STATE OF WISCONSIN CIRCUIT COURT DANE COUNTY

In the Matter of the Rehabilitation of:

Segregated Account of Ambac Assurance Corporation

Case No. 10CV1576

REHABILITATOR'S REPLY IN SUPPORT OF MOTION TO CONFIRM AND DECLARE THE NATURE OF THESE PROCEEDINGS

The MHPI Owners distort the scope and content of the order that the Rehabilitator seeks with his motion. The Rehabilitator is not requesting either an advisory opinion or an adjudication of the contractual issues being litigated by Ambac Assurance Corporation ("Ambac") and the MHPI Owners in other state courts (collectively, the "MHPI Cases"). Nor is the Rehabilitator seeking new factual findings regarding the specific policies that are at issue in those cases. To the contrary, the Rehabilitator's motion and proposed order address factual issues that are squarely within the jurisdiction of this Court, and which are disputed by the MHPI Owners.

To avoid errors by the courts presiding over the MHPI Cases about basic aspects of these proceedings, and potential resulting harm to the Segregated Account, the Rehabilitator seeks an order clarifying certain facts about what has transpired in this Court. This Court, and not courts in seven other states that have likely never presided over an insurer rehabilitation, is the most appropriate body to declare what has occurred in these proceedings. Those courts are free to determine what legal significance, if any, to afford this Court's ruling, but would benefit from an order that accurately reflects the factual record here, because the MHPI Owners have misstated the nature of these complex proceedings, enhancing the risk of inconsistent determinations by the courts presiding over the MHPI Cases. It is important for the Court to

address this issue because, despite the legally separate nature of the Segregated Account and Ambac, the financial viability of Ambac is essential to the successful rehabilitation of the Segregated Account. As a result, a misunderstanding could disrupt the carefully crafted structure of the Rehabilitator's court-approved Plan of Rehabilitation.

1. The Rehabilitator is not seeking an advisory opinion.

Contrary to the MHPI Owners' assertions, the order the Rehabilitator seeks is not an impermissible advisory opinion, and none of the cases they cite support their position. With this motion, the Rehabilitator seeks only a clarification of facts, which the MHPI Owners dispute, that are currently spread throughout the extensive record so that the intent of the Rehabilitator and this Court in approving the unusual two-insurer structure of this rehabilitation can be understood by courts unfamiliar with these proceedings. It is well-established that Wisconsin courts have the inherent power to clarify their existing rulings in pending cases. *See, e.g.*, *State v. Johnson*, 2014 WI 14, ¶ 1, 353 Wis. 2d 119, 846 N.W.2d 1 (granting motion for reconsideration in order to clarify nature of Supreme Court's prior decision in case); *Kontowicz v. American Standard Ins. Co. of Wis.*, 2006 WI 90, ¶ 3, 293 Wis. 2d 262,718 N.W.2d 111 (amending order in previous decision "in the interest of clarifying our opinion to facilitate its application").[1] Indeed, as discussed in the Rehabilitator's opening brief, and as acknowledged by the MHPI Owners, this Court has previously issued similar orders in these proceedings. (*See* Motion at 7, ¶¶ 14-15; MHPI Br. at 13-14.)

An impermissible advisory opinion, by contrast, seeks a decision *on the merits* where either a dispute no longer exists or the decision on the merits should be made in another forum.

[1] The MHPI Owners erroneously cite just one Wisconsin decision for their assertion that Wisconsin courts do not provide clarification of prior orders. (MHPI Br. at 11.) In that decision, *Commerce Bluff One Condo. Ass'n, Inc. v. Dixon*, 2011 WI App 46, ¶ 22 n.6, 332 Wis. 2d 357, 798 N.W.2d 264 (Ct. App. 2011), the movant requested that the Court of Appeals clarify the *trial court's* summary judgment ruling. Nothing in *Commerce Bluff* suggests that this Court cannot clarify its own rulings.

