COURT OF APPEALS OF WISCONSIN
DISTRICT IV

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In the Matter of the Rehabilitation of:

Segregated Account of
Ambac Assurance Corporation,

Case No. 10 CV 1576
Appeal No. _____

OFFICE OF THE COMMISSIONER OF INSURANCE OF THE STATE OF WISCONSIN,

Plaintiff/Respondent,

SEAN DILWEG, Commissioner of Insurance of the State of Wisconsin,

Petitioner/Respondent;

AMBAC ASSURANCE CORPORATION,

Other Interested Party/Respondent,

v.

AURELIUS CAPITAL MANAGEMENT, LP, FIR TREE, INC., KING STREET CAPITAL, L.P., KING STREET CAPITAL MASTER FUND, LTD., MONARCH ALTERNATIVE CAPITAL, LP, STONEHILL CAPITAL MANAGEMENT LLC,

Defendants/Appellant,

WELLS FARGO BANK, EATON VANCE MANAGEMENT, NUVEEN ASSET MANAGEMENT, RESTORATION CAPITAL MANAGEMENT, LLC, STONE LION CAPITAL PARTNERS, LP, THE

BANK OF NEW YORK MELLON,
FEDERAL HOME LOAN MORTGAGE
CORPORATION,

Defendants.

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**RMBS POLICYHOLDERS' BRIEF IN SUPPORT OF EMERGENCY MOTION FOR INJUNCTION PENDING APPEAL**

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Aurelius Capital Management, LP, Fir Tree, Inc., King Street Capital, L.P., King Street Capital Master Fund, Ltd., Monarch Alternative Capital LP, and Stonehill Capital Management LLC (collectively, the "RMBS Policyholders"), in their capacity as owners of or managers of funds that own residential mortgage-backed securities and other indebtedness insured by Ambac Assurance Corporation, by their attorneys, Reinhart Boerner Van Deuren s.c. and Jenner & Block LLP, move the Court for an injunction preventing the consummation of the CDS Settlement and distribution of settlement funds from the General Account pending appeal of the Circuit Court's ruling denying the RMBS Policyholders' Emergency Motion to Modify Order for Temporary Injunctive Relief.

## INTRODUCTION

The RMBS Policyholders need an injunction because Ambac Assurance Corporation ("AAC") may, within a matter of hours or days, begin dissipating the principal assets available to satisfy the RMBS Policyholders' claims. If AAC is allowed to proceed, it will transfer those assets – perhaps irretrievably – to at least 17 different financial institutions around the globe, all but one of which are headquartered in foreign countries or are owned by a foreign parent.[1] None of

[1] According to the Affidavit of Roger Peterson, submitted to the Court on May 20, 2010, the Bank Group consists of the following 17 institutions, all but one of which are headquartered in foreign countries or are owned by a foreign parent: (1) Banco Bilbao Vizcaya Argentaria, S.A. (Spain); (2) Banco Santander, S.A. (Spain); (3) Barclays Bank plc (England); (4) BNP Paribas (France); (5) Canadian Imperial Bank of Commerce (Canada); (6) Citibank, N.A. (United States); (7) Citigroup Global Markets Limited (United Kingdom); (8) Commerzbank AG London Branch (Germany); (9) Credit Agricole Corporate and Investment Bank (France); (10) Deutsche Bank AG London Branch (Germany); (11) Deutsche Bank AG New York Branch (Germany); (12) (footnote continued)

those financial institutions are presently subject to this Court's jurisdiction. Without an injunction, the RMBS Policyholders and other policyholders will be limited in their ability to recover the dissipated assets. And this will have occurred just two months after the case was filed.

