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

AMBAC ASSURANCE CORPORATION'S RESPONSE TO MHPI PROJECT OWNERS' SUR-REPLY IN SUPPORT OF THEIR OBJECTION TO THE REHABILITATOR'S PROPOSED SECOND AMENDED PLAN

PRELIMINARY STATEMENT

Almost eight years ago, the OCI placed Ambac's Segregated Account[1] into rehabilitation proceedings in an effort to protect Ambac, its policyholders, and the public from the effects of mushrooming claims in a portion of Ambac's book of business. The approach adopted by the OCI was a narrow and targeted rehabilitation of a then problematic book of business. It was designed to avoid triggering defaults in Ambac's healthy book. The OCI's approach to this rehabilitation is expressly authorized by Wisconsin's insurance laws and has been vindicated on several occasions by the Court of Appeals. As a result of painstaking efforts by the Rehabilitator and Ambac's management, the Segregated Account is now ready to exit rehabilitation and to merge back into the rest of Ambac. Following exit and merger, Ambac is poised to emerge from the shadow cast by the rehabilitation of its Segregated Account and to move forward, including by paying all policy claims in full.

[1] Capitalized terms used herein but not defined have the meanings ascribed by the Second Amended Plan.

Positions taken in other courts by the MHPI Project Owners undermine the statutorily-authorized approach taken by the OCI. In part because of the positions taken by the MHPI Project Owners, the Rehabilitator has determined that Article 6.13 is needed to protect Ambac post-exit, including to protect it from specious arguments that the rehabilitation of the Segregated Account has triggered defaults with respect to General Account policies. Article 6.13 is thus necessary to complete the carefully designed project begun in 2010, *i.e.,* to remediate the problems in the Segregated Account without triggering defaults in the General Account.

The argument by the MHPI Project Owners that Article 6.13 of the Plan is somehow inappropriate undermines the Wisconsin Insurance Code in a fundamental manner. Wisconsin insurance law expressly provides for the creation of a segregated account and the rehabilitation of such segregated account separate and apart from the rest of the insurer's business. One principal reason for this structure is to allow the rest of the business of the insurer to continue untainted by the rehabilitation of the segregated account. Article 6.13 of the Second Amended Plan proposed by the Rehabilitator ensures that the purpose of the Wisconsin insurance laws is carried out. The MHPI Project Owners seek to misuse the rehabilitation of the Segregated Account to do precisely what the Wisconsin insurance laws seek to prevent: to argue that the rehabilitation of the Segregated Account constitutes or has led to defaults related to insurance policies in the General Account.[2] The Commissioner of Insurance in his role as Rehabilitator of the Segregated Account has determined that Article 6.13 is necessary. The MHPI Project Owners provide no basis for this Court not to defer to the Commissioner in his enforcement of the

[2] The purpose of the Ambac Default provision is to protect policyholders who are counting on Ambac's ability to make payment. Here, (1) that ability has never been in doubt as to these transactions because they are in the General Account and the General Account is not in rehabilitation, and (2) the "Borrowers" (*i.e.*, the MHPI Project Owners) may not vitiate these important control rights based on terms of the Grantor Trust Agreements that expressly provide them no rights.

insurance laws. Moreover, no Segregated Account or General Account policyholder has objected to Article 6.13. Therefore, this Court should approve Article 6.13.

The MHPI Project Owners are attempting to use the rehabilitation of the Segregated Account to prevent Ambac from exercising bargained-for contract rights, even though they are not holders or even beneficial holders of an Ambac insurance policy or surety bond. Indeed, policy and/or surety bond holders have not objected to the Second Amended Plan, including Article 6.13.[3] The MHPI Project Owners, as non-parties, have no right to be heard in this rehabilitation case, including on the issue of what provisions have been determined by the Rehabilitator to be reasonably required to protect the Segregated Account and Ambac as a whole post exit.

Instead of policyholders, the MHPI Project Owners are each a "Borrower" as defined by a Grantor Trust Agreement under which trust certificates secured by the MHPI Projects were issued to investors.[4] The Grantor Trust Agreement related to each MHPI Project appointed U.S. Bank as the Grantor Trustee and transferred the majority of the original lender's rights and obligations under the loan documents to U.S. Bank for the benefit of the bondholders. In connection with the loans, Ambac acted as the "Credit Enhancer" by issuing bond insurance that guaranteed principal and interest payments. In consideration for Ambac taking on this risk, each Grantor Trust Agreement assigned to Ambac the right to enforce the rights of the Grantor

[3] This itself provides reason to reject the MHPI Project Owners' objection. *See Nickel v. FFI Fund Ltd.*, No. 2014AP2033 (Wis. Ct. App. Mar. 7, 2016) (summary disposition) (rejecting appeal by downstream holders because appellants were not parties to the rehabilitation and lacked standing to raise objections that could have been, but were not, raised by entities more directly affected).

