STATE OF WISCONSIN CIRCUIT COURT DANE COUNTY

In the Matter of Rehabilitation of Segregated Account of Ambac Assurance Corporation	)	Case No. 10 CV 1576

CONSOLIDATED REPLY MEMORANDUM OF LAW IN SUPPORT OF MOTION OF ONE STATE STREET LLC FOR DISSOLUTION AND MODIFICATION OF TEMPORARY INJUNCTION

One State Street LLC ("One State Street"), which is the landlord for the world headquarters of Ambac, located in New York, hereby replies to (i) the Brief in Opposition to All Motions (the "OCI Omnibus Brief") filed by the Commissioner of Insurance for the State of Wisconsin ("OCI"); (ii) OCI's Brief in Opposition to Motion filed by One State Street (the "OCI Lease Brief"); and (iii) Ambac Assurance Corporation's ("Ambac") Third Brief in Opposition to Various Motions (the "Ambac Lease Brief"), and collectively with the OCI Omnibus Brief and the OCI Lease Brief, the ("Briefs").[1]

In the Briefs, both Ambac and OCI have shown their true colors with respect to the Headquarters Lease. They now readily admit that they specifically designed their scheme of placing the Headquarters Lease into the Segregated Account in order to prejudice One State Street in the event of a potential bankruptcy of Ambac's parent company, AFG. (*E.g.,* Ambac Lease Brief at p.13.) That contingency has not yet occurred, and may never occur (i.e., that a potentially bankrupt AFG would use special bankruptcy powers to reject the lease and, at that point, vacate the premises). In contrast

[1] Capitalized terms defined in One State Street's Memorandum in Support (the "Memorandum") of its Motion to Dissolution and Modification of the TRO, and not otherwise defined herein, are used herein as defined in the Memorandum.

to this mere possibility that the Lease will be vacated, at the time they made the allocation to the Segregated Account and as of today (as they have been for years), substantially all of the business operations of both the General Account and the Segregated Account are run from the leased premises. In addition, Ambac and OCI acknowledge that the allocation is an express attempt to alter fundamentally the recovery rights of One State Street – an obligation they consider to be a major potential liability of Ambac.

Furthermore, such allocation was effectuated as surreptitiously as possible with OCI and Ambac failing to even mention the transfer of the lease liability in any pleading filed with the Court. In the Briefs, OCI and Ambac disingenuously assert that they adequately disclosed the transfer to the Segregated Account of the Lease liability, based solely on a listing of the liability on a lengthy schedule attached to an exhibit to the Petition for Rehabilitation. They admit, however, that the liability was not highlighted for, or even referenced to, the Court or other creditors, in any pleading. Indeed, and somewhat remarkably, what OCI and Ambac have done is virtually identical to actions that were declared to be a fraudulent conveyance over 80 years ago in a unanimous Supreme Court opinion of Justice Cardozo.

In the Briefs, OCI and Ambac attempt to refute One State Street's simple and straightforward points that (i) the Headquarters Lease liability is not an insurance policy liability; (ii) Ambac continues to occupy the Headquarters Lease to operate substantially all the General Account's operations, in addition to the operations of the Segregated Account and AFG; and (iii) Ambac remains fully liable for all Lease liabilities as a primary obligor. All of these are basic and critical differences between the Headquarters Lease and the various other types of insurance policy and other liabilities

allocated to the Segregated Account. In opposing this, OCI and Ambac's arguments consist of misdirection and citation to inapposite legal principles, whether regarding the actual lease liability and capitalization of the Segregated Account, fraudulent conveyance principles, or other arguments of One State Street.