All of the cases cited by the MHPI Owners fall into those categories. *See Constand v. Cosby*, -- F.3d --, No. 15-2797, 2016 WL 4268941, *5 (3d Cir. Aug. 15, 2016) (appellate issue of resealing documents was moot); *Am. Med. Servs., Inc. v. Mut. Fed. Sav. & Loan Ass'n*, 52 Wis. 2d 198, 203 (1971) (refusing to issue declaratory judgment that would not resolve controversy between the parties); *Miller v. F.C.C.*, 66 F.3d 1140, 1145 (11th Cir. 1995) (refusing to issue declaratory judgment where petitioners effectively asked the court "whether, at some future date, a candidate may bring a breach of contract action in state court"); *Deep v. Boies*, 493 F. Supp. 2d 88, 90 & n.2 (D. Me. 2007) (district court refused to tell state court what *res judicata* effect district court's order might have); *Amgen v. Sandoz, Inc.*, No. CV161276SRCCLW, 2016 WL 3965192, *6 (D.N.J. July 22, 2016) (refusing to issue declaratory judgment where issue before the court was moot).

The Rehabilitator has been very clear that he is *not* seeking a decision on the merits of the contractual disputes between Ambac and the MHPI Owners pending in other courts. One issue raised by the MHPI Owners in those disputes is whether this rehabilitation proceeding has caused an "Ambac Default" or a "Credit Enhancer Default" under the terms of the contracts applicable to Ambac and the MHPI Owners. (*See* Motion at 5-6.) The Rehabilitator stated in his opening brief: "To be clear, the Rehabilitator is not asking this Court to construe this contractual language or to adjudicate whether there has been an 'Ambac Default' or a 'Credit Enhancer Default' within the meaning of these agreements. These issues are to be decided by the courts where the MHPI Cases are pending." (*Id.* at 6, ¶ 12.) Nothing in the Rehabilitator's motion or proposed order requests that this Court resolve those issues.

In an effort to create the appearance that a ruling by this Court would effectively be a ruling on the merits in the MHPI Cases, the MPHI Owners mischaracterize a statement made by

Ambac's counsel[2] in those proceedings. At a hearing in the MHPI Case pending in Monterey County, Ambac's counsel stated: "[W]e will be arguing that the decision in Wisconsin about how to structure the rehabilitation of the segregated account is determinative of the issue that [the MHPI Owners] wish to present here."

The reason that this Court's decision approving the two-insurer structure of this rehabilitation may be determinative, however, is not because the Rehabilitator is seeking new or unsupported factual findings here. It is because of the contractual language at issue in the MHPI Cases. As the MHPI Owners state at page 6 of their brief, the contractual provision at the center of the MHPI Cases states that an "Ambac Default" occurs if

> a court of competent jurisdiction . . . enters a final and nonappealable order, judgment or decree (i) appointing a custodian, trustee, agent or receiver for Ambac or for all or any material portion of its property or (ii) authorizing the taking of possession by a custodian, trustee, agent or receiver of Ambac (or the taking possession of all or any material portion of Ambac's property).

Thus, the facts regarding precisely what rehabilitation structure this Court approved, including the distinctions between the Segregated Account and Ambac, and why that structure was adopted, appear to be essential to the ultimate resolution of those cases. The courts presiding over the MHPI Cases will decide how those facts apply to the contract language, but it is appropriate for this Court to resolve disputes over the facts themselves. As discussed in further detail below, the MHPI Owners' response confirms that there is a ripe controversy regarding basic facts about this rehabilitation.

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[2] The MHPI Owners assert that Ambac's counsel in those cases "works directly for the Rehabilitator." That statement is frankly ridiculous and reflects the MHPI Owners' misunderstanding of basic aspects of these proceedings. Ambac's counsel in the MHPI Cases is retained by Ambac and in no way works for the Rehabilitator.

2. There is a significant risk that another court would misunderstand basic aspects of this rehabilitation.

The risk that the courts presiding over the MHPI Cases will misunderstand what occurred in this Court is real, because these proceedings are hardly self-explanatory. They involve the application of an esoteric body of law – insurance rehabilitation – that most courts have never heard of. They involve a rehabilitation structure – the creation and rehabilitation of a legally separate segregated account – that is rarely used and not even available in many jurisdictions. They involve a category of insurance products – financial guaranty insurance – that is highly specialized and which most courts never encounter. And, as this Court well knows, the docket in these proceedings includes hundreds of lengthy filings. The risk of a misunderstanding by one or more courts is compounded by the fact that the MHPI Cases are being litigated in seven different venues. (*See* MHPI Owners' Br. at 5 n.4.)

