

COURT OF APPEALS OF WISCONSIN
DISTRICT IV

Appeal Nos. 2010-AP-2835 and 2011-AP-561

IN THE MATTER OF THE REHABILITATION OF:

SEGREGATED ACCOUNT OF AMBAC ASSURANCE
CORPORATION

THEODORE K. NICKEL and OFFICE OF THE COMMISSIONER OF
INSURANCE,

Petitioners-Respondents,

AMBAC ASSURANCE CORPORATION,

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,
DEUTSCHE BANK NATIONAL TRUST COMPANY, DEUTSCHE
BANK TRUST COMPANY AMERICAS, EATON VANCE, FEDERAL
HOME LOAN MORTGAGE CORPORATION, FEDERAL NATIONAL
MORTGAGE ASSOCIATION, FIR TREE INC., KING STREET
CAPITAL MASTER FUND, LTD., KING STREET CAPITAL, L.P.,
LLOYDS TSB BANK PLC, MONARCH ALTERNATIVE CAPITAL LP,
STONEHILL CAPITAL MANAGEMENT LLC, U.S. BANK
NATIONAL ASSOCIATION, WELLS FARGO BANK, N.A., as Trustee
for certain LVM bondholders, WILMINGTON TRUST COMPANY and
WILMINGTON TRUST FSB,

Interested Parties-Co-Appellants.

Appeals From The Circuit Court Of Dane County
Honorable William D. Johnston,
Presiding by Judicial Assignment

RESPONDENTS' RESPONSE BRIEF

**SUBMITTED BY THE OFFICE OF THE WISCONSIN COMMISSIONER OF
INSURANCE AND COMMISSIONER THEODORE K. NICKEL, AS THE COURT-
APPOINTED REHABILITATOR OF THE SEGREGATED ACCOUNT OF AMBAC
ASSURANCE CORPORATION**

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STATEMENT ON PARTY DESIGNATIONS AND IDENTIFICATION OF APPEALS

This Response Brief is submitted on behalf of the Office of the Wisconsin Commissioner of Insurance and Commissioner Theodore K. Nickel, as court-appointed Rehabilitator of the Segregated Account of Ambac Assurance Corporation (collectively “OCI”).¹

Appellants consist of several banks, as trustees with respect to policies insuring certain securitized transactions involving residential mortgage backed securities (“RMBS”); two banks and a loan issuer involved with a student loan policy referred to as the “ALL policy”; one of the bondholders and the bank trustee involved with the policy referred to as the Las Vegas Monorail (“LVM”) policy; several holders of beneficial interests (notes and bonds) issued with respect to insured RMBS transactions; and one counterparty on an assumed reinsurance contract.

In the consolidated appeals at issue here, Appellants seek review of three orders entered by the Dane County Circuit Court, the

¹ This insurer rehabilitation proceeding was commenced March 24, 2010 on the petition of Commissioner Sean Dilweg. Commissioner Dilweg served as the court-appointed rehabilitator through the Plan confirmation process in late 2010. In January 2011, Commissioner Nickel took office and became the successor rehabilitator. The rehabilitation court and this Court thereafter changed the case and appeal captions accordingly.

Honorable William D. Johnston presiding by designation (the “rehabilitation court”):

- OCTOBER 18, 2010 ORDER (R.387, JA.221), which set a hearing schedule relating to OCI’s motion to confirm its proposed Plan of Rehabilitation for the Segregated Account (the “Scheduling Order”);
- OCTOBER 26, 2010 ORDER (R.397, JA.225), which denied legal challenges to the establishment of the Segregated Account, motions to intervene and objections to the March 24, 2010 Injunction (the “Pre-Confirmation Motion Order”); and
- JANUARY 24, 2011 ORDER (R.556, JA.100), which confirmed OCI’s Plan of Rehabilitation. The Confirmation Order is the principal order on appeal and was entered following five days of hearings and a full day of oral argument in November 2010.

Three other orders of the rehabilitation court have been appealed, and those appeals are pending before this Court as follows:

- MAY 27, 2010 ORDER (R.127, JA.195), which denied motions to enjoin a settlement between Ambac and a group of international banks, rejected certain arguments regarding the establishment of the Segregated Account, and denied motions to intervene (2010-AP-1290);
- JULY 16, 2010 ORDER (R.258, JA.212), which denied objections related to the allocation of the LVM policy to the Segregated Account and denied motions to intervene (2010-AP-2022); and
- JUNE 14, 2011 ORDER, which enforced the March 24, 2010 Injunction against the Assured Guaranty Reinsurers (2011-AP-1486).

STATEMENT ON ORAL ARGUMENT AND PUBLICATION

OCI agrees with Appellants that oral argument may be useful to this Court, and that publication of this Court's opinion would provide guidance for Wisconsin insurer delinquency proceedings under WIS. STAT. ch. 645.

INTRODUCTION

The consolidated appeals prompting this Response Brief arise from an insurer rehabilitation proceeding under WIS. STAT. ch. 645, the largest such proceeding in Wisconsin history.

This rehabilitation pertains to the Segregated Account (“Segregated Account”) of Ambac Assurance Corporation (“Ambac”). Although headquartered in New York, Ambac is a Wisconsin-domiciled financial guaranty insurer regulated by OCI. Ambac had over \$300 billion of insured policy exposures (net par outstanding) when OCI commenced the proceeding on March 24, 2010.

Appellants’ arguments are largely shaped by their misguided view that insurer rehabilitation proceedings should be handled like normal adversarial lawsuits, such that:

- (1) *each* of the *thousands* of trustees, policyholders, contractual counterparties, bondholders and others with any interest pertaining to the rehabilitation proceeding has the right to intervene as a party and to conduct protracted discovery and adversarial claim-by-claim litigation against OCI; and
- (2) no deference should be accorded the decisions of OCI or the rehabilitation court.

In fact, the legislature never intended these specialized, OCI-supervised Chapter 645 insurer delinquency proceedings to devolve

into the type of policy-by-policy and claim-specific litigation that

Appellants seek to pursue. As explained in the Comments:

[Chapter 645] is designed to make rehabilitation a very flexible procedure. It is essential that it be regarded as *a management rather than as a legal task*. Though it is called a formal proceeding because it begins with a formal petition to a court and a hearing, thereafter it should be essentially informal in operation. The order is formulated to emphasize flexibility and informality, and *the rehabilitator is given broad powers*. He 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. (1967) (emphasis added).

Unlike Appellants, whose interests are narrow and self-serving, OCI's duty is far more complex: OCI must weigh *all* competing interests, and determine what is in the best interest of policyholders, creditors and the public *as a whole*.

Because OCI has expertise in administering the Wisconsin Insurance Code, and has no stake in the outcome, the legislature accorded it broad deference to make the complex rehabilitation choices necessary to achieve the statutory objectives of Chapter 645.

See WIS. STAT. ANN. § 645.32 cmt. (excerpted above).²

² *See also Minor v. Stephens*, 898 S.W.2d 71, 76 (Ky. 1995) (“The Commissioner is best qualified to perform the rehabilitation/liquidation process as he has no special interest in the outcome except to administer the matter for the maximum benefit of all interested parties.”).

Chapter 645 permits, but does not require, OCI to submit a rehabilitation plan to the court, and imposes no limitations on OCI regarding the form or content of a plan. WIS. STAT. § 645.33(5). If OCI chooses to employ a rehabilitation plan and applies to the court for approval, the court may, “after such notice and hearing as the court prescribes, . . . approve or disapprove the plan proposed, or may modify it and approve it as modified.” *Id.*

Nothing in Chapter 645 generally, or Section 645.33(5) specifically, indicates that judicial review of a plan should be less deferential than the review of any other discretionary action by OCI. Although the terminology for this deference varies over time periods and jurisdictions, it is accurately summarized by a national insurance treatise: absent “proof of illegality, abuse of discretion, or gross inequity, the trial court’s approval of a particular plan of rehabilitation is not subject to review.” 1 Steven Plitt, Daniel Maldonado & Joshua D. Rogers, COUCH ON INSURANCE § 5:24 (3d ed. 2009) (footnote, citations omitted).

Likewise, numerous courts have explained, “it is not the function of the courts to reassess the determinations of fact and public policy made by the Rehabilitator.” *Foster v. Mut. Fire, Marine & Inland Ins. Co.*, 614 A.2d 1086, 1091 (Pa. 1992). Stated another way,

[W]hile the Commissioner’s plan for rehabilitation cannot be implemented without a court finding that it is fair and equitable, deference is given to the means the Commissioner chooses to utilize in going forward with rehabilitation. As such, the Rehabilitator’s determination concerning the manner in which to proceed will not be set aside unless it is shown to be arbitrary or unreasonable.

LaVecchia v. HIIP of N.J., Inc., 734 A.2d 361, 364 (N.J. Super. Ct. Ch. Div. 1999).³

In sum, OCI is granted broad discretion to craft plans of rehabilitation for Wisconsin-domiciled insurers. The Plan at issue here should not be rejected or modified because Appellants have not shown that OCI erroneously exercised that discretion. As explained in the Confirmation Order—*see* R.556:2-53 (Findings ¶¶ 1-152), 53-61 (Conclusions ¶¶ 1-12), JA.100-63⁴—the Plan is the product of careful analysis and the sound exercise of OCI’s discretion.

³ See also *Matter of Mills v. Fla. Asset Fin. Corp.*, 818 N.Y.S.2d 333, 334 (N.Y. App. Div. 2006) (“The courts will . . . disapprove the rehabilitator’s actions only when they are shown to be arbitrary, capricious or an abuse of discretion.”).

⁴ Aside from citing to the Joint Appendix (“JA.”), references to court orders are designated “R.x:y (¶ z),” with “x” being the appeal record docket number, “y” being the document page number, and “z” being the paragraph number. Cites to hearing transcripts are designated “R.x at y:z,” with “x” being the docket number, “y” being the transcript page number, and “z” being the line numbers on the page. All substantive filings in the appellate record are publicly accessible at <http://ambacpolicyholders.com/record-on-appeal>.

COUNTER-STATEMENT OF ISSUES

1. Was the Plan of Rehabilitation (the “Plan”) for the Segregated Account an erroneous exercise of OCI’s discretion?

Answered Below: No; as the rehabilitation court determined:

The Plan is feasible and is fair and equitable to policyholders and others with an interest in the Segregated Account. The Plan represents a reasonable response to the financial condition of the Segregated Account and Ambac generally by addressing the serious financial hazards to policyholders, creditors, and the public, maximizing claims-paying resources, and providing flexibility to meet the purposes of rehabilitation on an ongoing basis, with this Court’s continued oversight.

(R.556:57 (¶ 15), JA.159.)

2. Are any of the rehabilitation court’s 152 paragraphs of Findings of Fact (“Findings”) supporting confirmation of the Plan clearly erroneous?

Answered Below: No; each of the rehabilitation court’s Findings in the Confirmation Order was supported by the evidence introduced by OCI and the testimony of its witnesses during extensive evidentiary proceedings.

3. Did the rehabilitation court adequately explain its rationale for confirming OCI’s Plan?

Answered Below: Yes; the rehabilitation court gave an extensive, detailed rationale for confirmation in

both its oral comments on the record (R.564 at 49:24-51:4), and in its 61-page Confirmation Order, which systematically explicated the factual and legal framework supporting confirmation in the form of comprehensive Findings annotated to the record and detailed Conclusions of Law (R.556, JA.100-63). The rehabilitation court also addressed many of the legal challenges to the rehabilitation in prior written decisions. (*See* R.397, JA.225-45; R.258, JA.212-220; R.127, JA.195-211.)

4. Were any of the rehabilitation court's rulings on discovery, scheduling or evidence an erroneous exercise of its discretion, or reversible error?

Answered Below: No; *see* Argument § II, *infra*.

5. Did OCI act appropriately in approving the establishment of the Segregated Account and placing it into rehabilitation?

Answered Below: Yes; the establishment and rehabilitation of the Segregated Account complied with Wisconsin law. (R.11:1-3 (¶¶ 1-2, 6), JA.191-193; R.127:8-15 (Findings ¶¶ 19-36, Conclusions ¶¶ 2-5), JA.202-09; R.258:8 (¶ 2), JA.219; R.397:7-10, 15-19, JA.231-34, 239-43; R.556:9-27, 47-50 (¶¶ 22-79, 134-142), JA.111-29, 149-52.) The Segregated Account is adequately capitalized because the assets of the General Account are subject to the Secured Note and Reinsurance Agreement, which OCI created and imposed against the General Account to fund the obligations of the Segregated Account under the Plan.

The federal district court (Crabb, J.) agreed with Judge Johnston's views about the Segregated Account. *See In re Segregated Account of Ambac Assurance Corp.* ("In re Segregated Acct."), --- F. Supp. 2d ---, 2011 WL 956855, at *2 (W.D. Wis. Jan. 14, 2011)

(Segregated Account has “access to 98% of Ambac’s current assets”); *id.* at *6 (protecting common pool of assets available to fund rehabilitation is “the linchpin that secures the entire enterprise”).⁵

6. Does Chapter 645 require OCI to demonstrate that its

Plan is preferable to liquidation?

Answered Below: No; Wisconsin law does not require OCI to demonstrate that rehabilitation of the insurer is preferable to liquidation. (R.556:55-56 (¶ 11), JA.157-58.) But, even if it did, OCI presented persuasive evidence that its Plan was better than liquidation. (R.556:18-22, 35-36, 55-56 (Findings ¶¶ 49-63, 105-09, Conclusions ¶¶ 11-13), JA.120-24, 137-38, 157-58.)

7. Did OCI abuse its discretion regarding the issues

giving rise to the various Plan-specific challenges—namely:

a. Does OCI’s Plan reasonably protect the interests of long-term claimants?

