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

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ARGUMENT

The Rehabilitator and Ambac try to obscure these essential facts:

- This case arises from contract disputes between the Assured Reinsurers and Ambac.
- The underlying contracts have broad arbitration agreements.
- Ambac is not in rehabilitation.
- The rehabilitation court prohibited the Assured Reinsurers from arbitrating, *and* decided the underlying contract dispute, all in the guise of enforcing the Injunction.

The Assured Reinsurers have a contractual right to arbitrate their disputes with Ambac. The Rehabilitator's counsel expressly recognized that right before these disputes arose.

The proceeding below was a shell game. The rehabilitation court allowed the Rehabilitator and Ambac to move the "pea" – the Injunction's scope, Ambac's place in the rehabilitation proceeding, and the status of the Assured Reinsurers' contract rights – wherever it had to go for them to prevail. This Court should reverse.

I. Review of the Rehabilitation Court's Interpretation of the Injunction Is *De Novo*.

Under *City of Wisconsin Dells v. Dells Fireworks, Inc.*, 197 Wis. 2d 1, 539 N.W.2d 916 (Ct. App. 1995), a circuit court's interpretation of its own injunction is reviewed *de novo*. The Rehabilitator and Ambac's contrary assertion misreads this controlling precedent.

City of Wisconsin Dells involved *two* rulings by the circuit court: its grant of an injunction and its later finding of contempt. *Id.* at 15, 21, 23. In its contempt decision, the circuit court interpreted its injunction. The court of appeals gave deference to the discretionary grant of an injunction, but not to the interpretation of it: "to the extent the determination of contempt involves an interpretation of the injunction, *that is a question of law that we review* de novo." *Id.* at 23 (emphasis added). The Assured Reinsurers are not seeking review of the rehabilitation court's grant of an injunction. Its interpretation of the Injunction is subject to *de novo* review.

II. The Injunction Does Not Prohibit the Assured Reinsurers from Arbitrating.

A. The Canon of Strict Construction Applies.

The Rehabilitator argues that the canon of strict construction of injunctions does not apply here "because [he]

did not seek any sanction against Assured based on its non-compliance with the Injunction." Rehab. Br. at 22. He cites no support for his contention that this canon is invoked only when sanctions are sought.

In any event, the Rehabilitator sought, and the rehabilitation court imposed, sanctions against the Assured Reinsurers. The Order states that the Assured Reinsurers violated the Injunction and that their failure to remedy these violations within 14 days "will result in sanctions." R.656:5 (¶¶ 1-2), A-App. 413. Even though the court granted the Assured Reinsurers a grace period, it used a sanction "to force [the Assured Reinsurers] into compliance with a court order." *Christensen v. Sullivan*, 2009 WI 87, ¶ 55, 320 Wis. 2d 76, 768 N.W.2d 798. The canon of strict construction applies.

B. The Rehabilitator and Ambac Fail to Read the Injunction's Provisions in Harmony.

Interpreting the Injunction requires the Court to read the following provisions in harmony:

- "[The Injunction] does not apply to policies or other contracts which remain in the Ambac General Account." R.9:1, A-App. 61.

- The Injunction instead "pertains to the Segregated Account, [and] policies, contracts, assets and liabilities allocated to the Segregated Account ...." *Id.*

- The Injunction enjoins proceedings against Ambac "in respect of the Segregated Account or policies ... contracts or liabilities allocated to the Segregated Account." R.9:2 (¶ 1), A-App. 62.

The Rehabilitator and Ambac do not offer a harmonizing interpretation. Instead, their interpretation subordinates the first provision quoted above to the second provision – and renders the first a nullity. Rehab. Br. at 20; Ambac Br. at 21-22. Under their interpretation, if a matter can be said to have *any* connection to the Segregated Account, the second provision trumps the first, and the Injunction *does* apply "to policies or other contracts which remain in the Ambac General Account." Ambac further attempts to shoehorn this dispute into the second provision by inaccurately characterizing it as "a dispute over a policy (and its corresponding liability) allocated to the Segregated Account." Ambac Br. at 22. This is not a dispute over such a policy or its liability. This is a dispute over payment obligations under contracts that remain in Ambac's General Account.