Moreover, OCI and Ambac try to muddy the waters by asserting that this is a dispute over a contingent liability. This Court is not the appropriate forum to resolve that dispute regarding the terms of the Headquarters lease, which is an issue of New York real estate law to be resolved, if necessary, in a New York court. For purposes of this motion, this Court must assume Ambac is the responsible party under the Lease, for if AFG was the only responsible party, the liability could not be placed in the segregated account at all. Indeed, both Ambac and OCI state that they are not currently seeking a court ruling on their theories as to why Ambac is not liable on the Lease. This Court must determine whether Ambac's operating expense—use of One State Street's premises as a work space—was properly placed in the Segregated Account. Indeed, to whatever extent Ambac and OCI believe that the liability is only contingent (despite the clear provisions imposing primary liability), they also must recognize that in the event that AFG were to reject the lease in bankruptcy, Ambac (i.e. the General Account) is required under Section 22.03(a) to enter into a new primary lease with One State Street. OCI's and Ambac's attempts to confuse this issue by questioning Ambac's responsibility under the lease amendments, but not seeking an actual Court ruling, are irrelevant and should be ignored. OCI asserts that One State Street is "scrambling" to collect on its lease payments because it fears AFG may file for bankruptcy. (OCI Lease Brief At p. 1.) On the contrary, OCI and Ambac are trying to cover their tails and avoid Ambac's obligations under the Lease by arguing that if the Headquarters Lease in fact is Ambac's

responsibility, the liability is going into the Segregated Account. In other words, OCI and Ambac deliberately tried to place One State Street in a lose/lose situation: a loss due to AFG bankruptcy if the lease liability belongs to AFG and a similar fate in the Segregated Account if the liability falls back to Ambac. Most of One State Street's arguments are already fully presented in its principal memorandum, and the responses of OCI and Ambac do not require further rebuttal. However, a few specific points are worthy of brief discussion in reply.

I. In Altering the Terms of the Secured Note and Reinsurance Agreement to Cover the Headquarters Lease Liability, OCI and Ambac Have Undermined All Current Findings Regarding Capitalization of the Segregated Account

In the Briefs, OCI and Ambac have altered their proposed scheme in order to save retroactively the rehabilitation process from One State Street's challenge. The changes are extremely telling. Specifically, both Ambac and OCI now represent that (i) any Segregated Account liability for the Headquarters Lease will be payable from proceeds of the Secured Note and the Reinsurance Agreement and (ii) these backstop arrangements represent adequate capitalization with respect to the Lease liability. This is a drastic change of position for OCI and Ambac; and it is essentially a concession that the original scheme (to which One State Street objected) was improper as to the Headquarters Lease. But perhaps most critical is that purporting to add the Headquarters Lease to the backstop arrangements creates a direct, adverse impact on all the insurance policies being allocated to the Segregated Account, and making the overall segregation and rehabilitation scheme unjustifiable.

First, the plain language of the Secured Note and the Reinsurance Agreement evidences that Ambac and OCI drafted the original documentation to support the argument that Ambac's liability for the Headquarters Lease was not covered by these backstop

facilities. For example, the Reinsurance Agreement states that it only covers liabilities for insurance policies, and not for "other liabilities" such as the Headquarters Lease:

> Reinsurer shall provide payment to the Ceding Company...in an amount equal to (a) [liabilities] under ***Covered Policies*** ("Cash Claim Payments")... plus (b) any other Cash Claim Payments....

Reinsurance Agreement, Section 1.02 (emphasis added). This limitation is not surprising since a reinsurance agreement by definition covers insurance liabilities. Indeed, Ambac essentially admits that the Reinsurance Agreement does not, absent revision or new undertaking, cover the Headquarters Lease. The best Ambac can say in its Brief is that "the Plan of Operation clarifies that the Segregated Account 'will support the liabilities allocated to it' with a list of resources that includes the Reinsurance Agreement." (Ambac Lease Brief at p.12.) There can be no doubt that, absent the alterations now being introduced in the Briefs (which result from One State Street's motion and arguments), Ambac and its General Account would have argued in the future that the Reinsurance Agreement's plain terms do not cover Ambac's Headquarters Lease liabilities.

