

COURT OF APPEALS OF WISCONSIN  
DISTRICT IV

---

In the Matter of the Rehabilitation of:

Segregated Account of  
Ambac Assurance Corporation,

Appeal No.  
2011AP000561

TED NICKEL and OFFICE OF THE  
COMMISSIONER OF INSURANCE,

Petitioners-Respondents,

AMBAC ASSURANCE,

Interested Party-Respondent,

DEPFA BANK, PLC,

Interested Party-Appellant,

ACCESS TO LOANS FOR LEARNING  
STUDENT LOAN CORPORATION,  
AURELIUS CAPITAL MANAGEMENT  
LP, BANK OF AMERICA, N.A.,  
CUSTOMER ASSET PROTECTION  
COMPANY (“CAPCO”), DEUTSCHE  
BANK NATIONAL TRUST COMPANY,  
DEUTSCHE BANK TRUST COMPANY  
AMERICAS, EATON VANCE,  
FEDERAL HOME LOAN MORTGAGE  
CORPORATION (“Freddie Mac”),  
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TREE INC., KING STREET CAPITAL  
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FARGO BANK, N.A. as Trustee for the  
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TRUST COMPANY, WILMINGTON  
TRUST FSB,

Interested Parties-Co-  
Appellants,

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

---

**APPELLANTS DEUTSCHE BANK NATIONAL  
TRUST COMPANY AND DEUTSCHE BANK TRUST  
COMPANY AMERICAS'S REPLY**

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Dated: September 8, 2011

## TABLE OF CONTENTS

	<b>Page</b>
ARGUMENT .....	1
I.    OCI’s Response Confirms That The Plan Is An Impermissible Liquidation Of The Segregated Account To Bail Out Ambac.....	1
II.   Contrary To OCI’s Assertions, The Trustees Simply Seek The Equitable Treatment To Which They Are Entitled By Law .....	4
III.  OCI Cannot Avoid The Force Of The Trustees’ Novation Argument.....	5
IV.  OCI Cannot Justify The Plan’s Overbroad Immunity Provisions .....	6
V.   OCI Fails To Excuse The Plan’s Unlawful Transfer Of Subrogation Rights .....	6
VI.  OCI Does Not Dispute The Burdens Imposed By The Plan On The Trustees .....	8
CONCLUSION .....	9

## TABLE OF AUTHORITIES

	<b>Page</b>
<b>CASES</b>	
<i>Carpenter v. Pac. Mut. Life Ins. Co.</i> , 74 P.2d 761 (Cal. 1937) .....	2
<i>Ervin v. City of Kenosha</i> , 159 Wis. 2d 464, 464 N.W.2d 654 (1991) .....	5
<i>Foster v. Mut. Fire, Marine &amp; Inland Ins. Co.</i> , 614 A.2d 1086 (Pa. 1992) .....	2
<b>STATUTES</b>	
Wis. Stat. § 601.01 .....	5
Wis. Stat. § 611.24 .....	6
Wis. Stat. § 645.08 .....	6, 8
Wis. Stat. § 645.32 .....	8
Wis. Stat. § 645.68 .....	4
<b>OTHER AUTHORITIES</b>	
COUCH ON INSURANCE § 5:29 (2011) .....	3

OCI's response confirms that the Order approving the Plan should be reversed.<sup>1</sup> The Legislature's statutory framework permits OCI to pursue either rehabilitation or liquidation when faced with a failing insurer like Ambac. Whichever option it chooses, OCI must exercise its discretion within the statutory framework. Instead, OCI has created a hybrid—which it calls a “targeted rehabilitation”—comprised of statutory provisions from each regime that are most favorable to Ambac. That patchwork approach is contrary to Wisconsin law, contravenes fundamental principles of fairness and equity, and should not be permitted to stand.

## **ARGUMENT**

### **I. OCI's Response Confirms That The Plan Is An Impermissible Liquidation Of The Segregated Account To Bail Out Ambac**

OCI does not dispute that Ambac is in a precarious financial position—or that Ambac has already defaulted on the first payments due on the surplus notes. *See* Trustees Br. 14 n.2. OCI's brief even quotes the federal district court's conclusion that “the whole point of the rehabilitation is to

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<sup>1</sup> Deutsche Bank National Trust Company and Deutsche Bank Trust Company Americas, each acting solely in its capacity as trustee for certain residential mortgage-backed securitization trusts (the “Trustees”), join in the reply submitted by U.S. Bank National Association.

rehabilitate Ambac Assurance Corporation.” OCI Br. 55 (citation omitted). But no Wisconsin statute permits a segregated account to be used, as here, to bail out an entire corporation at a time of financial crisis. Indeed, Wisconsin law is to the contrary. *See* Trustees Br. 7.

