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 CLOSING ARGUMENT AND BRIEF IN SUPPORT OF ITS MOTION TO FURTHER AMEND THE PLAN OF REHABILITATION

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INTRODUCTION

At this stage, it is undisputed that the Second Amended Plan, and the Consensual Transaction it seeks to facilitate, is fair and equitable and that the conditions that led to the Rehabilitation no longer exist. One objection however remains: the MHPI Projects want to be exempted from Article 6.13. This objection should be overruled.

As an initial matter, the Rehabilitator is proposing revisions to Article 6.13 to narrow the "cure" provision so that it applies only to Policies in the Segregated Account and related Transaction Documents. Alleged defaults in other agreements are deemed not to have occurred or existed because the Rehabilitator has concluded that this Rehabilitation Proceeding did not cause General Account policy defaults. Nevertheless, the MHPI Projects argue that this Court should cut them out of Article 6.13 of the Plan so they may continue to pursue litigation against the General Account on the theory that the mere fact of establishing the Segregated Account, and the manner in which OCI structured it, was an "event of default" under policies that insure payment of principal and interest on Bonds sold to finance their projects. That allegation, if accepted by other courts, would allow the MHPI Projects control of the housing projects by transferring or eliminating Ambac's control rights from the negotiated policy terms.

Ambac bargained for control rights in its financial guaranty policies so that it can effectively manage risk and potentially avoid debt payment defaults by others. Ambac had these control rights prior to the Rehabilitation, and the Rehabilitator's expert assumed in his analysis that control rights remain with Ambac by virtue of Article 6.13 being in the Plan. Without Article 6.13, and thus potentially without control rights, Ambac could be in a worse position with regard to exercising contractual rights post-exit than it was before OCI established the

Segregated Account. As a matter of policy, such a result would undermine the purpose of the Rehabilitation statute.

The MHPI Projects' objection to Article 6.13 then, if sustained, would threaten Ambac's claims-paying ability and impose expenses that Ambac would have to shoulder indefinitely, post-exit. Therein lies the problem: the MHPI Projects' "default" allegations will linger for years, threatening Ambac's control rights and claims-paying resources, contrary to the Rehabilitator's objectives throughout these Proceedings, which has been to eliminate the conditions that led to the Rehabilitation and allow a durable (*i.e.,* permanent) exit of the Segregated Account from Rehabilitation. In the judgment of the Rehabilitator, Article 6.13 is thus necessary for the Rehabilitator to carry out a durable exit.

Importantly, this Court ruled previously, in an Order that was affirmed by the Court of Appeals in a published decision, that it may enjoin other parties from exercising control rights at Ambac's expense over policies in the Segregated Account. *See Nickel v. Wells Fargo Bank*, 2013 WI App 129, ¶¶ 130-131, 351 Wis. 2d 539, 841 N.W.2d 482 (the commissioner's "ability to carry out [its] statutory duties" and to "protect the insured's interests as well as the interests of the creditors and the public with minimum interference with the normal prerogatives of proprietors" would be significantly harmed if the commissioner were not able to exercise control rights). Article 6.13, which protects those same control rights that are being returned to Ambac upon exit as a result of the merger, is therefore consistent with the *Nickel* holding on control rights.

This Court also ruled in its Order dated October 24, 2016, again affirmed on appeal, that it would run counter to OCI's stated purpose for establishing the Segregated Account, and the manner in which it was financed, if OCI's regulatory action were to be found to be a

rehabilitation ***of Ambac***, a taking of its assets by OCI, or appointment of a receiver. *See Dilweg v. Carlisle/Picatinny Family Housing L.P.*, No. 2016AP2169, ¶ 17 (Wis. Ct. App. Dec. 14, 2017) (unpublished). Consistent with these rulings, the Court may safely rule so again now.

The Second Amended Plan should therefore be confirmed and the Rehabilitator should be afforded deference on how to implement it. That discretion extends to Article 6.13 as it has with past orders that enjoined the loss of Ambac's control rights. *See Nickel*, 351 Wis. 2d 539, ¶ 138-145 ("[The Rehabilitation Court] has broad powers to enter an injunction to prevent the waste of Ambac's claims-paying resources…."). The MHPI Projects' objections should be overruled.