With the approval of the Wisconsin Office of the Commissioner of Insurance ("OCI"), AAC established a Segregated Account, pursuant to Wis. Stat. § 611.24, which authorizes the creation of an account separate from the company as long as it is adequately capitalized. AAC transferred from its General Account certain policies that AAC "expected to suffer material losses," including the RMBS policies, to the Segregated Account. (OCI's Verified Pet. for Order of Rehabilitation ("Rehabilitation Pet."), ¶ 9; Plan of Operation, § IV, attached to the Rehabilitation Pet. as Tab 1.) The principal funding source for the Segregated Account is AAC's General Account. OCI then petitioned the Circuit Court to enter an order of Rehabilitation for the Segregated Account. (*Id.*) Simultaneously, OCI announced a transaction that would commute almost all of the credit default swap ("CDS") contracts entered into by an AAC subsidiary in exchange for the immediate payment of $2.6 billion in cash and a $2 billion surplus note (the "CDS Settlement"), both to be paid from the General Account.

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Natixis (France); (13) Natixis Financial Products, Inc. (United States); (14) Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A. (Netherlands); (15) The Royal Bank of Scotland plc (Scotland); (16) Société Générale (France); and (17) UBS AG, London Branch (Switzerland).

In order for there to be meaningful review of OCI's actions to determine their legality and appropriateness, and to assure that all policyholders be treated equitably and fairly, the RMBS Policyholders sought an order requiring that the CDS Settlement not be consummated prior to review and approval of the Circuit Court, and to modify an Order for Temporary Injunctive Relief entered by the Circuit Court on March 24, 2010 ("Injunction Order").

On May 25, 2010, the Circuit Court denied the RMBS Policyholders' motion, and the CDS Settlement – and its $4.6 billion payment – is set to go forward. Contrary to Wisconsin law and a Cooperation Agreement integral to the rehabilitation, the Circuit Court ruled that it lacked jurisdiction to review the CDS Settlement. This ruling was in error. Further, the Circuit Court denied the RMBS Policyholders' request for an injunction pending appeal, despite the fact that the parties to the CDS Settlement had previously indicated that they would close after the hearing unless the closing was enjoined.

The Circuit Court has not issued its final judgment. It indicated that it would issue findings of fact and conclusions of law "in several days." Based on the Court's oral statements, however, we believe that order will be final and appealable. Upon the filing of the Circuit Court's judgment, we will file a notice of appeal to invoke this Court's jurisdiction. Until the Circuit Court enters its final order, however, the RMBS Policyholders have filed herewith a petition for interlocutory review to invoke this Court's jurisdiction. In aid of that petition, the

RMBS Policyholders hereby request an injunction of the CDS Settlement pending completion of appellate proceedings.

If an injunction is not entered, the RMBS Policyholders, similarly situated policyholders, and the public generally will be irreparably harmed. Without an injunction, if the court later concludes that the CDS Settlement is improper or the Segregated Account is inadequately capitalized, the money needed to adequately capitalize the Segregated Account will have been dissipated to at least 17 different financial institutions spread across the globe, all but one of which are headquartered in foreign countries or are owned by a foreign parent. The relief the RMBS Policyholders request – to enjoin the consummation of the CDS Settlement and the distribution of funds to the holders of the CDS contracts until the Court has resolved the RMBS Policyholders' appeal – will not harm any of the involved parties. An injunction is needed to maintain the *status quo* of assets presently available to satisfy policyholders' claims until this appeal is resolved.

## BACKGROUND

**AAC Rehabilitation**. AAC is a Wisconsin-domiciled insurer that provides financial guaranty insurance. Among other financial guaranty products, AAC insures structured finance obligations, such as residential mortgage-backed securities ("RMBS"), collateralized debt obligations, and credit default swaps. According to the Rehabilitation Petition (at ¶¶ 5-7), over the past three years AAC's financial position has deteriorated.

On March 21, 2010, AAC's Board of Directors, with the approval of OCI, voted to establish a Segregated Account, to which AAC would transfer certain policies, including the RMBS policies, from AAC's General Account. (Rehabilitation Pet. ¶ 9.) The Board then voted to place the Segregated Account into rehabilitation. (*Id.*) Three days later, on March 24, 2010, OCI petitioned the Circuit Court to enter the proposed Order of Rehabilitation for the Ambac policies and liabilities assigned to the Segregated Account. That same day, the Circuit Court also entered an Order for Temporary Injunctive Relief at OCI's request.

