COURT OF APPEALS OF WISCONSIN
DISTRICT IV

Appeal Nos. 2010-AP-1291 & 2010-AP-2022
(Consolidated)

In the Matter of the Rehabilitation of:

Segregated Account of
Ambac Assurance Corporation,

Appeal No.
2010-AP-1291

SEAN DILWEG, and OFFICE OF THE COMMISSIONER OF INSURANCE,

Plaintiffs-Respondents,

AMBAC ASSURANCE CORPORATION,

Interested Party-Respondent,

v.

WELLS FARGO BANK/Trustee of Bondholders, Bank of New York Mellon and Deutsche Bank National Trust Company,

Defendants,

FEDERAL HOME LOAN MORTGAGE CORPORATION,

Defendant-Petitioner-Co-Appellant,

AURELIUS CAPITAL MANAGEMENT LP, FIR TREE INC., KING STREET CAPITAL MASTER FUND, LTD., KING STREET CAPITAL LP AND STONEHILL CAPITAL MANAGEMENT LLC,

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Defendants-Petitioners-Appellants,

EATON VANCE MANAGEMENT, NUVEEN ASSET MANAGEMENT, RESTORATION CAPITAL MANAGEMENT, LLC AND STONE LION CAPITAL PARTNERS, LP,

Defendants-Co-Appellants-Petitioners.

Sean Dilweg, and Office of the Commissioner of Insurance,

Plaintiffs-Respondents,

Ambac Assurance, Appeal No. 2010AP2022

Interested Party-Respondent

v.

Wells Fargo Bank/Trustee of Bondholders,

Defendant-Co-Appellant,

Bank of New York Mellon, Deutsche Bank National Trust Company, Federal Home Loan Mortgage Corporation, Aurelis Capital Management LP, Fir Tree Inc., King Street Capital Master Fund, Ltd., King Street Capital, L.P., Monarch Alternative Capital LP and Stonehill Capital Management LLC,

Defendants

Eaton Vance Management, Nuveen Asset Management, Restoration Capital Management, LLC, Stone Lion Capital Partners LP,

Defendants-Appellants.

Appeals From The Circuit Court Of Dane County
Honorable William D. Johnston,
Presiding by Judicial Assignment

CONSOLIDATED BRIEF OF RESPONDENTS SEAN DILWEG, COMMISSIONER OF INSURANCE OF THE STATE OF WISCONSIN, AND THE OFFICE OF THE COMMISSIONER OF INSURANCE

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INTRODUCTION

The appellants[1] maintain the view that insurer rehabilitation proceedings are normal adversarial cases, in which:

(1) *each* of the *thousands* of trustees, policyholders and policy beneficiaries who have an interest in the outcome of the rehabilitation proceeding has: (a) the right to intervene as a party; (b) the right to conduct protracted discovery directed at the Rehabilitator and the insurer; and (c) the right to appeal any decision of the rehabilitation court, irrespective of principles of standing or finality; and

(2) no particular deference should be accorded the decisions of the Rehabilitator or the rehabilitation court.

In fact, Chapter 645 rehabilitation proceedings are non-adversarial in nature, and the legislature never intended such regulatory management cases to devolve into the type of

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[1] In this brief, the "RMBS Funds" are appellants Aurelius Capital Management, LP, Fir Tree, Inc., King Street Capital, L.P., King Street Capital Master Fund, Ltd., Monarch Alternative Capital, LP, and Stonehill Capital Management LLC.

The "LVM Funds" are appellants Eaton Vance Management, Nuveen Asset Management, Restoration Capital Management LLC, and Stone Lion Capital Partners L.P.

Appellant Federal Home Loan Mortgage Corporation ("Freddie Mac") joined in certain of the Funds' arguments. Because its positions mirror those of the Funds, this brief does not separately refer to Freddie Mac.

policy-and claim-specific litigation that the RMBS and LVM Funds seek to pursue. As explained in the comments, Chapter 645

> is designed to make rehabilitation a very flexible procedure. It is essential that it 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. Ann. § 645.32 cmt. (1967) (emphasis added).

Furthermore, unlike the Funds, whose interests are extremely narrow, the task of the Wisconsin Office of the Commissioner of Insurance and the Commissioner as court-appointed Rehabilitator (collectively "OCI") is far more complex: OCI must weigh *all* competing interests, and determine what is in the best interest of the insurer, policyholders, creditors and the public *as a whole*. Because OCI has expertise in administering Wisconsin insurance statutes, and has no personal stake in the outcome, the legislature accorded it deference in making the complex

rehabilitation choices necessary to achieve the statutory objectives of Chapter 645.

STATEMENT OF ISSUES

1. (a) Is an order denying an investor's motion to formally intervene in a non-adversarial insurance rehabilitation proceeding, where all interested persons have the ongoing right to participate and be heard, final and appealable? (b) If so, given the opportunity to be heard and the fact that OCI, in its capacity as Rehabilitator, was representing the interests of all policyholders, were the RMBS and LVM Funds entitled to intervene?

> Rehabilitation court: (a) Not considered; (b) No; *see* May 27, 2010 and July 16, 2010 Orders.

2. Were the Funds entitled to a temporary injunction to halt the consummation of an OCI-approved Bank Settlement between Ambac and the Bank Group, where the settlement commuted a multi-billion exposure at a deep discount, and the Funds failed to show any probability of success on the merits, irreparable harm or that they lacked an adequate remedy at law?

> Rehabilitation court: No; *see* May 27, 2010 Order.

3. Did the Segregated Account lack adequate capitalization under Wis. Stat. § 611.24(3)(a), or did the allocation of the RMBS policies to the Segregated Account constitute a novation, a taking, or a violation of the RMBS Funds' due process rights?

> Rehabilitation court: No; *see* May 27, 2010 Order.

4. Did the allocation of the LVM policy to the Segregated Account violate Wis. Stat. § 611.24(2) or the Equal Protection Clauses of the Wisconsin and United States Constitutions?

> Rehabilitation court: No; *see* July 16, 2010 Order.

STATEMENT ON ORAL ARGUMENT AND PUBLICATION

OCI submits that oral argument is warranted, and that publication of this Court's opinion would provide useful guidance in this and other insurer delinquency proceedings.

STATEMENT OF THE CASE

These appeals relate to two discretionary approvals by OCI, in its regulatory oversight of Ambac Assurance Corporation ("Ambac" or the "General Account") and as the court-appointed Rehabilitator of the Segregated Account of Ambac (the "Segregated Account"):

(1) OCI's approval of a settlement between Ambac and a number of large financial institutions ("Bank Settlement") to resolve potential claims of more than $12 billion, in exchange for a one-time payment of $2.6 billion in cash and $2 billion in surplus notes; and

(2) OCI's approval of Ambac's establishment of the Segregated Account under Wis. Stat. § 611.24(2).

None of the Funds contend that OCI erroneously exercised its discretion in approving these actions, which OCI reasonably deemed to be in the best interests of policyholders, creditors and the public based on OCI's extensive supervision over Ambac since the bond insurer's financial condition began to deteriorate in late 2007. Nor do they identify any erroneous exercise of discretion in the rehabilitation court's denial of their motions: to (1) intervene in the rehabilitation proceeding and take discovery of OCI and Ambac; (2) to temporarily enjoin the Bank Settlement; and (3) to challenge

the formation of the Segregated Account or the allocation of specific policies to that Account.

STATEMENT OF FACTS

I. AMBAC AND OCI'S REGULATORY OVERSIGHT

Ambac is a Wisconsin-domiciled insurer. (R.1 ¶ 2 (OCI-App. 1).) For most of the last 25 years, Ambac has been one of the largest "monoline"[2] insurers in the world. (R.2 at 1.) Generally speaking, Ambac insured investment debt, protecting holders of fixed-income obligations such as interest-bearing bonds and notes against non-payment of those obligations by the issuers. (R.2 at 1, 14.)

The complex investments Ambac insured typically involved hundreds of millions of dollars each with voluminous transaction documents that contain a minefield of embedded covenants, rights of waiver and variances, risks of cross-defaults and liquidity crises, automatic termination provisions, and other contractual "triggers" with varying consequences, as well as liquidated and accelerated damages provisions. (R.70 ¶¶ 29-35; R.74 ¶¶ 8-9; R.76-77 (OCI-App.

[2] The term "monoline" refers to the fact that Ambac exclusively wrote financial guaranty insurance and did not offer property, casualty, life, disability or other classes of insurance. (R.2 at 1.)

17-19, 59-63, 66).) Many of these "triggers" are activated by changes to Ambac's credit ratings, its continuing readiness to perform, and any regulatory actions that may interfere with its ability to make claims payments. (R.74 ¶ 9 (OCI-App. 37-38).) Regulation of Ambac therefore requires an assessment of these contractual risks during times of financial stress, both to measure Ambac's financial condition and contingencies affecting it and to ensure that any regulatory action will not create unnecessary harm to policyholders and the public. (R.74 ¶¶ 2-4, 8, 9(a)(ii) (OCI-App. 34-37).)

Beginning in late 2007, Ambac's financial outlook began to deteriorate as the subprime lending crisis began to resonate throughout the national economy. (R.1 ¶ 5 (OCI-App. 3); R.2 at 16.) As a result, many of the financial obligations Ambac insured or invested in—including instruments with exposure to residential mortgage-backed securities ("RMBS"), such as credit-default swaps ("CDS") guaranteeing collateralized debt obligations with underlying asset-backed securities ("ABS CDO")—suffered significant actual losses and/or sharp increases in projected future losses. (R.1 ¶¶ 4-5; R.74 ¶¶ 3, 19 (OCI-App. 2-3, 35, 43-44).) Ambac's liabilities mounted as an increasing number of

policyholders brought policy claims or were projected to have increasingly substantial future policy claims due to the deterioration of the underlying securitized obligations, while at the same time Ambac's claims-paying resources dwindled as many of its own investments lost value and could not be sold at fair-market value to meet increased liquidity needs. (R.1 ¶ 5 (OCI-App. 3).)

Ambac's ability to write new insurance business depended in large part on its ability to maintain triple-A ratings from major credit-rating agencies such as Moody's and Standard & Poor's, which provided a credit-rating boost to bonds of non-triple-A issuers if those bonds were insured by Ambac. (*Id.*) As Ambac's financial forecast darkened, its ratings began to drop from triple-A in late 2007 to levels indicating "extremely weak" or "very poor" financial security by mid-2009. (*Id.*) Ambac ceased writing new policies, and it was forced to post substantial additional collateral on certain policy "wrapped" securitized transactions due to various contractual triggers, which further diminished Ambac's general claims-paying resources. (*Id.*)

OCI increased its oversight of Ambac at the beginning of this slide in late 2007, with increasing involvement since

that time. (R.74 ¶ 3 (OCI-App. 35).) OCI also retained outside financial advisors and legal counsel with expertise pertaining to the specialized types of policies written by Ambac, the financial guaranty insurance business, restructuring, and Wisconsin insurance law. (*Id.*)

By 2009, OCI and its advisors were working on Ambac-related matters on essentially a daily basis, spending thousands of hours in their efforts to assess and protect policyholder interests in light of the complex problems posed by Ambac's decline. (R.1 ¶ 7; R.74 ¶ 4 (OCI-App. 4, 35).)

