

COURT OF APPEALS OF WISCONSIN
DISTRICT IV

In the Matter of Rehabilitation of:

Segregated Account of
Ambac Assurance Corporation

Appeal No. 2011 AP 561

TED NICKEL and OFFICE OF THE
COMMISSIONER OF INSURANCE,

Petitioners-Respondents,

AMBAC ASSURANCE,

Interested Party-Respondent,

v.

DEPFA BANK, PLC,

Interested Party-Appellant,

ACCESS TO LOANS FOR LEARNING
STUDENT LOAN CORPORATION,
AURELIUS CAPITAL MANAGEMENT LP,
BANK OF AMERICA, N.A., CUSTOMER
ASSET PROTECTION COMPANY
("CAPCO"), DEUTSCHE BANK
NATIONAL TRUST COMPANY,
DEUTSCHE BANK TRUST COMPANY
AMERICAS, EATON VANCE, FEDERAL
HOME LOAN MORTGAGE
CORPORATION ("Freddie Mac"),
FEDERAL NATIONAL MORTGAGE
ASSOCIATION ("Fannie Mae"), FIR TREE
INC., KING STREET CAPITAL MASTER
FUND, LTD., KING STREET CAPITAL,

L.P., LLOYDS TSB BANK PLC,
MONARCH ALTERNATIVE CAPITAL LP,
ONE STATE STREET LLC, STONEHILL
CAPITAL MANAGEMENT LLC, U.S.
BANK NATIONAL ASSOCIATION,
WELLS FARGO BANK, N.A., WELLS
FARGO BANK, N.A., as Trustee for the LVM
Bondholders, WILMINGTON TRUST
COMPANY, and WILMINGTON TRUST
FSB,

Interested Parties-Co-Appellants.

**APPEAL FROM ORDERS OF THE CIRCUIT COURT
OF DANE COUNTY CASE NO. 10 CV 1576
THE HONORABLE WILLIAM D. JOHNSTON PRESIDING**

**APPELLANT WELLS FARGO BANK, N.A., AS TRUSTEE FOR
THE LVM BONDHOLDERS, SUPPLEMENTAL OPENING BRIEF**

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ISSUE PRESENTED FOR REVIEW

If the LVM bond policies must remain in the Segregated Account, does the plan of rehabilitation confirmed by the circuit court lack a sufficient factual and legal basis to assure that money will be available after June 1, 2020 to pay the long-dated claims of the LVM Bondholders and thus discriminate against holders of long-dated claims?

Circuit Court's Determination: In answering this question, the circuit court found that the plan, which fails to even address how any claims arising after June 1, 2020 will be paid, does not discriminate against holders of long-dated claims.

ARGUMENT

Wells Fargo Bank, N.A., as Trustee for the LVM Bondholders (the “Trustee”), joins the appellants’ June 17, 2011 consolidated opening brief, except for Sections II, III and IV of the Argument. The Trustee submits this additional brief to discuss an important issue that is unique to the LVM Bondholders.

In Appeal No. 2010 AP 2022, which has been consolidated with this appeal, the LVM Bondholders established why their policies were improperly placed into the Segregated Account. The rehabilitation plan perpetuates that error and, accordingly, we incorporate those arguments here by reference.

If the LVM bond policies must remain in the Segregated Account, however, then the order confirming the plan of rehabilitation suffers an additional infirmity that we focus on in this brief. That is, the plan lacks a mechanism to assure that funds will be available to pay the known, certain claims of the LVM Bondholders, most of which will not mature until well past June 1, 2020. Such mechanisms are available, and indeed the Trustee proposed a reasonable remedy—that a cash reserve or similar vehicle be dedicated for long-term claims like the LVM Bonds. The Commissioner

rejected the Trustee's proposal and the circuit court, following the Commissioner's lead, refused even to consider it. This discrimination against long-dated claims in favor of short-dated claims presents reason alone why the order confirming the plan should be reversed.