C. The Rehabilitator Ignores His Prior Statements About the Injunction.

The Rehabilitator ignores his counsel's unambiguous explanation to the rehabilitation court of the scope of the Injunction at the time he sought its entry:

- "[The Injunction is] directed *solely* at policies and issues which have been allocated to the segregated account." R.150:18-19 (Tr. 18:17-19:1), A-App. 107-108 (emphasis added).

- "[T]here is a bright line separation between ... the rehabilitation proceeding as to the [S]egregated [A]ccount, not … tainting or affecting or spilling over into the affairs of the general account." R.150:9 (Tr. 9:15-19), A-App. 104.

- The Injunction was intended to enjoin "lawsuits by *Segregated Account* policyholders outside [the rehabilitation] proceeding." R.7:13, A-App. 46 (emphasis added).

The Rehabilitator points to other comments by his counsel about the need for "order, equity, and preservation of assets." Rehab. Br. at 26. These vague generalities do not affect the Rehabilitator's representations about the *scope* of the Injunction, or alter the conclusion that the Injunction does not bar the Assured Reinsurers from arbitrating their disputes with Ambac. These disputes are "affairs of the general" account, which the Rehabilitator said would not be "taint[ed]"

or "affect[ed]" by the Injunction. R.150:9 (Tr. 9:17-19), A-App. 104.

D. The Rehabilitator Distorts His Attorney's Emails.

In his June 15, 2010 email, the Rehabilitator's attorney told the Assured Reinsurers' attorneys:

> [T]he reinsurance agreements ... 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.626:20 (Ex. B), A-App. 200. The Rehabilitator and Ambac do not dispute that on its face, this email directly conflicts with their core position. Now, for the first time, the Rehabilitator tries to explain that inconsistency by contending that the email meant only that one *specific* dispute would be arbitrable. *See* Rehab Br. at 28. This belated argument is inconsistent with the text of the email, with the email chain preceding it, and with the Assured Reinsurers' affidavits. *See* R.626:3-4 (¶¶ 7-9), A-App. 181-82; R.627:4 (¶ 11), A-App. 259.

The attorneys also spoke and exchanged emails in November 2010. The Assured Reinsurers' email said:

> Without attempting to summarize everything we discussed on [a November 5] call, we just wanted to confirm your view that the plan of rehabilitation will not alter the contractual provisions of the reinsurance agreements ... or enjoin any actions that Assured Guaranty or its affiliates may take under such reinsurance agreements (including ... demanding arbitration in accordance with the terms of such reinsurance agreements).

R.626:35 (Ex. C), A-App. 216.

The Rehabilitator's attorney replied:

> *Generally we agree with your summary, but there is one caveat.* The additional rights your client has under the insolvency clause (right to notice and interpose a defense) necessarily must be exercised in the rehabilitation court, as that is where the underlying policy liability is located. Again, setoff is not affected, and general disagreements will remain subject to arbitration (consistent with the contract), but disputes relative to claim liabilities (if the claims are in the Segregated Account) will need to be handled in the Rehab Court.

R.626:54 (Ex. D), A-App. 236 (emphasis added).

The Rehabilitator and Ambac do not contend that the November emails – in which the Rehabilitator's attorney again stated a position directly at odds with the Rehabilitator's position in this Court – involved only a specific question and answer. They rely on the last

sentence in the email from the Rehabilitator's attorney, but gloss over the word "Again" that prefaces it. *See* Rehab. Br. at 27; Ambac Br. at 26-27. That word signals a rephrasing of what went before: the Assured Reinsurers' retention of their rights under the Reinsurance Agreements (including their rights to arbitrate) has a single exception, which kicks in only if the Assured Reinsurers contest a Segregated Account policyholder's claim. That exception is not relevant here.

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

The rehabilitation court did not hold that any amounts are "owed" to the Segregated Account by the Assured Reinsurers. It ruled that paragraph 7 of the Injunction compels the payment of amounts purportedly *owed to Ambac* under the Reinsurance Agreements. R.656:4 (¶¶ 13-14), A-App. 412. That determination misconstrues the paragraph and is belied by the Rehabilitator's statements to the court when he obtained the Injunction.

