COURT OF APPEALS OF WISCONSIN
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,

v.

FFI Fund Ltd., FYI Ltd., Olifant Fund, Ltd., Axonic Capital LLC, Axonic Credit Opportunities Master Fund LP and OC 523 Master Fund LTD,
Interested Parties-Appellants.

Appeal No. 2014AP002033

On Appeal from the Order of the Dane County Circuit Court
Case No. 2010CV001576
The Honorable William D. Johnston Presiding

INTERESTED PARTIES-APPELLANTS' BRIEF

REINHART BOERNER VAN DEUREN S.C.
R. Timothy Muth
WI State Bar ID No. 1010710
1000 North Water Street, Suite 1700
Milwaukee, WI 53201-2965
Telephone: 414-298-1000

GOODWIN PROCTER LLP
Emanuel C. Grillo
Eamonn O'Hagan
The New York Times Building
620 Eighth Avenue
New York, NY 10018-1405
Telephone: 212-813-8841

Attorneys for Interested Parties-Appellants

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Cases

Statutes

STATEMENT OF ISSUES FOR REVIEW

ISSUE I

Through the issuance of a declaratory judgment and permanent injunction, the Circuit Court awarded the Rehabilitator of the Segregated Account of Ambac Assurance Corporation (the "Rehabilitator") priority to a stream of funds under a Pooling and Servicing Agreement. Did the Circuit Court err in granting such relief when: (i) necessary third-parties with a conflicting claim to the funds at issue were not made parties and were not allowed to intervene and (ii) the Rehabilitator requested such relief simply by motion on less than 30-days' notice?

The Circuit Court awarded such relief, overruling objections from the Appellants FFI Fund Ltd., FYI Ltd., Olifant Fund, Ltd., Axonic Capital LLC, Axonic Credit Opportunities Master Fund LP, and OC 523 Master Fund Ltd. (collectively the "Senior Certificate Holders") that they were entitled to the procedural protections in Wis. Stat. §§ 645.05(1) and 806.04.

The appellate court's review of questions of law underlying the Circuit Court's decision is de novo. *Kocken v. Wis. Council*

40, 2007 WI 72, ¶ 26, 301 Wis. 2d 266, 732 N.W.2d 828. "Whether to allow or to deny intervention as of right is a question of law that [the appellate] court decides independently of the circuit court … but benefiting" from the circuit court's analysis. *Helgeland v. Wis. Municipalities*, 2008 WI 9, ¶ 41, 307 Wis. 2d 1, 745 N.W.2d 1.

ISSUE II

New York law, which governs the Pooling and Servicing Agreement, has long required courts to consider all relevant transaction documents under the doctrine of contractual integration. Did the Circuit Court err by (i) disregarding the Prospectus Supplement prepared by the parties in this transaction and filed with the U.S. Securities and Exchange Commission and (ii) considering extrinsic facts (including "facts" not even in the record) after finding no ambiguity in the Pooling and Servicing Agreement?

In interpreting the Pooling and Servicing Agreement, the Circuit Court ignored the Prospectus Supplement in violation of governing New York law. Moreover, the Circuit Court considered extrinsic information (including "facts" not made part of the

record) even though it concluded that the Pooling and Servicing Agreement was unambiguous.

The appellate court's review of questions of law underlying the Circuit Court's decision is de novo. *Kocken*, 301 Wis. 2d 266, ¶ 26. The standard of review of interpretation of a contract is de novo. *Dieter v. Chrysler Corp.*, 2000 WI 45, ¶ 15, 234 Wis. 2d 670, 610 N.W.2d 832.

ISSUE III

Did the Circuit Court err in interpreting the ***interest*** "waterfall" of the Pooling and Servicing Agreement to permit Ambac Assurance Corporation to obtain reimbursement for insurance payments made on account of ***principal***?

Disregarding the plain language and structure of the Pooling and Servicing Agreement and related transaction documents, the Circuit Court ruled that Section 5.01(a)(i) of the Pooling and Servicing Agreement permitted Ambac to obtain reimbursement for insurance payments made on account of principal even though that section is limited to reimbursement for payments made on account of interest.

The appellate court's review of questions of law underlying the Circuit Court's decision is de novo. *Kocken*, 301 Wis. 2d 266, ¶ 26. The standard of review of interpretation of a contract is de novo. *Dieter* , 234 Wis. 2d 670, ¶ 15.

STATEMENT ON ORAL ARGUMENT

Appellants request oral argument. Because of the complexity of the contract provisions raised in the case, we anticipate that the briefs may not fully address all of the Court's concerns, and oral argument will aid the Court in its resolution of the legal disputes and application of law to the facts in this case.

STATEMENT ON PUBLICATION

The Court's opinion in this case will meet the criteria for publication in Wis. Stat. § 809.23. Because Wisconsin regulates many insurance companies, issues raised in this appeal are likely to recur in future proceedings. A published opinion will aid the lower courts and the parties in addressing the issues of substantial and continuing public interest that have arisen in this rehabilitation and may arise in future insurance rehabilitations in this State and elsewhere.

STATEMENT OF THE CASE

I. The Nature of the Case and Statement of Facts

The Appellants are: (i) FFI Fund Ltd., FYI Ltd., and Olifant Fund, Ltd. (the "Investor Funds") and (ii) Axonic Capital LLC, Axonic Credit Opportunities Master Fund LP, and OC 523 Master Fund Ltd. (the "Axonic Parties"). The Investor Funds and the Axonic Parties are collectively referred to as the "Senior Certificate Holders." As described below, the errors of the Circuit Court resulted in a short-circuited proceeding that limited the Senior Certificate Holders' opportunity to protect their interests in millions of dollars of interest payments that were diverted from their proper distribution under the transaction documents.[1]

This appeal involves a mortgage securitization in which thousands of residential real estate mortgage loans were pooled together. (*See generally* R.904:6-31, A-App.497-522 (Second Fraser Aff., Ex. A, pp. S1-S26).) The interests in the pool were divided into several classes from senior classes with a higher

---

1 This appeal does not arise from the terms of the plan of rehabilitation for the Segregated Account of Ambac Assurance Corporation or the terms of any policy transferred to the Segregated Account (as defined below).

priority claim on the proceeds of the mortgages to junior classes with a lesser priority. (*Id.*) Ownership interests in the pool are represented by certificates, and the investors in the pool are known as certificate holders. (*Id.*) Interests in the pool are then sold to investors. (*Id.*) The Senior Certificate Holders hold uninsured certificates in those more senior classes. (R.906:3, A-App.867; R.901:1, A-App.475.)

When borrowers repay the principal and interest on their loans, the amounts owed to investors in more senior classes must be paid in full before the more junior classes can be paid. (*See generally* R.904:6-31, A-App.497-522.) This is often referred to as a distribution "waterfall" in which the flow of payments from borrowers first fills up the pool of senior classes before it spills over into payments to the next most senior class, which fills up and spills over to the next most senior class and so on. In this instance, the Circuit Court improperly authorized the prior payment of Ambac Assurance Corporation instead of the Senior Certificate Holders contrary to the terms of the relevant transaction documents.

The 2006 mortgage securitization involved in this appeal was known as the HarborView transaction. It involves a pool of $2.867 billion of primarily adjustable rate mortgages (the "Trust Fund"). (R.904:4, A-App.495.) Deutsche Bank National Trust Company ("Deutsche Bank" or the "Trustee") serves as trustee and holds the mortgages and coordinates the distribution of payments according to the waterfall provisions. (R.886:3, A-App.127 (Eleventh Peterson Aff., ¶ 6).) There are separate waterfall provisions in the HarborView transaction for principal payments and interest payments. (*See* R.886:289-93, A-App.241-245 (Eleventh Peterson Aff., Ex. D, pp. 85-89).)

Ambac Assurance Corporation ("Ambac") issued insurance that enhanced the credit of certain classes of certificates in the HarborView transaction (the "Policies"). (R.886:8-17, A-App. 132-141 (Eleventh Peterson Aff., Ex. A).) Essentially, Ambac promised that, if there was not enough money in the pool after payments to more senior classes, Ambac would step in and make the payments to the holders of insured certificates in that class. (*See generally id.*)

Several documents define the rights and obligations of the various parties to the HarborView transaction. Relevant to this appeal are (i) the Pooling and Servicing Agreement, dated September 1, 2006 (the "PSA") among Greenwich Capital Acceptance, Inc., as depositor, Greenwich Capital Financial Products, Inc., as seller, and Deutsche Bank National Trust Company, as trustee of the HarborView Mortgage Loan Trust (R.886:200-349, A-App.152-301 (Eleventh Peterson Aff., Ex. D)), and (ii) the Prospectus Supplement, dated October 3, 2006 (the "Prospectus Supplement") concerning approximately $2.867 billion principal amount of HarborView Mortgage Loan Trust Mortgage Loan Pass-Through Certificates, Series 2006-9 (the "Certificates") (R.904:3-373, A-App.494-864 (Second Fraser Aff., Ex. A).)