ARGUMENTS

I. The Revised Article 6.13 Addresses the Court's Default "Cure" Concern While Allowing a Clean Exit of the Segregated Account from Rehabilitation and Merger into the General Account in a Manner That Fulfills the Purpose of the Rehabilitation Statute.

Filed with this Brief is a revised Order Granting the Rehabilitator's Motion to Further Amend the Plan of Rehabilitation and Confirming the Second Amended Plan of Rehabilitation (the "Confirmation Order"). There are two primary revisions. The first revision incorporates the Court's October 24, 2016 order into the Confirmation Order; the second revision is meant to address the Court's questions as to why a default "cure" provision would be necessary if there are no General Account defaults, and then conform the Conformation Order to the hearing testimony.

First, the Rehabilitator has introduced paragraph 4(i) to the Findings of Fact. This new provision effectively incorporates paragraphs 10 and 17 of the Court's October 24, 2016 Order and confirms that the Rehabilitation Court has not entered any order of "insolvency, bankruptcy, rehabilitation, liquidation or reorganization" against Ambac nor has it appointed a "custodian, trustee, agent or receiver" or authorized the taking of Ambac or its assets by any such appointed

entity. (*See* Confirmation Order, p. 4, ¶ 4(i) i-ii.) There can be no reasonable dispute that this Court has issued no such order. Further, the MHPI Projects should not object to simply reincorporating an already-existing Order of this Court into the Confirmation Order.[1]

Second, the Rehabilitator has revised Article 6.13 to distinguish between "Policies" in the Segregated Account and related "Transaction Documents," from other agreements to which AAC or its subsidiaries are a party. The revised version narrows the "cure" provision to deem defaults and events of default cured only as to Policies and Transaction Documents. (*See* Confirmation Order, p. 6, ¶ 8.)[2] Any defaults within other agreements are not cured; instead, they are deemed not to have existed or occurred. (*See id.*) This revised language affirmatively "cures" any and all defaults in the Segregated Account while, consistent with this Court's October 24, 2016 Order, confirming that no defaults occurred or existed as to General Account policies. In other words, the revised Article 6.13 reiterates OCI's stated purpose behind establishing and structuring the Segregated Account, and adopts as this Court's factual findings, that General Account defaults have not occurred and do not exist as a result of these Rehabilitation Proceedings.

II. As a Matter of Sound Policy in Rehabilitations, Ambac Should Have the Same Contract Rights Post-Exit That It Had Prior to the OCI Initiated Rehabilitation.

A. Article 6.13 Protects Control Rights that Go Hand-In-Glove with Insurance Policies.

The record established that "control rights" include:

Ambac's contractual rights includ[ing] rights to approve amendments, waivers

[1] The Court of Appeals affirmed this Court's order dated October 24, 2016. *See Dilweg v. Carlisle/Picatinny Family Housing L.P.*, No. 2016AP2169, ¶ 17 (Wis. Ct. App. Dec. 14, 2017) (unpublished). As of today, MHPI Projects have not filed a Petition for Review with the Wisconsin Supreme Court.

[2] A "Policy" is defined in the Second Amended Plan as, "Any financial guaranty insurance policy, surety bond or other similar guarantee which was allocated to the Segregated Account pursuant to the Plan of Operation." (*See* Plan, p. 19, ¶ 1.77). A "Transaction Document" is defined in part as, "Any agreements relating to Policies . . . ." (*See id*., p. 26, ¶ 1.118).

> and consents, rights to access records, rights to receive information, rights to remove certain transaction parties with ongoing administrative responsibilities, rights to declare events of default, trigger events and early amortization events and rights to direct enforcement actions and the exercise of remedies, including the disposition of collateral.

(Barranco Aff. at ¶ 8.) Ambac negotiated these rights to "mitigate losses, which benefits both Ambac and the bondholders." (Barranco Aff. Exh. B at ¶ 5.) If Ambac is deprived these rights, they would be "exercisable by the bond trustee or the bondholders…." (*Id.* at ¶ 4.) Control rights are typical in insurance policies, and documents related thereto, and are important to the post-exit business of Ambac. Article 6.13 aims to preserves those rights.

