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**

Depfa Bank, plc	Case No. 10 CV 1576-B
Wells Fargo Bank, N.A., as trustee for certain RMBS certificateholders	Case No. 10 CV 1576-C
Bank of America, N.A., as trustee for certain RMBS certificateholders	Case No. 10 CV 1576-D
Deutsche Bank National Trust Company and Deutsche Bank Trust Company Americas, as trustees	Case No. 10 CV 1576-G
U.S. Bank N.A., as trustee for certain securitization trusts	Case No. 10 CV 1576 H
Access to Loans for Learning Student Loan Corporation and Lloyds TSB Bank plc	Case No. 10 CV 1576-I
Bank of New York Mellon, as trustee, indenture trustee or collateral agent for the benefit of holders and/or secured parties of certain obligations	Case No. 10 CV 1576-J
KnowledgeWorks Foundation and the Treasurer of the State of Ohio	Case No. 10 CV 1576-K

REHABILITATOR'S CONSOLIDATED BRIEF IN OPPOSITION TO ALL MOTIONS SCHEDULED FOR HEARING ON SEPTEMBER 9, 2010

Wisconsin Office of the Commissioner of Insurance and
Sean Dilweg, Commissioner of Insurance of the State of Wisconsin,
as Court-Appointed Rehabilitator of the Segregated Account
of Ambac Assurance Corporation

Dated this 17th day of August, 2010.

FOLEY & LARDNER LLP

Michael B. Van Sicklen, SBN 1017827
Matthew R. Lynch, SBN 1066370

Foley & Lardner LLP
150 East Gilman Street
Post Office Box 1497
Madison, Wisconsin 53701
Telephone: (608) 257-5035
Facsimile: (608) 258-4258

Attorneys for Wisconsin Office of the Commissioner of Insurance and Sean Dilweg, Commissioner of Insurance of the State of Wisconsin, as Court-Appointed Rehabilitator of the Segregated Account of Ambac Assurance Corporation

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PROCEDURAL POSTURE OF THE MOTIONS AT ISSUE

The Wisconsin Office of the Commissioner of Insurance and the Commissioner, as the appointed Rehabilitator of the Segregated Account of Ambac Assurance Corporation (collectively, the "Rehabilitator" or "OCI")[1] submits this brief in opposition to all pending, non policy-specific challenges to the establishment and structure of the Segregated Account and the March 24, 2010 injunction in force in this proceeding (collectively, the "September 9 Motions"). At issue are the challenges raised in motion papers filed by the following entities (collectively "Movants"):

- Depfa Bank, plc ("Depfa") (Dkt. 217-19) (scheduled as special proceeding case number 10 CV 1576-B);[2]
- Wells Fargo Bank, N.A., solely in its capacity as trustee for certain residential mortgage-backed securities ("RMBS") certificateholders ("Wells Fargo" or "Wells Fargo Trustee") (Dkt. 225-27) (scheduled as special proceeding case number 10 CV 1576-C);
- Bank of America, N.A., solely in its capacity as trustee for certain RMBS certificateholders ("Bank of America" or "Bank of America Trustee") (Dkt. 229-31) (scheduled as special proceeding case number 10 CV 1576-D);
- Deutsche Bank National Trust Company, solely in its capacity as trustee, and Deutsche Bank Trust Company Americas, solely in its capacity as trustee (collectively, "Deutsche Bank" or "Deutsche Bank Trustee") (Dkt. 93, 95, 207, 210-11) (scheduled as special proceeding case number 10 CV 1576-G);

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[1] The present motions concern actions during two time periods: actions by OCI as the regulator of Ambac prior to the Court's entry of the Order for Rehabilitation on March 24, 2010, and subsequent actions by the Commissioner as the Court-appointed Rehabilitator of the Segregated Account of Ambac Assurance Corporation. This brief uses the two terms interchangeably, as appropriate for the context.

[2] Depfa filed two sets of motions, which the Rehabilitator's August 13, 2010 letter to this Court refers to as "Depfa I" (dkt. 217-19) and "Depfa II" (dkt. 220-23). By agreement of the parties, the issues raised in the Depfa I motion will be split and argued partly on September 9 and partly on September 13, and portions of this brief, particularly Part II.B.i(5), may overlap with the issues Depfa will raise on September 13. As noted in the August 13 letter, Depfa and the Rehabilitator have postponed the briefing schedule on the Depfa II motion (which pertains to an interpleader case in New York) in anticipation of a consensual resolution of the issue raised in that motion.

- U.S. Bank N.A., solely in its capacity as trustee for certain securitization trusts ("U.S. Bank" or "U.S. Bank Trustee") (Dkt. 208-09, 211) (scheduled as special proceeding case number 10 CV 1576-H);[3]

- Access to Loans for Learning Student Loan Corporation ("ALL") (Dkt. 232-35) (scheduled as special proceeding case number 10 CV 1576-I);

- Lloyds TSB Bank plc ("Lloyds") (Dkt. 232-35) (scheduled as special proceeding case number 10 CV 1576-I);[4]

- Bank of New York Mellon, in its capacity as trustee, indenture trustee or collateral agent (directly and/or through its affiliates) for the benefit of holders and/or secured parties of certain obligations ("BNY" or "BNY Trustee") (Dkt. 213-15) (scheduled as special proceeding case number 10 CV 1576-J); and

- KnowledgeWorks Foundation and the Treasurer of the State of Ohio (collectively "KnowledgeWorks") (Dkt. 237-38, 240, 248, 250-51) (scheduled as special proceeding case number 10 CV 1576-K).

This brief does not address objections and challenges that will be argued on September 13 that depend upon facts and circumstances particular to the individual Movants. Specifically, this brief does not directly address the objections pertaining to: (1) a disputed office-space lease liability raised by One State Street, LLC (Dkt. 253-54), which are unique to that Movant; nor (2) the equal protection and other policy-specific challenges raised by Depfa, ALL/Lloyds, and KnowledgeWorks pertaining to the allocation of their student loan policies to the Segregated Account.[5] The Rehabilitator responds to those policy-specific issues in separate briefs filed today.

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[3] Deutsche Bank and U.S. Bank filed a combined brief (dkt. 211), which the Rehabilitator hereinafter refers to as the "Deutsche Bank/U.S. Bank Br."

[4] ALL and Lloyds filed joint motion papers and a combined brief (dkt. 235), which the Rehabilitator hereinafter refers to as the "ALL/Lloyds Br."

[5] This brief also does not address the challenges raised by PNC Bank, N.A. ("PNC"). (Dkt. 258.) Because of pending settlement talks in June, PNC did not file an opening brief in support of its motion. By agreement of counsel for PNC and the Rehabilitator, PNC's motion relating to servicing issues will be briefed and argued on a later schedule, absent settlement.

This brief addresses all other issues raised by Movants, namely: (1) legal challenges to the establishment and structure of the Segregated Account, including arguments that the Rehabilitator's approval of the establishment of the Segregated Account was unlawful; and (2) challenges to the Order for Temporary Injunctive Relief (the "Injunction Order") in force, including challenges to provisions enjoining the exercise of control rights, withholding of premiums and other objections. This brief also addresses Movants' motions to formally intervene as parties to this rehabilitation.

INTRODUCTION

Movants' multiple briefs in opposition to the actions of the Rehabilitator present an indiscriminate shotgun blast of every conceivable legal challenge, ranging from arguments that this rehabilitation proceeding "is not contemplated by any law of contracts, statutory provisions of the insurance code or basic common sense" (ALL/Lloyds Br. at 16) to arguments that it disregards *Marbury v. Madison*, 5 U.S. 137 (1803) (KnowledgeWorks Br. at 18). Among other contentions, Movants claim that the Rehabilitator (and this Court, in approving the Rehabilitator's actions) have violated: the common law doctrine of contractual novation; the administrative procedure of this state; Section 611.24 of the Wisconsin Statutes; several provisions of Chapter 645; the laws of various other states; multiple clauses of the Constitutions of both the United States and Wisconsin; and principles of prudent public policy and judicial administration. There are arguments that the Rehabilitator has gone beyond his authority (*see, e.g.*, ALL/Lloyds Br. at 12-13) and arguments that he has not done enough (*see, e.g.*, Deutsche Bank/U.S. Bank Br. at 26). There are arguments that this Court has exercised too much jurisdiction over this matter (*see, e.g.*, KnowledgeWorks Br. at 9-11), and too little (*see, e.g.*, Depfa Br. at 16). There is even an argument that the Rehabilitator and Ambac are co-conspirators in an unlawful "scheme" to create "an illusory rehabilitation" in order to "impale

policyholders with a 'Morton's Fork,'" with the "clear intent by the Commissioner to favor certain policyholders over others." (Depfa Br. at 2, 13, 19, 21.)[6]

Nowhere in Movants' hundreds of pages of briefing, however, will the Court find a single sentence disputing the three underlying premises of the Rehabilitator's actions:

> (1) policyholders and beneficiaries have a shared interest in maximizing Ambac's claims-paying resources and ensuring "[e]quitable apportionment of any *unavoidable* loss," Wis. Stat. § 645.01(4)(d) (emphasis added);
>
> (2) Ambac's deteriorating financial condition necessitated rehabilitation; and
>
> (3) a full-blown rehabilitation including the 14,000 policies remaining in Ambac's General Account would create additional *avoidable* losses by triggering contractual provisions that could render note and bond issuers that are currently meeting their Ambac-insured obligations to holders (such as Dunkin' Brands, Sonic, and Hertz) unable to meet them, and thus cause additional, substantial, and unnecessary claims for which Ambac would be liable, as well as material collateral damage to holders of Ambac's approximately 15,000 policies and the public generally.

The recognition and acceptance of this reality prompted the Rehabilitator to take the actions and seek the relief Movants now challenge.[7] While Movants occasionally pay lip service to the gravity of the situation prior to the commencement of rehabilitation, none of them

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[6] Depfa's "Morton's Fork" accusation is apparently an obscure reference to the tax policies of John Morton, Archbishop of Canterbury and Chancellor of England under Henry VII, who was tasked with restoring the depleted royal estate. According to subsequent historians, under Chancellor Morton "those who entertained king or chancellor lavishly were told that they could obviously afford to contribute handsomely, while those who, to avoid this fate, were parsimonious, [were told] that they must have a great deal stored away from which they could give." 39 *Oxford Dictionary of National Biography* 423 (2004). In other words, it appears that taxpayers under Chancellor Morton were asked to share equitable burdens in his plan to restore the State's depleted assets.