Under the Rehabilitation Order, the Segregated Account was capitalized with a $2 billion note and a reinsurance agreement with AAC, both of which are entirely dependent on the assets in AAC's General Account. The terms of the note and the reinsurance agreement provide that AAC is not obligated to make payments from the General Account to the Segregated Account if AAC's statutory surplus amount is below $100 million. (Secured Note, at 3, attached to the Rehabilitation Pet. as Ex. G; Aggregate Excess of Loss Reinsurance Agreement, at 2, attached to the Rehabilitation Pet. at Ex. H.) The RMBS Policyholders own, or are managers of entities that own, approximately $1 billion face amount of RMBS policies and other liabilities that have been allocated to the Segregated Account.[2]

[2] As of the May 25, 2010 hearing, the following interested parties – representing in excess of $20 billion in Ambac's policies – filed papers in the Circuit Court in response to the Rehabilitation Order: Wells Fargo Bank, National Association; RMBS Policyholders; LVM bondholders; Deutsche Bank National Trust Company and Deutsche Bank Trust Company Americas; U.S. National Bank Association; Bank of New York Mellon; Bank Insureds; and, Freddie Mac.

AAC is now on the verge of finalizing a Statement of Intent and related transactions with 17 financial institutions, all but one of which are headquartered in foreign countries or are owned by a foreign parent (the "Bank Group"), that are scattered all over the globe. (*See* OCI's Proposed Findings of Fact, ¶¶ 7, 14; R. Peterson Aff., ¶ 24.) The proposed settlement will permit a large portion of the General Account to be disbursed now, thereby endangering the ability of the Segregated Account to be adequately capitalized. Under the terms of the agreement, AAC would commute one class of its liabilities – substantially all of the CDS contracts, which it chose not to include in the Segregated Account. The Commissioner indicated that the transaction could close as early as May 25, 2010. (*See* May 6, 2010 Letter from Michael B. Van Sicklen to the Honorable William D. Johnston at 1.) Once the CDS Settlement closes, AAC will (i) pay $2.6 billion from the General Account to the Bank Group, and (ii) issue a $2 billion note payable to the Bank Group. (*See* Nowicki Aff., Ex. A at 6.)

**RMBS Policyholders Requested The Court To Review The CDS Settlement**. As soon as they learned of the Statement of Intent, the RMBS Policyholders sought to obtain more information about the proposed transaction. They feared that the proposed settlement would transfer funds from AAC's General Account and undermine AAC's ability to comply with its obligation to fund the Segregated Account. In addition, the transaction could prefer one group of AAC's creditors – the holders of CDS contracts – to the detriment of policyholders, a preference that Wisconsin law does not permit. AAC and OCI

refused to provide the requested information, and the RMBS Policyholders filed an emergency motion to prevent the CDS Settlement from closing until the Circuit Court was provided a reasonable opportunity to review the legality of the transaction and OCI's actions. Alternatively, the RMBS Policyholders sought to modify the Injunction Order.

In response, OCI and AAC filed lengthy briefs, each supported by factual affidavits and documents. OCI also submitted proposed findings of fact. Although thereby conceding that the propriety of the settlement turned on factual issues, they continued to resist factual discovery. In short, they disclosed only what they were willing to disclose, on their terms, and opposed a fair exchange of factual materials.

**Proceedings In The Circuit Court**. The Circuit Court conducted a hearing on the RMBS Policyholders' motion on May 25, 2010. Agreeing with OCI and AAC, the court refused to permit factual discovery. The court refused to delay the hearing to permit the other parties, including the RMBS Policyholders, to develop additional factual support for their positions.