[4] *See* Affidavit of Stephen Ksenak, filed December 29, 2017, attaching as Exhibit A the Meade Grantor Trust Agreement.

Trustee so long as there has been no "Ambac Default."[5] In each deal, the Grantor Trust Agreement, which is one of the loan documents, includes a provision precluding Ambac from exercising rights delegated to it under the loan documents in the event of a "default." But, section 7.11 of the Grantor Trust Agreement also specifically excludes the MHPI Project Owners, who are "Borrowers" under those agreements, from being entitled to assert claims or rights under or by reason of that agreement. The investors, not the Borrowers, are the parties for whose benefit control rights would shift in the event of an Ambac default.[6] Section 7.11 provides:

> No Third Party Beneficiaries. This Trust Agreement shall be for the sole and exclusive benefit of the Depositor, the Grantor Trustee, the Owners, Ambac and their respective permitted successors, assignees and transferees and nothing in this Trust Agreement expressed or implied is intended or shall be construed to confer upon, or to give to, any other Person, including, without limitation, the Borrower, any right, remedy or claim under or by reason of this Trust Agreement or any terms hereof.

Notwithstanding the clarity of this provision, the MHPI Project Owners purport to be released from any obligation to recognize Ambac's control rights on the pretext that the rehabilitation of the Segregated Account is an event of default.

The MHPI Cases arise from Ambac's effort to enforce the MHPI Project Owners' obligation to replace the surety bond that Ambac issued to satisfy the requirement that the MHPI Project Owners maintain a debt service reserve equal to one year's principal and interest on the

[5] Some of the Grantor Trust Agreements refer to a "Credit Enhancer Default" as opposed to an "Ambac Default" and define that term by reference to a corresponding Credit Enhancement Agreement. The definitions of an "Ambac Default" and a "Credit Enhancer Default" are, however, substantially similar.

[6] The MHPI Project Owners' objection also misconstrues the default provisions, which protects *insureds*, *i.e.*, investors, not Borrowers, in the event the MHPI Project Owners fail to make payment. In certain circumstances, the documents allow insureds – but not the MHPI Project Owners – the ability to exercise rights and remedies with respect to the underlying insured obligations (referred to as "control rights").

loans. In the MHPI Cases, the MHPI Project Owners argue that an "Ambac Default" or "Credit Enhancer Default" supposedly arising out of the Segregated Account rehabilitation precludes Ambac from seeking to enforce the MHPI Project Owners' contractual obligation.

By virtue of its role in providing credit enhancement for the MHPI Projects, Ambac was delegated various rights of the Lender, including "control rights." It has attempted to enforce certain of these rights to require the MHPI Project Owners to fund the bargained-for reserve cushions in an aggregate amount in excess of $200 million that buffers against Ambac's potential downside exposure. The MHPI Project Owners, in order to avoid the application of these provisions, are trying to manipulate the effects of the Segregated Account's Rehabilitation by taking positions which conflict with Wisconsin insurance law. The MHPI Project Owners argue that an "Ambac Default" or "Credit Enhancer Default" supposedly arising out of the Segregated Account Rehabilitation precludes Ambac from being able to enforce its rights to have the MHPI Project Owners comply with their contractual obligations. The persistent efforts of the MHPI Project Owners undermine a core purpose of the targeted rehabilitation of the Segregated Account, and the objection here is an attempt to hijack the Segregated Account Rehabilitation to prevent Ambac from exercising control rights. Article 6.13 is thus necessary to complete the OCI's carefully designed project first begun in 2010.