[7] These remedial, regulatory considerations are detailed in the May 19, 2010 affidavit of OCI's Roger Peterson (dkt. 86) ("First Peterson Aff.") at ¶¶ 6-15, and have already been considered and favorably commented on by this Court (dkt. 137 ¶¶ 1-6, 19-33, 36; dkt. 318 at 8).

acknowledge the negative consequences that the relief they seek would have for other policyholders, the public, and the management of this rehabilitation proceeding.

Moreover, Movants never argue that the above-noted considerations that have guided the Rehabilitator are illegitimate or irrelevant to the purposes of Wisconsin's regulation of insurance. Other than making vague, self-evident assertions that the Rehabilitator's power is not unlimited (*see, e.g.*, Depfa Br. at 8), Movants never deny that Wisconsin insurance law gives the Rehabilitator broad discretion to accomplish the purposes being advanced here by the Rehabilitator. Tellingly, none of the Movants contend that the Rehabilitator abused his discretion in light of those objectives. Moody's, an independent financial-analysis firm, recently praised the effects of the Rehabilitator's efforts to alleviate hazards to policyholders and the public: "The creation of the Segregated Account and the termination of ABS CDOs [through the bank settlement approved by this Court] helped stabilize the insurer's financial conditions." (Affidavit of Michael B. Van Sicklen ("Van Sicklen Aff."), Ex. 3 at 2.)

By and large, Movants ignore the collective best interest of the many policyholders and other constituents affected by this rehabilitation and the undisputed reality of Ambac's hazardous financial condition. Blindly swinging the sledgehammer of a full-blown rehabilitation or liquidation of Ambac, as Movants implicitly suggest as their preferred alternative, would not better serve the purpose of "[e]quitable apportionment of any unavoidable loss." Wis. Stat. § 645.01(4)(d). It would instead transform presently avoidable losses into unavoidable ones, creating inequitable consequences for issuers that are performing and increasing the harm to all of Ambac's policyholders.

The same principle applies to the seemingly less drastic modifications some Movants propose, such as eliminating the injunction that protects the insurer's contractual

control rights against *ipso facto* and other inequitable termination provisions in various transactions. The control rights protected by the injunction enable the Rehabilitator to effectively manage the business of the Segregated Account and prevent substantial and immediate losses that would threaten claims-paying resources. Stripping the Rehabilitator of the rights preserved by the injunction would create an unfair detriment to policyholders as a whole, with at best only an illusory benefit for the few who seek such relief. (*See* the accompanying Fourth Affidavit of Roger A. Peterson ("Fourth Peterson Aff.") ¶¶ 11-14.)

In short, each Movant offers a host of arguments for promoting its own individual interests, but no consideration of the collective best interests of the rehabilitation and no citation to any instances where the Rehabilitator abused his discretion in responding to Ambac's dire financial condition. In so doing, Movants' challenges only illustrate the wisdom of granting OCI, the public agency charged with protecting the interests of *all* policyholders, *all* creditors, *and* the public, Wis. Stat. § 645.01(4), with "broad authority" to manage delinquent insurers, Wis. Stat. Ann. § 645.32 cmt.

Finally, in their zeal to promote their own self-interest, Movants largely ignore this necessarily broad authority and discretion of the Rehabilitator to accomplish the purposes of the rehabilitation. As this Court aptly noted, "[a] rehabilitation proceeding is not an adversarial litigation designed to adjudicate the diverse and divergent interests of each policyholder. It is a formal remedial measure to 'rehabilitate the business of a domestic insurer.' Wis. Stat. § 645.32(1)." (July 16 Order at 7.) Movants' efforts to litigate their own "diverse and divergent interests" must yield to the business and policy decisions of the Rehabilitator, the public official "best qualified to perform the rehabilitation/liquidation process as he has no special interest in

the outcome except to administer the matter for the maximum benefit of all interested parties." *Minor v. Stephens*, 898 S.W.2d 71, 76 (Ky. 1995).

ARGUMENT[8]

I. THE RIGHT TO BE HEARD DOES NOT ENTITLE MOVANTS TO FORMALLY INTERVENE AS PARTIES TO THIS PROCEEDING.

At the outset, it is appropriate to address one argument common to most of the Movants' filings. Movants seek formal intervention "out of an abundance of caution" in the event the Court determines that paragraph 12 of its injunction order does not grant them the right to be heard. (*See* Depfa Br. at 24; *see also* Deutsche Bank/U.S. Bank Br. at 2; ALL/Lloyds Br. at 1; BNY Br. at 10.) To the extent they seek intervention to establish their right to be heard in these proceedings, their motions are unnecessary because paragraph 12 expressly permitted interested parties to seek modification or dissolution of the Injunction Order by the date Movants filed their motions.

Although many of Movants' arguments fall outside the spirit of paragraph 12, which envisions challenges to the Injunction Order specifically, rather than generalized challenges to the formation of the Segregated Account and any and all actions taken prior to entry of the Order, the Rehabilitator does not object to allowing Movants to be heard on the

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[8] The Rehabilitator has presented many of the facts giving rise to this proceeding in prior filings, including the Verified Petition and other first-day filings and in the First Peterson Affidavit (dkt. 86). The Court also made formal determinations about much of the relevant background in its May 27, 2010 Findings of Fact and Conclusions of Law (dkt. 137) (hereinafter "Findings" and "Conclusions") and its July 16, 2010 Order denying the motions of Wells Fargo and certain LVM Bondholders (hereinafter the "July 16 Order"). Rather than repeat that background here, the Rehabilitator refers the Court to those prior documents—particularly Findings 1 through 6 and 19 through 36—and cites facts relevant to specific arguments as necessary below.

merits of their motions.[9] To the extent Movants argue that formal intervention is nevertheless necessary so they may take burdensome discovery and assert other rights of "parties" to an action, however, the Rehabilitator objects for the reasons this Court recently explained when it rejected an identical request for intervention.

A. This Court's Prior Decisions Correctly Distinguish Between Intervention and the Right to Be Heard.

Intervention pursuant to the Wisconsin Rules of Civil Procedure is distinct from the right to be heard in Chapter 645 rehabilitation proceedings. Intervention and formal party status carry certain legal ramifications that may be appropriate for civil litigation generally, but are not appropriate for the "management task" of rehabilitation. Wis. Stat. § 645.32 cmt. As this Court noted:

> Chapter 645 itself provides no right of intervention. . . . As long as policyholders have a basic right to be heard, which they do here, there is no need to intervene.
>
> Moreover, if every policyholder allocated to the Segregated Account were able to intervene, the overarching purpose of Chapter 645 would be frustrated, *i.e.*, "the protection of the interests of insureds, creditors, and the public generally, with minimum interference with the normal prerogatives of proprietors." Wis. Stat. § 645.01(4). A rehabilitation proceeding is not an adversarial litigation designed to adjudicate the diverse and divergent interests of each policyholder. It is a formal remedial measure to "rehabilitate the business of a domestic insurer." Wis. Stat. § 645.32(1). Accordingly, rehabilitation is "a very flexible procedure" that is "regarded as a management rather than a legal task. . . . [The rehabilitator] must act under the supervision of the court, of course, but the court's control should be liberal, not strict, and should be provided without cumbersome procedures." Wis. Stat. Ann. § 645.32 cmt. Therefore, in relying on Wis. Stat. § 803.09(1), [Movants] ignore the critical difference

[9] Obviously, prior decisions necessarily impact the merits of those arguments. As noted in Part II.A, *infra*, the Rehabilitator is not suggesting that this Court can or should ignore relevant precedent on these issues, particularly its own.

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> between ordinary, adversarial litigation and a rehabilitation proceeding.

(July 16 Order at 6-7; *see also* Conclusions ¶ 9.) *Accord O'Neal v. Oxendine*, 237 Ga. App. 171, 175, 514 S.E.2d 908 (1999) (trial court has broad discretion whether to permit discovery in rehabilitation proceedings).

Subject to the standing objection described below as to KnowledgeWorks and ALL, the Rehabilitator does not contest Movants' "right to be heard" on these motions consistent with this Court's prior rulings. Therefore, intervention is unnecessary and improper.

B. KnowledgeWorks and ALL Have Not Demonstrated a Right to be Heard.

The "basic right to be heard" in rehabilitation proceedings is not limitless, of course, and is subject to this Court's discretion. *See generally* Wis. Stat. Ann. § 645.32 cmt. Just as this Court need not entertain motions from prisoners in Kentucky who possess wild imaginations but lack any individualized interest in the proceedings (dkt. 195-96, 311), it also need not hear arguments from entities that are not policy beneficiaries and have not demonstrated any "concrete and particularized injury" or other threat of harm to them arising out of the actions they challenge. *Lujan v. Defenders of Wildlife*, 505 U.S. 555, 560 (1992) (discussing standing for judicial review). *Cf.* Wis. Stat. § 227.42 (showing of injury or threatened injury a prerequisite to right to hearing in regulatory proceedings). Two of the Movants—KnowledgeWorks and ALL—have failed to make such a showing here.

As acknowledged in their motion papers, KnowledgeWorks and ALL are the *issuers* or *administrators* of Ambac-insured bonds, unlike the bondholders which are the beneficiaries of the Ambac policies that guarantee the payments due from ALL or the Ohio Treasurer (for which KnowledgeWorks is the administrator). (KnowledgeWorks Br. at 4-6; ALL/Lloyds Br. at 4-6.) In other words, Ambac's policies protect bond holders in the event that

KnowledgeWorks or ALL default on their obligations under the bonds; they do not keep KnowledgeWorks or ALL from defaulting in the first place. The only way in which the injunction affects KnowledgeWorks and ALL is by paragraph 9.C, which *protects* KnowledgeWorks and ALL from the exercise of acceleration or early termination provisions by the bondholders and/or lenders to which KnowledgeWorks and ALL owe money.

As reflected in Exhibits 1 and 2 to the attached affidavit of counsel for the Rehabilitator, the Rehabilitator has asked counsel for KnowledgeWorks and the Ohio Treasurer several times why they would seek to invalidate an injunction that apparently protects their interests. (Van Sicklen Aff. Exs. 1 & 2.) Consistent with the role of the Rehabilitator to seek the "protection of the interests of insureds, creditors, and the public generally," Wis. Stat. § 645.01(4), the Rehabilitator asked those parties to explain why they object to the rehabilitation or the Injunction Order. (*Id.* Ex. 1.) The Rehabilitator's counsel noted that they "often have been able to accommodate concerns of parties-in-interest when doing so would not prejudice other policyholders or the prospects for rehabilitation," but they must first understand the nature of those concerns. (*Id.*) Those parties ignored the Rehabilitator's inquiries. (*Id.* ¶ 4.)

