispute with Ambac.

These representations by counsel for the Rehabilitator are also critical because they equitably estop the Rehabilitator from taking a contradictory position now. The Assured Reinsurers argued to the rehabilitation court that they relied on the Rehabilitator's representations when deciding not to object to the Injunction or to the Rehabilitator's Plan of Rehabilitation. *See* Assured Reinsurers' Br. in Opp'n at 27-29 (App. 504-506); *see also* Michener Aff. ¶¶ 6, 16 (App. 016, 018-019); Supplemental Michener Aff. ¶¶ 3 & 10-11 (App. 369, 371-372); Wiles Aff. ¶ 15 (App. 378-379); Dunham Aff. ¶ 14 (App. 407-408). Yet the rehabilitation court made no findings or conclusions of law about the representations by the Rehabilitator's counsel or about the Assured Reinsurers' equitable estoppel argument generally. *See* Order (App. 001-006).

4. The Assured Reinsurers' Rights Under the Federal Arbitration Act Are Not Reverse Preempted.

The rehabilitation court concluded that "[t]he Injunction preempts and renders inapplicable any . . . conflicting federal statutes," including "[t]he Federal Arbitration Act." Order ¶ 10 (App. 003). Although the Order does not explain the Injunction's primacy over federal law, the rehabilitation court could only have meant that the Injunction "reverse" preempts the Federal Arbitration Act under the McCarran-Ferguson Act. However, the McCarran-Ferguson Act "bars application of the [Federal Arbitration Act] to insurance contracts only in the context of a *state statute* evincing the same . . . ." *American Heritage Life Ins. Co. v. Orr*, 294 F.3d 702, 708 (5th Cir. 2002) (emphasis in original); *see also* 15 U.S.C § 1012 ("No Act of Congress shall be construed to . . . supersede *any law enacted by any state* for the purpose of regulating the business of insurance." (emphasis added)). The McCarran-Ferguson Act does not authorize the rehabilitation court to reverse preempt federal statutes simply by issuing its own conflicting orders.

5. The Injunction Does Not Require the Assured Reinsurers to Pay, in Cash, a Proportionate Share of Payments Made in Non-Cash Surplus Notes.

As explained above, the Injunction expressly has no application to contracts that, like the Reinsurance Agreements, remain in the Ambac General Account. The rehabilitation court therefore erred in concluding that the Assured Reinsurers violated the Injunction's prohibition against withholding payments "to

. . . the Ambac General Account *under or in connection with policies or contracts allocated to the Segregated Account*." Order ¶ 13 (App. 004) (quoting Injunction ¶ 7) (emphasis added). The Rehabilitator sought this paragraph of the Injunction so that policyholders or contract counterparties would "continue to pay the premiums they owe on *the policies allocated to the Segregated Account* and to make payments due on *contracts insured by the policies in the Segregated Account*." Injunction Br. at 3 (App. 563) (emphasis added). This paragraph of the Injunction has nothing to with the Reinsurance Agreements, which are neither policies allocated to the Segregated Account nor contracts insured by policies in the Segregated Account.

The rehabilitation court also erred in concluding that the Assured Reinsurers "owe" the disputed payments to Ambac in the first place. *See* Order (App. 004) ¶ 14. Whether the Assured Reinsurers owe these payments depends on how the Reinsurance Agreements are construed. As explained in connection with issues #6-8 below, this issue of contract interpretation was not properly before the rehabilitation court, and the court in any event erred in construing the Reinsurance Agreements.

6. The Contract Dispute Between the Assured Reinsurers and Ambac Was Not Properly Raised or Adjudicated in the Rehabilitation Proceeding.

The Rehabilitator's motion against the Assured Reinsurers purported to seek only enforcement of the Injunction – not an order declaring and enforcing

the parties' rights under the Reinsurance Agreements. *See* Rehabilitator's Mot. at 1 (App. 432) (moving the rehabilitation court "to enforce its March 24, 2010 injunction against parties-in-interest Assured Guaranty Corp. and Assured Guaranty Re Ltd."). Nevertheless, the Order adjudicates the Assured Reinsurers' rights under the Reinsurance Agreements in two short and conclusory paragraphs. *See* Order ¶ 15 (App. 004-005) (construing the Reinsurance Agreements' arbitration and insolvency clauses); *id.* ¶ 16 (App. 005) (construing an unspecified clause in the Reinsurance Agreements).

Even if the Rehabilitator's motion had sought such relief, nothing in Chapter 645 authorized the rehabilitation court to adjudicate a contract dispute involving Ambac – but not the Segregated Account – as a party. Section 645.34 simply requires other Wisconsin courts to stay actions against an insurer in rehabilitation "for such time as is necessary for the rehabilitator to obtain proper representation and prepare for further proceedings." Wis. Stat. § 645.34(1). No provision in Chapter 645 states that litigation involving the insurer in rehabilitation – much less related litigation to which that insurer is not even a party – should be adjudicated by the rehabilitation court.