The Certificates are sub-divided into different classes by priority, including "Senior Certificates" and "Subordinate Certificates." (R.904:11-13, A-App.502-504 (Second Fraser Aff., Ex. A, pp. S-6-S-8).) Section 5.01 of the PSA, which is governed by New York law, and the Prospectus Supplement set forth the relative priorities of each class of Certificates with respect to

distributions of proceeds from the Trust Fund. (R.886:289-98, A-App.241-250 (Eleventh Peterson Aff., Ex. D, pp. 85-94); R.904:101, A-App.592 (Second Fraser Aff., Ex. A, p. S-96).) The Senior Certificate Holders hold Class 2A-1A Certificates (R.906:3, A-App.867). Ambac is the insurer of Class 2A-1C2 Certificates (the "Insured Certificates" as held by the "Junior Insured Class") (R.886:2, A-App.126 (Eleventh Peterson Aff., ¶ 5)), which is junior to the Certificates held by the Senior Certificate Holders (the "Senior Uninsured Class"). (R.904:12, A-App.503 (Second Fraser Aff., Ex. A, p. S-7).) Under the Policies, Ambac must pay the Junior Insured Class to the extent assets in the Trust Fund are not available to satisfy the Insured Certificates under the interest and principal "waterfalls" set forth in Section 5.01 of the PSA on the relevant dates. (R.886:9, A-App.133 (Eleventh Peterson Aff., Ex. A, p. 1).) Ambac then steps into the shoes of the Junior Insured Class if Ambac pays under its Policies.

A year after the HarborView transaction closed, the Great Recession began. Mortgage defaults increased significantly including defaults on mortgages involved in the HarborView transaction, and Ambac became obligated to make payments to

the holders of Insured Certificates. (R.886:3-4, A-App.127-128 (Eleventh Peterson Aff., ¶ 7).) It was this kind of liability, across a wide variety of financial guarantees issued by Ambac, which led the Wisconsin Commissioner of Insurance to commence the present rehabilitation proceedings involving the Segregated Account of Ambac Assurance Corporation (the "Segregated Account"). *See Nickel v. Wells Fargo Bank (In re Rehab. of Segregated Account of Ambac Assurance Corp.)*, 2013 WI App 129, 351 Wis. 2d 539, 841 N.W.2d 482 (hereinafter "*Nickel*"). The Policies issued by Ambac on the Insured Certificates in the HarborView transaction became part of the Segregated Account. (R.886:2, A-App.126 (¶ 4).)

Mortgage borrowers continue to pay amounts into the Trust Fund and thus, funds have been available to pay interest under the PSA's ***interest*** waterfall. (R.886:5, A-App.129 (¶ 12).) The dispute on appeal is the extent that Ambac as the insurer for the Junior Insured Class may be reimbursed for principal as well as interest payments under the interest waterfall. Under the PSA, Ambac only has a subrogation right to be reimbursed for interest amounts it paid to the Junior Insured Class to the extent

there are funds in the interest waterfall which would otherwise go to such Junior Insured Class. (R.886:213, A-App.165 (Ex. D., p. 9).) Contrary to the terms of the PSA, the Trustee and the Rehabilitator decided that Ambac should be reimbursed for amounts it paid both for principal ***and*** interest out of the interest waterfall. (R.886:6, A-App.130 (¶ 16).) The Senior Certificate Holders dispute this interpretation and assert that Ambac should only be reimbursed for interest payments out of the interest waterfall.

By letters dated March 25, 2014 and April 8, 2014, the Senior Certificate Holders objected to the Trustee's interpretation of the PSA and encouraged the Trustee "to seek judicial direction as other trustees have done in similar situations." (R886:350-54, A-App.302-306 (Eleventh Peterson Aff., Ex. E); R.906:22, A-App.886 (Investor Funds Objection, Ex. A, p.1).)

II. Procedural Status of the Case

Although this dispute does not directly implicate the rights of any insured or an insurer under a policy, but rather a series of unrelated mortgage securitization documents, this appeal arguably comes before this Court out of the rehabilitation

proceedings for the Segregated Account. The background of those rehabilitation proceedings is detailed in this Court's decision in *Nickel* and will not be repeated here. None of the Senior Certificate Holders participated in any fashion in the prior litigation surrounding the rehabilitation of the Segregated Account.

As noted above, the Senior Certificate Holders wrote to the Trustee in March and April 2014 to object to the Trustee's interpretation of the PSA's waterfall provisions and to request that the Trustee "seek a judicial direction as other trustees have done in similar situations." (R.886:350-54, A-App.302-306 (Eleventh Peterson Aff., Ex. E); R.906:22, A-App.886 (Investor Funds Objection, Ex. A, p. 1).) Instead, on June 9, 2014, the Rehabilitator, with the Trustee's apparent support as described below, filed a motion seeking both a declaratory judgment and a permanent injunction enforcing the interpretation of the PSA which favored Ambac (the "Motion"). (R.885, A-App. 110-124.)

Specifically, the Rehabilitator sought an order from the Circuit Court declaring that his purported interpretation of the PSA's waterfall provisions was correct and compelling all

relevant entities to comply with that interpretation. (*See generally* R.885, A-App. 110-124.) Thus, the requested relief sought to adversely affect the rights of the Senior Uninsured Class, including, but not limited to the Senior Certificate Holders. The sole support for the motion was an affidavit of Roger A. Peterson, Special Deputy Commissioner for the rehabilitation of the Segregated Account. (R.886, A-App.125-306.)

On that same day, the Trustee disseminated a notice of the Motion to Certificate holders. (R.906:24-27, A-App.888-891 (Investor Funds Objection, Ex.B).) In that notice, the Trustee did not solicit any input from the Certificate holders but merely directed that "any holder of Securities who disagrees with the relief sought in the Motion must pursue any objection [to the relief sought in the Motion] independently of the Trustee." *Id.*

The Axonic Parties moved to intervene and requested an extension of time to respond to the motion beyond the 30 days so as to conduct discovery among other things. (R.894, A-App.424-425; R.895:5, A-App.430.) That motion to intervene was denied. (R.933:71, A-App.105.) The Senior Certificate Holders both filed

briefs opposing the Motion on July 2, 2014. (R.902, A-App.477-491; R.906, A-App.865-891.)

In opposing the Motion, the Senior Certificate Holders demonstrated that under Section 5.01(a)(i)(C) of the PSA, Ambac is entitled to reimbursement for payments made under the Policies solely with respect to interest ***after*** interest payments are made to the holders of Senior Certificates. (R.886:289-90, A-App.241-242 (Eleventh Peterson Aff., Ex. D, pp. 85-86) (PSA § 5.01(a)(i)(B)-(C)).) Under PSA Sections 5.01(a)(ii) and 5.01(a)(iii), Ambac is logically entitled to "any Certificate Reimbursement Amounts," which include payments made under the Policies with respect to principal, ***after*** the principal payments are made to the holders of Senior Certificates. (R.886:291-92, A-App.243-244 (Ex. D, pp. 87-88) (PSA §§ 5.01(a)(ii)(A)-(B); 5.01(a)(iii)(A)-(B)).) Thus, under the PSA, interest payments and insurance reimbursement payments for interest are distinguished from principal payments and insurance reimbursement payments for principal. Insurance reimbursements for payments must follow the appropriate category of payment.

III. Disposition in the Circuit Court

The Circuit Court conducted a hearing on the Motion on July 7, 2014. (R.933, A-App.035-109(July 7, 2014 Hearing Transcript).) No witnesses testified. There were no rulings on the admissibility of evidence and no prior opportunity to conduct discovery. The hearing consisted of the arguments of counsel followed by the Circuit Court's ruling from the bench. First, the Circuit Court denied the Axonic Parties' Motion to Intervene. (R.933:71, A-App.105.) The Circuit Court then granted the Motion in its entirety. (R.933:72-73, A-App.106-107.)

In providing the reasons for its ruling, the Circuit Court first ruled that the PSA was unambiguous. (R.933:72, A-App.106.) Notwithstanding this conclusion, the Circuit Court supported its ruling with extrinsic evidence, including facts not in the record, but at the same time ignored critical transaction documents. First, the Circuit Court asserted that all of the parties to the PSA had agreed on its proper interpretation (although there was no evidence in the record to this effect) and that all of those parties had been consistently proceeding under that interpretation in administering the reimbursements to

Ambac. (*Id.*) The Circuit Court also concluded that the Certificate holders had acquired their interests after the Trustee had already begun administering the reimbursements in this fashion and that the Appellants therefore had notice of this interpretation prior to acquiring Certificates (again in the absence of any such evidence). (*Id.*) Moreover, the Circuit Court made no finding as to what state's law should apply, whether the contract was integrated, or whether parol evidence should be allowed beyond the purported extrinsic evidence considered by the Circuit Court.

