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WISCONSIN COURT OF APPEALS
DISTRICT IV

03-02-2017

**CLERK OF COURT OF APPEALS
OF WISCONSIN**

Appeal No. 2016AP002169

In the Matter of the Rehabilitation of:
Segregated Account of Ambac Assurance Corporation:

Sean Dilweg and Office of the Commissioner of Insurance

Plaintiffs-Respondents,

v.

Carlisle/Picatinny Family Housing L.P., Fort Bliss/White Sands Missile Range Housing L.P., Fort Detrick/Walter Reed Army Medical Center Housing LLC, Stewart Hunter Housing LLC, Monterey Bay Military Housing, LLC, Monterey Bay Land, LLC, Meade Communities LLC, Bragg Communities LLC, Polk Communities LLC, Rucker Communities LLC, Riley Communities LLC, Fort Lee Communities LLC, and Fort Leavenworth Frontier Heritage Communities, II, LLC,

Interested Parties-Appellants.

Appeal from the October 24, 2016 Order of
the Dane County Circuit Court, Case No. 10CV1576,
Honorable Richard G. Niess, Presiding

REPLY BRIEF OF THE APPELLANTS

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INTRODUCTION

The Rehabilitator argues that because it disagrees with the MHPI Projects' argument that an "Ambac Default" has occurred as a result of the Rehabilitation Proceedings, a controversy existed for adjudication by the Rehabilitation Court. The Rehabilitator cannot avoid that the MHPI Projects' Ambac Default argument is made in separate litigation, to which the Segregated Account is not a party and over which the Rehabilitation Court has no jurisdiction. To support its argument that the Rehabilitation Court nonetheless had jurisdiction to enter the October 24, 2016 Order (R. 1025, App. 1), the Rehabilitator falsely claims that the MHPI Projects' arguments in their separate litigation are based on "misrepresentations" that require clarification by the Rehabilitation Court. To the contrary, the MHPI Projects' arguments regarding the *result* of the Rehabilitation Proceedings are accurate, regardless of whether those results were *intended* by the Rehabilitator at the time.

As the Rehabilitation Court made clear, it does not have jurisdiction to decide whether, as a matter of fact, an Ambac Default has occurred under the MHPI Project Documents, which are not in the Segregated Account; that determination must be made by the several courts presiding over the MHPI Projects' litigation. (R. 1025, App. 1.) It is undisputed that the Segregated Account is not a party to the litigation between the MHPI Projects and Ambac, and the Rehabilitator cites no authority for the extraordinary proposition that a position taken by a litigant creates a justiciable controversy with a nonparty.

Likewise, *none* of the MHPI Projects' policies have been allocated to the Segregated Account, and the MHPI Projects are not parties to the Rehabilitation Proceedings.

The Rehabilitator's attempt to justify the Rehabilitation Court's order by arguing the MHPI Litigation "pose[s] a threat to the claims paying resources of the General Account" (Resp. Br. at 39), likewise fails. The Rehabilitator offers no evidence that such a threat exists, and there was no such evidence in the record.

ARGUMENT

A. The Rehabilitator Misstates the Applicable Standard of Review.

The Rehabilitator claims it is "clear" that this Court should use the deferential standard applicable to a circuit court's review or reconsideration of a ruling, citing *Koepsell's Olde Popcorn Wagons, Inc. v. Koepsell's Festival Popcorn Wagons, Ltd.*, 2004 WI App 129, ¶ 6, 275 Wis. 2d 397, 685 N.W.2d 853. But the Rehabilitation Court never purported to review or reconsider a prior ruling. The Rehabilitator asked the court to do precisely the opposite, requesting a "concise explanation, based on rulings already made." (R. 1011 at ¶ 13.) The Rehabilitator took care to state it "[did] not seek to amend or otherwise vary these prior determinations." (R. 1011 at 8, ¶ 18, Supp. App. 87.) And the Rehabilitation Court made clear it was entering a "Cliff's Notes" version of its prior orders, not reviewing or reconsidering those rulings. (R. 1034 at 23:12-25, App. 30.) The question for this Court is not whether the findings themselves are factually correct, but whether the Rehabilitation Court had jurisdiction to enter an order expressly

intended for use in unrelated actions beyond its exclusive jurisdiction, which contained factual findings not based on the record. Such jurisdictional determinations are properly reviewed *de novo*. *Van Deurzen v. Yamaha Motor Corp. USA*, 2004 WI App. 194, ¶ 9, 276 Wis. 2d 815, 688 N.W.2d 777.