Control rights allow insurers to monitor projects such as the military housing developments in this case to help ensure the underlying transactions can pay their debts. If these control rights were to fall into the hands of parties with no incentive to avoid defaults, a moral hazard would be created that would inevitably lead to a claim on the policy. The Rehabilitator's Expert, Mr. McGettigan, explained at hearing as follows:

> Let's say credit deteriorates on a given project [and] control right rest with the bondholders or the trustee [as opposed to Ambac]. Now the bondholders and the trustee may choose to be diligent and endeavor to work together to improve the creditworthiness of the project or, ultimately, knowing that there's an Ambac Assurance policy backing principal and interest payments, they might not spend as much time on that to ensure credit quality as, say, Ambac would—whose money is at risk.

(Jan. 4, 2018 Hr'g Trans. at p. 174:2-12.)

Moral hazard is to be avoided. For centuries, courts have recognized that moral hazard "is never negligible. It is always material to the risk." *Conn. Fire Ins. Co. v. Manning*, 160 F. 382, 385 (8th Cir. 1908). The moral component, and moral hazard's influence on mitigating risk, not only must "'influence the underwriter,'" but "[i]t should also influence the Superintendent of Insurance in determining what is financially hazardous for the policyholders." *In re People*, 280 A.D. 517, 523 (N.Y. App. Div. 1952) (analyzing moral hazard in the context of insurance

superintendent's petition to seize control and liquidate insurer) (quoting *Columbian Ins. Co. of Alexandria v. Lawrence*, 27 U.S. 25, 49 (1829)). Avoiding moral hazard is thus both a policy and legal objective in insurance rehabilitations. But ultimately in this case, preservation of Ambac's control rights is, in the Rehabilitator's judgment, a necessary protection of claims-paying resources that will allow successful implementation of the Second Amended Plan.

B. Article 6.13 Restores Ambac's Pre-Rehabilitation Control Rights As To Policies in the Segregated Account and Should Preserve Those Rights as To General Account Policies.

But for the establishment of the Segregated Account, Ambac would have unquestioned control rights to manage risks associated with all their policies. (*See* Jan. 4, 2018 Hr'g Trans. at p. 206:2-8) (explaining that Ambac has control rights in nearly all of its policies). As a result of OCI's decision to rehabilitate the Segregated Account, the Rehabilitator assumed authority over control rights related to Segregated Account policies. *Nickel*, 351 Wis. 2d 539, ¶¶ 130-131. The Confirmation Order, and specifically the merger of the Segregated Account back into the General Account, returns those control rights to Ambac. It would be an inconsistent and untenable result if Ambac were allowed unquestioned post-exit control rights as to policies previously in the Segregated Account, but be forced to defend its control rights related to General Account policies that were never subject to Rehabilitation. Such a result would contradict both a fundamental premise of the Rehabilitation and also Wisconsin's statute authorizing the creation of a segregated account in the first place. *See* Wis. Stat. § 611.24.

Article 6.13 ensures that Ambac will have these control rights that it previously enjoyed and may continue to exercise going forward. Striking Article 6.13 or exempting the MHPI Projects, could leave Ambac without control rights and, thus, in a worse position post-exit than it had been prior to the Rehabilitation. Approving Article 6.13 on the other hand will restore Ambac to the position it was in prior to the Rehabilitation and allow it to better manage risk post-

exit while prohibiting third parties from interfering with its control rights. Article 6.13 is therefore a proper exercise of this Court's authority to affirm the considered judgment of the Rehabilitator in furtherance of a durable exit of the Segregated Account from Rehabilitation. *See Nickel*, 351 Wis. 2d 539, ¶ 145.

C. Control Rights are Important to Doing Business Post-Exit.

1. Control Rights Help to Manage Risk and Avoid Defaults.

The loss of Ambac's control rights would likely stall, and possibly prevent, remediation efforts with respect to a transaction (*e.g.*, changing servicers, negotiating loan repurchases, conducting certain litigation). (*See* Barranco Aff. Exh. B ¶ 7; *see also* Barranco Aff. ¶ 12.) Mr. McGettigan provided the following discussion to demonstrate the importance of control rights:

> [C]ontrol rights allow the entity that is on the hook for the principal and interest to take steps to potentially minimize loss and reduce the . . . size of a loss if, in fact, a loss does result.
> . . .
> If a credit becomes troubled . . . control rights can provide what I would call trip wires, if you will, that allow the insurer to take steps in an attempt to improve the creditworthiness of the credit in question.

(Jan. 4, 2018 Hr'g Trans. at p. 162:9-13; 171:22-172:2.) (*See also id.* at pp. 210:22-25 & 211:1-6) (explaining the risk of Ambac losing control rights).

