STATE OF WISCONSIN
COURT OF APPEALS
DISTRICT IV

In the Matter of the Rehabilitation of:
Segregated Account of Ambac Assurance Corporation:

Ted Nickel and Office of the Commissioner of Insurance,

Petitioners-Respondents,

Ambac Assurance,

Interested Party-Respondent,

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

2011-AP-1486

Ohio, United States of America, U. S. Bank National Association, Wells Fargo Bank, N.A., Wells Fargo Bank, N.A. as Trustee for LVM Bondholders, Wilmington Trust Company and Wilmington Trust FSB,

Interested Parties,

Assured Guaranty Corp. and Assured Guaranty Re Ltd.

Interested Parties-Appellants.

Appeal from the June 14, 2011, Order of
the Dane County Circuit Court, Case No. 2010-CV-1576,
William D. Johnston, LaFayette County Circuit Court Judge,
Presiding by Judicial Assignment Order

OPENING BRIEF OF APPELLANTS

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TABLE OF CONTENTS

Page

TABLE OF CONTENTS
(continued)

Page

TABLE OF CONTENTS
(continued)

Page

TABLE OF CONTENTS
(continued)

Page

TABLE OF AUTHORITIES

Page

Cases

Statutes

Other Authorities

INTRODUCTION

This appeal arises from contract disputes under reinsurance agreements. A number of the issues concern the effect of an insurance company rehabilitation on contract disputes where the rehabilitator assured the contract parties that their contract rights would not be affected by the rehabilitation.

In 2003 and 2004, Assured Guaranty Re Ltd. and Assured Guaranty Corp. (together, the "Assured Reinsurers") entered into reinsurance contracts (the "Reinsurance Agreements") with Ambac Assurance Corporation ("Ambac") to share the risks under certain of Ambac's insurance policies. In March 2010, Ambac allocated some of those policies to a segregated account (the "Segregated Account"). The Segregated Account – but not Ambac itself – is the subject of the rehabilitation proceeding below brought by the Wisconsin Commissioner of Insurance, Theodore K. Nickel, as court-appointed rehabilitator (the "Rehabilitator"). Ambac did not allocate the Reinsurance Agreements to the Segregated Account.

In March 2011, the Rehabilitator entered into a settlement agreement with holders of some policies allocated to the Segregated Account, under which the Segregated Account paid the holders a combination of cash and "surplus notes" issued by the Segregated Account (the "Surplus Notes"). The Commissioner of Insurance has absolute discretion in determining whether to allow any payments on the Surplus Notes, and it is uncertain whether the Surplus Notes will ever be paid, or if so when.

The Rehabilitator and Ambac contend that the Reinsurance Agreements obligate the Assured Reinsurers to pay Ambac a proportionate share of the cash plus the principal amount of the Surplus Notes. The Assured Reinsurers contend that under the Reinsurance Agreements they are not obligated to pay cash based on the principal amount of the Surplus Notes because those amounts do not reflect losses incurred by Ambac or by the Segregated Account, and losses in those amounts may never be incurred.

The parties further disagree about the proper forum for resolution of these disputes. The Reinsurance Agreements have broad arbitration provisions that require arbitration of disputes subject to a very limited exception that does not

apply here. The Assured Reinsurers served demands for arbitration on Ambac based on these provisions, and then petitioned a New York state court to compel arbitration.

The Rehabilitator and Ambac responded by moving the rehabilitation court for an order that the Assured Reinsurers had violated an injunction against suing the Segregated Account, which had been entered at the outset of the rehabilitation proceeding (the "Injunction"). However, nothing in the express language of the Injunction prohibited any of the Assured Reinsurers' actions. By its terms, and as the Rehabilitator explained to the court in seeking injunctive relief, the Injunction explicitly provides it "does not apply to policies or other contracts which" – like the Reinsurance Agreements – "remain in the Ambac General Account."

The Rehabilitator's own counsel agreed with the Assured Reinsurer's interpretation of the Injunction in 2010, when he confirmed by e-mail that the Injunction "does not apply to enjoin any actions that Assured Guaranty or its affiliates may take under the insurance agreements (including . . . demanding arbitration in accordance with the terms of the agreement)." Moreover, the Rehabilitator had the opportunity

to craft the terms of the precise injunction desired – his proposed language was entered by the Court verbatim.

This appeal also concerns how the Assured Reinsurers' contract dispute with Ambac should be litigated if Ambac is not contractually required to arbitrate. In moving to enforce the Injunction, the Rehabilitator asked the rehabilitation court to adjudicate the entire dispute as part of the motion, without bringing a discrete action. The Assured Reinsurers objected to that forum, not least because the rehabilitation court lacks personal jurisdiction over Assured Guaranty Re Ltd. ("AG Re"), as well as to the truncated process by which the court decided the contract dispute.

Finally, when the rehabilitation court decided the merits of the parties' contract disputes, it erred in deciding that the Reinsurance Agreements require payment of the principle amount of Surplus Notes delivered by the Segregated Account before payment is made on such Surplus Notes. In so deciding, the rehabilitation court improperly rewrote the express terms of the Reinsurance Agreements, with no basis for doing so, and further violated the "follow the fortunes" provisions in those agreements. If this Court concludes that the rehabilitation court acted properly in

deciding the contract disputes, it should still reverse the rehabilitation court on the merits.

STATEMENT OF ISSUES PRESENTED

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

The rehabilitation court declined to address this issue, but did exercise personal jurisdiction over AG Re.

(2) Does the Injunction prohibit the Assured Reinsurers from arbitrating their disputes under their contracts with Ambac, even though these contracts have not been allocated to the Segregated Account?

The rehabilitation court answered yes.

(3) Does the Injunction require the Assured Reinsurers to pay, in cash, their proportionate share of the principal amounts of Surplus Notes paid by the Segregated Account in settlements?

The rehabilitation court answered yes.

(4) Was it proper for the rehabilitation court to decide, on the Rehabilitator's motion, contract disputes between the Assured Reinsurers and Ambac under contracts not allocated to Ambac's Segregated Account?

The rehabilitation court declined to address this issue, but did adjudicate the merits of the Assured Reinsurers' contract dispute with Ambac.

(5) Do the Reinsurance Agreements permit the Assured Reinsurers to demand arbitration of disputes with Ambac arising under those agreements?

The rehabilitation court answered no.

(6) Do the Reinsurance Agreements require the Assured Reinsurers to pay, in cash, their proportionate share of the principal amounts of the Surplus Notes?

The rehabilitation court answered yes.

STATEMENT ON ORAL ARGUMENT AND PUBLICATION

The Assured Reinsurers request oral argument due to the large number of issues and the novelty of some of those issues. Oral argument will aid the Court in its application of law to facts.

The Assured Reinsurers believe the Court's opinion will meet the criteria for publication because it will apply established law to a factual situation significantly different from those presented in other published opinions. *See* Wis. Stat. § (Rule) 809.23(1)(a)2.

STATEMENT OF THE CASE

This case concerns a discrete set of disputes and a discrete order within the Chapter 645 rehabilitation proceeding against Ambac's Segregated Account. On April 18, 2011, the Rehabilitator moved to enforce the Injunction against the Assured Reinsurers. R.617, A-App. 156-57. He sought an order requiring the Assured Reinsurers to refrain from seeking arbitration of their disputes with Ambac, to withdraw a petition to compel Ambac to arbitrate filed in a New York court, and to make certain payments under the Reinsurance Agreements. *Id.* Ambac joined the motion. R.620, A-App. 177-78.

In an order dated June 14, 2011, the rehabilitation court granted the Rehabilitator's motion in full. R.656, A-App. 409-15. The Assured Reinsurers appealed.

FACTS AND PROCEDURAL HISTORY

A. The Assured Reinsurers and the Reinsurance Agreements.

AG Re is a company organized under Bermuda law, with its principal place of business in Bermuda. R.627:2 (¶ 3), A-App. 257. It does not do business in the United States and did not appear in the rehabilitation proceeding before the

Rehabilitator filed a motion against it. *Id*. Assured Guaranty, an affiliate of AG Re, is a Maryland corporation with its principal place of business in New York. *Id.*

In 2003, Assured Guaranty and Ambac entered into a Second Amended and Restated Surplus Share Agreement (the "Surplus Share Agreement"), under which Assured Guaranty agreed to reinsure a portion of certain insurance policies issued by Ambac. R.627:28-57 (Ex. B), A-App. 286-315. In 2004, AG Re and Ambac entered into a Facultative Reinsurance Agreement (the "Facultative Agreement"), under which AG Re agreed to reinsure a portion of certain insurance policies issued by Ambac and an affiliate, Ambac Assurance UK Limited ("Ambac U.K."). R.627:9-27 (Ex. A), A-App. 265-284.