The Circuit Court's written order expressly included both declaratory and injunctive relief:

> [T]he Court hereby orders and declares that … the phrase "reimbursement amounts owed to the Certificate Insurer" … means an amount of money equal to those amounts Ambac and the Segregated Account pay out under the Policies, regardless of whether those amounts are attributable to principal or interest; and
>
> 3. All parties … shall calculate the reimbursement amounts due … and shall promptly transmit … in accordance with past practice and this Order.

(R.918:1-2, A-App.001-002.) The Senior Certificate Holders timely filed their Notice of Appeal on August 21, 2014. (R.922.)

ARGUMENT

I. The Circuit Court Prejudiced the Senior Certificate Holders by Issuing a Final Declaratory Judgment and Permanent Injunction Affecting Substantive Rights of Strangers to the Rehabilitation Proceedings with No More Process Than a Motion and Hearing on 30-Days' Notice.

The Circuit Court's ruling must be reversed because Wisconsin law does not permit the granting of a final declaratory judgment and a permanent injunction against non-parties (such as the Senior Certificate Holders) through the abbreviated procedure employed by the Rehabilitator. By denying the Senior Certificate Holders the procedural protections required by Wisconsin law, the Circuit Court prejudiced the Senior Certificate Holders. These protections would have included the ability to contest the Circuit Court's personal jurisdiction over affected parties, to challenge disputed facts, to develop and present evidence, and to then, based on an adequate record, brief outcome-determinative issues such as contractual integration and ambiguity. Because these fundamental protections were denied the Senior Certificate Holders (as well as the entire Senior Uninsured Class), the Circuit Court's ruling cannot stand.

A. Uninsured Certificate Holders Are Strangers to the Rehabilitation Proceedings.

Until the filing of the Motion, nothing in the rehabilitation proceedings affected the rights of holders of uninsured Certificates in the HarborView transaction. Holding an uninsured Certificate in the HarborView transaction means that the Certificate was not insured by Ambac, and therefore, such Certificate holders are not claimants in the Segregated Account. Uninsured Certificate holders did not come into privity of contract with Ambac as a result of the HarborView transaction, nor are they third party beneficiaries of any contractual promise of Ambac as a result of the HarborView transaction. These interests of the Senior Certificate Holders have quite simply been outside of the scope of the rehabilitation proceedings being conducted in the Circuit Court. (*See supra* pp. 5-11.)

The Rehabilitator does not and cannot dispute this point.

B. The Order Lacked a Statutory Basis and Ignored Applicable Requirements for Obtaining the Relief Sought.

The Motion of the Rehabilitator cited no provision of Wisconsin law to sustain the requested relief in a dispute

between these strangers to the rehabilitation and the Trustee. (R.885, A-App.110-124) The Rehabilitator pointed to no provision of the Wisconsin insurance liquidation statutes, Wisconsin civil procedural statues or Wisconsin trust law which provided the procedural or jurisdictional basis to allow the Trustee to pay the Rehabilitator on account of the rights of the Junior Insured Class ahead of the Senior Certificate Holders. (*Id.*) In the record on appeal, this Court will not find a statutory basis in the Motion filed by the Rehabilitator or the Order entered by the Circuit Court.

Although the Rehabilitator did not offer any statutory support for his approach, Wisconsin statutes in fact govern the type of relief sought here. Wisconsin Stat. § 645.05(1) directs the Rehabilitator to comply with chapter 813 to obtain injunctive relief against other parties. Wisconsin Stat. §806.04 governs the awarding of declaratory relief.

While Wisconsin law does authorize a duly appointed rehabilitator to apply to the court for "restraining orders, temporary and permanent injunctions, and other orders," that authority is not unlimited. Wis. Stat. § 645.05(1). Rather, the

Rehabilitator's authority is subject to—and limited by—the rules for applying for, obtaining, and issuing such orders under Wisconsin law. *Id.* ("Any receiver appointed in a proceeding under this chapter may at any time apply for and any court of general jurisdiction in this state may grant, ***under the relevant sections of ch. 813***, such restraining orders, temporary and permanent injunctions, and other orders . . .") (emphasis added).

The Order entered by the Circuit Court contains permanent injunctive relief, ordering all parties to the securitization transaction to administer funds in accordance with the Rehabilitator's interpretation. (R.918, A-App.001-002.) Wisconsin law recognizes that a permanent injunction is "an extremely powerful instrument" that is "not to be issued lightly." *Pure Milk Prods. Coop. v. Nat'l Farmers Org.*, 90 Wis. 2d 781, 800, 280 N.W.2d 691 (1979). Not surprisingly, therefore, a permanent injunction will be granted only to prevent irreparable injury to the party seeking the injunction. *See id.*; Wis. Stat. § 813.05(1). Moreover, "[i]njunctions operate in personam and will not issue against one who is beyond the court's jurisdiction." *Dalton v. Meister*, 84 Wis. 2d 303, 311, 267 N.W.2d 326 (1978)

(finding that nonparty is not subject to injunction and may be held in contempt for violating it only to the extent it aided and abetted a party in violation of injunction).

Thus, under Wisconsin law, a court may not enjoin entities that are not parties to the proceeding before it nor subject to the court's jurisdiction. Here, neither the Investor Funds nor the Axonic Parties were ever made parties to the action. In fact, the Axonic Parties attempted to intervene, but were denied the right to do so. (R.933:71, A-App.105.) The Investor Funds specifically objected to the Circuit Court's attempt to exercise jurisdiction over them in a way which would impact their contractual and other rights in the securitization. (R.906:1, A-App.865.) Beyond denying the Axonic Parties' motion to intervene, the Circuit Court made no findings with respect to its jurisdiction to affect the rights of these strangers to the rehabilitation proceedings. (See R.933:72-73, A-App.106-107.) As a result, the injunctive relief granted by the Circuit Court cannot stand.

The declaratory relief in the Circuit Court's order also runs afoul of Wisconsin law. As in the case of injunctive relief, a party seeking a declaration of rights must join all necessary parties in a

suit seeking that declaration. Under Wisconsin law, "[w]hen declaratory relief is sought, ***all persons shall be made parties who have or claim any interest which would be affected by the declaration, and no declaration may prejudice the right of persons not parties to the proceeding***." Wis. Stat. § 806.04(11) (emphasis added); *Fire Ins. Exch. v. Basten*, 202 Wis. 2d 74, 549 N.W.2d 690 (1996) (interested persons must be joined as parties in a declaratory judgment action). The declaration in the Circuit Court's Order prejudiced the Senior Certificate Holders (and all other members of the Senior Uninsured Class) by declaring that payments received by the Trustee should be paid to Ambac rather than to the Senior Certificate Holders and other holders in the Senior Uninsured Class.[2]

---

[2] Although the Rehabilitator's Motion failed to meet the requirements to obtain declaratory and injunctive relief, the Rehabilitator did not lack for procedural tools to appropriately pursue such relief. Interpleader has been used successfully to resolve the precise issue in dispute here (*i.e.*, whether a PSA's waterfall provisions permitted a certificate insurer to obtain reimbursement for losses related to both principal and interest before the holders of insured certificates are entitled to recover principal). *See, e.g., Wells Fargo Bank, N.A. v. ESM Fund I, LP*, 785 F. Supp. 2d 188 (S.D.N.Y. 2011), *aff'd*, 504 Fed. App'x 38 (2d Cir. 2012). Yet another procedural mechanism for deciding a dispute over a PSA's waterfall provisions is a trust instruction proceeding. *See, e.g., In re Trusteeship Created by Am.Home Mortg. Inv. Trust 2005–2*, No. 14 Civ. 2494, 2014 WL 3858506 (S.D.N.Y. July 24, 2014). Unlike the motion practice below, both an interpleader and a trust instruction proceeding provide parties

C. Prior Decisions Related to the Ambac Segregated Account Do Not Govern the Interpretation of the PSA.

The Rehabilitator asserted that three prior decisions related to the Ambac Segregated Account support the Circuit Court's abbreviated procedure and findings in this matter. (R.933:5-28, A-App.039-062.) In fact, all those settings are both factually and procedurally distinguishable. As such, those decisions cannot support the Circuit Court's ruling.

