

October 18, 2016

**Via Hand-Delivery**

Honorable Richard G. Niess  
Dane County Courthouse, Room 5109  
215 South Hamilton Street  
Madison, Wisconsin 53703

Re: *In the Matter of the Rehabilitation of Segregated Account of  
Ambac Assurance Corporation;*  
Dane County Circuit Court Case No. 10 CV 1576

Dear Judge Niess:

Pursuant to your order at the October 11, 2016 hearing in the above-referenced case, enclosed please find clean and redlined versions of the Rehabilitator's proposed revised Order Granting Rehabilitator's Motion to Confirm and Declare the Nature of These Proceedings. The redline shows the Rehabilitator's proposed changes to the original order he submitted with his motion.

The new proposed order contains revisions to paragraphs 10 and 17. In paragraph 10, the phrase "nonetheless deemed to trigger contractual defaults linked to" has been replaced with "considered to be," in order to make that paragraph easier to understand. The phrase "or other measures adjunct to such a rehabilitation, such as" has also been deleted from paragraph 10 to avoid any ambiguity regarding the specific actions that the Rehabilitator considers to be contrary to OCI's stated purpose in adopting the unique two-insurer structure of this rehabilitation. In paragraph 17, the word "deemed" has been replaced with "considered," in order to make the paragraph consistent with the new phrasing of paragraph 10.

Counsel for the Rehabilitator and the MHPI Owners were unable to reach agreement regarding the contents of a revised order and are therefore submitting separate proposals. During the parties' discussions, the MHPI Owners argued that the phrase "the taking of possession of Ambac's assets" should be replaced with "a direct transfer of assets from Ambac to the Segregated Account at its establishment." As support for this proposal, the MHPI Owners cited paragraph 71 of the Court's January 21, 2011 Confirmation Order, which states that the Rehabilitator decided against "allocating hard assets directly to the Segregated Account at its establishment."

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Although the MHPI Owners' proposed revision roughly tracks that language, it misses the point of paragraphs 10 and 17 of the Rehabilitator's proposed order. Those paragraphs are expressly intended to convey the Rehabilitator's purpose in adopting the unique structure of this Rehabilitation, and to enumerate broad categories of actions that would run counter to that purpose. The record in this proceeding shows that the Rehabilitator's purpose was to avoid tripping a wide range of default triggers contained in a large number of contracts. (*See, e.g.*, Confirm. Order ¶ 51 (OCI "became aware of various default triggers in a large number of contracts"; ¶ 52 ("Each of Ambac's policies and sets of policies contained different covenants and triggers"; ¶ 54 ("OCI sought an approach that would address up to 40 years of potential policy liabilities in a manner that would not trigger covenants and cause defaults in the thousands of Ambac policies . . .").

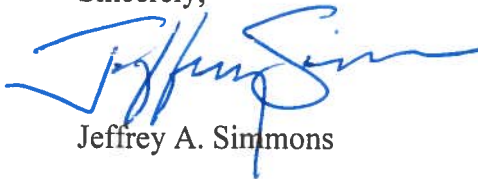
The Rehabilitator's proposed order uses the phrase "the taking of possession of Ambac's assets" because that is what the MHPI Owners contend occurred in these proceedings. (*See* Oct. 10, 2016 Aff. of Jeffrey A. Simmons, Ex. B at 2-3.) The point of the pending motion is to accurately and concisely restate the record in these proceedings in a manner that will be useful to the courts presiding over the MHPI Cases. The fact that the Court did not use that precise language in the Confirmation Order does not change his obvious purpose. It was impractical for the Rehabilitator or this Court to enumerate in the Rehabilitation Order every subtle permutation of trigger-language that the Rehabilitator was attempting to avoid in the thousands of contracts at issue. But there is no set of facts under which it would not run counter to that purpose to conclude that the Court-approved rehabilitation structure is "the taking of possession of Ambac's assets." As a result, the MHPI Owners' proposal to track the language in paragraph 71 of that Order to suggest that he was only concerned about triggers tied to "a direct transfer of assets from Ambac to the Segregated Account" is inaccurate factually and would mislead the MHPI Courts about the Rehabilitator's purpose and the types of actions that would run counter to that purpose.