Indeed, the MHPI Owners have already made statements and taken positions in those cases that reveal misunderstandings about fundamental aspects of this rehabilitation and that demonstrate the existence of a genuine controversy as to the facts about these proceedings. For example, in its Complaint against Ambac, one of the MHPI Owners alleged that "on March 24, 2010, pursuant to a court order, ***Ambac entered into rehabilitation proceedings in Wisconsin.***" (Oct. 10, 2016 Affidavit of Jeffrey A. Simmons, Ex. A at ¶ 24 (emphasis added).) Similarly, in response to interrogatories in one of the cases, the MHPI Owner stated: "as a result of the Wisconsin Proceedings, *Ambac* has entered rehabilitation;" and "the Wisconsin Commissioner of Insurance was appointed as a custodian, trustee, agent or receiver *for Ambac* and/or for all or a material portion of Ambac's assets, and . . . was authorized to take possession *of Ambac* and/or all or a material portion of Ambac's assets." (*Id.*, Ex. B at 2-3.)

The facts, however, are that the Commissioner of Insurance was not appointed as the Rehabilitator for Ambac, but for only the Segregated Account, which is a separate insurer under Wisconsin law. Wis. Stat. § 611.24(3)(e). Nor has the Rehabilitator been appointed as a custodian for or taken possession of "a material portion of Ambac's assets." As the Court of Appeals noted, "[i]t was imperative . . . that all assets remain in the general account because transferring the assets to the segregated account would have triggered acceleration and early termination provisions, causing massive losses that would have made it substantially more difficult if not impossible to save Ambac from insolvency." *In re the Rehabilitation of the Segregated Account of Ambac Assur. Corp.*, 2013 WI App 129, ¶ 82, 351 Wis. 2d 539, 841 N.W.2d 482. Given that the MHPI Owners have chosen to dispute these fundamental facts about these proceedings, it is appropriate for this Court to issue an order deciding this narrow dispute.

3. The order requested by the Rehabilitator falls squarely within this Court's jurisdiction.

Further demonstrating the risk that the facts of these proceedings will be misunderstood by the courts presiding over the MHPI Cases, the MHPI Owners' brief misstates how the separate relationship between the Segregated Account and Ambac affects this Court's jurisdiction. In the MHPI Owners' view, the fact that their policies were not allocated to the Segregated Account means that this Court must remain silent on any issues affecting those policies. The MHPI Owners argue that "the Rehabilitator's Plan that was approved by this Court depends on this Court having no jurisdiction over the policies at issue in the pending cases." (MHPI Owners' Br. at 6.)

On the contrary, Wis. Stat. § 645.05(1)(k) grants this Court the authority to issue orders regarding matters that may "prejudice . . . the administration of this proceeding." Decisions in

the MHPI Cases based on incorrect facts have the potential to materially prejudice these proceedings. The Segregated Account relies entirely on funds provided by Ambac through the Secured Note[3] and Reinsurance Agreement to pay the claims on its policies. If Ambac loses money in connection with its insurance under the MHPI policies, there will be less money available to pay claims on Segregated Account policies. Indeed, the MHPI Owners assert that the MHPI Cases will affect "over $200 million." (MHPI Owners' Br. at 4.) Moreover, Ambac's risk mitigation efforts, which include Ambac's use of its control rights to enforce contractual obligations of debt issuers, are important to the Rehabilitator and impact these proceedings. While this Court may not have jurisdiction over Ambac's policies themselves, it has the statutory authority to clarify the factual record in these proceedings to avoid the prejudice that could result from rulings in the MHPI Cases that are based on erroneous understandings of the facts.

4. **The Rehabilitator's proposed order is fully supported by this Court's prior rulings and the existing factual record in this case.**

The MHPI Owners' argument that the Rehabilitator is seeking unsupported factual findings is wrong. The MHPI Owners state:

> The Rehabilitator's Proposed Order includes factual findings regarding two key issues: (1) whether the Rehabilitator and this Court considered the ***specific trigger language*** in the MHPI Loan Documents in structuring the rehabilitation . . . ; and (2) whether a finding of an Ambac Default under the specific language of the MHPI Loan Documents would result in "***collateral damage***" to Ambac because it would trigger defaults under other policies with similar language.

(MHPI Owners' Br. at 7 (emphasis original).) Again, they state:

[3] The Secured Note was fully drawn down in May 2014. The Segregated Account now relies entirely on funds provided by Ambac pursuant to the Reinsurance Agreement to pay claims of Segregated Account policyholders.