The Circuit Court indicated that it intended to deny the RMBS Policyholders' motion on purely legal grounds. The Court stated that it lacked jurisdiction to review the transaction because it involved the General Account which was not in rehabilitation. The Circuit Court indicated that it would enter written findings of fact and conclusions of law "in several days." Based on the Circuit Court's oral statements, we believe that its order will constitute a final,

appealable order. Upon the filing of the Circuit Court judgment, we will file a notice of appeal to invoke this Court's jurisdiction. Until the Circuit Court enters its final order, however, the RMBS Policyholders have filed herewith a petition for interlocutory review to invoke this Court's jurisdiction.

At the conclusion of the hearing, the RMBS Policyholders orally moved to enjoin the CDS Settlement pending appeal of the Circuit Court's order. Alternatively, the RMBS Policyholders requested that the Circuit Court at least enjoin the CDS Settlement until this Court could rule on a motion for an injunction. The Circuit Court denied both requests and declined to permit any relief.

Accordingly, as set forth herein, the RMBS Policyholders seek an order enjoining the consummation of the CDS Settlement and the distribution of funds to the Bank Group pending this Court's review. Unless the transaction is enjoined pending review, the RMBS Policyholders may be irreparably injured as detailed below.

## AN INJUNCTION SHOULD BE GRANTED

### I. The RMBS Policyholders Seek An Order Preventing The Improper Distribution Of Funds To The Holders Of The CDS Contracts.

The RMBS Policyholders seek temporary relief to enjoin the consummation of the CDS Settlement and the distribution of funds from the General Account to the holders of the CDS contracts pending appeal. If those funds are distributed, and the Circuit Court later agrees with the RMBS

Policyholders that the settlement was approved in error, it may be difficult, costly, or impossible to restore the *status quo*. To avoid this harm, the RMBS Policyholders request the Court direct that the CDS Settlement be enjoined and the distribution of any funds to the holders of the CDS contracts be withheld so that they may be retained in the General Account if this Court later concludes the settlement is unlawful. The RMBS Policyholders request that this injunction remain in place until the Court decides the appeal.

## II. An Injunction Is Appropriate Because The RMBS Policyholders Will Be Substantially And Irreparably Harmed If An Injunction Is Not Entered.

Section 808.07 of the Wisconsin Statutes empowers this Court to "suspend, modify, restore or grant an injunction" during the pendency of an appeal. Section 808.07 also authorizes the Court to enter a stay to preserve the *status quo* while a party pursues an appeal: "During the pendency of an appeal, a trial court or an appellate court may . . . [m]ake any order appropriate to preserve the existing state of affairs or the effectiveness of the judgment subsequently to be entered." Wis. Stat. § 808.07(2)(a)(3). A court should grant an injunction pending appeal when it is necessary to preserve the existing state of affairs, where the appeal presents debatable questions of law, where substantial rights are affected, and where it can be granted without depriving the parties of a substantial right. *Banach v. City of Milwaukee*, 31 Wis. 2d 320, 331, 143 N.W.2d 13, 18 (1966). Accordingly, the Wisconsin Supreme Court has found that an injunction pending appeal is appropriate where, as here, the moving party shows that: (1) it is likely

to succeed on the merits of the appeal; (2) it will suffer irreparable injury unless an injunction is granted; (3) no substantial harm will come to the other interested parties; and (4) an injunction will do no harm to the public interest. *See, e.g.*, *State v. Gudenschwager*, 191 Wis. 2d 431, 440, 529 N.W.2d 225, 229 (1995).

Here, a balancing of the factors supports an injunction of the CDS Settlement. The RMBS Policyholders will suffer irreparable injury if an injunction is not granted, while little to no harm will result to AAC or the Bank Group if an injunction is granted. *See Banach*, 31 Wis. 2d at 330, 143 N.W.2d at 18 (finding that the court's "inherent equitable power should be allowed to preserve the status quo to insure that equity will not be denied plaintiffs if they should be successful on appeal").