Answered Below: Yes; as the rehabilitation court found:

The testimony at the hearing demonstrates that the Plan fairly balances and protects . . . the competing interests of policyholders with “long-tail” interests and those having “short-tail” interests. Certain of the objectors with “short-tail” interests argued that the Plan is too conservative regarding the percentage of cash being distributed in early years; conversely, objectors with

⁵ As noted in the Statement of the Case § III.D, *infra*, this proceeding was briefly in federal court after the IRS removed it in December 2010. Judge Crabb remanded the proceeding to state court on January 14, 2011. *See id.*

“long-tail” interests argued that the Plan distributes cash too rapidly and should contain provisions for paying a certain percentage of each cash payment into a long-term “reserve.” While neither extreme is satisfied by the intermediate balance struck by the Rehabilitator pursuant to the Plan, the Court finds that the balance struck by the Rehabilitator is fair and reasonable under the circumstances.

(R.556:51-52 (¶ 148), JA.153-54.)

b. Was it appropriate for OCI to classify claims arising under reinsurance contracts differently than claims arising from insurance policies?

Answered Below: Yes; the Wisconsin Insurance Code treats reinsurance contracts differently than insurance policies, and the Plan’s classification of reinsurance contract claims as subordinate to policy claims is consistent with OCI’s past practice and the holdings of every court nationwide that has ruled upon the issue. (R.556:32, 48 (¶¶ 94-95, 137-38), JA.134, 150.)

c. Did OCI comply with Wisconsin law in regard to the Plan provisions pertaining to set-offs, preservation of contract rights, preservation of control rights, immunity and indemnification, or trustee duties?

Answered Below: Yes; those injunctive and Plan provisions are consistent with Wisconsin law and well within OCI’s discretion as Rehabilitator. (R.397:10-12, JA.234-36; R.556:37-40 (¶¶ 114-123), JA.139-42.)

COUNTER-STATEMENT OF THE CASE

I. AMBAC AND ITS DETERIORATION

Until its decline, Ambac was one of the largest and most successful financial guaranty insurers in the world. (R.2:1.)

Ambac's history, complex business operations and financial deterioration are discussed in detail in the Confirmation Order. (R.556:12-16 (¶¶ 29-42), JA.114-118.)

Suffice it to note that, by early 2010, OCI concluded that it needed to take formal regulatory action under Chapter 645 to address the growing risks Ambac's deteriorating financial condition posed to its policyholders, creditors and the public. (R.556:15-16 (¶¶ 41-42), JA.117-18; R.127:8 (¶ 19), JA.202.) Appellants do not dispute the wisdom of OCI's determinations about the need for regulatory action or the timing of such action.

II. OCI'S CONSIDERATION OF REGULATORY OPTIONS AND ITS DECISION TO REHABILITATE THE SEGREGATED ACCOUNT

Having determined that regulatory action needed to be taken, OCI evaluated three options: (1) the liquidation of Ambac; (2) the rehabilitation of Ambac as a whole; or (3) the targeted rehabilitation of parts of Ambac through a segregated account.

OCI's decision-making here was informed by the unique risks presented by Ambac's books of business, which insure "some of the most complicated financial instruments ever created." (R.556:18 (¶ 50), JA.120.) Ambac's policies are not "off the shelf" contracts; they insure intricate, individually negotiated transactions that generally include embedded covenants, default triggers, and

liquidated-damages provisions tied to the avoidance of formal delinquency proceedings. (R.556:18-19 (¶¶ 51-52), JA.120-21.) If these contractual triggers were tripped, there was a risk that claims against Ambac’s already-strained resources would immediately multiply—resulting in more claimants competing for distributions from a smaller pool of claims-paying resources, among other consequential harms.⁶ (R.556:22 (¶ 60), JA.124.) *See also In re Segregated Acct.*, 2011 WL 956855, at *1-*2 (describing unique challenges faced by OCI). OCI sometimes referred to these risks as “collateral damage.” (R.556:18-19 (¶ 51), JA.120-21.)

A. Liquidation Option

OCI considered and rejected the liquidation option because the disadvantages of liquidation were obvious and substantial. (R.556:20-21 (¶¶ 56-57), JA.122-23.)

First, liquidation would have required the cancellation of all Ambac policies on only 15 days’ notice, leaving all policyholders suddenly without coverage for future losses on obligations otherwise insured for up to 40 years. (R.556:20-21 (¶ 57), JA.122-23; R.561 at 162:23-163:11.)

⁶ OCI also recognized that it may not have been possible to effectively enjoin the exercise of all such triggers, which varied across policies. (R.556:19 (¶ 52), JA.121.)

Second, because replacement coverage is largely unavailable for most Ambac obligations for which losses are expected, the massive policy cancellations required by a liquidation would have resulted in years of policy-by-policy litigation over the quantification of damages for future anticipated losses and the relative priority of such claims. (R.556:20-21 (¶ 57), JA.122-23; R.561 at 169:12-22, 171:3-11.)

Third, liquidation would have caused a number of costly defaults due to policy “triggers,” as well as mark-to-market damage claims—seeking the cost of equivalent replacement coverage in the open market—in policies calling for them. (R.556:20-21 (¶ 57), JA.122-23; R.561 at 162:23-163:11.)

Fourth, liquidation would have resulted in a materially smaller pool of claims-paying resources because it would have required Ambac to return more than \$2 billion in previously received (but unearned) premiums, and would have eliminated Ambac’s right to receive over \$1 billion in future premiums. (R.556:20-21 (¶ 57), JA.122-23; R.561 at 171:12-172:14.)

OCI “concluded rather quickly that [liquidation] was a suboptimal choice[.]” (R.561 at 174:16-175:5.)

B. Full Rehabilitation Option

OCI also considered and opted not to pursue the rehabilitation of Ambac as a whole. As detailed in the evidence and the rehabilitation court's Findings, the principal drawback of a full company rehabilitation is that it likely would have triggered significant additional large claims which would have resulted in the policyholders presently allocated to the Segregated Account receiving less in a full-company rehabilitation than under the present Plan.

As of March 2010, when OCI needed to act, the vast majority of Ambac's 15,000 policies (more than 90%) insured problem-free transactions, with little or no projected future losses *unless* they were subjected to a rehabilitation. (R.127:9 (¶ 21), JA.203.) By way of example, OCI determined that rehabilitation of Ambac's relatively small number of "Commercial ABS" policies alone might have created additional, otherwise avoidable losses in excess of \$1 billion. (R.127:9 (¶ 21), JA.203.)

Other segments of Ambac's business would have faced similar adverse consequences, including the acceleration of obligations of Ambac affiliates that issued interest rate and currency swaps and guaranteed investment contracts, all of which were insured by Ambac (R.127:9-10 (¶ 22), JA.203-04), and the possible

assertion of more than \$10 billion in otherwise avoidable mark-to-market damages relating to credit default swaps and collateralized loan obligations. (R.561 at 153:25-156:15; R.560 at 146:23-148:2.)

Thus, the “full rehabilitation” option was viewed as carrying significant and unnecessary risks of harm to policyholders because of the prospect that it would trigger far greater claims. (R.556:18-19 (¶¶ 51-52), JA.120-21; R.127:9-10 (¶¶ 20-24), JA.203-04.)

A full rehabilitation also posed risks to the domestic economy. OCI received comments from economic leaders and government entities—including the United States Treasury Department and the New York Federal Reserve—expressing concern that a full rehabilitation of Ambac posed systemic risks of market disruption and unpredictable downstream consequences for the economy. (R.127:10 (¶ 23), JA.204; R.560 at 143:23-145:15.) “In broad terms, the discussions [OCI] had with the New York Fed and others affirmed [its] perception that systemic risks related to Ambac could exist and that they were worth considering in [the] overall plan[] development.” (R.562 at 33:8-12.)

C. Targeted Rehabilitation Option

Because liquidation or a full rehabilitation had so many disadvantages, OCI determined that a surgical segregated account

approach would have the most beneficial outcome for all policyholders. (R.556:22 (¶ 60), JA.124; R.560 at 151:7-21.)

To accomplish this purpose, OCI utilized WIS. STAT. § 611.24(2), a statute that is unique to Wisconsin insurance law. Section 611.24(2) permits an insurer (with OCI's approval) to establish a segregated account for any parts of its business, thus creating what the legislature characterized as "a company within a company." WIS. STAT. ANN. § 611.24 cmt. OCI has previously used segregated accounts in connection with other Chapter 645 proceedings. (R.556:22 (¶ 61), JA.124; R.561 at 157:15-159:3.)

OCI exercised substantial care to ensure that this structure would meet the purposes of "protecting the interests of insureds, creditors, and the public generally" and foster the "equitable allocation of any unavoidable loss," WIS. STAT. § 645.01(4), without triggering massive avoidable losses. (R.556:23 (¶ 64), JA.125.)

Specifically, OCI engaged in an extensive assessment of Ambac's complex business, studying key categories of policies and particularly troubled individual policies to understand their terms and expected losses. (*Id.*; R.561 at 177:17-181:23.) It then approved the allocation to the Segregated Account of approximately 1,000 policies with material projected losses, structural problems in the underlying insured transactions, and/or contractual triggers that

could not be avoided without injunctive relief, while keeping the remaining 14,000 healthy, performing policies in the “General Account” of Ambac. (R.556:23 (¶ 65), JA.125; R.562 at 157:19-160:7; R.127:12-13 (¶¶ 27-31), JA.206-07.)

OCI also allocated all known, potentially material non-policy liabilities of the General Account to the Segregated Account, including the General Account’s obligations under certain reinsurance contracts and leases. (R.556:23 (¶ 66), JA.125.)

In creating the Segregated Account, it was imperative that Ambac’s claims-paying resources remain in the General Account. Many of Ambac’s performing policies with no anticipated losses—primarily its massive book of municipal bond policies—were subject to acceleration, early termination and other triggers if Ambac transferred assets to affiliates or other entities such as the Segregated Account. (R.556:25 (¶ 70), JA.127; R.561 at 156:16-157:14.) Therefore, rather than allocating hard assets directly to the Segregated Account at its establishment, OCI opted to capitalize the Segregated Account by imposing a Secured Note for \$2 billion and an excess-of-loss Reinsurance Agreement against the General Account. (R.556:25 (¶ 71), JA.127; R.561 at 195:21-196:21.) With the exception of a \$100 million statutory surplus required for licensing by regulators in other states, the Secured Note and

Reinsurance Agreement give the Segregated Account absolute, on-demand use of *all* assets of the General Account to satisfy Segregated Account liabilities. (R.556:26 (¶¶ 74-75), JA.128; R.561 at 199:12-15.) Thus, allowed claims against the Segregated Account are treated on “equal footing” with claims against the General Account in regard to the shared common pool of claims-paying resources. (R.556:49 (¶ 140), JA.151.)

OCI determined that this capitalization of the Segregated Account was fair and adequate for the rehabilitation. (R.556:26 (¶ 75), JA.128; R.561 at 199:6-11, 199:24-200:3; R.563 at 59:13-25.)

III. THE REHABILITATION PROCEEDING

A. Commencement Of The Rehabilitation, And Expertise Of Judge Johnston

OCI initiated the rehabilitation of the Segregated Account on March 24, 2010 by filing a Verified Petition for Rehabilitation and a Motion for Temporary Injunctive Relief in Dane County Circuit Court, *see* WIS. STAT. § 645.31, where the case was assigned to Judge William D. Johnston. (*See* R.1, JA.246-60; R.6.)

Because of the specialized and complex nature of such proceedings, all Chapter 645 cases have been assigned to Judge Johnston for 20-plus years, a practice that has been reduced to a standing order. (R.3:2-3 (¶ 6).) Consequently, Judge Johnston has

developed substantial expertise overseeing these specialized, sometimes decades-long proceedings. (*See, e.g.*, R.561 at 157:21-158:21 (Northwestern National); R.471 at 85:9-11 (Reliable Life); R.271 at 21:23-22:3 (American Star); *Matter of the Liquidation of American Eagle Insurance Co.*, 2005 WI App 177, 286 Wis. 2d 689, 704 N.W.2d 44.)

B. The First-Day Injunction

OCI obtained an injunction (the “Injunction”) under WIS. STAT. § 645.05 at the outset of the proceeding, which protected OCI, the Segregated Account and the claims-paying resources for OCI’s Plan. (R.9:2 (¶ 1), JA.176; R.556:27 (¶ 77), JA.129.) All affected persons were given notice and opportunity to challenge the Injunction in the rehabilitation court. (R.9:13-14 (¶ 12), JA.187-88.)

C. The Plan Confirmation Process

OCI filed its Plan on October 8, 2010. (R.371.) The Plan was structured as OCI had outlined in its Petition six months earlier. (R.1:9-10 (¶ 12).) Although not required by Chapter 645, OCI also filed a detailed Disclosure Statement explaining the terms and operation of the Plan, with extensive business and financial records and other information regarding the Segregated Account’s current and projected financial condition. (*See* R.372, JA.343.)

On October 14, 2010, the rehabilitation court held a scheduling conference regarding the Plan confirmation process. In denying objectors' requests for formal discovery, the rehabilitation court noted:

[W]hen you start going down the discovery [path], then when you start testing every theory and that can drag on and be years in the making to resolve, and with the idea of coming up with an alternate suggestion for a plan, that really invades what the province of the OCI is under the statutes here and their particular duty.

In this particular case, I think sooner is better. I think with all of the . . . extensive briefing that has occurred, everybody I think is up to speed on their particular issues and we can go forward with the proponents of the plan giving their testimony and being examined as to that testimony and then, upon completion of that, come to the point of making a decision as to whether the plan . . . [is] a proper exercise of [OCI's] discretion.