ARGUMENT

I. This Court Has Authority To Approve Article 6.13.

A. Article 6.13 applies Wisconsin law in this Proceeding to protect a durable exit.

The Commissioner is tasked with both administering and enforcing Wisconsin's insurance laws. *See* Wis. Stat. § 601.41(1) ("The commissioner *shall administer and enforce* chs. 600 to 655...") and Wis. Stat. § 601.41(2) ("The commissioner shall have all powers specifically

granted to the commissioner, or reasonably implied in order to enable the commissioner to perform the duties imposed by sub. (1).”). These statutory provisions enable the Commissioner to enforce Wisconsin insurance law precisely as it was administered in this case, including adopting a rehabilitation plan with Article 6.13 to, among other things, preserve all of Ambac’s contract rights. The Wisconsin legal framework that allows rehabilitation of a segregated account could be rendered unworkable if, absent Article 6.13, parties could assert that the Rehabilitation of the Segregated Account constitutes a default with respect to General Account policies. This is true because claims that Ambac’s General Account policies are in default are value-destructive and will undermine the durability of the re-integrated Ambac. In light of the need to fully protect the re-integrated Ambac, the Rehabilitator has decided it is necessary for the Second Amended Plan to make crystal clear that no General Account defaults have occurred as a result of this Proceeding. Consistent with the Court of Appeals holding in *Nickel*, the Commissioner’s exercise of his discretion must be given deference. *Nickel*, 2013 WI App 129, ¶ 120, 351 Wis. 2d 359, 841 N.W.2d 482 (“[T]he commissioner’s determinations regarding the interpretation and application of statutes it is charged with administering are entitled to great weight deference”).[7]

Article 6.13 contains no stay of litigation, as did prior injunctions issued in this case, but it is also within the same scope of actions “to prevent persons or entities from jeopardizing the success of the insurance rehabilitation,” as sanctioned by *Nickel.* By approving Article 6.13, this Court will reconfirm its prior orders, including that rehabilitation relates only to the Segregated Account and therefore that any alleged defaults based on these Proceedings are cured and have no effect.

[7] Even under a lesser standard of deference, the Rehabilitator’s reasonable exercise of discretion is entitled to deference.

The MHPI Project Owners try to avoid this Court's jurisdiction—reserved by Article 7.1 of the Initial Plan "to hear, determine, and enforce Causes of Action that may exist by or against the Segregated Account or by or against the General Account or AAC or the Management Services Provider in regards to the Segregated Account"—by claiming "the [MHPI] cases do not meet this description [of 'matters, in regards to the Segregated Account'] as they are breach of contract cases arising out of policies in the General Account." To the contrary, however, claims such as those asserted by the MHPI Project Owners have been determined by the Rehabilitator to pose a threat to the targeted rehabilitation of the Segregated Account. These threats are explained in the Affidavit of David P. Barranco in Support of Confirmation of the Second Amended Plan of Rehabilitation of the Segregated Account of Ambac Assurance Corporation, filed Dec. 11, 2017 ("Barranco Aff.") ¶¶ 9-14. Although Article 6.13 pertains to contracts of both the Segregated and General Accounts, the Rehabilitator's determination that the assertion against Ambac of defaults resulting from the rehabilitation of the Segregated Account is a threat to durability upon exit is sufficient to invoke this Court's authority to approve the inclusion of Article 6.13 in the Second Amended Plan.[8]

Article 6.13 is consistent with this entire Proceeding, which utilized the tools provided by Wis. Stat. § 611.24(e) "in order to save Ambac from insolvency.[9] *See Dilweg v. Carlisle/*

[8] The MHPI Project Owners also misconstrue what Article 6.13 does. Contrary to their arguments that Article 6.13 delves into the specifics of the MHPI transaction documents, Article 6.13 does not consider "specific trigger language in the MHPI Loan Documents," MHPI Sur-Reply Brief at 7, nor does it include any finding of fact that a default "under the specific language of the MHPI Loan Documents" would cause collateral damage today. *Id.* at 7, 14-18. Article 6.13 states the impact on contract rights of the decision to limit Rehabilitation to the Segregated Account, the formation and capitalization of the Segregated Account and of the Second Amended Plan and the transactions it encompasses. The MHPI Project Owners' persistent mischaracterizations further underscore the need for Article 6.13.

[9] Article 6.13 can also be viewed as relief incidental to the Rehabilitation Court's declaration in the Plan of the scope of the rehabilitation of the Segregated Account, of its jurisdiction and of the impact on the General Account of the rehabilitation case, the Segregated Account's exit from rehabilitation and the merger back into the General Account. *See* Wis. Stat. § 806.04(1)-(3) (authorizing court to construe