Nothing in the Constitution, Chapter 645, or the Court's Injunction Order requires the Court to entertain objections from entities that are not aggrieved by the actions they challenge. Because these Movants have not established that they have been or will be adversely impacted by the Injunction Order, the Court should deny them the right to be heard on their objections to that Order.

II. MOVANTS' CHALLENGES TO THE ESTABLISHMENT AND STRUCTURE OF THE SEGREGATED ACCOUNT FAIL.

As noted above, most of the challenges filed on the deadline for objecting to the Injunction Order do not pertain to the injunction at all. They are instead thinly veiled motions

for the Court to reconsider its prior rulings regarding the legality of the Segregated Account. But rather than citing new facts, making new arguments, pointing to new relevant law, or directly confronting the Court's prior decisions—as one normally would expect in a forthright motion to reconsider—Movants generally incorporate or rehash the same legal arguments the Court previously rejected, sometimes word-for-word. (*See, e.g.*, ALL/Lloyds Br. at 9-20; Deutsche Bank/U.S. Bank Br. at 6 n.3, 22, 25; KnowledgeWorks Br. at 14-15; Depfa Br. at 20-23.)

Movants may vary their points of emphasis, but their bottom-line challenges are the same as those of Wells Fargo, the RMBS Holders, or the LVM Bondholders: according to them, the Segregated Account was not established in accordance with Wis. Stat. § 611.24, effected an improper novation, and violated the Constitution. Movants fail to demonstrate why the Court should change its prior rulings.

Even if the Court treated these issues as if they were new, as Movants urge, they are no more persuasive now than they were when first raised by Wells Fargo more than four months ago. The police power of the State of Wisconsin "extends to all the great public needs," a principle that is "peculiarly apt when the business of insurance is involved—a business to which the government has long had a 'special relation.'" *Cal. State Auto. Ass'n Inter-Ins. Bureau v. Maloney*, 341 U.S. 105, 109 (1951). In exercising that power, Wisconsin has seen fit to delegate to the Commissioner of Insurance, both as regulator and as the Rehabilitator, broad authority to use his expertise to identify and employ practical, individualized approaches in regulating insurers in a number of areas, including approving the establishment of segregated accounts and commencing and directing the rehabilitation of distressed insurers. *See, e.g.*, Wis. Stat. Ann. ch. 645, cmt. to subch. III (noting that the rehabilitation statutes "leave the commissioner considerable discretion to decide on direction depending on the specific facts of

the individual case, subject of course to court control"); Wis. Stat. Ann. § 645.32 cmt. (noting that the rehabilitation order "is formulated to emphasize flexibility and informality, and the rehabilitator is given broad powers"); Wis. Stat. Ann. § 611.24 cmt. (1971) (permitting "optional segregated accounts under any circumstances the corporation wishes, if the separation meets the commissioner's approval"); Wis. Stat. Ann. § 611.19 ("[M]uch discretion should be left to the commissioner to set minimum capital and surplus requirements for an individual corporation based on its own plans.").

OCI's approval of the Segregated Account and commencement of this rehabilitation were both expressly authorized by clear statutory grants of discretion, and those actions constituted a rational, practical exercise of that discretion in response to the threats posed by Ambac's hazardous financial condition. No reasonable reading of Wisconsin law or the United States Constitution would bar this effective, long-deliberated regulatory plan to address the complex problems facing Ambac and the potentially dire effects of those problems on policyholders and the public.

A. Movants' Challenges Have Been Raised and Rejected Before, and Movants Offer No Persuasive Reason to Revisit Them.

Movants support their challenges with citation to a host of largely irrelevant (and sometimes seemingly random) cases ranging from *Marbury v. Madison* to an 1876 case involving oaths of office for railroad commissioners. (*See* KnowledgeWorks Br. at 18; ALL/Lloyds Br. at 20 (citing *Bohlman v. Green Bay & Minn. Ry. Co.*, 40 Wis. 157 (1876).) In doing so, most Movants all but ignore the substance of the one decision that squarely addresses virtually all of their challenges to the legality of the Segregated Account, whether based in statute, the Constitution, or common law—namely, this Court's rejection of those challenges in its May 27, 2010 Findings of Fact and Conclusions of Law. In that decision, this Court held:

- The formation of the Segregated Account, the allocation of less than 1,000 of Ambac's almost 15,000 policies thereto, and the commencement of this rehabilitation of the Segregated Account was a fair and reasonable response to Ambac's financial condition. It addresses the serious financial hazards the allocated policies presented to Ambac and all of its policyholders (including those allocated to the Segregated Account), maximizes claims-paying resources, and avoids the unpredictable and potentially substantial collateral damage to Ambac, its policyholders, and the public that would accompany a full rehabilitation of Ambac. (Findings ¶ 36.)

- *The Segregated Account was formed in compliance with Wisconsin law.* Wis. Stat. § 611.24(2). (Conclusions ¶ 2.)

- For the reasons stated in the Affidavit of Roger A. Peterson and in the above findings of fact, *OCI acted well within its discretion in approving the establishment of the Segregated Account.* (Conclusions ¶ 3.)

- The standards for novation, as recognized by the common law of contracts, are inapplicable to the allocation of certain policies to the Segregated Account, which was statutorily authorized under Wisconsin law. *The allocation of policies to the Segregated Account was proper and did not effect an improper novation of contract.* (Conclusions ¶ 4.)

- *The establishment of the Segregated Account was constitutional.* For the reasons stated in the Findings of Fact and OCI's opposition brief, the allocation of Movants' policies to the Segregated Account did not effectuate a taking of Movants' property. Movants also had no due process right to notice and a hearing prior to OCI's approval of the Segregated Account. (Conclusions ¶ 5.)

(Emphasis added.) Movants cite no new law, fact, or other legitimate ground for reconsidering this Court's conclusions. They merely repeat or repackage the same arguments that Wells Fargo and the RMBS Holders previously made to this Court.

In implicit recognition of this fact, Movants make a series of illogical assertions that effectively amount to a request that the Court adopt voluntary amnesia regarding the procedural history of this case. (*See* Deutsche Bank/U.S. Bank Br. at 14 (arguing that if the

Court were to "rely on, or even consider the RMBS/LVM Findings and Conclusions when deciding this motion, it would be denying the Trustees their day in court"); *see also* Depfa Br. at 9 n.4; KnowledgeWorks Br. at 26.) For several reasons, these arguments fail.[10]

First, Movants had notice and an opportunity to be heard at the May 25 hearing involving, among other issues, the RMBS Holders' statutory and constitutional challenges to the establishment of the Segregated Account. The RMBS Holders raised those issues in their motion briefing on April 30 (dkt. 51), the Court set a May 25 hearing date for that motion (dkt. 60), and numerous parties-in-interest appeared and were heard at that hearing—including Deutsche Bank and U.S. Bank. The United States Court of Appeals for the Seventh Circuit recently discussed the responsibilities owed by third parties like the Movants in such situations:

> Once the judge not only flags an issue as important but also sets a schedule for its resolution, the time has come to intervene. People potentially affected by the decision can't sit on the sidelines, as if intervention were a petition for rehearing. If they receive notice that the court will hold a hearing to address a particular question, they must participate rather than wait and see what the court does.

United States v. Blagojevich, --- F.3d ---, 2010 WL 2778838 (7th Cir. July 12, 2010).

Though formal intervention was unwarranted in this non-adversarial regulatory proceeding, nothing prevented Movants from advancing their arguments on these issues when they were first presented to the Court. Rather than taking a position on the legal validity of the Segregated Account when the issue was argued in May, however, Movants elected to remain silent.[11] Several Movants entered formal appearances at the May 25 hearing, but opted to "take

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[10] One Movant, BNY, acknowledges the Court's prior decision, notes that the decision is on appeal, and reserves BNY's rights pending the outcome of the appeal. (BNY Br. at 9.) Therefore, this section of the brief does not apply to BNY.

[11] All of the Movants were served with formal written notice of these proceedings and were instructed to monitor the court-approved public Web site, ambacpolicyholders.com, if they
continued …

no position at this time regarding the creation or composition of the Segregated Account." (Dkt. 94, 97.) Though apparently secretly harboring the same objections to the Segregated Account that the RMBS parties then before the Court made, Movants did not speak up regarding any of these challenges until June 22—the last day for filing objections *to the injunction* issued by the Court.[12]

Moreover, Movants also failed to express their views or file anything regarding the merits of the arguments by Wells Fargo and the LVM Bondholders at the July 9 hearing in this matter, even though that hearing also had been on the Court's calendar for months. (Dkt. 27.) They instead filed last-minute "emergency" motions to postpone the hearing, which the Court properly denied: "After hearing argument, the Court determined that the emergency movants had sufficient time to file timely motions with the Court which would have provided all counsel an opportunity to review and respond to them." (July 16 Order at 4.) For the same reason, Movants cannot offer any excuse for "sitting on the sidelines" rather than actively expressing their views and participating once Wells Fargo flagged the fundamental, threshold issue of the validity of the Segregated Account in early April.

Second, it would be both unfair and absurd for the Court to "forget" or revisit its prior rulings every time a new party-in-interest sees fit to challenge the legality of the Segregated Account, as Movants suggest. (*See, e.g.*, KnowledgeWorks Br. at 26 n.7.) Any party who

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wished to track the court proceedings. (Dkt. 3, 10, 30, 145-47.) Thus, none of the Movants can claim that they were not on notice about the earlier hearings.

[12] As noted above, generalized challenges to the establishment and formation of the Segregated Account are distinct from challenges to the injunction issued *after* the establishment of the Segregated Account and *after* the commencement of its rehabilitation. Movants cannot rely on the existence of a deadline for challenging the Injunction Order as a reasonable excuse for holding their tongues for almost three months after receiving notice of the establishment of the Segregated Account, and more than two months after the Court set the hearing for the first motion challenging the legality of the Segregated Account.

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wished to challenge the Segregated Account could stay silent, wait for the Court to accept or reject challenges by other parties, and then either enjoy the benefits if the Court ruled in favor of the earlier movants or bring their own challenges if the earlier movants lost. Movants fail to explain how fostering an unending series of challenges regarding the same acts and issues, with the Court unable to "even consider" prior rulings when deciding them, is consistent with the practical, "very flexible" and "essentially informal" nature of rehabilitation proceedings. Wis. Stat. Ann. § 645.32 cmt.