(R.471 at 82:8-83:11; *see also* R.258:7, JA.218; R.509:2 (¶ 2).)

Although the rehabilitation court denied formal discovery, it permitted objectors to submit written objections to the Plan and “factual questions that the Objector[s] wish[] to bring to the attention of the Rehabilitator prior to the Plan confirmation hearing.”

(R.387:2 (¶ 2.a., c.), JA.222.) On November 8, 2010, Appellants and other parties-in-interest served OCI with more than 100 questions, many of which were written in interrogatory form. (*See* R.424, R.443, R.464:Annex; R.428:1-6.) OCI filed a thorough 38-

page response to those questions as a supplement to its Disclosure Statement. (*See* R.484.)

The rehabilitation court then held a five-day evidentiary hearing regarding the merits of the Plan in November 2010. (R.560-64.)

D. Removal And Remand Of The Proceeding

On December 8, 2010, after the confirmation hearing, the IRS removed the rehabilitation proceeding to federal court. In granting OCI's motion to remand, the federal district court (Crabb, J.) commented favorably on OCI's Segregated Account rehabilitation structure, and the importance of protecting the common pool of assets available to fund both Ambac and the Segregated Account. *See In re Segregated Acct.*, 2011 WL 956855, at *6 (discussed at Argument § IV.A, *infra*).

E. The Plan

Upon remand, the rehabilitation court issued its Plan Confirmation Order. The core features of the confirmed Plan are as follows:

1. Claim Priorities: Allowed claims are classified and treated in accordance with the claim priorities in WIS. STAT. § 645.68.
2. Administrative Expense Claims: To be paid promptly in full in cash.

3. Policy Claims: To be processed and paid monthly in full, as and when those claims are presented and due, through an initial mix of 25% cash and 75% surplus notes bearing interest at 5.1%.
4. Contract and Other Subordinate Claims: To be paid in full with interest-bearing junior surplus notes.
5. Annual Report and Adjustments: OCI must file an annual report each June regarding the rehabilitation and make decisions about adjusting the cash/note percentages on policy-claim payments and allowing payments on the surplus notes.
6. Alternative Resolutions: Claimants desiring to commute or modify their policies or contracts, in lieu of having their interests handled through the Plan, may pursue those options pursuant to the Plan's "alternative resolution" provisions.

(See generally R.567, JA.587-727.)

STANDARD OF REVIEW

Findings of Fact: Trial court findings of fact should be affirmed unless they are clearly erroneous. WIS. STAT. § 805.17(2).

A finding of fact is clearly erroneous only when "it is against the great weight and clear preponderance of the evidence." *Phelps v. Physicians Ins. Co. of Wis.*, 2009 WI 74, ¶ 39, 319 Wis. 2d 1, 768 N.W.2d 615 (citation omitted).

Scheduling, Discovery and Evidentiary Matters: The rehabilitation court's decisions relating to scheduling, discovery and

admission of evidence are reviewed under an erroneous exercise of discretion standard. *See Schneller v. St. Mary's Hosp. Med. Ctr.*, 162 Wis. 2d 296, 305-06, 470 N.W.2d 873, 876 (1991) (scheduling); *Shibilski v. St. Joseph's Hosp. of Marshfield, Inc.*, 83 Wis. 2d 459, 470-71, 266 N.W.2d 264, 270 (1978) (discovery); *Martindale v. Ripp*, 2001 WI 113, ¶ 28, 246 Wis. 2d 67, 629 N.W.2d 698 (evidence).

OCI Decisions on Matters Within its Discretion: In

reviewing discretionary agency decisions, Wisconsin courts “cannot rule . . . on the wisdom of an agency’s decision[,]” but are restricted to determining whether the agency “is empowered by the legislature to exercise its authority” in the matter at hand. *Maple Leaf Farms, Inc. v. Dep’t of Natural Res.*, 2001 WI App 170, ¶ 35, 247 Wis. 2d 96, 633 N.W.2d 720; *see also Nat’l Motorists*, 2002 WI App 308, ¶ 25 (“[W]e may reverse OCI’s discretionary decision . . . only if it is arbitrary and capricious.”) (internal citation omitted). *Accord* WIS. STAT. § 227.57.

Questions of Law and Interpretation of Insurance

Statutes: Although questions of law are subject to *de novo* review, OCI’s interpretation of the insurance statutes that it administers are entitled to deference. *See Nat’l Motorists Ass’n v. Office of Comm’r*

of Ins., 2002 WI App 308, ¶¶ 10-13, 259 Wis. 2d 240, 655 N.W.2d 179.

ARGUMENT

I. THE REHABILITATION COURT EXERCISED ITS INDEPENDENT JUDGMENT IN CONFIRMING THE PLAN, AND APPELLANTS FAIL TO SHOW THAT ANY OF THE COURT'S FINDINGS OF FACT ARE CLEARLY ERRONEOUS

A. The Rehabilitation Court Fully Explained Its Rationale For Approving The Plan

Contrary to Appellants' assertion, the record fully supports the rehabilitation court's decision to adopt OCI's proposed form of order. After considering five days of evidence, the rehabilitation court explained in open court why OCI's Plan is appropriate:

THE COURT: This is an extremely complex and difficult situation. I have watched the testimony of the Commissioner and especially Mr. Peterson over the . . . two days that he was on the stand. It was as grilling a series of questionings as I've seen any witness undergo in all my years on the bench. . . . [T]he evaluation shown to have been made, the factors gathered, the procedures followed as testified to by [OCI's] Mr. Peterson leads me to believe, as [OCI] consistently pointed out, *that they were acting in what would be the best interest of their policyholders, doing what is fair for them.* . . .

I thought it was a presentation that clearly established that it was fair, it was equitable. It was an extremely well thought out, well based decision.

And for the purposes of the Plan it certainly meets the criteria as being a solid exercise of the discretion . . . of the OCI, certainly is fair and equitable from what I can see of this.

(R.564 at 50:1-51:4 (emphasis added).)

Having presided over the Plan confirmation process and observed the witnesses first-hand, the rehabilitation court's views are entitled to deference. *See Stevenson v. Stevenson*, 2009 WI App 29, ¶ 14, 316 Wis. 2d 442, 765 N.W.2d 811 (“the trial court is the ultimate arbiter of the credibility of witnesses”). *Accord* WIS. STAT. § 805.17(2).⁷

B. The Rehabilitation Court's Adoption Of OCI's Proposed Order Over Appellants' Proposed Orders Does Not Change Appellants' Burden Of Having To Show That The Court's Findings Are Clearly Erroneous

A party seeking to overturn a court's findings must show that they are clearly erroneous, that is, “against the great weight and clear preponderance of the evidence.” *Phelps*, 2009 WI 74, ¶ 39.

Appellants attempt to avoid this heavy evidentiary burden by arguing that the rehabilitation court erred in adopting OCI's proposed form of order. (Consol. Br. at 1, 33-38.)

Appellants' argument is contrary to settled law. As our Supreme Court has explained, when a trial court signed findings and

⁷ Appellants introduced live testimony from a single witness—James Schacht, a retired Illinois insurance regulator who had no experience with Wisconsin rehabilitation law or proceedings. (R.556:43-44 (¶ 133(a)), JA.145-46.) The rehabilitation court noted that it “did not find Mr. Schacht's testimony . . . to be credible or particularly relevant in the context of this Plan and the Wisconsin rehabilitation proceeding.” (R.556:43 (¶ 133), JA.145.)

conclusions prepared by counsel for one party, “they became the findings and the conclusions of the trial judge and the responsibility of their correctness became his.” *Karp v. Coolview of Wis., Inc.*, 25 Wis. 2d 299, 301, 130 N.W.2d 790, 791 (1964) (citations omitted).

Likewise, this Court has noted,

while . . . [the court] received a draft of the findings of fact, conclusions of law, and judgment from [one party,] . . . once [the court] signed the document and it was entered . . . , it became the judgment of the court. . . . [A]n unambiguous written judgment, prepared by one of the attorneys and then signed and entered by the court, clearly expressed the court’s intent; *we did not attach any significance to the fact that the judge did not draft it.*

Cashin v. Cashin, 2004 WI App 92, ¶ 13, 273 Wis. 2d 754, 681 N.W.2d 255 (emphasis added). *See also Anderson v. Bessemer City*, 470 U.S. 564, 572 (1985) (“[E]ven when the trial judge adopts proposed findings verbatim, the findings are *those of the court* and may be reversed *only if clearly erroneous.*”) (citations omitted, emphasis added).

Appellants also ignore the fact that they supported and participated in the procedure they now criticize. The rehabilitation court invited all interested persons to submit proposed findings and conclusions of law after the close of evidence. (R.564 at 207:7-211:17.) Appellants agreed to that procedure (*see id.*), and most of them—like OCI—subsequently submitted proposed orders in

advance of the full day of oral argument. (See R.520-22, R.526, R.529-30, R.532-34.) Appellants cannot participate in a process, submit their own proposed orders, and then later complain when the court chooses OCI's proposed order over theirs. See *Shoreline Gas, Inc. v. Grace Res., Inc.*, 786 So. 2d 137, 141 (La. Ct. App. 2001).

C. Appellants Fail To Show That *Any* Of The Rehabilitation Court's Findings Are Clearly Erroneous

Of the 152 Findings in the Confirmation Order, Appellants specifically take issue with only 20 of them. (See Consol. Br. at 36-37, 45, 92 (citing R.556, Findings ¶¶ 20, 58, 72, 95, 97, 105-09, 134-35, 139-142); BofA/Wilmington Br. at 11-12 (also citing ¶¶ 114, 137, 145); Wells Fargo-RMBS Br. at 11 (also citing ¶ 150).) Thus, the vast majority of the Findings are undisputed.

As to the few challenged Findings, Appellants only assert in summary fashion that those Findings are “unsupported by, or contrary to, the evidentiary record, or . . . the subject of significant legal and factual disputes.” (Consol. Br. at 36-37; BofA/Wilmington Br. at 11; Wells Fargo-RMBS Br. at 11.) Appellants fail to explain *which* of the cited Findings are unsupported by the record, or *what* contrary evidence shows that the Findings are disputed, or *why* they believe those Findings are clearly erroneous.

Even if Appellants could meet their evidentiary burden with respect to *any* of the 20 (of 152) Findings they purport to dispute, they fail to explain why any allegedly erroneous Finding is alone material or supports reversal of the Confirmation Order rather than being *harmless error* in view of the landslide of undisputed Findings.

For example, Appellants object to the rehabilitation court's Findings that the Segregated Account was adequately capitalized. (See Consol. Br. at 44-45 (citing Findings ¶¶ 139-42).) But Appellants do not contest any of the Findings that discuss the capital structure of the Segregated Account and the basis for the rehabilitation court's conclusion that it was adequately capitalized. (See R.556:25-27 (¶¶ 70-71, 73-76), JA.127-29.) In fact, the challenged Findings are supported by the plain language of the Secured Note and Reinsurance Agreement, as well as the hearing testimony of OCI's Roger Peterson—which the rehabilitation court expressly found to be “more credible and well-grounded” than the limited evidence offered by Appellants. (R.556:49-50 (¶¶ 140-42), JA.151-52.)

D. *Trieschmann* Is Inapposite

Appellants cite *Trieschmann v. Trieschmann*, 178 Wis. 2d 538, 541-44, 504 N.W.2d 433, 434-35 (Ct. App. 1993), for the

proposition that a trial court’s “failure to articulate the factors upon which it based its decision is an independent basis to reverse the ruling.” (Consol. Br. at 35; *see also* BofA/Wilmington Br. at 11; Wells Fargo-RMBS Br. at 11.)

Trieschmann is inapposite for two reasons: (1) it has no application outside the divorce context; and (2) even if it did, this is not a case like *Trieschmann* where the trial court failed to provide *any* reviewable basis for its decision. The 61-page Confirmation Order contains a detailed explication of the rehabilitation court’s basis for confirming the Plan. (*See* R.556, JA.100-163.)

No court has ever applied *Trieschmann* outside the divorce context. The *Trieschmann* court made clear that its reasoning—which Appellants excerpt out of context (Consol. Br. at 35-37)—was specific to divorce proceedings. 178 Wis. 2d at 541-42, 504 N.W.2d at 434. Furthermore, this Court has expressly limited *Trieschmann* to the divorce context. *See Kersten v. H.C. Prange Co.*, 186 Wis. 2d 49, 60, 520 N.W.2d 99, 104 (Ct. App. 1994) (“*Trieschmann* does not apply; it is a divorce case. . . . This case is a contract dispute. . . . We therefore review the entire record, not just the trial court’s explanation, in determining whether there is any credible evidence to support the factual finding”).

Moreover, even if *Trieschmann* were applicable beyond the divorce context, it is inapposite here. In *Trieschmann*, “the trial court failed to provide *any rationale or justification* for the maintenance award.” 178 Wis. 2d at 543, 504 N.W.2d at 435 (emphasis added).

The situation here could not be more different. The rehabilitation court explained its rationale for crediting the testimony of OCI’s witnesses on the record during the hearings, and its 61-page Confirmation Order contains detailed Findings and Conclusions that explain the court’s basis for approving the Plan. *Cf. In re Joy P.*, 200 Wis. 2d 227, 241, 546 N.W.2d 494, 500-01 (Ct. App. 1996) (*Trieschmann* inapposite where trial court’s findings and conclusions were adequate and its reasoning was discernible from record).