The MHPI Owners' proposal to include the phrase "at the establishment" to paragraphs 10 and 17 and "at the time" to paragraph 17 is similarly misleading. Nothing in the record suggests that the Rehabilitator's purpose of avoiding contractual triggers ended at the time the Segregated Account was established in 2010. The Rehabilitator's purpose was to create a structure that would make both Ambac and the Segregated Account viable for the life of the Plan of Rehabilitation. (*See, e.g.*, Confirm. Order ¶ 54 ("OCI sought an approach that would address up to 40 years of potential policy liabilities . . ."). That remains the Rehabilitator's purpose today. (*See, e.g.*, March 22, 2016 Aff. of Daniel J. Schwartzer ¶¶ 7, 9 (explaining that the Rehabilitator's financial projections for the Segregated Account run through 2052 and that the Rehabilitator "continues to closely monitor Ambac policies insuring obligations associated with . . . certain military housing projects."). Indeed, if the Rehabilitator's purpose had changed, he would not have filed the present motion.

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For these reasons, the Rehabilitator respectfully requests that you enter his proposed revised order. Thank you for your consideration of this matter.

Sincerely,



Jeffrey A. Simmons

Enclosures

cc: All Counsel of Record (with enclosures, via email)

Clean Version

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In the Matter of the Rehabilitation of:

Case No. 10CV1576

Segregated Account of Ambac Assurance Corporation

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ORDER GRANTING REHABILITATOR'S MOTION TO  
CONFIRM AND DECLARE THE NATURE OF THESE PROCEEDINGS

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This matter came before the Court on the Motion (the "Motion") of the Court-appointed Rehabilitator (the "Rehabilitator") of the Segregated Account of Ambac Assurance Corporation (the "Segregated Account") for a declaratory order clarifying the nature of these rehabilitation proceedings (the "Proceedings"). As set forth in the Motion, the Rehabilitator has requested this declaration to provide such clarification in connection with certain litigation pending in other jurisdictions in which parties adverse to Ambac Assurance Corporation ("Ambac" or the "General Account") have made arguments characterizing the Court's March 24, 2010 Order of Rehabilitation (the "Rehabilitation Order"), the Court's January 21, 2011 Order Confirming the Rehabilitator's Plan of Rehabilitation (the "Confirmation Order"), as affirmed by the Wisconsin Court of Appeals, 2013 WI App 129, 351 Wis. 2d 539, 841 N.W.2d 482, or the Proceedings generally.

This Court does not seek to decide the merits of disputes involving the General Account that are pending in other courts. As the Rehabilitation Order explains, "[t]his proceeding pertains solely to the Segregated Account . . . and does not pertain to policies, contracts, assets, equity ownership interests, and liabilities remaining in Ambac's General Account."

Rehabilitation Order ¶ 2. Nonetheless, as described in greater detail at Paragraphs 80-84 of the Confirmation Order, the Wisconsin Office of the Commissioner of Insurance ("OCI") has an

interest in and continues to monitor developments in the General Account. OCI's authority to do so rests on "OCI's regulatory authority and as a contractual party under the Secured Note and Reinsurance Agreement subject to the Rehabilitator's authority to oversee and enforce contractual obligations." Confirmation Order ¶ 84. OCI's continued oversight of the General Account is appropriate in light of the unique structure of this rehabilitation and the capitalization of the Segregated Account, which are discussed in greater detail below. *See* Confirmation Order ¶ 82.

Accordingly, OCI has an interest in ensuring that Ambac (*i.e.*, the General Account) does not lose legal rights due to a misunderstanding or mischaracterization of these Proceedings. Because OCI is concerned that this could occur, to the detriment of both Ambac and the Segregated Account, OCI has asked this Court to clarify the nature of these Proceedings and the regulatory choices that they reflect in the hope that such clarification would be helpful to sister courts that must decide the legal ramifications of these Proceedings for the General Account.

Based on this Court's review of the Motion and all submissions by all parties-in-interest relating thereto, and for good cause shown, the Rehabilitator's Motion is hereby GRANTED and the Court hereby makes the following Findings of Fact and Conclusions of Law in support of this Order, which shall not be construed as amending or varying this Court's prior orders.

#### **FINDINGS OF FACT AND CONCLUSIONS OF LAW**

1. These Proceedings are for the rehabilitation of a Wisconsin-domiciled insurer under Chapter 645 of the Wisconsin Statutes. The subject of these Proceedings is a segregated account established under Wis. Stat. § 611.24. *See* Rehabilitation Order ¶ 2.
2. As background, Wisconsin law allows an insurer to establish a segregated account "for any part of its business" with the approval of the Commissioner of Insurance (the

“Commissioner”). Wis. Stat. § 611.24(2). A segregated account is treated as a separate insurer for purposes of entering into rehabilitation proceedings under Chapter 645. *See* Wis. Stat. § 611.24(3)(e).