In essence, Ambac's continued use of control rights to manage its troubled or potentially troubled credits (of which, there continue to be many), will be an integral part of its risk mitigation efforts after this Rehabilitation is over. The Rehabilitator anticipated this to be the case. Indeed, Special Deputy Commissioner Schwartzer testified that Ambac would use "control rights to ensure that there wasn't a default by the policy that they're insuring" and that Ambac's utilization of control rights "meant that [Ambac was] protecting the claims-paying resources [of] the general account." (Jan. 4, 2018 Hr'g Trans. at pp. 82:2-4; 78:3-5.) The Rehabilitator's concern is that "the loss of control rights . . . would mean additional claims-paying resources that

would be depleted from the general account." (*Id*. at p. 64:24 – 65:4.) As a result, ensuring that Ambac will have the ability to exercise control rights post-confirmation is a protective measure that the Rehabilitator believes, in his discretion, will be an important part of Ambac's operations going forward.

2. Article 6.13 is Assumed by the Rehabilitator's Expert to be in the Plan and Enforceable.

The Rehabilitator's expert assumed that Article 6.13 would apply to all potentially implicated parties, including the MHPI Projects, post-exit; without such guarantees, there could be detrimental effects. Specifically, the Rehabilitator's Expert took Article 6.13 into account when drafting his Expert Report (*see* McGettigan Report at n. 5), and when testifying at the Confirmation Hearing (*see, e.g.,* Jan 4, 2018 Hr'g Trans. at pp. 159-162). The analysis performed was based, in part, on the assumption that Article 6.13 would be in the Plan and enforceable to aid future remediation opportunities and, thereby, further increase the margin of safety. He testified as follows:

> A And if I could make a final point, I can't stress enough.
>
> In my December 11th report, I mention that the company had a funnel of derisking opportunities that involved approximately $2.5 billion of net par outstanding. The RMBS collapse transactions reduced that number by about $200 million. There's still, just even based on where we were in December, $2.3 billion of derisking opportunities that the company's evaluating, negotiating, so forth, some of which will come to pass, some of which will not come to pass. As that funnel gets resolved, new ones will develop.
>
> Q So your point is this is ordinary and customary to –
>
> A Yeah.
>
> Q -- make these transactions and could add to the margin of safety.
>
> A Yes.

(Jan 4, 2018 Hr'g Trans. at pp. 177-178). Without control rights, these on-going remediations and commutations could be in jeopardy. Therefore, Article 6.13 should remain in the Second Amended Plan to support the Rehabilitator's Expert's conclusions.

3. Article 6.13 is an Expedient Method to Ensure A Successful Rehabilitation.

Although Mr. McGettigan stated affirmatively that Article 6.13 "is not" determinative of durability, it is nonetheless "material" due to the control rights issue. (Jan. 4, 2018 Hr'g Trans. pp. 161:17-25; 162:1-13.) So although Article 6.13 is not necessary for the durability analysis, failure to include Article 6.13 could have adverse, though incalculable, consequences on the Transaction. As Mr. Barranco stated, loss of control rights "is value-destructive and contrary to the Rehabilitator's durability assumptions." (Barranco Aff. at ¶ 9.) Mr. Barranco also explained at the Confirmation Hearing that control rights resulted in an estimated savings to Ambac of $300-$400 million over an 8 to 10-year period. (Jan. 4, 2018 Hr'g Trans. p. 203:21-23.)

To move forward with the Transaction and the exit of the Segregated Account from Rehabilitation, with certainty, Article 6.13 must remain in the Second Amended Plan. This measure is in line with the Rehabilitator's ability to take "necessary or expedient" measures to ensure the Rehabilitation's success. *See* Wis. Stat. § 645.33; *see also Koken v. Fid. Mut. Life. Ins. Co.*, 803 A.2d 807, 812-817 (Pa. Commw. Ct. 2002) (holding that injunctive relief for claims against non-debtors was "necessary and proper" because allowing such suits to proceed would "affect[] directly and adversely what the liquidator is attempting to achieve through her proceedings").

