STATE OF WISCONSIN CIRCUIT COURT DANE COUNTY

In the Matter of the Rehabilitation of:

Segregated Account of Ambac Assurance Corporation

Case No. 10-CV-1576 – B

DEPFA BANK, PLC'S POST-HEARING BRIEF

I. INTRODUCTION

The November 15-19, 2010 evidentiary hearing on the Commissioner's proposed Plan of Rehabilitation for the Ambac Segregated Account ("Plan") finally revealed to Ambac's policyholders the real story behind this rehabilitation proceeding. However, contrary to OCI's presumed intentions, what the hearing revealed is that OCI abused its discretion by pursuing a "rehabilitation" proceeding for the inappropriate and illegal purpose of intentionally disadvantaging policyholders with near-term claims in order to "bring them to the table" to give Ambac a stronger position from which to negotiate commutations (settlements) for significantly less than what the policyholders are owed. The policyholders who refuse to settle and instead pursue a claim under the Plan will be required to make a high risk loan to Ambac, in the form of a Surplus Note equal to 75% of what the policyholder is owed, all for the direct benefit of Ambac's General Account policyholders who will all receive 100% payment on any claims they incur in the future. In short, one group of Ambac's policyholders, who are to be paid 25 cents-on-the-dollar, are required to finance Ambac's survival so that it can pay 100 cents-on-the-dollar to its General Account Policyholders. A Plan that is as patently unfair as it is illegal should not be confirmed.

Prior to the evidentiary hearing on the Plan, OCI had firmly rejected and even ridiculed Depfa's early characterization of the Segregated Account rehabilitation process as seeking to disadvantage Segregated Account policyholders by impaling them on "Lord Morton's Fork"[1] in order to benefit General Account policyholders. This hearing stripped the OCI of any ability to continue to sugar coat the Plan and Rehabilitation process. Commissioner Dilweg confirmed *on direct examination* that he instituted the Plan for the express purpose of helping Ambac "derisk" the company's loss exposures by pressuring Segregated Account policyholders to commute (settle) their policy claims for a fraction of what Ambac owes. 11/15/10 Hearing Transcript at 149 (after achieving the Bank Group Settlement, the Commissioner's next step was to "turn and look at how we continue to work with the company to derisk further exposures") and 151 ("You know, part of the struggle here is policyholders who were getting that hundred cents on the dollar, that $150 million a month, you know, they weren't that exited to come to the table and stop that payment"). The Commissioner also confirmed that the Segregated Account has "no assets" and was never intended to function as an "independently viable insurer" as required under Wisconsin's Segregated Account statute. 11/18/10 Hearing Transcript at 215.

So, the bottom line, as revealed by the testimony, is simple. Ambac lacks sufficient assets and cash flow to pay its policy liabilities as they come due; thus Ambac is insolvent. Ambac was unsuccessful in raising the additional capital necessary to survive. So the OCI came up with a "solution" in the form of this proposed Plan – force Segregated Account policyholders either to choose between settling their claims at a large discount, which frees up capital for other policyholders, or file a claim under the Plan and thereby finance Ambac's

[1] The allusion to Morton's Fork is a variation on a "Hobson's Choice" – a choice between a bad option or nothing at all. Lord Morton was famous for affording his dinner guests with a choice between two bad alternatives, just as the Commissioner has done here.

capital needs for the next decade by taking a subordinated Surplus Note in lieu of 75% of their claim amounts.

The Plan is illegal for a number of reasons. The most obvious reason is that the Commissioner lacks the statutory authority to do what he has done. The Wisconsin Segregated Account statute may well be "unique in the nation," but on its face it does not authorize the Commissioner to create a segregated account for the sole purpose of hindering policyholders' ability to be paid on claims. Nor does the statute authorize the creation of a segregated account for the purpose of restructuring an insolvent company's claims liabilities on only a select number of its policies. An action by the Commissioner that exceeds his statutory authority is, by definition, an abuse of discretion. *Duel v. State Farm Mut. Auto. Ins. Co.*, 240 Wis. 161, 170, 1 N.W.2d 887, 891 (1942) ("[T]he insurance commissioner has only such powers as are conferred by statute and . . . these must be found within the four corners of the statute.") (citations omitted). In addition, the testimony clearly established that the Plan violates the constitutional rights of Segregated Account policyholders by, among other things, taking their property rights for the direct benefit of other Ambac policyholders and the public. Further, the Plan is unfair and unreasonable, in that it arbitrarily discriminates against certain policyholders without any rational basis.