Picatinny Family Housing L.P., Appeal No. 2016AP2169, ¶ 2 (Wis. Ct. App. Dec. 14, 2017) ("*Dilweg*") ("in order to save Ambac from insolvency ... [OCI] established a segregated account for Ambac's greatest liabilities and initiated a rehabilitation proceeding for the segregated account"), citing *Nickel*, 2013 WI App 129, ¶¶ 2-9. *Nickel* also contradicts the MHPI Project Owners' self-serving view because that decision clarifies that protection of Ambac as a whole is both consistent with this entire Proceeding and within the Rehabilitator's and this court's power. "As the commissioner has explained, the creation of the segregated account and the decision to pursue a targeted partial rehabilitation is in the best interests of segregated account policyholders *because it protects Ambac's claims-paying resources from the contractual default triggers* that likely would have resulted in Ambac's financial collapse." *Nickel*, 2013 WI App 129, ¶ 73 (emphasis added). As the *Nickel* court declared:

> The circuit court has the power to take action to prevent persons or entities from jeopardizing the success of the insurance rehabilitation. For example, the court may grant a permanent injunction, as it did here, to prevent, among other things: (1) interference with the rehabilitation proceedings; (2) waste of the insurer's assets; (3) the institution of actions or proceedings; and (4) "threatened or contemplated action that might lessen the value of the insurer's assets or prejudice the rights of policyholders, creditors, or shareholders, or the administration of the proceeding." WIS. STAT. § 645.05(1)(c), (d), (f), and (k). We conclude that the circuit court properly issued an injunction that is "necessary and proper" to prevent the institution of proceedings that may interfere with the insurance rehabilitation and waste or lessen the value of Ambac's assets, to the detriment of policyholders, creditors, and shareholders alike. See id.

Id, ¶ 103.

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contract rights and legal relations that are "affected by a statute, municipal ordinance, contract or franchise," whether before or after a contract is breached.).

B. The MHPI Project Owners' reliance on the Assured Decision is misplaced.

The Wisconsin Court of Appeals' unpublished decision affirming the Rehabilitation Court's 2012 injunction against arbitration demanded by Assured Guaranty Corp. and Assured Guaranty Re Ltd., *In re Ambac Assur. Corp*., No. 2011AP1486 (Wis. Ct. App. Oct. 24, 2013) (unpublished) (per curiam) ("Assured Decision"), supports the Rehabilitator's position that Article 6.13 is lawful and proper. The Assured Decision affirmed this Court's order that "enjoin[ed] arbitration of any disputes with Ambac in any court other than the rehabilitation court." That injunction foreclosed the resolution of disputes in the courts of other States. By contrast, Article 6.13 states the effects of the Proceeding in this court since 2010.

As parties claiming rights with respect to General Account contracts, the MHPI Project Owners are analogously situated to Assured, which was the counterparty to reinsurance contracts in the General Account (although the ceded policies were in the Segregated Account). When Assured went to court to compel arbitration to determine the scope of its reinsurance obligations to Ambac, *id.*, ¶¶ 3, 6, the Court of Appeals held this Court had authority over the reinsurance contracts even though they were in the General Account. The appellate court affirmed this Court's order enjoining Assured's recourse to other courts because "the specific dispute Assured sought to have arbitrated in this case was the application of … its reinsurance contracts" to these Proceedings. *Id.*, ¶ 16. So too, here. The MHPI Project Owners assert that they will suffer prejudice if they cannot continue to argue, in other States' courts, that the creation and capitalization of the Segregated Account and administration thereof during rehabilitation triggered a default under the provisions of the loan documents in their Projects. As with Assured, however, the dispositive issue is not which account contains the contracts at issue, but instead whether the alleged triggering events about which the MHPI Project Owners want to litigate are

within this Court's jurisdiction. Here, consistent with the Assured Decision, they are. The decision, therefore, cuts against the MHPI Project Owners' position.

Moreover, the Assured Decision cannot be read in isolation from the *Nickel* opinion affirming the initial rehabilitation plan, which was issued the same day. *See* Assured Decision, ¶ 4. *Nickel* is the general backdrop against which the more specific Assured Decision must be viewed. In failing to reference *Nickel*, the MHPI Project Owners overlook clear authority for Article 6.13. At issue in *Nickel* was this Court's injunction preventing trustee banks—*i.e.*, Segregated Account policy beneficiaries, who held enforcement rights under the relevant transaction documents—from enforcing Ambac's agreement to "transfer its control rights to them in the event that Ambac defaulted on its contractual obligations," which the policy beneficiaries asserted due to a failure to pay claims in full. *See id.*, ¶ 139. The appellate court was not persuaded that the trustee banks' contractual rights to take over Ambac's control rights were paramount to the protections provided by the injunction. The *Nickel* court, therefore, affirmed this Court's injunction because "the rehabilitation court has the power to take action to prevent persons or entities from jeopardizing the success of the insurance rehabilitation" and "has broad powers to enter an injunction to prevent the waste of Ambac's claims-paying resources." *Id*, ¶ 145; *see also id.*, ¶ 103 (this Court "properly issued an injunction that is 'necessary and proper' to prevent the institution of proceedings that may interfere with the insurance rehabilitation and waste or lessen the value of Ambac's assets, to the detriment of policyholders, creditors, and shareholders alike").[10] In light of the broad authority affirmed in *Nickel* to prohibit the exercise by actual policy beneficiaries of contract rights based on an actual failure to pay claims in full and to prevent litigation in other courts entirely, there is no doubt that this Court has the authority

