STATE OF WISCONSIN : CIRCUIT COURT : DANE COUNTY

In the Matter of the Rehabilitation of:

SEGREGATED ACCOUNT OF AMBAC ASSURANCE CORPORATION

Case No. 10 CV 1576
Hon. Richard G. Niess

REHABILITATOR'S OPPOSITION TO THE COFINA BONDHOLDERS' MOTION TO ADJOURN PROCEEDINGS ON CONFIRMATION OF THE PLAN

Dated: December 11, 2017.

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INTRODUCTION

Cyrus Capital Partners, L.P., Polygon Global Partners LLP, and Taconic Capital Advisors, LP, (the "**COFINA Bondholders**") are not parties to this Rehabilitation; they are beneficiaries of a single General Account policy, outside of this proceeding, that insures bonds issued by an instrumentality of Puerto Rico known as COFINA. They do not have standing to seek adjournment of the hearing on the Rehabilitator's Second Amended Plan (the "**Plan**") which seeks to effectuate a transaction to pay Segregated Account claims. Importantly, the COFINA Bondholders seek to adjourn the Motion hearing ***indefinitely***. In doing so, they ask, in effect, to enjoin the Consensual Transaction, which would result in substantial additional expense, upset strict deadlines agreed upon by AAC and the Ad Hoc Group of creditors as part of the Rehabilitation Exit Support Agreement ("**RESA**"), and potentially foreclose an opportunity for the Segregated Account to emerge from Rehabilitation, allowing policy holders to finally receive payment of their policy claims.

The Court should deny the COFINA Bondholders' motion to adjourn these proceedings (the "**Motion to Adjourn**") and confirm the Plan over their objections for the reasons more fully stated in the Rehabilitator's Brief in Reply to Objections, submitted concurrently. This brief solely addresses the COFINA Bondholders' Motion to Adjourn, which the Rehabilitator asks the Court to address at the December 14, 2017 Pretrial Conference.

ARGUMENT

I. AN INDEFINITE ADJOURNMENT WOULD CAUSE THE PARTIES TO VIOLATE THE RESA AND THUS DERAIL THE CONSENSUAL TRANSACTION

The COFINA Bondholders seek an indefinite adjournment. They believe more information *may* be available in Puerto Rico's PROMESA Title III restructuring proceedings "in the relatively near future." (Motion to Adjourn at p. 16.) They argue this information, whatever

it may be, will be important to measure AAC's exposures on insured General Account Puerto Rico debt. However, the COFINA Bondholders are well aware that under the RESA, AAC must close on the Consensual Transaction no later than April 15, 2017, or one or more parties will have the right to cancel it.[1] Thus, time is of the essence to move forward now, before the Consensual Transaction, which the Rehabilitator has determined is in the best interests of Segregated Account holders, is no longer on the table.

Specifically, should the Court grant an indefinite adjournment, the deadlines in the RESA will expire without closing the Consensual Transaction. Therefore, an indefinite extension of the RESA would be necessary to keep the Consensual Transaction viable. But an indefinite extension of the RESA is likely impossible to secure given the ongoing accretion, complexity of the deal, the number of parties, the carrying costs, and the restrictions in place upon the parties until the Consensual Transaction concludes.

First, under the terms of the RESA, deferred payment obligations ("**DPOs**") continue to accrete at 5.1% until the Rehabilitator's Motion is granted and the Consensual Transaction is closed. Under the current model, DPOs and Surplus Notes owed to third parties are accreting at approximately $15 million[2] per month. Over time, this accretion will negatively impact AAC by cutting into the Rehabilitator's margin of safety required for a durable exit.

Second, as part of the RESA the Ad Hoc Group agreed to significant restrictions on their ability to trade DPOs and General Account Surplus Notes. Those restrictions were necessary to maintain majority support for the Consensual Transaction and comply with SEC protocol. An

[1] (*See generally* RESA at § 7, attached to the Disclosure Statement as Exhibit C.) The signing date of the RESA was July 19, 2017. After the signing date, section 7 requires the Rehabilitator to file its Motion to Amend the Plan within 75 days (Oct. 2, 2017) and commence a confirmation hearing within 180 days (Jan. 15, 2018), and also requires AAC to consummate the Consensual Transaction within 270 days (Apr. 15, 2018).

[2] Excluding any savings to AAC from delaying issuance of secured notes, and excluding interest on approximately $515 million of surplus notes, which will still be outstanding.

indefinite extension of the RESA is not feasible for the Ad Hoc Group, whose business involves, in large part, trading in these types of financial instruments. Even a date-specific extension will not likely be palatable to the Ad Hoc Group.

Without the RESA in place, the Rehabilitator will be unable to move forward with the Plan to conclude the Rehabilitation. And without participation of the Ad Hoc Group in the exchange contemplated under the Plan, the Deferred Amount holders could not receive the same effective consideration package. The RESA is thus the lynchpin of the Second Amended Plan.

