STATE OF WISCONSIN CIRCUIT COURT DANE COUNTY

In the Matter of the Rehabilitation of:

Case No. 10 CV 1576

SEGREGATED ACCOUNT OF
AMBAC ASSURANCE CORPORATION

POST-CONFIRMATION HEARING BRIEF OF ACCESS TO LOANS FOR LEARNING STUDENT LOAN CORPORATION AND LLOYDS TSB BANK PLC

Access to Loans for Learning Student Loan Corporation ("ALL Student Loan") and Lloyds TSB Bank plc (together "ALL/Lloyds") appeared and participated in the confirmation hearing in this case held on November 15-19, 2010. They will appear and participate by their counsel in closing arguments on November 30, 2010. At that time, they will ask the Court to deny the Rehabilitator's motion for confirmation of its proposed rehabilitation plan (the "Plan"). In support of their request, they are submitting the accompanying proposed findings of fact and conclusions of law. They also submit this brief summarizing reasons that the Court should deny the Plan.

Rather than repeat in detail previous submissions, ALL/Lloyds adopt their prior briefs and supporting affidavits as support for the denial of the Plan. Further support for the denial of the Plan includes all of the proposed findings of fact and conclusions of law they are submitting, many of which will not be specifically addressed in this short brief. ALL/Lloyds further adopt consistent arguments for denial of the plan made by all other entities that have objected to or opposed confirmation of the Plan.

ARGUMENT

The evidence submitted during the confirmation hearing strengthens the contentions ALL/Lloyds have made throughout their participation in this case, which began on June 22, 2010. In particular, (1) there was no legal or factual basis for OCI to virtually simultaneously approve the creation of the Segregated Account and place the Segregated Account in insurer delinquency proceedings; (2) regardless of the lawfulness of the Segregated Account, there was an insufficient factual basis to place the ALL Student Loan policies into the Segregated Account; (3) OCI has failed to provide sufficient information to ALL/Lloyds to enable them to fully evaluate the proposed rehabilitation plan and determine if their policies were properly allocated to the Segregated Account; and (4) OCI failed to provide sufficient evidence to the Court at the November 15-19, 2010 hearing to demonstrate the lawfulness of the Segregated Account or the placement of specific policies into the Segregated Account. In addition, the hearing evidence failed to demonstrate any reasonable basis to confirm OCI's proposed Plan.

I. THE FAILURE TO PROVIDE ALL/LLOYDS WITH BASIC AND AVAILABLE INFORMATION OR THE OPPORTUNITY FOR EVEN LIMITED DISCOVERY PRECLUDES PLAN CONFIRMATION AS A MATTER OF LAW.

Sean Dilweg, the Commissioner of Insurance, testified at the confirmation hearing that he followed a policy of "transparency" regarding disclosure of information about the rehabilitation of the Segregated Account. (11/15/10 Tr. at 164) He acknowledged, however, that in this litigation he instead advocated the denial of each and every

information or discovery request by any and all interested parties that he did not want to grant. (*Id*. at 237) As ALL/Lloyds and other interested parties have contended throughout this proceeding, the Court's denial of all information and discovery requests opposed by OCI violated the interested parties' rights as participants in this proceeding and rights guaranteed by the due process clauses of the U.S. and Wisconsin constitutions.

As the participating policyholders and other interested parties informed the Court prior to the scheduling conference, they needed "basic information … to evaluate the terms of any plan of rehabilitation, including information concerning the obligations and the claims paying resources of both the Segregated Account and the General Account." (Statement of Certain Policyholders (Oct. 14, 2010), dkt. # 468.) The evidence presented at the confirmation hearing established that at least some of the information was readily available to Ambac and OCI, could have been provided to interested parties without violating confidentiality or other policies, included data necessary to determine whether policyholders of policies allocated to the Segregated Account were treated equitably, and was necessary to permit the objective evaluation of the proposed rehabilitation plan. (*E.g.*, ALL/Lloyds' Proposed Findings of Fact and Conclusions of Law Nos. 51 and 52, hereinafter "Lloyds' Proposed Findings" or "Lloyds Proposed Conclusions")

For example, Ambac and OCI could have provided ALL/Lloyds with policy and loss data for policies in the General Account to permit the determination of whether the material projected impairment on the ALL/Lloyds policy was comparable – but they refused to do so and the Court declined to require them to make the disclosures. (Lloyds' Proposed Findings Nos. 24, 51 and 52) Moreover, OCI and Ambac did not inform