I. FACTS UNIQUE TO THE CLAIMS OF LONG-DATED LVM BONDHOLDERS

The following are the relevant background facts. The LVM Bondholders own or manage funds that collectively own "first tier" bonds—the LVM Bonds—that the State of Nevada issued to fund the construction of a monorail system in Las Vegas. (R.17:20.) The LVM Bonds are to be repaid by the monorail's operator, Las Vegas Monorail Co. (the "Monorail"), out of the Monorail's net revenues. (R.465:130.) Wells Fargo is Trustee for the first-tier bonds held by the LVM Bondholders. (R.17:19.) These municipal bonds, initially rated Triple-A, were believed to be a conservative municipal bond investment appropriate for college or retirement accounts, and were widely held by mom and pop-type investors for these purposes, directly or through mutual-fund accounts. (R.17:20-21.)

Most of the LVM Bonds will not mature for more than 20 years, that is, after the year 2030. (R.563:13; R.465:35-36.) Thus, while the face value of the outstanding LVM Bonds is currently just over \$520 million,

the total amount ultimately due on the bonds for future principal and interest is more than \$1.163 billion.¹ (R465:127-128.) Accordingly, as acknowledged by Roger Peterson, the Director of the Bureau of Financial Analysis and Examination, the LVM Bondholders are “long-tail” claimants. (R.563:13.)

Ambac Assurance Company (“Ambac”) issued the LVM bond policy, a municipal-bond insurance policy that insures payment of the principal and interest, as well as accreted value, on the LVM Bonds when such payment is due. (R.17:20-21.) Ambac also issued a \$21 million surety bond guaranteeing payment of principal and interest on the LVM Bonds. (R.17:21.)

The Monorail is in bankruptcy. (R:12:20; R.372:24, JA.366.) The LVM Bonds are expected to receive minimal recovery in the pending Chapter 11 proceeding. (R.372:24, JA.366.) Moreover, under the plan, all underlying claims (such as the LVM Bondholders’ claims against the Monorail) relating to any payment under the plan are deemed to be assigned to Ambac. (R.567:24, JA.610; *see also* R.372:44, JA.386;

¹ These principal and interest amounts were calculated with respect to 100% of the LVM Bonds. In December 2010, however, holders of more than 70% of the LVM Bonds entered into a settlement agreement with Ambac and the Commissioner. Although that settlement agreement involves various contingencies, it may ultimately resolve all issues with respect to more than 70% of the LVM Bonds.

R.562:61-64.) Accordingly, the main source of repayment of the LVM Bonds is Ambac. The amount and timing of Ambac's exposure is a known quantity—Ambac has confirmed that its total exposure for future principal and interest payments under the policies is approximately \$1.163 billion. (R.465:128.)

II. THE PLAN TREATS LONG-DATED CLAIMANTS DIFFERENTLY THAN SHORT-DATED CLAIMANTS

The LVM Bondholders have challenged their placement in the Segregated Account. (*See* Appeal No. 2010 AP 2022, consolidated with 2011 AP 561.) But in this appeal we focus on an additional reason, beyond those identified in the consolidated opening brief, why the rehabilitation plan violates Wisconsin law: it discriminates against holders of long-dated claims.

The plan provides that, as of the effective date, holders of permitted policy claims will receive cash equal to 25 percent of the permitted claim amount, and surplus notes equal to 75 percent of the permitted claim amount. (R.567:15, JA.601.) But, all agree that under the plan's terms, if the money runs out paying short-dated claims—*i.e.*, claims coming due in the near future—nothing will be left for holders, like the LVM

Bondholders, of long-dated claims. (R.563:31-32; R.372:80, JA.422; *see also* R.392:5.)

The Commissioner correctly acknowledged that he is statutorily required to ensure that the plan provides “equitable treatment for all policyholders.” (R.392:5.) *See, e.g.*, Wis. Stat. § 601.01(2) (policyholders must be treated “fairly and equitably”); Wis. Stat. § 645.01(4)(d) (rehabilitations must ensure the “protection of the interests of insureds, creditors, and the public generally ..., through ... [e]quitable apportionment of any unavoidable loss”). He further conceded that, to ensure that all policyholders are treated equitably, the plan must make sure holders of long-dated claims receive the same treatment as short-dated claims. (*Id.*) The problem, however, is that the plan fails to ensure that Ambac will maintain adequate claims-paying resources to pay the holders of long-dated claims on par with holders of short-dated claims. In fact, the plan makes *no provision for anything occurring after June 1, 2020* (R.392:5), yet the bulk of the LVM Bondholders’ claims will mature well after that date. (R.563:13; R.465:35-36.)