3. Here, the Commissioner approved Ambac’s creation of the Segregated Account on March 24, 2010. Before that, OCI and Ambac had conducted an extensive review of Ambac’s policies to determine which should be allocated to the Segregated Account and which should remain in the General Account. *See* Confirmation Order ¶¶ 64-69. As the Court of Appeals explained, “[a]fter completing this assessment, the commissioner approved the allocation of approximately 1000 policies with material projected losses, structural problems, and contractual triggers to the segregated account and left the remaining 14,000 healthy, performing policies in the general account.” 2013 WI App 129 at ¶ 37.

4. The Commissioner then commenced these Proceedings to rehabilitate the Segregated Account on March 24, 2010, the same day the Segregated Account was created.

**OCI’s Decision to Limit Rehabilitation to the Segregated Account**

5. Paragraphs 49-63 of the Confirmation Order describe OCI’s examination of Ambac in late 2009 and early 2010, and its consideration of various regulatory options to address the significant risks facing Ambac and its policyholders. These portions of the Confirmation Order explain OCI’s decision to limit this rehabilitation to the Segregated Account, as opposed to all of Ambac, and what OCI sought to achieve by proceeding in this more limited fashion.

6. In the course of its investigation of Ambac, OCI became aware that many of Ambac’s contracts contain language, referred to as “triggers,” providing that placing Ambac into rehabilitation or liquidation proceedings would constitute a default. Confirmation Order ¶¶

51-52. OCI concluded that a full rehabilitation of all of Ambac “could have triggered costly defaults” in many of these contracts, which would cause “substantial losses” that have been referred to as “collateral damage” in these Proceedings. *Id.* ¶ 51.

7. Thus, OCI sought an approach that could address Ambac’s acute financial challenges “in a manner that would not trigger covenants and cause defaults in thousands of Ambac policies.” *Id.* ¶ 54. OCI therefore adopted what it has called a surgical approach of rehabilitating only a segregated account of Ambac, as opposed to Ambac as a whole, which OCI concluded would provide the most beneficial outcome for all policyholders. *See* Confirmation Order ¶ 60.

8. OCI chose to limit the rehabilitation to the Segregated Account, and not to place Ambac into rehabilitation, in order to avoid causing defaults under Ambac contracts containing triggers linked to the commencement of rehabilitation proceedings against Ambac or to other measures that typically accompany rehabilitation proceedings.

9. Accordingly, the Rehabilitation Order entered by this Court took certain actions with respect to the Segregated Account, but not the rest of Ambac. Paragraph 2 of the Rehabilitation Order placed the “Segregated Account” in rehabilitation and explained, “[t]his proceeding pertains solely to the Segregated Account and to the policies, contracts, rights, assets, equity ownership interests, and liabilities allocated to it in accordance with Wis. Stat § 611.24, and does not pertain to the policies, contracts, assets, equity ownership interests, and liabilities remaining in Ambac’s General Account.” In Paragraph 3, the Commissioner was appointed as “Rehabilitator of the Segregated Account,” but not of Ambac. Paragraph 6 of the Rehabilitation Order provides that the Rehabilitator “shall take possession of the assets of the Segregated Account,” and refers to the Rehabilitator “managing the affairs of the Segregated



Account.” These provisions do not refer to taking possession of the assets of Ambac or managing the affairs of Ambac.

10. Given the precautions that OCI took to limit these Proceedings to the Segregated Account, and its reasons for avoiding a rehabilitation of Ambac as a whole, it would run counter to OCI’s stated purpose in adopting this measured approach to rehabilitation if the existence of these Proceedings is considered to be the commencement of a rehabilitation of Ambac, the entry of an order of relief against Ambac by this Court, the appointment of a rehabilitator for Ambac, the taking possession of Ambac’s assets, or the appointment of an official to manage the affairs of Ambac.

#### **Formation and Capitalization of the Segregated Account**

11. As explained in Paragraphs 70-76 of the Confirmation Order, OCI’s targeted rehabilitation approach also shaped the capital structure created for the Segregated Account. OCI was aware that many of Ambac’s contracts “contained provisions restricting Ambac’s transfer of assets away from the General Account.” Confirmation Order ¶ 70. Based on these contractual provisions, OCI was concerned that providing capital for the Segregated Account through a material transfer of assets from Ambac “would have created massive litigation as well as substantial loss to Ambac.” *Id.* ¶ 70.

12. Therefore, OCI opted to capitalize the Segregated Account in a matter that avoided “allocating hard assets directly to the Segregated Account at its establishment.” *Id.* ¶ 71. OCI decided to leave the bulk of the insurer and its assets outside of rehabilitation “due to the existence of the triggers in transactions insured by Ambac relating to delinquency proceedings and assets transfers.” *Id.* ¶ 61.