In the end, the testimony at the hearing established that both the Plan itself, and the process utilized to create and implement the Plan, suffer from statutory and constitutional infirmities, and actually inflict harm on the very people that the OCI is charged with protecting. Accordingly, the Rehabilitator's motion to confirm the Plan should be denied.

II. DISCUSSION

A. The Deficient Process Associated with the Promulgation of the Plan and the Conduct of the Confirmation Hearing Requires Rejection of the Plan.

1. The "Fairness Hearing" Fell Short of the Requirements of Section 3(a)(10) of the Securities Act of 1933.

As the Court was informed at the outset, the confirmation hearing was both a hearing on the Commissioner's Plan under Wisconsin law, as well as a "fairness hearing" required under Section 3(a)(10) of the Securities Act of 1933. Conducting a fairness hearing under Section 3(a)(10) is a requirement that must be met in order for the Surplus Notes to be issued to policyholders without the preparation and filing of a formal registration statement with the SEC. The hearing that was actually conducted violated Section 3(a)(10) by failing to provide adequate discovery and failing to evaluate the fairness of the "value" of the proposed Surplus Notes. *See Continental Assurance Co. v. Macleod-Stedman, Inc.*, 694 F. Supp. 449, 468 (N.D.Ill. 1988) (noting among other fairness hearing factors the "scope of discovery record as an indicator of the adequacy of the investigation into the facts" and "the apparent alternatives to the settlement") (citation omitted); *see also* 15 U.S.C. § 77c(a)(10). Here, the policyholders were denied any access to formal discovery related to the Commissioner's support for his Plan (*see, e.g.*, 10/14/10 Hearing Transcript at 81:25-83:21), and were further denied the opportunity to review that underlying support at the November 15-19, 2010 hearings (*see, e.g.*, 11/18/10 Hearing Transcript at 67-69 (remediation analysis confidential); *id.* at 94 (valuation of run-off of municipal bond books confidential); *id.* at 127-30 (Court's denial of re-cross of witness)). Therefore, Depfa and the other policyholders were without critical information required to evaluate and be heard on the fairness of the Commissioner's Plan and the "value," if any, that they would gain under the proposed issuance of the Surplus Notes in that Plan. *See Continental Assurance Co.*, 694 F. Supp. at 468 (noting value of new securities exceeded liquidation value).

This missing information included specific facts and figures underlying the rejection of alternative plans, the liquidation value of the respective policies, and other modest documentation to allow policyholders to fully evaluate the Plan. This purposeful refusal to provide meaningful information under the guise of confidentiality is in direct contravention of what ought to happen at a "fairness hearing." *See Continental Assurance Co.*, 694 F. Supp. at 468-69 (noting extensive access to information and experts, including liquidation analysis).

The OCI was clearly caught between a rock and a hard place in connection with meeting the requirement under Section 3(a)(10) to provide evidence of the "value" of the Surplus Notes in order to allow the court to weigh the fairness of the exchange of policy claims for the mix of cash and Surplus Notes offered under the Plan. On the one hand, OCI felt it necessary to assert that the mix of cash and notes constituted "payment in full" by giving policyholders the indubitable equivalent of full and timely payment on claims. 11/15/10 Hearing Transcript at 190 (Commissioner Dilweg: "Under Wisconsin law <u>we are paying the full claims</u> through a cash surplus note split that will be evaluated each year on a going-forward basis.") On the other hand, to meet the requirements of Section 3(a)(10), the OCI needed to acknowledge the extraordinary risk associated with the ultimate payment of the Surplus Notes. In the hearing, OCI ended up taking the irreconcilable position that receipt of the cash and notes under the Plan was "payment in full" but that the future was too unpredictable to allow anyone, including the Commissioner and the Court, to make a reasoned determination of the real "value" of the Surplus Notes. Failing to adduce evidence of the value of the exchange means that OCI may not reasonably rely on the registration exemption under Section 3(a)(10), which means that issuance of the Surplus Notes will potentially result in violations of the Securities Act of 1933.