II. ADJOURNMENT DOES NOTHING TO RESOLVE THE RISKS ASSOCIATED WITH PUERTO RICO

The foundation for the COFINA Bondholders' Motion to Adjourn is that the parties do not know the full scope of financial fallout from Puerto Rico. Essentially, they seek to enjoin confirmation indefinitely until (a) a new fiscal plan is presented by the Puerto Rico Oversight Board, (b) a debt repayment plan is negotiated and approved as part of Puerto Rico's PROMESA Title III restructuring proceedings, and (c) the full effects of Hurricane Maria are known and resolved. These events could take years to finally resolve based on the standard set by the motion of the COFINA Bondholders.

The Rehabilitator is well aware of these issues, and its advisors have historically projected large losses in Puerto Rico. This comes as no surprise, and those risks have been incorporated into the financial modeling conducted by the Rehabilitator's Expert. Even taking into account updated loss projections, the Consensual Transaction still allows AAC to exit the Rehabilitation and remain durable.[3] This is all the more reason to conclude this proceeding now, as opposed to delaying indefinitely. Given the benefits of consummating the Plan and Consensual Transaction, there is no reason to wait.

[3] (*See* Updated McGettigan Report at p. 1.)

III. THE COFINA BONDHOLDERS LACK STANDING

The COFINA Bondholders are not parties to this dispute.[4] Indeed, the only parties to this proceeding are the Rehabilitator and the Company. *Nickel v. Wells Fargo Bank*, 2013 WI App 129, ¶ 19, 351 Wis. 2d 539, 841 N.W.2d 482. Therefore, the COFINA Bondholders have no standing to bring their Motion to Adjourn. *See, e.g., In re Am. Rds. LLC*, 496 B.R. 727, 732 (Bankr. S.D.N.Y. 2013) (denying motion to adjourn because party did not have standing to participate in proceedings). Moreover, the COFINA Bondholders are *not* even policyholders of the Segregated Account, which is the only entity in Rehabilitation; they are policy beneficiaries of a single policy in the General Account. Therefore, the Court should deny the Motion to Adjourn because the COFINA Bondholders have no basis to object to a Rehabilitation Plan with respect to the Segregated Account, let alone effectively terminate it by delay.

IV. AN ADJOURNMENT WOULD EFFECTIVELY ENJOIN THE CONSENSUAL TRANSACTION

A. The COFINA Bondholders Should Be Required To But Cannot Meet The Standard For Injunctive Relief

The COFINA Bondholders attempt to frame their motion to adjourn as a matter-of-course issue; indeed, the "the Court has inherent power to control its docket, and changes to the schedule are 'within the limits of the [court's] discretion.'" *Parker v. Wisconsin Patients Comp. Fund*, 2009 WI App 42, ¶ 9, 317 Wis. 2d 460, 767 N.W.2d 272 (quoting *Hefty v. Strickhouser*, 2008 WI 96, ¶ 31, 312 Wis.2d 530, 752 N.W.2d 820). But here, the request to adjourn is really an injunction in disguise, designed to delay the Consensual Transaction indefinitely beyond the deadlines in the RESA. The effect of an indefinite adjournment would cause a breach of the RESA, putting at risk an opportunity for the Segregated Account to exit Rehabilitation in the

[4] *See* Rehabilitator's Response Brief (filed herewith) for a more complete discussion of the COFINA Bondholders' lack of standing which is incorporated herein by reference.

near term. This would function as a permanent injunction to enjoin AAC and the Ad Hoc Group from ever closing the Consensual Transaction. Accordingly, the Court should apply the standard for granting an injunction when considering the Motion to Adjourn.

A party seeking an injunction "must show a sufficient likelihood" of irreparable harm, must "lack an adequate remedy at law," and must "establish that 'on balance, equity favors issuing the injunction.'" *See generally, Pure Milk Prods. Co-op v. Nat'l Farmers Org.*, 90 Wis. 2d 781, 800, 280 N.W.2d 691 (1979); *Sunnyside Feed Co. v. City of Portage*, 222 Wis. 2d 461, 472, 588 N.W.2d 278 (Ct. App. 1998); *Nettesheim v. S.G. New Age Prods., Inc.*, 2005 WI App 169, ¶ 21, 285 Wis. 2d 663, 702 N.W.2d 449. The COFINA Bondholders cannot meet this formidable standard.

First, the COFINA Bondholders cannot establish ***any*** harm, let alone harm that would be irreparable. They only hold potential, contingent claims against a single policy in the General Account. The exit of the Segregated Account from Rehabilitation will have no direct impact on the COFINA Bondholders, including any rights they hold under the policy insuring their bonds. Their unsubstantiated assertions—that making payments to Segregated Account policyholders today would increase the payment risk of their un-crystalized claims (which may never become actual claims)—is a speculative statement that does not come close to irreparable harm.

