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In the Matter of the Rehabilitation of:  
Segregated Account of Ambac Assurance Corporation

Case No. 10 CV 1576  
Honorable William D.  
Johnston

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**ORDER DENYING CONFIRMATION OF PLAN OF REHABILITATION AS TO ONE  
STATE STREET LLC, WITH FINDINGS OF FACT AND CONCLUSIONS OF LAW**

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This matter came before the Court on the Rehabilitator's Motion for Confirmation of Plan of Reorganization, dated October 8, 2010 (the "Motion"), which seeks confirmation of the Plan of Rehabilitation of the same date (the "Plan").<sup>1</sup> Based on this Court's review of the Plan and the briefs, affidavits, exhibits, and other materials on file in these proceedings, as well as the testimony and argument presented at the hearing on confirmation of the Plan (the "Confirmation Hearing"), the Motion is hereby DENIED with respect to the Plan's treatment of One State Street LLC ("One State Street").

**FINDINGS OF FACT**

1. The Rehabilitator has not established that the proposed Plan is fair and equitable to One State Street.
2. The Rehabilitator offered four sets of projections in Exhibits D through G of the Disclosure Statement. One State Street is only projected to obtain a recovery on the Junior Surplus Notes it is proposed to receive in scenario 1 (Disclosure Statement Ex. D), and this projected recovery is entirely predicated on \$2 billion in projected recoveries (the "R&W Remediation Recoveries") in litigation based on breaches of representation and warranties made by mortgage originators in obtaining insurance policies from Ambac. The only evidence

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<sup>1</sup> Capitalized terms defined in the Plan and not otherwise defined herein are used as defined in the Plan.

presented regarding the \$2 billion in projected R&W Remediation Recoveries was the testimony of Commissioner Dilweg who testified that OCI does not agree with AAC's \$2 billion estimate. Accordingly, scenario 1, which assumes \$2 billion in R&W Remediation Recoveries, has no indicia of reliability. In the absence of any evidence to support the estimate of \$2 billion in R&W Remediation Recoveries assumed in scenario 1, the only conclusion the Court may draw from the evidence is that One State Street is provided no value under the Plan.

3. Further, the testimony established that the surplus notes provided to the settling banks in the bank settlement, which are to be *pari passu* with the Surplus Notes issued by the Plan, are currently trading at "cents on the dollar." The Junior Surplus Notes proposed to be provided to One State Street are, by their terms, subordinated to the Surplus Notes. Accordingly, based on the only market evidence presented at the Confirmation Hearing, the Junior Surplus Notes effectively have no value. Additionally, the interest rate for the Junior Surplus Notes is the same as the interest rate for the senior Surplus Notes notwithstanding that (i) the Junior Surplus Notes plainly carry a far greater risk of nonpayment, and (ii) even if payments will be made under the Junior Surplus Notes, which the evidence establishes is unlikely, such payments would not be made until 2050 under scenario 1. Thus, the interest rate set under the Plan for the Junior Surplus Notes is not an adequate rate to even begin to provide the Junior Surplus Notes with any significant value.

4. Similarly, in the absence of any value to be provided to One State Street under the Plan, the Segregated Account does not have, and has never had, adequate capital and surplus with respect to One State Street.

5. In contrast to the absence of value to be provided under the Plan to One State Street, the testimony established that One State Street would receive a 100% recovery on its

claim in a properly calculated liquidation analysis that (i) is calculated as of the proposed effective date of the Plan, (ii) excludes future, non-incurred policy claims from projected claims payments, and (iii) includes in claims-paying resources either (x) \$2 billion in proceeds that would be realized in a liquidation from the sale of policies to a third-party insurer or (y) \$2 billion in R&W Remediation Recoveries. Even if no sale proceeds or R&W Remediation Recoveries would be realized in a liquidation, One State Street would still be entitled to a 72.8% recovery on its claim calculated as of the proposed effective date of the Plan.

6. With respect to the releases and immunities proposed to be provided to AFG under Articles 8 and 9 of the Plan, no evidence was presented to establish that AFG provided any consideration to AAC, policyholders, creditors, or any other party to support the release of AFG from any liability under the Headquarters Lease.

### **CONCLUSIONS OF LAW**

1. The United States and Wisconsin Constitutions require that all claimants receive value under a plan of rehabilitation that is equal to or greater than the value that such claimants would receive in a liquidation.

2. In determining whether claimants receive the liquidation value of their claims, the Court may not give any deference to any findings or determinations made by the Office of the Commissioner of Insurance.

3. To determine whether claimants receive the liquidation value of their claims in a plan of rehabilitation, this Court must make two factual determinations. First, the Court must make a factual determination regarding the value that is proposed to be received under the Plan. Second, the Court must make a factual determination regarding the value that would be obtained in a liquidation as of the proposed effective date of the Plan.

4. In an insurance liquidation under Wisconsin law, insurance policies must either be transferred to a third-party insurer or are terminated within fifteen days from the date of entry of the liquidation order. In either case, future, non-incurred policy claims are not entitled to any payment from the liquidating insurance company. Accordingly, the liquidation analysis in this case cannot project any payments with respect to future, non-incurred policy claims.