Moreover, this purported "fairness" hearing, was anything but fair. Because the Commissioner refused to permit the Court to conduct a fairness hearing in a manner that complied with the requirement of Section 3(a)(10), the issuance of the Surplus Notes under the Plan will not be exempt from registration with the SEC. This flaw not only exposes Ambac to new liabilities for the illegal issuance of unregistered securities in violation of the 1933 Act, but also renders the Surplus Notes effectively worthless to the unfortunate policyholders that receive the Notes. In the end, the Plan fails to provide for the *lawful* payment of 75% percent of every Permitted Policy Claim, and accordingly confirmation of the Plan should be denied.

2. **The Commissioner Has Not and Cannot Demonstrate that the Plan Comports with the Fairness He is Charged with Upholding.**

The Commissioner's authority to "reform and revitalize" an insolvent insurer, Wisconsin Statute § 645.33(2), is limited by his duty to protect both the interests of the insolvent insurer's policyholders and the public at large. *See Commercial Nat'l Bank v. Superior Court of Los Angeles County*, 17 Cal. Rptr. 2d 884, 889 (Cal. Ct. App. 1993) (noting that the law "imposes a fiduciary duty on the Commissioner, as a trustee, to all policyholders to ensure that each is treated fairly and shares ratably with other policyholders."). However, the Commissioner has confounded this duty by undertaking a rehabilitation process that, by design and from the very first moment, placed unwarranted emphasis on the interests of the General Account policyholders, while neglecting the well-being of the Segregated Account policyholders and the public of Wisconsin at large. As such, the Plan constitutes an abuse of the Commissioner's discretion and must be rejected by this Court.

a. **The Commissioner Impermissibly Conflates the Interests of the Segregated Account and General Account.**

Rather than subject all of Ambac to rehabilitation, the Commissioner directed Ambac to create a new entity (the Segregated Account) as a holding pen for "impaired policies"

for the sole purpose of placing that entity into rehabilitation. *See* 11/17/10 Hearing Transcript at 158 (Testimony of Roger Peterson, noting risks associated with policies required their seclusion to protect "overall structure"); *see also* Disclosure Statement at 7. The Court then appointed the Commissioner as rehabilitator of just the Segregated Account, not Ambac as a whole, thus restructuring only a subset of the Ambac policies issued by the previously undivided Ambac and leaving undisturbed the policies remaining in the General Account. 11/15/10 Hearing Transcript at 140-43; *see also*, Plan at p. 1. In practice, this means that the General Account policyholders (who are paid 100 cents on the dollar for their claims) are favored, while the Segregated Account policyholders (who receive 25 cents per dollar for their claims in cash, and 75% in an unregistered and illegally issued security – a Surplus Note) are cast aside.[2] This inequity is completely unsound as the only policyholders relevant to the Commissioner's "duty" in this context are those in the Segregated Account, not the General Account or Ambac as a whole.[3] Despite this important distinction, the Commissioner repeatedly justifies the treatment of the Segregated Account policyholders by referencing the benefit to Ambac as a whole and the General Account policyholders in particular (11/15/10 Hearing Transcript at 170), thereby undermining his contention that he has acted for the good of the relevant policyholders - those in

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[2] Depfa continues to maintain that the value of any Surplus Notes issued instead of cash payments are of questionable value as is demonstrated by the Commissioner's own analysis, which acknowledges that full recovery on those notes is uncertain. *See* Disclosure Statement at 66-68. Moreover, these Surplus Notes operate as a forced high-risk loan of capital by Segregated Account policyholders to the General Account. *See, e.g.,* 11/16/10 Hearing Transcript at 28-30 (Commissioner Dilweg testifying that the failure to generate new capital from any other source necessitated the Plan and the Surplus Note provisions).