[10] Accordingly, no one has objected or could object to the application of Article 6.13 to policies allocated to the Segregated Account.

to, among other things, take the more tailored step of adopting Article 6.13 to enforce the OCI's use of Wisconsin law to prevent defaults and loss of control rights by Ambac related to any of its insured transactions.

C. *FGIC* and *Mutual Benefit* provide precedent for approving Article 6.13.

Cases from other jurisdictions confirm that this Court has the authority to approve the inclusion of Article 6.13 in the Second Amended Plan. The New Jersey court overseeing the *Mutual Benefit* rehabilitation stayed litigation of a complaint filed three months prior to the rehabilitation court's stay order. *See Matter of Mut. Ben. Life Ins. Co*., 258 N.J. Super. 356, 364, 609 A.2d 768, 773 (App. Div. 1992). There, a bond trustee in Tennessee had declared a default by Mutual Benefit's real estate affiliate, accelerated a secured loan, filed a complaint, and obtained appointment of a receiver in Tennessee. Other bond trustees were threatening similar actions against Mutual Benefit affiliates in Maryland and South Carolina. The stay order issued by the *Mutual Benefit* rehabilitation court stopped all such proceedings against Mutual Benefit and its affiliates, including those actions already filed in Tennessee.

FGIC, a financial guaranty insurance company like Ambac, was rehabilitated in New York without the benefit of a segregated account statute like Wis. Stat. § 611.24. Absent that benefit, New York's Superintendent of Insurance imposed a moratorium on claims payments two years prior to placing FGIC into rehabilitation, thereby giving FGIC breathing room to restructure. During that moratorium, FGIC, with oversight from the New York Insurance Department, formulated a plan that sold FGIC's municipal book of business to National Public Finance Guarantee Corporation and commuted other liabilities. Like this case, the FGIC rehabilitation effort was protected by the Order of Rehabilitation that included broad injunctions to stop actions against FGIC and its property. No permanent declaration of contract rights had,

however, been made by the FGIC court or the Superintendent, as regulator or as rehabilitator, to prevent defaults caused by the payment moratorium and the rehabilitation case prior to the approval of the FGIC rehabilitation plan. As part of FGIC's rehabilitation plan, the New York rehabilitation court approved a provision, almost identical to Article 6.13, to protect FGIC and its affiliates. As in *FGIC*, Article 6.13 goes farther than the injunctions imposed prior to exit, because upon exit, the entirety of Ambac requires protection from claims that the targeted Rehabilitation of the Segregated Account somehow triggered defaults. But, unlike FGIC—which had defaulted on its policy payment obligations prior to rehabilitation—the General Account has paid all claims, and therefore did not default on its payment obligations before or during the Segregated Account rehabilitation. Therefore, the terms of Article 6.13 here are less intrusive than the similar provision incorporated in FGIC's rehabilitation plan.

The cases that the MHPI Project Owners cite to support the argument that this Court must defer to the seven other court cases involving the MHPI Project Owners are inapposite, as none involved delinquency proceedings or the deference due to orders issued in such proceedings. The decisions in *Isermann v. MBL Life Assur. Corp.*, 231 Wis. 2d 136, 605 N.W.2d 210 (Ct. App. 1999), and *Morgan Stanley Mortg. Cap., Inc. v. Ins. Comm'r, State of California*, 18 F.3d 790 (9th Cir. 1994), illustrate that this Court need not defer to those other States' courts presiding over contract disputes to which Ambac is a party, and that because of the public policies that require that rehabilitation be centralized, other States' courts will extend both comity and full faith and credit to Article 6.13.