II. APPELLANTS’ OBJECTIONS TO THE REHABILITATION COURT’S DISCOVERY, SCHEDULING AND EVIDENTIARY RULINGS ARE MERITLESS

The rehabilitation court’s decisions relating to discovery, scheduling, and admission of evidence are reviewed under an erroneous exercise of discretion standard. *See Standard of Review, supra.*

This Court’s review of such decisions is “highly deferential”:

Discretionary determinations are not tested on appeal by our sense of what might be a “right” or “wrong” decision in the case. Rather, the determination will stand “unless it can be said that *no reasonable judge, acting on the same facts and underlying law, could reach the same conclusion.*”

Olivarez v. Unitrin Prop. & Cas. Ins. Co., 2006 WI App 189, ¶ 16, 296 Wis. 2d 337, 723 N.W.2d 131 (citations omitted, emphasis added).

A. Denial Of Discovery

The rehabilitation court did not err in denying Appellants’ discovery requests. (Consol. Br. at 90-93.)

There is no right to discovery in a rehabilitation proceeding, and Appellants are not formal parties in the proceeding. Chapter 645 makes no provision for discovery, and Appellants ignore the fact that a rehabilitation proceeding is fundamentally different than typical civil litigation. As the rehabilitation court explained:

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.

(R.258:7, JA.218.)

[T]o claim that there is an initial right to intervene . . . in the rehabilitation as a lawsuit and start taking discovery and proceeding in an adversarial manner is way beyond the scope of what was intended by Chapter 645 and the type of proceeding that is set up by that chapter of our statutes.

(R.271 at 23:24-24:4.)

Appellants ignore the Comments to WIS. STAT. § 645.32 cited by the rehabilitation court,⁸ and fail to explain how their attempt to transform OCI's management task of rehabilitation into an adversarial litigation can be reconciled with Chapter 645.⁹

Instead, Appellants insist that they should be able to pursue full discovery under WIS. STAT. § 804.01(2)(a). (Consol. Br. at 90; U.S. Bank Br. at 8.) However, that statute governs the right of “[p]arties” to obtain discovery in civil litigation. While the rehabilitation court has afforded Appellants the right to be heard on all issues, neither they nor the thousands of other entities affected by the rehabilitation are “parties” to this non-adversarial proceeding. (R.127:16-17 (¶ 8), JA.210-11; *see also* R.271 at 21:23-22:3 (trial court, Johnston, J., presiding, denied motion to intervene in

⁸ Appellants acknowledge that statutory commentary is “particularly persuasive in considering the Insurance Code.” (Consol. Br. at 39 n.4.)

⁹ In agreeing with OCI that the case caption should be changed so Appellants are referred to as “interested parties,” not “defendants” or “proposed intervenors,” this Court noted that “the terms in our present caption do not accurately reflect the nature of a rehabilitation proceeding, which generally has a petitioner and a subject.” (May 5, 2011 Order at 10-11.)

liquidation of American Star, No. 92-cv-4579 (Wis. Cir. Ct. Dane County), because, as long as policyholders and others “have a basic right to be heard, [they] do not have a need to intervene”).

Appellants also ignore the rehabilitation court’s reasons for denying discovery. (*See* R.471 at 82:8-83:11 (discovery would likely delay proceedings by years, objectors already were “up to speed” based on extensive written submissions, and objectors’ proposal to use discovery to fashion an alternative plan “invades” OCI’s discretion); R.509:2 (¶ 2) (discovery unduly burdensome, implicated the confidentiality of third-party financial data, and was unlikely to lead to information not already produced); R.127:16-17 (¶ 8), JA.210-11 (documents relating to OCI’s decision-making are statutorily privileged under WIS. STAT. § 601.465(1m)(a)).)

Appellants’ discovery argument also elevates form over substance. They assert that they were denied “all” discovery, but fail to acknowledge that OCI produced hundreds of pages of detailed financial and business records in advance of the confirmation hearing, covering all aspects of Ambac and its Segregated Account. (*See* R.556:5, JA.107.)

Moreover, pursuant to the October 18, 2010 scheduling order (R.387:2 (¶ 2.c), JA. 222), Appellants served over 100 written fact questions in interrogatory form, which OCI answered before the

hearing. (See R.424; R.443; R.464:Annex A.) And, with OCI's detailed written responses in hand (R.484), Appellants proceeded to cross-examine OCI's witnesses at length during the five days of hearings. To the extent that Appellants had fact questions for OCI, they were afforded the opportunity to ask those questions and fully took advantage of it.

Finally, contrary to Appellants' assertion, there are no "[n]ational standards" permitting discovery in insurer delinquency proceedings. (Consol. Br. at 91.) For example, in *O'Neal v. Oxendine*, 514 S.E.2d 908 (Ga. Ct. App. 1999), the rehabilitation court refused to permit discovery, denied the motion to intervene, and agreed with the rehabilitator that the transaction was "fair and equitable to all parties in interest[.]" *Id.* at 910 (internal quotation omitted). The appellate court affirmed, noting:

. . . O'Neal failed to provide the trial court with any concrete basis to expect that allowing discovery was likely to lead to evidence that would affect the trial court's decision. . . .

Although the court technically "denied" the motion to intervene, it allowed O'Neal to participate fully in the approval hearing and to raise objections. . . .

Accordingly, he has not shown how he has been harmed by the denial of his motion to intervene.

O'Neal, 514 S.E.2d at 911-12.

The *O'Neal* court's grounds for denying intervention and discovery are equally applicable here. (*See* R.471 at 82:8-83:11; R.509:2 (¶ 2); R.127:16-17 (¶ 8), JA.210-11.)

B. Scheduling

The rehabilitation court weighed the competing proposals regarding confirmation hearing dates and set a schedule based on its view that “sooner is better.” (*See* R.471 at 82:8-83:11.)

Appellants argue that the schedule violated their due process rights (Consol. Br. at 93-97), but they do not address *any* of the rehabilitation court's stated reasons for its scheduling decision, or cite *any* case where a court found a due process violation in a similar situation.

Appellants' assertion that the schedule deprived them of the right to meaningfully participate at the hearings is belied by the record. (*See* R.564 at 50:2-8 (Appellants' examination of Mr. Peterson was “as grilling a series of questionings as I've seen any witness undergo in all my years on the bench”).)

Finally, Appellants speculate that OCI's delay in commencing payments under the confirmed Plan suggests that OCI wanted a prompt confirmation hearing solely “to gain a strategic advantage over Appellants[.]” (Consol. Br. at 94-96). To the contrary, the delay is because OCI is evaluating new information and

events that came to light *since* the hearing, as Appellants are aware. (See June 1, 2011 Rehabilitation Report at 4-5, 6-7, 15 (discussing litigation with IRS over \$700 million tax refund, and issues stemming from Chapter 11 bankruptcy of AFGI).)¹⁰

C. Admission of Evidence

Appellants next argue that portions of the voluminous information OCI provided through its Disclosure Statement and the attachments, amendments and supplements thereto (collectively “the Disclosure Statement”) should have been excluded on hearsay grounds. (Consol. Br. at 97-107.) Appellants’ evidentiary objection fails for multiple reasons.

First, in the court below, a number of Appellants stipulated that:

The Rehabilitator’s Disclosure Statement . . . shall be deemed *admitted in evidence* and shall constitute part of the record of the Plan Confirmation Hearing[.]

(R:493:2 (¶ 3) (ALL/Lloyds stipulation) (emphasis added); R.511:1 (¶ 2) (Depfa stipulation); R.491:2 (¶ 3) (BofA, Wells Fargo-RMBS stipulation); *see also* R.556:6 (¶ 12), JA.108.) ALL/Lloyds and Depfa joined in the consolidated brief, which raises the hearsay objection to the Disclosure Statement. Thus, setting aside the fact

¹⁰ See <http://ambacpolicyholders.com/storage/courtfilings/06012011/Report%20on%20the%20Rehabilitation%206-1-11.pdf>.

that ALL/Lloyds and Depfa violated their stipulations, the Disclosure Statement is “admitted in evidence” with respect to all of their challenges set forth in the consolidated brief.¹¹

Second, Appellants specifically object to only *one* Finding that relies on the Disclosure Statement. (Consol. Br. at 92, 97-98, 99-100 (citing Finding ¶ 20).) The vast majority of the rehabilitation court’s Findings cite to the hearing testimony of OCI’s witnesses and provide an independent basis for affirming the Confirmation Order.

Moreover, as to the lone Finding Appellants challenge, Mr. Peterson gave non-hearsay testimony that the challenged liquidation analyses contained in the initial October 8th Disclosure Statement and the later November 12th Amendment merely confirmed OCI’s pre-rehabilitation rejection of the liquidation option.

- Q. Okay. And describe this relationship to the Liquidation Analysis that we just walked through and the original October 8th Disclosure Statement. How do they differ?
- A. Well, perhaps this [November 12 liquidation analysis] is more detailed in terms of numbers

¹¹ While other Appellants who joined in the consolidated brief may claim not to be bound by the ALL/Lloyds and Depfa stipulations, they did not object to them and it would be anomalous for this Court to decide the *same* issues raised in the *same* brief based on potentially different records.

and particular estimates, but . . . from a qualitative perspective, they are very similar. *The same types of risks are identified in this analysis as was done in the previous [October 8] filing and was part of our consideration for months prior to filing the rehabilitation.*

(R.561 at 174:5-15 (emphasis added); *see also* R.556:21 (¶ 58), JA.123.)

Third, Appellants’ hearsay objection also fails on the merits.

The Disclosure Statement is not hearsay because the information contained therein was not offered for the truth of the matter asserted. None of the financial scenarios in the Disclosure Statement reflect what *will* happen in the future. As the rehabilitation court explained, the purpose of the scenarios is to “illustrat[e] *potential* outcomes under the Plan.” (R.556:9 (¶ 20), JA. 111 (emphasis added).)

Finally, even if the Disclosure Statement were subject to the hearsay rules, the rehabilitation court correctly ruled that it fell within the “public records” exception to the hearsay rule. (R.560 at 91:12-92:16.) Specifically, Section 908.03(8)(c) allows as an exception to the hearsay rule:

. . . reports, statements, or data compilations, in any form, of public agencies, setting forth . . . (c) . . . factual findings resulting from an investigation made pursuant to authority granted by law

WIS. STAT. § 908.03(8).

Although Chapter 645 does not *require* the preparation or submission of documents such as the Disclosure Statement, OCI is authorized by law to do so. *See* WIS. STAT. §§ 645.33(2), (3) and (5).

There also is no merit to Appellants' argument that portions of the Disclosure Statement are objectionable because they were prepared with the assistance of advisors and therefore have layers of hearsay. (Consol. Br. at 101-04.) "If the inquiry was carried out with lawful authority, Wis. Stat. § 908.03(8)(c) encompasses the additional layers of hearsay." Daniel D. Blinka, 7 WISCONSIN PRACTICE SERIES, WISCONSIN EVIDENCE § 803.8 at 787 (3d ed. 2008); *see also Combs v. Wilkinson*, 315 F.3d 548, 555 (6th Cir. 2002) ("Investigative reports 'embody the results of investigation and accordingly are often not the product of the declarant's firsthand knowledge.'") (citing 2 MCCORMICK ON EVIDENCE § 296 (5th ed. 1999)).

Finally, Appellants offer no reason to question the trustworthiness of the Disclosure Statement. Mr. Peterson was "involved in developing the four scenarios[.]" "OCI created the scenarios to provide a scope of potential outcomes," and "OCI's estimates for loss reflected in the Disclosure Statement reflect its independent judgment[.]" (R.556:33-34 (¶¶ 100-01), JA.135-36.)

III. OCI’S DECISION TO PURSUE A PARTIAL REHABILITATION OF AMBAC RATHER THAN A FULL REHABILITATION OR LIQUIDATION WAS NOT AN ERRONEOUS EXERCISE OF DISCRETION

A. The Legislature Gave OCI Broad Discretion To Choose Between Rehabilitation And Liquidation

Chapter 645 states that OCI “may” seek either a rehabilitation or a liquidation on any one of numerous interchangeable criteria. *See* WIS. STAT. §§ 645.31, 645.41. The criteria “*leave the commissioner considerable discretion to decide on direction depending on the specific facts of the individual case, subject of course to court control.*” WIS. STAT. ANN. ch. 645, introductory cmt. to subch. III (emphasis added).

While liquidation is one mechanism to achieve a run-off of insurer liabilities, neither the statutes nor the statutory comments limit OCI’s “considerable discretion” to determine whether it is the appropriate course given “the specific facts of the individual case.” *Id.*

Nor is a rehabilitation required to have greater ambitions than the orderly run-off sought here:

The rehabilitation, in order to be legitimate, does not have to restore the company to its exact original condition. So long as the rehabilitation properly conserves and equitably administers “the assets of the involved corporation in the interest of investors, the public and others, (with) the main purpose being the public good” the plan of rehabilitation is appropriate.

Foster, 614 A.2d at 1094 (citation omitted).

This discretion is well-placed with OCI. In dealing with a deteriorating insurer, it is not realistic to fashion a restructuring arrangement that guarantees a best-case outcome for every party-in-interest. Policyholders are not entitled to each choose the form of remedy they like best, or “to force, at their own wish or whim,” their remedy of choice regardless of the impact on others. *Neblett v. Carpenter*, 305 U.S. 297, 305 (1938). *Accord Application of People, by Van Schaick*, 268 N.Y.S. 88, 96, *aff’d*, 191 N.E. 521 (N.Y. 1934) (affirming rehabilitation plan where insurer “will most likely be saved millions of dollars by the method of rehabilitation proposed”).

B. OCI Had Discretion To Pursue A Narrow Form Of Rehabilitation

There is no merit to Appellants’ contentions that: (1) OCI lacked discretion to pursue a targeted delinquency proceeding directed at the troublesome policies of an insurer where, as here, there is a rational basis for doing so; and (2) OCI bore, and failed to meet, the fictitious burden of showing that the targeted Segregated Account rehabilitation structure was more favorable to the affected policyholders than a liquidation. (Consol. Br. at 42-46, 63-74.)