The absence of such authorization is not surprising, because, as the rehabilitation court itself has stated, "[a] rehabilitation proceeding is *not an adversarial litigation* designed to adjudicate the diverse and divergent interests of each policyholder." July 16, 2010 Order at 7 (App. 592) (emphasis added;

quoting a brief by Ambac). Even in a comparatively adversarial liquidation proceeding, the liquidator is empowered to initiate litigation *but not as a mere subcomponent of the liquidation proceeding*. *See* Wis. Stat. 645.46(12) (liquidator authorized to "institute in the name of the insurer or in his or her own name any suits and other legal proceedings, *in this state or elsewhere . . . .*" (emphasis added)). The rehabilitation court erred in enlarging the proceeding's scope to accommodate a discrete dispute that would not have been appropriate even in a liquidation.

Finally, even if the rehabilitation proceeding were an appropriate place for adversarial litigation, the Assured Reinsurers were improperly denied all the procedures that ordinarily would attend contract litigation, such as pleadings, discovery, dispositive motion practice, and trial. The rehabilitation court instead resolved this dispute based solely on the Rehabilitator's motion, a set of briefs and affidavits in support or opposition, and a single hearing. Unlike past receivers, the Rehabilitator did not try to initiate any kind of discrete action against the Assured Reinsurers that might have afforded due process. *Contrast All-Star Insurance Corp.*, 110 Wis. 2d 72, 74, 327 N.W.2d 648 (1983) (liquidator commenced discrete actions against defendants to recover money due under contracts); App. to Appellant's Br. at 1-4 and App. of Def.App. Lee M. Scarborough & Co. at I & 101-13, *All-Star Ins.*, 110 Wis. 2d 72, found in 4127 *Appendices and Briefs*, 110 Wis. 2d 58-118, at tab 2 (Wis. Stat. Law Library)

(providing copies of the summonses and complaints served on the *All-Star Ins.* defendants).

7. The Reinsurance Agreements Permit the Assured Reinsurers to Demand Arbitration of Their Contract Dispute with Ambac.

The Reinsurance Agreements both state, in relevant part, that disputes arising out of those contracts must be arbitrated unless "the Company is subject to Proceedings [under Chapter 645 of the Wisconsin Statutes]." Order ¶ 5 (App. 002); Michener Aff. Ex. A, art. 15 (App. 034); *id.* Ex. B, art. 16 (App. 058-059). The rehabilitation court concluded that "the Company is subject to [Chapter 645] Proceedings" within the meaning of these contract provisions. Order ¶ 15 (App. 004-005). But "the Company" plainly is not subject to Chapter 645 proceedings, because "the Company" is defined as Ambac in one contract and as Ambac plus Ambac U.K. in the other. *See* Michener Aff. Ex. A at 1 (App. 023); *id.* Ex. B at 1 (App. 044). Neither Ambac nor Ambac U.K. is subject to a Chapter 645 proceeding. The only insurer being rehabilitated is the Segregated Account. *See* Discl. St. at 1 (App. 194) ("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.").

The Rehabilitator, in fact, has repeatedly stressed that the Chapter 645 proceeding against the Segregated Account is *not* a proceeding against Ambac. 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 ¶ 9(a)(v) (App. 601). In a brief to this Court, the Rehabilitator stated that "Ambac is not in the above-captioned Segregated Account rehabilitation proceeding." Mot. to Dismiss RMBS Movants' Purported Appeal of Right of Trial Court's Non-Final Denial of Temp. Inj. Relief at 1 (App. 623). In a letter to the Securities and Exchange Commission on behalf of the Segregated Account, Foley represented that "[t]he Rehabilitation does not include Ambac Assurance, its general account or [Ambac Financial Group, Inc.]." Letter from Steven R. Barth (Nov. 11, 2010) at 1 (App. 624). *See also, e.g.*, Br. in Opp'n to Wells Fargo's Mot. to Modify Temp. Inj. Order and to Intervene at 4 (App. 644) ("OCI determined that placing Ambac as a whole into a rehabilitation proceeding would trigger material damages to the detriment of all policyholders."); Br. in Opp'n to the LVM Movants' Various Mots. at 12 (App. 646) (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 at 5 (App. 648) ("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.'"); Rehabilitator's Consol. Br. to the Court of Appeals of Wisconsin at 18 (App. 652) ("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 (App. 653) ("[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) . . . ."); Rehabilitator's Br. in Supp. of Mot. to Remand at 10 (App. 655) ("[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.").

8. The Reinsurance Agreements Do Not Require the Assured Reinsurers to Pay, in Cash, a Proportionate Share of Payments Made in Non-Cash Surplus Notes.

In concluding that the Reinsurance Agreements require the Assured Reinsurers to make the disputed cash payments, the rehabilitation court relied chiefly on the Reinsurance Agreements' insolvency clauses, which apply when "Proceedings . . . against the Company pursuant to Chapter 645 of the Wisconsin

Insurance Code" have been initiated. Order ¶¶ 4, 15 (App. 002, 004-005). But for the reasons given above, these provisions do not apply. The Rehabilitator has not initiated rehabilitation proceedings against "the Company," which the Reinsurance Agreements define to mean Ambac or Ambac plus Ambac U.K.