The Secured Note's terms are not materially any better. Indeed, OCI and Ambac cannot even agree among themselves which subclause of the Secured Note covers liabilities relating to the Headquarters Lease. (*See* Verified Petition, Tab 1, Exh. G, Secured Note at p. 2, Subclause 1(a)(A),) OCI cites the second phrase within that subclause (plus supposed clarifying language in the Plan of Operation). (*See* OCI Lease Brief at pp. 2, 4.) By contrast, Ambac points to a very generic mention of "other liabilities" in fourth phrase in that subclause. (*See* Ambac Lease Brief at p. 12.) Needless to say, One State Street suspects that had it not raised the issue, this very vague language that does not expressly mention the Lease, and upon which OCI and Ambac

cannot agree, would have been used to justify the position that the backstop arrangements do not cover the Headquarters Lease liabilities.

Alas, the last-minute efforts of OCI and Ambac to provide backstop coverage for the Headquarters Lease liability creates an even greater deficiency in the allocation of liabilities to, and the capitalization of, the Segregated Account. Adding the $94 million Headquarters Lease liability[2] to the other liabilities covered by the Secured Note and Reinsurance Agreement undermines all of the capitalization analysis that has been previously been presented to OCI, to this Court and to other creditors and policyholders of the Segregated Account. All such analysis failed to contemplate a $94 million, or greater, Lease obligation. (*See, e.g.,* Affidavit of Catherine J. Matanlefiled by Ambac on May 20) (not discussing the Lease). As such, there actually are no current findings that support the capitalization of the Segregated Account. Apparently appreciating this fundamental blow to the arguments justifying the creation of the Segregated Account, OCI and Ambac are compelled to use the euphemism "sufficient threat" to describe the Headquarters Lease liability. (Ambac Lease Brief at p. 13.) Alas,

[2] Ambac and OCI assert that $94 million is the possible Lease liability, which for purposes of this motion must be assumed by the Court to be the true liability. Note that Ambac and OCI have expressly excluded from their briefs any actual argument regarding a reduction in such liability amount, and in fact actively avoid having that issue litigated at this time. Once again, OCI and Ambac resort to merely trying to cast aspersions against One State Street in order to try to color the Court's views. For example, OCI insinuates that a lease amendment that added a floor was done after the lease was assigned to AFG, and therefore somehow entirely released Ambac as a lease obligor and guarantor. OCI Lease Brief at p.1. What OCI fails to mention, *inter alia*, is that (i) the Lease expressly provides that even if liabilities were increased after assignment, Ambac remained primarily liable for the original obligations and (ii) the Lease amendment to which OCI refers was not done subsequently or somehow without knowledge of Ambac, but rather *was done at exactly the same time* as the Lease was assigned. In fact, the lease assignment contains language making the assignment effective only the day after the lease amendment on which OCI and Ambac apparently base all of their arguments. In all events, the Briefs expressly say that they are not litigating this issue now. Instead, they raise the specter of a $94 million liability, and that must be taken to be true at this stage.

One State Street reserves all rights to assert greater amounts, and agrees that issues (if any) regarding the Lease are more properly litigated before the courts of the State of New York.

in the event of an AFG lease rejection in an AFG bankruptcy (the focal contingency that OCI and Ambac raise), the liability of Ambac is very real. OCI's own resulting fundamental alteration of its capitalization analysis for the Segregated Account compels a reopening of OCI's review and must compel the Court to retract any conclusions regarding the appropriateness of the creation of the Segregated Account.

In particular with regard to the Lease liability, there is no credible finding that the capacity of One State Street to recover on this liability is properly protected. On one hand, OCI and Ambac justify the transfer of the Lease liability to the Segregated Account by arguing that the liability is sufficiently significant as to require its transfer to the Segregated Account for fear that it will otherwise cause a "run on the bank." Simultaneously, the argument is made that the liability is so remote as to be irrelevant to the capitalization analysis of the Segregated Account. In actuality, the liability may be real, and would be large. Neither OCI nor Ambac actually want to litigate the issue, apparently, which suggests they know their argument is weak.