[3] The Commissioner has asserted that he is empowered to protect all of Ambac (OCI's 10/21/10 Brief ISO of Plan at 9-11); however, his exercise of authority to protect Ambac as a whole within the context of the rehabilitation of the Segregated Account is a "shadow rehabilitation" in excess of his authority and in contravention of law. *See* Wis. Stat. §645.32; *see also Grode v. Mut. Fire, Marine & Inland Ins. Co.*, 572 A.2d 798, 804 (Pa. Commw. Ct. 1990), *aff'd, in part, sub nom., Foster v. Mut. Fire, Marine & Inland Ins. Co.*, 614 A.2d 1086 (Pa. 1992) (rehabilitator's ability to make decisions is circumscribed by the court's mandate to "act as a check on potential discretionary abuse and to insure equitable apportionment of loss").

the Segregated Account subject to rehabilitation.[4] Moreover, his actions continue to endanger the welfare of the Segregated Account policyholders as the Segregated Account itself has no assets (11/16/10 Hearing Transcript at 32-33) and the assets of the General Account are now the target of pilfering by the bankruptcy estate of Ambac's parent company, Ambac Financial Group, which filed for bankruptcy on November 8, 2010.[5] 11/15/10 Hearing Transcript at 169-71 (acknowledging risks of AFG bankruptcy generally) and 11/16/10 Hearing Transcript (acknowledging that when exercising control over General Account, the Commissioner acts merely as a regulator, not as a court appointed rehabilitator with actual title to and control over the company's assets). Therefore, unless and until the Commissioner rehabilitates Ambac as a whole, his power to ensure that the Segregated Account policyholders have access to real financial assets with which to pay claims will remain subject to great risk and uncertainty.

b. <u>The Plan will Harm, not Protect the Wisconsin Public.</u>

Despite any assurances from the Commissioner to the contrary (*see* 11/15/10 Hearing Transcript at 143, 146),[6] approval of the Plan will result in harm to the public of Wisconsin. As discussed in Depfa's prior briefing, Ambac's financial troubles and the unprecedented actions taken by the Commissioner in response to those troubles have revealed a heretofore unknown danger of buying insurance from, or doing any commercial business with, a

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[4] That the Commissioner created the Segregated Account with no assets such that it must rely on the General Account for any claim payments does not alter this analysis, but rather underscores it. Despite Wisconsin Stat. §611.24's requirement that a Segregated Account be adequately capitalized at its inception, as the Commissioner has stated in direct testimony, "there are no assets in the Segregated Account, only liabilities." 11/16/10 Hearing Transcript at 32-33. Clearly, the Segregated Account is the ugly red-headed step-child in this analysis.

[5] Depfa notes that November 8, 2010, was also the Court's deadline for any objections to confirmation of the Plan, which prejudiced Depfa against fully addressing the significance of this development.

[6] Without any evidentiary or factual support, the Rehabilitator asserts that the Plan will save several hundred thousand jobs at Dunkin Donuts, Hertz, and Sonic Corporation. *See* 11/16/10 Hearing Transcript at 161-62 (suggesting that complete rehabilitation of Ambac could have led to bankruptcy of Hertz and Dunkin Donuts). However, Depfa questions the imminence of such potential losses and points to the economic implications arising from the non-speculative, quantifiable losses born by the policyholders of the Segregated Account under this Plan.

Wisconsin-domiciled insurer. Simply put, a purchaser of Wisconsin-domiciled insurance can no longer be sure that said insurer will be responsible to pay that policyholder's claims. If the Commissioner's interpretation of Wisconsin law (and the discretion afforded him under that law) is correct, policyholders who buy insurance from a Wisconsin-domiciled company are not legally entitled to rely upon the full financial backing and protection of the insurer's entire asset portfolio. Rather, policyholders of a Wisconsin-domiciled insurance company may end up holding nothing more than the ability to pursue coverage from an undercapitalized or illiquid Segregated Account, while the insurer's management rebuilds the company's business around policyholders who pay premiums, but never submit claims. Certainly these risks will have an adverse impact on businesses, jobs, and the long-term public good of Wisconsin. Therefore, approval of the Plan will harm, not protect, the Wisconsin public.[7]

3. "Rehabilitating" From Beneath a Cloak of Secrecy Violates the Spirit and Intent of Wis. Stats. 645.