This Court's decision in *Nickel* does not permit the Rehabilitator to ignore proper legal procedure and jurisdiction in any dispute merely because the Rehabilitator is involved. The appeals at issue there dealt with the creation of the rehabilitation plan for the Segregated Account (the "Plan" or the "Rehabilitation Plan") and the appropriateness of rehabilitating only a portion of Ambac's business. This Court's decision found

---

with conflicting interests in the two possible interpretations to intervene. Thus, efficient and effective procedural mechanisms for resolving the exact type of dispute involved in this matter are available while offering all affected parties the rights to be heard.

that in a challenge to the preparation of the Rehabilitation Plan—which, unlike the instant case was ***not*** a dispute among parties to a separate agreement—that the only requirement was notice and a hearing. *Nickel*, 2013 WI App 129, ¶¶ 110-11. That decision was based on the language of Wis. Stat. § 645.33(5), a subsection dealing only with the administrative and management task of the creation and approval of a ***plan*** :

> (5) **Reorganization plan**. The rehabilitator may prepare a plan for the reorganization, consolidation, conversion, reinsurance, merger or other transformation of the insurer. Upon application of the rehabilitator for approval of the plan, and after such notice and hearing as the court prescribes, the court may either approve or disapprove the plan proposed, or may modify it and approve it as modified.

Wis. Stat. § 645.33(5). Thus, this section only applies to the plan approval process and ***not*** to a dispute among parties to a separate agreement. As such, it cannot mean that, in any other litigation that may subsequently take place between the Rehabilitator and any other entity, the Rehabilitator can have any and all disputes settled simply by filing a motion and holding a hearing in the Circuit Court.

The Rehabilitator also contended that this Court's decision in *Nickel v. Assured Guaranty Corp. (In re Rehabilitation of*

Segregated Account of Ambac Assurance Corp.), No. 2011AP1486, 2013 WI App 138, 351 Wis. 2d 681, 840 N.W.2d 137, 2013 WL 5745987 (Oct. 24, 2013) (unpublished) (hereinafter "*Assured Guaranty*"), eliminated the requirement that persons needed to be made parties before their rights can be adjudicated. The issue in *Assured Guaranty* was personal jurisdiction over a reinsurer. *Id.*, ¶¶ 9-14. Unlike here, the reinsurer in that matter had a contract with Ambac. *Id.*, ¶ 2. Key to this Court's decision were the provisions in Wis. Stat. § 645.04, which provide special basis for jurisdiction over the reinsurers of insolvent insurance companies and which specifically address arbitration clauses in reinsurance contracts – the subject matter of that action. *Id.*, ¶¶ 11-12. Here, (i) no contract or other relationship exists between the Senior Certificate Holders and Ambac arising from the HarborView securitization, (ii) no statute exists establishing jurisdiction over this dispute, and (iii) the Motion did not seek to enforce a term of the Rehabilitation Plan against parties to the earlier proceedings. As such, the decision in *Assured Guaranty* does not cover this dispute.

Finally, the decision in *In re Rehabilitation of the Segregated Account of Ambac Assurance Corp.*, No. 13-cv-325-bbc (W.D. Wis. July 8, 2013) (order granting motion for remand) (hereinafter "*OneWest*"), dealt with the propriety of removing an action out of the receivership court to federal district court, not in interpretation of a contract such as the PSA. The sole issue there was whether OneWest Bank, a party to Ambac's rehabilitation proceedings, could remove the Rehabilitator's motion in that case to federal court. *See generally id.* That motion in *OneWest* sought approval of the Rehabilitator's exercise of Ambac's contractual right to replace OneWest as a servicer of mortgage loans underlying certain RMBS insured by Ambac. *Id.* at 1. The court did not address whether the type of relief sought by the Rehabilitator here (which significantly impacts non-parties to the rehabilitation) can be granted on motion. Thus, neither the *OneWest* decision, nor the prior decisions of this Court, sanction awarding declaratory and injunctive relief against strangers to a proceeding on the basis of a simple motion.[3]

---

[3] At the hearing in the Circuit Court, Deutsche Bank, as Trustee, argued that it has been enjoined under the Circuit Court's Order approving the

D. The Circuit Court's Failure to Require the Rehabilitator to Observe Wisconsin Law Prejudiced the Senior Certificate Holders.

The Circuit Court's decision to award declaratory and permanent injunctive relief on motion adversely impacted the ability of the Senior Certificate Holders to protect their rights. Consistent with the typical practice for adjudicating legal disputes over contract meanings, as well as the relevant Wisconsin statutes, the Rehabilitator and the Trustee could have filed a complaint for declaratory and injunctive relief. The legal sufficiency of that pleading could be tested by motion and if it survived that motion, an answer would be filed. The Rehabilitator may then be able to move for judgment on the pleadings, or there would be a determination of whether the

---

Rehabilitation Plan from commencing an interpleader or other action. (R.933:60-61, 63, A-App.094-095, 097.) Of course, Deutsche Bank never petitioned the Circuit Court for relief from that order for purposes of commencing an interpleader or trust instructions action. Other courts have concluded that the initiation of an interpleader where one interested party is an insurance receiver does not violate any injunctions associated with the receivership. *McDonough Caperton Shepherd Grp., Inc. v. Acad. of Med., Cleveland*, Nos. 89-3045, 89-3163, 888 F.2d 1392, 1989 WL 128675, at *3-5 (6th Cir. Oct. 30, 1989) (unpublished).

material facts surrounding the contract were undisputed.[4] This would necessarily require a determination by the court of whether the contract was integrated, what documents made up the contract, and whether the contact was unambiguous. The Circuit Court could decide the timing and scope of any discovery depending on the answers to these questions. If the facts are undisputed the court could rule on summary judgment, and if the facts are disputed, the court would hold a trial.

As argued in the next section, the Circuit Court's failure to enforce these safeguards led the Circuit Court to reach an incorrect result.

II. The Circuit Court's Errors in the Process of Contract Construction Warrant Reversal.

The procedural infirmities discussed above resulted in substantial and prejudicial construction errors that require reversal of the Circuit Court's ruling. As discussed below, the Circuit Court: (i) failed to consider the Prospectus Supplement as

---

4 The parties then would have had the opportunity to engage in discovery. The lack of discovery in this matter is particularly distressing given the "findings" made by the Circuit Court with respect to parties that did not even appear.

required by controlling New York law; (ii) relied on extrinsic information notwithstanding its ruling that the PSA was unambiguous; and (iii) based its ruling on assumed facts not in the record. Whether considered individually or collectively, these errors warrant reversal.

A. The Doctrine of Contractual Integration Under New York Law Required the Circuit Court to Consider the Prospectus Supplement.

In its ruling below, the Circuit Court disregarded the Prospectus Supplement, which was prepared by the parties in the underlying mortgage securitization and filed with the U.S. Securities and Exchange Commission (the "SEC"). (R.933:71-73, A-App.105-107.) In doing so, the Circuit Court accepted the Rehabilitator's erroneous argument that the Prospectus Supplement constituted "extrinsic evidence" that the Circuit Court was prohibited from considering. (*Id.*; R.885:13-14, A-App.122-123 (Rehabilitator's Motion, ¶ 24).) As noted above, the PSA is governed by New York Law. New York's long-standing doctrine of contractual integration required the Circuit Court to

consider the Prospectus Supplement and thus, its failure to do so constituted reversible error.[5]

In support of its argument, the Rehabilitator generically invoked New York's "plain meaning" and "four corners" rules of contract interpretation. (R.885:10-11, A-App.119-120 (Rehabilitator's Motion, ¶ 18) (citing *Mazzola v. County of Suffolk*, 143 A.D.2d 734, 735 (N.Y. App. Div., 2d Dept. 1988); *R/S Assocs. v. N.Y. Job Dev. Auth.*, 771 N.E.2d 240, 242 (N.Y. Ct. App. 2002)).) By doing so, the Rehabilitator ignored relevant cases and cited only these inapposite decisions with no relevance to the case at hand. For example, the *Mazzola* case involved a contract for the sale of real property and whether a party intended the term "condemnation" to have its ordinary meaning. *Mazzola,* 143 A.D.2d at 735. The *R/S Associates* case involved a simple loan agreement and whether extrinsic evidence could be considered to interpret the unambiguous interest rate set forth in the contract. *R/S Assocs.*, 771 N.E.2d at 242. Neither of those

---

5 As explained below in Section III.A., the Prospectus Supplement makes clear that the Rehabilitator's interpretation of the PSA's waterfall provisions is untenable.

cases addressed the issue of whether, under New York law, a prospectus supplement may be considered when interpreting the waterfall provisions in a related pooling and servicing agreement for a mortgage securitization.

By contrast, federal district and appellate courts in New York recently decided this precise issue under New York law. In *Wells Fargo Bank, N.A. v. Financial Security Assurance Inc.* ("*Wells Fargo II*"), the United States Court of Appeals for the Second Circuit affirmed the ruling of the United States District Court for the Southern District of New York in *Wells Fargo Bank, N.A. v. ESM Fund I, LP* ("*Wells Fargo I*" and, together with *Wells Fargo I,* the "*Wells Fargo* Decisions"). *Wells Fargo Bank, N.A. v. Fin. Sec. Assurance Inc.*, 504 Fed. App'x 38 (2d Cir. 2012) (summary order); *Wells Fargo Bank, N.A. v. ESM Fund I, LP*, 785 F. Supp. 2d 188 (S.D.N.Y. 2011).