This creates an issue for the allocation of other liabilities to the Segregated Account. Of course, if OCI and Ambac actually believe their assertions that Ambac has no further liability on the Headquarters Lease, then they should leave that liability in the General Account, so as not to disturb the existing capitalization findings for the Segregated Account. This is the only way to avoid affecting OCI and Ambac's arguments with respect to all other liabilities being pushed to the Segregated Account, many of whom are policyholders, trustees, and bondholders who dispute the capitalization of that account.

OCI seemingly understands that its arguments create this very fundamental tension and contradiction. As a result, OCI resorts to the most facially

outlandish and transparent argument in a last-ditch attempt to make the Segregated Account seem properly capitalized. OCI argues that One State Street is fully protected on its Ambac claim because the $2 billion potentially payable under the Secured Note and Reinsurance Agreement far exceeds OCI's estimate of the $94 million Headquarters Lease liability. This suggestion is blatantly disingenuous. It might be an authentic point if the Lease liability was the sole liability covered by the $2 billion of coverage. But, as OCI knows, the $2 billion Secured Note and the Reinsurance Agreement cover the myriad policy liabilities that Ambac has placed into the Segregated Account, not just the Headquarters Lease liability. There is, thus, no evidence that the One State Street claim is protected.

The assignment to the Segregated Account of the Headquarters Lease liability thus clearly imposes a quandary. If the Secured Note and Reinsurance Agreement do not cover the Headquarters Lease, the transfer of the Headquarters Lease liability to the Segregated Account necessarily fails (and OCI and Ambac concede this, as they seek to change their scheme). On the other hand, imposing at this juncture the Headquarters Lease on the backstop arrangements fundamentally undermines and compromises the earlier OCI findings (and this Court's review of those findings) regarding the capitalization of the Segregated Account.

II. The Allocation to the Segregated Account Is an Intentional Fraudulent Conveyance Under Both New York and Wisconsin Law

OCI and Ambac argue against the allegation of intentional fraudulent transfer by stating that no "fraud" occurred. The Briefs thereby erroneously confuse the law of ordinary fraud with the law of intentional fraudulent conveyances. It is black-letter law that an intentional fraudulent conveyance does not require any sort of affirmative misrepresentation to creditors. *E.g., Brandon v. Anesthesia & Pain Mgmt.*

Assocs., Ltd., 419 F.3d 594, 600 (7th Cir. 2005) (discussing the identical Illinois statute). Rather, the law simply requires that the transferor have acted "with intent to hinder, delay or defraud" a creditor. N.Y. Debtor Creditor Law § 276; Wis. Stat. § 242.04(1). Such a transfer is still actionable as an actual fraudulent conveyance even if implemented in the most open and notoriously public manner. Amazingly, what OCI and Ambac have done here was specifically condemned by the Supreme Court in 1932.

That they intend to hinder and delay One State Street is openly admitted by both Ambac and OCI in their respective Briefs. OCI and Ambac acknowledge that there is a potential looming liability of the General Account to One State Street of at least $94 million.[3] OCI and Ambac specifically foresee that liability arising in the event that AFG files for bankruptcy and rejects the Headquarters Lease. Indeed, the allocation of the Headquarters Lease liability to the Segregated Account specifically targets One State Street, in a manner different from virtually all other liabilities allocated to the Segregated Account and placed into the rehabilitation. Ambac and OCI argue that because One State Street would be subordinated (under Wis. Stat. § 645.68) in a liquidation proceeding of Ambac, One State Street is not being harmed, defrauded or otherwise hindered. In fact, the contrary is true. The subordination of a claim of One State Street relating to the Headquarters Lease liability is only possible if OCI actually put the General Account assets into a liquidation or rehabilitation. By OCI's own admission, an overall rehabilitation of Ambac's General Account is precisely what OCI says it is trying to avoid. So instead, OCI is specifically targeting the Lease liability by placing it into the

[3] OCI and Ambac both specifically state that they are not at this stage opposing the existence of that liability – only that they are reserving their right to do so.