The Commissioner's own briefing has held out *Carpenter* as the seminal case that this Court should look to for guidance. *See* OCI's 10/21/10 Brief ISO of Plan at 6-13. However, these proceedings have not comported with the national standards originally articulated in *Carpenter*, which afford significantly more discovery and other process than was afforded in this case. *See Carpenter v. Pac. Mut. Life Ins. Co. of Cal.*, 74 P.2d 761, 770-71 (Cal. 1937) (describing intervention, evidence, and alternatives posed at confirmation hearings lasting six weeks); *see also Tex. Commerce Bank v. Garamendi*, 14 Cal. Rptr. 2d 854 (Cal. Ct. App. 1992) (extensive judicial proceedings and multiple evidentiary hearings extending over a number of

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[7] Not only does the Plan fail to protect the public, any theoretical protection it affords to General Account policyholders appears to be illusory, given the OCI's position that the OCI is empowered to create a series of new Segregated Accounts within Ambac as new liabilities emerge. 11/18/10 Hearing Transcript at 227 (Mr. Peterson testifying that "Yeah. We're not precluded or the company wouldn't be precluded from creating another Segregated Account.")

months); *Commercial Nat'l Bank v. Superior Court of Los Angeles County*, 17 Cal. Rptr. 2d 884 (Cal. Ct. App. 1993) (same); *Tex. Commerce Bank-El Paso, N.A. v. Garamendi*, 34 Cal. Rptr. 2d 155 (Cal. Ct. App. 1994) (same). On the contrary, the Commissioner has refused to provide basic information underlying the Plan, such that the policyholders have had no choice but to oppose approval of the Plan.[8] *See, e.g.*, 10/14/10 Hearing Transcript at 89:17-90:15. Moreover, the Commissioner has refused to collaborate with the policyholders on the appropriate form of rehabilitation,[9] and instead, has produced the Plan in a vacuum that is not likely to withstand appellate scrutiny. *See Garamendi v. Golden Eagle Ins. Co.*, 27 Cal. Rptr. 3d 239, 251 (Cal. Ct. App. 2005) (recognizing robust process ensures durability of rehabilitation plan). The Commissioner's preferential settlements and fraudulent transfers -- *e.g.*, the $4 billion Bank Group settlement of CDO liabilities – further demonstrate his perceived entitlement to forego substantive, timely disclosures. *See, e.g.,* 11/15/10 Hearing Transcript at 150:5-12 (describing the "four to six month" undisclosed settlement process with limited numbers of claimant banks); *see also* 4/30/10 Emergency Motion of RMBS (first bringing imminent Bank settlement to Court's attention); 5/5/10 Emergency Stay Motion of LVM Bondholders (same). Obviously, Wis. Stat. 645 requires greater process than has been afforded in this case.

[8] This unwarranted concealment is further demonstrated by the Commissioner's secret deal to commute a large reinsurance agreement between Ambac UK and Ambac that had been assigned to the Segregated Account. Depfa disclosed its interest in that contract in its June 22, 2010 filing; however, Depfa did not learn of its commutation until the Commissioner disclosed it in his Disclosure Statement (*see* p. 24), nor did the Commissioner consult this Court. This lack of transparency demonstrates that neither the Court nor the parties can have any confidence that the Commissioner will not alter the information in the Disclosure Statement without notice to the Court or the policyholders whenever he feels empowered to do so.

[9] Request for Proposal bidding and auction process has become the norm in complex insolvencies because it ensures transparency and credibility, in addition to permitting the free market to bring forth the best possible solution.