In *Wells Fargo I*, the district court, in interpreting the waterfall provisions of a pooling and servicing agreement (the "*Wells* PSA"), relied on the terms of the prospectus supplement for the underlying mortgage certificates in addition to the *Wells* PSA itself. *Wells Fargo I*, 785 F. Supp. 2d at 195, 197. On appeal

to the Second Circuit, the certificate insurer argued, among other things, that the district court erred in considering the prospectus supplement because the *Wells* PSA had been determined to be unambiguous. *Wells Fargo II*, 504 Fed. App'x at 40. The Second Circuit rejected this argument invoking the doctrine of contractual integration:

> As an initial matter, we reject Assured's argument that the district court erred ***in considering, in interpreting the PSA, the Prospectus Supplement*** and other transaction documents related to the PSA. Under New York law, which governs the PSA, the district court properly considered ***all writings forming part of a single transaction***, *see This Is Me, Inc. v. Taylor*, 157 F.3d 139, 143 (2d Cir. 1998) . . .

Id. (emphasis added). This result was warranted notwithstanding the fact that the *Wells* PSA's waterfall provisions were determined to be unambiguous on their face. *Id.* Thus, because the prospectus supplement and the *Wells* PSA were drafted as part of the same transaction (*i.e.,* the mortgage securitization), they were properly considered together under New York's doctrine of contractual integration.[6] *Wells Fargo II*,

---

6 Tellingly, the Rehabilitator did not even mention the *Wells Fargo* Decisions in its Motion even though both decisions were brought to the Rehabilitator's attention before he filed the Motion. (R.886:354, A-App.306 (Eleventh Peterson Aff., Ex. E, p. 4).)

504 Fed. App'x at 40.

Here, the Circuit Court erred as a matter of law by failing to consider the Prospectus Supplement in interpreting the waterfall provisions of the PSA whether or not those provisions appeared to be unambiguous on their face. This error prejudiced the Senior Certificate Holders because, as explained further below, the Prospectus Supplement makes clear that the Rehabilitator's interpretation of the PSA's waterfall provisions is incorrect.[7]

Although the Rehabilitator attempted to downplay the precedential impact of the *Wells Fargo* Decisions, those rulings applied long-standing principles of New York law that a

---

[7] During oral argument before the Circuit Court, counsel for the Rehabilitator attempted to minimize the import of the *Wells Fargo* Decisions based on the fact that the Second Circuit affirmed the district court through an unpublished, "summary order," which is not binding precedent under the rules of the Second Circuit. (R.933:23–25, A-App.057-059.) *See also* 2d Cir. R. 32.1.1(a). However, whether or not the Second Circuit's affirmance of the district court is binding precedent, that decision (along with the District Court's published opinion) remain persuasive authority. 2d Cir. R. 32.1.1(b). Indeed, even if the Second Circuit's affirmance of the district court was deemed "precedential" by the rules of the Second Circuit, it would still not be "binding" on a Wisconsin state court. Nevertheless, because both *Wells Fargo I* and *Wells Fargo II* address the precise question of New York law at issue here, they are relevant authority. As such, statements by the Rehabilitator's counsel during oral argument that it was "improper" to even "talk about" the *Wells Fargo* Decisions were baseless. (R.933:69, A-App.103.)

prospectus supplement must be considered when interpreting a pooling and servicing agreement for a mortgage securitization. The United States District Court for the Southern District of New York recently confirmed this approach in *In re Trusteeship Created By American Home Mortgage Investment Trust 2005-2*, No. 14 Civ. 2494, 2014 WL 3858506 (S.D.N.Y. July 24, 2014) ("*Am. Home*"). *Am. Home* involved an apparent conflict between the waterfall provisions in a pooling and servicing agreement (the "*Am. Home* PSA") and the description of those waterfall provisions in the related offering documents, including a prospectus supplement. *Am. Home*, 2014 WL 3858506, at *6. In interpreting the *Am. Home* PSA under New York law, the court explained that although the *Am. Home* PSA unambiguously provided that one class of securities was senior to another, that document "does not stand alone" because "[u]nder New York law, all writings forming part of a single transaction are to be read together." *Id.* at *20 (citation and internal quotation marks omitted). Therefore, "courts reading one document from a deal

will consider other documents from the same deal" under New York law.[8] *Id.* (emphasis added).

Based on the foregoing, the court unequivocally determined that "in constructing the [*Am. Home* PSA], I am ***required*** to read it alongside the Prospectus [Supplement]" and other offering materials. *Id.* at *21 (emphasis added). Thus, consistent with the *Wells Fargo* Decisions, the *Am. Home* court properly followed New York's doctrine of contractual integration as it applies to a pooling and servicing agreement and prospectus supplement. *Id.*; *see also MBIA Ins. Corp. v. Credit Suisse Sec. (USA) LLC*, 927 N.Y.S.2d 517, 521, 525 (Sup. Ct. 2011) (addressing RMBS insurer's claims for breach of contract and misrepresentation and explaining that "the court has considered ***full copies of the transaction documents***, which include the Insurance Agreement, . . . the Pooling and Servicing Agreement, . . . a prospectus, . . . a prospectus supplement, . . . and a loan schedule." (emphasis added)); *cf. Smith v. Litton Loan Servicing, LP*, No. 10-14700,

---

8 At a very minimum, the court explained, the consideration of offering documents is necessary to determine whether the agreement contains any ambiguities. *Id.*

2012 WL 1444636, at *1 n.1 (E.D. Mich. Apr. 26, 2012) ("Rather than citing the actual pooling and service agreement, Plaintiff points to the prospectus . . . in order to establish the agreement's terms. . . . The prospectus summarizes the terms of the agreement, and the Court shall likewise refer to this document.").

Furthermore, the *Am. Home* court also noted that it was ***logically*** necessary to consider the prospectus supplement when interpreting the *Am. Home* PSA because the latter "explicitly referenced" the prospectus supplement and incorporated certain of its underwriting criteria. *Am. Home*, 2014 WL 3858506, at *20. Here too, the PSA explicitly references the Prospectus Supplement and incorporates certain of its provisions. For example, PSA Section 6.02(d), which governs registration, transfer, and exchange of Certificates, provides that neither "the Trustee, the Certificate Registrar or the Depositor shall have any liability for transfers . . . made in violation of the restrictions on transfer described in the Prospectus Supplement . . ." (R.886:314, A-App.266 (Eleventh Peterson Aff., Ex. D, p. 110).) Similarly, PSA Section 12.01, which governs amendments to the PSA, provides that the PSA may be amended without the consent of

Certificate holders "to conform the terms hereof to the description thereof provided in the Prospectus [Supplement]." (R.886:340, A-App.292.) As in *Am. Home*, interpreting these PSA provisions ***requires*** reference to the Prospectus Supplement.

Based on the foregoing, the Prospectus Supplement is not "extrinsic evidence." Moreover, it is not mere "marketing pitch material" as the Rehabilitator suggested. (R.933:66, A-App.100.) Putting aside this erroneous characterization of a mandatory disclosure document that was filed with the SEC,[9] such an argument and finding contradicts the cases cited above applying New York law.

Indeed, offering documents such as the Prospectus Supplement "are the instruments disclosing all of the ***material terms and conditions*** of the placement of the Notes[,]" which, if inaccurate, could constitute securities fraud. *Am. Home*, 2014 WL 3858506, at *20 (emphasis added); *see also Steed Fin. LDC v.*

9 The Senior Certificate Holders were precluded from taking discovery in these proceedings. Had the Senior Certificate Holders been given the opportunity to conduct discovery, they could have sought to demonstrate that the Prospectus Supplement was an integral transaction document drafted by the parties to the PSA.

Nomura Sec. Int'l, Inc., No. 00 Civ. 8058, 2001 WL 1111508, at *1 (S.D.N.Y. Sept. 20, 2001). As the court explained in *Am. Home*,

> It is not tolerable in a disclosure regime for a governing document to be materially inconsistent with other governing documents. Giving effect to an inconsistency would defeat the disclosure regime's purpose, by creating undisclosed changes: disappointing the expectations of investors who relied on the disclosure documents. In order to avoid such uncertainty, ***it is necessary to read disclosure documents and governing documents together, as a single suite of documents ….***

Am. Home, 2014 WL 3858506, at *22 (emphasis added).

