



In the Matter of the Rehabilitation of:

Case No. 10 CV 1576

Segregated Account of Ambac Assurance Corporation

REHABILITATOR'S NOTICE OF MOTION AND MOTION TO CONFIRM AND DECLARE THE SCOPE OF THE RELIEF ISSUED UNDER THIS COURT'S PRIOR ORDER FOR INJUNCTIVE RELIEF

**By the Commissioner of Insurance of the State of Wisconsin,
as Rehabilitator of the Segregated Account of
Ambac Assurance Corporation**

I. NOTICE OF MOTION

TO: All Parties-in-Interest

PLEASE TAKE NOTICE that the Commissioner of Insurance of the State of Wisconsin, as Rehabilitator of the Segregated Account of Ambac Assurance Corporation, has moved the Court as set forth below to approve the Rehabilitator's motion to confirm and declare relief respecting the March 24, 2010 Order for Injunctive Relief. The motion is scheduled to be heard by the Court on Wednesday, September 12, 2012, commencing at 9:00 a.m. before the Honorable William D. Johnston at the Lafayette County Courthouse, 626 Main Street, Darlington, Wisconsin. Please take further notice that any objections to the relief requested by the Rehabilitator in this Motion should be in writing, with the basis for the objection explained with specificity, and filed and served by no later than noon (Central Time) on Thursday, September 6, 2012.

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DANE CO. CIRCUIT COURT

PLEASE TAKE FURTHER NOTICE that any interested parties may appear at the hearing telephonically pursuant to the Court's standard tele-court procedure. Anyone interested in appearing telephonically should make the appropriate arrangements in advance of the hearing by calling 800-924-5680.

II. REHABILITATOR'S MOTION

Pursuant to the authority granted under Chapter 645 of the Wisconsin Statutes, the Commissioner of the Office of the Commissioner of Insurance, as the court-appointed Rehabilitator (the "Rehabilitator") of the Segregated Account (the "Segregated Account") of Ambac Assurance Corporation ("Ambac"), hereby moves the Court as detailed below to confirm the scope of the existing Injunction¹ in this matter to protect the interests of policyholders and creditors of the Segregated Account, as well as the public, consistent with Wis. Stat. §§ 645.01(4) and 645.05(1).

Specifically, the requested relief seeks to confirm and declare the scope and meaning of the Injunction to eliminate any doubt as to the effect of this "Proceeding" and the "Events" (as previously defined in the Injunction and discussed below) upon the contractual rights and interests of Ambac and the Segregated Account respecting transactional documents relating to policies in the Segregated Account covering residential mortgage-backed securities ("RMBS"). The grounds for this Motion are as follows:

1. The "Events" are defined in the Injunction to mean "the Proceedings and any acts taken or not taken or authorized to be taken pursuant thereto, including without limitation the failure of the Segregated Account, the Allocated Subsidiaries, or

¹ The "Injunction" refers to the Court's March 24, 2010 Order for Temporary Injunctive Relief (dkt. 9), as supplemented by its November 8, 2010 Order for Temporary Supplemental Injunctive Relief (dkt. 517) and made permanent by its January 24, 2011 Decision and Final Order Confirming the Rehabilitator's Plan of Rehabilitation (dkt. 692).

Ambac to pay amounts due under any policies, contracts, or other obligations that have been allocated to the Segregated Account or to which any of the Allocated Subsidiaries is a party.” (Injunction ¶ 4.) The “Proceedings” are defined as “this legal proceeding, together with all filings, motions, orders, writs, and other authorizations relating thereto and findings made in connection herewith.” (*Id.* ¶ 2.)

2. This Court entered the Injunction to, among other things, prevent a number of “threatened or contemplated action[s] that might lessen the value of the insurer’s assets or prejudice the rights of policyholders, creditors or shareholders, or the administration of the proceeding.” Wis. Stat. § 645.05(1)(k). The core of this relief consisted of preventing parties to contracts with the Segregated Account, Ambac and their affiliates from terminating, claiming breach, asserting defenses or otherwise impairing the rights of Ambac and the Segregated Account under those contracts on the basis of any of the Events. (*See, e.g.*, Injunction ¶ 4 (enjoining parties from “terminating, collecting on, or claiming against” policies or contracts “on the basis of the Events”); ¶ 5 (enjoining assertion of mark-to-market or other termination damages otherwise permitted under contracts); ¶ 6 (enjoining parties from failing to honor contractual rights that Ambac would have had absent the Events); ¶ 7 (enjoining parties from failing to pay obligations owed, “or that would have been owed but for the occurrence of the Events,” to Ambac); and ¶ ¶ 9-A to F (enjoining the exercise of various actions, in various contexts, “on the basis of the Events” under a number of different types of contract documents) (*see*, in particular, Injunction ¶ 9-B, which details the scope of the Injunction as to the policies respecting “Residential Mortgage-Backed Securities (“RMBS”). Indeed, the risk of contractual harm on the basis of the Events was the primary reason the Rehabilitator sought entry of the Injunction on an *ex parte*

basis, without providing advance notice to policyholders and other contractual counterparties. (Plan Confirmation Order at 27 (¶ 78).)