Third, and perhaps most importantly, Movants offer no reason why their present arguments are materially different from, or more meritorious than, the arguments the Court previously rejected. In most cases, they are identical. The Rehabilitator has set forth the relevant facts in the Verified Petition and affidavits on file, and Movants offer no new evidence in response and no reason to doubt the accuracy of the Rehabilitator. Indeed, they never state what could or would be gained by discovery or an evidentiary hearing, other than more legal formalities and delay.[13]

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[13] Movants contend that the Court cannot find facts without an evidentiary hearing, citing *Wis. Auto Title Loans v. Jones*, 2006 WI 53, ¶ 40, 290 Wis. 2d 514, 714 N.W.2d 155, a case involving a question of procedural unconscionability, and *In re Termination Rights of Jayton S.*, 2001 WI 110, 246 Wis. 2d 1, 629 N.W.2d 768, a case involving the termination of parental rights. (Deutsche Bank/U.S. Bank Br. at 14-15.) Neither case stands for the unorthodox proposition that an evidentiary hearing must accompany every motion raising factual issues, or that affidavits are insufficient to support factual findings. In *Jones*, the court held that "an evidentiary hearing is not required so long as the record contains facts of record and reasonable inferences therefrom sufficient to support a circuit court's findings of fact," which were lacking in that case because there was "no affidavit evidence" *or* an evidentiary hearing. *Jones*, 2006 WI 53, ¶¶ 39, 41. *Jayton S.* was a case governed by the Wisconsin Children's Code, a statutory chapter with a number of specialized procedural protections to meet the "heightened legal safeguards" necessary to protect against erroneous deprivations of parental rights. *Jayton S.*, 2001 WI 110, ¶¶ 21-22. Neither case offers a factual or legal parallel to this rehabilitation proceeding where the Rehabilitator has put forth numerous affidavits and other supporting evidence to support the exercise of his discretion.

In sum, there is no reason for the Court to ignore its prior decisions on the validity of the Segregated Account. The Court can and should reject Movants' challenges to the Segregated Account by reaffirming and adopting the reasoning of its May 27, 2010 Findings of Fact and Conclusions of Law and its July 16, 2010 Order denying the motions of Wells Fargo and the LVM Bondholders.

B. Movants' Challenges to the Segregated Account Fail on Their Merits.

Even if the Court were to pretend that it had not already ruled on these issues of law, as Movants urge, the outcome should remain the same. While Movants' briefs are littered with assumptions and assertions of what they believe the law *should* be, they largely ignore what the black letter of the law actually says: OCI is authorized to approve optional segregated accounts for "any part" of an insurer's business, Wis. Stat. § 611.24(2); OCI is given the discretion to commence rehabilitation proceedings for a segregated account, Wis. Stat. §§ 611.24(3)(e), 645.31 to 645.35; and neither federal nor state law otherwise prohibits OCI's discretionary exercise of that authority here.

i. The Segregated Account was Validly Established Under Wis. Stat. § 611.24.

Movants raise a host of challenges about the formation of the Segregated Account under Wisconsin law, but none of them overcome the plain legislative delegation of authority to OCI regarding approvals of segregated accounts:

> Optional segregated accounts. With the approval of the commissioner, a corporation may establish a segregated account for any part of its business. *The commissioner shall approve unless he or she finds that it would be contrary to the law or the interests of any class of insureds.*

Wis. Stat. § 611.24(2) (emphasis added). For the reasons described below, OCI acted well within its discretion in approving the establishment of the Segregated Account for the allocated

part of Ambac's business, and in concluding that it was not contrary to the law or the interests of any class of insureds.

(1) The Segregated Account Has Access to Adequate Capital.

First, Movants persist in the disingenuous argument that OCI abused its discretion in approving the Segregated Account because it is inadequately capitalized. *See* Wis. Stat. § 611.24(3)(a). They relatedly fault OCI for commencing the rehabilitation immediately after the Segregated Account was formed.

Movants' arguments betray a fundamental (and, at this point, presumably willfully disingenuous) misunderstanding of the Secured Note and Reinsurance Agreement on file with this Court since this proceeding was commenced. The following are samples of some of Movants' false assertions:

- "The Segregated Account, however, is capitalized only with a non-marketable $2 billion dollar note with questionable value issued by Ambac and non-marketable interests in certain affiliated limited liability companies." (ALL/Lloyds Br. at 10.)
- "[Ambac] has purported to divide its assets and to subordinate the rights of one group of claimants to the rights of the remainder of its claimants." (Deutsche Bank/U.S. Bank Br. at 5.)
- "The Segregated Account is drastically underfunded and, as was its purpose, is filled with numerous liabilities that are likely to consume the limited available resources assigned to the Segregated Account." (Depfa Br. at 21 n.10.)

As is clear from the face of the Plan of Operation and Secured Note and Reinsurance Agreement, and as has been repeated by the Rehabilitator in multiple briefs and hearings in this matter, *the Segregated Account has access to all of the assets of Ambac,* in pari passu *with General Account policyholders, unless the payment of claims would cause Ambac's assets to fall below $100 million*—a number that constitutes less than two percent of Ambac's

claims paying assets.[14] In other words, the Segregated Account was capitalized with more than 98 percent of Ambac's current assets, despite being allocated the liabilities of less than 1,000 of Ambac's 15,000 insurance policies. (Findings ¶¶ 26-27, 31; First Peterson Aff. ¶ 10.)

Further, Movants' stated fear that Ambac's assets will diminish to the $100 million threshold someday, prior to drastic changes to the scope of this proceeding, is posturing. In carrying out its statutory duties, OCI would be required to take further regulatory action as to the Ambac accounts long before Ambac deteriorated anywhere close to the unfortunate point where less than two percent of its current assets remain to pay Segregated Account and General Account liabilities. Given that Movants' extreme hypothetical will never become reality, Movants should not be heard to claim now that they are receiving subordinated treatment based on their speculative assumptions that (1) one day Ambac's assets might be less than two percent of their current level, and (2) OCI will neglect its statutory duties by failing to take corrective action long before that point to assure that the remaining assets are fairly distributed.

The $100 million floor currently in place merely ensures that OCI will have the opportunity to take such appropriate corrective action without the complication of parallel delinquency proceedings or license forfeiture in other states. So long as Ambac maintains that $100 million cushion, it will not fall below the legally required minimum surplus in any state in which it does insurance business. Falling below such minimums could trigger delinquency proceedings in those states, with the potential to cause additional avoidable losses for policyholders.

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[14] As explained later in this brief, the $100 million limitation exists to ensure that Ambac satisfies statutory capital requirements in all jurisdictions where it is licensed.

Movants' mischaracterization of the funding for the Segregated Account is understandable. Without it, their capitalization arguments are facially frivolous for the reasons described below.

Wisconsin law places the determination of minimum capitalization requirements squarely within the discretion of OCI. For segregated accounts, "*[t]he commissioner* shall specify . . . the minimum capital or the minimum permanent surplus and the initial expendable surplus to be provided for each segregated account" and "*the commissioner* shall require the corporation to have and maintain an adequate amount of capital and surplus in the segregated account." Wis. Stat. § 611.24(3)(a) (emphasis added). Determining the level of capital and surplus required is an "exercise of discretion" by the Commissioner, and "much discretion should be left to the commissioner to set minimum capital and surplus requirements for an individual corporation based on its own plans." Wis. Stat. Ann. § 611.19 cmt. The law does not curb OCI's discretion in a manner that would render capitalization requirements arbitrarily high; "[o]n the contrary, the clear and unmistakable purpose of this section is to encourage the commissioner to demand only so much as is needed, and no more." *Id.*

Here, OCI demanded that the Segregated Account be capitalized with all claims paying assets available to Ambac, except for $100 million to ensure compliance with licensing requirements. OCI has exercised its discretion in a reasonable manner by requiring that Segregated Account policyholders have access to virtually all the resources available to pay their claims prior to the allocation of their policies to the Segregated Account. Because the Segregated Account restructuring lessens the overall claims exposure of all policyholders by avoiding the collateral damages described in this Court's prior findings (at ¶¶ 21-24), it <u>increases</u>

the relative value of the capital which will be available under the rehabilitation plan to pay Segregated Account claims.

Under such circumstances, there is no legal basis on which to require additional capitalization for the Segregated Account.[15] "Sub. (3)(a) [of the segregated account statute] requires that a segregated account be equipped with an adequate *share* of the corporation's capital and surplus." Wis. Stat. Ann. § 611.24 cmt. (emphasis added). Separate capitalization may be necessary "*if* the account is to be expected to function and survive like a separate corporation." *Id.* (emphasis added). But "[i]f it carries no risks not assumed by the corporation's general account"—as is the case here—"the commissioner may set the required figure at zero under § 611.19(1)." *Id.*

(2) Wisconsin Insurance Law Does Not Mandate Allocation of Policies by the Type of Risk Which is Insured.

Movants echo the recently rejected arguments of the LVM bondholders in contending that Wis. Stat. § 611.24 required Ambac to allocate policies according to "certain *classes, types* or *lines* of insurance in certain situations . . . but not based on the relative strengths of individual policies within a type." (KnowledgeWorks Br. at 12, 16.) Movants do not supply a legal definition for what they think would constitute a "class, type, or line" of insurance. Financial guaranty insurance is a specific "class of insurance business." Wis. Stat. § 611.24(1)(a)(am). Because <u>all</u> of Ambac's insurance policies are financial guaranty policies,

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[15] Moreover, as a practical matter, there is no untapped source from which to miraculously fund greater capital support.

acceptance of Movants' "class" argument would lead to the unreasonable result that monoline insurers like Ambac cannot establish segregated accounts.[16]

Movants' argument ignores the law. Section 611.24(2), the relevant statutory provision for the establishment of the Segregated Account, makes clear that "[w]ith the approval of the commissioner, a corporation may establish a segregated account *for any part of its business*." Wis. Stat. § 611.24(2) (emphasis added). There are no artificial restrictions based on classes, lines, types, or other artificial tests for classifying insurance policies or what parts of the insurer may be allocated.[17] The legislature could easily have included such restrictions in the optional segregated account provision, as it did in mandating segregated accounts for certain "classes of insurance business" in a separate provision of the segregated account statute. *See* Wis. Stat. § 611.24(1). It did not, however, so Movants' implicit request to amend Section 611.24(2) to include a similar restriction is addressed to the wrong branch of state government.

(3) OCI Did Not Abuse Its Discretion in Finding That the Establishment of the Segregated Account was Not Prejudicial to Any "Class" of Policyholders.

