COURT OF APPEALS OF WISCONSIN
DISTRICT IV

In the Matter of the Rehabilitation of:

Segregated Account of Ambac Assurance Corporation:

Appeal No. 2011AP561

TED NICKEL and the OFFICE OF THE COMMISSIONER OF INSURANCE,

Petitioners-Respondents,

AMBAC ASSURANCE,

Interested Party-Respondent,

v.

DEPFA BANK, PLC,

Interested Party-Appellant,

ACCESS TO LOANS FOR LEARNING STUDENT LOAN CORPORATION, AURELIS CAPITAL MANAGEMENT LP, BANK OF AMERICA, N.A., CUSTOMER ASSET PROTECTION COMPANY ("CAPCO"), DEUTSCHE BANK NATIONAL TRUST COMPANY, DEUTSCHE BANK TRUST COMPANY AMERICAS, EATON

VANCE, FEDERAL HOME LOAN MORTGAGE CORPORATION ("FREDDIE MAC"), FEDERAL NATIONAL MORTGAGE ASSOCIATION ("FANNIE MAE"), FIR TREE INC., KING STREET CAPITAL MASTER FUND, LTD., KING STREET CAPITAL, L.P., LLOYDS TSB BANK PLC, MONARCH ALTERNATIVE CAPITAL LP, STONEHILL CAPITAL MANAGEMENT LLC, U.S. BANK NATIONAL ASSOCIATION, WELLS FARGO BANK, N.A., WELLS FARGO BANK, NATIONAL ASSOCIATION AS TRUSTEE FOR THE LVM BONDHOLDERS, WILMINGTON TRUST COMPANY AND WILMINGTON TRUST FSB,

Interested Parties-Co-Appellants,

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

REPLY BRIEF OF WELLS FARGO, N.A. IN ITS CAPACITY AS TRUSTEE AND IN SIMILAR CAPACITIES FOR CERTAIN RMBS TRUSTS AND AS INDENTURE TRUSTEE ON CERTAIN STUDENT LOAN-BACKED SECURITIES TRANSACTIONS AND ON BEHALF OF THE CERTIFICATEHOLDERS AND NOTEHOLDERS FOR SUCH TRUSTS AND TRANSACTIONS

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The undersigned Appellant, the Wells Fargo Trustee,[1] submits this Reply Brief pursuant to WIS. STAT. §809.19 and the Court's Order dated May 3, 2011.

PRELIMINARY STATEMENT

In its Brief ("Resp. Br."), OCI insists that its Plan takes account of certain "broader perspectives considered by OCI" and accuses Appellants of pursuing only selfish personal interests. (*See* Resp. Br. at 58-59.)

Securitization trustees like the Wells Fargo Trustee do not stand to gain anything from a successful result, since they are not the ultimate beneficiaries of the policies. OCI is in no position to suggest that the Wells Fargo Trustee has improperly pursued its own self-interest by pressing for exculpation and indemnification, since OCI ensured that the Plan included sweeping immunity and indemnification

[1] Defined terms are as used in Appellant's Opening Brief.

provisions for itself (*see* R.567:35-36). In pursuing reversal of the erroneously entered Confirmation Order, Appellant seeks protection of contractual rights to which Ambac agreed when it issued the policies and exculpation no greater than that which OCI has given itself.

ARGUMENT

I. The Circuit Court Committed Reversible Error By Not Independently Addressing the Record Evidence

The Circuit Court erred by adopting OCI's proposed order without explaining its decision to reject *all* the proposed findings of fact and conclusions of law submitted by the Appellant and others. (*Compare* R.531 *with* R.556.) Many "findings" contained in the Circuit Court's order consist of conclusory statements, adopted verbatim from OCI's proposed order, with no citation to the Record whatsoever. (*See, e.g.*, ¶¶145,

150.) Because the Circuit Court has failed to articulate the basis for its findings and conclusions, Appellants are under no obligation to prove a negative, *i.e.*, that support for the challenged findings does not exist. *See James River Ins. Co. v. Kemper Casualty Ins. Co.*, 585 F.3d 382, 385 (7th Cir. 2009).