Segregated Account (which effectively subordinates the lease liability) despite not being entitled to do so.

The intentional hindrance and delay of One State Street's recourse against Ambac is particularly egregious in light of Ambac's continuing occupancy of the leased premises. The Headquarters Lease itself expressly provides that Ambac remains primarily liable for all lease obligations. See Lease Section 7.03(a). Ambac, and especially its General Account, is deliberately retaining all of the direct benefits of the Headquarters Lease while actively seeking to use the allocation of the liability to the Segregated Account to hinder and delay One State Street's recourse to General Account assets. After all, a purported "transfer" (or incurrence of obligation) while the original debtor (here the General Account) retains all the actual benefits of ownership is a classic type of intentional fraudulent conveyance. *See, e.g.,* Wis. Stat. 242.04(2)(b) (original debtor retaining possession and benefit of property after the purported transfer is an express statutory "badge of fraud" under the UFTA). *See also Freeland v. Enodis Corp.*, 540 F.3d 721, 733 (7th Cir. 2008) (applying substantially similar Indiana law).[4] The Briefs made extensive reference to a possible AFG bankruptcy filing and termination of the Headquarters Lease. While an AFG bankruptcy filing and lease rejection are currently speculative, what is certain is that the benefits of the Headquarters Lease are currently being enjoyed by Ambac and the General Account, all the while the General Account is seeking to shed itself of the attendant liability. In addition, while OCI and Ambac now are extremely concerned about this potentially large liability arising from an AFG lease rejection, they never saw fit to describe it to this Court or to other creditors in

[4] The Uniform Fraudulent Conveyance Act, still in force in New York, did not yet codify the so-called "badges of fraud," but the law is substantively no different. *E.g., Pen Pak Corp. v. LaSalle Nat'l Bank*, 240 A.D. 2d 384 (N.Y. App. Div. 1997).

court filings. *See, e.g.,* Wis. Stat. 242.04(2)(c) (various kinds of concealment are badges of fraud).

Most importantly, this is not a novel point of fraudulent conveyance law. Indeed, nearly 80 years ago the Supreme Court of the United States, in a unanimous opinion by Justice Cardozo, concluded that an open, court supervised appointment of a receiver, done for the purpose of delaying full payment to creditors, even if creditors might expect full payment, was an intentional fraudulent conveyance. The facts of *Shapiro v. Wilgus*, 287 U.S. 348 (1932), are most instructive. There, a business operator believed that he simply needed some additional time from creditors, before they levied on his assets, in order to be able to sell those assets at prices that would pay creditors in full and even return a small surplus to him, the owner of the business. Most creditors of the business agreed, but two did not. The business owner therefore decided that he would place his business into a court-supervised receivership and an injunction to prevent creditor lawsuits in order to delay collection efforts by the two creditors. The business owner even had to take a preliminary step (done immediately prior to seeking the receivership) of placing the business assets into a corporation because under state law he could not obtain a receiver for his sole proprietorship, but could for the corporation.

This is four-square with the facts presented to this Court. Ambac and OCI have cut a deal with many, but not all, creditors for a delay in their recourse, in the hopes that time and recovery of asset values will result in full payment and even a small surplus to Ambac's owner, the parent company AFG. OCI and Ambac determined that they needed a preliminary change in corporate form (creation of the Segregated Account) to effectuate their goal. They made that corporate change and immediately, and openly, sought a court-supervised receivership and the injunction at issue. This is a fraudulent

conveyance, and as Justice Cardozo noted, has been the exact type of behavior that has been a fraudulent conveyance for over 400 years of consistent Anglo-American law on this subject. An extended quotation from *Shapiro v. Wilgus*, which reversed lower court opinions that had held the receivership to be proper, provides all the authority that remains necessary on this point.