Movants also argue that OCI should have found that the establishment of the Segregated Account was "contrary to . . . the interests of [a] class of insureds," Wis. Stat.

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[16] Although it is difficult to follow the arguments by KnowledgeWorks and ALL on this issue, they appear to be contending that financial guaranty policies that insure student loans should be treated as a separate "class" of insurance. This is a variant on the contention by the LVM bondholders that financial guaranty policies that insure public-finance or public transportation risks like the Monorail are separate "classes" of insurance. (Dkt. 167.) That logic fails for the reasons the Rehabilitator previously argued (*see* dkt. 266), and this Court echoed, in denying the various motions regarding the allocation of the LVM policy.

[17] This is consistent with comments to related statutes amended at the same time as Section 611.24. *See* Wis. Stat. Ann. § 611.19 cmt. (1971) ("The old classifications of insurance by kinds or lines are less significant under the proposed revision [to the capital and surplus requirements]. . . . The section avoids the necessity of using the technical terms 'kinds' or 'lines' by letting the corporation classify its own business . . . subject to the commissioner's approval.").

§ 611.24(2), and therefore disapproved it. In making this argument, Movants now claim that the relevant "class of insureds" consists of those policyholders whose policies were allocated to the Segregated Account (*see* Deutsche Bank/U.S. Bank Br. at 20-21), directly contradicting their argument (dealt with in the prior subsection of this brief) that the Segregated Account is invalid because it divided policies within the same "class" of insurance. Essentially, Movants claim that because the establishment of the Segregated Account "works to the detriment of certain classes of policyholders"—*i.e.*, them—the Commissioner "could not possibly have concluded that the establishment of the Segregated Account was in [their] best interests . . . because all claims payments are currently suspended" and they lost the "unrestricted right to payment on their policies from all assets owned and controlled by Ambac." (Depfa Br. at 19; Deutsche Bank/U.S. Bank Br. at 20-21).

Movants' argument conflates the consequences of rehabilitation, which was inevitable for the policies allocated to the Segregated Account, with the consequences of establishing the Segregated Account. Prior to the approval of the Segregated Account, the Commissioner had "two realistic regulatory choices" for Ambac, and both entailed the commencement of rehabilitation proceedings. (Findings ¶ 20.) The Commissioner opted for the more surgical, targeted approach of those two options, which involved the allocation of certain policies with impairments and/or triggers to the Segregated Account and rehabilitating only the Segregated Account. (Findings ¶¶ 20, 25-26.) Either way, however, the policies that were allocated to the Segregated Account were going to be subject to a rehabilitation proceeding, which would have included a suspension of claims payments and other injunctive relief for the same reasons expressed in the Rehabilitator's first-day filings in this proceeding. Ambac's hazardous financial condition and the specific circumstances of the allocated policies had already

assured that these policies would be in essentially the same situation they are now. Therefore, Movants' nostalgic desire to return to the days "[b]efore March 24, 2010," when "all policyholders shared an unrestricted right to payment on their policies from all assets owned and controlled by Ambac," is unrealistic. (Depfa Br. at 19.)

The relevant question now is whether it was prejudicial to the interests of Segregated Account policyholders to leave Ambac's other policies in the General Account. OCI's advisors reasonably determined that the policies remaining in the General Account presented little risk to the claims paying resources of Ambac if left outside rehabilitation, whereas they could cause catastrophic collateral damage and additional drains on those resources if subjected to rehabilitation. (Findings ¶¶ 21-23, 31.) OCI therefore determined that "the creation of the Segregated Account and the Allocation create a fair and appropriate balance between (i) those assets and liabilities allocated to the Segregated Account and (ii) those assets and liabilities remaining within [Ambac's] general account, both at present and according to future projections" and "that the creation of the Segregated Account and the Allocation serve the interests of the public and policyholders." (Findings ¶ 26.)

Subsequent events have confirmed OCI's conclusions. From March 24, 2010 (the date the Verified Petition was filed) through the end of July 2010, Ambac paid less than $13 million with respect to claims presented in the ordinary course as to policies in the General Account. (Fourth Peterson Aff. ¶ 16.) By contrast, during the same time period, more than $784 million in claims were presented with respect to policies allocated to the Segregated Account.[18] (*Id.*)

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[18] This figure does not taken into account the approximately $44 million in recoveries on those policies, which include reimbursements and other payments obtained through
continued …

(4) OCI Did Not Exceed Its Authority in Approving the Segregated Account and Petitioning for Its Rehabilitation.

Movants also argue that, even if OCI did not violate Wisconsin statutory law, it nevertheless "act[ed] without legal authority" by approving the Segregated Account and commencing its rehabilitation. (ALL/Lloyds Br. at 12-13; Depfa Br. at 9.) Movants claim that OCI's actions were not authorized by statute and therefore were *ultra vires* and invalid. Movants fail to explain *how* OCI acted without legal authority, however, for good reason: all of the challenged actions of the Commissioner are expressly authorized or required by the Wisconsin Statutes.

An insurer may establish a segregated account for "*any* part of its business" and "under *any* circumstances the corporation wishes." Wis. Stat. § 611.24(2) & cmt. (emphasis added). Wisconsin law *requires* the Commissioner to approve the establishment of such segregated accounts, so long as the Commissioner finds that their establishment would not be contrary to the law or the interests of any class of policyholders. *Id.* Wisconsin law authorizes the Commissioner to petition for the rehabilitation of a segregated account, Wis. Stat. § 611.24(3)(e), on the same grounds as he is authorized to petition for the rehabilitation of any other "insurer" under Wisconsin law, Wis. Stat. §§ 645.03(1)(f), 645.31. In sum, the legislature expressly gave OCI the authority to take every action Movants challenge.

Even if Movants had identified some ambiguity regarding OCI's authority to take the actions at issue—and they have not—OCI is entitled to have such ambiguities resolved in its favor. As the Court of Appeals has noted, "OCI is charged by statute with administering and enforcing Wis. Stat. chs. 600 to 655[,]" and Wisconsin courts "may give varying degrees of

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securitization trusts. (*Id.*) The Injunction Order preserves the right to continue receiving payments included in the approximately $44 million in recoveries on these policies. (*Id.*)

deference to an agency's interpretation of a statute that it is charged with administering." *Nat'l Motorists Ass'n v. Office of the Comm'r of Ins.*, 259 Wis. 2d 240, 251, 655 N.W.2d 179 (2002). Of those degrees of deference, "great weight deference" is appropriate where, as here, "an agency's interpretation and application of a statute are intertwined with value and policy determinations inherent in the agency's statutory decision-making function." *Id. See also* Wis. Stat. § 611.24(2) (charging the Commissioner with determining whether a segregated account would be contrary to law or the interests of any class of insureds); Wis. Stat. § 645.01(4) (charging the Commissioner with applying the rehabilitation statutes for the "protection of insureds, creditors, and the public generally"). "Great weight deference" requires the court to "affirm OCI's construction and application of the statutes if they are reasonable—even if an alternative reading of the statutes is more reasonable," and places the burden of proving unreasonableness on the party seeking to overturn agency action. *Nat'l Motorists Ass'n*, 259 Wis. 2d at 252.[19]

Movants ignore this heavy burden. Rather than arguing that OCI's straightforward reading of Chapters 611 and 645 is somehow unreasonable and therefore unworthy of deference, Movants ask the Court to graft upon the Wisconsin insurance statutes additional restrictions and requirements that the legislature did not see fit to include, such as:

- a new rule that the Commissioner cannot approve the establishment of a segregated account unless the insurer is financially sound (Deutsche Bank/U.S. Bank Br. at 21-22);
- a new rule that the Commissioner cannot rehabilitate a segregated account without also rehabilitating the insurer that forms it (Depfa Br. at 3); and

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[19] Depfa refers to Wis. Stat. § 227.57(8) (Depfa Br. at 8), but slyly omits the most relevant clause of Wis. Stat. § 227.57(8) in this case: ". . . *but the court shall not substitute its judgment for that of the agency on a matter of discretion.*" *Id.* (emphasis added).

- a new rule requiring the Commissioner to "specifically explain" why each policy is included or excluded from a segregated account (ALL/Lloyds Br. at 13; KnowledgeWorks Br. at 20-21).

Given that these new legislative proposals suggested by Movants are absent from Section 611.24 and Chapter 645, Movants should not be heard to fault OCI for not following them.

(5) OCI Exercised Its Authority Reasonably.

Movants also argue that, even if Section 611.24 grants OCI the authority to take the actions at issue, it exercised that authority unreasonably given the circumstances here. (Depfa Br. at 8-16; ALL/Lloyds Br. at 12-13; KnowledgeWorks Br. at 15.) To the contrary, in light of Ambac's hazardous, rapidly deteriorating condition and the rows of financial dominoes ready to tumble upon any regulatory misstep, OCI navigated those hazards and exercised its authority in a manner that protected the interests of all policyholders and the public far better than the alternatives. (Findings ¶¶ 21-26, 36.) The hazards confronting Ambac, and the rationale for OCI's decisions, have been described at length in prior affidavits and numerous filings and will not be repeated here. Those materials amply justify OCI's discretionary decision to exercise its authority to approve and rehabilitate the Segregated Account, and Movants cannot *plausibly* argue that doing so was unreasonable.

Unable to argue the issue based on the facts and relevant law, several Movants ignore the actual grounds for OCI's actions and instead attack imaginary scenarios in which they claim OCI allegedly acted in accordance with some secret insidious intent to harm them. (*See, e.g.,* Deutsche Bank/U.S. Bank Br. at 20-21; ALL/Lloyds Br. at 12-13, 16.) Depfa's brief offers the most extreme example of this tactic, brimming with offensively accusatory rhetoric devoid of factual or legal support. Without a scintilla of supporting evidence, Depfa alleges that: acting

"in concert,"[20] the Rehabilitator and Ambac "contrived"[21] "a scheme"[22] for the "furtive establishment of the Segregated Account,"[23] an "artifice"[24] over which the Rehabilitator would "supposedly assume[] control,"[25] but would in fact allow for a "'shadow rehabilitation"[26]—an "illusory rehabilitation"[27] that is really "a liquidation proceeding artificially created to wash out disfavored assets and policyholders"[28] at the same time "favored assets"[29] "are quickly flying out of Ambac and into the hands of the various settling parties"[30] or used to "unjustly enhance claims paying resources for . . . favored policies" in the General Account.[31] Depfa further alleges that this "scheme"[32] gives Ambac "extraordinary and coercive leverage"[33] "to extort payment,"[34] to hold policyholders "hostage,"[35] and to "force insureds to accept nominal settlements,"[36] with the Rehabilitator standing by to allocate their policies into the Segregated Account if such a "low-

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[20] Depfa Br. at 13.