Even under the clear error standard, the Rehabilitation Court's decision cannot be affirmed. The decision may be sustained only if the court "has examined the relevant facts, applied a proper standard of law, and, using a demonstrated rational process, reached a conclusion that a reasonable judge could reach." (Resp. Br. at 17.) The court's October 24, 2016 order implies the Rehabilitator considered certain facts despite there being no such facts in the record. Specifically, the court held:

[I]t would run counter to OCI's stated purpose . . . 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.

(R. 1025 at 5, ¶ 10, App. 5.) Similarly, the court held "it would run counter to OCI's stated purpose . . . 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." (R. 1025, App. 7, ¶ 17.)

Paragraphs 10 and 17 of the Order characterize the Rehabilitator's purpose in 2010 and 2011 by reference to unique language contained in the MHPI Projects' policies, though there is no evidence the Rehabilitator ever reviewed the

MHPI Projects' policies or considered that language when the Rehabilitation was structured. The court reached a conclusion that no reasonable judge could reach by resort to the record. Hence, the court's decision is properly held to a *de novo* standard of review. *Van Deurzen*, 276 Wis. 2d 815, ¶ 9.

B. The MHPI Projects' Arguments In Separate Litigation Did Not "Misrepresent" The Rehabilitation Proceedings.

The Rehabilitator manufactures two supposed "misrepresentations" to suggest that there was a justiciable controversy before the Rehabilitation Court. First, it takes issue with the MHPI Projects' argument that "Ambac entered into rehabilitation proceedings" (Resp. Br. at 2-3.) Second, it contends that the MHPI "persisted with that position" in arguing that "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 portion of Ambac's asset." (*Id.*) As a threshold matter, these arguments are not "misrepresentations" but accurately reflect the actual economic result of the Proceedings.

The Rehabilitator concedes that "[a]lthough only the Segregated Account is in rehabilitation, OCI maintains an interest in and continues to monitor developments in the General Account." (Resp. Br. at 6.) The Rehabilitator further admits that the Segregated Account was capitalized with the Secured Note and the Reinsurance Agreement. (Resp. Br. at 6-7.) But the Rehabilitator ignores that the Rehabilitator was given significant rights regarding the assets in the General

Account, including the right to approve any investment over \$5 million (*see* R. 1010 at 9-10) and the right to approve the payment of any dividends (*see* R. 1, at 71 and 85.) The Rehabilitator also ignores that as a direct result of the Secured Note and the Reinsurance Agreement, the Rehabilitator was (i) authorized to take virtually all of the assets of the General Account to pay claims in the Segregated Account (R. 556, Supp. App. 33, ¶ 75 (“all assets of the General Account are available to pay Segregated Account claims under the Plan”)), and (ii) has in fact taken over \$3.7 billion from the General Account to date (*see* R. 1010 at 8-9 and 30-31). From these facts, the MHPI Projects have accurately argued in their separate litigation against Ambac that “Ambac” entered rehabilitation when certain policies were placed into a Segregated Account, when the Rehabilitator was given approval rights regarding the General Account and when, as a direct result of the Rehabilitation Proceedings, substantially all of Ambac’s assets were used to capitalize the Segregated Account.

C. The Rehabilitation Court’s Clarifying Order Exceeded The Court’s Jurisdiction.

The Rehabilitator cites three sources of authority for the Rehabilitation Court’s jurisdiction to issue the clarifying order: the Wisconsin Rehabilitation Statute, the Confirmation Order, and the court’s inherent authority. None of these authorizes entry of the disputed order.

1. The MHPI Litigation Does Not “Threaten” The Proceedings And, Thus, The Rehabilitation Statute Does Not Provide Authority.

First, the Rehabilitator relies on Wisconsin Statute § 645.05(1)(k), which provides that the court may issue orders “necessary and proper” to prevent threats to the Segregated Account and the administration of the Rehabilitation Proceeding. But this order was neither necessary nor proper. The MHPI Project litigation was originally initiated by *Ambac* with multiple suits against the MHPI Projects for damages and specific performance of their policies’ cash-funding provisions. Only after Ambac filed suit did the MHPI Projects file declaratory judgment actions in several state courts. Ambac in turn filed counterclaims and new state court suits, again seeking damages and specific performance. The MHPI Projects have asserted an Ambac Default only as a defense or as a basis for declaratory relief.

In the current litigation, the MHPI Projects have asserted no claim for damages arising from an Ambac Default, seeking only declaratory relief and payment of legal fees. The litigation, therefore, does not prejudice the rights of policyholders in the General Account or the Segregated Account, and it poses no threat to the administration of the Rehabilitation Proceeding. Further, if an Ambac Default is found under the unique language contained in the MHPI Projects’ documents, there is no evidence these triggers would lead to any “collateral damage” to the Segregated Account. (R. 1017 at 15-16.)