1. OCI has the authority to pursue a targeted rehabilitation proceeding

a. Wisconsin law permits the rehabilitation of “any part” of an insurer’s business

Wisconsin law expressly permits OCI to pursue a targeted rehabilitation of portions of an insurer’s business, rather than the whole. In a provision unique to Wisconsin insurance law, an insurer may establish (with OCI’s approval) a segregated account for “any part of its business,” and that segregated account is “deemed a separate insurer” for the purposes of a Chapter 645 rehabilitation. WIS. STAT. § 611.24(2), (3)(e). OCI has previously utilized Wisconsin’s segregated account statute to tailor delinquency proceedings to the specific circumstances of the case. (R.556:22 (¶ 61), JA.124.)

Appellants claim that OCI’s employment of that mechanism here results in different treatment among policyholders of the two accounts—Segregated Account policyholders are subject to deferred payments under the Plan while General Account policyholders are not—and they contend that this inequality violates Chapter 645. In essence, Appellants read Section 645.01(4)’s statement that delinquency proceedings are intended to promote the “*equitable* apportionment of any unavoidable loss,” to mean that OCI is bound

to pursue *equal* apportionment at any cost, even if it would cause large avoidable losses that leave all policyholders worse off than they otherwise would have been under the Plan. (Consol. Br. at 47.)

As the rehabilitation court noted, Appellants' interpretation "ignore[s] or alter[s] the plain language of Wis. Stat. § 645.01(4)[.]" (R.556:45-46 (¶ 133(d)), JA.147.) "Equal" and "equitable" are not synonyms, and Wisconsin law does not treat them as such. *See, e.g.,* WIS. STAT. § 767.61 (marital property distributed "equally" unless "equitable" considerations warrant different result); *Kind v. Vilas County*, 56 Wis. 2d 269, 275, 201 N.W.2d 881, 884 (1972) (land rights statute requires apportionment "on an equitable, but not necessarily equal basis"). To read "equitable" as necessarily "equal" distorts the express purpose of the legislature in enacting Chapter 645, contrary to established principles of statutory interpretation.

The difference in treatment here is equitable because it maximizes the recovery for *all* policyholders in both accounts by avoiding enormous financial losses that would have been triggered by a broader delinquency proceeding. (R.556:22 (¶¶ 60, 63), JA.124.) Moreover, OCI's Plan allows it to retain the flexibility to "take additional regulatory action if policies or other potential liabilities of the General Account threaten the fair and equitable

treatment of Segregated Account policyholders under the Plan.”
(R.556:28-29 (¶¶ 83-84), JA. 130-31.)

Appellants offer no legitimate basis to overturn the rehabilitation court’s determination that OCI was “acting in what would be the best interest of policyholders, doing what is fair for them” in pursuing a targeted rehabilitation that avoids unnecessary harm. (R.564 at 50:12-14.)

b. Other precedent supports OCI’s targeted rehabilitation

Carpenter v. Pacific Mutual Life Insurance Co., 74 P.2d 761 (Cal. 1937) (en banc), *aff’d sub nom. Neblett v. Carpenter*, 305 U.S. 297 (1938) (collectively, “*Carpenter*”)—Appellants’ principal case authority—specially authorizes the use of targeted delinquency proceedings to avoid greater harm, even when they result in differences in treatment among policyholders.

(i) The analogous background of *Carpenter*

Pacific Mutual was a financially hazardous California insurer. 74 P.2d at 775-76. The California Commissioner found that, while Pacific’s core business was generally sound, a discrete subset of policies was “draining the old company to disaster.” *Id.* at 767, 776, 778.

The court noted that applying a one-size-fits-all approach to the entire company, or implementing a more severe form of delinquency proceeding, carried the risk of significant collateral damage. Altering the coverage under the majority of policies that did not threaten financial harm risked impairing Pacific’s “valuable intangible assets” worth “several millions of dollars.” *Id.* at 772, 776. Such action also may have risked an overall reduction in claims-paying resources due to other potential consequences. *Id.* at 778-79.

Here, like the Commissioner in *Carpenter*, OCI examined Ambac’s business and identified a minority of policies (approximately 1,000 of the 15,000 in-force policies) that posed material risks to Ambac’s financial condition. (R.556:23 (¶¶ 64-65), JA.125.) Also as in *Carpenter*, OCI concluded that an overbroad or overly severe delinquency proceeding risked causing numerous adverse consequences and collateral damage. (R.556:18-21 (¶¶ 49-59), JA.120-23.)

(ii) The analogous structure of the delinquency proceeding in *Carpenter*

In *Carpenter*, rather than liquidating Pacific, or rehabilitating all policies, the Commissioner divided Pacific into two parts. 74 P.2d at 772. One part—the “new company”—was to receive

“substantially all” of the assets of the insurer. *Id.* at 768. Through a reinsurance agreement, the new company would provide continuing coverage for healthy policies on the same terms as before, and coverage for hazardous policies at the same premium rates but with “a reduced benefit schedule,” with the possibility of restoring these reduced benefits over time depending on the financial condition of the new company. *Id.* at 768, 770-71. After its formation, the new company was not subject to a delinquency proceeding.

The second part—the “old company”—was to be liquidated; the policies of parties who “dissented” from joining the new company were terminated and those policyholders were required to present their damage claims in the liquidation proceeding. *Id.* at 771. While the old company lacked assets except its ownership interest in the new company and an agreement by the new company to provide certain payments on claims, its policyholders received protection by virtue of the Commissioner’s retention of interests in the new company. *Id.*

Similarly, OCI effected a two-part division of policies (the healthy and the hazardous) among two parts of Ambac: the General Account, which is outside delinquency proceedings (but subject to OCI’s regulatory control); and the Segregated Account, which is subject to this proceeding.

**(iii) The analogous legal challenges
in *Carpenter***

At the plan confirmation hearings in *Carpenter*, “several hundred policyholders appeared,” 74 P.2d at 770, and raised numerous unsuccessful legal challenges. The court denied challenges to the Commissioner’s decision to opt for a narrow restructuring of only portions of the business rather than delinquency proceedings that would affect all policyholders. *Id.* at 774-76.

Most pertinently, the *Carpenter* court rejected challenges by the holders of hazardous policies who argued that the Commissioner had impermissibly interfered with their private contractual rights:

It is no longer open to question that the business of insurance is affected with a public interest. The state has an important and vital interest in the liquidation or reorganization of such a business. . . . Neither the company nor a policyholder has the inviolate rights that characterize private contracts. The contract of the policyholder is subject to the reasonable exercise of the state’s police power.

Id. at 774-75.

The *Carpenter* court upheld the Commissioner’s distinction between: (a) policyholders who would retain full coverage; and (b) other policyholders who would receive reduced coverage under the plan:

. . . [U]nder the circumstances here existing the difference in treatment was justified. The life policyholders, and the commercial health and accident

policyholders were paying adequate premiums for their insurance and these phases of the old company's business were highly profitable. The non-can policyholders were not paying adequate premiums, and this fact was the primary cause of the difficulties of the old company. The non-can policies were draining the old company to disaster.

Id. at 778.

The court rejected the argument that the reduction in benefits should have been equalized, identifying a number of potential harms that could ensue if benefits under the healthy policies were “reduced so as to be equalized with the [hazardous] policies.” *Id.* at 778-79. In other words, *Carpenter* held that a Commissioner-imposed reorganization plan calling for reductions in benefits to some policyholders but not others, rather than an across-the-board cut to all policyholders, is rational and not “arbitrary or improperly discriminatory,” *id.* at 775, when doing so could prevent avoidable losses.

This was the same basis on which the rehabilitation court upheld OCI's decision to pursue a targeted rehabilitation of the Segregated Account. (*See, e.g.*, R.127:8-14 (¶¶ 19-36), JA.202-08; R.556:9-10, 20-22, 35-36, 47-48, 53, 55-56 (Findings ¶¶ 22, 55-63, 105-09, 134-36, Conclusions ¶¶ 1-2, 11-13), JA.111-12, 122-24, 137-38, 149-50, 155, 157-58.)

- 2. OCI was not required to show that a targeted rehabilitation was more favorable than a liquidation, but, in any event, did so**
 - a. A liquidation analysis was not required**

Carpenter's holding is clear: policies with a distressed insurer are "subject to the reasonable exercise of the state's police power," and "[t]he *only* restriction on the exercise of this power is that the state's action shall be reasonably related to the public interest and shall not be arbitrary or improperly discriminatory." 74 P.2d at 774-75 (emphasis added).

Appellants nevertheless mischaracterize *Carpenter* as *limiting* OCI's discretion to implement a targeted rehabilitation, unless it employs precisely the same structure utilized in *Carpenter*. (See Consol. Br. at 64-65, Deutsche Br. at 11.) According to Appellants, OCI can only avoid that "requirement" if it affirmatively proves "what policyholders would recover if a liquidation occurred" and "quantif[ies] the policyholders' liquidation value as of the effective date of the Plan." (*Id.* at 69-70.)

Neither Wisconsin nor federal law limit OCI's discretion in this way, and the alleged "requirement" urged by Appellants is not part of the *Carpenter* holding.

(i) A liquidation analysis or opt-out is not required under Wisconsin law or rehabilitation practice generally

Under Chapter 645, OCI has the discretion to choose the form of delinquency proceeding “depending on the specific facts of the individual case.” WIS. STAT. ANN. ch. 645, introductory cmt. to subch. III. Appellants ignore this clear legislative guidance. There are no statutory requirements pertaining to either the contents of a plan or any particular burden or showing OCI must satisfy to confirm one.

Only Texas and Utah appear to have adopted requirements along the lines Appellants suggest. *See* TEX. INS. CODE § 443.103(c)(1); UTAH CODE § 31A-27a-303(3)(a). Wisconsin has not joined them; there are no such provisions in Chapter 645. Instead, the Wisconsin legislature has preserved OCI’s broad discretion to decide the specific type of delinquency proceeding to employ in each specific case.

Moreover, in no prior rehabilitation has OCI *ever* been required to provide a financial analysis comparing the projected outcomes under a rehabilitation plan against the outcome of a hypothetical liquidation, nor has it *ever* included a “liquidation value opt-out” provision. (R.556:35 (¶ 105), JA.137.)

OCI's practice in this regard is consistent with that of other state regulators: Commissioners typically explain their reasons for choosing rehabilitation over liquidation, as well as the basis for any disparities in treatment among policyholders and, so long as those explanations are not arbitrary or improperly discriminatory, the plans are approved. *See, e.g., Foster*, 614 A.2d at 1094; *Carpenter*, 74 P.2d at 775-78 (cited in Consol. Br. at 67).

While insurance commissions, in their discretion, *may* choose to employ a "liquidation value opt-out" provision, *see generally Commercial Nat'l Bank in Shreveport v. Super. Ct.*, 17 Cal. Rptr. 2d 884 (Ct. App. 1993) ("*CNB*"), Appellants offer no case holding that the inclusion of a liquidation analysis or opt-out is *mandatory* in an insurer delinquency proceeding. Nor do they identify any case where a court has faulted a rehabilitation plan for not containing a liquidation analysis or opt-out.

Appellants do note that *CNB* "reject[ed a] plan that failed [the] *Carpenter* standard." (Consol. Br. at 67.) But the "*Carpenter* standard" violated in *CNB* is not the "*Carpenter* standard" advocated by Appellants. *CNB* merely held that:

[i]t has not been established that the disparate treatment bears any reasonable relationship to the public interest in rehabilitating the insolvent insurer, or that it is necessary to preserve the rights of all the policyholders. . . . We need not and do not undertake

to evaluate [the provisions of a revised plan], beyond observing again that *any plan that is reasonably related to the public interest and which is not arbitrary or improperly discriminatory should suffice.*

17 Cal. Rptr. 2d at 898 (emphasis added). That highly deferential standard—and not some technical liquidation analysis or opt-out valuation—is all that *Carpenter* requires.

(ii) A liquidation analysis or opt-out is not constitutionally required

It is well-established that a rehabilitation may need to “compromise individual interests in order to avoid greater harm to a broader spectrum of policy holders and the public.” 1 COUCH ON INSURANCE § 5:22. *See also Carpenter*, 74 P.2d at 774-75 (“The contract of the policyholder is subject to the reasonable exercise of the state’s police power.”). *Accord Minor*, 898 S.W.2d at 80; *Foster*, 614 A.2d at 1095. It is also well-established that such compromises necessary to administer the estate of a delinquent company do not constitute “takings” requiring payment of compensation from the State. *See Connolly v. Pension Benefit Guar. Corp.*, 475 U.S. 211, 224 (1986) (no taking where government “has taken nothing for its own use, and only has nullified a contractual provision . . . by imposing an additional obligation that is otherwise within the power of Congress to impose”); *Ky. Cent. Life Ins. Co. v. Stephens*, 897 S.W.2d 583, 589 (Ky. 1995) (rejecting claim that

insurer delinquency proceeding constituted a taking of contractual rights).

According to Appellants, *Carpenter* holds that OCI's exercise of these powers in a rehabilitation is contingent upon providing a detailed liquidation analysis or opt-out. In fact, neither *Carpenter* nor any case citing *Carpenter* has imposed such a requirement.¹² The only *Carpenter* "standard" is the "not arbitrary or improperly discriminatory" standard discussed above.

What the *Carpenter* Court *did* do, however, was unequivocally reject both the factual and legal premises of the Appellants' arguments there. The key paragraph of that decision states:

The petitioners have no constitutional right to a particular form of remedy. They are not entitled, as against their fellows who prefer to come under the plan and accept its benefits, to force, at their own wish or whim, a liquidation which under the findings will not advantage them and may seriously injure those who accept the benefit of the plan.