The general rule that the court where the first filing occurs controls does not apply in insurance delinquency proceedings (*see, e.g.*, *Mutual Benefit*, discussed *supra*) and bankruptcy.[11]

[11] Federal bankruptcy courts, which are analogous courts of equity, have the equitable power to grant necessary releases and injunctions protecting non-debtor parties. Bankruptcy courts' "'residual

Morgan Stanley Mortg. Cap. and *Isermann* speak to the deference that state courts extend to the injunctions imposed by other state's rehabilitation courts to protect affiliates and thereby to prevent collateral damage to a rehabilitation effort. In *Isermann,* the Wisconsin court granted comity to the injunction approved by the New Jersey court in connection with Mutual Benefit Life's rehabilitation plan in order protect an affiliate and successor in interest to Mutual Benefit Life. In *Morgan Stanley,* the Ninth Circuit held that because a California state court's *in rem* jurisdiction over rehabilitation case of Executive Life Insurance Company was asserted first and extended to assets of affiliates in which insurer had ownership interest, full faith and credit was due to the state court's injunction.

Indeed, if this Court approves Article 6.13 as part of the Second Amended Plan, it will conclusively determine that this Rehabilitation does not constitute a default, and that determination will be entitled to full faith and credit in other states.[12] The purpose of the Full Faith and Credit Clause "was to alter the status of the several states as independent foreign sovereignties, each free to ignore obligations created under the laws or by the judicial proceedings of the others, and to make them integral parts of a single nation." *Milwaukee County v. M.E. White Co.*, 296 U.S. 268, 277 (1935). A judgment contained in an "equity decree[]" is equally entitled to full faith and credit. And once the requirements of full faith and credit are met,

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authority' permits the bankruptcy court to release third parties from liability to participating creditors if the release is 'appropriate' and not inconsistent with any provision of the bankruptcy code." *In re Airadigm Commc'ns, Inc.,* 519 F.3d 640, 657 (7th Cir. 2008) ("A bankruptcy court 'appl[ies] the principles and rules of equity jurisprudence,' *Pepper v. Litton*, 308 U.S. 295, 304 (1939), and its equitable powers are traditionally broad, *United States v. Energy Resources Co., Inc.*, 495 U.S. 545, 549 (1990).").

[12] Article IV, Section 1 of the United States Constitution, known as the "Full Faith and Credit Clause," addresses the duties that states within the United States have to respect the "public acts, records, and judicial proceedings of every other state." The Clause effectuates that purpose by requiring each State to respect judgments issued by other States. "A final judgment in one State, if rendered by a court with adjudicatory authority over the subject matter and persons governed by the judgment, qualifies for recognition throughout the land." *Baker by Thomas v. Gen. Motors Corp*., 522 U.S. 222, 233 (1998). "For claim and issue preclusion (res judicata) purposes, in other words, the judgment of the rendering State gains nationwide force." *Id.*

there is "no roving 'public policy exception' to the full faith and credit due judgments." *Baker*, 522 U.S. at 233 (emphasis removed). The credit due to the other state's judgment is mandatory. "'[T]he full faith and credit clause of the Constitution precludes any inquiry into the merits of the cause of action, the logic or consistency of the decision, or the validity of the legal principles on which the judgment is based.'" *V.L. v. E.L.*, 136 S. Ct. 1017, 1020 (2016), quoting *Milliken v. Meyer*, 311 U.S. 457, 462 (1940). Under these principles, the approval of the Second Amended Plan, including Article 6.13, would clearly constitute a judgment entitled to full faith and credit in other States.

The Full Faith and Credit Clause has special force in the context of rehabilitation proceedings, where a centralized forum is vital to the efficacy of rehabilitation.[13] Indeed, the U.S. Supreme Court has applied the Clause in the context of rehabilitation proceedings. *See Underwriters Nat. Assur. Co. v. N. Carolina Life & Acc. & Health Ins. Guar. Ass'n*, 455 U.S. 691 (1982). In *Underwriters*, the Court held that an Indiana court's approval of a rehabilitation plan providing that the rehabilitated insurer "will have no liability to any guaranty association..." was entitled to full faith and credit from North Carolina courts where both courts had jurisdiction to determine whether a deposit held by the North Carolina guaranty association could be applied pursuant to North Carolina law to pre-rehabilitation claims against the insurer. Because the Indiana rehabilitation court fully and fairly considered the question of its jurisdiction to issue the injunction, the Supreme Court held that the Indiana rehabilitation court's decision was entitled to

[13] *See Motlow v. S. Holding & Sec. Corp*., 95 F.2d 721, 725–26 (8th Cir. 1938) ("Experience has demonstrated that, in order to secure an economical, efficient, and orderly liquidation and distribution of the assets of an insolvent corporation for the benefit of all creditors and stockholders, it is essential that the title, custody, and control of the assets be intrusted *[sic]* to a single management under the supervision of one court. Hence other courts, except when called upon by the court of primary jurisdiction for assistance, are excluded from participation. This should be particularly true as to proceedings for the liquidation of insolvent insurance companies[.]").