The LVM Bondholders received assurances years ago that the Ambac insurance policy would protect them from possible losses.

Unfortunately, the investors were initially burned by the Monorail bankruptcy, and now by Ambac's insolvency. The Commissioner's plan, by failing to ensure adequate claims-paying resources for the long-dated claims, simply maintains the uncertainty for these investors.

A. The Commissioner Confirms that Equal Treatment to Long-Dated Claimants Is Required

According to the Commissioner, to strike the proper balance between long-dated and short-dated claimants, the plan must set the initial cash percentage at a level low enough to ensure that (1) the General and Segregated Accounts both have adequate claims-paying resources throughout the life of the plan, and (2) the probability that long-dated claimants will receive a cash percentage distribution on their claims is the same as holders of short-dated claims. (R.372:80, JA.422.) The Commissioner underscored this point in its submissions to the circuit court:

[I]f the Cash Percentage were set too high such that claims-paying resources were exhausted before long-dated Policy Claims matured, Holders of short-dated Policy Claims would receive more favorable treatment under the Plan than Holders of long-dated Policy Claims.

(Id.; see also R.392:5.)

The Commissioner set the initial cash percentage at 25%. (R.372:80-81, JA.422-23.) The Commissioner based that decision on his

analysis of Ambac’s loss exposure and revenue projections, which form the “basis for the four [financial projection] scenarios that are presented in the Disclosure Statement.” (R.561:186.)

B. The Plan Fails to Provide Equal Treatment to Long-Dated Claimants

There are four reasons why the Commissioner’s approach presents a substantial, unacceptable, inequitable and unnecessary risk to the LVM Bondholders.

First—The plan does not even attempt to address how most of the LVM Bondholders’ claims will be paid. As the Commissioner confirmed, *there is no plan after June 1, 2020.* (R.392:5 (the plan does not “address the treatment of permitted policy claims expected to arise after June 1, 2020”).) This means that the plan the circuit court confirmed contains no provision for the payment of LVM Bondholders’ known claims, most of which Mr. Peterson confirms are certain to become due long after June 1, 2020. (R.563:13.) No one—including the Commissioner—knows whether or how the Segregated Account will pay these future certain claims. Thus, while the circuit court concluded that the “Plan is feasible and is fair and equitable to policyholders” and “fairly balances and protects” holders of

long-dated claims (R.556:54, 60, JA.153, 159), there is simply no factual basis for that foundational conclusion.

Second—As the Commissioner conceded, the financial projections on which it based the 25% cash percentage are “inherently uncertain,” “inherently unpredictable,” and are not “indicative of the future financial position or results of operations of the Segregated Account.” (R.372:59, 76, JA.401, 418; *see also* R.561:205-206.) According to the Commissioner, the ultimate losses in the General Account—which, under the plan, will be providing the claims-paying resources for the Segregated Account—may “materially” exceed the projections that form the admitted “worst-case” scenario. (R.372:71, JA.413.) Indeed, according to Mr. Peterson, *all* the scenarios in the financial projections may be “materially understated.” (R.563:41.) Remarkably, the circuit court approved the plan without any assurance that the Segregated Account will be able to maintain the 25% cash percentage throughout the life of the Segregated Account.

Third—The Commissioner did not conduct available alternative analyses when establishing the 25% cash percentage. Mr. Peterson admitted that the Commissioner’s stress case estimates were based on Moody’s “Scenario 3.” (R.563:32.) Moody’s, however, offered many

different economic scenarios (ranging from the most optimistic economic conditions (“S1”) to the direst (“S6”). (*Id.* at 33.) Of these scenarios, Mr. Peterson admits that the Office of the Commissioner of Insurance (“OCI”) modeled its “worst-case” scenario on S3, and failed to analyze those projections against the more onerous conditions in the S4, S5, or S6 models. (*Id.* at 36.) Why OCI modeled its “worst case” scenario based on better-than-worst-case economic conditions remains a mystery, but the circuit court did not inquire into this discrepancy and simply accepted the Commissioner’s self-limiting analysis. (R.556:35-36, JA.134-135.)