B. The Arbitration Clauses and the Delinquency Exceptions.

In both Reinsurance Agreements, the parties agreed to submit "any dispute or claim" to arbitration. Article 16 of the Surplus Share Agreement provides:

> Except … in the event of the Company being subject to Proceedings, any dispute or claim arising out of this Agreement shall be submitted to arbitration in accordance herewith as a condition precedent to the commencement of any right of action hereunder.

R.627:42, A-App. 300. Article 15 of the Facultative Agreement is virtually identical. R.627:20, A-App. 276.

An exception to the arbitration clauses makes the arbitration clauses ineffective "in the event of the Company being subject to Proceedings." R.627:42 (art. 16), A-App. 300; *see also* R.627:20 (art. 15), A-App. 276 (making the arbitration clauses ineffective "in the event of the Company is subject to Proceedings"). Both agreements define "Proceedings" as "Proceedings . . . against the Company pursuant to Chapter 645 of the Wisconsin Insurance Code." R.627:19 (art. 14), A-App. 275; R.627:42 (art. 15), A-App. 300. "The Company" is defined as Ambac in the Surplus Share Agreement, and as Ambac plus Ambac U.K. in the Facultative Agreement. R.627:9 (intro.), A-App. 265; R.627:28 (intro.) A-App. 286.

C. The Liability Clauses and Insolvency Clauses.

Article 5 of the Facultative Agreement provides that "[t]he interest and liability of the Reinsurer . . . shall follow the fortunes of the Company . . ." and further that "[t]he Reinsurer shall be liable for its proportionate share of the risk associated with each Policy, including all Losses arising

under the Policies . . . ." R.627:14, A-App. 270. Similarly, Article 6 of the Surplus Share Agreement states that "[t]he liability of the Reinsurer . . . shall follow that of the Company . . . ." R.627:37, A-App. 295. Both agreements define "Loss" as "the amount of liability paid or to be paid by the Company . . . .". R.627:12 (art. 4), A-App. 268-69; R.627:34 (art. 5), A-App. 292.

The Reinsurance Agreements contain insolvency clauses, which state in relevant part:

> In the event of the insolvency of the Company or of Proceedings . . . against the Company pursuant to Chapter 645 of the Wisconsin Insurance Code . . . the reinsurance under this Agreement shall be payable to the Company (or its manager) or to its liquidator, receiver or statutory successor, on the basis of the liability of the Company under Policies reinsured without diminution because of the insolvency of or Proceedings against the Company, or because the liquidator, receiver or statutory successor of the Company has failed to pay all or any part of a claim.

R.627:19 (art. 14), A-App. 275; R.627:41-42 (art. 15), A-App. 299-300. Like the delinquency exception to the arbitration clauses, the insolvency clauses are triggered by Chapter 645 proceedings against "the Company," *id.*, which is defined as described above. R.627:9 (intro.), A-App. 265; R.627:28 (intro.) A-App. 286.

D. The Rehabilitation Proceeding.

On or about March 24, 2010, Ambac allocated certain insurance policies it had issued, including some policies reinsured under the Reinsurance Agreements, to the Segregated Account. R.1:5, A-App. 5. The Rehabilitator then placed the Segregated Account into rehabilitation under Chapter 645. R.1:7-8, A-App. 7-8. Neither Reinsurance Agreement has been allocated to the Segregated Account; they remain in the General Account of Ambac. R. 627:3 (¶ 8), A-App. 258.

Throughout the proceeding below, Ambac and the Rehabilitator repeatedly have stressed that this is a rehabilitation of the Segregated Account, and is *not* a rehabilitation of Ambac. The Rehabilitator's Disclosure Statement Accompanying Plan of Rehabilitation, filed on October 8, 2010, broadcast that point, and its importance, on page 1:

> NEITHER [AMBAC] NOR ITS GENERAL ACCOUNT, NOR ANY OF THE POLICIES, CONTRACTS, ASSETS, EQUITY OWNERSHIP INTERESTS AND RIGHTS OR LIABILITIES IN THE GENERAL ACCOUNT, IS IN REHABILITATION AS PART OF THE PROCEEDING OR OTHERWISE.

R.372:13, A-App. 128 (capitalized in original).

When gaining approval of his proposed rehabilitation plan, the Rehabilitator persuaded the court that an important factor in his decision to initiate a delinquency proceeding only against the Segregated Account, and not against Ambac, was the need to avoid the effect of contractual provisions that would be triggered if Ambac were subject to a Chapter 645 proceeding. The rehabilitation court adopted the Rehabilitator's proposed findings that Ambac must not be rehabilitated because "numerous Ambac policies and transaction documents included 'triggers' that could be 'pulled' upon [Ambac] being subject to a rehabilitation or liquidation proceeding," and that rehabilitating only the Segregated Account has allowed the Rehabilitator to avoid "trigger[ing] covenants across almost all policies and caus[ing] other adverse consequences and collateral damages." R.531:23, 26 (¶¶ 52, 60), A-App. 138, 141; R.568:23, 26 (¶¶ 52, 60), A-App. 151, 154.

E. The Injunction.

On March 24, 2010, after a hearing at which the Rehabilitator presented his reasons for seeking injunctive relief, the rehabilitation court entered the Injunction in exactly the form proposed by the Rehabilitator. R.9, A-App. 61-76.

At the outset, the Injunction states that it "pertain[s] to the Segregated Account, [and] policies, contracts, assets and liabilities allocated to the Segregated Account . . ." and that it "*does not apply to policies or other contracts which remain in the Ambac General Account*." R.9:1, A-App. 61 (emphasis added). This limitation is consistent with a provision in the Order for Rehabilitation entered the same day: "[t]his proceeding . . . does not pertain to the policies, contracts, assets, equity ownership interests, and liabilities remaining in Ambac's General Account." R.11:1 (¶ 2), A-App. 77.

In the order appealed from, the rehabilitation court cited paragraphs 1 and 7 of the Injunction. *See* R.656:3-4 (¶¶ 10-14), A-App. 411-12. Paragraph 1 enjoins the commencement of legal proceedings "in respect of the Segregated Account or policies . . . contracts or liabilities allocated to the Segregated Account." R.9:2 (¶ 1), A-App. 62; R.656:3-4 (¶¶ 11-12), A-App. 411-12. Paragraph 7 enjoins the withholding of payments "owed . . . to . . . the Ambac General Account under or in connection with policies . . . allocated to the Segregated Account." R.9:5 (¶ 7), A-App. 65; R.656:4 (¶¶ 13-14), A-App. 412.

F. Discussions with the Rehabilitator.

The Assured Reinsurers' counsel, Debevoise & Plimpton LLP ("Debevoise"), identified provisions of the Injunction it believed were improper and prepared to file objections to it. R.626:2 (¶ 5), A-App. 180. In May and June 2010, Debevoise sought confirmation from counsel for the Rehabilitator, Foley & Lardner LLP ("Foley"), that the Reinsurance Agreements were not allocated to the Segregated Account and the Injunction did not apply to these agreements. R.626:2-3 (¶¶ 6-7), A-App. 180-81.

Foley orally advised Debevoise that the Reinsurance Agreements remained in Ambac's General Account. R.626:2-3 (¶ 6), A-App. 180-81. Foley then confirmed in a June 14, 2010 email that the Injunction did not affect the Assured Reinsurers' rights, including their right to arbitrate disputes, under the Reinsurance Agreements:

> [T]he reinsurance agreements between Ambac Assurance Corporation, as ceding company and affiliates of Assured Guaranty, as reinsurer, have not been allocated to the Segregated Account and therefore are not subject to the rehabilitation proceeding. Accordingly, the temporary injunction does not apply to enjoin any actions that Assured Guaranty or its affiliates may take under the insurance agreements (including . . . demanding arbitration in accordance with the terms of the agreement).

R.626:3-4 & 20 (¶ 9 & Ex. B), A-App. 181-82 & 200.

Relying on the Rehabilitator's interpretation, the Assured Reinsurers did not object to the Injunction. R.627:5-6 (¶ 16), A-App. 260-61; R.651:2 & 4-5 (¶¶ 3 & 10-11), A-App. 346 & 348-49; R.653:6 (¶ 15), A-App. 384-85; R.652:5-6 (¶ 14), A-App. 354-55.

After the Rehabilitator filed a proposed plan of rehabilitation on October 8, 2010, Debevoise sought to confirm it too would not limit the Assured Reinsurers' rights under the Reinsurance Agreements. R.626:4 (¶ 12), A-App. 182. On November 5, 2010, Debevoise and Foley discussed that issue, and in an email that day Debevoise summarized Foley's statement of the Rehabilitator's position:

> [W]e just wanted to confirm your view that the plan of rehabilitation will not alter the contractual provisions of the reinsurance agreements between Ambac Assurance Corporation, as ceding company and affiliates of Assured Guaranty as reinsurer or enjoin any actions that Assured Guaranty or its affiliates may take under such reinsurance agreements (including exercising contractual netting and set-off provisions, or demanding arbitration in accordance with the terms of such reinsurance agreements).