II. THE COMMUTATION OF TROUBLED AMBAC POLICIES

In 2008 and 2009, Ambac, acting under OCI's regulatory supervision, engaged in negotiations with various policyholders regarding bilateral restructurings and commutations to mitigate or remove certain large policy exposures from Ambac's books in exchange for a relatively small percentage of Ambac's projected future liability under those policies. (R.70 ¶ 11; R.74 ¶ 7; R.127 at 3-4, ¶¶ 5-6 (OCI-App. 36, 66, 213-14).) Ambac made approximately $1.8 billion in commutation payments in 2008 and another $1.4 billion in payments in 2009, all of which were vetted and

"non-disapproved" by OCI. (R.74 ¶ 7; R.127 at 3, ¶ 5 (OCI-App. 66, 213).)

In the fall of 2009, a group consisting of large financial institutions (the "Bank Group"),[3] holding the bulk of Ambac's guarantees of ABS CDO initiated discussions with Ambac regarding a global commutation of these exposures. (R.74 ¶ 17, R.70 ¶ 12 (OCI-App. 43, 66-67).) As negotiations continued, OCI took an increasingly active role in overseeing, evaluating and facilitating discussions between Ambac and the Bank Group. (R.74 ¶ 17, R.70 ¶ 13 (OCI-App. 43, 67).)

Of its policy obligations, Ambac's ABS CDO exposures presented the greatest threat to its financial condition, and the greatest uncertainty in projecting and planning for long-term stability. (R.74 ¶¶ 8, 17-18 (OCI-App. 36, 43).) OCI extensively evaluated those exposures over time, and its assessments were increasingly alarming. (R.74 ¶ 31 (OCI-App. 50-51).) By early 2010, Ambac's ABS CDO exposures were at best expected to account for roughly

[3] The Bank Group members are identified in R.74 ¶ 24 (OCI-App. 48).

$8 billion in losses (discounted to present value), with materially greater losses should interest rates increase or OCI's loss estimates on these exposures continue their upward trend. (R.74 ¶¶ 23, 31 (OCI-App. 45-47, 50-51).) At worst, the ABS CDO exposures would immediately eviscerate Ambac's claims-paying resources by the exercise of contractual triggers that permitted policy beneficiaries to immediately terminate their CDS contracts and seek "mark-to-market" damages.[4] Given the magnitude of the expected losses on these exposures, successful claims by the Bank Group members for mark-to-market damages would have been approximately $12.9 billion—an amount in excess of all of Ambac's claims-paying assets. (*Id.*)

OCI considered measures to prevent such potentially catastrophic losses from the mark-to-market triggers absent settlement, including research into the likelihood that ABS CDO policy losses would be viewed as subordinate to other policy losses under the priority system of Wis. Stat. § 645.68

[4] Mark-to-market damages are measured by the cost of equivalent replacement coverage in the open market.

should OCI commence formal insurance delinquency proceedings. (R.74 ¶ 29 (OCI-App. 50).)

In the end, OCI recognized that the weight of authority supported the view that the Bank Group's contracts constituted insurance under Wisconsin law, and that the only certainty arising from a dispute over subordination was costly litigation with the Bank Group, prolonged instability, and years of delays in rehabilitating Ambac and making payments to other policy claimants. (*Id*.)

To reach common ground regarding the range of projected financial losses and the projected mark-to-market claims, Ambac and the Bank Group selected a well-respected, independent third party appraisal firm with expertise in valuing ABS CDO. (R.70 ¶ 17 (OCI-App. 68-69).) The firm completed its appraisal in early 2010, finding that the present value of projected losses on the Bank Group's insured ABS CDO even without mark-to-market claims ranged from $8.7 billion (base case) to $10.4 billion (stress case), and increased to $12.9 billion in losses to Ambac upon the successful assertion of mark-to-market damage claims. (R.74 ¶¶ 21-34; R.70 ¶¶ 19-20 (OCI-App. 44-52, 69-70).) The appraiser's estimates were generally in line with OCI's own assessments

of Ambac's ABS CDO exposures. (R.74 ¶ 26 (OCI-App. 49).)

After months of negotiations, Ambac and the Bank Group reached a non-binding statement of intent to commute Ambac's outstanding ABS CDO exposures in exchange for a one-time payment of $2.6 billion in cash to the Bank Group, and $2 billion in surplus notes payable over time. (R.127 at 7, ¶ 14 (OCI-App. 217).) As described *infra*, the consideration "paid to the Bank Group under the settlement, as a percentage of their projected claims, is substantially less generous than the consideration which will be paid to policyholders in the Segregated Account" under the proposed plan of rehabilitation, now under consideration by the rehabilitation court. (R.74 ¶ 33 (OCI-App. 51).)

OCI encouraged and approved Ambac's settlement with the Bank Group. (R.74 ¶¶ 19, 26-31, 34-37 (OCI-App. 43-44, 49-54).) OCI believed, and continues to believe, that settling Ambac's growing, volatile ABS CDO exposures at a major discount inures to the benefit of all Ambac policyholders and avoids costly litigation that would delay and reduce recoveries to other policyholders, and possibly prevent such recoveries altogether if the Bank Group

prevailed in such litigation. (R.74 ¶ 37 (OCI-App. 54).) The Bank Settlement also alleviated many of OCI's concerns, as relayed by economic leaders, that a sudden collapse of Ambac posed downstream, systemic risks to the national economy as a whole. (R.74 ¶¶ 9(a)(vi), 37 (OCI-App. 38, 54).)

III. OCI'S DECISION TO REHABILITATE THE SEGREGATED ACCOUNT

By early 2010, it was clear to OCI that even a successful commutation of Ambac's ABS CDO exposures would not alone suffice to protect Ambac's 15,000 policyholders from its perilous financial situation. (R.74 ¶¶ 6-8 (OCI-App. 35-36).) As Ambac's claims payments and projected losses mounted, OCI decided that it needed to take regulatory action to address the growing risk that Ambac would become insolvent before its in-force policy obligations were satisfied, and an inequitable and uncontrollable scramble for assets would ensue. (*Id.*)

The only realistic option was to commence some form of rehabilitation proceeding under Chapter 645, Wis. Stats. (R.74 ¶¶ 8-9 (OCI-App. 36-37).) Rehabilitation is "a very flexible procedure" that is "appropriate for insurers in serious

difficulty, when the problem is no longer easily correctable." Wis. Stat. Ann. § 645.32 cmt. (1967).

Rehabilitation grants OCI, as rehabilitator, "full power to direct and manage, . . . and to deal with the property and business of the insurer." Wis. Stat. § 645.33(2). As rehabilitator, OCI would have the authority to take control of the insurer, place a temporary moratorium on claims payments, enjoin the exercise of certain contractual triggers, and present a plan for rehabilitation to promote the "[e]quitable apportionment of any unavoidable loss" for the ultimate benefit of policyholders, creditors, and the public. Wis. Stat. §§ 645.01(4), 645.05, 645.33. In short, it would ideally allow for the orderly run-off of Ambac's liabilities, and avoid the dislocations experienced by other monoline insurers such as MBIA and Syncora. (R.1 ¶ 8(c) (OCI-App. 7-8).)

Due to the complexity of Ambac's business, however, an overbroad rehabilitation proceeding posed a risk of additional, unnecessary harm to the vast majority of Ambac's policyholders and related transaction parties—like the Sonic Corporation (franchisor of the drive-in restaurant chain) and the Hertz Corporation (vehicle and equipment rental

company)—that are dealing with stable, performing commercial or public-finance transactions. (R.74 ¶ 9(a) (OCI-App. 37-38).) As noted earlier, many of the transaction documents relating to obligations Ambac insures include "triggers" that permit counterparties to declare defaults, accelerate payments, and take other actions that would create additional material losses to the detriment of all policyholders if subjected to a formal delinquency proceeding. (*Id.*) While OCI concluded that many of these triggers could be effectively enjoined by immediate action in the rehabilitation court under Wis. Stat. § 645.05, it found that many other trigger-related risks might not be avoided with certainty through the exercise of OCI's regulatory authority or the rehabilitation court's injunctive powers, because many of these risks are particular to the specific insured obligations. (*Id.*)[5] OCI referred to the potential harm arising out of an overbroad delinquency proceeding as "collateral damage." (R.74 ¶ 9(a)(i) (OCI-App. 37).)

[5] Unlike other classes of insurance (*e.g.*, life, casualty or health insurance), where the underlying risks and coverages are standardized policy-to-policy, financial guaranty policies issued by Ambac tend to be highly individualized because they "wrap" complex and widely disparate underlying commercial obligations. (R.9 at 6-13, ¶ 9; R.74 ¶ 10 (OCI-App. 21-28, 40).)

For example, Ambac insures commercial asset-backed securities ("Commercial ABS") issued by major operating entities such as Sonic and Hertz, which employ well over 100,000 people. (R.76 ¶ 2; R.77 ¶¶ 3-4 (OCI-App. 59, 62).) If Ambac were subjected to a rehabilitation proceeding, however, lenders might have ceased funding those issuers' financing facilities or special-purpose entities or required those issuers to divert operating income to make accelerated securities payments, which would increase the likelihood that those entities would default on their obligations (thus causing increased losses both to Ambac and the issuer). (R.76 ¶¶ 4, 7; R.77 ¶¶ 6, 9-10 (OCI-App. 60-63).)

OCI and Ambac estimated that the collateral damage associated with Commercial ABS could exceed $1 billion in additional claims against Ambac alone. (R.74 ¶ 9(a)(iv) (OCI-App. 38).) Economic leaders also warned OCI that an overbroad rehabilitation of Ambac could create broader market disruptions and risks to the larger economy. (R.74 ¶ (9)(a)(vi) (OCI-App. 38).)

Furthermore, like the policies insuring the Sonic and Hertz transactions, OCI found that the vast majority of Ambac's policies (more than 14,000 out of nearly 15,000

policies in force) insured problem-free transactions with little or no projected impairments. (R.74 ¶ 9(a)(v) (OCI-App. 38).) These policies posed no foreseeable threat to Ambac's claims-paying resources *unless*, in some instances, they were subjected to a rehabilitation proceeding and incurred collateral damage. (R.74 ¶ 9(a)(vi) (OCI-App. 38).)

Therefore, OCI opted to utilize a more surgical approach: to rehabilitate a Segregated Account, created pursuant to Wis. Stat. § 611.24(2) and subject to rehabilitation under Wis. Stat. § 645.31 *et seq.*, which was comprised of Ambac's most troubled policies, while leaving Ambac's stable General Account outside the rehabilitation proceeding. This approach addressed Ambac's clear need for rehabilitation while eliminating the dangers and drawbacks of a full-blown rehabilitation for all policyholders, including those in the Segregated Account. (R.74 ¶ 9(b) (OCI-App. 39-40).)

On March 24, 2010, OCI granted its approval to formally establish the Segregated Account, supported by a $2 billion secured note and an excess of loss reinsurance agreement from Ambac's General Account. (R.127 at 11, ¶ 26 (OCI-App. 221).) Under the terms of the secured note

and reinsurance agreement, the Segregated Account has access to virtually all of the General Account's claims-paying resources to satisfy claims as they arise, in accordance with a plan of rehabilitation. (*Id.*)

IV. THE SEGREGATED ACCOUNT ALLOCATIONS

OCI worked closely for weeks with outside advisors and Ambac to identify those policies with projected losses and/or triggers that best met OCI's criteria for allocation to the Segregated Account. (R.74 ¶ 10 (OCI-App. 40).)

Policies that were (a) without material projected losses, (b) for which the collateral damage of rehabilitation could outweigh the benefits, and/or (c) for which the policyholders signed a binding agreement to forbear from the exercise of contractual triggers, were left in the General Account. (R.74 ¶ 12 (OCI-App. 41).)