[21] *Id.* at 10.

[22] *Id.*

[23] *Id.* at 14.

[24] *Id.* at 9.

[25] *Id.* at 14.

[26] *Id.* at 16.

[27] *Id.* at 21.

[28] *Id.* at 19.

[29] *Id.* at 2.

[30] *Id.* at 18.

[31] *Id.* at 2.

[32] *Id.* at 15.

[33] *Id.* at 2.

[34] *Id.* at 15.

[35] *Id.*

[36] *Id.* at 3.

ball settlement offer is rejected."[37] According to Depfa, the rehabilitation being supervised by this Court is nothing more than a grand conspiracy to "impale policyholders like Depfa with a 'Morton's Fork.'"[38]

Frankly, the Rehabilitator is unsure where to begin in responding to Depfa's conspiracy theory, a disjointed tale with no factual support in which everyone involved is allegedly being treated unfairly except Ambac—the one entity that is guaranteed to lose everything if the claims being paid under the rehabilitation plan ultimately exceed its resources. With regard to the Segregated Account, policies are not being "washed out"; this proceeding was commenced to protect claims-paying resources so policies can be honored to the fullest extent possible. (Verified Pet. ¶ 8(c).)

With regard to settlements, Depfa's characterization of OCI and the Commissioner as Ambac's stooges is both offensive and baseless. Given that the settlements reached to date have been brought before the Court for review and approval, Depfa evidently is implicating the Court in its conspiracy accusations.

The Rehabilitator has the responsibility to protect policyholders "to the fullest possible extent," *Minor*, 898 S.W.2d at 78, and Depfa identifies no facts suggesting that he has neglected that responsibility in settlement discussions. Both practically and legally, the Rehabilitator has no ability to compel any policyholder—much less a major financial institution like Depfa, represented by a national law firm—to reach an agreement it does not want to reach. If policyholders like Depfa wish to commute their policies, they are free to initiate such discussions. If they wish to keep their policies in force and make claims under a rehabilitation

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[37] *Id.* at 14.

[38] *Id.* at 2.

plan once it is approved, they are equally free to do so. Depfa offers no evidence that these choices involve coercion, extortion, or impalement.

Depfa's principal objection appears to be that it has not received a settlement offer it deems satisfactory.[39] This self-centered complaint is not a ground for challenging any legal proceeding, much less an insurance rehabilitation involving the interests of thousands of other parties-in-interest. To be clear, the Rehabilitator has not approved settlements that give a settling policyholder treatment more favorable than it would likely receive under the rehabilitation plan, for the obvious reason that such settlements would be inequitable to policyholders as a whole. (Fourth Peterson Aff. ¶ 15.) Depfa cannot complain that the Rehabilitator is abusing his discretion by declining to give it special treatment at the expense of others.

(6) The Commissioner Met All Procedural Requirements for Approving the Segregated Account.

One Movant (KnowledgeWorks) makes the confusing assertion that, because the Segregated Account was established under Section 611.24, this Chapter 645 rehabilitation proceeding "cannot go forth until the Commissioner's approval of the Segregated Account has been legally made and issued, and substantially affected persons are given the opportunity to challenge such action." (KnowledgeWorks Br. at 10.) KnowledgeWorks's contention has no basis in fact or law.

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[39] Depfa suggests in its brief (at page 7) that it might file evidence—possibly under seal—to support its conspiracy theory, but it did not do so before the August 17 deadline for the Rehabilitator and Ambac to file their responsive briefs. To avoid being unfairly surprised by some later untimely filing by Depfa, the undersigned called and directly asked Depfa's California-based counsel about it on Friday, August 13, 2010, and was told that Depfa would make no such surprise evidentiary submission before the hearing; it would merely file a reply brief.

First, the Segregated Account *was* legally established in accordance with Section 611.24(2). That statute's requirements are straightforward: "the commissioner shall approve [an insurer's establishment of a segregated account] unless he or she finds that the segregated account would be contrary to the law or to the interests of any class of insureds." Wis. Stat. § 611.24(2). No waiting periods, special administrative proceedings, or magic words are necessary.

KnowledgeWorks nevertheless urges the Court to write such formalities into the law by arguing that certain regulatory requirements in two unrelated statutes—Sections 617.21 and 227.47—should be made to bear on the legal effect of the Commissioner's decision to approve the Segregated Account. Neither statute applies here. Section 617.21 and Section 40.04 of the Wisconsin Administrative Code for Insurance require certain paperwork and approvals from OCI to protect "against *inter*corporate transactions" between an insurer and its affiliates. Wis. Stat. § 617.01(2) (emphasis added). The creation of a segregated account appears in a different statutory chapter and is, by definition, an *intra*-corporate matter involving only the insurer. *See* Wis. Stat. § 611.24(2) ("[A] corporation may establish a segregated account for any part of *its* business.") (emphasis added).

Section 227.47, meanwhile, demands written decisions by an agency or hearing examiner in *contested administrative cases*. It does not require such formal justification for agency action or inaction before it becomes contested, nor should it. It would be absurd to require the Department of Natural Resources, for example, to issue "findings of fact and conclusions of law" before handing out a hunting or fishing license, Wis. Stat. § 29.024, or the Department of Regulation and Licensing to make findings as to whether an applicant has met the requirements to perform acupuncture, Wis. Stat. ch. 451.

To the extent KnowledgeWorks is actually seeking to lift the injunction to allow them to contest the establishment of the Segregated Account in regulatory proceedings through Chapter 227, and thus obtain a written decision from OCI pursuant to Wis. Stat. § 227.47, that relief would be both futile and unnecessary. First, the Rehabilitator's letter approving the Segregated Account sets forth his position regarding its establishment, on grounds that are relevant to the standards of Section 611.24 (including the interests of insureds and capitalization) (*See* Findings ¶ 26). There is no reason to issue essentially the same findings and conclusions again. Second, though it is not governed by the procedures set forth in Chapter 227, this Chapter 645 action *is* a regulatory proceeding, *see* Wis. Stat. Ann. § 645.01 cmt., and parties-in-interest are taking full advantage of the opportunity to "ask the Commissioner, a public servant, to justify his actions" (KnowledgeWorks Br. at 19) in the same forum (the Dane County Circuit Court) where their challenges would ultimately be decided following administrative review, Wis. Stat. §§ 227.52 to 227.59. It is difficult to understand what KnowledgeWorks would gain by obtaining leave to commence parallel regulatory proceedings at the agency level, other than to delay the resolution of its own challenges.

ii. Section 611.24 is Not Unconstitutional.

After attacking the Rehabilitator's purported failure to comply with Section 611.24 of the Wisconsin Statutes, Movants turn their attention to attacking the statutes themselves. Adopting or borrowing heavily from the unsuccessful arguments Wells Fargo and the RMBS Holders raised in April, Movants attack Section 611.24 and/or Chapter 645 as unconstitutional and in derogation of the common law. Movants' arguments are no less infirm now than when the Court rejected them in May and July. Due to that fact, the Rehabilitator incorporates his prior responses to these arguments, as presented in prior briefing (dkt. 84, at 26-33) and the First Peterson Affidavit, and will not repeat them here.

There is only one somewhat new constitutional challenge. Movant KnowledgeWorks identifies (but does not develop) an argument that this proceeding violates the Contract Clauses of the federal and state constitutions, which are substantially identical.[40] (KnowledgeWorks Br. at 12-13.) Because the Contract Clause applies only to legislative action, *Barrows v. Jackson*, 346 U.S. 249, 260 (1953), the Rehabilitator assumes that KnowledgeWorks is challenging the constitutionality of either the rehabilitation provisions of Chapter 645 or the segregated account statute, Wis. Stat. § 611.24.[41] Either way, KnowledgeWorks' half-developed challenge fails.

First, a state cannot pass a law "impairing the obligation of contracts" that are not yet in existence. Therefore, it is "settled doctrine . . . that the contract clause applies only to legislation subsequent in time to the contract alleged to have been impaired." *Munday v. Wisconsin Trust Co.*, 252 U.S. 499, 503 (1920). The rehabilitation statutes were enacted in 1967, and the optional segregated account provision was enacted in its current form in 1971, Wis. Stat. Ann. §§ 611.24, 645.31 through 645.35, long before the issuance of the KnowledgeWorks policies in 2005 and 2006 (KnowledgeWorks Br. at 5.) Therefore, rather than impairing those policies, it is presumed that those statutes were incorporated into the policy terms. *Abilene Nat. Bank v. Dolley*, 228 U.S. 1, 5 (1913); *Dairyland Greyhound Park*, 2006 WI 107, ¶ 60.

Second, KnowledgeWorks' Contract Clause challenge would fail even if the statutes at issue were brand new. Rehabilitation courts have uniformly rejected arguments based

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[40] Wisconsin courts rely upon the decisions of the United States Supreme Court in interpreting Wisconsin's analogous Contract Clause provision. *See Dairyland*, 2006 WI 107, ¶ 51.

[41] As previously noted by this Court (July 16 Order at 6), Movants are required to serve notice on the Attorney General "in all cases involving constitutional challenges" to a Wisconsin statute. *Kurtz v. City of Waukesha*, 91 Wis. 2d 103, 116-17, 280 N.W.2d 757 (1979). There is nothing in the record to suggest that Movants have met this threshold requirement.

on the Contract Clause, holding that the substantial public interest in the regulation of insurance is sufficient to trump individual policyholders' private contractual interests. *See, e.g., Foster v. Mut. Fire, Marine & Inland Ins. Co.*, 614 A.2d 1086, 1095 & n.4 (Pa. 1992) (rejecting a Contract Clause challenge and confirming a plan that altered contractual rights because it "foster[ed] the legitimate public purpose of safeguarding the public interest from the potentially innumerable consequences of [the insurer's] insolvency"); *Carpenter v. Pac. Mut. Life Ins. Co.*, 74 P.2d 761, 774-75 (Cal. 1937) (rejecting contract clause challenge because "[t]he contract of the policyholder is subject to the reasonable exercise of the state's police power. The only restriction on the exercise of this power is that the state's action shall be reasonably related to the public interest and shall not be arbitrary or improperly discriminatory."), *aff'd*, *Neblett v. Carpenter*, 305 U.S. 297 (1938).