III. The MHPI Projects' Objections Should Be Overruled.

A. The MHPI Projects Do Not Have Standing Because They Are Not Policyholders.[3]

Based on the briefs filed by Ambac (*see, e.g.,* Rehabilitator's Brief in Response to Objections at pp. 7-15), the Barranco and Ksenak Affidavits, and the testimony at the hearing, the MHPI parties are not policyholders and do not have standing in this case. (*See, e.g.,* Jan. 4, 2018 Hr'g Trans. at p. 87:19-25 & 88:5-6.) To reiterate, the MHPI Projects do not have standing to challenge the timing and amount of claims payments to holders of Deferred Amounts because the policies that insure the debt issued to fund their projects are not in the Segregated Account. (Resp. Brief p. 9.) The MHPI Projects have only argued they are policyholders because they paid insurance premiums. That argument is not sufficient to establish standing. *Nickel v. FFI Fund Ltd.*, No. 2014AP2033, at 4 (Wis. Ct. App. Mar. 4, 2016) ("[L]egal principles and judicial policies" that underlie a rehabilitation proceeding weigh against allowing individual certificate or policyholders to have standing to challenge orders issued by the rehabilitation court following the adoption of a rehabilitation plan); *see also Nickel v. Aurelius Capital Mgmt. LP*, No. 2011AP2708, at 6-7 (Wis. Ct. App. Mar. 1, 2013) (dismissing appeal for lack of standing by group of investors who challenged the rehabilitator's decision to enter into an agreement they claimed affected their financial interests). The MHPI Projects do not have standing in this dispute and have been provided more than sufficient due process given their lack of standing.

Moreover, as explained at the hearing, "the developers themselves are not policyholders." (Jan. 4, 2018 Hr'g Trans. p. 88:5-6.) As such, they have no rights in this proceeding. Section 600.03(37) requires the alleged "policyholder" have the ability to "control" the policy. *Id.*

[3] Notably, counsel at the hearing did not even know whether the MHPI Projects were insureds or additional insureds under the policies under which they claim to have benefits. (*See* Jan. 4, 2018 Hr'g Trans. at p. 89, 12-22.)

(explaining that policyholder is "the person who ***controls*** the policy by ownership") (emphasis added). Simply paying the premium is not sufficient without "control." *See, e.g., Schaefer v. Physicians Plus Ins. Corp.*, 174 Wis. 2d 488, 492, 497 N.W.2d 776 (Ct. App. 1993) (emphasizing "control" rather than payment of premiums to determine who a policyholder is). In *Schaefer*, the court determined that the state group insurance board was the policyholder (and not the state employee that subscribed to the insurance plan), because the state board contracts with the insurer for purposes of providing a group insurance plan. *See generally id.*

Here, lenders involved with the MHPI Projects contracted with Ambac for a surety bond and an insurance policy to reduce their borrowing costs on their projects. The named insureds, however, are the trustees (or the lenders) that control the bond sale proceeds. The policy beneficiaries are private bondholders. But it is the trustee (or the lender directly), who may make claims in the event the MHPI Projects do not make their debt payments.

The MHPI Projects themselves are simply "Borrowers" who are prohibited by the Grantor Trust Agreement from asserting claims or rights under that agreement. (Ambac Surreply at pp. 3-4. *See also* Ksenak Aff., Exh. A.) The trustees and lenders are the parties with control of the policies and are thus the actual "policyholders." Therefore, the MHPI Projects have no standing for the additional reason that they are not even policyholders of Ambac.[4]

B. Provisions Like Article 6.13 Are Customary In Insolvency Proceedings And Demonstrate Comity Should Not Be A Concern.

The Wisconsin Insurers Rehabilitation and Liquidation Act (the "Act") allows a rehabilitation court to enter any order that is "necessary and proper to prevent" any "action that

[4] Even if the MHPI Projects were policyholders, this Court has defaulted to the commissioner's discretion even when it comes to contract rights; as explained previously by this Court, and affirmed on appeal, "[t]he contract of the policyholder is subject to the reasonable exercise of the state's police power." *Nickel v. Wells Fargo Bank*, 2013 WI App 129, ¶ 176, 351 Wis. 2d 539, 841 N.W.2d 482. The commissioner would have the discretion to impose Article 6.13 notwithstanding its impact on the MHPI Projects even if the MHPI Projects were policyholders (which they are not). *Id.*

might lessen the value of the insurer's assets or prejudice the rights of policyholders . . . or the administration of the proceeding." Wis. Stat. § 645.05(k). The Act serves to "protect the interests of insureds, creditors, and the public generally" by authorizing the Rehabilitator to take numerous steps in carrying out his obligations to "reform and revitalize the insurer." Wis. Stat. §§ 645.01(4) and 645.33; *see also* § 645.05. Indeed "the purpose of coming out of any reorganization is for a fresh start and to . . . have all issues be resolved." (Jan. 4, 2018 Hr'g Trans. p. 170:4-13.) Article 6.13 attempts to accomplish that objective and, as Mr. McGettigan testified, it is "consistent with other confirmation orders" in his experience with bankruptcies. (*Id*.)