Thus, the fact that the Prospectus Supplement is not itself an executed "contract," does not undermine its legal significance nor does it alter the conclusion that the Circuit Court was required to consider it under New York's doctrine of contractual integration. *See, e.g., Wells Fargo II*, 504 Fed. App'x at 40; *Am. Home*, 2014 WL 3858506, at *21-22; *Wells Fargo I*, 785 F. Supp. 2d at 195; *MBIA Ins. Corp.*, 927 N.Y.S.2d at 521; *cf. DaCruz-Crossely v. U.S. Bank Nat'l Ass'n*, 926 F. Supp. 2d 405, 407 (D. Mass. 2013) (explaining that the "governing documents" of a mortgage securitization include both "the Prospectus Supplement ***and*** Pooling and Servicing Agreement" (emphasis added)).

In failing to consider the Prospectus Supplement, the Circuit Court ignored New York principles of contract

interpretation and based its ruling on an incomplete documentary record. For this reason, the Circuit Court's ruling must be reversed.

B. The Circuit Court Erred When It Considered Extrinsic Information Not Even in the Record After Finding No Contract Ambiguity.

Although the Circuit Court concluded that the PSA was unambiguous, it paradoxically relied on extrinsic information to buttress this conclusion.[10] (R.933:72, A-App.106.) First, the Circuit Court assumed the existence of an "agreement" among all of the parties to the PSA ratifying the Rehabilitator's interpretation of the waterfall provisions. (*Id.* ("[Y]ou start with the fact that the parties to the agreement, the four parties, are all in agreement. They do not find any ambiguity or other difficulty in interpreting their agreement.").) Second, the Circuit Court hypothesized in the absence of any evidence that (i) the Rehabilitator's disputed interpretation of the waterfall provisions was already "in place" at the time the Senior Certificate Holders acquired their Certificates and (ii) the Senior Certificate Holders

"were aware of" the disputed interpretation of the PSA's waterfall provisions at the time they acquired their Certificates. (*Id.* ("I agree with [counsel for the Rehabilitator] . . . that was the policy and procedure in place when the holders bought their certificates, they were aware of that – they now contend that one has to look at their perspective . . .").) None of these "facts" are in the record.[11]

---

10 As explained below, even if it was proper for the Circuit Court to rely on extrinsic information, the Circuit Court nonetheless committed reversible error by relying on extrinsic facts that are not even in the record.

11 Specifically, there is nothing in the record even purporting to establish the views of two of the three parties to the PSA: Greenwich Capital Acceptance, Inc., (the "Depositor") and Greenwich Capital Financial Products, Inc. (the "Seller"). Similarly, there is no evidence in the record concerning the timing of when the Senior Certificate Holders acquired their Certificates or their pre-acquisition knowledge of the disputed interpretation of the PSA. Rather than relying on evidence in the record to establish the purported "facts" cited above, the Circuit Court appears to have instead relied on statements of the Rehabilitator's counsel during oral argument. (*See* R.933:13, A-App.047 (counsel for the Rehabilitator stating to Circuit Court that "[n]obody that's a party to the contract is in any disagreement regarding its intent and meaning on the provisions at issue"); R.933:14, A-App.048 (counsel for the Rehabilitator suggesting that Circuit Court assume, without evidence, that Senior Certificate Holders "purchased post Rehabilitation with knowledge of the Trustee's historic interpretation . . .").) However, as Wisconsin courts have universally acknowledged, statements of counsel are not evidence. *See, e.g.*, *Merco Distrib. Corp. v. O & R Engines*, Inc., 71 Wis. 2d 792, 795-96, 239 N.W.2d 97 (1976) ("Arguments or statements made by counsel during argument are not to be considered or given weight as evidence."); *State v. CGIP Lake Partners, LLP*, 2013 WI App 122, ¶ 35, 351 Wis. 2d 100, 839 N.W.2d 136 (holding that circuit court erred in making factual determination because neither party introduced admissible evidence to support such finding and that "counsel's statement to that effect was not

If the Circuit Court had already determined that the PSA was unambiguous, then under governing principles of New York contract law, it should not have considered extrinsic information. *See, e.g., Macy's, Inc. v. J.C. Penney Corp.*, 989 N.Y.S.2d 238, 257 (Sup. Ct. 2014) ("Only when a contract is found to be ambiguous will a court look to extrinsic evidence to resolve the ambiguity."). Accordingly, it was reversible error for it to consider (i) the purported "agreement" among the PSA parties regarding its proper interpretation, (ii) the purported timing of when the Senior Certificate Holders acquired their Certificate and (iii) the Senior Certificate Holders' purported knowledge of the disputed interpretation of the PSA at the time they acquired their Certificates. *Kennedy v. Valley Forge Ins. Co.*, 612 N.Y.S.2d 712, 714 (App. Div. 1994) ("[I]t is well settled that, when a contract is unambiguous, circumstances extrinsic to the contract may not be considered.").

---

evidence."); *Hatch v. Hatch*, 2007 WI App 136, ¶ 22 n.7, 302 Wis. 2d 215, 733 N.W.2d 648 ("At the hearing, attorneys for the parties made various allegations about the parties' conduct, but did not offer any evidence. Statements of attorneys are not evidence.").

In this way, the Circuit Court effectively gerrymandered the evidence it incorporated into its ruling. On the one hand, it ignored the Prospectus Supplement in violation of New York's doctrine of contractual integration, while on the other hand, it accepted and relied on extrinsic evidence of the parties' purported intent after declaring the PSA to be unambiguous. On this basis, the Senior Certificate Holders should have been afforded the opportunity to develop and present their ***own*** evidence. *Richied v. D.H. Blair & Co.*, 710 N.Y.S.2d 25, 28 (App. Div. 2000) ("In light of this ambiguity, I would find that it was error to grant defendants' motion to dismiss the cause of action for breach of contract and would, instead, grant the parties the opportunity to discover and present extrinsic evidence relevant to intent.").

For example, the Circuit Court should have permitted the Senior Certificate Holders to develop and present evidence that the terms of the Prospectus Supplement were heavily reviewed and relied upon by the parties to the PSA and that such terms

reflected the parties' actual intent.[12] The Senior Certificate Holders did not have any such opportunity. The Circuit Court's error was therefore prejudicial to the Senior Certificate Holders and its decision should not be permitted to stand. Moreover, because the Circuit Court's decision relied on facts not even in the record, it must be reversed as a matter of Wisconsin evidentiary law. *See, e.g.*, *State v. CGIP Lake Partners, LLP*, 2013 WI App 122, ¶ 35, 351 Wis. 2d 100, 839 N.W.2d 136; *State v. Madlock*, 230 Wis. 2d 324, 336-37, 602 N.W.2d 104 (Ct. App. 1999) (concluding that it was an erroneous exercise of discretion for circuit court to base its decision on facts not in the record); *Hoeft v. Friedli (In re Estate of Friedli)*, 164 Wis. 2d 178, 181, 473 N.W.2d 604 (Ct. App. 1991) ("[B]ecause the trial court incorrectly took judicial notice of a fact not in evidence while deciding the four-element test, we reverse and remand on that test.").

---

12 The inability of the Senior Certificate Holders to intervene in the Circuit Court proceedings or to obtain discovery of this type further magnifies the Circuit Court's erroneous conclusion that the Rehabilitator could obtain the relief below by simple motion.

III. The PSA Does Not Allow Reimbursement to Ambac of Principal Losses from the Interest Waterfall.

In addition to the procedural and contract construction errors addressed *supra*, the Circuit Court's decision should be reversed because it simply failed to interpret the PSA correctly. Contrary to the Rehabilitator's suggestion, none of the Circuit Court's prior orders in any way approved the Rehabilitator's interpretation. In fact, it was just never addressed. For the reasons discussed below, the terms of the transaction documents plainly contradict the Rehabilitator's interpretation of the PSA that the Circuit Court incorrectly endorsed.

A. The Plain Language of the Transaction Documents' Waterfall Provisions Requires Payment of Interest Before Reimbursement of Ambac for Principal Payments.

The PSA requires Deutsche Bank, the Trustee, to make distributions from "Available Funds" on scheduled "Distribution Dates." (R.886:289, A-App.241 (Eleventh Peterson Aff., Ex. D, p. 85) (PSA § 5.01).) There are separate and distinct distribution waterfalls under the PSA depending on whether the distributions arise from interest payments or principal payments on the underlying mortgages in the Trust Fund. (*See* R.886:289-93, A-

App.241-245 (Ex. D, pp. 85-89).) Under, the "interest waterfall" of Section 5.01(a)(i), the "Interest Remittance Amount" is to be distributed in accordance with the following priorities – all in respect of interest payments[13]:

> ***first***, to deposit the "Final Maturity Amount" into the "Final Maturity Reserve Account";
>
> ***second***, to pay the "Monthly Interest Distributable Amount" and the "Unpaid Interest Shortfall Amount," if any, to the holders of the Senior Certificates (including the Insured Certificates) *pro rata*;
>
> ***third***, to pay "reimbursement amounts" owed to the Certificate Insurer (*i.e.*, Ambac);
>
> ***fourth***, to pay the "Monthly Interest Distributable Amount" to the holders of Subordinated Certificates (in order of priority), and
>
> ***fifth***, to the excess cash waterfall of PSA Section 5.01(a)(iv).