Ultimately, less than 1,000 policies (representing approximately $67 billion in net par outstanding) were allocated to the Segregated Account, while approximately 14,000 policies (representing over $300 billion in net par outstanding) were left in the General Account. That allocation outcome was consistent with OCI's objective to

provide continuing durable coverage outside of a rehabilitation proceeding to as many policyholders as possible without creating undue risks of inequitable treatment or threats to claims-paying resources available to all policyholders. (R.74 ¶ 10 (OCI-App. 40).)

RMBS policies were allocated to the Segregated Account because the actual and projected impairments on RMBS were substantial and short-term. (R.74 ¶ 11 (OCI-App. 40-41).) In 2009 alone, Ambac made approximately $1.6 billion in gross claim payments, with the vast majority related to RMBS obligations. (R.74 ¶ 6 (OCI-App. 35).) OCI determined that, absent regulatory action, Ambac "likely would face claim payment demands in excess of $2 billion related to RMBS policies in 2010," which "would have jeopardized the financial security of all Ambac policyholders." (R.74 ¶¶ 6, 11 (OCI-App. 35, 40-41).)

The policy relating to the Las Vegas Monorail ("LVM") was allocated to the Segregated Account because LVM filed for Chapter 11 bankruptcy in January 2010, and the LVM exposure, which could exceed $350 million in the absence of remediation, "represent[ed] one of the highest

projected individual deal losses in the Segregated Account." (R.74 ¶ 13 (OCI-App. 41).)

Like the LVM policy, Numerous other policies with public-finance components also were allocated to the Segregated Account. Over forty-two direct public-finance policies were allocated to the Segregated Account, as well as over 150 swap surety policies, in which Ambac insured scheduled payments in respect of certain swap contracts between municipalities or other public finance issuers and professional counterparties. (R.74 ¶ 14 (OCI-App. 41-42).)

OCI's allocation criteria have proven to be accurate. Between March and May 2010, Ambac paid less than *$10 million* in claims with respect to the approximately *14,000* policies in the General Account. (R.74 ¶ 12 (OCI-App. 41).) By contrast, absent rehabilitation, Ambac estimated that it would have paid approximately *$300 million* in RMBS claims alone between March and April 2010, not to mention claims on other Segregated Account liabilities. (R.74 ¶ 11 (OCI-App. 40).) Thus, while Segregated Account policies accounted for less than 7 percent of the total policies in force of the Segregated and General Accounts combined,

they accounted for more than 96 percent of total policy claims.

V. PROCEDURAL HISTORY

After the establishment of the Segregated Account on March 24, 2010, OCI immediately filed a Verified Petition for Rehabilitation and a Motion for Temporary Injunctive Relief with the Dane County Circuit Court, in order to prevent mass contract terminations and the accompanying scramble for assets that would otherwise ensue. (R.74 ¶ 39 (OCI-App. 54-55); R.2 at 20-21.) In accordance with longstanding practice in insurer delinquency proceedings, the case was assigned to Judge William D. Johnston.[6]

The rehabilitation court held an emergency, same-day hearing, after which it entered an order for rehabilitation of the Segregated Account and granted the accompanying motion for temporary injunctive relief. The Injunction Order permitted any person affected by it to subsequently request its

[6] By statute, all Wisconsin delinquency proceedings involving insurance companies must be commenced in Dane County Circuit Court or the circuit court for the county where the insurer is located. Wis. Stat. § 645.31. Because of the specialized and complex nature of such proceedings, the Chief Judge for the Fifth Judicial Administrative District has for the past 20 years assigned all such cases to Judge Johnston, a practice that has been reduced to a standing order. Consequently, Judge Johnston has developed substantial, recognized judicial expertise in the field. (*See generally* R.3.)

modification or dissolution, in whole or in part. (R.9 ¶ 12 (OCI-App. 28-29).) The court also approved a form of notice, which OCI immediately began communicating to all known, potentially affected persons and entities. (R.10.)

The Injunction Order prevented the exercise of any contractual triggers and stabilized Ambac while OCI prepared a plan for the rehabilitation of the Segregated Account. (R.9 (OCI-App. 16-31).) Concurrently, Ambac and the Bank Group continued working toward a settlement of Ambac's ABS CDO book. (R.70 ¶¶ 13-15 (OCI-App. 67-68).)

A. May 27, 2010 Order, Denying Motions To Enjoin The Bank Settlement, To Challenge The Creation Of The Segregated Account, And To Intervene.

Shortly after commencement of the rehabilitation proceedings, the RMBS Funds filed an "emergency" motion seeking to enjoin the consummation of the Bank Settlement and to invalidate the Segregated Account and re-allocate the policies held by the RMBS Funds back to Ambac's General Account. (R.37-40.)

The LVM Funds also moved to enjoin the Bank Settlement. (R.41-43.) Unlike the RMBS Funds, however,

the LVM Funds did not seek to invalidate the Segregated Account. (R.42 at 2 n.2.)

Neither the RMBS nor the LVM Funds attempted to show that they were policyholders. Rather, the Funds claimed to have unspecified beneficial interests as holders of notes or bonds issued by trusts with Ambac policies. There is no contractual privity between Ambac and the Funds; they are indirect policy *beneficiaries*, but not policy*holders*. (*See* RMBS Br. at 26-27.) Nevertheless, the Funds sought to formally intervene and obtain "party" status in the proceedings under Wis. Stat. § 803.09(1). (R.38, 42.)

On May 20, OCI filed its opposition brief, affidavits (including the affidavit of OCI's Director of the Bureau of Financial Analysis and Examinations, Roger A. Peterson ("Peterson Affidavit")), exhibits and proposed findings of fact and conclusions of law, which cited to the affidavits and exhibits. (*See* R.72-74 76-77.) Although OCI did not object to the RMBS Funds having the opportunity to be heard by the court, OCI did object to their request to intervene as "parties" to the regulatory rehabilitation proceedings affecting hundreds or thousands of various entities. (R.73 at 33-34.)

In the days leading up to the hearing, a number of other entities made filings with the court, including Freddie Mac, which joined the motion to enjoin the Bank Settlement (R.98-100), and the Bank Group, which filed an *amicus* brief that opposed the injunction motions and set forth its arguments for policyholder priority and termination damages should the Bank Settlement fall apart. (R.93.)

On May 25, 2010, the court held a lengthy hearing on the RMBS and LVM Funds' motions, during which both OCI's and Ambac's primary affiants were present. (R.151 at 4:10-24, 7:6-20 (OCI-App. 82, 85).) Twenty-two attorneys entered appearances and were afforded an opportunity to be heard on the motions. The RMBS and LVM Funds presented their arguments during the hearing, but did not challenge OCI's or Ambac's evidence relating to the two approvals at issue.

At the close of the hearing, the court stated that it would deny the RMBS and LVM motions. With regard to the motions to enjoin the Bank Settlement, the court first noted that it was unclear whether it had authority to enjoin *Ambac* from consummating a transaction, given that the Segregated

Account, not Ambac, was in rehabilitation. (R.151 at 125-26 (OCI-App. 203-04).)

Moreover, the court noted that it would

> give great deference to the role of the Commissioner of Insurance as a regulator. I have to do that by statute. And in this particular case, the expertise, the knowledge is with that agency and I have to respect that . . . . [H]ow they go about negotiating what are going to be [a] tremendous number of issues relying on their expertise, their gathering of professionals to assist them in analysis, this is expertise that I think the motions are inviting me to have an opportunity to get into the decision-making process here and pass on that.
>
> That is not, I think, my role.

(R.151 at 125:22-126:1, 126:11-17 (OCI-App. 203-04).)

The court also indicated that it had reviewed "these very extensive documentation motions [and] briefings that have been filed" by all entities, and that the "findings [OCI is] asking to be made appear to be amply supported in the record this court has before it and will likely be followed[.]" (R.151 at 125:14-16, 129:5-7 (OCI-App. 203, 207).) The court adopted OCI's proposed findings in its May 27, 2010 Order, including the following:

> In light of independent third party appraisals and OCI's own assessments, the proposed Bank Group Settlement is a fair and reasonable compromise that will benefit

> policyholders of both the General and Segregated Accounts by capping potentially massive future losses for a mix of cash and notes representing a substantial discount under all financial scenarios. The Bank Group Settlement also avoids costly litigation and brings greater certainty and stability to the financial condition of the General and Segregated Accounts.
>
> If the Bank Group Settlement is temporarily enjoined, that injunction will likely cause the settlement to fall apart and never close . . . [possibly resulting in] losses far in excess of the $4.6 billion capped settlement.
>
> 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.

(R.127 at 13-14, ¶¶ 34-36 (OCI-App. 223-24).)

The RMBS Funds filed a notice of appeal and moved this Court for emergency injunctive relief pending appeal. This Court denied the motion for injunctive relief, noting among other grounds that the RMBS Funds "have not established that the rehabilitation court erroneously exercised

its discretion when it denied either the motion for an injunction or the request for a stay made at the end of the hearing." (6/2/10 Ct. App. Order at 5.) The Bank Settlement was consummated on June 7, 2010. (R.158.)

The LVM Funds and Freddie Mac also appealed the denial of their motions to enjoin the Bank Settlement and to intervene.

OCI moved to dismiss all three appeals on multiple grounds, including the absence of finality. This Court denied the motions to dismiss, accepting the Funds' representation that "[t]he circuit court's order disposed of the entire matter in litigation between these parties." (6/18/10 Ct. App. Order at 4.)

B. July 16, 2010 Order, Denying The LVM Funds' Challenge To The Allocation Of Their Policy To The Segregated Account.

On June 9, the LVM Funds filed another motion, arguing that the allocation of the LVM policy to the Segregated Account violated Wis. Stat. § 611.24(2) and the Equal Protection Clause. (R.146-147.) The LVM Funds again moved to intervene and to take discovery, without identifying how discovery would further their purely legal arguments. (R.147 at 15-17.)

After another hearing at which the LVM Funds were permitted to be heard, the rehabilitation court denied their second challenge to OCI's actions in a July 16, 2010 Order. Noting the plain language of Wis. Stat. § 611.24(2) and its comments, the court rejected the LVM Funds' argument that the statute permits segregated accounts only for "all policies of the same type." (R.258 at 5-6 (OCI-App. 232-33).) The court also rejected the LVM Funds' constitutional challenge, reiterating its prior findings that the allocation choices were reasonable, including its findings that the LVM policy constituted "one of the highest projected individual deal losses in the Segregated Account" and that, "[b]esides the LVM polic[y], other policies with public-finance components" were also allocated to the Segregated Account. (R.258 at 5, 8 (OCI-App. 232, 235); R.127 at 12-13, ¶¶ 29-30 (OCI-App. 222-23).)

The court also denied the LVM Funds' second request to intervene, noting that "[a]s long as policyholders have a basic right to be heard, which they do here, there is no need to intervene," and that, under Wis. Stat. § 803.09, OCI "was acting for the benefit of all policyholders, including the LVM Funds." (R.258 at 6-8 (OCI-App. 233-35).)

The LVM Funds (and the LVM trustee, Wells Fargo Bank, N.A.) appealed the July 16 Order.

This Court consolidated the appeals related to the May 27 Order (No. 2010AP1291) and the July 16 Order (No. 2010AP2022). (10/8/10 Ct. App. Order.)