> The conveyance and the receivership are fraudulent in law as against non-assenting creditors. They have the unity of a common plan, each stage of the transaction drawing color and significance from the quality of the other; but, for convenience, they will be considered in order of time as if they stood apart. The sole purpose of the conveyance was to divest the debtor of his title and put it in such a form and place that levies would be averted. The petition to issue execution and the answer by the receivers leave the purpose hardly doubtful. Whatever fragment of doubt might otherwise be left is dispelled by the admissions of counsel on the argument before us. One cannot read the opinion of the Court of Appeals without seeing very clearly that like admissions must have been made upon the argument there. After a recital of the facts the court stated in substance that the aim of the debtor was to prevent the disruption of the business at the suit of hostile creditors and to cause the assets to be nursed for the benefit of all concerned. Perceiving that aim and indeed even declaring it, the court did not condemn it, but found it fair and lawful. In this approval of a purpose which has been condemned in Anglo-American law since the Statute of Elizabeth (13 Eliz., ch. 5), there is a misconception of the privileges and liberties vouchsafed to an embarrassed debtor. A conveyance is illegal if made with intent to defraud the creditors of the grantor, but equally it is illegal if made with intent to hinder and delay them. Many an embarrassed debtor holds the genuine belief that if suits can be staved off for a season, he will weather a financial storm, and pay his debts in full. The belief, even though well founded, does not clothe him with a privilege to build up obstructions that will hold his creditors at bay. . . .
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> The conveyance to the corporation being voidable because fraudulent in law, the receivership must share its fate. It was part and parcel of a scheme whereby the form of a judicial remedy was to supply a protective cover for a fraudulent design. The design would have been ineffective if the debtor had been suffered to keep the business for himself. It did not gain validity when he transferred the business to another with a capacity for obstruction believed to be greater than his own. The end and aim of this receivership was not to administer the assets of a corporation legitimately conceived for a normal business purpose and functioning or designed to function according to normal business methods. What was in view was very different. A corporation created three days before the suit

> for the very purpose of being sued was to be interposed between its author and the creditors pursuing him, with a restraining order of the court to give check to the pursuers.
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> Never is such a remedy available when it is a mere weapon of coercion, a means for the frustration of the public policy of the state or the locality. It is one thing for a creditor with claims against a corporation that is legitimately his debtor to invoke the aid of equity to conserve the common fund for the benefit of himself and of the creditors at large. Whatever hindrance and delay of suitors is involved in such a remedy may then be incidental and subsidiary. It is another thing for a debtor, cooperating with friendly creditors, to bring the corporation into being with the hindrance and delay of suitors the very aim of its existence. The power to intervene before the legal remedy is exhausted is misused when it is exercised in aid of such a purpose. Only exemplary motives and scrupulous good faith will wake it into action.
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> The receivership decree assailed upon this record does not answer to that test. We have no thought in so holding to impute to counsel for the debtor or even to his client a willingness to participate in conduct known to be fraudulent. The candor with which the plan has been unfolded goes far to satisfy us, without more, that they acted in the genuine belief that what they planned was fair and lawful. Genuine the belief was, but mistaken it was also. Conduct and purpose have a quality imprinted on them by the law.

Id. at 353-57 (Cardozo, J.) (citations omitted). This is exactly what OCI and Ambac have done here, which is not surprising as they find themselves in economic circumstances, following the financial crisis of 2008-2009 that are very similar, in many ways, to those that faced businesses and the Supreme Court in the early 1930s. It cannot be countenanced by this Court.