Unable to muster authority to support its position, OCI attempts—but fails—to distinguish the Trustees’ authorities. In *Carpenter*, unlike here, the entire company had been placed in liquidation—and the policyholders were allowed to opt out. *Carpenter v. Pac. Mut. Life Ins. Co.*, 74 P.2d 761, 770-71 (Cal. 1937) (en banc). *Carpenter*—to which OCI devotes an entire section of its brief—thus permitted the plan there precisely *because* it accorded policyholders the protections denied them here.

OCI insists (at 48-50) that opt out is not required but cannot distinguish caselaw directly to the contrary. *See Foster v. Mut. Fire, Marine & Inland Ins. Co.*, 614 A.2d 1086, 1093-94 (Pa. 1992) (“Under [*Carpenter*], creditors must fare at least as well under a rehabilitation plan as they would under a liquidation”); *Carpenter*, 74 P.2d at 777. The law is clear, and “requires ... that the creditor or policyholder

receive the liquidated value of his contract rights without any unreasonable delay.” COUCH ON INSURANCE § 5:29 (2011).

OCI is left to argue (at 40) that it has done this before. But in that instance, adequate assets were transferred to the segregated account. 11/16/2010 Tr. 157:15–159:18. That is not so here—and OCI does not even attempt to argue otherwise. Instead, OCI insists that the Segregated Account passes muster because it has “*access*” to most of the General Account’s assets. OCI Br. 20 (emphasis added). The statutory standard is “adequacy,” however, *not* “access.”

Given Ambac’s precarious financial situation, OCI’s assurances provide little (if any) comfort. OCI admits it “retain[s] the discretion to determine when, and to what extent, surplus notes are paid.” OCI Br. 59-60, 61. OCI offers no justification for paying Segregated Account policyholders 75 percent in notes but General Account holders 100 percent in cash, or for engaging in the pretense that Segregated Account policyholders are being paid 100 percent in cash. OCI does not dispute that the notes are worth only pennies on the dollar, or that Ambac has already defaulted on the notes. Ambac’s claims of access thus do not



alter the conclusion that the Circuit Court reversibly erred in approving such a woefully undercapitalized plan.

**II. Contrary To OCI's Assertions, The Trustees Simply Seek The Equitable Treatment To Which They Are Entitled By Law**

OCI argues that the Trustees seek “equal” treatment, while the law provides only for “equitable” treatment. OCI Br. 41. But OCI’s semantic quibbles cannot change that the Plan does not accord Segregated Account policyholders the equitable treatment to which they are entitled by law.

Wisconsin law requires that “[n]o subclasses shall be established within any class.” Wis. Stat. § 645.68. OCI does not dispute that the Segregated Account policies are in the same line of business as General Account policies—or that segregated accounts may only be used to segregate different lines of business. Trustees Br. 6, 22.

The Plan, however, unlawfully assigns some policyholders to the Segregated Account, while others in the same class—or business line—remain in the General Account. Moreover, Segregated Account policyholders do not have the option to receive liquidation value of their claims, but will be paid 75 percent in notes of dubious

value—while General Account policyholders are paid 100 percent in cash.

OCI's sole excuse for treating Segregated Account policyholders inequitably is that otherwise "collateral damage" would occur. OCI Br. 63. But OCI has never provided an actual example of that undefined term or any tangible explanation of what it means.

### **III. OCI Cannot Avoid The Force Of The Trustees' Novation Argument**

OCI does not address the Trustees' novation argument except to refer the Court to briefing in a related appeal. OCI Br. 57. Nothing in that briefing refutes the Trustees' argument that the Plan's forced transfer of the trust policies to the Segregated Account is an illegal novation.

OCI's primary argument is that Wisconsin Statute § 601.01(7) has superseded the common law on which the Trustees rely. That is not so, because the statute is not inconsistent with the common law. *See Ervin v. City of Kenosha*, 159 Wis. 2d 464, 476, 464 N.W.2d 654 (1991) (legislative intent to change common law must be clearly expressed).