Any amounts the Assured Reinsurers might owe to Ambac under the Reinsurance Agreements do not come within paragraph 7 because they are not owed "under or in

connection" with a Segregated Account policy. That language does not cover the Reinsurance Agreements, which are neither policies allocated to the Segregated Account nor contracts insured by policies in the Segregated Account. As the Rehabilitator explained to the court in March 2010, paragraph 7 compels payments "under" Segregated Account policies in order to ensure that the counterparties on those policies "continue to pay the premiums they owe on the *policies allocated to the Segregated Account*," and it mandates payments "in connection with" Segregated Account policies in order to ensure that counterparties "make the payments due on *contracts insured by the policies in the Segregated Account*." R.7:5, A-App. 38 (emphasis added).

IV. The Arbitration Clauses Remain in Effect.

A. The Arbitration Clauses Apply Unless Ambac Is in a Chapter 645 Proceeding.

The parties to the Reinsurance Agreements agreed to specific consequences if Ambac went into a Chapter 645 proceeding: a loss of arbitration rights and certain changes in the Assured Reinsurers' payment obligations. In entering into these agreements, the Assured Reinsurers accepted the risk of those consequences *if* that event occurred. The triggering

event is "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 "Company" is Ambac (or Ambac and Ambac Assurance UK Limited under the Facultative Agreement) – not an account or a portion of Ambac that might be created later. R.627:28 (intro.), A-App. 286; R.627:9 (intro.), A-App. 265.

Wisconsin law has contemplated rehabilitating segregated accounts for almost 40 years, *see* Laws of 1971 c. 260, § 72 (creating Wis. Stat. § 611.24(3)(e)), and the parties could have provided in the Reinsurance Agreements that, for these provisions, the "Company" includes a segregated account of Ambac. Yet, they manifested no intent that consequences would ensue if, instead of entering a Chapter 645 proceeding, Ambac created a segregated account and placed it in rehabilitation. The Assured Reinsurers agreed to the consequences only upon an *Ambac* delinquency proceeding.

The Rehabilitator asserts there is no "rational basis" to distinguish between Chapter 645 proceedings for Ambac and for an Ambac segregated account. Rehab. Br. at 48-49. There was nothing irrational about drawing the line as the

parties did. Even if there were, what matters under governing New York law is not what the parties should have or might have agreed to, but what they specified in their written agreement. *See S.R. 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 and Ambac contend that a Chapter 645 proceeding for Ambac is indistinguishable from a proceeding for an Ambac segregated account. *See* Ambac Br. at 11 ("[F]or policies allocated to the Segregated Account, *Ambac is the Segregated Account*." (emphasis in original)); *see also* Rehab Br. 43 (same). That position is strikingly inconsistent with Wisconsin law, and with their position earlier in the proceeding:

- As Ambac acknowledges, a segregated account is "a separate 'insurer'" for purposes of Chapter 645. Ambac Br. at 9; Wis. Stat. § 611.24(3)(e).[1]
- A segregated account's liabilities are its own and are not chargeable to the insurer that created it. *See* Wis. Stat. § 611.24(3)(c).
- In 2010, the Rehabilitator told the court that he chose a rehabilitation limited to the Segregated Account precisely because of the legal distinction between the

[1] The Segregated Account's status as a separate insurer also rebuts Ambac's argument that the Reinsurance Agreements are contracts with a delinquent insurer for purposes of sections 645.04(3) or 645.58(2). The Reinsurance Agreements are with Ambac, a non-delinquent insurer.

two: a rehabilitation of only the Segregated Account enabled the Rehabilitator and Ambac to circumvent contractual triggers that would be pulled if Ambac went into rehabilitation. *See* R.74:6 (¶9(a)(ii)), A-App. 83; R.127:9 (¶ 21), A-App. 93; R.531:23 & 26 (¶¶ 52 & 60), A-App. 138 & 141; R.568:23, 26 (¶¶ 52, 60), A-App. 151, 154.

The Rehabilitator and Ambac once were emphatic about the fact that "NEITHER [AMBAC ASSURANCE CORPORATION] NOR ITS GENERAL ACCOUNT ... IS IN REHABILITATION." R.372:13, A-App. 128 (capitalized in original). That changed when these disputes incentivized them to argue otherwise.

B. Assured Guaranty's Payment of Cash to Meet Its Contractual Obligation Is Not Probative of the Meaning of "Losses."

In March 2011, when it commuted a policy allocated to the Segregated Account, Ambac called for payment from Assured Guaranty. R.643:2 (¶ 5). Because Assured Guaranty did not believe the principal amounts of the Surplus Notes were "losses" under its Reinsurance Agreement, it did not pay those. R.643:2 (¶ 5). Assured Guaranty did pay its reinsurance share of the cash paid to commute that policy. R.643:2 (¶¶ 7-8).