> [T]he proposed Order in essence requires this Court to hold that an Ambac Default should not be found under the (c)(i) and (c)(ii) triggers because the Rehabilitator and this Court considered the ***specific trigger language*** in the MHPI Loan Documents in structuring the rehabilitation, and concluded that a finding of Ambac Default under the specific language of the MHPI Loan Documents would result in "***collateral damage***" because it would trigger defaults under other policies with similar language.

(*Id.* at 14-15 (emphasis original).)

Contrary to those statements, nowhere in the Rehabilitator's motion or proposed order does he state (or remotely suggest) that he is seeking any findings regarding the "specific trigger language" of individual MHPI policies or what collateral damage might result from a finding of an Ambac Default under those policies.[4] Instead, the Rehabilitator seeks findings regarding the reasons for the creation of the Segregated Account and for limiting which policies were allocated to it. All of those findings are fully supported by citations to the existing record in these proceedings. (*See generally* Motion and Proposed Order.)

After attacking the straw man of "factual findings" that the Rehabilitator never sought and that appear nowhere in the Rehabilitator's proposed order, pages 15-16 of the MHPI Owners' brief reveal the false picture that they wish to paint, and why there are disputed factual issues about what occurred in these proceedings that this Court should decide. More specifically, the MHPI Owners contend that: (1) Sean Dilweg, the former Rehabilitator, accepted that the unique structure of this rehabilitation would trigger defaults in policies allocated to the General Account (MHPI Owners' Br. at 15); and (2) the solution to the

[4] The MHPI Owners' brief contains extensive argument about the current potential for "collateral damage" and discovery they took relating to the specific contractual triggers in their policies and collateral damage relating to their specific policies. Although the Rehabilitator is advised that Ambac disputes many of the factual assertions made by the MHPI Owners in connection with those arguments, the arguments are irrelevant to the issues before this Court and will not be addressed here. No one should infer that the Rehabilitator's determination not to be pulled into an argument about issues that are irrelevant to this motion constitutes an acknowledgement by the Rehabilitator, Ambac, or anyone else.

"specific classes of policies that had been considered in the Rehabilitation Proceedings," including "commercial asset backed securities," was that all such policies "were placed in the Segregated Account subject to this Court's Injunction." (*Id.* at 16.) These factual assertions about these proceedings are entirely false, are used to support the false conclusion that the Rehabilitator and this Court are indifferent to defaults in General Account policies, and demonstrate the need for this Court to provide the clarification that the Rehabilitator seeks.

First, the MHPI Owners mischaracterize Commisioner Dilweg's testimony at this Court's hearing to confirm the Rehabilitator's Plan of Rehabilitation. At the hearing, Commissioner Dilweg testified: "[I]t became clear to me that it would be difficult to craft [an injunction] that would affect and [en]join all of those covenants and triggers." (MHPI Br. at 15.) The MHPI Owners argue that this testimony shows "the Rehabilitator and the Court were aware that structuring the proceedings to place only a portion of the company into Rehabilitation would not avoid all defaults," suggesting that the Rehabilitator accepted that a rehabilitation of the Segregated Account would trigger defaults in General Account policies. (*Id.*) In fact, Commission Dilweg was saying the opposite of what the MHPI Owners suggest: the reason he did not place Ambac into rehabilitation and did not allocate many of Ambac's policies to the Segregated Account was to *avoid* contractual defaults that might result from subjecting those policies to a rehabilitation proceeding. The difficulties in enjoining defaults were a reason to keep certain policies *outside* of the rehabilitation. It is this sort of mischaracterization of the record by the MHPI Owners that confirms the need for this Court to clarify the factual record that is relevant for purposes of the MHPI Cases.

Second, the MHPI Owners seek to distinguish the MHPI Loan Documents from the "commercial asset backed securities," which they acknowledge "had been considered in the