Although not binding on this Court, Chapter 11 reorganization proceedings provide analogous support to this Court's application of the Act. *See Commercial Nat'l. Bank v. Superior Ct.*, 14 Cal. App. 4th 393, 419 (Cal. Ct. App. 1993) (holding that "chapter 11 proceedings . . . are analogous to insurance rehabilitations"). As such, underlying bankruptcy principles are "instructive in the context of insurance insolvency. . . ." *Id*.; *see also Koken*, 803 A.2d at 814-819 (comparing and contrasting sections of the bankruptcy code to the Insurance Act). Notably, this Court is afforded more "flexible and informal procedures . . . in the rehabilitation context" than the statutory framework given to federal bankruptcy courts. *Nickel*, 351 Wis. 2d 539, ¶ 187.

Here, there are two questions to which bankruptcy cases provide insight. The first is whether a court has jurisdiction to approve releases of claims held by a party against a non-debtor. The U.S. Supreme Court has directly addressed this question in *Celotex Corp. v. Edwards*, 514 U.S. 300 (1995), holding not only that bankruptcy courts have "related-to" jurisdiction to enter third-party injunctions, but also that such injunctions cannot be collaterally

attacked in another court—even in cases where the controversy does not directly involve property of the bankruptcy estate. The jurisdictional basis is found within sections 105(a) and 1334(b) of the Bankruptcy Code, which provide exclusive jurisdiction to bankruptcy courts for matters "arising under . . . arising in or related to" a bankruptcy case.

Wisconsin's Chapter 645 works in a similar way to the bankruptcy code on the jurisdictional question. It provides exclusive jurisdiction to the Rehabilitation Court for all rehabilitation matters "or other relief preliminary to, incidental to, or relating to such proceedings." Wis. Stat. § 645.04(3). This is in line with the Bankruptcy Code and the rationale employed in *Celotex*, and affords Wisconsin courts with similar jurisdictional authority. Indeed, the language used in § 645.04(3) all but mimics the jurisdictional grant afforded to bankruptcy courts as part of 11 U.S.C. § 1334(b).

The second question is whether a court may approve releases, injunctions, or other similar provisions that benefit a non-debtor as part of a plan. On this question, bankruptcy courts also provide insight. Specifically, non-debtor releases are warranted when they are integral to the debtor's ongoing success, when the non-debtor has contributed substantial assets to the debtor, and when the injunction/release provisions assist with the reorganization process. *See Behrmann v. Nat'l Heritage Found. Inc.*, 663 F.3d 704, 711-12 (4th Cir. 2011); *see also In re Dow Corning Corp.*, 280 F.3d 648, 658 (6th Cir. 2002) (employing various factors). Moreover, the majority of federal circuit courts hold that third-party releases are authorized under 11 U.S.C. § 105(a), which allows the bankruptcy court to "issue any order . . . that is necessary or appropriate to carry out the provision of this title." *See, e.g.*, *id.; In re Ingersoll Inc.*, 562 F.3d 856 (7th Cir. 2009); *In re Metromedia Fiber Network Inc.*, 416 F.3d 136 (2nd Cir. 2005); *In re Continental Airlines*, 203 F.3d 203 (3rd Cir. 2000).

Again, Wis. Stat. § 645.05 is a provision similar to 11 U.S.C. § 105(a). Other state rehabilitation courts have drawn similar comparisons. For example, in *Koken v. Fid. Mut. Life Ins. Co.*, the Pennsylvania Commonwealth Court upheld certain release and injunctive provisions as "necessary and proper . . . to carry out a rehabilitation plan," drawing a direct comparison to 11 U.S.C. § 105. *Koken*, 803 A.2d at 817-819. Not surprisingly, the Court of Appeals in this Rehabilitation has likewise held that the existing plan's injunctive provisions that protect Ambac's parent company were "necessary and proper" under Wis. Stat. § 645.05(1)(c), (d), (f), and (k). *Nickel*, 351 Wis. 2d 539 at ¶¶ 102-03; *see also Ins. Comm'r v. Arcilio*, 561 N.W.2d 412 (Mich. Ct. App. 1997) (holding similarly under Mich. Comp. Laws § 500.8105(1)(k)). The *Nickel* case and other related appeals from this proceeding are the primary authorities in Wisconsin for the issues relevant today; this Court should have no hesitation to adopt the prior rationale in confirming Article 6.13 as part of the Second Amended Plan. Doing so is also entirely consistent with prevailing bankruptcy cases that have reviewed similar issues.