13. Instead of transferring assets from Ambac to the Segregated Account, OCI

elected to provide the Segregated Account two newly-created instruments issued by the General Account: a \$2 billion Secured Note and an Excess-of-Loss Reinsurance Agreement.

Confirmation Order ¶ 71. These instruments would allow the Segregated Account to draw funds from Ambac if necessary later in the Proceedings to pay policy claims and other expenses permitted under a Court-approved Plan of Rehabilitation. *Id.*

14. OCI decided to capitalize the Segregated Account in this fashion because it enabled the Segregated Account to have adequate capital without tripping contractual “triggers” that could have applied as a consequence of an asset transfer. In other words, OCI’s objective was to capitalize the Segregated Account in a way that would provide adequate funding going forward from the assets of the General Account, but *not* through a transfer of assets from Ambac that could trigger the adverse provisions contained in numerous Ambac contracts.

15. In affirming the adequacy of this capital structure, the Court of Appeals took note of OCI’s objectives in capitalizing the Segregated Account with the Secured Note and Excess-of-Loss Reinsurance Agreement: “The purpose of doing so was to isolate the claims-paying resources in the general account from the liabilities in the segregated account in order to avoid various contractual default triggers.” 2013 WI App 129 at ¶ 38. Further, “it was imperative that Ambac’s claims-paying resources remain in the General Account’ because they would be ‘subject to acceleration, early termination and other triggers’ if Ambac directly capitalized the segregated account with assets from the general account.” 2013 WI App 129 at ¶ 43 (quoting the Rehabilitator’s appeal brief).

16. Indeed, the Court of Appeals rejected an argument that the Plan of Rehabilitation

constituted a transfer of assets without fair consideration,<sup>1</sup> explaining:

In any event, as we have already explained, the commissioner had sound reasons for keeping the assets attributable to the segregated account in the general account. *It was imperative, according to the commissioner, 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. The commissioner should pursue rehabilitation as opposed to liquidation whenever possible and structuring the plan in a way that likely would have prevented the commissioner from pursuing rehabilitation would not be in keeping with that general principle.

2013 WI App 129 at ¶ 82 (emphasis added).

17. Given these considerations, it would run counter to OCI's stated purpose of capitalizing the Segregated Account in a manner that avoided triggering contractual defaults and causing collateral damage if Ambac's issuance of the Secured Note and Excess-of-Loss Reinsurance Agreement were considered to constitute a transfer of assets from Ambac to the Segregated Account or the appointment of a receiver for Ambac's assets.

WHEREFORE, IT IS HEREBY ORDERED that the Rehabilitator's Motion to Confirm and Declare the Nature of These Proceedings is GRANTED

Dated: \_\_\_\_\_

BY THE COURT

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<sup>1</sup> The appellants were contending that the Plan involved a transfer of assets from the Segregated Account to the General Account, which is the opposite of what Ambac's counterparties are now claiming in other litigation.

# Track Changes Version

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In the Matter of the Rehabilitation of:

Case No. 10CV1576

Segregated Account of Ambac Assurance Corporation

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This Court does not seek to decide the merits of disputes involving the General Account that are pending in other courts. As the Rehabilitation Order explains, "[t]his proceeding pertains solely to the Segregated Account . . . and does not pertain to policies, contracts, assets, equity ownership interests, and liabilities remaining in Ambac's General Account." Rehabilitation Order ¶ 2. Nonetheless, as described in greater detail at Paragraphs 80-84 of the Confirmation Order, the Wisconsin Office of the Commissioner of Insurance ("OCI") has an interest in and

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Accordingly, OCI has an interest in ensuring that Ambac (*i.e.*, the General Account) does not lose legal rights due to a misunderstanding or mischaracterization of these Proceedings. Because OCI is concerned that this could occur, to the detriment of both Ambac and the Segregated Account, OCI has asked this Court to clarify the nature of these Proceedings and the regulatory choices that they reflect in the hope that such clarification would be helpful to sister courts that must decide the legal ramifications of these Proceedings for the General Account.

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#### **OCI's Decision to Limit Rehabilitation to the Segregated Account**

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6. In the course of its investigation of Ambac, OCI became aware that many of Ambac's contracts contain language, referred to as "triggers," providing that placing Ambac into rehabilitation or liquidation proceedings would constitute a default. Confirmation Order ¶¶ 51-52. OCI concluded that a full rehabilitation of all of Ambac "could have triggered costly defaults" in many of these contracts, which would cause "substantial losses" that have been referred to as "collateral damage" in these Proceedings. *Id.* ¶ 51.

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Dated: \_\_\_\_\_

BY THE COURT

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