---

13 During oral argument before the Circuit Court, counsel for the Rehabilitator incorrectly referenced the PSA's definition of "Interest Remittance Amount" as being composed of both interests and "principal prepayments." (R.933:34, A-App.068.) Counsel for the Rehabilitator failed to inform the Circuit Court that the definition of "Interest Remittance Amount" only includes principal prepayments "up to the amount of related ***Deferred Interest*** for such Distribution Date." (R.886:227, A-App.179 (Eleventh Peterson Aff., Ex. D, p. 23) (PSA § 1.01) (emphasis added).) The PSA defines Deferred Interest as "the excess, if any, of the ***amount of interest*** accrued on such Mortgage Loan from the preceding Due Date to such due date over the portion of the Monthly Payment ***allocated to interest*** for such Due Date." (R.886:221, A-App.173 (Ex. D, p. 17) (PSA§ 1.01) (emphasis added).) Thus, despite counsel for the Rehabilitator's incomplete and selective quotation of the definition of "Interest Remittance Amount," that definition includes payments attributable solely to interest.

(*See* R.886:289-91, A-App.241-243 (Ex. D, pp. 85-87).)

By contrast, the "principal waterfall" of PSA Sections 5.01(a)(ii) and 5.01(a)(iii) set forth the payment priorities with respect to principal proceeds from Trust Fund assets as follows:

> ***first***, (i) principal proceeds from assets subject to "Loan Group 1" are to be used to repay principal amounts owed to holders of Class 1A-1A Certificates and (ii) principal proceeds from assets subject to "Loan Group 2" are to be used to repay principal owed to the holders of the Senior Certificates (other than the holders of Class 1A-1A Certificates), *pro rata*;
>
> ***second***, to pay "any Certificate Insurer Reimbursement Amounts due to the Certificate Insurer" (*i.e.*, Ambac);
>
> ***third***, to repay principal amounts owed to holders of Subordinate Certificates in order of priority; and
>
> ***fourth***, to the excess cash waterfall of PSA Section 5.01(a)(iv).

(*See* R.886:291-93, A-App.243-245 (Ex. D, pp. 87-89).)

As to the "Certificate Insurer Reimbursement Amounts" due to Ambac in the second step of the "principal waterfall," that term ***is expressly defined in the PSA to include draws under the insurance policies with respect to principal***. (R.886:213, A-App.165 (Ex. D, p. 9) (PSA § 1.01) (defining "Certificate Insurer Reimbursement Amount" to include "***all amounts*** previously paid

by the Certificate Insurer with respect of Insured Amounts . . . . ") (emphasis added).)

Thus, while the principal waterfall provisions in Sections 5.01(a)(ii) and 5.01(a)(iii) permit reimbursement to Ambac for losses related to principal and interest under the express definition of "Certificate Insurer Reimbursement Amounts," the interest waterfall provision in Section 5.01(a)(i) was intentionally drafted to permit reimbursement to Ambac only for losses related to interest. Section 5.01(a)(i) does not use the defined term "Certificate Insurer Reimbursement Amount" that picks up both principal and interest. Therefore, although the Rehabilitator argued that the interest provisions of Section 5.01(a)(i)(C) of the PSA permits Ambac to be reimbursed for principal losses, that argument is contradicted by the transaction documents. The Prospectus Supplement corroborates this conclusion and expressly provides that under the interest waterfall of PSA Section 5.01(a)(i), Ambac is only entitled to reimbursement "with respect to ***draws made under the Policy with respect to interest***." (R.904:101, A-App.592 (Second Fraser Aff., Ex. A, p. S-96) (emphasis added).)

Thus, by opting ***not*** to use the term "Certificate Insurer Reimbursement Amount," which includes losses attributable to both principal and interest, the interest waterfall of PSA Section 5.01(a)(i)(C), ***intentionally excludes principal losses from the "reimbursement amounts" to which Ambac may be entitled***. The Prospectus Supplement merely confirms this result and must be considered under governing New York law.[14]

B. The Circuit Court's Decision Ignores the PSA's Priority System with Respect to "Realized Losses" and Improperly Elevates Ambac's Subrogation Rights.

Even without regard to the Prospectus Supplement, the Rehabilitator's interpretation of the PSA's interest waterfall cannot withstand scrutiny. Under the priority system set forth in the PSA, "Realized Loss" (*i.e.,* the amount of unpaid principal) is allocated among the Certificate holders according to seniority. (R.886:298, A-App.250 (Eleventh Peterson Aff., Ex. D, p. 94) (PSA

---

14 Assuming a conflict between the Prospectus Supplement and the PSA existed, such a conflict would, at best, create an ambiguity as to the meaning of the interest waterfall provisions. *Am. Home*, 2014 WL 3858506, at *22-23. In those circumstances, the Circuit Court should have permitted the Senior Certificate Holders to develop and present extrinsic evidence to ascertain the parties' intent. *Id.* The failure to do so would have ***also*** constituted reversible error under governing New York law. *See Richied*, 710 N.Y.S.2d at 28. (*See supra* at p. 42.)

§ 5.03(b)).)

Permitting Ambac to receive reimbursement under PSA Section 5.03(a)(i)(C) on account of principal losses incurred by the Junior Insured Class before more senior Certificates have had their principal repaid in full would eviscerate the PSA's allocation of Realized Loss by seniority. It is undisputed that the principal balance of the Insured Certificates has been reduced to zero and the more senior class has been allocated substantial Realized Losses. (R.886:353, A-App.305 (Ex. E, p. 3).) As explained by the *Wells Fargo* Decisions, such a result is impermissible under New York law.

The *Wells Fargo* Decisions addressed the same interpretive issue that was before the Circuit Court: whether a PSA's waterfall provisions permitted a certificate insurer to obtain reimbursement for losses related to both principal and interest before the holders of insured certificates are entitled to recover principal. Similar to the PSA at issue here, the *Wells* PSA provided the certificate insurer ("Assured") "with the right to be repaid some or all of its payouts at certain steps in the waterfall …." *Wells Fargo I*, 785 F. Supp. 2d at 192. Thus, the dispute in

the *Wells Fargo* Decisions similarly focused on whether Assured was entitled to reimbursement for losses related to principal, as opposed to interest, at a given point in the waterfall. *Id.*

According to the district court in that case, Assured's argument was unsupportable because it would have the effect of frustrating the structural priorities among the certificates:

> If Assured's interpretation were correct, then the Super Senior certificates would be structurally subordinated to the [insured] certificates through the operation of the Policy and the payment waterfall. Because the [insured] holders would be paid out in full by the Policy, and Assured would be paid back in full before the Super Senior certificates are repaid, when the Trust experiences losses, Super Senior holders would bear the losses first, with Assured bearing losses only if the Super Senior principal is completely wiped out. Such an interpretation cannot be squared with the express intent of the drafters to maintain an unsubordinated, ERISA eligible, Super Senior class.

Wells Fargo I, 785 F. Supp. 2d at 196. As explained above, the Rehabilitator's interpretation of the PSA is equally unsupportable because it would permit Ambac to obtain reimbursement on account of principal owed to the Junior Insured Class ***before*** more senior Certificates have been repaid principal without regard to the Prospectus Supplement. For this additional reason, the Circuit Court's interpretation of the PSA was in error and should be reversed.

The Circuit Court's ruling must also be reversed because it would impermissibly elevate Ambac's subrogation rights. This conclusion follows as a matter of New York law as set forth in the *Wells Fargo* Decisions. As noted above, like the Rehabilitator here, the certificate insurer in the *Wells Fargo* Decisions argued that the *Wells* PSA permitted reimbursement of principal amounts paid to holders of insured certificates ***before*** more senior certificates received principal payments. Objecting certificate holders also pointed out in response that such an argument ignores the fact that Assured could only "collect funds that arise from its subrogation to the certificates it insures, to wit, any amount that would otherwise be paid to the [insured] certificateholders had they not given up their rights to it." *Wells Fargo I*, 785 F. Supp. 2d at 194.

Agreeing with the objecting certificate holders, the district court concluded that under the disputed waterfall provision, "Assured is entitled to whatever funds would otherwise be owed to the [insured] holders, which it receives in the step immediately following the step at which the [insured] holders would otherwise be paid." *Id.* at 195. Thus, Assured was not entitled to be

reimbursed for principal losses at that step in the waterfall because at that point, it did not yet have rights of subrogation with respect to principal payments.