The rehabilitation court's order also violates the Reinsurance Agreements' text stating that that the Assured Reinsurers' interest and liability will "follow the fortunes" of Ambac. Michener Aff. Ex. A, art. 5 (App. 028); *see also id.* Ex. B, art. 6 (App. 053) (reinsurers' liability "shall follow that of [Ambac]"). In the settlement context, this language requires application of the "follow-the-settlements doctrine," a fundamental tenet of reinsurance law that generally obligates a reinsurer to pay its proportionate share of a settlement entered into by the entity it is reinsuring, whether that 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).

The rehabilitation court deviated from the follow-the-settlements doctrine here, because it required the Assured Reinsurers to pay a share of the Surplus Notes' principal value in cash, even though the Commissioner has absolute discretion over when – and whether – to pay the Surplus Notes, and even though the Rehabilitator and Ambac did not even attempt to prove that the Surplus Notes have a value equal to or approximating their principal amounts. The cash payments required of the Assured Reinsurers do not follow the payments made in non-cash Surplus Notes. They instead provide a potential windfall to Ambac, allowing it to count Surplus Notes that may never actually be paid as the equivalent of an immediate cash loss entitling them to an immediate infusion of cash from the Assured Reinsurers.

9. To the Extent It Was Required to Exercise Discretion, the Rehabilitation Court Erred in Adopting the Rehabilitator's Proposed Order Nearly Verbatim Without Providing Its Own Reasoning.

The Assured Reinsurers believe the Order decided issues of law that this Court reviews *de novo*. However, if this Court determines that any part of the Order involved a discretionary determination, it also should conclude that the rehabilitation court erred in failing to exercise its discretion.

When making a discretionary determination, a circuit court commits reversible error if it adopts one side's proposed findings and conclusions without independently explaining its reasoning. *See Trieschmann v. Trieschmann*, 178

Wis. 2d 538, 540, 541, 504 N.W.2d 433 (Ct. App. 1993) (circuit court failed to properly exercise its discretion where it adopted a litigant's memorandum, which proposed findings of fact and conclusions of law, as its own decision without further explanation). The rehabilitation court failed to provide its own reasoning here. The Order is substantively identical to the proposed order that the Rehabilitator submitted along with his motion on April 18. *Compare* Order (App. 001-006) *with* Rehabilitator's Proposed Order (App. 008-013). The rehabilitation court did not even amend the proposed order to account for issues, such as the question whether the rehabilitation court had personal jurisdiction over AG Re, that the Rehabilitator's counsel apparently did not anticipate when drafting the proposed order. Thus, it is impossible "to determine if the [rehabilitation] court's decision is a product of the court's rational decision-making process or that of [the Rehabilitator's] attorney." *Trieschmann*, 178 Wis. 2d at 542.

B. An Immediate Appeal Will Clarify Further Proceedings in the Rehabilitation Action.

As the rehabilitation court recognized, the Rehabilitator intends to make future settlements for a combination of cash and surplus notes, which will implicate the same objections that the Assured Reinsurers raised below. *See* Order ¶ 7 (App. 003) (future payments under the Plan of Rehabilitation "will consist of a combination of cash and surplus notes"). Because the Assured Reinsurers are likely to succeed on the merits of their appeal, immediate review

would clarify proceedings relating to those future settlement agreements.

It is critical that the court of appeals supply that clarification now, because if the Order is not final for purposes of appeal, the Assured Reinsurers may not have a right of appeal until the rehabilitation proceeding ends. By that time, requiring Ambac to disgorge disputed payments made by the Assured Reinsurers could disrupt the plan that allowed the rehabilitation to conclude. Immediate review of the Order will prevent the Court from having to unscramble the egg by ordering the rehabilitation court to undo what could end up being many years' worth of payments.

Immediate review also will clarify further proceedings below in the event the Rehabilitator seeks relief against other counterparties to contracts allocated to Ambac's General Account. If the Rehabilitator seeks relief against General Account counterparties other than the Assured Reinsurers, a number of the issues raised in this appeal – especially personal jurisdiction, the Injunction's application to General Account contracts, and the propriety of adjudicating discrete contract disputes within the rehabilitation proceeding – are likely to be relevant.

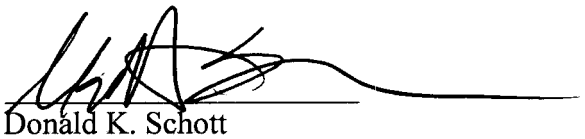
CONCLUSION

The rehabilitation court's June 14 order is final for purposes of appeal, and this petition may be dismissed as unnecessary in light of the Assured Reinsurers' Notice of Appeal from that order. In the alternative, and for the reasons given above, the Assured Reinsurers respectfully request that the Court grant this

petition and accept the Assured Reinsurers' appeal on an interlocutory basis.

Dated: June 28, 2011

QUARLES & BRADY LLP

By: 

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WIS. STAT. § (RULE) 809.50(4) CERTIFICATION

I certify that this petition for leave to appeal conforms to the rules contained in Wis. Stat. § (Rule) 809.50(1) for a petition produced using a proportional serif font. The length of this petition is 7,597 words.

Dated: June 28, 2011

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