Indeed, many of the Circuit Court's unsupported "findings" are demonstrably incorrect. The Circuit Court characterized the Plan's burdens on trustees as "*de minimis*" (¶114), without explaining the basis for that conclusion or considering any of the evidence filed by the Wells Fargo Trustee that identifies the burdens. (R.459:5-7.)[2]

The Circuit Court also asserted that the Plan would treat policy claims in accordance with the

priority scheme set forth in WIS. STAT. §645.48 (¶137), but as shown in Point II.B below, claims in the Segregated Account will actually be treated *differently* in a liquidation, depending on the timing of when the claims are submitted/allowed. The Circuit Court conclusorily asserted that the holders of permitted claims will receive Surplus Notes "in complete satisfaction of such claims," ignoring the evidence that in three of four financial scenarios, there will be insufficient funds to pay the principal of the Surplus Notes when they mature in 2020 – or even in 2050 if OCI sees fit unilaterally to extend the maturity date. (R.390:4-79; R.562:67-70.) In short, the Confirmation Order is rife with conclusory assertions that find no factual support in the Record.

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[2] OCI's witness acknowledged on cross-examination that the Plan will impose duties and responsibilities on trustees for which it

II. The Plan Contains Terms that Harm the Interests of Policyholders

A. OCI Refused to Consider Specific Proposals the Wells Fargo Trustee Made

OCI has jealously guarded its authority to oversee the rehabilitation (*see, e.g.,* Resp. Br. at 38-40), so it should not be heard to criticize the Wells Fargo Trustee for having failed to "suggest[ ] a different structure or different provisions." (Resp. Br. at 58-59.) Any intimation that Appellant did not make specific proposals to OCI in an effort to resolve its objections to the Plan is belied by OCI's decision to amend its original proposal to add new exculpation and indemnification terms. (R.566:32-35.) While that language ultimately did not address all trustee concerns, it was undeniably the product of Appellants' efforts to negotiate with OCI. OCI's attempt to paint

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provides no compensation. (R.562:239-242.)

Appellants as having failed to offer reasonable alternatives only adds insult to the injury of OCI's refusal to consider seriously the majority of suggestions made.

B. The Plan Unfairly Discriminates Between Policyholders

Although OCI argues that the Plan can lawfully discriminate as between holders of claims in the General Account and those in the Segregated Account, it entirely fails to address Appellant's showing that the Plan runs afoul of Section 645.68 by discriminating between different holders of claims in the Segregated Account.[3]

[3] OCI's insistence that the Segregated Account is a "separate insurer" (Resp. Br. at 62) from Ambac is directly undermined by its argument elsewhere that claims in both accounts will be satisfied from the identical set of assets (*see id.* at 54 (arguing that "the Segregated Account and the General Account have *equal access* to the same *common pool* of resources") (emphasis in original).)

Under the Plan, claims on the Surplus Notes will, in the event of liquidation, be subordinated to pending claims on policies. (*See* R.372:52-53.) This subordination of claims on Surplus Notes, which relate back to earlier policy claims, to current policy claims demonstrates that the Plan discriminates *within* the Segregated Account. (*See* Opening Br. at 23-25.) By OCI's own characterization of the requirements of WIS. STAT. §645.68, the Plan thus unlawfully discriminates between policy claims.