R.626:4-5 & 35 (¶ 14 & Ex. C), A-App. 182-83 & 216. The next day, Foley confirmed in an email that the Assured Reinsurers retained their contractual rights to arbitrate. Foley "[g]enerally . . . agree[d] with [the Debevoise] summary" and

acknowledged that "general disagreements will remain subject to arbitration (consistent with the contract)." R.626:5 & 54 (¶ 15 & Ex. D), A-App. 183 & 236. Relying on Foley's statements, the Assured Reinsurers did not object to the Plan. R.627:5-6 (¶ 16), A-App. 260-61.

Foley's e-mail added to its general endorsement of the Debevoise summary a "caveat" about potential disputes over "underlying policy liabilities" for polices allocated to the Segregated Account. It explained that if the Assured Reinsurers wanted to step into Ambac's shoes and contest claims under the underlying insurance policies, they would have to do so in the rehabilitation court: "[t]he additional rights your client has under the insolvency clause (right to notice and to interpose a defense) necessarily must be exercised in the rehabilitation court, as this is where the underlying policy liability is located." R.626:5 & 54 (¶ 16 & Ex. D), A-App. 183 & 236.

Under the Plan of Rehabilitation (which is not yet effective, almost 8 months after confirmation by the rehabilitation court), holders of policies allocated to the Segregated Account are to receive 25% of their permitted claim amounts in cash and 75% in Surplus Notes. R.372:38

(§ V.B.2), A-App. 131. The Commissioner of Insurance has "absolute discretion in determining whether to allow payments to be made on the Surplus Notes." R.372:51 (§ VI.C), A-App. 134.

G. The Contract Disputes.

The Segregated Account entered into a commutation agreement, or settlement, with the holder of a policy reinsured under one of the Reinsurance Agreements, and it expects to enter into additional commutation agreements of this kind. Under these agreements, a combination of cash and Surplus Notes is delivered to the policyholders in satisfaction, not of claims brought against the Segregated Account in the rehabilitation proceeding, but of underlying insurance obligations, and the policy is terminated. R.627:6 (¶ 18), A-App. 261; R.618:7, A-App. 164.

Ambac demanded that the Assured Reinsurers pay, in cash, their reinsured portions not only of the cash payment but also of the principal amount of Surplus Notes delivered. R.627:6 (¶ 19), A-App. 261. The Assured Reinsurers paid their shares of the cash payment, but asserted that the Reinsurance Agreements do not obligate them to pay cash to Ambac based on delivery of the Surplus Notes' principal

unless and until those notes are actually paid. R.627:7 (¶ 22), A-App. 262.

H. The Arbitration Demands and Litigation in the Rehabilitation Court.

On April 7, 2011, the Assured Reinsurers demanded that Ambac arbitrate this dispute pursuant to the Reinsurance Agreements' arbitration clauses. R.627:8 (¶ 25), A-App. 263. On April 8, they filed a petition to compel arbitration in a New York court. R.627:8 (¶ 26), A-App. 263. On April 18, the Rehabilitator moved the rehabilitation court for an order requiring the Assured Reinsurers to refrain from arbitrating disputes with Ambac, to withdraw their petition to compel arbitration, and to pay in cash their shares of the Surplus Notes' principal amounts. R.617, A-App. 156-57. The Rehabilitator did not serve a summons or complaint before filing the motion. The Rehabilitator also did not support his motion with affidavits from the Foley lawyers who spoke and corresponded with the Assured Reinsurers' counsel about the Injunction and the Plan of Rehabilitation. *See* R.617-619; R.637-639A; R.646-647 (the Rehabilitator's motion and all supporting papers).

On June 14, 2011, the rehabilitation court entered an order granting all relief sought by the Rehabilitator. R.656, A-App. 409-15. The court adopted, verbatim, the Rehabilitator's proposed order. *Compare* R.656, A-App. 409-15 *with* R.673, A-App. 517-22; *see also* R.672, A-App. 516 (enclosing proposed order).

STANDARD OF REVIEW

All issues raised in this appeal are questions of law subject to *de novo* review. *See Capitol Fixture & Woodworking Group v. Woodma Distrib.*, 147 Wis. 2d 157, 160, 432 N.W.2d 647 (Ct. App. 1988) (personal jurisdiction); *Park Manor Ltd.v. Wis. Dep't of Heath & Family Servs.*, 2007 WI App 176, ¶ 13, 304 Wis. 2d 512, 737 N.W.2d 88 (interpretation of court order); *Milas v. Labor Ass'n of Wisconsin, Inc.*, 214 Wis. 2d 1, 8, 571 N.W.2d 656 (1997) (equitable estoppel); *Klemm v. Am. Transmission Co.*, 2011 WI 37, ¶ 17, 333 Wis. 2d 580, 798 N.W.2d 223 (statutory interpretation); *Xerox Corp. v. Wis. Dep't of Revenue*, 2009 WI App 113, ¶ 12, 321 Wis. 2d 181, 772 N.W.2d 677 (due process); *Johnson v. Heritage Mut. Ins. Co.*, 188 Wis. 2d 261, 265, 524 N.W.2d 900 (Ct. App. 1994) (contract interpretation).

ARGUMENT

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

Where a court does not have personal jurisdiction, its rulings "[do] not bind [an out-of-state person] personally, regardless of how familiar he may have been with the proceedings in the case." *Harley-Davidson, Inc. v. Selectra Int'l Designs, Ltd.*, 861 F. Supp. 754, 755 (E.D. Wis. 1994). Absent waiver or consent, a court lacks personal jurisdiction over a nonresident unless the nonresident is "subject . . . to jurisdiction under a Wisconsin long arm statute." *In re All-Star Ins. Corp.*, 110 Wis. 2d 72, 76, 327 N.W.2d 648 (1983). In arguing the rehabilitation court's jurisdiction over AG Re, the Rehabilitator relied primarily on Wis. Stat. § 645.04(5), which applies in Chapter 645 proceedings, and secondarily on § 801.05(10), the insurance-focused subsection of the general long arm statute. Neither statute confers jurisdiction over AG Re.

Both statutes impose two basic requirements: (1) the nonresident must be served pursuant to Wis. Stat. § 801.11, *see* Wis. Stat. §§ 645.04(5), 801.05(intro.); and (2) there must be a substantive basis for jurisdiction. Wis. Stat. §§

645.04(5)(a)-(c), 801.05(10). The plaintiff or petitioner shoulders the burden of showing these requirements are met. *FL Hunts, LLC v. Wheeler*, 2010 WI App 10, ¶ 7, 322 Wis. 2d 738, 780 N.W.2d 529. The Rehabilitator did not serve AG Re according to § 801.11 or demonstrate a substantive ground for jurisdiction under either statute.

Moreover, the rehabilitation court's exercise of jurisdiction over AG Re was not consistent with the Due Process Clause of the Fourteenth Amendment to the United States Constitution. *See All-Star Ins. Corp.*, 110 Wis. 2d at 76; *Kopke v. A. Hartrodt S.R.L.*, 2001 WI 99, ¶ 22, 245 Wis. 2d 396, 629 N.W.2d 662. Due process did not permit jurisdiction here because AG Re did not purposefully avail itself of the privilege of conducting activities in Wisconsin.

The rehabilitation court made no findings to support its exercise of personal jurisdiction. *See generally* R.656, A-App. 409-15.

A. The Rehabilitation Court Lacked Jurisdiction Over AG Re Because the Rehabilitator Failed to Serve AG Re Pursuant to § 801.11.

Service of an insurer under § 801.11 requires service of a *summons* to initiate an action. *See* Wis. Stat. §§

801.11(5)(a), (d). The summons must be paired with a complaint and must require the defendant to answer the complaint or demand a copy if it has not been served. Wis. Stat. § 801.09(2).

At the outset of the rehabilitation proceeding, the Rehabilitator acknowledged that if he pursued discrete litigation claims, he would need to "effect service in accordance with Chapter 801." R.4:3 (¶ 4), A-App. 32.[1] However, when asking the rehabilitation court to decide the dispute between Ambac and the Assured Reinsurers in April 2011, the Rehabilitator did not serve a summons or complaint, and he argued service under § 801.11 was "unnecessary" to establish personal jurisdiction over AG Re. R.637:19-21, A-App. 336-38. The Rehabilitator had it right in March 2010: the long arm statutes explicitly require service pursuant to § 801.11. Wis. Stat. § 645.04(5); § 801.05(intro.).