Ambac argues that Assured Guaranty's payment to Ambac of its reinsurance share of the cash payment, where

the underlying payment was made by the Segregated Account, demonstrates Assured Guaranty's understanding that "Ambac" in the Reinsurance Agreements can mean the "Segregated Account." Ambac Br. at 12-17. This argument misapprehends why Assured Guaranty made this payment. Assured Guaranty understood that it and Ambac had agreed that the parties' rights and obligations under the Reinsurance Agreements were not affected by the Segregated Account's Chapter 645 proceeding. R.643:2 (¶ 4). Moreover, the demand for payment under the Reinsurance Agreement came from Ambac, not from the Rehabilitator or the Segregated Account. *Id.* (¶¶ 5-6.) Given its understanding that Ambac and it retained their contractual rights and obligations, Assured Guaranty believed it should make a reinsurance payment regardless of who wrote the check to the policyholder. That is why Assured Guaranty paid its share of the cash payment. R.643:3 (¶¶ 7-8). That payment proves nothing about Assured Guaranty's understanding of the scope of "Ambac" in the Reinsurance Agreements.

V. The Surplus Notes' Principal Amounts Are Not Amounts "To Be Paid."

In improperly resolving the merits of the underlying contract disputes, the rehabilitation court decided that the principal amounts of Surplus Notes delivered in commutations constitute amounts "to be paid" that the Assured Reinsurers must pay to Ambac in cash. That determination is indefensible.

It is undisputed that the Surplus Notes may never be paid, and that they have a market value below their principal amounts. The Surplus Notes are not unconditional promises to pay. They are essentially promises to pay cash at some indeterminate time *if*, according to the Commissioner of Insurance, sufficient cash is available. Under the Rehabilitator's own financial projections, there are three (out of four) scenarios in which Surplus Note holders will receive less than 100% of the outstanding principal. *See* R.372:78-80 (§VIII.C.3).[2] No one knows what amount (if any) is going "to be paid" pursuant to the Surplus Notes, or when (if ever)

[2] The Rehabilitator also declined to dispute this point in a related appeal before this Court. *Compare* June 17, 2011 Consol. Opening Br. in Case No. 11-AP-561, at pp. 50-56 (explaining that the Surplus Notes are worth far less than their principal amount due to uncertainty over future payment) *with* Rehabilitator's Aug. 9, 2011 Resp. Br. in Case No. 11-AP-561).

payment might happen. That is why no one views them as a substitute for cash.

The Rehabilitator argues that the Surplus Notes should be deemed to be worth their principal amounts because section 4.04 of the Plan of Rehabilitation deems them to have that value. That is both irrelevant and incorrect. The commutation payments at issue were not made under the Plan of Rehabilitation, which is not yet in effect. When effective, the Plan will require "Each Holder of a Permitted Policy Claim" to accept the Surplus Notes in full satisfaction of their claims. R.567:22-23 (§ 4.04(d)), A-App. 146-47. The Plan imposes no such requirement on policyholders whose claims are being commuted, or on the Assured Reinsurers. Moreover, the Plan does not say that the Surplus Notes are worth any amount, much less assert the counter-factual proposition that they are worth their principal amount. Nothing in the Plan establishes Surplus Notes' principal amounts as amounts "to be paid" by the Assured Reinsurers to Ambac under the Reinsurance Agreements.

VI. There Is No Personal Jurisdiction Over AG Re.

The Rehabilitator argues that the statutes requiring service of process are not applicable, Rehab Br. at 56-59, but

relies on these very statutes as a basis of personal jurisdiction over AG Re. Section 645.04(5) expressly confers jurisdiction only over persons "served pursuant to s. 801.11 in an action brought by the receiver." Section 801.05 authorizes jurisdiction only over "person[s] served in an action pursuant to s. 801.11." The Rehabilitator cannot rely on these statutes to establish personal jurisdiction and simultaneously disregard the service requirement they impose.

CONCLUSION

The Assured Reinsurers respectfully request that this Court reverse the rehabilitation court's June 14 order.

Dated: October 31, 2011

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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 2,926 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 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.

Dated: October 31, 2011

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CERTIFICATE OF SERVICE

I hereby certify that on October 31, 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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