full faith and credit in North Carolina courts. *See id.* This Court's approval of Article 6.13 would similarly be entitled to full faith and credit.[14]

Indeed, the policy reasons favoring full faith and credit in the context of rehabilitation proceedings are so strong that courts have voluntarily accorded full faith and credit even where not strictly required as a matter of federal constitutional law. In *Reliance Ins. Co. v. Hernandez*, No. F040704, 2003 WL 22064371, at *3 (Cal. Ct. App. Sept. 5, 2003), for instance, the California Court of Appeals held that a trial court with jurisdiction over claims against Reliance Insurance Company properly granted full faith and credit to an anti-suit injunction entered by a Pennsylvania court to protect Reliance's liquidation case. That Pennsylvania injunction was issued without notice to the California plaintiff who had done nothing to submit to the jurisdiction of the Pennsylvania court (unlike the MHPI Project Owners, who had notice and have appeared in this court on numerous occasions) and, therefore, full faith and credit was not technically applicable. Because of the policy considerations that require centralized delinquency proceedings for insurers, the appellate court concluded that "[e]ven though the trial court was not required to give full faith and credit to the anti-suit component of the order of liquidation, the trial court did not abuse its discretion by doing so." *Id.*[15] *See also Arroyo v. Chesapeake Ins. Co.*,

[14] When State courts consider injunctions issued by other States' courts to protect insurance delinquency proceedings, they do not consider the issues addressed by the cases cited by the MHPI Project Owners. As the Rehabilitator explained on pages 38 and 39 of his Brief in Response to Objections to its Motion to Further Amend the Plan of Rehabilitation, filed on December 11, 2017, "None of the cases cited by the MHPI Projects involves rehabilitation or the broad jurisdiction granted to the Rehabilitation Court pursuant to chapter 645." Courts considering delinquency proceeding injunctions issued by other States apply the Uniform Insurers Liquidation Act (UILA) if adopted in the States at issue and grant comity, or, as to non-adopting States, courts apply the policies favoring centralized proceedings and afford full faith and credit to other States' injunctions (in the same manner approved by the *Underwriters* Court.

[15] In *Reliance*, preclusion was not strictly required under the Full Faith and Credit Clause because the Pennsylvania court did not have personal jurisdiction over Mr. Hernandez and Mr. Hernandez had no notice prior to the injunction or opportunity to object. That is clearly not the case here, as the MHPI Project Owners have had numerous opportunities to be heard by this Court.

209 Pa. Super. 174, 178, 224 A.2d 101, 103 (1966) ("full faith and credit requires that Maryland's statutory receiver be accorded the same protection [in Pennsylvania] against liens acquired here after his appointment [as receiver for Chesapeake Ins. Co. in Maryland]").

In the context of a rehabilitation case pending in New York, which like Wisconsin has adopted the Uniform Insurers Liquidation Act ("UILA"),[16] the California appellate court held in *Serio v. The Superior Court*, No. G030164, 2002 WL 31794160, at *1 (Cal. Ct. App. Dec. 13, 2002), that the trial court erred by not granting comity to the New York rehabilitation proceeding. Because "the UILA contains a statutory mandate that the out-of-state stay order be honored," the California court granted the rehabilitator's petition for a writ directing the California trial court to stay proceedings, and agreed that "the order of rehabilitation entered in New York enjoins all persons from prosecuting any lawsuits against Frontier under the [UILA], and must be honored by the California courts." *Id.*

These cases illustrate that this Court's exercise of its authority in this rehabilitation case is entitled to respect through comity and/or full faith and credit from other States' courts.

II. The MHPI Project Owners Are Asking Other States' Courts To Determine Whether Ambac Is Subject to a Delinquency Proceeding, a Task Reserved to Wisconsin Courts.

By asking seven courts in other States whether the effect of this Proceeding is that Ambac has "defaulted" within the meaning of the relevant project agreements, the MHPI Project Owners are asking those courts to conclude, among other things, that the OCI's use of chapter 645 in the context of a segregated account established under Wis. Stat. § 611.24 is a delinquency proceeding as to the General Account. A ruling by a court of another State on whether Ambac is

[16] Wisconsin and California are also "reciprocal states" as defined by California's version of the UILA, which was adopted by the California legislature in 1988 as Cal. Ins. Code § 1064.1 – 1064.13. "Reciprocal state" means any state other than this state in which in substance and effect the provisions of this act are in force, including the provisions requiring that the commissioner or equivalent insurance supervisory official be the receiver of a delinquent insurer." Cal. Ins. Code § 1064.1.

subject to a delinquency proceeding could conflict with the conclusions reached in the Clarification Order regarding the scope of these Proceedings.