Carpenter, 305 U.S. at 305 (citing, *inter alia*, *Doty v. Love*, 295 U.S. 64 (1935), which upheld a plan of reorganization involving "the

¹² The only rehabilitation cited by Appellants for this point discusses the rational basis for pursuing rehabilitation over liquidation in generalized terms; it did not require a liquidation analysis or opt-out. See *Foster*, 614 A.2d at 1094, *aff'd* *g* *Grode v. Mut. Fire, Marine & Inland Ins. Co.*, 572 A.2d 798 (Pa. Commw. Ct. 1990).

compromise of liabilities” and no liquidation opt-out provision against constitutional challenges, *id.* at 70, 73-74).

The particular form of rehabilitation plan at issue in *Carpenter* did not set the constitutional floor for all plans, as Appellants contend. The salient point is that the court emphasized that policyholders “have no constitutional right to a particular form of remedy.” *Carpenter*, 305 U.S. at 305.

b. Even if a liquidation analysis were required, OCI provided one

In assessing regulatory options to address Ambac’s financial straits, OCI concluded that liquidation was “sub-optimal” because, among other reasons, it would require the immediate termination of policies for which alternative coverage was unavailable and trip contractual triggers that would create larger claims. (R.556:20-21 (¶¶ 56-57), JA.122-23.)

On November 8, 2010, Appellants argued that OCI was required to provide a more detailed liquidation analysis. (R.414:6-10; R.417:12-13; R.419:3-6; R.429:12-13; R.440:22-24.) Consistent with its practice of disclosing as much information as it feasibly could regarding the Plan (R.556:31 (¶¶ 89-90), JA.133), OCI responded prior to the Plan hearing by providing financial details on

the adverse consequences it previously described. (R.483, JA.578-

86.) The rehabilitation court found that:

This analysis, together with the prior explanations of the risks and likely outcomes of a liquidation of Ambac or the Segregated Account and further explication of those consequences by OCI's witnesses, clearly and convincingly demonstrate that the Plan provides a more favorable outcome for policyholders than the full rehabilitation or liquidation of Ambac

(R.556:35-36 (¶ 106), JA.137.)

The documentary evidence and testimony introduced by OCI gave detailed examples of the billions of dollars of additional claims that might arise from liquidation or a rehabilitation of the entire company. Based on that evidence, the rehabilitation court found:

[The] examples provided by OCI illustrate how a rehabilitation or liquidation of the General Account . . . would substantially add to the overall loss claims without adding any corresponding increase to the claims-paying resources available to satisfy claims of both accounts.

(*Id.* (¶ 109), JA.138.)

Appellants offer no basis for reversing these Findings. At the hearing, Appellants asked OCI's primary witness to change variables and hypothesize different contingencies that could result in higher liquidation recoveries. (Consol. Br. at 72-73.) The witness noted that each of these hypotheses included assumptions that were unwarranted or highly contingent (*see, e.g.*, R.562 at 77:14-79:21,

218:23-219:8), or would affect the rehabilitation and liquidation analyses equally. For example, Appellants assert that the liquidation analysis failed to “include \$1 billion of assets held by Ambac UK, . . . [which] would have increased the amount available to satisfy claims in a liquidation.” (Consol. Br. at 73.) They fail to note that even if that money were available to Ambac—and at present it is not (R.562 at 218:23-219:8)—it also would be available to satisfy claims in a rehabilitation. Such hypotheses do not show that liquidation is even incrementally more favorable, let alone indicate that the rehabilitation court’s Findings were clearly erroneous.

IV. THE ESTABLISHMENT AND STRUCTURE OF THE SEGREGATED ACCOUNT

A. Capitalization

Appellants continue to press the fiction that the Segregated Account has “no assets” and “only liabilities,” and therefore was not adequately capitalized under WIS. STAT. § 611.24(3)(a). (Consol. Br. at 38-46; Deutsche Br. at 25-27; ALL/Lloyds Br. at 14.)

In fact, the Segregated Account and the General Account have *equal access* to the same *common pool* of resources. (R.556:25-26 (¶¶ 71-75), 48-50 (¶¶ 139-42).) As the rehabilitation court explained,

The plan of operation, the secured note and reinsurance agreement . . . [give] the Segregated

Account access to all of the assets of Ambac on par with the general account policyholders unless the payment of Claims would cause Ambac's assets to fall below \$100,000,000.00, which is less than two percent of Ambac's claims paying assets. . . . The OCI has exercised reasonable discretion in requiring the Segregated Account policyholders have access to virtually all of the resources available to pay their claims prior to the allocation of their policies to the Segregated Account.

(R.397:9-10, JA.233-34.)

This is not a situation of a "good account" versus "bad account," as alleged by Appellants. As Judge Crabb found in rejecting the IRS's similar challenges to the Segregated Account:

Although the segregated account is deemed to be a separate insurer for purpose of rehabilitation, it is not actually a separate corporation from Ambac. Indeed, the whole point of the rehabilitation is to rehabilitate Ambac Assurance Corporation. The Commissioner and the presiding judge have made the decision that treating the assets and liabilities as they have is best calculated to lead to a successful rehabilitation. The judge held a five-day hearing on the scope and nature of the proceeding and determined that the relationship between the general account and segregated account is fair and equitable. Thus, the plan to rehabilitate the segregated account *depends in large part on the assets of the general account being protected* by the first-day and supplemental injunctions. Allowing the United States to proceed against Ambac or any of the affiliates and subsidiaries would amount to *pulling out the linchpin that secures the entire enterprise*.

In re Segregated Acct., 2011 WL 956855, at *6 (emphasis added).

OCI has broad discretion to set capital and surplus amounts.

WIS. STAT. ANN. § 611.19 cmt. (1971) ("[M]uch discretion should

be left to the commissioner to set minimum capital and surplus requirements[.]”). “Sub. (3)(a) [of the segregated account statute] requires that a segregated account be equipped with an adequate *share* of the corporation’s capital and surplus.” WIS. STAT. ANN. § 611.24 cmt. (emphasis added). Separate capitalization may be necessary “*if* the account is to be expected to function and survive like a separate corporation.” *Id.* (emphasis added). But “[i]f it carries no risks not assumed by the corporation’s general account”—as is the case here, through the Secured Note and Reinsurance Agreement—“the commissioner may set the required figure at *zero* under § 611.19(1).” *Id.* (emphasis added).

Appellants argue that the Segregated Account could not possibly have been adequately capitalized because it is in rehabilitation. (Consol. Br. at 42.) Appellants ignore WIS. STAT. § 611.24(3)(e), which expressly authorizes OCI to place segregated accounts into Chapter 645 delinquency proceedings. Appellants also ignore the phrase “adequate share of the corporation’s capital and surplus” in the statutory comments. The Segregated Account possesses an “adequate share” of Ambac’s capital and surplus pursuant to the Secured Note and Reinsurance Agreement, which give the Segregated Account on-demand access to essentially all of the assets of the General Account. (R.556:25 (¶ 71-72), JA.127.)

Equally meritless is Appellants' conjecture that obligations of the Secured Note and Reinsurance Agreement to fund Plan payments are illusory because OCI might not enforce them. As OCI's Mr. Peterson made clear in his testimony, these Plan-support obligations are "absolute." (R.562 at 188:21-189:4; R.563 at 106:5-24, 108:3-16.)

B. Allocations

Some Appellants raise objections about the allocation of specific policies or liabilities to the Segregated Account, but OCI had a rational basis for each of the challenged allocations. (R.556:23-24 (¶¶ 64-69), JA.125-26.)

Eaton, which holds only a small minority percentage of the LVM bonds, objects to the allocation of the LVM policy to the Segregated Account. (Br. at 11.) That objection is addressed fully in OCI's November 18, 2010 Consolidated Brief in Nos. 2010-AP-1291 and 2010-AP-2022, at 20-21, 28-30, 63-64, 77-82, which is incorporated here by reference.

Deutsche Bank's objection (Br. at 15-17) that the allocations constituted an unlawful novation also was addressed in OCI's November 18, 2010 Consolidated Brief at 68-71.

ALL/Lloyds' objection (Br. at 10-13) to the allocation of its student loan policy to the Segregated Account also is without merit,

for the reasons stated by the rehabilitation court following the unrefuted testimony of OCI's witness David Barranco. (*See* R.556:24 (¶¶ 67-69), JA.126.)

V. APPELLANTS' PLAN-SPECIFIC CHALLENGES LACK MERIT

Appellants' Plan-specific challenges highlight the reason that OCI, with no personal stake of its own, is vested with broad discretion to decide what regulatory approach is in the best interest of policyholders, creditors and the public as a whole.

Tellingly, each Appellant would prefer a Plan that compromises the interests of *others* rather than their own. (*Compare, e.g.,* BofA/Wilmington Br. at 31, Wells Fargo-RMBS Br. at 31 (trustees arguing that the indemnification and immunities extended to them are “inadequate”) *with* RMBS Funds Supp. Br. at 6-11 (arguing that the same provisions are “unlawfully overbroad” and unduly restrict their ability to sue their trustees).)

No rehabilitation plan—whether for the Segregated Account or Ambac as a whole—could incorporate each of the Appellants' self-serving positions, because the maximum benefit for interested parties as a whole does not necessarily equate to the maximum benefit for *each* particular party.

Appellants complain about various aspects of OCI's Plan, but *none* of them suggests a different structure or different provisions

that would more effectively address the concerns of all policyholders, creditors and the public, as well as the financial and practical reality and management concerns of this proceeding. Their briefs ignore the broader perspectives considered by OCI, and second-guess OCI's discretionary decision-making without evaluating the factors that informed OCI's discretion.

Each of Appellants' self-interested challenges is addressed below.

A. The Plan's Protection Of Long-Term Claimants

Eaton, a holder of LVM bonds with anticipated losses years in the future, and its trustee, Wells Fargo (together, the "LVM Appellants"), argue that OCI abused its discretion by inadequately protecting long-dated claimants like them. (Eaton Br. at 20-26; Wells Fargo-LVM Br. at 4-12.)

Their complaints are unpersuasive. OCI commenced this proceeding to prevent short-dated RMBS claimants from consuming a disproportionate share of Ambac's resources to the disadvantage of long-dated claimants like Eaton. (R.556:16 (¶ 42), 18 (¶ 49) JA.118, 120.) OCI has taken significant steps to provide such protection—implementing a temporary claims-payment moratorium, establishing a Plan with a conservative deferred payment approach to claims, and retaining the discretion to determine when, and to what extent,

surplus notes are paid, depending on Ambac’s financial outlook—
over the objections of short-dated claimants.

With the Plan, OCI sought to balance the competing demands
of the short-dated and long-dated claimants in a way that was fair to
both. The rehabilitation court found that OCI succeeded.

(R.556:51-52 (¶ 148), JA.153-54.)

On appeal, the LVM Appellants argue that the rehabilitation
court erred in failing to adopt their “reserve” proposal, whereby OCI
would reserve \$290 million at the outset on account of the LVM
policy plus additional amounts when it makes distributions under the
Surplus Notes. (Eaton Br. at 23-24.) This proposal is unnecessary
and unworkable. As OCI’s witnesses explained at the hearing, and
as the rehabilitation court found:

The cash-note split percentage was kept low at the
outset to protect against the possibility of Ambac in the
future finding itself unable to pay the cash portion.
The split percentage incorporates a conservative
approach to Ambac’s claims-paying resources and
creates a cushion against worse-than-expected
financial outcomes. For that reason, establishing
reserves for long-term policies, as requested by the
LVM Funds and Wells Fargo LVM, would have been
duplicative of OCI’s already-conservative approach to
claims-paying resources. Even under the worst of the
four scenarios presented by OCI, Ambac would still
have a sufficient cushion above the 25 percent cash
payments with which to pay at least some of the
Surplus Note obligations.

(R.556:34 (¶ 103), JA.136.) (citations omitted).) The LVM Appellants present no basis for overturning this Finding.

The LVM Appellants cite two non-insurer bankruptcy cases where courts made reserves mandatory, without acknowledging that the 75% deferred-payment structure created by the issuance of interest-bearing surplus notes in the Plan is, by its very nature, a cash reserve. Under the Plan, payments on the surplus notes are to be made only when and “so long as it does not expose the Segregated Account to the possibility of being unable to make cash payments in the future.” (R.556:34 (¶ 102), JA.136.) There is no need for an additional “reserve,” which would only give rise to another layer of legal challenges about the proper amounts to be reserved for each policy, which policies should be subject to the reserve, and how reserves should be adjusted over time as loss estimates change.

The Plan’s protections are sufficient. Witnesses testified at length regarding OCI’s ongoing supervision of Ambac’s financial situation and continuing flexibility to take proper action to ensure fair treatment under the Plan if financial conditions change. The Plan also obligates OCI to provide “annual reports [each June] to the Court on the financial condition of the Segregated Account, the administration of the Plan, and the propriety of any adjustments to the cash percentage” of claims payments. (R.556:28-29 (¶¶ 82-84),

43 (¶¶ 131-32), JA.130-31, 145.) The first such annual report was issued June 1, 2011.¹³

B. The Plan’s Adherence To The Priority Structure In Section 645.68

Some Appellants contend that the Plan improperly implements the claim-priority structure set forth in Section 645.68, which they mischaracterize as the “absolute priority rule,” because: (1) General Account claims are paid in full when any arise, whereas Segregated Account policy claims receive deferred payments under the Plan; (2) the Plan does not dictate the priority structure should various future contingencies arise; and (3) claims under reinsurance contracts are treated as contract claims, which are given lower priority than insurance policy loss claims. As described below, Appellants ignore the relevant statutes and make assumptions not supported by the record, the Court’s Order, OCI’s actions in prior delinquency proceedings, or its statements regarding this proceeding.