Fourth—The Commissioner has refused to provide policyholders with the data underlying its financial projections. (R.471:22-24, 66-76, 81-84; R.67; R.68.) Thus, policyholders have been unable to conduct an independent review of the projections. The Commissioner’s stated goal of this proceeding was to ensure “transparency” and to provide policyholders with an “avenue to understand what’s happening to them.” (R.560:165.) Unfortunately, the Commissioner fell far short of his target.

For all these reasons, the LVM Bondholders have no reason to believe they will be paid on par with other Segregated Account policyholders. While the Commissioner intends to begin paying short-

dated claimants 25% in cash in the coming months, the LVM Bondholders have no assurance that they will receive even that when their post-2020 claims accrue.

III. THE TRUSTEE'S PROPOSAL ADDRESSES THE INEQUITABLE TREATMENT

The Trustee offered the trial court a practical, reasonable modification to the plan that would minimize these uncertainties. Specifically, the Trustee asked that the Commissioner, at minimum, set aside 25% in cash—through a reserve, trust account, or other like vehicle—for claims he already knows will come due under the LVM bond policies, including the more than \$1 billion in scheduled claims testified to by Ambac. (*See* R.464:26-30; R.465:128; R.563:50-51.) During the hearing, the Commissioner's witnesses did *not* testify that the Trustee's request was impracticable. Nevertheless, they summarily dismissed it, saying it would add "no particular value" and would merely be "duplicative" of the purported protections provided by OCI's financial projections. (R.561:208.) The Commissioner lacked any valid basis to make these assertions, as demonstrated by OCI's ubiquitous admissions that its projections are unreliable. (R.372:59, 76, JA.401, 418; *see also* R.561:205-206.)

The discrimination presented here is particularly invidious given that the underlying LVM Bonds were meant to be low-risk investments for conservative, long-term investors. The LVM Bondholders' policies were lumped in with the risky, mostly short-term investments that populate the Segregated Account. Yet the LVM Bondholders are treated less favorably than the other Segregated Account claimants whose claims stand a much better chance of being paid simply because they mature earlier. Accordingly, the plan fails to comport with the equality of treatment mandated by Wis. Stat. § 601.01(2), and the circuit court should not have confirmed the plan in this form.

At minimum, and in addition or in the alternative to the relief sought in the appellants' consolidated brief, this Court should reverse the confirmation order and direct the circuit court to require the Commissioner to set aside funds specifically designated for the payment of the LVM Bondholders' long-dated policy claims. *See, e.g., In re Western Asbestos Co.*, 313 B.R. 832, 842-43 (Bankr. N.D. Cal. 2003) (in order to ensure that reorganization plan treated holders of long-dated claims (unliquidated claims) on par with holders of short-dated claims (liquidated claims), the court required the plan to "reserve a sufficient amount from any distribution

made to liquidated claims so that an equivalent percentage payment may be made to any claims liquidated in the future”).

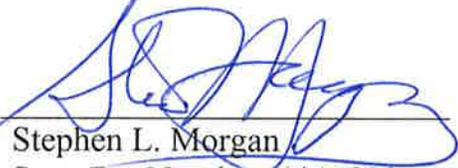
CONCLUSION

For the above reasons, the Court should reverse the order confirming the rehabilitation plan and, at minimum, order the circuit court to require the Commissioner to adopt the mechanisms proposed by the Trustee to ensure that holders of long-dated claims are treated on a par with holders of short-dated claims.

Dated this 5th day of July, 2011.

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FORM AND LENGTH CERTIFICATION

I hereby certify that this brief conforms with this Court's May 5,
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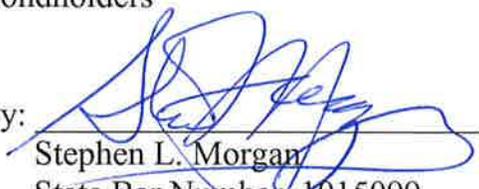
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Dated this 5th day of July, 2011.

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CERTIFICATION OF COMPLIANCE WITH RULE 809.19(12)

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all opposing parties.

Dated this 5th day of July, 2011.

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