C. The Plan Unfairly Requires Policyholders To Fund Recoveries for Other Policyholders

Sections 4.04(g) and (h) of the Plan permit Ambac to maintain its subrogation rights for full reimbursement, in cash, for claims previously satisfied through a combination of cash and Surplus Notes, even where Ambac's obligation to pay the principal amount

due under the Surplus Notes has not been satisfied. (R.567:23-24.) OCI does not dispute Appellant's characterization of the operation of these terms. Instead, OCI points out that "there are very few insured trusts holding available cash." (Resp. Br. at 75.) The problem arises when Ambac seeks reimbursement in respect of prior policy claims when cash becomes available to the trusts *in the future*. The Plan permits OCI to reimburse itself from such future cash as if it had paid claims in cash, even where it has only paid 25% in cash. When it does so, Ambac is permitted to use the extra 75% cash for any purpose, including paying other policyholders. There has been no authority cited that would permit Ambac effectively to redistribute cash associated with one transaction to another transaction or other purpose.

OCI explicitly acknowledged this problem in Amendment No. 2 to the Disclosure Statement (*see* R.482:4-5), but rather than seeking to amend the Plan to address this inequity, it instead demands that policyholders "seek alternative resolutions," without offering any assurance that they will be made whole. (Resp. Br. at 76.) The Court should reject OCI's suggestion that it be granted unfettered discretion to remedy a problem of its own creation.

D. OCI Ignores That Ambac Explicitly Agreed to Give Up Control Rights

To justify the Plan provisions that purport to grant OCI certain control rights in respect of the transactions it has insured, it relies on WIS. STAT. §645.01(4)'s vague directive that rehabilitation should "protect the interests of insureds, creditors, and the public generally, with minimum interference with the

normal prerogatives of *proprietors*." (*See* Resp. Br. at 77 (emphasis added)). Significantly, the statute does not define "proprietors," but OCI apparently believes it refers to insurers like Ambac. Even if OCI is correct, the quoted language does not support its position, since the insurer's "normal prerogatives" cannot extend beyond the rights it negotiated when it issued the policies. The policies and related agreements specifically provide that in the case of payment default, Ambac can no longer wield direction or control rights. (*See* R.192:2-3.) Nothing in the Wisconsin Statutes permits OCI to restore rights to Ambac that Ambac specifically promised to relinquish.

OCI's argument that trustees will somehow harm the interests of insureds and other investors is nothing more than an after-the-fact attempt to re-trade a deal that was struck when the policies were written.

III. Section 8.02 Is Necessary to Administer the Rehabilitation

Although the Wells Fargo Trustee seeks reversal of the Confirmation Order, if this Court affirms, it should not disturb Section 8.02 of the Plan, which provides for exculpation and indemnification of Appellants and other third parties required to provide services under the Plan. The RMBS investors who have argued that Section 8.02 is too broad fail to consider WIS. STAT. §645.05(1)(k), which gives the Circuit Court broad authority to enter any order necessary for the administration of the rehabilitation. OCI has acknowledged the concern of securitization trustees that certain persons might bring claims against them for their involvement in implementation of the Plan. OCI properly recognized that the exculpation and

indemnification of trustees is "necessary" to administer the rehabilitation. (*See* R.613a:20-21; R.556:56-57.)

The exculpation and indemnification in Section 8.02 are limited only to "[a]ctions taken in compliance with the Plan." (R.567:32.) There is thus no risk that Section 8.02 will absolve trustees from all liability they otherwise might have to certificateholders. It ensures that those affected by the rehabilitation do not effect an "end-run" around the terms of the Plan by seeking to impose liability on third-parties who have been compelled to participate in the Plan's implementation.

CONCLUSION

For the reasons set forth above and in its Opening Brief, the Wells Fargo Trustee respectfully requests that the Court reverse the Confirmation Order.

Dated this 8th day of September, 2011.

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FORM AND LENGTH CERTIFICATION

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 1539 words.

Dated this 8th day of September, 2011.

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CERTIFICATION OF COMPLIANCE WITH RULE 809.19(12)

I hereby certify that:

I have submitted an electronic copy of this brief, excluding appendix, if any, which complies with the requirements of s 809.19(12). I further certify that:

This electronic brief is identical in content and format to 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 8th day of September, 2011.

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