1. Section 645.68 does not apply to the General Account

For the purposes of Chapter 645, a segregated account is deemed a separate insurer and therefore may be separately subjected to rehabilitation, “without disturbing the other segregated operations

¹³ See n.10, *supra*.

of the corporation.” WIS. STAT. ANN. § 611.24(3)(e) & cmt. Section 645.68 establishes the order of distribution of assets to claimants of the estate of the “insurer” that is subject to delinquency proceedings. Thus, the only relevant inquiry regarding Section 645.68 is whether the Plan treats *Segregated Account claims* in their proper priority, which it does. The payment of claims against the General Account would only be subject to the Section 645.68 priority structure if it too were in rehabilitation or liquidation.

Moreover, even if the Section 645.68 priority structure were somehow applicable to the General Account as well as the Segregated Account, the “absolute priority rule” is not. It is well-established that a plan of rehabilitation may reduce benefits for some policies, but not others, so long as there is a rational basis for doing so. *See Carpenter*, 74 P.2d at 778-79. Such a basis clearly exists here: to reduce benefits paid on General Account policies would result in greater harm to all policyholders in the form of the collateral damage described by OCI’s witnesses (and the rehabilitation court) (R.556:18-20, 47-48 (¶¶ 50-55, 134, 136), JA.120-22, 149-50), while paying Segregated Account claims immediately and in full without the Plan would have threatened the stability of the insurer in the same way that certain policies in

Carpenter threatened to “drain[] the old company to disaster.”

Carpenter, 74 P.2d at 778.

Finally, as a practical matter, Segregated Account policyholders have not been materially prejudiced by the non-applicability of Section 645.68 to the General Account. In determining which policies to allocate to the Segregated Account, OCI went to great lengths to allocate all policies in which material, non-recoverable losses were expected. (R.556:23-24 (¶¶ 64-69), JA.125-26.) As a result, through the confirmation hearing, there were only \$13 million in loss claims among the 14,000 policies in the General Account, compared to around \$900 million in loss claims among the approximately 1,000 policies in the Segregated Account. (R.556:28 (¶ 80), JA.130.)

2. Appellants’ speculation regarding the effect of future events on the priority structure is misguided

OCI remains “conscious of the risks of unfairness to Segregated Account policyholders” if “policy claims and other liabilities of the General Account develop to the point where they would have a material effect on Ambac’s available claims-paying resources”; is continuously monitoring the General Account; and “has retained its authority to take additional regulatory action if policies or other potential liabilities of the General Account threaten

the fair and equitable treatment of Segregated Account policyholders under the Plan, including a rehabilitation of the General Account if necessary.” (R.556:28 (¶¶ 81-83), JA.130.) As noted by the rehabilitation court,

OCI’s witnesses testified at length regarding its commitment to take such actions as necessary to protect policyholders. . . . OCI cannot offer guarantees regarding future financial conditions, but it has assured policyholders and this Court that it is not self-interested and will continue to act in the interests of policyholders and the public generally—as opposed to the interests of AFGI or any individual policyholder, to the extent such interests conflict with those of policyholders as a whole—in taking appropriate steps to protect the fairness of the Plan.

(R.556:29 (¶ 84), JA.131.)

Appellants do not challenge this Finding, but they raise a number of “what-if” scenarios that ignore it, imagining circumstances in which OCI might unfairly harm their interests by allowing the General Account “to plunder assets that would otherwise go to policyholders allocated to the Segregated Account.” (Consol. Br. at 59; *see generally id.* at 56-63.) Each of these arguments rests on the baseless assumption that OCI *will* abuse its responsibilities and act in bad faith if given the chance, and the Plan should therefore predetermine or limit the decisions OCI and the rehabilitation court can make in the future.

Appellants cite no legal support for their assumption, which contradicts the bedrock principle that rehabilitation is “formulated to emphasize flexibility and informality, and the rehabilitator is given broad powers.” WIS. STAT. ANN. § 645.32 cmt. Consistent with those principles, “[t]he Plan is developed to be flexible to address uncertainties over time, including the ability to amend and adjust the Plan with Court approval.” (R.556:43 (¶ 131), JA.145.)

Despite the stated benefits of this flexibility (and the protection of Court approval and ongoing supervision), Appellants object that the Plan: (1) does not dictate what priorities will apply if OCI later determines that a full rehabilitation is appropriate; and (2) does not bar OCI from approving payments to Ambac’s holding company (AFGI). (Consol. Br. at 56-58, 60-63.)

Neither objection is ripe. If OCI subsequently determines that a full rehabilitation of Ambac is in the best interest of policyholders under all the facts and circumstances, Plan amendments for dealing with Ambac as a whole will be developed. However, the present Plan should not be faulted for not including speculative provisions for a different, larger rehabilitation that does not presently exist.

Barring OCI from approving any payment, under any circumstance, to AFGI would be short-sighted. The witnesses

testified that OCI will not approve dividends or other payments to AFGI unless it serves the interest of Segregated Account policyholders. (R.560 at 220:19-23, 221:24-222:11; R.561 at 226:4-20.)

3. The Plan properly treats claims under reinsurance contracts as subordinate to policyholder claims

The rehabilitation court found that the Plan properly “treats claims under reinsurance agreements as general creditor claims, consistent with the established precedent of other jurisdictions . . . and consistent with OCI’s past practices in rehabilitations and liquidations under Chapter 645.” (R.556:32 (¶¶ 94-95), JA.134.)

CAPCO’s argument—that its reinsurance contracts should be treated as “policies” under Section 645.68(3) because “policies” is defined broadly in WIS. STAT. § 600.03(35)—is flawed for the following reasons: (1) the Wisconsin Insurance Code distinguishes between reinsurance contracts and insurance policies; and (2) relevant precedent treats reinsurance contracts as class 5 general creditor claims, not as senior class 3 policyholder claims. Tellingly, CAPCO does not cite a single case from *any* jurisdiction that has held that claims on reinsurance contracts are “policy” claims warranting the same priority as “claims under policies for losses incurred.” *Compare* WIS. STAT. § 645.68(3) and (5).

a. Reinsurance contracts are not insurance “policies” under the Wisconsin Insurance Code

Section 600.01(1)(b)(1) provides that: “unless otherwise expressly provided, chs. 600-646 do not apply to: (1) Reinsurance.” The statutory definitions of “insurance” and “policy” contained in Section 600.03 make no mention of reinsurance. Thus, no reference to an insurance “policy” within the Insurance Code should be interpreted to apply to a reinsurance contract, unless otherwise stated.

Chapter 645 is consistent with this approach in treating insurance and reinsurance differently. The few sections that apply to reinsurance contracts expressly say so. *See* WIS. STAT. § 645.52(3) (“Fraudulent Reinsurance Transactions”); *id.* § 645.58 (“Reinsurer’s Liability; Arbitration Costs”). Where reinsurance is expressly included in the statute, it is always discussed in terms of “reinsurance contracts,” *see id.*, and is not described as a “policy.” As such, the reference to “policies” in the Section 645.68(3) priority

statute has consistently been construed by OCI as limited to insurance policies, and excluding reinsurance contracts.¹⁴

Because reinsurance contracts are not “policies” within the meaning of the Wisconsin Insurance Code, they cannot give rise to “claims under policies” that receive priority treatment under Section 645.68(3). Such claims therefore are treated within the lower class designated for “[a]ll other claims” in § 645.68(5).

b. Precedent supports treating reinsurance contract claims as a lower priority than insurance policy claims

Every other jurisdiction to address the proper priority of reinsurance claims also has held that they receive lower priority than policy claims. *See, e.g., Covington v. Ohio Gen. Ins. Co.*, 789 N.E.2d 213, 216 (Ohio 2003) (reinsurance agreements are not “policies” under state priority statute); *In re Liquidation of Sussex Mut. Ins. Co.*, 694 A.2d 312, 318 (N.J. Super. Ct. App. Div. 1997) (if legislature intended to give reinsurance same priority as insurance, it would have expressly said so); *In re Liquidations of Reserve Ins. Co.*, 524 N.E.2d 538, 540 (Ill. 1988) (same holding,

¹⁴ Wisconsin precedent supports this interpretation. In *Peerless Ins. Co. v. Manson*, 27 Wis. 2d 601, 135 N.W.2d 258 (1965), the Court distinguished insurance from reinsurance in the context of assessments by noting that the statutory chapter at issue included references to “reinsurance” as a distinct concept from more generalized insurance, and therefore, “as far as [the statutory

(footnote continued on following page)

noting that a “reinsurance agreement is different from a policy or contract of direct insurance in both form and substance”); *Neff v. Cherokee Ins. Co.*, 704 S.W.2d 1, 6-7 (Tenn. 1986) (“Since the statutes completely regulate direct policies, but embrace reinsurance merely incidentally, only direct policyholders or their third party beneficiaries are included in Class 3” of the priority statute); *Foremost Life Ins. Co. v. Dep’t of Ins.*, 409 N.E.2d 1092, 1097 (Ind. 1980) (had legislature intended to include reinsurance as a policy claim, it would have expressly said so).

Section 645.68 offers no indication of any intent to make such a significant departure from the claim priority schemes followed across the country. Nor has the legislature ever stepped in to change OCI’s longstanding interpretation of Section 645.68, which classifies reinsurance contract claims as class 5 claims. (R.556:32 (¶ 94), JA.134.)

Because CAPCO’s reinsurance claim is not a policy claim within the meaning of WIS. STAT. § 645.68(3), it necessarily falls within the Section 645.68(5) residual category covering “[a]ll other claims.”

chapter at issue] is concerned, the legislature treated reinsurance differently from insurance.” *Id.* at 607-08.

C. The Plan's Prohibition On Set-Offs

Appellant U.S. Bank contends that the Injunction improperly bars policyholders from setting off their obligation to pay premiums for the continuing coverage they receive under the Plan against their Segregated Account policy claims. (U.S. Bank Br. at 5-6.)

Wisconsin law does not permit this result. Under WIS. STAT. § 645.56(2)(d), “[n]o setoff or counterclaim may be allowed in favor of any person where . . . [t]he obligation of the person is to pay premiums, whether earned or unearned, to the insurer.” *See also In re Liquidation of All-Star Ins. Corp.*, 112 Wis. 2d 329, 336, 332 N.W.2d 828, 831 (Ct. App. 1983) (applying same). Further, Chapter 645 authorizes injunctions against “[a]ny threatened or contemplated action that might lessen the value of the insurer’s assets or prejudice the rights of policyholders [or] creditors.” WIS. STAT. § 645.05(k).

U.S. Bank contends that its contracts incorporate New York law, which allegedly permits set-off in delinquency proceedings. But New York insurer delinquency law does not apply here; this is a Wisconsin delinquency proceeding, and private parties cannot contractually decide for themselves to override Sections 645.56 or 645.05. *See Appleton Papers, Inc. v. Home Indem. Co.*, 2000 WI App 104, ¶ 44, 235 Wis. 2d 39, 612 N.W.2d 760 (“A provision that a contract of insurance shall be governed by the law of a given state is

void where . . . [it] would, if given force, evade statutory provisions declaring a rule of public policy[.]” *Accord Am. Eagle Ins. Co.*, 2005 WI App 177, ¶ 37. Thus, Wisconsin law applies, U.S. Bank’s right to set-off is subject to the broad equitable power of the rehabilitation court to enjoin the exercise of set-off rights in accordance with Chapter 645.

D. The Plan’s Preservation Of Ambac’s Contractual Rights

Appellants challenge Sections 4.04(g) and (h) of the Plan, which preserve Ambac’s preexisting contractual rights to recover insured losses from third parties. Section 4.04(g) gives Ambac the benefit of any “recoveries, reimbursements and other payments” received in connection with policies allocated to the Segregated Account. (R.567:19-20 (§ 4.04(g)), JA.609-10.) Section 4.04(h) maintains Ambac’s subrogation rights, *i.e.*, the right to recover insured losses from third parties. (R.567:20 (§ 4.04(h)), JA.610.) Appellants complain that Ambac should not retain full rights to recoveries and subrogation when policies allocated to the Segregated Account are paid only 25% in cash, with the 75% balance paid with interest-bearing surplus notes.

Appellants’ argument ignores OCI’s sound reasons for keeping “recoveries” in the General Account. Allocating recoveries

directly to the Segregated Account—rather than leaving them subject to the Secured Note in favor of the Segregated Account—risked violating the contractual covenants restricting Ambac’s ability to transfer assets that appear in numerous General Account policies. Breaching those covenants might have triggered additional claims under otherwise healthy General Account policies, creating additional demands on the resources available to pay Segregated Account claims. (R.561 at 156:16-157:14 (asset transfer restrictions); *id.* at 202:9-203:12 (reasons for allocation decisions); R.562 at 62:4-16 (same).) By keeping recoveries in the General Account, OCI avoided these additional potential claims, which would have exceeded the value of any recoveries, thus causing a net loss of resources available to pay Segregated Account policyholders.

Appellants also attack Plan Sections 4.04(g) and (h) as wrongfully “transferring” recoveries from the Segregated Account. (Consol. Br. at 78-81.) That allegation is unfounded because the recoveries in question always resided in Ambac’s General Account and were never allocated to the Segregated Account. The Plan of Operation, which memorialized the initial allocation of assets and liabilities to the Segregated Account, specified that the General Account retained “any recoveries arising from remediation efforts or reimbursement or collection rights with respect to policies allocated

to the Segregated Account,” subject to a security interest. (R.1:Ex. G (§ 2(a)(iv)), JA.309-10.) Thus, WIS. STAT. § 611.24(3)(h), which governs a “transfer” between accounts, is inapplicable. Nor is there a violation of WIS. STAT. § 611.24(3)(b), which requires that assets attributable to a segregated account remain identifiable as such. (*See* Consol. Br. at 79.)