Rehabilitation," by suggesting that these policies are different from the MHPI Loan Documents and were allocated to the Segregated Account. The MHPI Owners are wrong on both counts. In approving the unique structure of this rehabilitation, the Court expressly discussed three commercial asset backed securities (or Commercial ABS) policies, including Dunkin' Brands, Sonic Corporation and Hertz Corporation, which it considered "merely examples of a larger book of Commercial ABS transactions." (Jan. 21, 2011 Confirmation Order ¶ 53.) These policies were addressed in the context of explaining the types of defaults that would result from a full rehabilitation of all of Ambac. (*Id.* ¶ 55.) Accordingly, in order to avoid triggering defaults of this nature, OCI chose the more surgical approach of a rehabilitation limited to the Segregated Account. Contrary to the statement made at page 16 of the MHPI Owners' brief, these Commercial ABS policies were not allocated to the Segregated Account. These policies remained in the General Account – outside of rehabilitation – on the understanding that placing the Segregated Account into rehabilitation would not trigger defaults in the Commercial ABS policies. (*See* May 19, 2010 Aff. of Roger A. Peterson at 4, ¶ 9 (explaining that OCI rejected the option of a full rehabilitation of Ambac in part because "in certain commercial asset-backed security . . . transactions, the filing of a rehabilitation proceeding in respect of Ambac could give counterparties the right to declare certain defaults and accelerate payment of principal and interest on performing deals").

A review of the contractual triggers included in these Commercial ABS transactions reveals that they are substantially similar to the language contained in the MHPI Loan Documents.

> "Ambac Default" in MHPI Loan Documents includes: "a court of competent jurisdiction . . . enters a final and nonappealable order, judgment or decree (i) appointing a custodian, trustee, agent or receiver for Ambac or for all or any material portion of its property or (ii) authorizing the taking of possession by a

custodian, trustee, agent or receiver of Ambac (or the taking possession of all or any material portion of Ambac's property)."

"Insurer Insolvency Event" in Hertz Contracts includes: "(b) the Insurer shall commence a voluntary proceeding under any applicable rehabilitation...***or shall consent to the appointment of or taking possession by a receiver, liquidator, assignee, trustee, custodian sequestrator (or other similar official) for the Insurer or for any substantial part of its property***."

"Events of Bankruptcy" in Dunkin' Donuts Contracts includes: "(b) such Person shall commence a voluntary case or other proceeding under any applicable bankruptcy, insolvency, reorganization, debt arrangement, dissolution or other similar law now or hereafter in effect, or ***shall consent to the appointment of or taking possession by a receiver, liquidator, assignee, trustee, custodian, sequestrator (or other similar official) Person or for any substantial part of its property...***"

"Event of Bankruptcy" in Sonic Contracts includes: "(a) a case or other proceeding shall be commenced, without the application or consent of such Person, in any court, seeking the liquidation, reorganization, debt arrangement, dissolution, winding up, or composition or readjustment of debts of such Person, the appointment of a trustee, receiver, custodian, liquidator, assignee, sequestrator or the like for such Person or all or any substantial part of its assets...or (b) ***such Person shall... consent to the appointment of or taking possession by a receiver, liquidator, assignee, trustee, custodian, sequestrator (or other similar official) Person or for any substantial part of its property...***"

(MHPI Owners' Br. at 6; Simmons Aff., Exs. C-E (emphasis added).) Thus, while this Court has not expressly discussed the precise language of the MHPI Loan Documents, they are substantially similar to the language contained in Ambac's Commercial ABS policies.[5] The concerns expressed by the Rehabilitator, and recognized by this Court and the Court of Appeals, regarding collateral damage resulting from triggering defaults in policies that OCI chose to leave in the General Account apply with equal force to the MHPI Loan Documents. Simply put, one of the driving objectives of limiting this rehabilitation to the Segregated Account was to avoid triggering defaults in policies not allocated to the Segregated Account.

[5] The MHPI Owners also assert that the "MHPI Default triggers . . . are unique and more easily met than Ambac's typical default triggers." (MHPI Owners' Br. at 6.) Although that issue is outside the scope of the relief requested by the Rehabilitator here, the excerpts from the Hertz, Dunkin', and Sonic contracts show that assertion to be untrue.

As a result, the MHPI owners are wrong when they argue that an interest in avoiding the type of damage that would result from an Ambac Default under MHPI Policies, was not and could not be "based on the record that existed when the Rehabilitation was structured in 2010 or at the time of the Confirmation Order in 2011." (MHPI Owners' Br. at 15.) The record from 2010 and 2011 shows just the opposite. The fact that the MHPI Owners could make such a statement demonstrates both that there is a ripe controversy about the nature of these proceedings, and that it is important for this Court to resolve it.

CONCLUSION

For the reasons stated above and in the Rehabilitator's motion, the Rehabilitator respectfully requests that the Court grant his Motion to Confirm and Declare the Nature of These Proceedings and enter the Rehabilitator's proposed order.

Dated this 10th day of October, 2016 FOLEY & LARDNER LLP

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