Perhaps acknowledging this precedent, KnowledgeWorks focuses its Contract Clause argument on the establishment of the Segregated Account, rather than the rehabilitation or injunction that immediately followed. The establishment of the Segregated Account, however, is even less assailable on Contract Clause grounds. Like the rehabilitation statutes, the segregated account statute concerns the business of insurance, a field where the exercise of state police power is "peculiarly apt." *Cal State Auto. Ass'n Inter-Ins. Bureau v. Maloney*, 341 U.S. 105, 109 (1951). Unlike the rehabilitation and its accompanying Injunction Order, however, the establishment of the Segregated Account alone did not impose a "substantial impairment" on the rights of KnowledgeWorks, a threshold requirement for raising a Contract Clause challenge. *Energy Reserves Group, Inc. v. Kan. Power & Light Co.*, 459 U.S. 400, 411 (1983). The allocation of certain policies to the Segregated Account in and of itself had no direct impact on those policies; claims payments will be processed through the Segregated Account rather than

Ambac, but they will be paid from the same claims-paying assets as before. Such circumstances cannot constitute "substantial impairment." *See El Paso v. Simmons*, 379 U.S. 497, 515 (1965) ("Laws which restrict a party to those gains reasonably to be expected from the contract are not subject to attack under the Contract Clause, notwithstanding that they technically alter an obligation of a contract.")

III. THE COURT SHOULD AFFIRM THE INJUNCTION ORDER WITHOUT MODIFICATION.

Movants challenge relatively few specific provisions of the Injunction Order, but the fundamental flaw in even those limited objections is the same flaw that pervades their laundry list of complaints regarding the Segregated Account: they ignore clear statutes and precedent establishing the propriety of the injunctive relief in place. Wisconsin law authorizes OCI to seek, and this Court to impose, injunctive relief against *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." Wis. Stat. § 645.05(1)(k) (emphasis added). The injunctive provisions Movants challenge protect against just such a threat.

The challenges fall into four categories: (1) challenges to provisions of paragraphs 6 and 9, which enjoin parties from exercising certain *ipso facto*-type contractual clauses relating to control rights;[42] (2) challenges to paragraph 9's provisions establishing that trustees will be indemnified for certain actions through an administrative claim against the Segregated Account;[43] (3) challenges to paragraph 7, which enjoins policyholders from

[42] Wells Fargo Br. at 6-8; Bank of America Br. at 6-8; Deutsche Bank/U.S. Bank Br. at 27; BNY Br. at 6-8.

[43] Wells Fargo Br. at 8-10; Bank of America Br. at 8-10; BNY Br. at 8.

withholding or setting off premiums or other payments;[44] and (4) general challenges that the injunction (and the proceeding as a whole) grants too much authority to the Rehabilitator.[45] This brief addresses each in turn, but not before noting the liberal standards governing injunctive relief in insurance delinquency proceedings—standards that the Movants conveniently ignore.

A. Standards for Injunctive Relief

Chapter 645 authorizes a wide spectrum of injunctive relief in rehabilitation actions. *See generally* Wis. Stat. § 645.05 (specifically authorizing injunctive relief to prevent the institution or further prosecution of any actions or proceedings against the insurer, "interference with the receiver or the proceedings," waste of the insurer's assets or dissipation of bank accounts, obtaining preferences, and levying of execution, among others). Most broadly, however, Chapter 645 expressly allows the Commissioner to seek injunctions against

> any other 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(k).

Because the Commissioner is required to act within the public interest, Wis. Stat. § 601.15,[46] his conclusion that certain injunctive relief is "necessary and proper" to prevent

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[44] Deutsche Bank/U.S. Bank Br. at 26-27; BNY Br. at 8-9; KnowledgeWorks Br. at 18.

[45] KnowledgeWorks Br. at 16-22.

[46] *See also In the Matter of the Liquidation of Integrity Ins. Co.*, 754 A.2d 1177, 1186 (N.J. 2000) (insurance receiver had a "hybrid role," with fiduciary responsibility to the creditors of the insolvent insurer as opposed to the public at large, but at the same time acting in a public role); *PrimeHealth Corp. v. Ins. Comm'r*, 758 A.2d 539, 546 (Md. Ct. Spec. App. 2000) (as a public official, even when acting as a receiver, the Commissioner "is charged with a duty to act with a broad view toward minimizing financial harm to all policyholders, creditors, and the general public"); *El Paso Elec. Co. v. Tex. Dept. of Ins.*, 937 S.W.2d 432, 436 (Tex. 1996) (receiver for insolvent insurer performs a public, regulatory function and is a state officer, acting in behalf of the state and performing duties placed upon that office by state statutes); *Commercial Nat'l Bank v. Superior Ct.*, 17 Cal. Rptr. 2d 884, 886 (Cal. Ct. App. 1993) ("[I]n
continued …

prejudice to "policyholders, creditors or shareholders, or the administration of the proceeding" warrants considerable deference. *Cf.* Wis. Stat. § 227.57(10) ("Upon such review of [agency decisions] due weight shall be accorded the experience, technical competence, and specialized knowledge of the agency involved, as well as discretionary authority conferred upon it."). As the Kentucky Supreme Court has noted,

> The [insurance rehabilitation and liquidation] statutes are designed to provide a comprehensive, efficient, and orderly procedure for liquidating insurance companies while protecting the rights of interested parties. Statutorily, the Commissioner is the appointed person in exclusive control over the proceedings, with guidance and approval provided by the court. . . . The Commissioner is best qualified to perform the rehabilitation/liquidation process as he has no special interest in the outcome except to administer the matter for the maximum benefit of all interested parties.

Minor, 898 S.W.2d at 76. *See also Carpenter*, 74 P.2d at 774-75; *Foster*, 614 A.2d at 1092 (noting that the Rehabilitator has the responsibility to determine facts, plans, and public policy, and his determinations cannot be disturbed "in the absence of bad faith, fraud, capricious action or abuse of power") (quotation omitted).

OCI has deemed the relief specified in the Injunction Order to be necessary and proper to serve the purposes of Chapter 645. For the reasons described below, that determination is not an abuse of discretion as to the challenged provisions, and the Court should not modify the injunction order to modify or eliminate them.

B. Control Rights

The institutional trustees for RMBS holders (the "Trustees") move the Court to amend paragraphs 6 and 9 of the Injunction Order in broad terms to enable them to "refuse any

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accordance with this public policy, the Commissioner has undertaken to rehabilitate the business of ELIC. The statutory authority he exercises in that effort is an aspect of the police power of the state.").

directions delivered by the Commissioner in his capacity as Rehabilitator of the Segregated Account, where the relevant Governing Documents provide that direction or control rights have shifted from Ambac to Holders, due to the rehabilitation of the Segregated Account, the failure of Ambac or the Segregated Account to make a payment when due, or otherwise." (Wells Fargo Br. at 6; Bank of America Br. at 6; Deutsche Bank/U.S. Bank Br. at 27; BNY Br. at 6-7.) The Trustees' intent in seeking to modify that portion of the Injunction Order is clear: they seek to enable holders to make the "declaration of Events of Default under the Transaction Documents, the acceleration of payments due to the holders . . . and the transfer or liquidation of the collateral underlying such Trusts." (BNY Br. at 6.)[47]

Permitting those and other acts currently enjoined by paragraphs 6 and 9 would severely "lessen the value of the insurer's assets" and "prejudice the rights of policyholders[,]" and would interfere with the administration of this proceeding. Wis. Stat. § 645.05(1). Although the control rights may differ somewhat from transaction to transaction, typical control rights include the right to exercise control over the loan servicer (including the right to receive information such as loan files, and the right to terminate the servicer for failure to meet performance criteria), the authority to direct the trustee to assert rights under the transaction documents, the right to consent to amendments and waivers under the transaction documents, and the right to declare events of default, trigger events, and early amortization events. (Fourth Peterson Aff. ¶ 11.)

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[47] BNY asserts that its holders have independent control rights to terminate and force liquidation of collateral that "are otherwise permitted under the Transaction Documents, do not require the assent of Ambac, and arise out of occurrences other than the 'Events' or the financial condition of Ambac or the Segregated Account." (BNY Br. at 6.) Assuming such rights in fact exist—and BNY has not provided any evidence that they do—the grounds for enjoining them are no different than the grounds for enjoining the termination of control rights presently held by Ambac.

Retention of control rights is essential to the Rehabilitator's statutory duties to manage the business of the insurer and to "protect the interests of insureds, creditors, and the public generally, with minimum interference with the normal prerogatives of proprietors," Wis. Stat. §§ 645.01(4) & 645.33(2). (Fourth Peterson Aff. ¶ 12.) Access to information, management of waivers and amendments, and the ability to assert contractual rights and enforce contractual duties are all necessary tools for the day-to-day management of the Segregated Account in the collective best interests of policyholders and the public. (*Id.*)

The preservation of these control rights is also necessary to adequately protect claims-paying resources from avoidable losses—such as those that might accompany an untimely termination and liquidation of collateral, or an underperforming servicer—and to engage in remediation efforts to recover losses caused by third parties' misrepresentations, breaches of warranty, or other acts or omissions. (Fourth Peterson Aff. ¶ 13.) These remediation efforts, if successful, will serve the interests of Segregated Account policyholders by reducing potential strains on claims-paying resources. (*Id.*) Conversely, the loss of control rights would impede and possibly prevent attempts to remediate certain transactions. (*Id.*)

In addition, the loss of the insurer's control rights would not result in a corresponding gain for holders of the insured obligations. (Fourth Peterson Aff. ¶ 14.) Under the transaction documents, once the insurer's control rights are lost, some of those rights are lost entirely; the holders do not acquire the right to exercise them. (*Id.*) Those rights that are transferred to the holders may be difficult to exercise effectively due to contractual requirements for the consent of a majority, super-majority, or 100 percent of holders to the exercise of rights in some transactions. (*Id.*) Further, if holders were able to exercise such rights, they would be

under no duty to exercise them in a way that promotes (or at least does not hinder) the remedial goals of this rehabilitation. (*Id.*)

The Trustees do not, and cannot, contest that their holders' contractual rights are "subject to the reasonable exercise of the state's police power[,]" and "[t]he only restriction on the exercise of this power is that the state's action shall be reasonably related to the public interest and shall not be arbitrary or improperly discriminatory." *Carpenter*, 74 P.2d at 774-75. *Accord Minor*, 898 S.W.2d at 80 ("Neither the insurance company nor policyholders have inviolate rights that characterize ordinary private contracts. The policyholders' contracts as well as others with interest in the company, are subject to a reasonable exercise of state police power."); *Foster*, 614 A.2d at 1095 (confirming a plan that altered contractual rights because it "foster[ed] the legitimate public purpose of safeguarding the public interest from the potentially innumerable consequences of [the insurer's] insolvency"). There is nothing arbitrary or unfairly discriminatory in uniformly enjoining the transfer and exercise of certain contract rights that would be detrimental to the rehabilitation as a whole.