The COFINA Bondholders have other remedies available if their doomsday scenario comes to pass, which itself requires several extreme events to occur such as (i) litigating to a 100% loss outcome rather than settling, and (ii) the Title III court finding not only that Puerto Rico assets are not available to service debt—but also that the COFINA instrumentalities themselves are unconstitutional or otherwise invalid. Examples of other remedies available to the COFINA Bondholders include claims for constitutional takings against the Commonwealth,

or fraud/negligence claims against the underwriters, law firms, advisors, or investment bankers that put the structure together and marketed the bonds. Indeed such causes of action have been alleged and discussed as part of the ongoing dispute in the Title III proceedings. There may be other recovery avenues as well—or more likely, a negotiated settlement of one or more claims through Puerto Rico's restructuring efforts. Whether the COFINA Bondholders would ultimately prevail on one or more such claims is unknown, but the possibility of recovery and other legal pathways for recovery weigh against an injunction. The interests of parties in the Segregated Account, whose claims have already materialized, should outweigh any tangential, contingent claims asserted by the COFINA Bondholders. As such, the COFINA Bondholders do not lack other remedies at law, as would be required for injunctive relief.

In sum, the equities favor a resolution of this Rehabilitation proceeding. An adjournment that could jeopardize the RESA and the Plan should be denied. To date, Segregated Account policyholders with actual claims have received less than half of the amounts of their claims. The Consensual Transaction allows those crystalized claims to be paid in full. For these reasons, the COFINA Bondholders have failed to meet any of the prongs for injunctive relief under Wisconsin law and their Motion to Adjourn should be denied.

B. COFINA Bondholders Would Need to Post a Bond

Because the Consensual Transaction hangs in the balance, any adjournment of the Confirmation Hearing must be conditioned on the COFINA Bondholders posting a substantial bond. WIS. STAT. § 813.06 (stating that "the court or judge shall require a bond of the party seeking an injunction . . . not exceeding an amount to be specified, as he or she may sustain by reason of the injunction if the court finally decides that the party was not entitled thereto); *see also Becker v. Becker*, 66 Wis. 2d 731, 735-36, 225 N.W.2d 884 (Wis. 1975); *Arthur v. State*

Conservation Commission, 33 Wis. 2d 585, 591, 148 N.W.2d 17 (Wis. 1967) (it was error for the court to deny a request for a bond to a party against whom an injunction was sought).

The Consensual Transaction reflects a global resolution of more than $3.8 billion in outstanding policy claims that will be paid through cash disbursements, secured notes, and reallocated surplus notes. It also reflects a discount of 6.5% of claims, offset against accretion—a benefit that may be lost permanently if an adjournment is granted. This Rehabilitator's advisory team has opined that without these consensual terms, there is no likely alternative to exit this rehabilitation without going into a long-term, costly runoff scenario. Almost any delay of the hearing to approve the Plan will allow parties to terminate the transactions underlying the Plan, thus risking the collapse of the proposed Plan altogether. If the COFINA Bondholders want this Court to stop the Transaction, they must insure against this risk.

The amount of the bond required is within the discretion of the court. In this situation, the bond amount must be no less than the sum of (a) the total benefit of the 6.5% discount, (b) continuing accretion, (c) administrative costs that would be eliminated through confirmation, (d) and attorneys' fees that would be incurred as part of any delay. *See Becker*, 66 Wis. 2d at 736 (remanding case with instructions to the circuit court to "fix the amount of bond required by plaintiff"). The discount is valued today at approximately $233 million. Accretion on an aggregate basis on all outstanding amounts is $15 million for each month the Rehabilitation remains open. Lastly, administrative costs and attorneys' fees are estimated to be $6 million per month. *Muscoda Bridge Co. v. Worden-Allen Co.*, 207 Wis. 22, 29, 239 N.W. 649, 652, *reh'g denied*, 207 Wis. 36, 240 N.W. 802 (1932) (court explained that under WIS. STAT. § 268.06, the predecessor to § 813.06, "[i]t is the established law of this state that damages, sustained by reason of an injunction improvidently issued, properly include attorney fees for services rendered

in procuring the dissolution of the injunction, and also for services upon the reference to ascertain damages."). The benefits afforded to the Segregated Account and AAC as part of the Consensual Transaction on the other hand are substantial. Those benefits should be protected by a substantial bond.

CONCLUSION

For the foregoing reasons, the Rehabilitator respectfully requests that the Court deny the COFINA Bondholder's Motion to Adjourn.

Dated at Milwaukee, Wisconsin this 11th day of December, 2017.

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