After AG Re raised a jurisdictional objection, the Rehabilitator tried to moot the issue by serving a document

[1] This acknowledgement comported with past practice in delinquency proceedings. *See, e.g.*, *All-Star Insurance Corp.*, 110 Wis. 2d 72, 74, 327 N.W.2d 648 (1983) (liquidator commenced discrete actions against defendants to recover money due under contracts); App. to Appellant's Br. [in *All-Star Ins. Corp.*] at 1-4 and App. of Def.App. Lee M. Scarborough & Co. [in *All-Star Ins. Corp.*] at i & 101-13, found in 4127 *Appendices and Briefs*, 110 Wis. 2d 58-118, at tab 2 (Wis. State Law Library) (appending copies of the summonses and complaints served on the *All-Star Ins. Corp.* defendants).

labeled "summons" on AG Re. *See* R.631, A-App. 316-17. The delivery of this document did not correct the jurisdictional defect. First, there was no service under § 801.11, which required personal service on an officer, director, or managing agent of AG Re; on anyone apparently in charge of the office of such a person; or on AG Re's "agent" as defined in Wis. Stat. § 628.02. *See* Wis. Stat. § 801.11(5)(a), (d) (identifying permissible methods of serving an insurer). The Rehabilitator's process server went to the lobby of a New York City building, where Assured Guaranty has an office but AG Re does not, and delivered the "summons" to an in-house attorney for Assured Guaranty. R.639A:1-2 (¶¶ 2, 5), A-App. 340-41; R.642:1-2 (¶¶ 2, 4-5, 7), A-App. 342-43. That attorney has never worked for AG Re and is not authorized to accept service on behalf of AG Re or its officers or directors. *See* R.642:1-3 (¶¶ 2-4, 7-8), A-App. 342-44; R.639A:1-2 (¶¶ 2, 5), A-App. 340-41.

Second, the purported "summons" was deficient. Because it had no "filing stamp indicating the case number," it was not authenticated under Wis. Stat. § 801.09(4). *See* R.631, A-App. 316-17. An unauthenticated summons does not confer personal jurisdiction "regardless of the presence or

absence of prejudice." *Am. Family Mut. Ins. Co. v. Royal Ins. Co. of Am.*, 167 Wis. 2d 524, 534, 481 N.W.2d 629 (1992). The "summons" also was not paired with a complaint, did not state "the names and addresses of the parties to the action," did not direct AG Re to serve "an answer . . . if a copy of the complaint is served with the summons or a demand for a copy of the complaint," and did not notify that its failure to act timely could result in a default judgment. *See* R.631, A-App. 316-17.

B. The Rehabilitator Did Not Establish a Substantive Basis for Long Arm Jurisdiction.

The Rehabilitator also failed to meet its burden of showing a substantive basis for personal jurisdiction over AG Re under either of the long arm provisions relied upon. The rehabilitation court was silent on this issue. *See generally* R.656, A-App. 409-15.

1. Section 654.04(5) could apply only if AG Re had "written a policy of reinsurance for an insurer against which a rehabilitation or liquidation order [was] in effect when the action [was] commenced." § 654.05(5)(b). AG Re wrote reinsurance for Ambac, but not the Segregated Account, which is a separate insurer for purposes of a

rehabilitation proceeding. *See* § 611.24(3)(e) ("Each segregated account shall be deemed an insurer within the meaning of s. 645.03(1)(f).").

The rehabilitation order for the Segregated Account did not put Ambac or its General Account into rehabilitation. R.11:1 (¶ 2), A-App. 77. A"*liquidation* order under s. 645.42 for the general account or for any segregated account shall have effect as a rehabilitation order under s. 645.32 for all other accounts of the corporation." § 611.24(3)(e) (emphasis added). However, nothing provides that a *rehabilitation* order has any similar spillover effect, and the Rehabilitator has been emphatic that there is no such effect. *See, e.g.*, R.531:24-25 (¶¶ 55, 59), A-App. 139-40 (Commissioner of Insurance could commence a limited rehabilitation of just the Segregated Account but "could not have liquidated just the Segregated Account, as that action would have automatically triggered the rehabilitation or liquidation of the General Account under Wis. Stat. § 611.4(3)(e)."); R.372:13, A-App. 128 ("NEITHER [AMBAC] NOR ITS GENERAL ACCOUNT, NOR ANY OF THE POLICIES, CONTRACTS, ASSETS, EQUITY OWNERSHIP INTERESTS AND RIGHTS OR LIABILITIES IN THE GENERAL

ACCOUNT, IS IN REHABILITATION AS PART OF THE PROCEEDING OR OTHERWISE.") (capitalized as in original).

2. Section 801.05(10) is applicable only in an "action which arises out of a promise made anywhere to the plaintiff or some 3rd party by the defendant." This chapter 645 proceeding, however, arises from the Rehabilitator's assertions of the need to rehabilitate the Segregated Account, not from any promise by AG Re.

C. Even If a Long Arm Statute Applied, Due Process Precludes Jurisdiction.

The Due Process Clause permits courts to exercise jurisdiction only over nonresidents with sufficient "minimum contacts" with the forum state, "such that the maintenance of the suit does not offend 'traditional notions of fair play and substantial justice.'" *Kopke*, 2001 WI 99, ¶ 24 (quoting *Int'l Shoe Co. v. Washington*, 326 U.S. 310, 316 (1945)). Minimum contacts exist when a nonresident has "purposefully avail[ed] itself of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its law." *Id.* (quoting *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 475 (1985)). The nonresident must

have taken affirmative action directed at Wisconsin. *Asahi Metal Indus. Co. v. Superior Court*, 480 U.S. 102, 112 (1987).

The party asking the court to exercise personal jurisdiction has the burden of showing sufficient contacts to satisfy this requirement. *Kopke*, 2001 WI 99, ¶¶ 22-23 & n.7. The Rehabilitator did not, and cannot, show affirmative actions by which AG Re purposefully availed itself of the privilege of conducting activities in Wisconsin, invoking the benefits and protections of its laws. *See id.* AG Re does not do business in Wisconsin, has no office or employees in the state, and has taken no other action to conduct business here. *Id.* at 112-13. The exercise of personal jurisdiction over AG Re does not comply with due process.

This conclusion is consistent with *All-Star Ins. Corp.*, where the Wisconsin Supreme Court held that two non-resident agents were sufficiently "linked to Wisconsin by virtue of their contracts with All-Star *and their actions incident to the contracts*." *All-Star Ins. Corp.*, 110 Wis. 2d at 85 (emphasis added). Those "actions incident to the contracts" included sending insurance applications to All-Star in Wisconsin, making years' worth of telephone calls to

Wisconsin, sending premium payments to Wisconsin, and working with All-Star as it performed the contract entirely in Wisconsin. *Id.* at 83.

AG Re has not directed any comparable actions at Wisconsin. Ambac is based in New York, R.3:1 (¶ 2), A-App. 16, and AG Re's contacts with Ambac have all been with Ambac's New York office. R.627:3 (¶ 6), A-App. 258; *see also* R.627:23 (art. 19), A-App. 279 (AG Re required to send notices to Ambac in New York). The Facultative Agreement provides that it is governed by New York law, further confirming AG Re did not invoke the benefits and protections of Wisconsin law. R.627:24 (art. 22), A-App. 280; *see Burger King*, 471 U.S. at 481-82.

II. The Injunction Does Not Prohibit the Assured Reinsurers from Arbitrating Disputes Over the Reinsurance Agreements.

Without explaining its reasoning, the rehabilitation court concluded that the dispute the Assured Reinsurers sought to arbitrate falls within paragraph 1 of the Injunction as a dispute "in respect of the Segregated Account or policies . . . contracts or liabilities allocated to the Segregated Account." R.9:2 (¶ 1), A-App. 62; R. 656:3-4 (¶¶ 11-12), A-App. 411-12. This conclusion was erroneous because the

parties' dispute concerns the Assured Reinsurers' and Ambac's rights and duties under contracts – the Reinsurance Agreements – that have not been allocated to the Segregated Account. *See* R.627:3 (¶ 8), A-App. 258. The dispute is one in respect of a contract allocated to Ambac's General Account. *See id.* The Assured Reinsurers are not contesting the rights of policyholders under policies allocated to the Segregated Account.

Even if paragraph 1 of the Injunction, standing alone, could reasonably be construed as the rehabilitation court concluded, the court clearly erred. The complete terms of the Injunction, the rule that injunctions are strictly construed, the Rehabilitator's own statements about the Injunction's purpose, and the doctrine of equitable estoppel all preclude the Rehabilitator's expansive interpretation of the Injunction, which the court adopted.

A. The Injunction Does Not Prohibit Proceedings Arising from Contracts Allocated to Ambac's General Account.

At its outset, the Injunction unambiguously clarifies the limits on its scope: it "*does not apply* to policies or other contracts which remain in the Ambac General Account." R.9:1, A-App. 61 (emphasis added). This provision – which

the rehabilitation court did not mention – could not make it more clear that the Injunction does not reach counterparties exercising rights under contracts remaining in Ambac's General Account. Nothing in the Injunction's succeeding 16 pages purports to limit this unqualified pronouncement. *See generally* R.9, A-App 61-76.