3. For the avoidance of doubt, the Injunction contains a broad description of the contracts and other agreements as to which the interests of the Segregated Account and/or Ambac shall not be adversely affected or impaired by virtue of any of the Events. For instance, ¶ 6 of the Injunction prohibits parties from taking adverse action as to the interests of the Segregated Account or Ambac due to the occurrence of any of the Events or the financial condition of the Segregated Account or Ambac “under any agreements relating to policies or contracts allocated to the Segregated Account ... including any ... residential mortgage-backed security transaction documents ... or other financing or transaction documents of any kind (collectively, the “Transaction Documents”).” The Court also provided broad protection to the interests of Ambac and the Segregated Account as to the wide array of transactional agreements and contracts existing with respect to the policies in the Segregated Account pertaining to RMBS. At subsection 9-B, the Injunction provides that:

The Court has been advised that a number of policies allocated to the Segregated Account cover RMBS that Ambac insured directly. RMBS are described in more detail in the Commissioner’s Verified Petition and supporting brief. In furtherance of the other injunctive relief granted above, each party to the agreements pursuant to which the notes, certificates or other instruments (the “RMBS Notes”) were issued and the other transactional documents related thereto (collectively, the “RMBS Transaction Documents”) is specifically enjoined from [taking any actions, or asserting any positions or defenses, adverse to the interests of the Segregated Account and Ambac with respect to the defined Events and Proceedings.]

These broad definitions include, but are not limited to, the various Insurance and Indemnity Agreements, Pooling and Servicing Agreements and Mortgage Loan Purchase

Agreements executed in connection with the RMBS Transactions insured by the Segregated Account.

4. It has come to the attention of the Rehabilitator that parties to certain of the RMBS Transaction Documents relating to Segregated Account policies are contending that Ambac should not be able to enforce certain rights and claims due to the existence of the Proceedings or one or more of the other Events. Specifically, several such parties have argued that certain contract-based causes of action that Ambac possessed *prior* to the Proceedings or Events are no longer viable *because* of the Proceedings or Events; that is, that Ambac and the Segregated Account cannot exercise their right to demand the repurchase of loans that do not comply with representations and warranties or pursue claims for breach of contract, rescissory relief, misrepresentation and/or breach of contractual warranties pursuant to the policies and the RMBS Transaction Documents because the Proceedings or Events (namely, the rehabilitation filing and the payment moratorium, both approved by this Court) caused Ambac and the Segregated Account to be in default under those contracts or otherwise impaired the right of Ambac and the Segregated Account to seek recovery with respect to those Transaction Documents. Certain of the counterparties have argued that the rights of Ambac and/or the Segregated Account are suspended because they have defaulted on their insurance obligations due to the Proceedings or one or more of the Events. Other counterparties have framed the point as an affirmative defense, asserting that Ambac and/or the Segregated Account should not be permitted to recover for breach of contract or otherwise, due to their own breaches of the parties' agreements in the form of the Proceedings or one or more of the Events. Certain of these

counterparties refer to those occurrences as “insurer default,” “certificate insurer default,” or “credit enhancer default” (collectively the “Insurer Default Defenses”).

5. If these arguments were successful, Ambac and the Segregated Account would lose their pre-existing rights to obtain relief for counterparties’ breaches of the Transaction Documents due to the occurrence of the Events. This is precisely the type of consequence the Injunction was intended and crafted to prevent. The Rehabilitator believes that such a consequence is precluded by provisions of the existing Injunction. As noted above, virtually every paragraph of the Injunction aims to prevent contractual counterparties from taking advantage of the circumstance of rehabilitation to gain an inequitable advantage over policyholders, to prejudice policyholders as a whole, and/or to reduce claims-paying resources available to fund the Rehabilitation for the benefit of policyholders. For example, paragraph 7 of the Injunction enjoins parties from failing to pay obligations “owed (or that would have been owed but for the occurrence of the Events . . .) to the Segregated Account, any Allocated Subsidiary or the Ambac General Account under or in connection with policies or contracts allocated to the Segregated Account . . . or any Transaction Documents associated therewith or related thereto.” Assuming liability is proven, the damages arising from the above-referenced claims and causes of action constitute payments owed to Ambac; under paragraph 7, a party cannot claim a right to withhold them based on the occurrence of the Proceedings or other Events.