STANDARD OF REVIEW

The trial court's findings of fact will be affirmed unless they are clearly erroneous. Wis. Stat. § 805.17(2). Or, stated conversely, a trial court's findings of fact will be reversed only if the findings are against "the great weight and clear preponderance of the evidence." *Noll v. Dimiceli's, Inc.*, 115 Wis. 2d 641, 644, 340 N.W.2d 575, 577 (Ct. App. 1983).

The trial court's denial of a motion for a temporary injunction is a discretionary decision, which will be upheld absent an erroneous exercise of discretion. *Browne v. Milwaukee Bd. of Sch. Dirs.*, 83 Wis. 2d 316, 336, 265 N.W.2d 559, 568 (1978). "An appellate court will sustain a discretionary act if it finds that the trial court (1) examined the relevant facts, (2) applied a proper standard of law, and (3) using a demonstrated rational process, reached a conclusion that a reasonable judge could reach." (6/2/10 Ct.

App. Order at 5 (quoting *State v. Gudenschwager*, 191 Wis. 2d 431, 440, 529 N.W.2d 225, 229 (1995)).)

Although questions of law are subject to *de novo* review, OCI's interpretation of the insurance statutes that it administers are entitled to deference. *See Nat'l Motorists Ass'n v. Office of Comm'r of Ins.*, 2002 WI App 308, ¶¶ 10-13, 259 Wis. 2d 240, 655 N.W.2d 179.

ARGUMENT

I. THE DENIAL OF INTERVENTION IN A CHAPTER 645 PROCEEDING IS NEITHER FINAL NOR APPEALABLE AND, EVEN IF IT WERE, INTERVENTION WAS PROPERLY DENIED.

The underlying premise of these appeals is that the rehabilitation court's rulings on the Funds' motions were "final" as to them, and that "[t]he circuit court's order disposed of the entire matter in litigation between these parties." (6/18/10 Ct. App. Order at 4.) However, subsequent events in the rehabilitation court show that the rulings on appeal, which relate to the creation of the Segregated Account and the allocation of specific policies to that Account, are non-final decisions in the ongoing proceeding.

In October, OCI submitted its plan for rehabilitation of the Segregated Account to the court for approval. Public hearings on the confirmation of the plan began on November 15, 2010, after this Court denied a motion to stay the hearing pending a petition for permissive appeal filed by two different entities, and are still ongoing through the date of this filing. (*See* 11/12/10 Order in Case No. 2010AP2721.)

OCI's witnesses, which include the two primary affiants in opposition to the Funds' motions on appeal, are testifying at

that hearing, and all interested entities including the RMBS and LVM Funds—who previously represented to this Court that the proceeding was final as to them—are subjecting those witnesses to cross-examination.

After the hearing, the next step in the process will be the rehabilitation court's ruling, either approving, modifying, or rejecting OCI's plan of rehabilitation pursuant to Wis. Stat. § 645.33(5). If the court approves the plan of rehabilitation, then the Funds' (and any other entities') challenges to the Segregated Account can be reviewed on appeal in the full context of the plan of rehabilitation as well as the additional factual development that has taken place at the hearing. Alternatively, if the court rejects the plan, then that may moot or significantly narrow the Funds' premature challenges to the Segregated Account. As this Court noted in its November 12, 2010 Order in a related appeal, there is no reason not to let the rehabilitation proceeding play out: "The issues presented will be fully preserved, and their factual context better developed, following the hearing [on plan confirmation]." (11/12/10 Order in No. 2010AP2721-LV at 4.)

The hook the Funds have used to obtain interlocutory review of non-final decisions in the pending appeals is their inclusion of requests for intervention in their motions raising challenges to different aspects of the Segregated Account. However, as discussed below, the rationale for granting immediate review of orders denying motions to intervene in civil adversarial litigation is absent in the insurance rehabilitation setting. In any event, the rehabilitation court properly denied intervention in view of the Funds' (and other entities') robust and ongoing opportunity to be heard and to actively participate in the rehabilitation process.

A. Because The Denial Of Formal Intervention In The Insurance Rehabilitation Context Is Neither Final Nor Appealable, The Appeals Should Be Dismissed.

The denial of a motion to intervene in adversarial civil proceedings generally constitutes an appealable final order. The rationale for this rule is that, in the adversarial context, the denial of intervention shuts the courthouse door to the proposed intervenor; the case is "final" as to that entity.[7]

[7] Although OCI previously noted that the Funds' challenges to the denial of intervention was final and appealable, that was based on the Funds' own representation that their involvement in the rehabilitation proceeding was concluded. Subsequent events show that the Funds' representation was inaccurate.

By contrast, this rationale is absent in the insurance rehabilitation context. Even without formal intervention, the rehabilitation court has acknowledged that any interested person can continue to participate and be heard in the proceeding. (R.9 ¶ 12; R.151; R.258; R.271 at 8, ¶ 4 (OCI-App. 28-29, 79-210, 235.) The RMBS and LVM Funds have taken full advantage of this opportunity. Their motions to intervene were denied in the May 27, 2010 Order. However, what would have been a "final" act in a typical litigation had no effect on the Funds. They continued to file motions, attend hearings, and actively participate in the rehabilitation plan confirmation process. The second LVM appeal (No. 2010AP2022) seeks review of the rehabilitation court's July 16, 2010 Order, which came less than two months after the LVM Funds were first denied intervention.

Because the rationale for treating orders denying intervention as final and appealable in the adversarial litigation context is wholly absent in the insurance rehabilitation context, the orders denying the Funds' motion to intervene should be treated as neither final nor appealable.

B. If Reviewable, The Denial Of Intervention Should Be Affirmed.

The Funds' arguments concerning intervention are difficult to comprehend in the context of this case, because they were afforded the very relief they sought through intervention: to have their substantive challenges to the Bank Settlement and to the Segregated Account heard and decided by the rehabilitation court. All of them contended that intervention was unnecessary to secure that right:

> "The RMBS Policyholders do not believe that their formal intervention in this proceeding is required" and therefore seek intervention only "*to the extent that this Court deems it necessary*[.]" (R.53 ¶ 3 (emphasis added).)
>
> "The LVM Bondholders do not believe that their formal intervention in this proceeding is required. . . . Nevertheless, *if the Court were to determine that intervention is required*, the LVM Bondholders request that they be permitted to intervene as of right[.]" (R.42 at 18 (emphasis added).)
>
> "Freddie Mac requests that it be authorized to intervene in these proceedings, *if the Court deems such intervention necessary . . . .*" (R.99 at 4 (emphasis added).)

The rehabilitation court plainly *agreed* with the Funds that intervention was *not* necessary in order to appear and have their motions heard in a rehabilitation proceeding: "As long as policyholders have a basic right to be heard, which they do

here, there is no need to intervene." (R.258 at 7 (OCI-App. 234).) The court received their substantive motions, permitted them to appear and argue their motions, and ultimately denied the motions on factual and legal grounds. Nowhere did the rehabilitation court suggest that intervention was a prerequisite to obtaining the ultimate relief sought by their motions.

The Funds cannot now complain on appeal that the court below committed reversible error by agreeing with them that intervention was unnecessary in order to appear and be heard. If the Funds believed that intervention was necessary in order to obtain the relief sought by their motions, they had an obligation to raise that argument below, rather than inviting the circuit court down a path they now claim was reversible error. *See, e.g.*, *Gibson v. Overnite Transp. Co.*, 2003 WI App 210, ¶¶ 9-10, 267 Wis. 2d 429, 671 N.W.2d 388 (where a litigant frames an issue in a limited way and the trial court rules on that issue as framed, litigant has waived the right to frame it more expansively on appeal); *State v. Rogers*, 196 Wis. 2d 817, 827, 539 N.W.2d 897, 901 (Ct. App. 1995) ("We will not . . . blindside trial courts with

reversals based on theories which did not originate in their forum.").

Moreover, the Funds point to no prejudice arising from the denial of intervention. The rehabilitation court heard and decided the motions on appeal, has continued to hear and decide additional motions raised by the Funds, and is presently holding public hearings on the merits of the rehabilitation plan in which the Funds are actively participating. *See O'Neal v. Oxendine*, 514 S.E.2d 908, 912 (Ga. App. 1999) (rejecting appellate arguments regarding denial of motion to intervene in rehabilitation proceedings because "[a]lthough the trial court technically 'denied' the motion to intervene, it allowed O'Neal to participate fully in the approval hearing and to raise objections").

As the rehabilitation 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 between ordinary, adversarial litigation and a rehabilitation proceeding.

(R.258, at 6-7; *see also* R.127 at 16-17, ¶¶ 8, 9 (OCI-App. 226-27, 233-34).)

Furthermore, even if formal "intervention" were a requisite to be heard, policyholders, bondholders, and other entities do not need to intervene because OCI is fully and actively representing their collective interests. *See* R.127 at 13-14 ¶¶ 34-36; R.258 at 7 (OCI-App. 223-24, 234); *see also Helgeland v. Wis. Municipalities*, 2008 WI 9, ¶ 108, 307 Wis. 2d 1, 745 N.W.2d 1 ("[A]bsent some showing to the contrary, we presume that [state officials] will fulfill their duties under the law," rendering intervention unnecessary).

II. THE FUNDS' CHALLENGES TO THE DENIAL OF THEIR MOTIONS TO ENJOIN THE BANK SETTLEMENT SHOULD BE REJECTED.

The RMBS and LVM Funds gloss over the fact that their appeals seek to challenge the denial of their motions for a temporary injunction, which sought to enjoin the Bank Settlement. By framing the issue properly, the following points come into focus.

First, the Funds fail to show that any of the rehabilitation court's findings of fact are clearly erroneous or that the court erroneously exercised its discretion in denying the injunction. (*See* 6/2/10 Ct. App. Order at 5.)

Second, because the Funds' motions to enjoin the Bank Settlement were denied, and that settlement closed on June 7, 2010, the appeals seeking to enjoin the Bank Settlement are now moot.

A. The RMBS and LVM Funds Identify No Erroneous Exercise Of Discretion By The Rehabilitation Court.

1. The Funds Do Not Challenge The Court's Findings Of Fact.

The Funds do not dispute *any* of the rehabilitation court's findings of fact related to the denial of their motions

to enjoin the Bank Settlement, much less show that those findings are clearly erroneous. As the court found:

- Prior to the Bank Settlement, Ambac had commuted a number of troubled policies. (R.127 at 3, ¶ 5; R.74 ¶ 7 (OCI-App. 36, 213).)
- OCI projected that, absent a commutation, the ABS CDO exposures were likely to experience the greatest losses of all Ambac exposures. (R.127 at 4-5, ¶ 8; R.74 ¶ 19 (OCI-App. 43-44, 214-15).)
- Ambac and the Bank Group selected a well-respected third party to independently appraise the projected ABS CDO losses, and it found that the loss estimates ranged from $8.7 billion to $12.8 billion. (R.127 at 5-6, ¶¶ 10-12; R.74 ¶¶ 19-23 (OCI-App. 43-47, 215-16).)
- Under the Bank Settlement, in exchange for commuting $16.5 billion in net par exposure, with an appraised value of $8.7 to $12.9 billion, Ambac would transfer to the Bank Group in the aggregate $2.6 billion in cash and $2 billion in surplus notes. (R.127 at 7, ¶ 14; R.74 ¶¶ 23, 32 (OCI-App. 45-47, 51, 217).)
- OCI determined that the Bank Settlement reflected a compromise of many potential litigation considerations and other factors and was fair and equitable to all policyholders. (R.127 at 8, ¶ 17; R.74 ¶¶ 26-31, 34 (OCI-App. 49-52, 218).)
- "Settling the growing, volatile ABS CDO exposures at a major discount inures to the benefit of all other policyholders by capping those exposures, eliminating the possibility of costly, slow-moving mark-to-market litigation that would reduce recoveries to policyholders in the Segregated Account, impair Ambac's ability to provide continuing coverage to policyholders in the General Account, and delay the ultimate resolution of Ambac's financial situation." (R.127 at 8, ¶ 18; R.74 ¶¶ 31, 37 (OCI-App. 50-51, 54, 218).)