### A. The RMBS Policyholders Will Suffer Irreparable Harm Unless The Distribution Is Enjoined.

A party can satisfy the irreparable harm factor to obtain an injunction pending appeal by showing that the money paid pending appeal could not later be recovered. *See Scullion v. Wis. Power & Light Co.*, 237 Wis. 2d 498, 515, 614 N.W.2d 565, 574 (Wis. Ct. App. 2000).

In this case, if AAC is permitted to consummate the CDS Settlement, AAC will immediately distribute $2.6 billion in cash from the General Account and issue $2 billion in notes. The $2.6 billion distribution comprises a significant portion – 30% – of the $8.5 billion of assets remaining in the General Account. Upon execution, the $2.6 billion would be dispersed amongst 17 members of a

Bank Group, all but one of which are headquartered in foreign countries or are owned by a foreign parent. If the RMBS Policyholders are ultimately successful on appeal, it would be time-consuming and expensive for OCI to attempt to recover the $2.6 billion, which, given the potential jurisdiction issues over the foreign entities, would face significant and potentially dispositive hurdles. Indeed, OCI could be forced to expend time and money to litigate against the Bank Group to recover the funds. Litigation with the Bank Group would divert OCI's attention from the rehabilitation to the detriment of AAC and its policyholders. Even if OCI was successful in the litigation, it is unrealistic to believe OCI could recover the total amount disbursed without undue burden.

The loss of some or all of the $2.6 billion in cash and $2 billion in notes could irreparably harm the RMBS Policyholders. Under the Rehabilitation Order, the RMBS Policyholders and other policyholders must look to the Segregated Account, which has been capitalized with a $2 billion note and a reinsurance agreement with AAC, for payment of their claims. Both the note and the reinsurance agreement are supported principally by AAC's General Account, until the point at which AAC's surplus falls below $100 million, or such higher amount as determined by OCI. Transactions that deplete the General Account will limit the recovery by the RMBS Policyholders and other policyholders, and put at risk not only the rehabilitation of the Segregated account but also the viability of the General Account. Moreover, there is nothing in the rehabilitation papers that prevents AAC from engaging in additional transactions that materially impact the

General Account, effectively stripping the RMBS Policyholders of the opportunity to receive a fair distribution as required by Wisconsin law. In the absence of an injunction, the RMBS Policyholders will suffer irreparable harm.

### B. The RMBS Policyholders Are Likely To Succeed On The Merits Of Their Appeal.

Under Wisconsin law, a moving party need not show a high probability of success on appeal. *Scullion*, 237 Wis. 2d at 513, 614 N.W.2d at 573. Instead, the likelihood of success "that must be demonstrated is inversely proportional to the amount of irreparable injury the plaintiff will suffer absent the stay." *Gudenschwager,* 191 Wis. 2d at 441, 529 N.W.2d at 229.

It is likely the RMBS Policyholders will prevail on appeal. An injunction is needed to protect the policyholders from the irreparable harm that would result if the planned $4.6 billion payment is made by AAC to the Bank Group. The RMBS Policyholders submit that this Court is likely to reverse the Circuit Court's decision on the following grounds.

#### 1. The Circuit Court Erred In Finding It Lacked Jurisdiction To Review The CDS Settlement.

The RMBS Policyholders will demonstrate on appeal that the Circuit Court erred as a matter of law when it ruled that it lacked jurisdiction to review the CDS Settlement. The Circuit Court stated that the CDS Settlement was an action taken by OCI as regulator, not as rehabilitator, and therefore was not within the Circuit Court's power to review. The Circuit Court's legal ruling was in error.

OCI may not consent to a $4.6 billion settlement without court approval. (*See* RMBS Policyholders' Emergency Br. to Modify Inj., at 19-22; Reply of RMBS Policyholders at 2-6.) The rehabilitator's authority is not unlimited, as Wis. Stat. § 645.33(2) makes clear. The statute provides that in rehabilitation proceedings, "*[s]ubject to court approval*, the rehabilitator may take the action he or she deems necessary or expedient to reform or revitalize the insurer." Wis. Stat. § 645.33(2) (emphasis added). The Circuit Court abdicated this responsibility and gave OCI unfettered discretion to enter into extraordinary transactions.