The rehabilitation court ruled, *sub silentio*, that paragraph 1 of the Injunction effectively nullifies the Injunction's express exemption for contracts remaining in the Ambac General Account. That interpretation is unreasonable as a matter of law. *See Park*, 2007 WI App 176, ¶ 13 ("We interpret an order in the same way we interpret a contract; that is, we construe the language of the order as it stands, *attempting to give meaning to every provision*." (emphasis added)). As a matter of law, the Injunction does not enjoin a lawsuit or proceeding to resolve disputes between the Assured Reinsurers and Ambac under the Reinsurance Agreements.

B. An Expansive Interpretation of the Injunction Would Violate the Rule that Injunctions Are Strictly Construed.

Wisconsin courts have long held that "an injunction order must … be construed strictly in favor of the person

charged with violating it." *Wisconsin Central Railroad Co. v. Smith*, 52 Wis. 140, 8 N.W. 613, 614 (1881). For good reason, the same rule governs federal court injunctions: "all omissions or ambiguities . . . will be resolved in favor of [the enjoined party]."). 11A Wright & Miller, Federal Practice & Procedure § 2955 (2001). As the United States Supreme Court has explained, this rule recognizes that "basic fairness requires that those enjoined receive explicit notice of precisely what conduct is outlawed." *Schmidt v. Lessard*, 414 U.S. 473, 476 (1974). The rehabilitation court ignored this basic rule.

The Rehabilitator argued below that the rule of strict construction does not apply in this proceeding because Chapter 645 is "liberally construed to effect [its stated purpose]." R.637:5, A-App. 322 (quoting Wis. Stat. § 645.01). But liberally construing the text of Chapter 645 is entirely consistent with strictly construing the text of an *order* entered in a Chapter 645 proceeding. Nothing in Chapter 645 suggests that the time-honored, fairness-based rule of strictly construing injunctions should not apply to injunctions issued in Chapter 645 proceedings.

C. The Rehabilitator's Own Statements Show That the Injunction's Purpose Was Not to Enjoin Proceedings Arising Under Contracts Allocated to the General Account.

The Injunction reflects verbatim the relief sought by the Rehabilitator. When the Rehabilitator sought that relief, he confirmed it would not apply to policies or contracts in Ambac's General Account. *See* R.9:1, A-App. 61. The Rehabilitator told the court "the injunction . . . scrupulously tries to avoid any concern that policyholders in the general account have that we're somehow trying to unfairly enjoin them. It's directed solely at policies and issues which have been allocated to the segregated account . . . .". R.150:18-19 (Tr. 18:19-19:1), A-App. 107-108. He described "a bright line separation between what we're asking [the Court] to do as part of the rehabilitation proceeding as to the [S]egregated [A]ccount, not you know, tainting or affecting or spilling over into the affairs of the general account." R.150:9 (Tr. 9:15-19), A-App. 104. The Rehabilitator's message was clear: the Injunction would *not* cross this "bright line" by affecting the rights of parties to contracts that remained in Ambac's General Account.

In moving for an injunction, the Rehabilitator characterized the provision proscribing lawsuits as a standard first-day injunction "against lawsuits *by Segregated Account policyholders* outside [the rehabilitation] proceeding." R.7:13, A-App. 46 (emphasis added). He explained that the injunctive relief he sought "[fell] into four general categories" (R.7:10, A-App. 43):

- Parties with *policies or contracts allocated to the Segregated Account* might use ipso facto provisions in those contracts or policies to argue that the commencement of the rehabilitation proceeding enabled them to terminate those policies and contracts, or to assert rights under those policies and contracts that would lead to "enormous, inequitably inflated claims" *against the Segregated Account*. R.7:4, A-App. 37; *see also* R.7:11-12, A-App. 44-45.

- Claimants *against the Segregated Account* might seek immediate payment of their claims, undercutting the Rehabilitator's efforts to institute an orderly claims process. R. 7:4-5, 12; A-App. 37-38, 45.

- Holders of *policies and contracts allocated to the Segregated Account* might cease their payments of premiums and other amounts due, effectively enabling them to obtain priority for their claims *against the Segregated Account*. R. 7:5, 12-13, A-App. 38, 45-46.

- The Rehabilitator would be exposed to lawsuits and interference with his task if the "[s]tandard first-day injunctive provisions found in all Wisconsin rehabilitation proceedings," such as "injunctions against *lawsuits by Segregated Account policyholders outside this proceeding*," were not imposed. R. 7:5, 13, A-App. 38, 46.

(emphases added). At the hearing on his motion for injunctive relief, the Rehabilitator repeated this characterization of the relief sought. R.150:21-25 (Tr. 21-25), A-App. 110-14.

The Assured Reinsurers' efforts to arbitrate disputes with Ambac did not remotely implicate any of these concerns. The Assured Reinsurers had no claims against the Segregated Account at that time. They are not holders of policies, or counterparties to contracts, allocated to the Segregated Account. The arbitration the Assured Reinsurers sought was not one of the "lawsuits by Segregated Account policyholders" that the Injunction was intended to thwart. R.7:13, A-App. 46.

Moreover, before these disputes arose, the Rehabilitator's counsel expressly confirmed, orally and in writing, that the Reinsurance Agreements were outside the reach of the Injunction. In June 2010, Foley told the Assured Reinsurers that the Injunction "does not apply to enjoin any actions that Assured Guaranty or its affiliates may take under the [Re]insurance [A]greements (including . . . demanding arbitration in accordance with the terms of the agreement)." R.626:3-4 & 20 (¶ 9 & Ex. B), A-App. 181-82 & 200. In

November 2010, Foley again represented that, with a qualification not relevant here, disagreements about the Reinsurance Agreements would "remain subject to arbitration (consistent with the contract)." R.626: 5 & 54 (¶ 15 & Ex. D), A-App. 183 & 236.

Thus, in June and November, 2010, before it was in his interest to argue that the Injunction prevents the Assured Reinsurers from arbitrating contract disputes with Ambac, the Rehabilitator interpreted the Injunction in exactly the opposite way. The Rehabilitator did not explain this 180 degree change in his position. Nor did the rehabilitation court ask him to.

D. The Rehabilitator is Equitably Estopped from Arguing the Injunction Prohibits Arbitration of These Disputes.

Because the Assured Reinsurers relied on Foley's assurances that their rights against Ambac under the Reinsurance Agreements were not affected by the Injunction or Plan of Rehabilitation, the Rehabilitator is equitably estopped from now arguing the Injunction bars them from arbitrating their disputes with Ambac under those agreements.

Equitable estoppel requires: "(1) action or non-action, (2) on the part of one against whom estoppel is asserted, (3)

which induces reasonable reliance thereon by the other, either in action or non-action, and (4) which is to his or her detriment." *Milas v. Labor Ass'n of Wis., Inc.*, 214 Wis. 2d 1, 11-12, 571 N.W.2d 656 (1997). Each element is present here.

First, the statements by the Rehabilitator's counsel constituted "action" for purposes of equitable estoppel. *See, Washington v. Farmers Ins. Exchange*, 77 Wis. 2d 508, 515-16, N.W.2d 76 (1977)(insurer equitably estopped from denying coverage based on statement to policyholder). Second, the statements were made on behalf of the Rehabilitator. Third, the statements induced the Assured Reinsurers' reasonable reliance in deciding not to object to the Injunction or the Plan of Rehabilitation. R.627:5-6 (¶ 16), A-App. 260-61; R.651:2 & 4-5 (¶¶ 3 & 10-11), A-App. 346 & 348-49; R.653:6 (¶ 15), A-App. 384-85; R.652:5-6 (¶ 14), A-App. 354-55. Fourth, that reliance was to the Assured Reinsurers' detriment because they (or Assured Guaranty, which previously had appeared) could have used those objections to clarify their rights in 2010, preventing the Rehabilitator from taking a different position in 2011, when he had a motive to do so.

The Rehabilitator tried below to distort the "caveat" in Foley's November 2010 email into a statement that all disputes in any way "related to" claims allocated to the Segregated Account would have to be brought before the rehabilitation court. *See* R.618:5-6, A-App. 162-63. That is not what the November email said or what it meant. Rather, Foley "[g]enerally agreed" with the summary by the Assured Reinsurers' counsel of the Rehabilitator's stated position that "the plan of rehabilitation [would] not alter the contractual provisions of the [Reinsurance Agreements] . . . or enjoin any actions that [the Assured Reinsurers] may take under such reinsurance agreements (including . . . demanding arbitration in accordance with the terms of such reinsurance agreements)." R.626:4-5 & 35 (¶ 14 & Ex. C), A-App. 182-83 & 216.

The "caveat" concerned only disputes over "underlying policy liabilit[ies]" for policies allocated to the Segregated Account, and it related to the possibility that the Assured Reinsurers would contest claims by insureds under policies they reinsured. R.626:5 & 54 (¶ 16 & Ex. D), A-App. 183 & 236. The caveat did not relate to any provision in

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

III. The Injunction Does Not Require the Assured Reinsurers to Pay, in Cash, Their Proportionate Share of Settlement Payments Made in Surplus Notes.