In reaching its conclusion, the district court held that Assured's reimbursement rights under the waterfall provisions of the *Wells* PSA were co-extensive with its rights of subrogation, which were granted under the *Wells* PSA and the underlying insurance policies. *Id.* at 194. In so holding, the district court expressly rejected Assured's argument that its right of "reimbursement" under the waterfall provisions "is separate and independent from its right of subrogation." *Id.* at 194, 196-97 ("If the drafters had intended to provide Assured with a reimbursement right separate from its right of subrogation, it is implausible that they would use the waterfall to grant such a right and not include any mention of it in the section of the PSA expressly devoted to the rights of the Certificate Insurer . . . nor in the Policy or Prospectus Supplement."). According to the district court, "[t]he far more reasonable interpretation is that the provisions of the waterfall that provide for payment to Assured refer to the subrogation rights granted in the [*Wells*

PSA]." *Id.* at 197. On appeal, the Second Circuit unqualifiedly affirmed the district court's ruling. *Wells Fargo II*, Fed. App'x at 40-41.

Just as under the *Wells* PSA, Ambac's reimbursement rights under the waterfall provisions of the PSA here are co-extensive with the rights of subrogation conferred by the PSA and the Policies. Indeed, the PSA provision granting Ambac its subrogation rights expressly acknowledges that Ambac's reimbursement rights under PSA Section 5.01 are rights of subrogation ***conferred by the Junior Insured Class***:

> The Trustee hereby agrees on behalf of the Holders of the Insured Certificates (and ***each such Holder***, by its acceptance of its Insured Certificate hereby ***agrees***) ***for the benefit of the Certificate Insurer*** that, to the extent the Certificate Insurer pays any Insured Amount . . . to the Holders of the Insured Certificates, the Certificate Insurer ***will be entitled to be subrogated to any rights of such Holder*** to receive the amounts for which such Insured Amount . . . was paid, to the extent of such payment, ***and will be entitled to receive the Certificate Insurer Reimbursement Amount as set forth in Section 5.01***.

(R.886:288, A-App.240 (Eleventh Peterson Aff., Ex. D, p. 84) (PSA § 4.05(d)) (emphasis added).) If Ambac's "reimbursement" rights under Section 5.01 were independent contractual rights separate from its status as subrogee, it would be unnecessary for the

Junior Insured Class to expressly confer such reimbursement rights under the subrogation provision of the PSA.

The Policies themselves similarly confer rights of subrogation on Ambac to the extent Ambac makes payments to the Junior Insured Class. (R.886:13, 23, A-App.137, 147 (Eleventh Peterson Aff., Exs. A&B, p. 4 ("The Certificate Insurer shall be ***subrogated*** to the rights of each Holder to the extent of any payment by the Certificate Insurer under the Policy.") (emphasis added).) The Rehabilitator argues that the Policies "expressly memorialize" Ambac's reimbursement rights "***in addition*** to any common law subrogation or contractual subrogation rights provided in the Policies and PSAs." (R.885:4, A-App.113 (Rehabilitator's Motion, ¶ 4) (emphasis added).) The Rehabilitator was apparently referring to the Policy provisions stating as follows:

> The Certificate Insurer hereby agrees that if it shall be subrogated to the rights of Holders by virtue of any payment under this Policy, no recovery of such payment will occur unless the full amount of the Holders' allocable distributions for such Distribution Date can be made. In so doing, ***the Certificate Holder does not waive its rights to seek full payment of all Reimbursement Amounts owed to it hereunder or under the [PSA]***.

(R.886:13, 23, A-App.137, 147 (Exs. A&B, p. 4) (emphasis added).)

Contrary to the Rehabilitator's contention, the foregoing provision simply sets forth the following principles: (i) Ambac's subrogation rights are subordinated to the rights of the holders of Insured Certificates to receive their allocable distributions on any given Distribution Date; and (ii) the foregoing subordination does not effect a waiver of Ambac's subrogation rights. This provision does not in any way confer any additional rights on Ambac beyond subrogation. Thus, Ambac's "reimbursement" rights under PSA Section 5.01 are not distinguishable from those of the certificate insurer in the *Wells Fargo* Decisions (*i.e.,* those rights are co-extensive with Ambac's rights of subrogation). Accordingly, any argument by Ambac that its reimbursement rights somehow improve or elevate its rights of subrogation lacks merit and should be rejected just as the certificate insurer's identical argument in the *Wells Fargo* Decisions was rejected.

Based on the foregoing, Ambac cannot recover losses related to principal under PSA Section 5.01(a)(i)(C) because it has no subrogation rights with respect to principal payments at

that step in the distribution waterfall. As explained above, the holders of Insured Certificates (and thus, Ambac) have no right to receive payments of principal until later in the waterfall. This conclusion is dictated by New York law as set forth in the *Wells Fargo* Decisions. As a result, the Rehabilitator's interpretation of the PSA is incorrect and the relief in the Motion should not have been granted for this additional reason.

CONCLUSION

Senior Certificate Holders respectfully request that this Court reverse the Circuit Court's order approving the Motion.

Dated this 5th day of November, 2014.

Respectfully submitted,

/s/ R. Timothy Muth

R. Timothy Muth
WI State Bar ID No. 1010710
REINHART BOERNER VAN DEUREN S.C.
1000 North Water Street, Suite 1700
Milwaukee, WI 53201-2965
Telephone: 414-298-1000

GOODWIN PROCTER LLP
Emanuel C. Grillo
Eamonn O'Hagan
The New York Times Building
620 Eighth Avenue
New York, NY 10018-1405
Telephone: 212-813-8841

FORM AND LENGTH CERTIFICATION

I hereby certify that this brief conforms to the rules contained in Wis. Stat. § 809.19(8)(b) and (c) for a brief and appendix produced with a proportional font. The length of this brief is 10,067 words.

Dated this 5th day of November, 2014.

Reinhart Boerner Van Deuren s.c.
1000 North Water Street, Suite 1700
Milwaukee, WI 53202

Mailing Address:
P.O. Box 2965
Milwaukee, WI 53201-2965
Telephone: 414-298-1000
Facsimile: 414-298-8097

/s/ R. Timothy Muth
R. Timothy Muth
WI State Bar ID No. 1010710
tmuth@reinhartlaw.com

COURT OF APPEALS OF WISCONSIN
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,

Appeal No. 2014AP002033

v.

FFI Fund Ltd., FYI Ltd., Olifant
Fund, Ltd., Axonic Capital LLC,
Axonic Credit Opportunities Master
Fund LP and OC 523 Master Fund
LTD,
Interested Parties-Appellants.

On Appeal from the Order of the Dane County Circuit Court
Case No. 2010CV001576,
The Honorable William D. Johnston Presiding

CERTIFICATION REGARDING ELECTRONIC BRIEF PURSUANT TO WIS. STAT. §809.19(12)(f)

I hereby certify that I have submitted an electronic copy of this brief, excluding the appendix, if any, which complies with the requirements of Wis. Stat. § 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 certification has been served with the paper copies of this brief filed with the Court and served on all opposing parties.

Dated this 5th day of November, 2014.

Reinhart Boerner Van Deuren s.c.
1000 North Water Street, Suite 1700
Milwaukee, WI 53202

Mailing Address:
P.O. Box 2965
Milwaukee, WI 53201-2965
Telephone: 414-298-1000
Facsimile: 414-298-8097

/s/ R. Timothy Muth
R. Timothy Muth
WI State Bar ID No. 1010710
tmuth@reinhartlaw.com

COURT OF APPEALS OF WISCONSIN
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,

Appeal No. 2014AP002033

v.

FFI Fund Ltd., FYI Ltd., Olifant
Fund, Ltd., Axonic Capital LLC,
Axonic Credit Opportunities Master
Fund LP and OC 523 Master Fund
LTD,
Interested Parties-Appellants.

On Appeal from the Order of the Dane County Circuit Court
Case No. 2010CV001576
The Honorable William D. Johnston Presiding

CERTIFICATION AS TO DELIVERY OF INTERESTED PARTIES-APPELLANTS' BRIEF AND APPENDIX

I hereby certify that pursuant to Wis. Stat. § 809.80(3)(b)2., on November 5th, 2014, the Interested Parties-Appellants' Brief and Appendix were delivered to Federal Express for delivery to

the Clerk of the Wisconsin Court of Appeals within three calendar days.

Dated this 5th day of November, 2014.

Reinhart Boerner Van Deuren s.c.
1000 North Water Street, Suite 1700
Milwaukee, WI 53202

Mailing Address:
P.O. Box 2965
Milwaukee, WI 53201-2965
Telephone: 414-298-1000
Facsimile: 414-298-8097

/s/ R. Timothy Muth
R. Timothy Muth
WI State Bar ID No. 1010710
tmuth@reinhartlaw.com