The Circuit Court stated that it lacked authority to limit OCI's approval of the CDS Settlement with the General Account, because in that capacity OCI was acting only in its capacity as a regulator. Yet, the CDS Settlement with the General Account is inextricably intertwined with the rehabilitation. The General Account is the principal source of funding for the company in rehabilitation. The General Account is no longer obligated to contribute to the rehabilitation if AAC's statutory surplus falls below $100 million. (Secured Note, at 3; Aggregate Excess of Loss Reinsurance Agreement, at 2.) The CDS Settlement will cause the immediate transfer of $4.6 billion of cash and notes out of the General Account, thereby affecting – if not endangering – the rehabilitation. Thus, the arbitrary and unreviewed separation of AAC into Segregated and General Accounts does not deprive the Circuit Court of the power to review OCI's actions.

As courts in other states have recognized, a rehabilitator's ability to make decisions is "circumscribed by [the Courts'] mandate to act as a check on potential discretionary abuse and *to insure equitable apportionment of loss*." *Grode v. Mut. Fire, Marine & Inland Ins. Co.*, 572 A.2d 798, 804 (Pa. Commw. Ct. 1990) (emphasis added), *aff'd in part sub nom.*, *Foster v. Mut. Fire, Marine & Inland Ins. Co.*, 614 A.2d 1086 (Pa. 1992). For example, courts may review rehabilitation orders to ensure that policyholders do not receive worse treatment in rehabilitation than they would get in liquidation, and that rehabilitation plans do not discriminate unfairly among different classes of policyholders and creditors. *See id.*; *In re Conservation of Alpine Ins. Co.*, 741 N.E.2d 663, 665-68 (Ill. App. Ct. 2000).

The RMBS Policyholders do not contend that the Commissioner, as rehabilitator, is required to seek court approval for each and every decision made in the course of the rehabilitation. Rather, Wis. Stat. § 645.33(2) imposes the requirement of court approval upon "action[s] he or she deems necessary or expedient to reform or revitalize the insurer." However this phrase might be applied in other circumstances, there can be no doubt here that OCI deems the CDS Settlement to be an action that is "necessary or expedient to reform or revitalize" the Segregated Account because the claims addressed by the CDS Settlement would otherwise be allocated to the Segregated Account. Consequently, it falls within the requirement of prior court approval under the plain language of Wis. Stat. § 645.33(2).

Moreover, the Cooperation Agreement between AAC and the Segregated Account, which establishes the relationship of the accounts during the rehabilitation, requires the Segregated Account's written consent to consummate any transaction by AAC that involves consideration or other proceeds in excess of $5,000,000. (*See* Cooperation Agreement, § 1.02, attached to Rehabilitation Pet. as Ex. B.) The $4.6 billion CDS Settlement would, of course, exceed that threshold many times over. The need for the Segregated Account's consent for such transactions is understandable because the Segregated Account's principal source of funding, and its lifeblood for its reformation or revitalization, is AAC. Given the magnitude of the CDS Settlement, however, the Commissioner, acting on behalf of the Segregated Account as rehabilitator, cannot give his consent without the Circuit Court's review. *See* Wis. Stat. § 645.33(2).

**2. The Circuit Court Erred In Refusing Discovery.**

The Circuit Court erred in not permitting discovery or conducting a hearing to evaluate whether the CDS Settlement is in compliance with the Wisconsin Insurance Code provision requiring that distributions to AAC general creditors be subordinated to policyholders' claims. (*See* Reply of RMBS Policyholders, at 6-11.) Because the question of whether OCI's actions are fair and equitable to all policyholders is a fact based question that necessarily requires discovery, discovery is needed to review the lawfulness of OCI's actions. The RMBS Policyholders are entitled to conduct limited discovery into the capitalization of the Segregated Account and the appropriateness of the CDS Settlement to provide

the Circuit Court with sufficient information to review and determine whether to approve the actions of OCI.