Unable to show that any of the rehabilitation court's findings of fact are clearly erroneous, the Funds argue that the court erred in adopting OCI's findings of fact and conclusions of law "verbatim" (or "wholesale") instead of drafting its own opinion. (LVM Br. I at 14, 20, 25-27; RMBS Br. at 30-32, 45; *see also* LVM Br. II at 15-16.) However, as this Court has explained,

> while the record here shows that [the court] received a draft of the findings of fact, conclusions of law, and judgment from [one party,] . . . once [the court] signed the document and it was entered by the clerk of the circuit court, it became the judgment of the court. . . . This conclusion is consistent with *Jackson v. Gray*, 212 Wis. 2d 436, 441-42, 444, 569 N.W.2d 467 (Ct. App. 1997), in which we held that an unambiguous written judgment, prepared by one of the attorneys and then signed and entered by the court, clearly expressed the court's intent; *we did not attach any significance to the fact that the judge did not draft it*.

Cashin v. Cashin, 2004 WI App 92, ¶ 13, 273 Wis. 2d 754, 681 N.W.2d 255 (emphasis added); *see also Karp v. Coolview of Wis., Inc.*, 25 Wis. 2d 299, 301, 130 N.W.2d 790, 791 (1964) (When court signed findings and conclusions prepared by counsel for one party, "they became the findings and conclusions of the trial judge and the responsibility of their correctness became his.") (citations omitted); *Anderson*

v. City of Bessemer City, N.C., 470 U.S. 564, 572 (1985) ("[E]ven when the trial judge adopts proposed findings verbatim, the findings are those of the court and may be reversed *only if clearly erroneous*.") (citations omitted, emphasis added)).[8]

Moreover, the Funds' reliance on *Trieschmann v. Trieschmann*, 178 Wis. 2d 538, 541-44, 504 N.W.2d 433, 434-35 (Ct. App. 1993), is misplaced. (RMBS Br. at 31-32; LVM Br. I at 4-5, 16, 26-27.) In that case, "the trial court failed to provide any rationale or justification for the maintenance award" and the reviewing court had "no insight into the court's decision-making process." *Trieschmann*, 178 Wis. 2d at 543-44, 504 N.W.2d at 435. This Court noted:

> [W]e do not hold that a trial court may never accept the rationale and conclusions contained in one party's brief to the court. If the court chooses to do so, however, it must indicate the factors which it relied on in making its decision and state those on the record.

Id. at 544, 504 N.W.2d at 435; *see also In re Joy P.*, 200 Wis. 2d 227, 241, 546 N.W.2d 494, 500-01 (Ct. App. 1996)

[8] Decisions from other jurisdictions are to the same effect. *See, e.g., In re A.G.*, 667 S.E.2d 662, 665-66 (Ga. Ct. App. 2008); *Scoleri v. Scoleri*, 766 N.E.2d 1211, 1214-15 (Ind. Ct. App. 2002); *Klinkerfuss v. Cronin*, 289 S.W.3d 607, 613 (Mo. Ct. App. 2009); *Richards v. Knuchel*, 115 P.3d 189, 194 (Mont. 2005).

(distinguishing *Trieschmann*, Court of Appeals declined to remand case where trial court's findings and conclusions were adequate and its reasoning was discernible from record).

Here, the factors that the trial court relied upon are explained in the May 27, 2010 Order, in the affidavits and documents that directly support each of the findings of fact (*see* R.72),[9] and in the May 25 hearing transcript.

2. The Funds Satisfied None Of The Elements For Injunctive Relief.

Although the Funds challenge the denial of their motion to enjoin the Bank Settlement, they ignore the standard for injunctive relief.

"Injunctions, whether temporary or permanent, are not to be issued lightly." *Werner v. A.L. Grootemaat & Sons, Inc.*, 80 Wis. 2d 513, 520, 259 N.W.2d 310, 313 (1977). "[I]n order to warrant an injunction, the injury must be real, serious, material, and permanent, or potentially permanent; the right to the injunction must be clear; and the reasons for

[9] The RMBS Funds' assertion that the rehabilitation court's factual findings were made "without any support in the record" is inaccurate. (RMBS Br. at 45.) Each of OCI's proposed findings of fact were supported by citations to evidence. (*See* R.72.) Although the May 27 Order, which adopted OCI's proposed findings, does not include the citations, the findings all have record support.

granting it strong and weighty." *Kocken v. Wis. Council 40*, 2007 WI 72, ¶ 27 n.12, 301 Wis. 2d 266, 732 N.W.2d 828 (quotation omitted).

A party seeking a temporary injunction under Chapter 813 must demonstrate: (1) a reasonable probability of success on the merits; (2) lack of an adequate remedy at law as evidenced by an irreparable injury; and (3) that the injunction is necessary to preserve the status quo. *Sch. Dist. of Slinger v. Wis. Interscholastic Athletic Ass'n*, 210 Wis. 2d 365, 371, 563 N.W.2d 585, 588 (Ct. App. 1997).

a. The Funds Failed To Show Any Probability Of Success On The Merits.

(i) The RMBS Funds lack standing.

As a threshold matter, it continues to "not [be] clear from the papers in front of this court whether the [Funds] have standing to challenge the settlement agreement" between Ambac and the Bank Group. (6/2/10 Ct. App. Order at 5.) Specifically, whether policy beneficiaries have standing to assert claims that belong to policyholders (*i.e.*, trustees) turns on the language of the governing agreements and the trustees' actions vis-à-vis the beneficiaries.

In this case, the RMBS and LVM trustees filed their own briefs in the rehabilitation court.[10] Nevertheless, the RMBS Funds argue that "because the Trustees have not joined this appeal, the RMBS [Funds] have standing because their interests are not being sufficiently represented by the Trustees." (RMBS Br. at 25.) This is insufficient to establish the RMBS Funds' standing. As explained in their own authority (*id*. at 24), where "there is no evidence demonstrating that [the beneficiary] even asked the trustee to bring suit[,]"—or, in this case, an appeal—the exception permitting a beneficiary to bring an action if the trustee fails to bring a meritorious claim "cannot apply." *Tallmadge v. Boyle*, 2007 WI App 47, ¶¶ 25, 27, 300 Wis. 2d 510, 730 N.W.2d 173; *see also Klein v. Hartford Life & Accident Ins. Co.*, No. 09-C-562, 2009 WL 2160455, at **2-3 (E.D. Wis. July 17, 2009) (beneficiary provided evidence in the form of affidavit showing standing).

The RMBS Funds also lodge a procedural objection, arguing that OCI did not raise the standing issue in the

[10] *See* R.79, R.82, R.85 (filings by RMBS trustees Deutsche Bank, US Bank and Bank of New York Mellon); R.16 (filing by LVM trustee Wells Fargo Bank).

rehabilitation court. (RMBS Br. at 25-26.) Setting aside the fact that Ambac raised the standing issue (*see* R.69 at 16-18 & 18 n.2), this argument should be rejected because the considerations underlying the waiver doctrine "are less relevant when new arguments are raised by respondents who seek 'to uphold rather than reverse the result reached at trial.'" *Blum v. 1st Auto & Cas. Ins. Co.*, 2010 WI 78, ¶ 27 n.4, 326 Wis. 2d 729, 786 N.W.2d 78 (citation omitted). "Furthermore, it is well-established law in Wisconsin that an appellate court may sustain a lower court's ruling 'on a theory or on reasoning not presented to the lower court.'" *Id.* (citation omitted).

Even if the Funds could establish their legal standing, there are a host of problems with their merits position.

(ii) The Funds lack a legal basis to challenge the consummation or OCI approval of the Bank Settlement.

The Funds identify no case authority for the proposition that a policyholder (or indirect policy beneficiary) has the legal right to object to—much less enjoin—a negotiated settlement between an insurer (Ambac) and *other* policyholders (the Bank Group).

As to OCI, there is no legal basis for the Funds to challenge its approval of the Bank Settlement. Because the policies that were commuted in the Bank Settlement were not allocated to the Segregated Account (and therefore were not subject to the rehabilitation proceedings), OCI approved the Bank Settlement pursuant to its general regulatory authority over insurers. *See* Wis. Stat. §§ 601.42, 601.43 and 611.01 through 611.78. Under Wisconsin law, OCI's duty is to "administer and enforce" the Insurance Code, Wis. Stat. § 601.41(1), and none of the statutes cited above require OCI to obtain the consent of the court, insurers or policyholders in carrying out its regulatory functions. Thus, OCI's approval of the Bank Settlement fell squarely within OCI's duties and discretionary authority as the State's insurance regulator.

Even if there were a basis for judicial review, such review would be limited. In reviewing discretionary administrative decisions, Wisconsin courts "cannot rule . . . on the wisdom of an agency's decision[,]" but are restricted to determining whether the agency "is empowered by the legislature to exercise its authority" in the matter at hand. *Maple Leaf Farms, Inc. v. Dep't of Natural Res.*, 2001 WI App 170, ¶ 35, 247 Wis. 2d 96, 633 N.W.2d 720; *see also*

Wis. Stat. § 227.57(8) ("[T]he court shall not substitute its judgment for that of the agency on an issue of discretion."). Here, the legislature granted OCI the authority to approve transactions such as the Bank Settlement, and OCI has explained the basis for its position in detail. There is no basis for the Funds to challenge the wisdom of those decisions. *Nat'l Motorists*, 2002 WI App 308, ¶ 25 ("[W]e may reverse OCI's discretionary decision . . . only if it is arbitrary and capricious. An agency decision is arbitrary and capricious if it lacks a rational basis.") (internal citation omitted); Wis. Stat. § 227.57(10) ("Upon such review [of agency actions] due weight shall be accorded the experience, technical competence, and specialized knowledge of the agency involved, as well as discretionary authority conferred upon it.").

(iii) The Funds' reliance on Wis. Stat. § 645.33(2) is misplaced.

The Funds argue that, given the relationship between Ambac's General Account (not in rehabilitation) and the Segregated Account (in rehabilitation), the court below was required to "approve" the Bank Settlement under Wis. Stat. § 645.33(2), even though the policies at issue were not

allocated to the Segregated Account. (*See* LVM Br. at 17-20; RMBS Br. at 45-50.)

To the contrary, section 645.33(2) provides, in relevant part:

> Subject to court approval, the *rehabilitator* may take the action he or she deems necessary or expedient to reform and revitalize the *insurer*.

Wis. Stat. § 645.33(2) (emphasis added). Because the Segregated Account is treated as a separate "insurer" under Wisconsin law, *see* Wis. Stat. §§ 611.24(e), 645.03(1)(f), the "insurer" referenced in section 645.33(2) is the Segregated Account. Moreover, the "rehabilitator" in that section refers to OCI, acting in its role as Rehabilitator of the Segregated Account—the only "insurer" subject to rehabilitation. Thus, the court approval requirement relates to actions taken by OCI, in its role as Rehabilitator, to reform and revitalize the Segregated Account.

In this case, the Funds sought to enjoin OCI, acting *in its role as regulator of Ambac*, from approving the Bank Settlement, which relates to policies that are in Ambac's General Account, *not* in the Segregated Account. Thus, on its face, section 645.33(2) does not apply to the transaction the Funds seek to enjoin.