This Proceeding has been pending since this Court first exercised jurisdiction almost eight years ago to apply chapter 645 to rehabilitate a segregated account created under Wis. Stat. § 611.24. The Clarification Order was entered in 2016, and, to date, no other court has reached the issues affected by the Clarification Order. Approval of Article 6.13 is now needed to mitigate the circumstances recognized by the *Underwriters* Court that "two [or more] courts, each having its own judicial system capable of adjudicating the rights and responsibilities of the parties [will] creat[e the] risk that two or more States will exercise their power over the same case or controversy, with the uncertainty, confusion, and delay that necessarily accompany relitigation of the same issue." *See Underwriters,* 455 U.S. at 706–07.

The Rehabilitator is not limited by his prior approaches to the threat posed by the MHPI Project Owners from taking the action and seeking the relief he now deems necessary to protect both the legislative scheme of Wisconsin and the integrated entity that will emerge following the Segregated Account's exit from Rehabilitation. Although the MHPI Project Owners note that this Court's and the Court of Appeals' prior decisions were limited to the relief provided by the Clarification Order, that fact merely suggests that these courts were responding to the issues presented at the time. Nothing in Wisconsin's statutes or in this Court's or the Court of Appeals' prior orders prohibit the Rehabilitator from seeking appropriate relief to protect the rehabilitation effort upon exit from Rehabilitation. Notwithstanding that the Rehabilitator attempted a different approach in requesting the Clarification Order in 2016, the Rehabilitator has now exercised his discretion not just to clarify prior orders and protect the legislative scheme, but also to include Article 6.13 in the Second Amended Plan in order to free Ambac and, in turn, the protect the

Segregated Account's durable exit from any lingering doubt as to the effect of this Proceeding on the whole of Ambac's contract rights. The Rehabilitator has done this because, among other reasons, durability under the Second Amended Plan assumes the removal of threats posed by the defaults asserted by the MHPI Project Owners and that could be asserted by other counterparties or policyholders in an effort to strip Ambac of control rights in the future.

The Rehabilitator has now determined that Article 6.13 is necessary to protect the operation of the Second Amended Plan, in order to permit the Segregated Account to emerge from rehabilitation and be merged durably into the General Account. As explained by David Barranco, "if the General Account were not to be protected by Article 6.13, defaults could exist or be alleged to exist with respect to General Account contracts, resulting in many circumstances of control rights vesting in third parties, which is value-destructive and contrary to the Rehabilitator's durability assumptions." Barranco Aff. ¶ 9. "Protecting AAC's contract rights (including control rights) from default declarations by counterparties and policyholders remains important as the Segregated Account anticipates exiting rehabilitation and being merged with the General Account." Barranco Aff. ¶ 10. *See also* Barranco Aff. ¶¶ 11-14. Article 6.13 accomplishes that task and, as discussed above, is fully within the authority granted by the Wisconsin insurance laws.

The MHPI Cases are an extreme example of how this rehabilitation case can be manipulated by non-parties in an attempt to prevent Ambac from utilizing bargained-for contractual control rights. This alone justifies approval by this Court of Article 6.13 as a necessary component of the Second Amended Plan. Without Article 6.13, other parties to Ambac insured transactions might proceed, as have the MHPI Project Owners, in other courts to seek to deprive Ambac of control rights, based on defaults allegedly arising out of the Segregated

Account Rehabilitation or based on Segregated Account defaults that were remediated through the rehabilitation. In addition to the determinations made by the Commissioner, both as regulator of Ambac and as Rehabilitator of the Segregated Account, to include Article 6.13 in the Second Amended Plan, the fact that the MHPI Project Owners—who are not entitled to exercise rights under any contracts with Ambac—will continue to misuse the occurrence of this Segregated Account Rehabilitation to the detriment of re-integrated Ambac warrants the clarity and protection provided by Article 6.13.

CONCLUSION

For the reasons above, this Court should grant the Rehabilitator's Motion in its entirety, deny the Objections and approve the Second Amended Plan of Rehabilitation.

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Respectfully submitted,

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