4. **The Trial Court Was Without Jurisdiction to Conduct These Hearings.**

The Commissioner's motion to confirm the proposed Plan is founded on the threshold notion that the Commissioner and Ambac acted legally when they created the Segregated Account as a means of restructuring Ambac. *See* OCI's 10/8/10 Motion to Confirm Plan at 5, ¶ 7. The Court's rejection of the many challenges to the legality of the Segregated Account and its placement into rehabilitation presently are on appeal.[10] As a result of those appeals, which squarely place the legality of the Segregated Account within the jurisdiction of the Court of Appeals, District IV, this Court has been divested of jurisdiction to act on matters that relate to the rehabilitation of the Segregated Account. *See Griggs v. Provident Consumer Disc. Co.*, 459 U.S. 56, 58 (1982) (per curium) (noting filing of notice of appeal "divests the [trial court] of its control over those aspects of the case involved in the appeal" while "confer[ing] jurisdiction on the [appellate court]"); *see also*, Wis. Stat. § 808.075(3) (divesting jurisdiction upon filing of appellate record). The legality of the Segregated Account is not one of the instances where a lower court in an insolvency proceeding would retain jurisdiction. *See, e.g., In re Bryant*, 175 B.R. 9, 11-12 (Bankr. W.D. Va. 1994) (jurisdiction retained where (1) not related to issue of appeal, (2) order appealed is not appealable or is clearly frivolous, and (3) court's action will aid in appeal); *see also In re Bialac*, 694 F.2d 625 (9th Cir. 1982) (filing notice of appeal deprives bankruptcy court of jurisdiction to enter orders affecting or modifying issue or matter of appeal). Clearly, the requested approval of the Commissioner's Plan would

[10] In addition to Depfa's own appeal of these issues, which was filed with the Court of Appeals on November 5, 2010 (Case. Number 2010-AP-2835), the dispute over the legality of the creation of the Segregated Account and the Commissioner's immediate rehabilitation are also challenged in a consolidated appeal filed by the RMBS Bondholders and the LVM Bondholders (Court of Appeals, District IV, Appeal Number: Consolidated Appeals 2010-AP-1291), as well as appeals filed by Freddie Mac; WellsFargo Bank, N.A.; Access to Loans for Learning Student Loan Corporation; and Lloyds Bank, Pls. The appellate record has been lodged in many, if not all of these appeals, and therefore, pursuant to Wis. Stat. § 808.075(3), this Court has been divested of jurisdiction regarding the subject matter of these interlocutory appeals.

expand, alter, affect, or modify the legal status of the Segregated Account and the rights of the policyholders whose policies have been allocated to the Segregated Account. Under these well-established principles, the Circuit Court lacks jurisdiction to approve the Plan and should defer that approval until such time as the Court of Appeals concludes its review of the pending appeals relating to the legality of the Segregated Account.

Indeed, the OCI clearly has awakened to the fact that the appeals strip this Court of jurisdiction to confirm the Plan, because OCI has now filed (on the Wednesday evening before Thanksgiving) a motion to dismiss the pending appeals, in the hopes of salvaging this Court's jurisdiction over the issue of the legality of the Segregated Account. However, the legal position taken in the motion to dismiss, that the "final" ruling on the legality of the Segregated Account will not occur until the Plan is confirmed, is totally inconsistent with the position taken by the OCI at the outset of the evidentiary hearing that this issue was previously decided. Until the Court of Appeals rules on the pending appeals over the legality of the Segregated Account, this Court should refrain from confirming the Segregated Account Rehabilitation Plan.

B. Substantive Flaws in the Plan

1. Claim Penalty Provisions

OCI failed to rebut or even address the fundamental defect in the Plan that the Plan, as written, penalizes policyholders like Depfa – if they file a claim, they risk losing the right to their collateral, which is generally significantly more than they would be paid in cash on their claim.[11] *See* Aff. of Nancy Henderson in Supp. Of Depfa Bank, PLC's Objections to the Proposed Plan of Rehabilitation ("Henderson Aff."), ¶¶ 7-8; Stipulation Regarding Use of Aff. of

[11] While the OCI, through counsel, did offer to clarify that Depfa and other bondholders of Access to Loans for Learning ("ALL") would in all events receive the value of their collateral, and would only be required to claim for the shortfall under the relevant Ambac policy, no evidence or statement to such effect was placed on the record, nor did OCI introduce any evidence to rebut this extraordinary flaw in the Plan.