III. The Allocation to the Segregated Account Is a Constructive Fraudulent Conveyance

Ambac and OCI contend in their Briefs that any transfers to the Segregated Account were done for fair consideration because of the backstop arrangements, consisting of the Secured Note and the Reinsurance Agreement. Whatever

validity that assertion may have with respect to actual insurance policies that are allocated to the Segregated Account, as discussed above, the Headquarters Lease liability is fundamentally different from those policies in many ways. One aspect of this is that Ambac and OCI have not taken a position as to whether, within the Segregated Account, the Headquarters Lease liability is subordinate to policy liabilities, potentially pursuant to Wis. Stat. § 645.68(5). On the one hand, if OCI and Ambac assert such subordination, then One State Street would only have the protections of the Secured Note and Reinsurance Agreement after policy liabilities are paid in full. In that case, the Lease is plainly different and those backstop arrangements cannot be counted as fair consideration with respect to the transfer of the lease liability. If, on the other hand, OCI and Ambac seek to provide true backstop protection to the Headquarters Lease, without subordination, then the question arises whether policyholders who are objecting to the Segregated Account's capitalization were properly apprised of this position.

IV. There Are No Valid Technical Defenses to Fraudulent Conveyance

Ambac and OCI raise only two unsuccessful technical challenges to One State Street's clear and simple point that what has occurred here is, at the very least, an intentional set of actions designed to hinder and delay its recourse.

For example, OCI and Ambac contend that no transfer occurred. First, and as discussed in One State Street's principal brief, Ambac (or its General Account) has effectuated a transaction that, in effect, has made the General Account assets exempt from recovery by One State Street, and this is commonly viewed as a fraudulent transfer of assets away from a creditor. Fraudulent conveyance law has always been a broadly construed and flexible remedy that is not cabined by technical arguments like this. This is encapsulated, inter alia, in the Wisconsin Uniform Fraudulent Transfer Act when it

defines transfers to include "every mode, direct or indirect, . . . of disposing of or parting with an asset or an interest in an asset." Wis. Stat. § 242.01(12). Alternatively, even if not considered a transfer, what occurred here is the incurrence of new fraudulent obligations, which is also actionable. Wis. Stat. § 242.04(1) (allowing avoidance of "obligations incurred" in addition to transfers). Specifically, the General Account has *de facto* incurred new, senior liabilities (for all General Account liabilities) that are superior in right to whatever possible recourse, direct or indirect, that One State Street has against those General Account assets. In this case, again, the fraudulent conveyance is not the incurrence of a new liability by the Segregated Account (which OCI would control as rehabilitator), but rather a fraudulent conveyance that One State Street controls individually, as a creditor of Ambac (and the General Account).

Second, OCI expends a great deal of effort creating a straw man argument opposing the standing of One State Street to assert fraudulent conveyance claims regarding the allocation of the Lease liability and the establishment of the Segregated Account. Specifically, OCI cites a statutory provision that only a receiver may seek to avoid fraudulent conveyances relating to an insurer under rehabilitation. OCI surely appreciates that OCI is simply incorrect in applying this statutory restriction to the transfer of the Lease liability to the Segregated Account, and OCI apparently raises the argument simply to confuse the issue.

It is correct that the insurance rehabilitation statute empowers a receiver with the sole authority to avoid fraudulent conveyances made from the assets of the insurance unit in a rehabilitation proceeding. The statute, Wis. Stat. § 645.52, governs "transfer[s] made or suffered and every obligation incurred by an insurer." This provision, however, only grants exclusive control of actions relating to transfers out of

the assets properly belonging to an entity in rehabilitation. As such, here the statute would apply to transfers of assets that should belong to the Segregated Account, as well as all new types of obligations incurred by the Segregated Account. The receiver's exclusive right to pursue such actions, however, is wholly inapplicable to the fraudulent conveyance action that One State Street asserts. First of all, One State Street is alleging a fraudulent conveyance in its capacity as a creditor of Ambac's General Account. The General Account is not in rehabilitation. The fraudulent transfer is that the General Account has precluded its assets from being available to pay the Headquarters Lease liability. There is no receiver for the General Account, and any creditor of the General Account retains standing to bring a fraudulent conveyance action regarding transfers from the General Account.