The courts presiding over the MHPI Projects litigation are entitled to reach their own determinations regarding Ambac Default. If other courts are entitled to reach those decisions, it cannot be that those courts' ruling on issues squarely within their own jurisdiction presents a "threat" that implicates the Rehabilitation Court's authority to issue a preventive order.

2. The Confirmation Order Does Not Provide Authority For Entry Of An Order Designed For Use In Other Unrelated Litigation.

By its own terms, the Confirmation Order limits the Rehabilitation Court's exclusive jurisdiction to the Rehabilitation Proceeding. The Rehabilitator argues such jurisdiction includes "authority to issue orders providing guidance regarding the proceedings to any interested parties." (Resp. Br. at 23.) Though couched in the language of the Confirmation Order, the clarifying order is aimed squarely at actions outside the Rehabilitation Proceeding. (See R. 1025 at 2, App. 2 (Rehabilitator requested clarification "helpful to sister courts"); R. 1034 at 24:14-18, App. 31 ("I'm not telling them what to do . . .").) Even while disclaiming any intent to decide the issue for those sister courts, the Rehabilitation Court entered an order that purported to do just that, holding that "it would run counter to OCI's stated purpose" if these other courts were to find that an Ambac Default has occurred as a *result* of the Rehabilitation Proceeding. (R. 1025, App. 5, 7, ¶¶ 10, 17.)

3. The Rehabilitation Court’s “Inherent Authority” Does Not Extend to Issuance Of An Order When No Dispute Exists.

“[A]n impermissible advisory opinion [] seeks a decision on the merits where a dispute does not exist.” (Resp. Br. at 25.) Here, the sole argument that a “dispute” exists is based on the false premise that the MHPI Projects have made “misrepresentations” that need to be corrected. No such misrepresentations have been made, and the Segregated Account faces no harm or prejudice by the defenses or bases for declaratory relief asserted by the MHPI Projects in the state court litigation. The MHPI Projects are not parties to the Rehabilitation Proceeding, were not named as adverse parties for the purpose of the Rehabilitator’s motion, and are not engaged in litigation involving the Segregated Account. Nor has the Rehabilitator sought to intervene in any of the actions involving the MHPI Projects.

The Rehabilitator posits a purely hypothetical scenario to justify issuance of the clarifying order—the potential confusion of other courts interpreting orders from the Rehabilitation Proceeding. Yet no court presiding over litigation involving the MHPI Projects has expressed confusion about the Rehabilitation Proceedings or entered orders contradicting the Rehabilitation Court’s prior orders. The Rehabilitation Court’s basis is all the more tenuous given its acknowledgement that those other courts are properly entitled to make a determination of Ambac Default. “I’m not even contending that it’s particularly

material with what they've got before them because I don't know.” (R. 1034 at 24:10-18, App. 31.)

Even if the Rehabilitation Court perceived a threat from other courts' potential misinterpretation, the court did not have authority to issue an order that rewrites the record of the Rehabilitation Proceedings. *State v. Henley*, 2011 WI 67, 338 Wis. 2d 610, 802 N.W.2d 175.

The Rehabilitator has pointed to no evidence that the Rehabilitator ever considered the unique default language contained in the MHPI Projects' policies. Instead, the Rehabilitator now contends “that argument is irrelevant.” (Resp. Br. at 38.) Yet the Rehabilitation Court's purported “clarifying” order contains language taken directly from the MHPI Projects' policies. (*Compare, e.g.*, R. 1025, App. 5, ¶ 10 (holding it would run counter to purpose if Rehabilitation Proceedings are “considered to be . . . the taking possession of Ambac's assets), and R. 1011 at 130 (defining Ambac Default in part as entry of order “authorizing the taking of possession by a custodian, trustee, agent or receiver of Ambac (or taking of possession of all or any material portion of Ambac's property”).) This was an attempt by the Rehabilitator to have the Rehabilitation Court make new factual findings where none existed in the prior record, which are not supported by the prior record.