5. Further, any liquidation analysis calculating the liquidation value of class 5 claims must include in claims-paying resources the value that could be realized in the sale of policies to third-party insurers.

6. As set forth above, this Court finds that One State Street would receive a 100% recovery in a liquidation as of the effective date of the proposed Plan. In violation of the United States and Wisconsin Constitutions, the Plan proposes to provide One State Street with no, or at best minimal and highly speculative, recovery. Accordingly, the Plan cannot be confirmed as to One State Street.

7. Similarly, in light of the absence of any likelihood of recovery to One State Street under the Plan, the Segregated Account is not, and never was, adequately capitalized as to One State Street in violation of section 611.24(3) of the Wisconsin Statutes. Accordingly, the Plan, which seeks to continue the existence of the Segregated Account, cannot be confirmed as to One State Street.

8. The Plan also proposes ambiguous releases and immunities in favor of AFG. This Court and OCI do not have jurisdiction to provide AFG with any release of liability under the Headquarters Lease (as defined in the Objection of One State Street LLC to Motion for Confirmation of the Plan of Rehabilitation). Further, any third-party release to be issued in favor of AFG must be supported by consideration provided by AFG. The Plan cannot be confirmed as

to One State Street unless and until it expressly provides that AFG is not released from any liability under the Headquarters Lease by virtue of Articles 8 and 9 of the Plan.

9. The Plan also cannot be confirmed as to One State Street because it violates section 645.68 of the Wisconsin statutes, which provides a clear, mandated priority scheme. The Plan impermissibly classifies all claims in classes 5 through 11 as the same class, called “General Claims.” As a result, the Plan contemplates that all claims junior to class 5 claims will be treated *pari passu* with class 5 claims. The statute expressly forbids such a result by mandating that class 5 claims, such as the claim of One State Street, be paid in full prior to any recovery to classes 6 through 11.

10. Additionally, the Plan defines “General Claims” to include “any Claim submitted by One State Street, LLC.” Read literally, the Plan would preclude One State Street from filing an administrative expense claim. One State Street asserts that it would have an administrative expense claim against AAC in the event that AFG rejects the Headquarters Lease in its bankruptcy proceeding. Although this Court does not make any determination as to the proper treatment of such a claim for administrative expense priority in this Order, the Plan improperly prevents One State Street from seeking allowance of an administrative expense claim.

11. The Plan also cannot be confirmed because it violates section 645.65 of the Wisconsin statutes. The Wisconsin statutes require the Rehabilitator to provide written claims determinations, and a claimant is required to file an objection to the determination with the Court within sixty days. Section 4.06 of the Plan, however, purports to alter the claims process. Specifically, the Plan proposes that the Rehabilitator will provide written objections to claims, and any claimant who receives such a written notice must, within sixty days, respond not to the Court, but to the Rehabilitator in writing setting forth all factual and legal bases for the claim.

The Plan also purports to provide the Rehabilitator with a further undefined time to reassess the claim and submit a further notice of denial to the claimant. Under the proposed Plan, a claimant is only afforded the opportunity to seek judicial relief by filing a motion after this protracted process is complete. The Rehabilitator is afforded no discretion to re-write the statute, and the disputed claims process in section 4.06 of the Plan cannot be approved.

12. Section 7.02 of the Plan also cannot be confirmed because it provides that the Rehabilitator can petition the Court to amend the Plan if “the Rehabilitator has determined, in his sole and absolute discretion, that such an amendment is equitable to the interests of the Holders of Policy Claims generally.” Section 645.01 expressly provides that the purpose of rehabilitation is for the “protection of the interests of insureds, creditors, and the public generally” through the “[e]quitable apportionment of any unavoidable loss.” Accordingly, the statute expressly requires that the Rehabilitator act in the protection of the interests of not only Policy Claims, but also in the protection of the interests of General Claims.

13. Section 8.01 of the Plan cannot be confirmed because it provides that upon “Distribution,” defined to include the distribution of the Junior Surplus Notes, the claims are to be full and unconditionally settled, satisfied, discharged, and released. While a distribution under a properly approved Plan may discharge a claim as to the entity in rehabilitation, there is no basis or rationale to deem the claim as paid in full. Determining a claim to be full and unconditionally settled upon distribution may have unintended consequences beyond this case, and section 8.01 of the Plan cannot be confirmed as proposed.

14. In order to allow the remainder of the Plan to proceed to confirmation, this Court hereby orders that the lease liability (if any) of AAC to One State Street cannot be allocated to the Segregated Account, and therefore is not subject to the Plan. OCI may inform this Court

within 10 days if it desires to withdraw confirmation of the Plan in its entirety rather than proceed with confirmation of the Plan with the One State Street provisions severed, per this Order.

WHEREFORE, IT IS HEREBY ORDERED that the Motion is hereby DENIED with respect to the claim of One State Street LLC.

Dated: \_\_\_\_\_

BY THE COURT:

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Honorable William D. Johnston  
Lafayette County Circuit Court Judge  
Presiding by Judicial Appointment