Likewise, the LVM Funds' reliance on a bankruptcy rule and bankruptcy cases—as "guidance" as to how a rehabilitation proceeding should be run—is misplaced. (*See* LVM Br. I at 21 & 21 n.7, 22-24.) Setting aside the fact that the bankruptcy rule is inapplicable and the cited cases are distinguishable,[11] the Bank Settlement was negotiated in the course of business outside the rehabilitation proceedings, as were numerous prior commutations that took place between Ambac and policyholders in 2008 and 2009. Thus, there is no basis to apply a bankruptcy framework to the commutation of policies that were not subject to a delinquency proceeding.

Finally, although the rehabilitation court concluded that "OCI has broad discretion to approve or disapprove the Bank Group Settlement under its general regulatory authority over insurers," citing Wis. Stat. §§ 601.42, 601.43, and

[11] For example, the LVM Funds' primary case authority, *In re Aweco, Inc.*, 725 F.2d 293 (5th Cir. 1984), is inapposite. (*See* LVM Br. I at 24-25.) In that case, there were "gaping holes" in the settlement record, including a major discrepancy between the court's finding regarding the value of the assets ($30 million) and the examiner's testimony as to value of the assets ($17 million), and the fact that the examiner had no experience in estimating liquidation values or relating to refineries, and did not know whether the refinery was subject to prior liens. 725 F.2d at 299. By contrast, in this case, the LVM Funds raise no challenges to the independent third party's qualifications or its appraisals of the ABS CDO loss exposures, which were corroborated by OCI's own analysis.

611.01 through 611.78, it also noted its approval of OCI's actions with respect to the Bank Settlement:

> Movants have identified no facts to suggest that Ambac or OCI should be enjoined from executing, consummating or approving the Bank Group Settlement, in light of OCI's considered judgment that the Bank Group Settlement is in the best interest of all policyholders, including those whose policies have been allocated to the Segregated Account, and OCI's view that the consideration to be paid to the Bank Group, as a percentage of their projected claims, is substantially less generous than the consideration to be paid to policyholders in the Segregated Account under the expected plan of rehabilitation.

(R.127 at 15-16, ¶ 6(c) (OCI-App. 225-26).) Thus, even if court approval of the Bank Settlement were required, the trial court's detailed discussion in its May 27 Order constitutes such approval.

(iv) The LVM Funds' argument that the Bank Group policies were subordinated to other policies was fully considered by OCI and the rehabilitation court.

The LVM Funds argue that policies relating to CDS obligations are not "insurance" under Wisconsin law and, if allocated to the Segregated Account, would be subordinated

to other types of policy claims under Chapter 645's priority scheme. (LVM Br. I at 28-31.)

However, the LVM Funds misunderstand the difference between: (a) identifying *an* argument; and (b) demonstrating a probability of success on the merits. While the LVM Funds identify *an* argument, they do not come close to showing the latter.

In the court below, the LVM Funds acknowledged that the issue of whether ABS CDO constitutes insurance was unsettled, and "[t]here are no cases one way or the other" on the issue. (R.151 at 119:115-23 (OCI-App. 197).) Moreover, OCI has historically found that Ambac policies relating to CDS obligations are insurance (R.93 at 7 & Ex. B), and as the Bank Group noted in its *amicus* brief in the court below, there is substantial legal support for that characterization. (*See* R.93 at 7-8 & Ex. D (Bank Group noting that New York Insurance Department has approved such policies and treated them as insurance).)

Both OCI and the rehabilitation court took the LVM Funds' speculative subordination argument and other open issues into account in their assessment of the Bank Settlement, which is a compromise of many potential

litigation considerations and other factors. (*See* R.127 at 8, ¶ 17; R.74 ¶ 29 (OCI-App. 50, 218).) The LVM Funds identify no abuse of discretion in OCI's regulatory decision-making.

(v) The Funds' requests for discovery are not a basis for injunctive relief.

The Funds argue that the rehabilitation court erred in denying their request for discovery before deciding their motions for a temporary injunction. (RMBS Br. at 45, 51-52; LVM Br. I at 32.) This same argument was rejected in *O'Neal v. Oxendine*, 514 S.E.2d 908 (Ga. App. 1999). In *O'Neal*, the rehabilitator for an insurer reached an agreement that would eliminate the rehabilitating insurer's policy obligations through reinsurance. *Id.* at 909. The rehabilitator sought court approval of the transaction.[12] *Id.* Prior to the hearing on the rehabilitator's motion for approval, O'Neal—a creditor of the insurer—moved to intervene, sought discovery relating to the transaction "to enable him to determine whether approval of the reinsurance agreement was fair and

[12] Unlike here, the agreement in *O'Neal* was between the insurer in rehabilitation and a reinsurer. *Id.* Therefore, court approval was required. Ga. Code § 33-17-13.

in his best interest," and appeared at the hearing to argue that approval should be delayed to allow discovery into the fairness of the transaction. *Id.* at 909-10.

The rehabilitation court refused to permit discovery, denied the motion to intervene, and agreed with the rehabilitator that the transaction was "fair and equitable to all parties in interest and calculated to maximize the value accorded to creditors." *Id.* at 910 (internal quotation omitted).

The Georgia Court of Appeals affirmed the rehabilitation court's decision to approve the transaction and deny O'Neal's motions for intervention and discovery, on grounds that are equally relevant here:

> [T]he trial court was faced with several considerations. First, and perhaps most important, . . . any delay in approval of the agreement could have jeopardized the ability of the Commissioner to close the transaction in a timely manner. Moreover, requiring [the reinsurer] to submit to depositions and produce all documents relating to the proposed agreement, as requested by O'Neal, could have affected [the reinsurer's] willingness to consummate the transaction. In denying O'Neal's motion, the trial court indicated it was "hesitant" to do anything to jeopardize the transaction.
>
> In addition, O'Neal failed to provide the trial court with any concrete basis to expect that

> allowing discovery was likely to lead to evidence that would affect the trial court's decision as to whether to approve the reinsurance agreement. . . . [T]his clearly authorized the trial court to conclude that the possible benefits of allowing discovery were outweighed by the danger of delay, particularly in light of the Commissioner's evidence regarding the deteriorating financial condition of the company and the adverse consequences of rejecting the reinsurance agreement. . . .
>
> Although the court technically "denied" the motion to intervene, it allowed O'Neal to participate fully in the approval hearing and to raise objections to the reinsurance agreement. Although O'Neal elected to present no testimony in opposition to the approval motion, he was not prevented from doing so by the trial court. Accordingly, he has not shown how he has been harmed by the denial of his motion to intervene.

Id. at 911-12.

Here, the rehabilitation court fully explained its reasons for denying the Funds' request for discovery on similar grounds:

> As policyholders, Movants do not have standing as parties to seek discovery in this rehabilitation proceeding. Moreover, even if Movants were parties and there were a basis for them to seek discovery in this proceeding, documents relating to OCI's regulatory decision-making are statutorily privileged under Wisconsin law. *See* Wis. Stat. §§ 601.465(1m)(a), (2m)(a). Finally, the discovery Movants seek would be futile because the scope of the Court's review of agency decision-making is very narrow and OCI, in the Peterson Affidavit, has

> demonstrated a reasoned basis for its actions to address the grave risks posed by Ambac's declining financial situation. As a matter of law, policyholders such as Movants cannot challenge the wisdom of OCI's decision-making, so long as OCI had a rational basis for its regulatory choices.

(R.127 at 16-17, ¶ 8 (OCI-App. 226-27).) *See also Fanshaw v. Med. Protective Ass'n of Ft. Wayne, Ind.*, 52 Wis. 2d 234, 240, 190 N.W.2d 155, 159 (1971) (where "[a]ppellant contends that the lower court abused its discretion in limiting or denying discovery" the appellate court "will not reverse unless abuse is clearly shown").

b. The Funds Failed To Show Any Irreparable Harm.

The rehabilitation court ruled that:

> Movants have failed to satisfy their burden of demonstrating irreparable harm. Their arguments regarding potential adverse consequences of the Bank Group Settlement on them are too speculative to be accorded weight. Moreover, their claims about the Settlement are measurable in money damages and the Bank Group members clearly are collectible as to the amounts at issue.

(R.127 at 15, ¶ 6(b) (OCI-App. 225).)

Similarly, in denying RMBS Funds' motion to enjoin the Bank Settlement pending appeal, this Court noted:

> [W]e are not convinced that the RMBS [Funds] will suffer irreparable harm if the injunction is not granted. We are not convinced that the fact

> that the Bank Group is comprised of foreign banks means that the funds will be dissipated and uncollectible. Because the movants have not established that they will suffer irreparable harm, the request for an injunction is denied.

(6/2/10 Ct. App. Order at 6.)

Because the LVM Funds' arguments are based solely on speculation regarding possible consequences of the Bank Settlement on their positions, and because they have failed to show that they lack an adequate remedy at law (assuming there was a legally cognizable theory of relief), they have failed to make the requisite showing of irreparable harm. *See Werner*, 80 Wis. 2d at 520, 259 N.W.2d at 314; *Waste Mgmt. of Wis., Inc. v. Dep't of Natural Res.*, 144 Wis. 2d 499, 511-12, 424 N.W.2d 685, 690 (1988) (the "mere possibility" of future harm is not sufficient to confer the right of a private party to challenge agency actions); *Nader v. Altermatt*, 347 A.2d 89, 97-98 (Conn. 1974) (rejecting policyholder challenge to commissioner's approval of an insurer's restructuring because "[m]ere generalizations and fears [of a future adverse impact on policyholders] are not sufficient to establish aggrievement").

c. The Funds Failed To Show That The Injunction Would Maintain The Status Quo.

As the rehabilitation court found, the Bank Settlement "*continues* Ambac's business practice *over the past two years* of commuting troubled policies at steep discounts from exposure estimates, with OCI's regulatory involvement and approval, outside of rehabilitation." (R.127 at 13, ¶ 33 (emphasis added); *see id.* at 3, ¶ 5 (Ambac made approximately $1.8 billion in commutation payments in 2008 and another $1.4 billion in 2009) (OCI-App. 213, 223).)

Because the Funds sought to enjoin Ambac's continuation of a business practice that existed prior to the events giving rise to the alleged ground for injunctive relief, denial of the temporary injunction was proper because it would disturb rather than preserve the status quo. *See Mogen David Wine Corp. v. Borenstein*, 267 Wis. 503, 510, 66 N.W.2d 157, 160 (1954) ("There was no allegation . . . that the acts on defendant's part which plaintiff sought to enjoin were any different after [the act giving rise to the lawsuit] than they were before. Therefore, the temporary injunction, if granted, would have disturbed the status quo and prevented

the defendant from [conducting business] in the same manner he had been doing[.]").

d. The Harm To Ambac And Others Outweighed Any Alleged Harm To The Funds.

The Funds also ignore the harm that an injunction of the Bank Settlement would have caused Ambac and others. As OCI explained:

> [T]he likely result of [the Bank Settlement] not closing will be that the total amount of claims that will need to be treated pursuant to any rehabilitation (regardless of whether it is purely in the Segregated Account or the resulting turmoil and litigation with the Bank Group ultimately forces OCI to place the entire company into a rehabilitation) will be several billion dollars higher, thus substantially diminishing the amount of consideration which the Rehabilitator will be able to pay policyholders through a rehabilitation plan. . . .