The cases cited by the Rehabilitator do nothing to resolve the issue. In *State v. Johnson*, 2014 WI 16, 353 Wis. 2d 119, 846 N.W. 2d 119, the Wisconsin Supreme Court issued a clarifying order regarding a prior *per curiam* decision, to

ensure the circuit court to which the case was being remanded understood the effect of the Supreme Court's deadlock as affirming the Court of Appeals. The Supreme Court's order thus addressed an issue that was imminent and directly related to the issue that had been previously presented by the same parties. Here, the Rehabilitation Court purported to address confusion that does not exist in courts and cases expressly outside its jurisdiction. In *Kontowicz v. Am. Standard Ins. Co. of Wisconsin*, 2006 WI 90, ¶ 3, 293 Wis. 2d 262, 718 N.W.2d 111, the Supreme Court clarified a prior decision and amended the language of the opinion to "facilitate its application." The clarification was directed at an issue of statutory interpretation that had previously been before the court and would have an actual effect on any case involving the same statute. That is plainly different from the Rehabilitation Court's entering an order that offers unsupported and non-binding suggestions to other courts about the Rehabilitator's purpose.

D. The MHPI Projects Have Sufficiently Identified The Rehabilitation Court's Erroneous Factual Findings And Explained Why They Were Erroneous.

The Rehabilitator argues the MHPI Projects failed to identify and explain the erroneous factual findings in the Rehabilitation Court's order. Yet the Rehabilitator admits the MHPI Projects identified Paragraphs 10 and 17 of the order as erroneous, and the erroneous nature of those findings is discussed at length in the MHPI Projects' Opening Brief. (*See App. Br. at 15-18.*) The findings were erroneous for at least two reasons.

First, the Rehabilitation Court’s factual findings are inconsistent with the record evidence that was before the Court at the time its prior Orders were entered. Tracking the MHPI Projects’ policy definition of Ambac Default, Paragraph 10 of the clarifying order states:

[I]t would run counter to OCI’s stated purpose . . . 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.

(R. 1025, App. 5, ¶ 10 (emphasis added).) Yet this statement of purpose is belied by the record, which contains no facts to suggest that the Rehabilitator ever considered the unique policy language when structuring the Rehabilitation.

Similarly, Paragraph 17’s implication that “collateral damage” would result “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” is belied by the undisputed facts that exist today. Contrary to the Rehabilitator’s argument (Resp. Br. at 38), this is highly relevant. Though the court’s statement of the Rehabilitator’s purpose is historical, the court’s clarifying order was issued in 2016 for use in ongoing litigation pending in front of foreign tribunals. The order states certain potential findings by another court “would run counter” to the Rehabilitator’s originally stated purpose. (See Paragraphs 10 and 17, quoted *supra* at 3.) But there is no evidence that a finding of Ambac Default today in another court in an unrelated case involving the General Account will produce the

collateral damage originally feared by the Rehabilitator. The evidence available to the Rehabilitation Court today demonstrates the opposite. (R. 1017 at 16–18.)

Second, an evidentiary hearing was necessary to support Paragraphs 10 and 17 of the clarifying order. The Rehabilitator’s argument to the contrary only begs the question. Paragraphs 10 and 17 inject unsupported findings about what considerations informed the Rehabilitator’s original purpose, as well as unsupported findings about what hypothetical future rulings by other courts will do.

The Rehabilitator suggests that the MHPI Projects failed to request an evidentiary hearing, (Resp. Br. at 32), but this misses the point that the court made *no* findings of fact. The Court purported to be “clarifying” prior orders. The fact the prior proceedings in the Rehabilitation Court did not contain a factual record relating to the MHPI Projects’ unique default triggers proves their point that there was no support for the October 24, 2016 Order.

CONCLUSION

Based on the above and the MHPI Projects’ Opening Brief, the Court should reverse the Circuit Court’s October 24, 2016 Order and find that the Circuit Court erred by (1) entering a procedurally improper advisory opinion; (2) including factual findings in its October 24, 2016 Order that were unsupported by the factual record before the Court without the benefit of an evidentiary hearing; and (3) by including factual findings regarding the risk of “collateral damage” that are inconsistent with the undisputed facts that exist today.

Dated: March 2, 2017

Respectfully submitted,

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CERTIFICATIONS

I hereby certify that this brief conforms to the rules contained in s. 809.19(8)(b) and (c) for a brief and appendix produced with proportional serif font. The length of this brief is 2,993 words.

I further certify that I have submitted an electronic copy of this brief which complies with the requirements of s. 809.19(12). I further certify that this electronic brief is identical in content and format to the printed form of the brief filed as of this date.

A copy of this certificate has been served with the paper copies of this brief filed with the court and served on all opposing parties.

Dated: March 2, 2017

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I hereby certify that on March 2, 2017, I caused three true and correct copies of this brief to be served by first-class mail, postage prepaid, upon the person listed below:

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