The rehabilitation court held that the Assured Reinsurers violated paragraph 7 of the Injunction, which enjoins withholding payments "owed . . . to . . . the Ambac General Account under or in connection with policies . . . allocated to the Segregated Account." R.9:5 (¶ 7), A-App. 65; R.656:4 (¶¶ 13-14), A-App. 412. That expansive reading of paragraph 7 contradicts the Injunction's plain text, is not consistent with the Injunction's stated purpose, and violates the rule that injunctions must be strictly construed.

A. The Rehabilitation Court's Interpretation of the Injunction Is Not Consistent with Its Text.

The rehabilitation court erred in deciding that, for purposes of paragraph 7, the Assured Reinsurers "owe" Ambac a proportionate share of settlement payments made in Surplus Notes. Whether the Assured Reinsurers "owe" such amounts raises a question as to the Assured Reinsurers' and Ambac's rights and obligations under the Reinsurance

Agreements. As explained in parts IV through VI below, these contract disputes were not properly before the rehabilitation court, and the court in any event erred in construing the Reinsurance Agreements.

The rehabilitation court also erred in concluding that any payments the Assured Reinsurers might owe to Ambac would be "under or in connection with policies . . . allocated to the Segregated Account" within the meaning of paragraph 7. Any payments owed to Ambac would be owed under the Reinsurance Agreements, which have not been allocated to the Segregated Account. As explained above, by its terms the Injunction "does not apply to policies or other contracts which remain in the Ambac General Account." R.9:1, A-App. 61. Paragraph 7 of the Injunction cannot reasonably be construed to negate that unequivocal language. *See Park*, 2007 WI App 176, ¶ 13.

B. The Rehabilitation Court's Interpretation Is Not Consistent with the Injunction's Stated Purpose.

Nothing in paragraph 7 purports to resolve contract disputes between Ambac and counterparties to contracts not allocated to the Segregated Account. When seeking injunctive relief, the Rehabilitator explained why he sought

the provision in paragraph 7 mandating payments "under or in connection with" Segregated Account policies. He explained that "some policies and contracts allocated to the Segregated Account relieve counterparties and policyholders of the duty to pay premiums or other payments upon the filing of a formal delinquency proceeding, but allow them to continue to retain coverage and merely set off the amounts owed against future losses." R.7:12-13, A-App. 45-46. It was important, the Rehabilitator argued, that counterparties and policyholders not exercise their rights under these provisions, lest "policyholders suffering no pecuniary loss . . . inequitably and impermissibly prioritize their claims by paying themselves *ahead* of any loss or deferred payment notes which would otherwise eventually be due under the Commissioner's rehabilitation plan." R.7:13, A-App. 46 (emphasis in original). The Rehabilitator told the court that paragraph 7's provision mandating payments "under or in connection with" Segregated Account policies would ensure that policyholders or contract counterparties would "continue [1] to pay the premiums they owe *on the policies allocated to the Segregated Account* and [2] to make payments due *on*

contracts insured by the policies in the Segregated Account." R.7:5, A-App. 38 (emphasis added).

That has nothing to do with the disputed payments that the Rehabilitator claims are owed under the Reinsurance Agreements, which are neither policies allocated to the Segregated Account nor contracts insured by Segregated Account policies. The Assured Reinsurers had no such claims against the Segregated Account and were not seeking to exercise rights under a set-off provision triggered by the Segregated Account's delinquency. Their disputes with Ambac in no way implicate the Rehabilitator's rationale for paragraph 7: to ensure policyholders or contract counterparties "continue to pay the premiums they owe on the policies allocated to the Segregated Account and to make payments due on contracts insured by the policies in the Segregated Account." R.7:5, A-App. 38.

C. The Rehabilitation Court Violated the Rule of Strict Construction by Interpreting the Injunction Expansively.

Despite the rule that "an injunction order must … be construed strictly in favor of the person charged with violating it," *Wisconsin Central Railroad Co.*, 8 N.W. at 614 (1881), the rehabilitation court broadly construed paragraph 7

of the Injunction to mandate disputed payments under General Account contracts. The court in effect interpreted paragraph 7 as overriding the provision that the Injunction "does not apply to policies or other contracts which remain in the Ambac General Account." R.9:1, A-App. 61. It did so even though in March 2010 the Rehabilitator presented a much more limited rationale for mandating payments of amounts "owed."

IV. The Contract Dispute Between the Assured Reinsurers and Ambac Was Not Properly Raised by the Rehabilitator's Motion or Adjudicated as Part of the Rehabilitation Proceeding.

A. The Rehabilitation Court's Role Is to Liberally Supervise the Rehabilitation, Not to Adjudicate Adversarial Litigation.

The Rehabilitator's motion against the Assured Reinsurers sought enforcement of the Injunction. *See* 617:1 (moving the court "to enforce its March 24, 2010 injunction against parties-in-interest Assured Guaranty Corp. and Assured Guaranty Re Ltd."). In granting that motion, the rehabilitation court also adjudicated the Assured Reinsurers' contract rights and obligations in two paragraphs of its order. *See* R. 656:4-5 (¶ 15), A-App. 412-13 (construing the Reinsurance Agreements' arbitration and insolvency clauses);

R.656:5 (¶ 16), A-App. 413 (construing an unspecified clause in the Reinsurance Agreements).

Even if the Rehabilitator's motion had sought such relief, Chapter 645 would not have authorized the rehabilitation court to adjudicate this contract dispute with Ambac – which was not with the Segregated Account, the delinquent insurer. Section 645.34 simply requires Wisconsin courts to stay actions against an insurer in rehabilitation (*i.e.*, the Segregated Account, not Ambac) "for such time as is necessary for the rehabilitator to obtain proper representation and prepare for further proceedings." § 645.34(1). By contrast, in a *liquidation* proceeding, "all actions and all proceedings against the insurer whether in this state or elsewhere shall be abated . . . ." § 645.49(1).

The absence of such authorization makes sense because, as the rehabilitation court itself recognized, "[a] rehabilitation proceeding is *not an adversarial litigation* designed to adjudicate the diverse and divergent interests of each policyholder." R.258:7, A-App. 122 (emphasis added).[2]

[2] Even in a liquidation proceeding, the liquidator is empowered to initiate litigation, but such litigation is *not a component part of the liquidation proceeding*. *See* Wis. Stat. 645.46(12) (liquidator authorized to "institute in the name of the insurer or in his or her

"[R]ehabilitation is 'a very flexible procedure' that is 'regarded as a management rather than a legal task,'" and "'the court's control [of the Rehabilitator] should be liberal, not strict, and should be provided without cumbersome procedures.'" *Id.* (quoting Wis. Stat. Ann. § 645.32 cmt.)). The rehabilitation court's role as a deferential supervisor is not compatible with its adjudication of contract rights in adversarial litigation. That would be true even if the delinquent insurer was a party to those disputes – as was not the case here.

B. By Employing an Abbreviated Procedure that Deferred to the Rehabilitator, the Rehabilitation Court Denied the Assured Reinsurers Due Process.

The process by which the rehabilitation court adjudicated the contract dispute between Ambac and the Assured Reinsurers did not comport with the rules governing the proper resolution of disputes. The Assured Reinsurers were denied the procedures that ordinarily attend litigation, such as pleadings to frame the dispute, discovery, dispositive motion practice, and trial. The rehabilitation court resolved

own name any suits and other legal proceedings, *in this state or elsewhere* . . . ." (emphasis added)). A rehabilitation proceeding should not encompass a discrete dispute that would not have been appropriate even in a liquidation.

this dispute based solely on the Rehabilitator's motion to enforce the Injunction, briefs and affidavits in support or opposition, and a hearing without testimony.

This truncated procedure violated the Assured Reinsurers' rights to a proceeding that comports with due process of law. "The fundamental requirement of due process is the opportunity to be heard at a meaningful time and in a meaningful manner." *Mathews v. Eldridge*, 424 U.S. 319, 333 (1976) (internal quotation marks omitted). The Assured Reinsurers did not have a meaningful opportunity to be heard in the rehabilitation court, where their contract rights were determined according to a drastically abbreviated procedure.

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

In both Reinsurance Agreements, the parties agreed to arbitrate all disputes arising out of those contracts unless "the Company is subject to Proceedings [under Chapter 645 of the Wisconsin Statutes]." R.627:20 (art. 15), A-App. 276; R.627:42 (art. 16), A-App. 300. The rehabilitation court concluded this exception applies because "the Company" is subject to Chapter 645 Proceedings. R.656:4-5 (¶ 15), A-App. 412-13. This conclusion contradicts the plain language

of the Reinsurance Agreements, which expressly define "the Company" as Ambac or as Ambac plus Ambac U.K. Limited, neither of which is in a delinquency proceeding.