(R.74 ¶¶ 34-35 (OCI-App. 51-52).)

In its May 27 Order, the rehabilitation court concluded that:

> Ambac, the Segregated Account, and policyholders, would be subject to a significant risk of harm if the Bank Group Settlement did not close, and the Bank Group members exercised their contractual *ipso facto* and insolvency triggers. Movants do not address the issue of the bond needed to support an injunction, but OCI believes that a reasonable bond would be in the billions of dollars. This Court need not determine the appropriate

> amount of a bond here because the other requirements for injunctive relief are not met.

(R.127 at 16, ¶ 6(d) (OCI-App. 226); *see also* Wis. Stat. § 813.06 (bond requirement).)

In sum, having failed to show that any of the requirements for injunctive relief are met, the RMBS and LVM Funds' challenges to the denial of their motions to enjoin the Bank Settlement should be rejected.

B. The Consummation Of The Bank Settlement Mooted The Funds' Attempt To Enjoin That Settlement.

The object of the Funds' motions for injunctive relief was to prevent the consummation of the Bank Settlement. Because the rehabilitation court and this Court both denied the Funds' requests to prevent that transaction from closing, the Bank Settlement closed in June. As a result, the Funds' request for injunctive relief is now moot.

In the June 18, 2010 Order, this Court observed that the following two OCI positions were inconsistent:

> (a) The Funds were not subject to irreparable injury because any damages were quantifiable and there was no evidence that the Bank Group was not collectible if a legally cognizable claim existed; and

(b) the consummation of the Bank Settlement mooted the issue on appeal (*i.e.*, whether the Funds were entitled to an injunction to prevent the Bank Settlement from closing).

(6/18/10 Ct. App. Order at 5.)

However, OCI respectfully submits that there is no inconsistency between these two positions. Whether the Funds have a cognizable claim against the Bank Group based on the transfer of money from Ambac to the Bank Group as a result of the Bank Settlement was neither litigated nor resolved in the court below. The issue that was litigated and resolved was the RMBS and LVM Funds' failure to satisfy the criteria for obtaining an injunction to stop Ambac and the Bank Group from entering into the Bank Settlement. Neither this Court nor the rehabilitation court has the authority to undo a transaction after it has occurred. *See PRN Assocs. LLC v. Dep't of Admin.*, 2009 WI 53, ¶ 40, 317 Wis. 2d 656, 766 N.W.2d 559 ("We cannot unravel a contract when it has already been fully performed.").

The RMBS Funds cite this Court's June 2, 2010 Order for the proposition: "if this Court were to reverse, OCI and the Segregated Account could attempt to recover the funds improperly disbursed to the [Bank Group], or to seek

whatever relief would otherwise be available." (RMBS Br. at 52.) In fact, all the June 2 Order states is: "[w]e are not convinced that the fact that the Bank Group is comprised of foreign banks means that the funds will be dissipated and uncollectible." (6/2/10 Ct. App. Order at 6.) Moreover, because neither OCI nor the Segregated Account is a party to the Bank Settlement, and OCI's role was to approve that Settlement pursuant to its general regulatory authority, there is no legal basis for the RMBS Funds' position.

III. THE FUNDS' CHALLENGES RELATING TO THE SEGREGATED ACCOUNT SHOULD BE REJECTED.

This consolidated appeal highlights how narrow and divergent the interests of the different investors are. On the one hand, the RMBS Funds contend that the formation of the Segregated Account and the transfer of the RMBS policies to the Segregated Account were unlawful. (RMBS Br. at 27-44.)

On the other hand, the LVM Funds praise the creation of the Segregated Account, noting that it "served *laudable goals*, including the preservation of Ambac's claims-paying resources and the prevention of preferential payments to near-term claimants at the expense of long-term claimants."

(LVM Br. II at 4 (emphasis added).) They applaud the allocation of their co-appellants' RMBS policies to the Segregated Account, but object to the allocation of their own LVM policy to the Segregated Account. (*Id.*)

This example shows why the Wisconsin legislature granted OCI, with no personal stake, the authority to administer the insurance statutes and how best to accomplish the goals of Chapter 645. *See* 1 Steven Plitt, Daniel Maldonado & Joshua D. Rogers, COUCH ON INSURANCE § 5:22 (3d ed. 2008) (rehabilitator "may, for example, compromise individual interests in order to avoid greater harm to a broader spectrum of policy holders and public"); *Minor v. Stephens*, 898 S.W.2d 71, 76 (Ky. 1996) ("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.").

The Funds do not challenge *any* of the rehabilitation court's findings of fact related to the exercise of OCI's discretion in approving the Segregated Account or the allocation of the RMBS and LVM policies to the Segregated Account, much less show that they are clearly erroneous. As

discussed below, the Funds' legal arguments are all without merit.

A. The RMBS Funds' Challenges Should Be Rejected.

1. The Segregated Account Was Adequately Capitalized.

The RMBS Funds assert that the Segregated Account was not adequately capitalized under Wis. Stat. § 611.24(3)(a). (RMBS Br. at 28-34.) To the contrary, the Segregated Account is capitalized through "a $2 billion note and an excess of loss reinsurance agreement from the General Account." (R.127 at 11, ¶ 26 (OCI-App. 221).) As a result, the Segregated Account has access to virtually all of Ambac's claims-paying assets (*i.e.*, all amounts above the $100 million required surplus), despite being allocated less than 1,000 of Ambac's over 15,000 policies. (*See id.*; *see also* R.74 ¶ 10 (OCI-App. 40); R.1 Tab 1, Exs. G & H.)

Moreover, under Wisconsin law, the determination of minimum capitalization requirements falls squarely within OCI's discretion. 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. (1971). 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 a $100 million surplus 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 damage described in the rehabilitation court's prior findings (R.127 at 9-10, ¶¶ 21-24 (OCI-App. 219-20)), it *increases* 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 basis on which to require additional capitalization for the Segregated Account. "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. (1971) (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, through the Secured Note and Reinsurance Agreement—"the commissioner may set the required figure at zero under § 611.19(1)." *Id.*

Nevertheless, the RMBS Funds argue that OCI could not have determined whether the Segregated Account was adequately capitalized because it immediately petitioned for

its rehabilitation. (RMBS Br. at 33-34.) If such an argument were accepted, it would essentially rewrite Wis. Stat. § 611.24(3)(e), which expressly authorizes OCI to place segregated accounts into Chapter 645 delinquency proceedings. It would also delete the phrase "adequate share of the corporation's capital and surplus," which the Segregated Account clearly possesses to the fullest extent possible,[13] from the statutory comments.

2. The Establishment Of The Segregated Account Was Not A Novation.

The RMBS Funds argue that the allocation of their policies to the Segregated Account was ineffective because it allegedly failed to meet the requirements for novation under the common law of contracts. (RMBS Br. at 34.) However, this argument mixes unrelated legal concepts and has no application here.

Novation is a doctrine of the common law of contracts that permits the substitution of parties to a contract or the substitution of obligations between them so long as it is

[13] OCI would take further regulatory action under Chapter 645 if Ambac's surplus fell below $100 million. (R.222 at 15.) That minimum surplus merely ensures Ambac's continuing compliance with regulatory minimum requirements in states in which it is licensed to do business.

supported by consideration and the express or implied consent of the affected parties. *Navine v. Peltier*, 48 Wis. 2d 588, 593-94, 180 N.W.2d 613, 615 (1970); Restatement (Second) of Contracts § 280 (1981); *see also Brooks v. Hayes*, 133 Wis. 2d 228, 245 n.9, 395 N.W.2d 167, 174 n.9 (1986) (citing the Restatement (Second) of Contracts and other common law as the sources of the doctrine of novation in Wisconsin).[14]

In short, novation (or its absence) is a defense to claims and counterclaims for breach of contract, not a ground to invalidate regulatory approvals pursuant to statute. Whether the establishment of Segregated Account would have effected a novation under the common law of contracts, absent the existence of Wis. Stat. § 611.24, is irrelevant. Specifically, principles of contract law inform insurance statutes only "so far as consistent with the other purposes of

[14] Novation is an affirmative defense available to a party to the original contract and a condition precedent for a party to the new contract to recover for its breach. *See* 30 Richard A. Lord, WILLISTON ON CONTRACTS § 76:40 (4th ed. 2004) ("The existence of a novation is an affirmative defense to a claim for breach of an earlier contract because a novation operates to discharge the prior agreement."); *see also Navine*, 48 Wis. 2d at 590, 180 N.W.2d at 613 ("The action is on a promissory note. The defense is a claimed novation."); *Shank v. William R. Hague, Inc.*, 192 F.3d 675, 691-92 (7th Cir. 1999) (affirming summary judgment because the plaintiff did not acquire the right to recover under the contract due to a lack of effective novation).

[Chapters 600 to 655 of the Wisconsin Statutes]," Wis. Stat. § 601.01(7), and meeting the requirements for novation as applied in other contexts is inconsistent with the plain language of a statute permitting insurers to establish, and OCI to approve, segregated accounts for "any part" of their businesses. Under the RMBS Funds' view, improper novation could be used as a ground to challenge *any* statute or official act that might alter contractual obligations, from bankruptcy statutes to food and drug regulations to embargoes in times of war. None of the cases cited by the RMBS Funds remotely suggest that a common law defense to breach of contract is a ground to invalidate or modify statutorily authorized regulatory actions.

In addition, in invoking the issue of novation, the RMBS Funds fail to identify a substituted contract. *See* Restatement (Second) of Contracts § 280. The language of their respective policies is unchanged and, under Wisconsin law, Segregated Accounts are not wholly separate obligors from the insurer that forms them, but are instead a "corporation within a corporation" with access to an "adequate share" of the primary corporation's assets. Wis. Stat. Ann. § 611.24 cmt. (1971). This is especially true in this

matter given the structure of the Segregated Account, whereby the pool of assets available to pay policyholder claims (via the secured note and the reinsurance policy from Ambac) is essentially the same as existed prior to establishment of the Segregated Account.

3. There Was No Taking.

The RMBS Funds contend that the allocation of their policies to the Segregated Account was an unconstitutional taking[15] because OCI replaced their "contractual right to make claims against an insurer with a policyholders' surplus of nearly $892 million and assets of $8.5 billion" with "new contracts" requiring them to make claims only against the Segregated Account. (RMBS Br. at 40.)

However, the RMBS Funds never identify the source of their purported "contractual right to make a claim against an insurer" with a policyholders' surplus of some given amount. The Wisconsin legislature enacted Section 611.24 in 1971, well before the issuance of RMBS Funds' policies. Neither Ambac nor its policyholders can use private contracts

[15] Because the RMBS Funds do not assert that the protections under the state and federal constitutions differ, OCI applies a federal constitutional analysis.

to restrict the exercise of OCI's authority. *See, e.g., Norfolk & W. Ry. Co. v. Am. Train Dispatchers' Ass'n*, 499 U.S. 117, 130 (1991) (terms of pre-existing statutes are part of contract); *U.S. Trust Co. of N.Y. v. New Jersey*, 431 U.S. 1, 22 (1977) ("One whose rights, such as they are, are subject to state restriction, cannot remove them from the power of the State by making a contract about them.") (citation omitted).

Therefore, to the extent those policies granted the holders the right to make a claim against Ambac rather than a segregated account thereof, that right was merely conditional, subject to OCI's preexisting authority and duty to approve the establishment of segregated accounts in accordance with Wis. Stat. § 611.24.