No statute allows Ambac to unilaterally force policyholders to accept a new insurer. Nor does any statute authorize OCI to impose such a novation (particularly for the benefit of an insurer that is not itself in rehabilitation). And there is no merit to OCI's contention that segregated accounts are not separate from the insurer that forms them. *See* Wis. Stat. § 611.24(3)(e) & comments (each segregated account "shall be deemed an insurer" and is "expected to function and survive like a separate corporation").

#### **IV. OCI Cannot Justify The Plan's Overbroad Immunity Provisions**

OCI attempts to justify the Plan's overbroad (and unlawful) immunity provisions by conclusorily asserting that without them, OCI could not obtain the cooperation of other entities and individuals necessary to implement the Plan. OCI Br. 79. That argument fails because it ignores the plain language of the rehabilitation statute, which expressly limits the individuals and entities entitled to immunity. *See* Wis. Stat. § 645.08(2).

#### **V. OCI Fails To Excuse The Plan's Unlawful Transfer Of Subrogation Rights**

OCI claims (at 73) that the transfer of Segregated Account policyholders' subrogation rights to Ambac was

necessary to avoid violating contractual covenants in General Account policies. That argument not only betrays that the true purpose of the Plan is to rehabilitate Ambac as a whole, but also confirms that stripping those rights from the Segregated Account policyholders exceeds OCI's mandate.

OCI characterizes these recoveries as “always [having] resided in Ambac’s General Account and ... never [having been] allocated to the Segregated Account.” OCI Br. 73. But that ignores: (i) the Plan’s plain language, which states that a Segregated Account policyholder is “deemed to have *assigned* its rights relating to that payment ... to [Ambac]” (J.A.610, § 4.04(h)); (ii) that subrogation rights always belonged to the Segregated Account policyholders; and (iii) that the creation and funding of the Segregated Account itself was unlawful and void. *See* Trustees Br. 5-11.

Glossing over the inequities—i.e., that as the new “holder” of subrogation rights, Ambac must be paid 100 percent in cash, while the Segregated Account policyholders are forced to accept 75 percent in notes of dubious value—OCI suggests that any inequity is theoretical and may be remedied by the Plan’s alternative resolution scheme or the Circuit Court’s authority to modify the Plan. OCI Br. 75.

Those assurances ring hollow, given that the cash payment ratio may be modified by OCI at any time (J.A.616, § 7.02) and Ambac has already defaulted on its payments.

**VI. OCI Does Not Dispute The Burdens Imposed By The Plan On The Trustees**

OCI does not dispute the administrative burdens that the Plan would impose on the Trustees. Instead, OCI argues that: (i) any burdens are addressed by Section 8.02 of the Plan (which purportedly protects the trustees from third-party liability), and (ii) OCI is willing to address any problems. OCI Br. 81-82.<sup>2</sup>

Those assurances are both insufficient and irrelevant. It is OCI's burden to fashion a Plan that is equitable at the outset. Wis. Stat. § 645.32(1). The Plan does not satisfy that standard. Instead, the Plan permits Ambac to reap the benefits of OCI's "targeted rehabilitation," while placing the burdens on the Trustees.

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<sup>2</sup> Some RMBS policyholders argue that the Trustees do not even come within the scope of Wisconsin Statute § 645.08(2) in the first instance. RMBS Br. 7-8. That is incorrect. As the RMBS policyholders concede, Section 8.02 applies to the Trustees insofar as they are implementing the Plan, thereby making them OCI's "agents" in that regard. As OCI's agents, they unquestionably fall within the statute. Wis. Stat. § 645.08(2).

## CONCLUSION

The Circuit Court's Order should be reversed.

Dated this 8th day of September, 2011.

Respectfully submitted,

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capacity as Trustee, and DEUTSCHE  
BANK TRUST COMPANY  
AMERICAS, solely in its capacity as  
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**FORM AND LENGTH CERTIFICATION**

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I hereby certify that this brief conforms to the rules contained in § 809.19(8)(b) and (c) of the Wisconsin Statutes for a brief produced with a proportional serif font. The length of this brief is 1540 words.

Dated this 8th day of September, 2011.



Respectfully submitted,

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**CERTIFICATION OF COMPLIANCE WITH RULE  
809.19(12)**

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I hereby certify that:

I have submitted an electronic copy of this brief,  
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**CERTIFICATE OF SERVICE**

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