6. Each of the counterparties to the RMBS Transaction Documents were served via first class mail with hard copies of this Court’s March 24, 2010 Order For Temporary Injunctive Relief, along with copies of the Commissioner’s Verified Petition and related first-day filings, including the Order for Rehabilitation and the court-

approved Form of Notice order. *See* Joint Affidavits of Service filed April 26, 2010. Additionally, information about the Temporary Order for Injunctive Relief was published nationally. The scope of relief provided for in the Injunction became permanent pursuant to the Court's order confirming the Rehabilitator's Plan of Rehabilitation (see Confirmation Order at page 59, ¶ 9; dkt. 692).

7. Nevertheless, and for the avoidance of doubt, the Rehabilitator believes it appropriate to have the court declare its meaning and intent on this issue to avoid any risk of misinterpretation of the Injunction by parties or a foreign court, especially in light of the fact that Ambac's contract-based causes of action constitute significant policyholder assets. Although the Rehabilitator believes that the language of the Injunction so clearly prohibits the Insurer Default Defenses described above in numbered paragraph 4 of this Motion that it arguably would be appropriate to seek to hold parties raising such defenses in contempt of this Court's Injunction, the Rehabilitator elected to pursue the less aggressive approach reflected in this Motion in the hope that those counterparties may simply have not been aware of, or understood, the scope of this Court's Injunction.

8. As noted at the Plan confirmation hearing and in the Plan disclosure materials, the Segregated Account and Ambac possess valuable claims and causes of action against various counterparties and/or third-party obligors to RMBS Transaction Documents that arise out of breaches of representations and warranties, other breaches of contract and, in some cases, fraudulent conduct that occurred prior to the Proceedings and other Events (the "RMBS Remediation Claims"). (11/16/10 Tr. at 202:9-206:4.) The RMBS Remediation Claims are described in greater detail in the Rehabilitator's accompanying Motion For Approval Of The Process For Settling RMBS

Remediation Claims (the “Settlement Process Motion”). The Settlement Process Motion also describes the value of those Claims to the rehabilitation in greater detail, and reviews the process by which the Rehabilitator assesses, pursues and proposes to settle such Claims. Rather than reiterate those descriptions here, the Rehabilitator refers the Court and other readers to the Settlement Process Motion for that information. Successful pursuit of the RMBS Remediation Claims will have a substantial positive impact on the rehabilitation.

9. The Rehabilitator’s act of commencing the rehabilitation and the following of orders issued under it should not, and does not, eliminate these valuable pre-existing assets of the insurer. *See* Wis. Stat. § 645.05(1)(k) (permitting the entry of injunctive relief to prevent “any threatened or contemplated action that might lessen the value of the insurer’s assets”); *North Carolina ex rel. Long v. Alexander & Alexander Servs., Inc.*, 711 F. Supp. 257, 264 (E.D.N.C. 1989) (holding that defenses raised against an insurer in rehabilitation are invalid to the extent they arise out of conduct by the Commissioner). If it were otherwise, then the Rehabilitator would be deterred from initiating formal delinquency measures, a result that the legislature sought to avoid in enacting Chapter 645. *See* Wis. Stat. Ann. ch. 645 introductory cmt. on “Basic Problems” (identifying regulatory “[r]eluctance to take effective action” as a primary problem addressed in Chapter 645).

10. This Court has the authority to enter the proposed relief for the same reasons that justified its entry of the various Injunction provisions preserving Ambac’s contract rights notwithstanding the Events. As this Court noted in rejecting challenges to those provisions:

[C]ontractual rights [relating to insurers] are ‘subject to the reasonable exercise of the state’s police power[,] and ‘[t]he only restriction on the exercise of this power is that the state’s action shall be reasonably related to the public interest and shall not be arbitrary or improperly discriminatory.’ *Carpenter [v. Pac. Mut. Life Ins. Co. of Cal.]*, 74 P.2d [761,] 744-75 [(Cal. 1937)]. *Accord Minor [v. Stephens]*, 898 S.W.2d [71,] 80 [(Ky. 1996)] (“Neither the insurance company nor policyholders have inviolate rights that characterize ordinary private contracts. The policyholders’ contracts as well as others with an interest in the company, are subject to a reasonable exercise of state police power.”); *Foster [v. Mut. Fire, Marine & Inland Ins. Co.]*, 614 A.2d [1086,] 1095 [(Pa. 1992)] (confirming a plan that altered contractual rights because it ‘foster[ed] the legitimate public purpose of safeguarding the public interest from the potentially innumerable consequences of [the insurer’s] insolvency”). There is nothing arbitrary or unfairly discriminatory in uniformly enjoining the transfer and exercise of certain contract rights that would be detrimental to the rehabilitation as a whole.