ALL/Lloyds of the "material projected losses" that caused its policy to be allocated to the Segregated Account, let alone how the projected timing and amount of those losses compared to policies in the General or Segregated Accounts. (Lloyds' Proposed Findings Nos. 21-24) Nor was ALL/Lloyds provided the option to continue to forbear the exercise of the trigger in its policy (the increased "default interest rates") as was provided to others as a basis for keeping policies in the General Account. (*Id*. at No. 21) Further, neither before nor during the hearing did OCI or Ambac define "short tail" or "long tail" or, even assuming the ALL/Lloyds policy was "short tail," explain whether or how the ALL/Lloyds policy was different from other "short tail" policies in the General Account. (*Id*. at No. 23) The continued failure to provide ALL/Lloyds with basic information before and during the confirmation hearing precludes confirmation of the proposed rehabilitation plan.

II. THE FORMATION OF THE SEGREGATED ACCOUNT WAS UNLAWFUL.

This brief will not try to summarize or repeat the hundreds of pages of briefs that have been submitted in this case regarding the lawfulness of the creation of the Segregated Account. Instead, it will provide the following selected points for the Court's consideration about which there was significant evidence at the confirmation hearing.

1. OCI was unable to provide any evidence that it satisfied the requirements for issuance of a certificate of authority under Wis. Stat. § 611.20 for the Segregated Account. (Lloyds Proposed Conclusions No. 2, 11, 12 and 15). Indeed, it did not appear to know whether it had issued a certificate of authority with the approval of the Segregated Account as "a newly organized corporation" or whether the Segregated

Account was "established after a certificate of authority ha[d] been issued." (*See* Wis. Stat. § 611.24(3)(a)). Moreover, OCI failed to provide any evidence that it complied with Wis. Stat. § 611.13, requiring an organization permit and certificate of incorporation. (Lloyds Proposed Conclusions No. 2, 13, 14 and 15) Though asserting that the Segregated Account is a "separate insurer" – insulating General Account policies from insurer rehabilitation and Court supervision – OCI failed to assert that the basic requirements for creating a separate insurer were satisfied or that any statutory provision or other authority exempted the Segregated Account from those basic requirements. While one of its witnesses – Roger Peterson – speculated that maybe an organizational permit was not required as the Segregated Account was a "corporation within a corporation," OCI did not provide any evidence or argument in support of his speculation.

2. Despite contending throughout these proceedings that pursuant to Wis. Stat. 611.24(3), OCI had the unfettered discretion to establish "the minimum capital or the minimum permanent surplus and the initial expendable surplus to be provided for [the General Account]," it failed at the confirmation hearing to submit any supporting foundational evidence. Wis. Stat. § 611.24(3)(a) requires the specification of such minimums "in the certificate of authority of a newly organized corporation." Yet, OCI did not and apparently could not produce a certificate of authority for the Segregated

Account. Nor did OCI present any evidence or argument to suggest that it could instead rely on Ambac's certificate of authority.[1]

3. ALL/Lloyds and most other interested parties have contended throughout this case that as a matter of law the Segregated Account could not meet the requirement of Wis. Stat. § 611.24(3)(a) for "an adequate amount of capital and surplus" when it was created on the same day that OCI found it was necessary to place it in insurer delinquency proceedings. By definition, the requirement for creation of a segregated account – as described in the official comments to the statute – that a segregated account be "adequately capitalized to make it independently viable," was violated by the immediate placement of the Segregated Account in rehabilitation under Wis. Stat. ch. 645. No evidence submitted at the confirmation and no argument made before or during the confirmation hearing did anything to refute the common sense conclusion that the Segregated Account's creation violated the requirement for adequate capital and surplus. (Lloyds Proposed Conclusions No. 2, 4-10)

4. The contention by OCI and Ambac that the reference in Wis. Stat. § 611.24(3)(e) to insurer delinquency proceedings evidences a statutory intent to, in effect, trump the requirement for adequate capital and surplus in § 611.24(3)(a) is absurd on its face. Section 611.24(3)(e) reads as follows:

[1] If OCI attempts, at this late stage of these proceedings, to argue that the Segregated Account is covered by Ambac's certificate of authority, then all of its arguments that the Commissioner had the complete discretion under the statute to establish the minimum capital and surplus requirements are irrelevant. The only issue, then, under § 611.24(3)(a), is whether the Segregated Account had adequate capital and surplus, which is an issue of a statutory construction (an issue of law for the Court to decide), rather than an issue of the Commissioner's discretion.