The RMBS Policyholders seek discovery to ensure that the parties are treated equitably and fairly as the law requires. Among other things, the RMBS Policyholders contend that the Bank Group may not be insured parties, but should be subordinated and treated as general creditors. If the Bank Group's interests are ultimately determined to be subordinate to the policyholders, the CDS settlement will disburse $4.6 billion to parties that should not receive any funds. Discovery is necessary to ensure that the CDS Settlement does not afford preferential treatment to the Bank Group in violation of the Wisconsin Insurance Code's purpose "[t]o ensure that policyholders, claimants and insurers are treated fairly and equitably." Wis. Stat. § 601.01(2); *see* RMBS Emergency Br. to Modify Inj., at 22-23; Reply of RMBS Policyholders, at 6-11.

Discovery may further address whether the Segregated Account is adequately capitalized, which is a statutory prerequisite to its creation. *See* Wis. Stat. § 611.24(3)(a). OCI presented no factual support to the Circuit Court for its conclusory assertion that there is an adequate amount of capital and surplus for the Segregated Account. (*See* Plan of Operation, § V.) OCI only asserted that the Segregated Account is adequately capitalized and, without providing any underlying data or analysis, requested that the Circuit Court simply accept as true OCI's assertion. The AAC General Account is the principal source of capital and funding for the Segregated Account. The CDS Settlement will have a major

impact on the AAC General Account – depleting 30% of its funds – and would significantly decrease the assets available to support the Segregated Account's liabilities and to fund the rehabilitation plan. Thus, the CDS Settlement will further imperil the capitalization of the Segregated Account, and thereby injure the RMBS Policyholders. Discovery and further proceedings in the Circuit Court will permit a reasoned evaluation of these important issues.

### C. An Injunction Will Not Cause Substantial Harm To Any Interested Party.

In evaluating the substantial harm factor, a court should "consider the substantiality of harm asserted, the likelihood of its occurrence, the adequacy of the proof provided and whether it truly is a harm that cannot be remedied by the later collection of the judgment plus interest." *Scullion*, 237 Wis. 2d at 516, 614 N.W.2d at 574. Irreparable harm to the moving party and the risk of substantial harm to the non-moving party should be balanced; injury to one frequently means a lack of harm to the other. Here, the balance heavily favors an injunction.

An injunction of the action will not cause substantial harm to any interested parties. To protect the other parties' interests, the RMBS Policyholders have proposed that AAC and the Bank Group may tender the Bank Group's policies and the $2.6 billion in cash to an escrow agent. If the settlement is ultimately found to be appropriate, the parties can consummate the Settlement and the escrow agent can distribute the money to the Bank Group. Conversely, in the event the Court ultimately finds that the settlement cannot proceed, the funds would be

returned to the General Account. Undoubtedly, the potential harm to the Bank Group in placing the $2.6 billion into escrow for a brief period of time pales in comparison to the irreparable and substantial injury faced by the RMBS Policyholders if the settlement is overturned and entities are permitted to dissipate the funds they receive. Moreover, any potential harm to interested parties will be minimized because the RMBS Policyholders are pursuing an expedited appeal.

On balance, the harm, if any, caused by the delay in litigating this lawsuit is insubstantial when compared to the substantial and irreparable harm facing the RMBS Policyholders.

**D. An Injunction Will Benefit The Public's Interest.**

The public has an interest in ensuring that a proposed rehabilitation plan is fair and equitable. *See* Wis. Stats. §§ 645.33(5); 601.01(2). Moreover, a segregated account must be adequately capitalized under Wisconsin law. *See* Wis. Stat. § 611.24(3)(a). An undercapitalized segregated account is illegal. *Id.* Wisconsin law is structured to grant OCI authority to approve a segregated account when certain statutory safeguards are met. OCI cannot isolate what it considers to be "bad" policies from a company without adhering to the necessary statutory safeguards, which in the case of rehabilitation provide for court approval.