(Oct. 26, 2010 Court Decision (dkt. 489), at 11.)

11. Similarly, there is nothing arbitrary or unfairly discriminatory in confirming and declaring the scope, meaning and intent of the Injunction to ensure that parties to contracts relating to policies in the Segregated Account cannot avoid contractual obligations or consequences on the basis of the Proceeding, claim-payment moratorium or other of the Events. Indeed, it would be inequitable and unjust for such parties’ misrepresentations, breaches of warranties and, in some cases, fraudulent conduct to be a substantial cause of the insurer’s delinquency (causing billions of dollars in damages), only to escape liability *because* of the very Events they helped cause.

12. There is a community of interest by and between the Segregated Account and Ambac respecting the RMBS Remediation Claims. Section IV of the Plan of Operation for the Segregated Account (attached at Tab 1 to the Commissioner’s Verified Petition for Rehabilitation provides that:

Remediation. All remediation claims, defenses, offsets, and/or credits (except to the extent described in clause (iv) of Section V-“Collateral Security” below) if any, in respect of policies allocated to the Segregated Account, whether now existing or hereafter arising, are allocated to the Segregated Account together with such policies.

While the entitlement to receive cash recoveries from the RMBS Remediation Claims was not allocated to the Segregated Account, such recoveries are subject to the Secured Note running in favor of the Segregated Account and constitute part of the “Collateral Security” for the Secured Note. As specified in the Plan of Operation at § V-(iv), Ambac’s General Account granted a security interest in favor of the Segregated Account in “any recoveries arising from remediation efforts or reimbursement or collection rights with respect to policies allocated to the Segregated Account.” Because of this community of interest and the substantial claims-paying resources it provides to the Segregated Account, the Injunction intentionally protects both the Segregated Account and Ambac with respect to actions, claims and defenses of third parties respecting the Events and these Proceedings. *See Wis. Stat. §§ 645.05(d) and (k).*

13. The Rehabilitation Court’s interpretation of its own injunction is subject to the highly deferential “erroneous exercise of discretion” standard of review. It is well settled that a trial court’s decision to grant an injunction is a discretionary one and the scope of the injunction is also within the trial court’s discretion.” *City of Wis. Dells v. Dells Fireworks, Inc.*, 197 Wis. 2d 1, 15, 539 N.W.2d 916, 921 (Ct. App. 1995). Appellate review of such discretionary decisions is “highly deferential”:

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

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

Antibiotics Co., 62 F.3d 903, 908 (7th Cir. 1995) (Posner, C.J.) (“When the district judge who is being asked to interpret an injunction is the same judge who entered it and is thus familiar with its history, . . . we should give particularly heavy weight to the district court’s interpretation.”). As explained in the insurer rehabilitation context involved here:

To further the rehabilitation scheme, courts may impose injunctions prohibiting commencement or prosecution of litigation against an insolvent insurer while rehabilitation efforts are underway. *Trial courts have considerable discretion concerning the scope of any such injunctions, including whether an injunction should be modified, and we will only disturb such a determination if the court abused its discretion.*

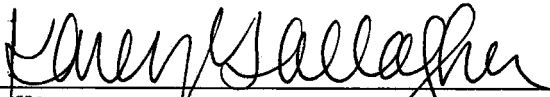
In re Rehabilitation of Frontier Ins. Co., 870 N.Y.S.2d 144, 146 (N.Y. App. Div. 2008) (emphasis added, citations omitted).

14. The Rehabilitator will not argue (and does not intend) that this Motion or the relief sought in it affects the fully briefed appeals presently pending before the Wisconsin Court of Appeals that pertain to the Injunction. The appellants in those appeals before the Wisconsin Court of Appeals need not file a special reservation of rights in this Court with respect to this Motion to confirm that understanding.

15. For all of the reasons set forth above, the Rehabilitator respectfully requests that this Court grant this Motion to Confirm and Declare Relief Respecting March 24, 2010 Order for Injunctive Relief by granting this Motion and entering relief in a form consistent with that proposed in the accompanying form of order.

Dated this 17th day of August, 2012.

COYNE, SCHULTZ, BECKER & BAUER, S.C.

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