Further, the RMBS Funds' policies give them the right to reimbursement of policy claims; there is no ground to distinguish between reimbursement from Ambac proper or the Segregated Account of Ambac, particularly when both accounts draw upon the same pool of claims-paying resources and have access to those resources to virtually the same extent. For that reason, no harm befell those entities whose

policies were allocated to the Segregated Account merely because of their allocation to the Segregated Account.[16]

Finally, even if the RMBS Funds have some cognizable property interest in the contractual right to make a claim against Ambac rather than its Segregated Account, they did not suffer a "taking" within the meaning of the Constitution. *See Connolly v. Pension Benefit Guar. Corp.*, 475 U.S. 211, 223-24 (1986) (no taking where government "has taken nothing for its own use, and only has nullified a contractual provision . . . by imposing an additional obligation that is otherwise within the power of Congress to impose"); *Carpenter v. Pac. Mut. Life Ins. Co. of Cal.*, 74 P.2d 761, 774-75 (Cal. 1937) ("The contract of the policyholder is subject to the reasonable exercise of the state's police power."), *aff'd sub nom*, *Neblett v. Carpenter*, 305 U.S. 297 (1938).

[16] To the extent they assert a taking based on the terms of a yet-to-be-confirmed plan of rehabilitation, that argument also fails. *See, e.g., Ky. Cent. Life Ins. Co. v. Stephens*, 897 S.W.2d 583, 589 (Ky. 1995) (rejecting claim that a delinquency proceeding effected an unconstitutional taking of contractual rights).

4. There Was No Due Process Violation.

The RMBS Funds also argue that OCI violated their due process rights by failing to provide them with notice and the opportunity to be heard prior to approving the allocation of the RMBS policies to the Segregated Account. (RMBS Br. at 42-44.) This argument fails for numerous reasons.

First, the Constitution did not entitle the RMBS Funds to any process prior to the formation of the Segregated Account. For the reasons described above, the RMBS Funds had no discernable, recognized property interest in the vague contractual rights they assert. Because OCI's approval of the Segregated Account in and of itself did not deprive them of life, liberty, or property, the Due Process Clause is inapplicable. U.S. Const. amend. XIV. The same holds true to the extent the RMBS Funds contend that due process required OCI to give them notice prior to petitioning for rehabilitation of the Segregated Account. *See, e.g.*, *Carpenter*, *supra*.

Second, even if the RMBS Funds had such an interest, due process did not require advance notice and a hearing here. Due process is a function of: (1) the private interest that will be affected by the official action; (2) the risk of an erroneous

deprivation of such interest through the procedures used; and (3) the government's interest, including the burdens imposed by alternative procedures. *Mathews v. Eldridge*, 424 U.S. 319, 335 (1976). Here, the private interest affected by OCI's approval of the Segregated Account was minimal; as noted above, the policy terms remained the same and claims payments would be made from the same pool of resources. The risk and consequences of an erroneous deprivation of that interest are similarly negligible, given that OCI may re-allocate policies to the General Account if warranted, and the RMBS Funds received immediate notice of the allocation and an invitation to be heard in the rehabilitation court following entry of the Injunction Order protecting against the precipitous exercise of contractual triggers. (R.9 ¶ 12 (OCI-App. 28-29).)

On the other hand, OCI's interest in relation to its duty to protect policyholders and public was immense. Notice and hearings prior to OCI's approval of the Segregated Account would have been both administratively impossible and disastrous for policyholders as a whole, for three reasons.

First, because Ambac has approximately 15,000 policies and an unknown number of beneficiaries, it was not

practical for OCI to conduct discussions on a confidential basis with all interested entities. (R.74 ¶ 39 (OCI-App. 54-55).)

Second, there was no practical way to identify the holders of RMBS securities, either because such securities are traded frequently or are held in nominee names and are effectively screened by intermediate trustees. (*Id.*)

Third, OCI was concerned that conducting non-confidential discussions with policyholders and beneficiaries prior to having a rehabilitation court injunction in place would have greatly enhanced the risk that entities would have attempted to exercise the various *ipso facto* and insolvency triggers in their contracts. "Had those triggers been pulled, it would have had a disastrous effect on OCI's effort to rehabilitate Ambac and protect policyholders." (*Id.*) *See also* Wis. Stat. Ann. § 645.32 cmt. (warning that the effects of a "run on the bank" mentality can render rehabilitation a "futile exercise").

Under such circumstances, due process does not demand a pre-deprivation notice and hearing. *See Ingraham v. Wright*, 430 U.S. 651, 680 (1977) (government interest and the "burdens of complying with the procedural requirements"

outweighed the benefits of pre-deprivation notice and hearings); *Mathews*, 424 U.S. at 348 ("At some point the benefit of an additional safeguard to the individual affected . . . and to society in terms of increased assurance that the action is just, may be outweighed by the cost.").

B. The LVM Funds' Challenges Should Be Rejected.

1. The LVM Funds Misread Wis. Stat. § 611.24(2).

The LVM Funds misread the segregated account statute and legislative history in *three* different respects.

First, the LVM Funds contend that "the segregated account statute make[s] clear that such accounts must be created by *type* of insurance." (LVM Br. at 20 (emphasis added).) However, the applicable provision, Section 611.24(2), entitled "OPTIONAL SEGREGATED ACCOUNTS," contains no such limitation. It states:

> 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 the segregated account would be contrary to the law or to the interests of any class of insureds.

Wis. Stat. § 611.24(2) (emphasis added).[17]

Second, the LVM Funds quote Section 611.24(1), entitled "MANDATORY SEGREGATED ACCOUNTS," and excerpt comments to that section, but neither that section nor the comments apply to the Segregated Account, which was created under Sub. (2) of Section 611.24. (*See* LVM Br. II at 19-22.)

Although Wisconsin law requires the establishment of mandatory segregated accounts for certain classes of insurance business if an insurer also engages in other classes of insurance business, Wis. Stat. § 611.24(1), nothing in the *optional* segregated account provision requires segregation of accounts by class of insurance, Wis. Stat. § 611.24(2). If otherwise, OCI would be unable to approve the establishment of any segregated account for Ambac, because it is a "monoline" insurer that offers only one class of insurance. Section 611.24(2) does not make that distinction, nor does it

[17] In approving the Segregated Account, OCI found that the Segregated Account was lawful and served the best interests of Ambac's only "class of insureds"—policyholders of financial guaranty insurance. (R.127 at 11, ¶ 26 (OCI-App. 221); R.74 ¶ 9(b)(i) Ex. 1.) As noted in Wis. Stat. § 611.24(1)(am), "financial guaranty insurance" is a specific "class of insurance business," and Ambac, as a "monoline" insurer, engages only in this class of business.

require a monoline insurer to create sub-classes of insurance based on undefined, arbitrary characteristics of the insured risk such as whether it insures the obligations of a municipality, a corporation, or some other entity or person, as the LVM Funds suggest.

Third, the LVM Funds misread the comment to Section 611.24(2), which provides:

> Sub. (2) provides for optional segregated accounts *under any circumstances the corporation wishes*, if the separation meets the commissioner's approval. This i[n] effect extends to all insurance the liberality of former s. 206.385(1) . . . . S. 206.385(1) is continued expressly (with minor changes) for life insurers in s. 611.25(2).

Wis. Stat. Ann. § 611.24 cmt. (1971) (emphasis added).

The LVM Funds argue that the reference to "former s. 206.385(1)" in the comment shows that the intent in Section 611.24(2) was to permit segregated accounts for specific types of insurance business. (LVM Br. at 24-26.) However, the comment states that former Section 206.385(1) is continued (with minor changes) as current Section 611.25(2), and the comment to the latter states:

> The language of former s. 206.385(1) *is so broad* as to permit *any desired portion* of the insurer's business to be in separate accounts.

Wis. Stat. Ann. § 611.25(2) cmt. (1971) (emphasis added). Thus, the LVM Funds have no textual support for any of their assertions.

Because Section 611.24(2) allows the establishment of a segregated account for "any part" of an insurer's business and "provides for optional segregated accounts *under any circumstances the corporation wishes*, if the separation meets the commissioner's approval," Wis. Stat. Ann. § 611.24 cmt. (1971) (emphasis added), LVM's statutory challenge to the allocation of their policy to the Segregated Account fails.

2. There Was No Equal Protection Clause Violation.

The LVM Funds do not even mention the fact that their Equal Protection challenge—to the allocation of their policy to the Segregated Account—is subject to the most deferential of standards: "rational basis" review. (*See* LVM Br. II at 27-32.)

Under Equal Protection Clause analysis,[18] as long as the distinction made does not involve a "suspect class" or a fundamental right—which governmental actions "[i]n the

[18] The state and federal Equal Protection Clauses are interpreted to be identical. *State v. Post*, 197 Wis. 2d 279, 317 n.21, 541 N.W.2d 115, 128 n.21 (1995).

area of economics and social welfare" do not—courts will uphold a classification if "*any* state of facts reasonably may be conceived to justify it." *Dandridge v. Williams*, 397 U.S. 471, 485 (1970) (emphasis added, internal quotation omitted). Even if it results a disparity in treatment, "[s]uch a classification cannot run afoul of the Equal Protection Clause if there is a rational relationship between the disparity of treatment and some legitimate government purpose." *Heller v. Doe*, 509 U.S. 312, 320 (1993).

Here, the allocation of the LVM policy to the Segregated Account easily meets this standard. As explained above, allocation decisions were based on whether policies had material projected losses and/or triggers that jeopardized Ambac's liquid claims-paying resources and thus put all Ambac policyholders at risk, regardless of the type of obligation the financial guaranty policies insured.

In the case of the bankrupt LVM, the loss exposure (of over $350 million) was one of the highest projected individual deal losses in the Segregated Account, and was approximately 35 times greater than the combined losses (to date) of the roughly 14,000 policies in the General Account.

(R.127 at 12-13, ¶¶ 29, 31; R.74 ¶¶ 12-13 (OCI-App. 41, 222-23).)

The LVM Funds do not dispute that the treatment of the LVM policy met OCI's criteria for allocation to the Segregated Account, or that nearly 200 other policies with public finance components also were allocated to the Segregated Account, under the same criteria that was applied to the LVM policy. (*See* R.127 at 12-13, ¶ 30 (OCI-App. 222-23).)

Finally, the LVM Funds' case authority supports OCI's position. (LVM Br. II at 27-28.) In *Carpenter*, the California Supreme Court upheld as rational a distinction in treatment between the majority of an insurer's policies that were generally sound and a minority of policies that, upon examination, were found to be "draining the old company to disaster." *Carpenter*, 74 P.2d at 767, 776, 778.

CONCLUSION

For the reasons stated above, the rehabilitation court's May 27, 2010 and July 16, 2010 Orders should be affirmed.

Dated this 18th day of November, 2010.

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CERTIFICATION

I certify that this brief conforms to the rules contained in sec. 809.19(8)(b) and (c), Stats., for a brief produced using a proportional serif font: Minimum printing resolution of 200 dots per inch, 13 point body text, 11 point for quotes and footnotes, leading of minimum 2 points, maximum of 60 characters per full line of body text.

The length of this brief is 15,833 words.

Dated this 18th day of November, 2010.

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CERTIFICATE OF COMPLIANCE WITH WIS. STAT. § 809.19(12)

I hereby certify that:

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CERTIFICATE OF SERVICE

I hereby certify that on November 18, 2010 I served by first class mail, post prepaid, upon counsel listed below the Consolidated Brief of Respondents Sean Dilweg, Commissioner of Insurance of the State of Wisconsin, and the Office of the Commissioner of Insurance and appendix.

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