> *Delinquency proceedings.* Each segregated account shall be deemed an insurer within the meaning of s. 645.03 (1) (f). A liquidation order under s. 645.42 for the general account or for any segregated account shall have effect as a rehabilitation order under s. 645.32 for all other accounts of the corporation. Claims remaining unpaid after completion of the liquidation under ch. 645 shall have liens on the interests of shareholders, if any, in all of the corporation's assets that are not liquidated, and the rehabilitator may transform the liens into ownership interests under s. 645.33 (5).

While § 611.24(3)(e) implicitly suggests that a segregated account may be subject to rehabilitation, it explicitly states that "any segregated account" can be subject to insurer liquidation under § 645.42. As even OCI might be forced to agree, the creation and liquidation of a segregated account on the same day would be absurd; yet, the contention that a segregated account can be placed in rehabilitation at the same time of its creation depends on the absurd interpretation of § 611.24 that a segregated account can be simultaneously created and liquidated. Statutes should not be construed to reach absurd results. *State ex rel. Kalal v. Circuit Court for Dane County*, 2004 WI 58, ¶ 46, 271 Wis. 2d 633, 681 N.W.2d 110. The only reasonable construction of Wis. Stat. § 611.24(3)(e) is that if, over time, a segregated account – initially created as an independently viable separate insurer – experiences problems requiring rehabilitation or liquidation, it can then be the subject of such proceedings under Wis. Stat. ch. 645.

5. OCI has consistently and repeatedly asserted throughout these proceedings that the Segregated Account as a matter of fact and law had adequate capital and surplus at the same time that it required rehabilitation. The evidence – and absence of evidence – presented during the confirmation hearing confirmed that there is no factual support for this contradictory standard. It did not satisfy the impossible standard that a right to

timely payment in cash of 100% of a valid claim is equal to a conditional right to 25% cash and a wholly uncertain payment of the balance in the form of Surplus Notes at an uncertain time in the future. Moreover, OCI's contention that the Segregated Account "has access to all of the assets of Ambac, in *pari passu* with General Account policyholders" based on the Secured Note and Reinsurance Agreement was contradicted at the confirmation hearing. The evidence established that the assurance of full payment in the note and agreement was invalid, illusory, and unenforceable against "all assets of the General Account" because the "assurances" were subject to broad contingencies and preconditions. (Lloyds Proposed Findings Nos. 32-47) The evidence at trial was consistent with a close reading of the Disclosure Statement: There is no assurance that any payment will be made for valid claims in the Segregated Account.

III. The Rehabilitation Plan Unlawfully Creates Two Classes of Policyholder Creditors

The Segregated Account – and the rehabilitation plan based on it – unlawfully created two classes of policyholder creditors in violation of Wis. Stat. § 645.01(4)(d), § 611.24(2) and § 645.68(3). The myth that General Account policyholders and Segregated Account policyholders were treated equally was proven to be simply a myth. On March 24, 2010, OCI sought and obtained Court approval for the creation of two classes of Ambac policyholders – those with policies in the General Account and those with policies in the Segregated Account. As described above, and in detail in the ALL/Lloyds proposed findings of fact and conclusions of law, those two classes were not

and are not equal. Accordingly, a rehabilitation plan based on the creation of those two classes is invalid as a matter of law.

IV. The ALL/Lloyds Policy Should be Returned to the General Account

The OCI did not present admissible evidence in the five days of hearings that supported a reasonable or rational basis for allocating the Lloyds Policy to the Segregated Account as compared to the policies that remained in the General Account. (Lloyds Proposed Findings Nos. 19-24) Moreover, the Lloyds Policy is unlike the other policies that were allocated to the Segregated Account in important aspects, as unlike the mortgage-backed securities and credit-default swap guaranty insurance losses, ALL and Lloyds are wholly innocent with respect to its potential, future losses, as the only reason that there is any potential for losses against the Lloyds Policy is the financial downfall of Ambac. (Lloyds Proposed Findings Nos. 25-31) A policyholder should not be punished because its insurer caused the potential losses to occur.

Therefore, the Lloyds Policy should be allocated back to the General Account. ALL/Lloyds specifically challenged the OCI's allocation of the Lloyds policy and agreed to waive confidentiality as to its future "material projected losses," but OCI failed to present sufficient evidence as to the extent of those losses. Rather, OCI's evidence was pure speculation.

V. CONCLUSION

For these reasons, ALL/Lloyds respectfully requests that the Court (1) reject the Proposed Plan of Rehabilitation; (2) enter an Order removing the ALL/Lloyds Policies from the Segregated Account and return those policies to Ambac's General Account, and

(3) grant such other and further relief as the Court deems necessary.

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