Nancy Henderson at Plan Confirmation Hearing ("Stip."), ¶ 1. Under the Claim Penalty Provisions,[12] upon submission of a Claim, Ambac will seize the trust collateral and then pay only a portion of that cash amount to the claimant under the 25% cash component of the claim payment provisions under the Plan. OCI's presentation at the Hearings ignored this flaw. This contravenes public policy, which does not permit such improvements to an insurer's contractual position. *See Dardar v. Ins. Guar. Ass'n*, 556 So.2d 272, 274 (La. Ct. App. 1990) (holding that insurance rehabilitator, with authority to conduct business of an insolvent insurer, steps into the shoes of the insurer and is bound by the same constraints as is the insurer in the normal course of business). Further, the confiscatory nature of the Claim Penalty Provisions render the Plan defective. *See Calfarm Ins. Co. v. Deukmejian*, 771 P.2d 1247, 1250-55 (Cal. 1989) (violation of due process due to lack of relief from confiscatory rates); *see also Neblett v. Carpenter*, 305 U.S. 297, 305 (1938) (while policyholders have no constitutional right "to a particular form of remedy," they are entitled to as least the liquidation value of their claims); *Carpenter,* 74 P.2d at 778 (same). Therefore, the Plan must be rejected.

2. **<u>The Plan Violates Wisconsin Law and Exceeds the Commissioner's Authority.</u>**

While it is clear that the Court was divested of jurisdiction to hold the Confirmation Hearing, the process was nonetheless helpful in that the Commissioner was forced to articulate his motives in formulating this rehabilitation process and about the operation of the Plan. He made the following things clear.

He created the Segregated Account to "sequester" Ambac's liabilities solely for the purpose of effecting a restructure of the claim payment obligations, not to create a legitimate Segregated Account as contemplated under Wis. Stats. § 611.24. Contrary to the mandates of

[12] The "Claim Penalty Provisions" are made up of Sections 4.04(g) and (h) of the Plan and the Proof of Policy Claim Form (Exhibit C to the Plan).

§ 611.24(3)(a), the Segregated Account has no assets. *See* 11/15/10 Hearing Transcript at 214; 11/16/10 Hearing Transcript at 32-22. It has no prospect of being a going concern (11/15/10 Hearing Transcript at 215; 11/16/10 Hearing Transcript at 55-56) and has disadvantaged policyholders allocated to it.[13] *See* Wis. Stat. 611.24(2) (prohibiting segregated account approval where contrary to interests of class of insureds); *see also* Wis. Stat. 645.31 (only allowing rehabilitation of segregated accounts where such account may be successfully rehabilitated without substantial increase in the risk of loss to creditors of the insurer or the public). Rather, it is a convenient, although misguided manner of running-off the "troubled" policies and other liabilities of Ambac, while feathering the nest of the General Account with Segregated Account assets. *See* 11/15/10 Hearing Transcript at 214 (goal to run-off business and terminate account) 11/16/10 Hearing Transcript at 55-56 (purpose to run-off liabilities). This is not within the contemplation of Wis. Stat. § 611.24.

Moreover, despite his statutory duty to act otherwise (*see Garamendi v. Executive Life Ins. Co.*, 21 Cal. Rptr. 2d 578, 584-85 (Cal. Ct. App. 1993) (duty to conserve and equitably administer assets), the Commissioner wields the Segregated Account like Lord Morton's Fork, forcing the disadvantaged policyholders of the Segregated Account to Ambac's settlement table and protecting the favored General Account policies from the rehabilitation proceedings. 11/15/10 Hearing Transcript at 188-189 (noting intent "[t]o bring people to the table to resolve the policy claims with the insurance company"). He did this knowingly and intentionally to coerce the Segregated Account policyholders into settling for less than what they were owed to free up capital for policyholders of the General Account. *See* 11/15/10 Hearing Transcript at

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[13] Despite assertions that the Segregated Account is protected by the assets of the General Account, Depfa is compelled to note (1) that the assets of the General Account continue to be diminished by settlements and commutations approved by the Commissioner, and (2) that the Commissioner has not acted to protect the General Account from the bankruptcy of Ambac's parent, Ambac Financial Group by placing Ambac's entire asset base into Rehabilitation.