The rehabilitation court essentially rewrote the Reinsurance Agreements by expanding the definitions of "the Company" to include the Segregated Account, which is the only insurer in rehabilitation. *See* Wis. Stat. § 611.24(3)(e) ("Each segregated account shall be deemed an insurer within the meaning of s. 645.03(1)(f)."). The rehabilitation court had no reasonable basis for concluding that the parties intended for the arbitration clauses' delinquency exceptions to apply upon a rehabilitation of Ambac's Segregated Account. Moreover, the Rehabilitator is judicially estopped from arguing that a rehabilitation of the Segregated Account is legally indistinct from a rehabilitation of Ambac as a whole; Interpreting the arbitration clauses in that way contradicts the Rehabilitator's pre-dispute interpretation; and this expansive interpretation of the delinquency exceptions to the arbitration clauses violates the rule that arbitrability must be presumed where there is a broad arbitration clause.

A. The Reinsurance Agreements Require Arbitration Because "the Company" Is Not Subject to a Delinquency Proceeding.

Under New York law, which governs the Reinsurance Agreements, R.627:24 (art. 22); A-App. 280; R.627:46 (art. 22), A-App. 304, where an "agreement on its face is reasonably susceptible of only one meaning, a court is not free to alter the contract to reflect its personal notions of fairness and equity." *Greenfield v. Philles Records, Inc.*, 98 N.Y.2d 562, 569-70 (2002); *see also In re Matco-Norca, Inc. v. Matz*, 802 N.Y.S.2d 707, 708 (N.Y. App. Div. 2005). The Reinsurance Agreements unambiguously define the "Company" as Ambac (or Ambac plus Ambac U.K.). *See* R.627:9 (intro.), A-App.265; R.627:28 (intro.), A-App. 286. Ambac is not subject to a Chapter 645 proceeding. R.372:13, A-App. 128 ("NEITHER [AMBAC] NOR ITS GENERAL ACCOUNT, NOR ANY OF THE POLICIES, CONTRACTS, ASSETS, EQUITY OWNERSHIP INTERESTS AND RIGHTS OR LIABILITIES IN THE GENERAL ACCOUNT, IS IN REHABILITATION AS PART OF THE PROCEEDING OR OTHERWISE.") (capitalized as in original).

The rehabilitation court had no legally sufficient basis to rewrite the contracts' unambiguous definitions of "the Company." The Rehabilitator argued below - without any factual support – (1) that when the parties entered into the Reinsurance Agreements, they did not anticipate only a segregated account of Ambac would be subject to a Chapter 645 proceeding; and (2) that if the parties had anticipated that contingency, they would have agreed to make the insolvency clause apply upon a rehabilitation of the Segregated Account. R.637:11-12, A-App. 328-29. As a matter of law, the Rehabilitator's speculation that the parties might have been amenable to a more expansive definition than the one they actually agreed to is insufficient to affect the interpretation of the arbitration clauses.

It is well established that "a party's uncommunicated subjective intent cannot supply the ultimate meaning" of a contract term. *SR Int'l Bus. Ins. Co. v. World Trade Ctr. Props., LLC*, 467 F.3d 107, 125 (2d Cir. 2006) (applying New York law). The Rehabilitator's contention does not rise even to the level of such an "uncommunicated subjective intent." Wholly without evidentiary support, he argues that the parties *would have* had a certain intent *if* they had contemplated a

future rehabilitation of the Segregated Account. There is no contention that the parties actually considered expanding the delinquency exceptions to cover the delinquency of an insurer other than Ambac or Ambac U.K.

The best evidence of the parties' intent – and, in this case, the only evidence that is properly considered – is the unambiguous term they put in their writing. *See Greenfield v. Philles Records, Inc.*, 98 N.Y.2d 562, 569 (2002).

B. The Rehabilitator Is Judicially Estopped from Arguing There Is No Distinction Between a Rehabilitation of Ambac and a Rehabilitation of the Segregated Account.

In seeking approval of his proposed plan of rehabilitation, the Rehabilitator argued that a rehabilitation of only the Segregated Account should proceed precisely because that would *avoid* triggering contractual provisions conditioned upon *Ambac* being subject to a Chapter 645 proceeding. R.531:23 & 26 (¶¶ 52 & 60), A-App. 138 & 141. He urged the rehabilitation court to find that only the Segregated Account could be rehabilitated, because "numerous Ambac policies and transaction documents included 'triggers' that could be 'pulled' upon [Ambac] being subject to a rehabilitation or liquidation proceeding," and

rehabilitating only the Segregated Account allowed the Rehabilitator to avoid "trigger[ing] covenants across almost all policies and caus[ing] other adverse consequences and collateral damages." *Id.* The rehabilitation court accepted these proposed findings when it confirmed the Rehabilitator's plan. R.568:23, 26 (¶¶ 52, 60), A-App. 151, 154.

Likewise, in opposing an emergency motion for relief from the Injunction, the Rehabilitator presented an affidavit stating that OCI had elected not to put Ambac in rehabilitation in part because "the filing of a rehabilitation proceeding in respect of Ambac could give counterparties the right to declare certain defaults and accelerate payment of principal and interest on performing deals." R.74:6 (¶9(a)(ii)), A-App. 83. The rehabilitation court agreed, and found that "a rehabilitation in respect of Ambac could have given [certain] corporate issuers' lenders the right to withhold financing for the payment on [notes issued by the corporate lenders] and counterparties the right to accelerate and declare defaults upon certain triggering events could arise due to Ambac's rehabilitation." R.127:9 (¶ 21), A-App. 93.

Judicial estoppel precludes a party from arguing a position where "(1) a party against whom estoppel is sought

presents a later position that is 'clearly inconsistent' with the earlier position; (2) the facts at issue are the same in both cases; and (3) the party to be estopped convinced the first court to adopt its position." *State v. White*, 2008 WI App 96, ¶15, 312 Wis. 2d 799, 754 N.W.2d 214.

These elements are present here. The Rehabilitator persuaded the rehabilitation court that a rehabilitation of the Segregated Account is distinct from a rehabilitation of Ambac for purposes of contract provisions the Rehabilitator did not want to trigger, and later took the opposite position when confronted with provisions in the Reinsurance Agreements he did want to trigger.

The Rehabilitator cannot have it both ways, as his interests at any given moment may dictate. Having persuaded the rehabilitation court that rehabilitation of the Segregated Account would not enable parties to invoke contract rights that *would* be triggered by a rehabilitation of Ambac, the Rehabilitator is judicially estopped from arguing the opposite now.

C. The Rehabilitator's Position is Contrary to His Own Pre-Dispute Interpretation.

Even if there were any ambiguity in the delinquency exceptions to the arbitration clauses, the Rehabilitator's "practical interpretation . . . for any considerable period of time before it comes to be the subject of controversy is deemed [to be] of great, if not controlling, influence." *Old Colony Trust Co. v. City of Omaha*, 230 U.S. 100, 118 (1913). Under New York law, "the parties' course of performance under the contract is considered to be the 'most persuasive evidence of the agreed intention of the parties.'" *Fed Ins. Co. v. Ams. Ins. Co.*, 691 N.Y.S.2d 508, 512 (N.Y. App. Div. 1999) (internal citation omitted); *accord Coliseum Towers Assocs. V. Cnty. of Nassau*, 769 N.Y.S.2d 293, 296 (N.Y. App. Div. 2003); *Ocean Transp. Line, Inc. v. Am. Phil. Fiber Indus., Inc.*, 743 F.2d 85, 90-91 (2d Cit. 1984).

In June and November 2010, before any disputes about the parties' arbitration rights, the Rehabilitator and the Assured Reinsurers agreed the Injunction and the Plan did not eliminate either side's right to "demand[] arbitration in accordance with the terms of the agreement," and "general disagreements will remain subject to arbitration (consistent

with the contract)." R.626:20 (Ex. B), A-App. 200; R.626:54 (Ex. D), A-App. 236. The Rehabilitator's position now – that the arbitration clauses were tendered inoperative in March 2010, when the Rehabilitator first put the Segregated Account into rehabilitation – flies in the face of his own pre-dispute interpretation. The interpretation the Rehabilitator stated, when the goal was to seek clarification and a common understanding rather than to prevail in a dispute, constitutes "persuasive evidence" of the parties' actual intent. *Fed Ins. Co.*, 691 N.Y.S.2d at 512.

D. The Rehabilitation Court's Interpretation of the Arbitration Clauses Violates the Rule that Arbitrability is Presumed When an Arbitration Clause is Broad.

The arbitration clauses state that "any dispute or claim" will be submitted to arbitration unless an exception applies. R.627:20 (art. 15), A-App. 276; R.627:42 (art. 16), A-App. 300. At issue here is the narrow exception triggered "in the event of the Company being subject to [Chapter 645] Proceedings." R.627:20 (art. 15), A-App. 276; R.627:42 (art. 16), A-App. 300. These are broad arbitration clauses, creating a presumption of arbitrability that must be clearly rebutted.