In sum, the language and goals of the Wisconsin Act are similar to those employed in federal bankruptcy proceedings. The Bankruptcy Code provides debtors with a number of tools necessary to implement a plan of reorganization, such as the ability to (a) merge or consolidate the debtor with one or more entities, (b) cancel or modify any instrument, and (c) cure or waive any default, among many other things. *See* 11 U.S.C. § 1123(a)(5)(C)-(G). Simply put, a debtor "may rewrite the contract" as part of its reorganization plan. *In re Mayslake Village-Plainfield Campus, Inc.*, 441 B.R. 309, 319 (Bankr. N.D. Ill. 2010) (internal citation omitted). Accordingly, the Rehabilitator has crafted Article 6.13 to provide a means to ensure successful completion of the Second Amended Plan. Indeed where the rehabilitated Segregated Account is being merged back into Ambac's General Account, the protections afforded to the rehabilitated

entity pursuant to Article 6.13 make logical sense. Bankruptcy courts have consistently held similarly and there is no reason this Court should find otherwise.

IV. The Second Amended Plan May Be Confirmed as Proposed by the Rehabilitator.[5]

A. The Consensual Transaction is Fair and Equitable.

The Consensual Transaction is fair and equitable to all policyholders. As testimony at the January 4, 2018 hearing made evident:

> [t]he final conclusion is that this second amended plan is in the best interest of all the policyholders, both the segregated and general account holders; that it is fair and equitable; and that it is, in fact, durable. And the emerged company will have the wherewithal to pay claims 100 cents on the dollar moving forward.

(Jan. 4, 2018 Hr'g Trans. at p. 53: 9-15.)

Mr. McGettigan explained that "the consideration to be provided to beneficiaries of deferred amounts and general account surplus notes under the consensual transaction is fair and equitable to such holders and beneficiaries." (Jan. 4, 2018 Hr'g Trans. at pp. 103:23-25 & 104:1.) Fair and equitable in this case ensures fairness to each policyholder. Article "6.13 make[s] sure that the merged account -- when the segregated account is merged back in the general account -- [is] cured of any defaults and retains its claims-paying ability for **all claimants** including MHPI." (*Id.* at p. 71:12-16) (emphasis added). As a result, the Court should find that the Second Amended Plan provides fair and equitable treatment to, and is in the best interests of Policyholders, Creditors, and other Interested Parties of the Segregated Account, and the public in general. (*See* Confirmation Order at p. 4, ¶ 5.)

B. The Company is Durable Post-Exit.

Moreover, as the Rehabilitator's filings proposed, and the testimony at the Confirmation Hearing confirmed, the Company is durable post-exit; "consummation of the consensual

[5] All parties we adequately provided disclosure of the documents and notice of the hearing. The documents were all published to the Ambac Policyholder's website and all parties were granted fair notice and entitled to attend the Confirmation Hearing subject to Wis. Stat. § 645.33(5).

transaction on a post-exit basis and Ambac will be able to pay all of its claims in full in cash on a timely basis with a margin of safety to spare." (Jan. 4, 2018 Hr'g Trans. at p. 104:5-8.)

Although Article 6.13 and the control rights it protects are not determinative of durability, and are difficult to quantify (*see id.* at p. 161:14-16) (indicating a specific dollar value cannot be attached to value Article 6.13), Article 6.13 is material to durability. Article 6.13 seeks to protect insurance policy control rights, that are important contractual rights used to manage risk and, therefore, protect claims-paying resources. (*See id.* at 19-25; 162:1-13.) Control rights may be used to "avoid defaults" and "potentially minimize loss," and thus retaining such rights will have a positive impact on Ambac's durability.