The Rehabilitator notes that Movants make their control rights challenges in the abstract. In practice, the Rehabilitator understands that situations may arise in the context of an individual deal covered by a Segregated Account policy where the injunction against the exercise of certain control rights would cause harm to discrete policyholders, while consenting to the exercise of those rights might not adversely impact policyholders as a whole. In such circumstances, those affected policyholders or their trustees are encouraged to contact representatives of the Rehabilitator or Ambac directly to try to accommodate a practical, individually tailored resolution. The Injunction Order is necessarily broad to address as many potential threats to the Segregated Account as possible, but the Rehabilitator does not intend for

its application to stand as an obstacle to common-sense business decisions that may be appropriate in the context of particular transactions.

C. Indemnification

Under the transaction documents, the Trustees have a right to indemnification for actions taken at the direction of the controlling party—in this case, the Rehabilitator—and paragraph 9.B.2(iv) of the Injunction Order recognizes their right to such indemnification. The Trustees nevertheless complain that they will receive indemnification in the form of an administrative claim against the Segregated Account. They want the Court to amend the Injunction Order to allow "indemnification payable by Ambac's General Account whenever it exercises direction or control rights," due to concerns that the Segregated Account is not "a creditworthy indemnitor" with "identifiable liquid assets." (*See, e.g.*, Bank of America Br. at 9-10.)

These concerns are misplaced. Because the General Account and the Segregated Account have access to the same assets, their "creditworthiness" is not materially different. Other contractual obligations of the Segregated Account are treated as priority administrative expenses (Order for Rehabilitation ¶ 7), just as one of the Trustees recently received full payment of an administrative claim for expenses relating to the Court-approved commutation with the Weinstein Portfolio Funding Company LLC (Second Matanle Aff. ¶ 12). The Trustees offer no compelling reason to deviate from this practice to accommodate their misguided and speculative fears regarding the capitalization of the Segregated Account.

D. Set-Off (Withholding Premiums)

Three of the Trustees (Deutsche Bank, U.S. Bank, and BNY) also seek to modify paragraph 7 of the Injunction Order, which prevents them from withholding or setting off premiums as they become due. They want to escrow those premiums indefinitely pending

judicial review of these proceedings. In fact, one of the Trustees (Deutsche Bank) began to withhold premiums after the injunction order was served on it, and has to date deprived the Segregated Account of approximately $1.10 million due it. (Matanle Aff. ¶ 36.) Deutsche acted in direct willful violation of this Court's Injunction Order without first obtaining relief.[48]

In short, the Trustees seek license to cease contributing to Ambac's liquid claims-paying resources, without consequence, while they and other Movants and parties-in-interest litigate their meritless challenges to the Segregated Account. Meanwhile, all policyholders—including those who would be contractually barred from withholding premiums even if the injunction were lifted—suffer the fallout of fewer liquid claims-paying resources available to make cash payments under the rehabilitation plan.

Wisconsin law does not permit this inequitable result. Under Wis. Stat. § 645.56(2)(d), "[n]o setoff or counterclaim may be allowed in favor of any person where . . . [t]he obligation of the person is to pay premiums, whether earned or unearned, to the insurer." *See also In re Liquidation of All-Star Ins. Corp.*, 112 Wis. 2d 329, 336, 332 N.W.2d 828, 831 (Ct. App. 1983) (same). Further, Chapter 645 authorizes injunctions against "[a]ny threatened or contemplated action that might lessen the value of the insurer's assets or prejudice the rights of policyholders [or] creditors." Wis. Stat. § 645.05(k).

The Trustees ignore this law. They merely contend that their contracts incorporate New York law, which permits set-off, and therefore this Court should honor that

[48] Deutsche has offered no explanation for why it should not be held in contempt for willfully violating this Court's explicit order and the mandate of Wis. Stat. § 645.56(2)(d) (discussed below) which clearly prohibits parties like Deutsche from setting off the premium payments they owe the insurer in rehabilitation. If the Court is not satisfied with Deutsche's explanation at the hearing for why it willfully violated the Court's Order, it has the explicit authority under paragraph 10 of the Injunction Order to cancel Deutsche's entitlement to present loss claims for payment.

contract right. (BNY Br. at 8-9; Dkt. 95 at 4-7.) This argument stops several steps short. Whatever the Trustees' contractual right to setoff might ordinarily be in New York, it is subject to the broad equitable power of this Court to enjoin the exercise of contract rights in a rehabilitation proceeding in accordance with Chapter 645. *See, e.g.*, *Carpenter*, 74 P.2d at 774-75.

E. The Injunction Order Grants the Rehabilitator the Authority Necessary to Best Serve the Interests of Policyholders and the Public.

Finally, Movants make a general challenge to the role of the Rehabilitator in this proceeding. This challenge does not identify any specific abuse of authority, but merely contends that the Injunction and Rehabilitation Orders provide him with too much authority:

> The expansive grant of power and authority to [Ambac] and the Rehabilitator/Commissioner, which essentially allows each to do as they please with regard to the rehabilitation and the policies involved, places the rehabilitation further beyond the reach of this Court for proper oversight.

(KnowledgeWorks Br. at 21.)

The answer to this challenge is twofold. First, this Court has granted no power and authority to Ambac. It has instead taken power from it by granting the Petition for Rehabilitation of the Segregated Account and appointing the Commissioner as Rehabilitator, with "the full powers and authority granted pursuant to Wis. Stat. §§ 645.33 to 645.35 and all other applicable laws as are reasonable and necessary to fulfill his duties and responsibilities under this Order." (Order for Rehabilitation ¶ 4.) Ambac has no authority over the Segregated Account except those duties that have been re-delegated to it by the Rehabilitator, and that re-delegation may be rescinded at any time. (Order for Rehabilitation ¶ 6.) In addition, the Plan of Operation requires the Rehabilitator's approval for numerous General Account actions to protect the common source of funding for both the General Account and Segregated Account. (Verified

Pet., Tab 1 & Exs. A, B, G & H.) Ambac can hardly "do as it pleases with regard to the rehabilitation and the policies involved."

Second, the Rehabilitator's authority is indeed expansive, as it must be in order to serve the purposes of rehabilitation proceedings. As noted in the commentary to Chapter 645, and universally echoed in rehabilitation proceedings in other jurisdictions:

> It is essential that [rehabilitation] be regarded as a management rather than as a legal task. Though it is called a formal proceeding because it begins with a formal petition to a court and a hearing, thereafter it should be essentially informal in operation. The order is formulated to emphasize flexibility and informality, and the rehabilitator is given broad powers. He must act under the supervision of the court, of course, but the court's control should be liberal, not strict, and should be provided without cumbersome procedures.

Wis. Stat. § 645.32 cmt. *See Matter of Mills v. Fla. Asset Fin. Corp.*, 818 N.Y.S. 2d 333, 334 (N.Y. App. Div. 2006) ("[C]ourts will generally defer to the rehabilitator's business judgment and disapprove of the rehabilitator's actions only when they are shown to be arbitrary, capricious or an abuse of discretion."); *LaVecchia v. HIP of N.J., Inc.*, 734 A.2d 361, 364 (N.J. Super. Ct. Ch. Div. 1999) ("[T]he rehabilitator's determination concerning the manner in which to proceed [in rehabilitating an insurer] will not be set aside unless it is shown to be arbitrary and unreasonable."); *Minor*, 898 S.W.2d at 76 ("Statutorily, the Commissioner is the appointed person in exclusive control over the proceedings, with guidance and approval provided by the court."); *Foster*, 614 A.2d at 1092 ("[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."); 1 Lee R. Russ & Thomas F. Segalla, *Couch on Insurance* § 5:22 (3d ed. 2008) (noting the "broad discretion" of the rehabilitator). Thus, this Court's "expansive

grant of power and authority" to the Rehabilitator is not merely permissible, but required under established law.

Further, there is no allegation that the Rehabilitator has abused these powers, nor that the Rehabilitator has deprived this Court of its supervisory role. As this Court properly recognized, limiting the Rehabilitator's ability to act by imposing greater formality would only undermine the accomplishment of the objectives of rehabilitation:

> [T]here is a great deal of power . . . in Chapter 645, the power and authority given to the Rehabilitator and to the Commissioner outside the scope of a judicial proceeding in the sense that the Court is there to review, but they have authority to take over a company, to create these accounts, to manage the company, to make decisions on policies, and then they may develop a plan of rehabilitation. . . .
>
> [T]here isn't an adversarial process that says you can now go in and challenge each and every decision [of the Rehabilitator]. If this were the case, it would be unable to be handled. There would be such a morass of litigation, discovery and everything, all the energy would be spent in these adversarial proceedings.

(Transcript of July 9 Hearing at 23-25.)

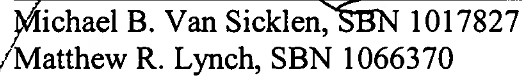
Notably, for all of their motions and asserted desires to challenge every aspect of this proceeding, none of the Movants address the guiding principles of rehabilitation outlined by the Court above. None put themselves in the shoes of this Court or the Rehabilitator and propose an alternative approach that would better serve the purposes of this massive rehabilitation effort and the interests of the public and *all* policyholders, rather than just their own. This Court should continue to reject Movants' open-ended invitation to transform the "management task" of rehabilitation to protect collective interests into an impractical, adversarial legal battle.

CONCLUSION

For the foregoing reasons, this Court should deny the Motions identified in the Scheduling Order for hearing on September 9.

Dated this 17th day of August, 2010.

FOLEY & LARDNER LLP

By: 

Michael B. Van Sicklen, SBN 1017827
Matthew R. Lynch, SBN 1066370

Attorneys for Wisconsin Office of the Commissioner of Insurance and Sean Dilweg, Commissioner of Insurance of the State of Wisconsin, as Court-Appointed Rehabilitator of the Segregated Account of Ambac Assurance Corporation

Foley & Lardner LLP
150 East Gilman Street
Post Office Box 1497
Madison, Wisconsin 53701
Telephone: (608) 257-5035
Facsimile: (608) 258-4258