"Where the arbitration clause is broad, there arises a presumption of arbitrability and arbitration of even a collateral matter will be ordered if the claim alleged implicates issues of contract construction or the parties' rights and obligations under it." *Louis Dreyfus Negoce S.A. v. Blystad Shipping & Trading Inc.*, 252 F.3d 218, 224 (2d Cir. 2001) (internal quotation marks and citations omitted). Where there "is a broad arbitration clause, providing for only a narrow exception, a court should compel arbitration unless there is *positive, unambiguous assurance that the dispute is within that narrow exception*." *Roso-Lino Beverage Distribs., Inc. v. Coca-Cola Bottling Co.*, 749 F.2d 124, 126 (2d Cir. 1984) (emphasis added).

The rehabilitation court apparently did not consider this rule. It did not find such "positive, unambiguous assurance" that the arbitration clauses' delinquency exceptions were triggered when Ambac's Segregated Account went into rehabilitation, and there is none. To the contrary, the Reinsurance Agreements unambiguously make this exception applicable only if "the Company" – Ambac or Ambac plus Ambac U.K. – becomes subject to a delinquency proceeding.

VI. The Reinsurance Agreements Do Not Require the Assured Reinsurers to Pay, in Cash, Their Share of the Amounts of the Surplus Notes.

Under the Reinsurance Agreements, the Assured Reinsurers are to share in the economic consequences of any settlement reached by Ambac. Yet the rehabilitation court ordered payments by the Assured Reinsurers based on an amount that exceeds what Ambac or the Segregated Account is paying.

A. The Reinsurance Agreements Require the Assured Reinsurers to Follow Ambac's Settlements with Policyholders.

The Reinsurance Agreements provide that the Assured Reinsurers' interest and liability will "follow the fortunes" of Ambac. R.627:14 (art. 5), A-App. 270; *see also* R.627:37 (art. 6), A-App. 295, (reinsurers' liability "shall follow that of [Ambac]"). These contract provisions invoke the follow-the-fortunes doctrine of reinsurance law, under which a reinsurer is placed in no better or worse a position than the reinsured. Under this doctrine, "the reinsurer will follow the fortunes or be placed in the position of the [insurer]." *Bellefonte Reinsurance Co. v. Aetna Cas. and Sur. Co.*, 903 F.2d 910, 912 (2d Cir. 1990) (internal citation omitted). "[T]he doctrine burdens the reinsurer with those risks which the direct insurer

bears under the direct insurer's policy covering the original insured." *Id.*

In the settlement context, the follow-the-fortunes doctrine becomes the "follow-the-settlements doctrine," a fundamental tenet of reinsurance law that generally obligates a reinsurer to pay its proportionate share of a settlement entered into by the entity it is reinsuring, whether that settlement is beneficial or burdensome. *See generally N. River Ins. Co. v. ACE Am. Reins. Co.*, 361 F.3d 134, 139-40 (2d Cir. 2004).

Insofar as settlements are effected by delivery of Surplus Notes, the Assured Reinsurers could follow these settlements either by paying their proportionate share in Surplus Notes or by paying their share in cash if and when cash payments are made on the Surplus Notes. Requiring the Assured Reinsurers to make cash payments in respect of the principal amount of Surplus Notes delivered in the settlements is inconsistent with the follow-the-settlements doctrine, and therefore, with the Reinsurance Agreements.

B. By Their Terms, the Insolvency Clauses Do Not Apply.

The rehabilitation court circumvented the "follow-the-fortunes" provisions in the Reinsurance Agreements by deciding that the Reinsurance Agreement's insolvency clauses were triggered by the rehabilitation proceeding. R.656:4-5 (¶ 15), A-App.412-13. The insolvency clauses apply "[i]n the event of the insolvency of the Company or of Proceedings . . . against the Company pursuant to Chapter 645 of the Wisconsin Insurance Code." R.627:19 (art. 14), A-App. 275; R.627:41-42 (art. 15), A-App. 299-300.

The insolvency clauses are inapplicable for the same reason the delinquency exceptions to the arbitration clauses are inapplicable: "The Company" is not subject to Chapter 645 proceedings, because "the Company" is defined as Ambac in one contract and as Ambac plus Ambac U.K. in the other (R.627:9 (intro.), A-App. 265; R.627:28 (intro.), A-App. 286), and there is no Chapter 645 proceeding against either of them. R.372:13, A-App. 128; Wis. Stat. § 611.24(3)(e). As explained above, having persuaded the rehabilitation court that putting the Segregated Account into rehabilitation prevented Ambac's contract parties from

invoking contract terms that would have been triggered by a rehabilitation of Ambac, the Rehabilitator is judicially estopped from arguing the rehabilitation of the Segregated Account triggers contractual provisions that require *Ambac's* deliquency.

In addition, the insolvency clauses provide only that the Assured Reinsurers will have certain obligations with respect to payments of claims against an insolvent insurer. R.627:19 (art. 14), A-App. 275; R.627:41-42 (art. 15), A-App. 299-300 (reinsurance payable . . . without diminution . . . because the liquidator, receiver or statutory successor of the Company has failed to pay all or any part of a claim"). They do not provide that an insurer's other agreements and settlements change or augment the Assured Reinsurers' obligations to follow those settlements. *Id.* Under the commutation agreements at issue, cash and Surplus Notes are delivered to policyholders in return for termination of their policies, not in satisfaction of claims those policyholders have asserted. R.627:6 (¶ 18), A-App. 261; R.618:7 (policy terminated altogether as part of settlement). Because the commutation agreements involve settlements, not payments

of claims, they would not trigger any obligations under the insolvency clauses even if "the Company" were insolvent.

C. The Surplus Notes' Principal Value Is Not an "Amount of Liability Paid or to Be Paid."

The rehabilitation court held, in the alternative, that the Assured Reinsurers are obligated to pay based on the principal amounts of the Surplus Notes delivered in settlements because those notes constitute "claims paid or to be paid" by Ambac within the meaning of the Reinsurance Agreements. R.656:5 (¶ 16), A-App. 413. Although the rehabilitation court did not specify any provision of the Reinsurance Agreements, the Assured Reinsurers infer that the court was referring to the Reinsurance Agreements' definitions of "Loss." Neither definition includes the quoted phrase "claims paid or to be paid," but each defines "Loss" as "the amount of liability paid or to be paid by the Company . . . ." R.627:12 (art. 4), A-App. 268-69; R.627:34 (art. 5), A-App. 292.

The principal amounts of the Surplus Notes do not represent an "amount of liability paid or to be paid" by Ambac. All payments on the Surplus Notes are contingent on approval by the Commissioner of Insurance, who has

"absolute discretion in determining *whether* to allow payments to be made on the Surplus Notes." R.372:51 (§ VI.C), A-App. 134 (emphasis added). Whether the principal amounts of the Surplus Notes are "to be paid," and if so when, is a matter of pure speculation. An amount "to be paid" for purposes of assessing the liability of a reinsurer following an insurer's settlement cannot reasonably be construed to include an amount that might or might not be paid, some day, as part of the settlement.

D. Section 4.04 of the Plan of Rehabilitation Is Irrelevant to the Parties' Contract Dispute.

The rehabilitation court also relied on Section 4.04 of the Plan of Rehabilitation, which requires holders of certain claims against the Segregated Account to accept Surplus Notes as a complete substitute for cash. That provision states:

> Each Holder of a Permitted Policy Claim . . . shall be required to accept any Surplus Notes (or any beneficial interest therein) issued to such Holder or beneficiary in accordance with this Plan, in lieu of any cash payments required to be made to such Holder or beneficiary in full and complete satisfaction of such cash payment obligation of the Segregated Account in respect of such Permitted Policy Claim, regardless of the existence of any provision in such Policy or any other underlying instrument(s) or contract(s) that would require, or that contemplates, the discharge of the obligations of the Segregated Account through the payment of Cash.

R.567:22-23 (§ 4.04(d)), A-App. 146-47.

Section 4.04 has no relevance to the present disputes because it requires only "Holder[s] of a Permitted Policy Claim" to treat Surplus Notes as cash payments. The Assured Reinsurers are not "Holder[s] of a Permitted Policy Claim."

CONCLUSION

For the reasons given, the Assured Reinsurers respectfully request that this Court reverse the rehabilitation court's June 14 order requiring the Assured Reinsurers to refrain from seeking arbitration of disputes with Ambac, to withdraw their petition to compel arbitration in New York state court, and to make certain payments under their reinsurance contracts with Ambac.

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CERTIFICATION OF FORM AND LENGTH

I hereby certify that this brief conforms to the rules contained in s. 809.19(8)(b) and (c) for a brief and appendix produced with a proportional serif font. The length of this brief is 10954 words.

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CERTIFICATE OF COMPLIANCE WITH RULE 809.19(12)

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

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I hereby certify that on September 12, 2011, I caused three true and correct copies of this brief to be served by first-class mail, postage prepaid, upon the persons listed below:

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