Moreover, it is simply nonsensical to understand the statute as restricting creditors from commencing and retaining control over allegations of fraudulent conveyance regarding the establishment of the Segregated Account, created by OCI itself. In fact, it is OCI who is the defendant in such action, and surely cannot also serve as the plaintiff. As such, it is clear that One State Street has standing to attack, as a fraudulent transfer, the conveyance of the Lease liability to the Segregated Account.

V. The Headquarters Lease Liability Is Not a Mere "Part" of the Business

Ambac and OCI argue that they can select the Headquarters Lease liability for allocation to the Segregated Account because the statute permits selection of any "part" of Ambac's business. However, this interpretation stretches the meaning of the statute out of all recognizable shape; and removes any real meaning from the phrase "part of the business." What OCI and Ambac are really asserting is that the statute instead authorizes them to pick and choose particular, specific "liabilities" or "obligations" for

placement in a segregated account, without regard to a particular business line or the actual facts as to the liability's place in Ambac's business. That is not a plain text reading of the statute.

In fact, Ambac is primarily liable for the Headquarters Lease liability.[5] Ambac occupies the entire premises to operate all of its business. There is no "part" of the business to which the Lease relates. To the contrary, the Headquarters Lease relates to the "entire" business of Ambac. Only if the statute allowed the selection of "particular obligations" of Ambac's business could the allocation of the Headquarters Lease be proper. That is not what the statute says. For the statute's term "part of the business" to have any meaning, the language must require there to be some identifiable portion of the business of the overall insurance company that is being allocated to a segregated account, perhaps along with the overhead that can be identified to the segregated part of the business. A segregation cannot encompass liabilities that relate to the entire business.

In response to this, Ambac contends that a segregated account is essentially the same as a subsidiary, and can therefore be used for "holding or managing property." (Ambac Lease Brief at p. 10.) But if Ambac simply formed a new entity, purported to have it assume a particular lease, and then placed the subsidiary into an insolvency proceeding, that lease could not be used for the benefit of the parent company. Yet that is precisely what Ambac is proposing; leaving One State Street only with recourse to the Segregated Account while the business of the General Account uses the Headquarters Lease as its primary office. There is no "part of the business" that Ambac could identify to which the lease relates.

[5] To repeat, while OCI and Ambac may dispute that conclusion elsewhere, their own Briefs assume (as this Court must) that the Lease liability is at least $94 million.

Summary

In short, the Headquarters Lease liability is fundamentally different from the policy liabilities allocated to the Segregated Account. The same arguments that OCI has advanced, and this Court has adopted, with respect to those policies cannot justify placing the Lease in the Segregated Account. Ambac, including its general account, continues to occupy the leased premises, and this lease is not a "part" of Ambac's business; the liability relates to the entire business, and cannot be allocated under the statute. Adding backstop coverage (from the Secured Note and the Reinsurance Agreement) for the Headquarters Lease only exacerbates the capitalization problems of the Segregated Account with respect to all other liabilities. And in the end, there is no question that the Headquarters Lease has been specifically targeted by Ambac in an attempt to hinder and delay One State Street's recourse to Ambac, violating long-standing and universally recognized principles of fraudulent conveyance law.

Respectfully submitted on Sept. 1, 2010.

GARVEY McNEIL & ASSOCIATES, S.C.
Attorneys for One State Street LLC

Anne M. Bensky
Wis Bar No. 1069210
Kathleen G. McNeil
Wis. Bar No. 1029920
One Odana Court
Madison, Wisconsin 53719
Tel: 608-256-1003
Fax: 608-256-0933

--and--

ROPES & GRAY LLP
Attorneys for One State Street LLC

Mark I. Bane
Admitted pro hac vice 7/21/10
1211 Avenue of the Americas
New York, New York 10036
Tel: 212-841-5700
Fax: 646-728-1662

D. Ross Martin
Admitted pro hac vice 7/21/10
One International Place
Boston, Massachusetts 02110
Tel: 617-951-7000
Fax: 617-235-0454