The Rehabilitator has concluded that upon closing of the Consensual Transaction, "[t]he purpose of the Segregated Account would have been met" and none of the grounds for rehabilitation would continue to exist. (*Id.* at p. 53:16-25.) As a result, the Court should find that the Second Amended Plan provides for a durable exit, consistent with the requirements of Wis. Stat. § 645.35(2). (*See* Confirmation Order at p. 4, ¶ 5.) In sum, this Rehabilitation has been accomplished; accordingly, the Court "shall order that [Ambac] be restored to possession of its property and the control of its business." *See* Wis. Stat. § 645.35(2).

C. The Rehabilitator's Conclusions Are Entitled To Deference.

It was well within the Rehabilitator's discretion to propose Article 6.13, which is aimed at protecting the financial integrity of Ambac after the merger. When exercising its authority under Chapter 645, the legislature provided that the rehabilitation statutes, "shall not be interpreted to limit the powers granted the commissioner." Wis. Stat. § 645.01(2). Indeed, the Court of Appeals recognized specifically that section 645.05(1)(k) authorized the Rehabilitator at "any time" to apply for, and the court to grant, injunctions "and other orders" as are "deemed necessary and proper" to prevent any "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." *Nickel*, 351 Wis. 2d 539, ¶ 103. That is precisely what Article 6.13 is designed to do.

Nickel provided this Court with a roadmap, reciting the standard this Court should use in deciding whether to uphold a decision made by the Rehabilitator concerning the methods used in rehabilitating the Segregated Account:

> When reviewing the circuit court's decision to approve the rehabilitation plan, we will uphold the determinations made by the rehabilitator unless the rehabilitator abused his or her discretion. *See id*. [*Foster v. Mut. Fire, Marine & Inland Ins. Co.,* 531 Pa. 598, 614 A.2d 1086 (1992)] at 609 ("[I]t is not the function of the courts to reassess the determinations of fact and public policy made by the Rehabilitator. Rather, the involvement of the judicial process is limited to the safeguarding of the plan from any potential abuse of the Rehabilitator's discretion."). *Mills v. Florida Asset Fin. Corp.*, 31 A.D.3d 849, 850, 818 N.Y.S.2d 333 (3rd Dep't 2006) ("The courts will generally defer to the rehabilitator's business judgment and disapprove the rehabilitator's actions only when they are shown to be arbitrary, capricious or an abuse of discretion."); *Kentucky Cent. Life Ins. Co. v. Stephens*, 897 S.W.2d 583, 588 (Ky. 1995) ("[T]he standard of the court's review of the rehabilitator's actions is one of abuse of discretion. Under the special statutory proceedings, the Commissioner is granted administrative discretion in the context of the insolvency/delinquency proceedings.").

Id. ¶ 18. In light of this standard, the Court's role is to oversee administration of the Rehabilitation, deferring to the Rehabilitator's discretion. *See* Wis. Stat. § 645.33(2) ("Subject to court approval, the rehabilitator may take the action he or she deems necessary or expedient to reform and revitalize the insurer").[6] In the specific situation of an exit from rehabilitation, the role of the Court is to "find[] that rehabilitation has been accomplished and that grounds for rehabilitation . . . no longer exist." Wis. Stat. § 645.35(2). Simply stated, for the reasons set

[6] Further, Wis. Stat. § 645.33(5) provides: "The rehabilitator may prepare a plan for the reorganization, consolidation, conversion, reinsurance, merger or other transformation of the insurer. Upon application of the rehabilitator for approval of the plan, and after such notice and hearing as the court prescribes, the court may either approve or disapprove the plan proposed, or may modify it and approve it as modified. If it is approved, the rehabilitator shall carry out the plan."

forth and based on the testimony at hearing, it was not an abuse of discretion for the Rehabilitator to include Article 6.13 in the Second Amended Plan to protect Ambac's claims-paying resources after the conclusion of the Rehabilitation Proceeding. The Court should thus approve Article 6.13, and find that it applies to the MHPI Projects, consistent with section 645.05(1)(k), prevailing case law, and the prior reasoning in *Nickel*.

CONCLUSION

For the foregoing reasons, the Rehabilitator respectfully requests that the Court overrule the remaining objection and grant its Motion to approve the Second Amended Plan and enter the Confirmation Order to effectuate the Segregated Account's exit from rehabilitation.

Dated at Milwaukee, Wisconsin this 16th day of January, 2018.

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