Without assurances that a segregated account is adequately capitalized, OCI would be permitted to circumvent the statutory safeguards and arbitrarily remove bad policies of a disfavored policyholder into a segregated account. The adequate capitalization requirement prevents OCI from removing "bad" assets to create a

bad-company/good-company structure. OCI's attempt to abdicate the responsibility to ensure adequate capitalization in rehabilitation proceedings will jeopardize Wisconsin's policy of promoting business growth. There would be a serious disincentive for anyone to purchase policies through Wisconsin insurance companies if their policies can be arbitrarily relegated into a segregated account that is undercapitalized, resulting in large losses to the insureds whose policies are classified in that disfavored group. The Wisconsin Legislature permits the use of segregated accounts only when they are adequately funded. The disregard of that standard would create a significant disincentive to obtain insurance from insurance companies domiciled in Wisconsin. The Circuit Court's careful review of the Segregated Account's capital adequacy protects Wisconsin from becoming hostile to business interests to the detriment of the public.

## III. A Bond Is Not Appropriate.

A court has the discretion to condition the granting of an injunction pending appeal on the filing of an undertaking or bond with the court. Wis. Stat. § 808.07(2)(b). The court's authority to condition a bond corresponds to the goal of "preserv[ing] the existing state of affairs or the effectiveness of the judgment subsequently to be entered." Wis. Stat. § 808.07(2)(a). In this case, requiring a bond is not only unnecessary, but would prejudice the rights of the RMBS Policyholders for three reasons.

***First***, a bond is not necessary to preserve the effectiveness of the judgment on appeal because the parties' interests are fully protected. If the CDS Settlement

is upheld, the funds can be distributed. The escrow arrangement described above will fully protect the parties if the RMBS Policyholders' appeal is unsuccessful.

***Second***, the Circuit Court's initial injunction order reflects that a bond is not needed in this case. In that order, the Circuit Court, in its discretion under Wis. Stat. § 645.08, declined to require OCI to post a bond. (Order for Temporary Injunctive Relief, ¶ 11.) The Circuit Court recognized that requiring a bond could act as an impediment to the efficient rehabilitation of AAC. The same reasoning applies to the present circumstance. If the Court agrees that the settlement should be blocked, the result will be the return to AAC of $2.6 billion in cash and a $2 billion note. The RMBS Policyholders believe that payment will assist OCI's efforts to rehabilitate AAC. Requiring a bond will impede that result.

***Third***, a bond in this case would be a practical impediment for the RMBS Policyholders to obtain review. In the Circuit Court, OCI argued that a $9.3 billion bond would have been appropriate if the Circuit Court granted RMBS Policyholders' Motion to Modify the Order for Injunctive Relief. (OCI's Brief in Opposition at 13-14.) Even the statutory maximum bond of $100 million (Wis. Stat. § 808.07(2m)) will deter the RMBS Policyholders from obtaining review of this case. Courts have held that a party should not be precluded from obtaining judicial review because of circumstances outside of their control. *See, e.g., City of Williamsport v. U.S.*, 273 F. Supp. 899, 904 (M.D. Pa. 1967) ("[U]nder the circumstances of this case, a requirement that plaintiffs post security would stifle

and, indeed, take away their right to judicial review . . . They should not be denied effective judicial review because of circumstances outside their control.").

For these reasons, the RMBS Policyholders should not be required to obtain a bond so that they can appeal the Circuit Court's ruling.

## CONCLUSION

The RMBS Policyholders respectfully request that the Court enjoin the consummation of the CDS Settlement and the distribution of settlement funds from the General Account pending the appeal of the Circuit Court's order denying the RMBS Policyholders' Emergency Motion to Modify Order for Temporary Injunctive Relief. The RMBS Policyholders further request that the Court find a bond is not required.

Dated this 26th day of May, 2010.

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