188-191.[14] This sort of "rehabilitation" is not permitted by law and is therefore an abuse of the Commissioner's discretion. *See, e.g., In re Jacobs*, 149 B.R. 983, 992-93 (Bankr. N.D. Okla. 1993) (insurance commissioner cannot use regulatory authority to extort payment or punish nonpayment of debt discharged in bankruptcy proceedings); *State ex rel. Time Ins. Co. v. Smith*, 184 Wis. 455, 481, 200 N.W. 65 (1924) (commissioner may not hold insurance license renewals hostage to effectuate reinterpretation of policy requirements). Therefore, the Plan must be rejected.

3. <u>The Settlement & Commutation Process Created by the Commissioner is Structurally Tilted in Ambac's Favor.</u>

Despite OCI's own admissions that Ambac is and has been underreserved based upon an overly rosy view of its true liabilities (11/16/10 Hearing Transcript at 147:11-23 (Roger Peterson testimony regarding OCI's "independent valuation" of loss exposure that showed a "significant differential" between Ambac's projections and OCI's loss projections), Ambac continues to seek settlements and commutations that try to "maximize . . . [Ambac's] . . . capital" (*e.g.*, to strike a good deal) (*see* 11/18/10 Hearing Transcript at 161). In other words, OCI's "independent" evaluation showed that Ambac's loss projections were too low, but at the same time, OCI has now placed Ambac in the position of negotiating for further settlement discounts off of numbers that OCI itself has already concluded are too low.

This skewed settlement and commutation stance is further demonstrated by OCI's stated mandate that it will only approve settlements that enhance Ambac's capital and surplus,

[14] The Commissioner testified extensively about his desire to "bring policyholders to the table" by placing the Segregated Account into rehabilitation, in order to provide for settlement agreements at "less than full value." *Id.* OCI's counsel, recognizing that the Commissioner's testimony clearly validated Depfa's long-standing complaint that this entire rehabilitation process was an abuse of the power and process of insurance company delinquency proceedings, attempted a feeble and incredible effort to rehabilitate the Commissioner on re-direct. 11/16/10 Hearing Transcript at 126-27. The effort was game, but ineffective. The Commissioner's testimony the prior day clearly established his actual intent to disadvantage policyholders to "bring them to the table."

meaning that the Commissioner will only approve settlements that are for *less* than Ambac's artificially low reserves or loss estimates. Therefore, despite the Commissioner's duty to the Segregated Account policyholders, the best settlement and commutation that any Segregated Account policyholder can hope for is a settlement that is materially *less* than the reserve amount, which the OCI has already admitted is too low.

III. CONCLUSION

The hearing conducted from November 15 through 19, 2010, finally revealed the true strategy of the OCI in managing Ambac's insolvency. What has been revealed is improper, unreasonable, unfair, and violates Wisconsin law and the constitution. For these reasons, as well as the reasons set forth in all of the other policyholder and creditor opposition submissions, Depfa respectfully asserts that the Court should deny confirmation of the Plan.

Dated this 29 day of November, 2010.

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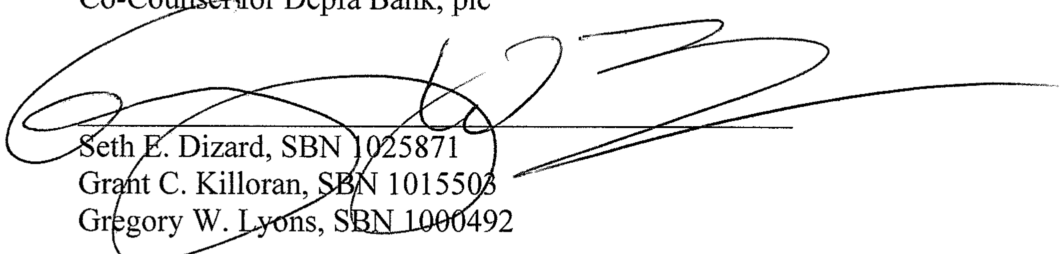

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