Appellants further argue that allowing Ambac to keep its recoveries violates Wisconsin’s “made whole” doctrine, which they describe as an “inviolable” rule that policyholders must be paid in full in cash before an insurer can exercise subrogation rights. (Consol. Br. at 81-85; *see also* BofA/Wilmington Br. at 15-19; Wells Fargo-RMBS Br. at 15-20; Depfa Br. at 12; Eaton Br. at 14-17.) Tellingly, Appellants fail to mention that this doctrine has never been applied in the rehabilitation context, and also fail to cite the recent Supreme Court decisions clarifying that the “made whole” doctrine does not lend itself to black letter rules, does not always apply, and depends on the equities of each case. *See Fischer v. Steffen*, 2011 WI 34, ¶ 34, -- Wis. 2d --, 797 N.W.2d 501 (the made whole doctrine does not lend itself to “the application of black-letter rules”); *Muller v. Soc’y Ins.*, 2008 WI 50, ¶ 60, 309 Wis. 2d 410, 750 N.W.2d 1 (“[T]he made whole doctrine is not applicable in all situations, and thus the test of ‘wholeness’ stated in *Rimes* is not the sole criterion for

determining whether an insurer may pursue its subrogation interest.”); *Paulson v. Allstate Ins. Co.*, 2003 WI 99, ¶17, 263 Wis. 2d 520, 665 N.W.2d 744 (application of the made whole doctrine “depends heavily upon the facts presented”).

Here, Ambac’s exercise of subrogation rights would benefit all policyholders equitably by maximizing claims-paying resources. (R.556:41-42 (¶¶ 124-27), JA.143-44.) Appellants’ contention that their contract rights may not be modified in an insurer delinquency proceeding ignores settled law. *See, e.g., Am. Eagle Ins. Co.*, 2005 WI App 177, ¶ 37; *Carpenter*, 74 P.2d at 774-75. *See also* WIS. STAT. § 645.05(1).

Appellants’ professed concerns are more theoretical than real because they fail to identify a single policy for which Ambac will recover more from third parties than Ambac will pay to policyholders *in cash*. The reason for this is simple: despite protestations that these Plan provisions might “drain the Trusts of cash” (Wells Fargo-RMBS at 15), there are very few insured trusts holding available cash. (R.556:41 (¶ 126), JA.143-44.) Even if there is excess cash in the future, Ambac may never recoup the approximately \$2 billion that it already paid on RMBS policies before rehabilitation commenced, much less the hundreds of millions

it will pay in cash shortly after the Plan becomes effective. (R.563 at 111:24-112:13.)

At the confirmation hearing, Appellants failed to rebut these facts. On appeal, they cite irrelevant authority. For example, Eaton argues that OCI cannot assert claims of individual policyholders, but Sections 4.04(g) and (h) of the Plan concern claims that policyholders had already agreed to assign to their insurer. Depfa labels these Plan provisions “confiscatory,” but cites cases concerning governmental price controls. Eaton and Wells Fargo-RMBS cite to a federal bankruptcy case that arose in wholly different circumstances.¹⁵

Finally, OCI acknowledges the theoretical possibility that Plan Sections 4.04(g) and (h) might cause an unfair result in isolated future situations. In those unlikely circumstances, OCI has invited policyholders to seek an alternative resolution pursuant to Section 3.06 of the Plan. Additionally, the rehabilitation court retains jurisdiction pursuant to Section 6.01 to modify the Plan or to correct defects. (R.567:24-25, JA.614-15.) Given the availability of these safeguards to address the remote possibility of a policy for which

¹⁵ *Nw. Mut. Life Ins. Co. v. Delta Air Lines, Inc. (In re Delta Air Lines, Inc.)*, 608 F.3d 139 (2d Cir. 2010), involved tax-driven leveraged aircraft leases, which bear little resemblance to insurance relationships.

Ambac actually recovers more than it pays, there is no reason to revise Section 4.04(g) and (h), which benefit policyholders as a whole. Thus, the rehabilitation court correctly found:

In light of the context of the broader Plan, the minority of deals for which recoveries might be frequent and obtainable, and the complexity of fashioning individualized, fair solutions for the many unique deals and deal structures, the recovery provisions are fair and equitable to policyholders as a whole.

(R.556:41-42 (¶ 126), JA.143-44.)

E. The Plan’s Treatment Of Ambac’s Control Rights

Two trustee banks complain that the Plan allows Ambac to retain “control rights,” *i.e.*, Ambac’s contractual rights to exercise remedies on behalf of insured securities, including liquidating collateral, inspecting records and changing servicers. (*See* BofA/Wilmington Br. at 25-27; U.S. Bank Br. at 6-7.) Without supporting legal authority, these banks argue that these valuable “control rights” should be forfeited when an insurer is rehabilitated.

This argument is antithetical to WIS. STAT. § 645.01(4), which explains that the purpose of Chapter 645 is to protect the interests of insureds and others “with minimum interference with the normal prerogatives of proprietors.” Stripping Ambac of its control rights simply because the Segregated Account is in rehabilitation

would interfere with its normal prerogatives as a proprietor, *i.e.*, to exercise control rights.

Additionally, removing Ambac's control rights would harm the interests of "insureds, creditors and the public generally" with no countervailing benefit. As witnesses Cathleen Matanle and Roger Peterson explained, removing control rights would forfeit valuable policyholder benefits, and would result in a less effective exercise of certain other benefits. (R.278 at 5-6 (¶¶ 11-14); R.286:2-5 (¶¶ 3-10).) Shifting control rights to trustee banks would carry the risk, in individual cases, of the premature liquidation of collateral at fire-sale prices, which could provide a quick profit to certain speculators purchasing insured bonds at a steep discount, but would harm Ambac and policyholders as a whole. (R.286:4-5 (¶ 10).) The trustee banks failed either to impeach OCI's witnesses or to offer evidence of their own that would suggest that removing Ambac's control rights would provide *any* benefit to policyholders. Thus, Appellants fall far short of demonstrating that the Rehabilitation Court clearly erred in finding that:

The Rehabilitator's ability to carry out his statutory duties, to manage the business of the insurer, to protect the insured's interests as well as the interests of the creditors and the public with minimum interference with the normal prerogatives of proprietors (Wis. Stats. Sec. 645.01(4), 645.33(2)), would be severely damaged if Paragraphs 6 and 9 were amended to

prevent the retention of control rights in the Rehabilitator.

(R.397:10-11, JA.234-35.)

F. The Plan’s Immunity and Indemnification Provisions

The Plan includes four sections establishing immunity and/or indemnification protections for certain parties connected with the Plan, which are necessary for the management and administration of the rehabilitation proceeding:

Sections 8.01, 9.01 and 9.02 preclude suits against the Segregated Account, Ambac or OCI (and its advisors) pertaining to acts “with respect to the Segregated Account, the Proceeding, this Plan (and the Confirmation Order related thereto), the consummation of this Plan, or the administration of this Plan,” unless the acts constitute intentional fraud or willful misconduct. (JA.616-17, 621-22.)

Section 8.02 precludes suits against trustees (or their agents) for acts or omissions “in respect of [their] compliance with the Plan.” (JA.618-20.)

These provisions protect entities tasked with carrying out the court-approved Plan and are vital to the Plan’s success. OCI cannot implement the Plan without assistance from numerous other entities and individuals (*see, e.g.*, R.556:38-39 (¶¶ 115-16), JA.140-41), and it cannot obtain that cooperation if those individuals face the threat of civil liability for performing services at OCI’s direction. It would be absurd for the rehabilitation court to approve the Plan against numerous legal challenges, only to have the individuals charged with

carrying out the Plan sued in courts across the country by policyholders raising the same challenges. The rehabilitation court so noted in its Findings. (R.556:40 (¶ 123), JA.142.)

Appellants ignore the court’s above-cited Finding and the plain language of the provisions at issue, mischaracterizing them as “needlessly protect[ing] [Ambac’s] insiders, its parent corporation, and other entities not involved in the rehabilitation of the Segregated Account” (Consol. Br. at 85), and “purport[ing] to release claims against all Ambac-related entities for essentially any action whatsoever, other than claims of intentional fraud or willful misconduct.” (Deutsche Br. at 19.) In fact, the provisions do not release anyone from any liability *except for* actions taken in connection with the rehabilitation and Plan, and they permit the rehabilitation court to hear any disputes relating to the Plan. These releases should only matter to Appellants if they are contemplating seeking civil liability in other jurisdictions against individuals for carrying out the Plan—an outcome that Chapter 645 does not permit. *See* WIS. STAT. § 645.04(3) (establishing exclusive jurisdiction of rehabilitation court for “relief preliminary to, incidental to or relating to such [delinquency] proceedings”); WIS. STAT. § 645.08(2) (granting immunity to the Commissioner and his agents for any “act or omission by any of them in the performance of their powers and

duties under this chapter”). *See also In re Segregated Acct.*, 2011 WL 956855, at *5-*9 (discussing broad scope of rehabilitation court’s exclusive jurisdiction).

In sum, these provisions prevent claimants from rendering this proceeding administratively and judicially unmanageable, and making it impossible as a practical matter for OCI to implement the Plan.

G. The Plan Provisions Relating To Trustee Duties

Several of the RMBS-trustee Appellants complain that the Plan may cause them administrative burdens and risk lawsuits against them. (Deutsche Br. at 21-22; BofA/Wilmington Br. at 19-22; 27-33; Wells Fargo-RMBS Br. at 20-23, 27-33.) In doing so, they fail to acknowledge the protections discussed above,¹⁶ which OCI added to the Plan to protect the trustees against claims. The trustees also ignore that OCI remains willing to assist in addressing any specific practical problem imposed by the Plan’s approach and in making the transition as seamless as possible, provided they offer

¹⁶ OCI modified the Plan to add Section 8.02, which protects the trustees from liability to third parties for carrying out the Plan. (R.556, Attach. B.) Although the trustees claim that this indemnification is “inadequate” protection (BofA/Wilmington Br. at 31, Deutsche Br. at 22), they do not specify where any alleged inadequacy exists.

enough specifics to enable OCI to do so. (R.556:37-38 (¶ 114), JA.139-40.)

In response to their concerns regarding administrative burdens, OCI has repeatedly reached out to the trustees to ascertain the nature of any practical problems, possible solutions, and the trustees' expenses in implementing the Plan, and to inform them that OCI is "continuing to be willing to work with the trustees on [their] issues." (R.563 at 118:9-121:7.) Rather than availing themselves of this opportunity to work through potential solutions, the trustees continue to vaguely complain regarding practical problems without offering *any* alternatives or solutions, and without providing quantification of the purported financial burdens or the specifics of overcoming them.

As such, the trustees' arguments ignore the reality of this situation. They complain that the Plan does not call for all claims to be fully paid in cash (Deutsche Br. at 22), complain that the rehabilitation has delayed payments (BofA/Wilmington Br. at 20), and complain that they will have to distribute notes (*id.* at 27-28), yet do not suggest that any of these measures are avoidable in light of the financial, practical and legal context of this rehabilitation, or how *any* plan of rehabilitation could avoid them.

CONCLUSION

For the reasons stated above, the rehabilitation court's January 24, 2011 Plan Confirmation Order, October 26, 2010 Pre-Confirmation Motion Order and October 18, 2010 Scheduling Order should be affirmed.

Dated this 9th day of August, 2011.

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Rehabilitator of the Segregated Account of
Ambac Assurance Corporation*

CERTIFICATION AS TO FORM AND LENGTH OF BRIEF

I certify under WIS. STAT. § 809.19(d) that this brief conforms to the rules contained in WIS. STAT. § 809.19(8)(b) and (c), as modified as to length by this Court's Order dated May 5, 2011 (at page 12). Although not expressly required by § 809.19(8)(c)(1) to be included, the word count below includes the Introduction and Standard of Review sections of this brief. The brief was produced using proportional serif font with minimum printing resolution of 200 dots per inch, 13 point body text and quotes, 11 point for footnotes, leading of minimum 2 points, maximum of 60 characters per full line of body text. Consistent with § 809.19(c), those portions of the brief described in § 809.19(1)(d), (e) and (f), and the Introduction and Standard of Review sections contain 16,057 words.

I further certify that this appeal is not taken from a circuit court order or judgment entered in a judicial review of an administrative decision and no part of the record is required by law to be confidential.

Dated this 9th day of August, 2011.

FOLEY & LARDNER LLP

/s/ Michael B. Van Sicklen

Michael B. Van Sicklen

**CERTIFICATE OF COMPLIANCE
WITH WIS. STAT. § 809.19(12)**

I hereby certify that I have submitted a separate electronic copy of this brief, which complies with the requirements of WIS. STAT. § 809.19(12).

I further certify that the submitted electronic brief is identical in content and format to the printed form of the brief filed as of this date.

A copy of this certificate has been served with the paper copies of this brief filed with the court and served on all opposing parties.

Dated this 9th day of August, 2011.

FOLEY & LARDNER LLP

/s/ Michael B. Van Sicklen

Michael B. Van Sicklen

CERTIFICATE OF SERVICE

I hereby certify that on August 9, 2011, I caused three true and correct copies of the Respondents' Response Brief to be served pursuant to Wis. Stat. § 809.19(8) by first-class mail on the attorneys for the Appellants listed below. All other counsel who have entered an appearance in the underlying rehabilitation proceeding have been served today electronically (via email).

Dated this 9th day of August, 2011.

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/s/ Michael B. Van Sicklen

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