

COURT OF APPEALS OF WISCONSIN  
DISTRICT IV

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In the Matter of the Rehabilitation of:

Segregated Account of  
Ambac Assurance Corporation,

Case No. 10 CV 1576  
Appeal No. \_\_\_\_\_

OFFICE OF THE COMMISSIONER OF  
INSURANCE OF THE STATE OF  
WISCONSIN,

Plaintiff/Respondent,

SEAN DILWEG, Commissioner of  
Insurance of the State of Wisconsin,

Petitioner/Respondent;

AMBAC ASSURANCE  
CORPORATION,

Other Interested Party/Respondent,

v.

AURELIUS CAPITAL  
MANAGEMENT, LP, FIR TREE, INC.,  
KING STREET CAPITAL, L.P., KING  
STREET CAPITAL MASTER FUND,  
LTD., MONARCH ALTERNATIVE  
CAPITAL, LP, STONEHILL CAPITAL  
MANAGEMENT LLC,

Defendants/Appellants,

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WELLS FARGO BANK, EATON  
VANCE MANAGEMENT, NUVEEN  
ASSET MANAGEMENT,  
RESTORATION CAPITAL  
MANAGEMENT, LLC, STONE LION  
CAPITAL PARTNERS, LP, THE

BANK OF NEW YORK MELLON,  
FEDERAL HOME LOAN MORTGAGE  
CORPORATION,

Defendants.

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**PRELIMINARY EMERGENCY  
PETITION FOR LEAVE TO APPEAL**

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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 (collectively, the “RMBS Policyholders”), in their capacity as owners of or managers of funds that own residential mortgage-backed securities and other indebtedness insured by Ambac Assurance Corporation, by their attorneys, Reinhart Boerner Van Deuren s.c. and Jenner & Block LLP, submit this Preliminary Emergency Petition for Leave to Appeal the Circuit Court’s ruling of May 25, 2010, denying the RMBS Policyholders’ Emergency Motion to Modify Order for Temporary Injunctive Relief.

**EMERGENCY RELIEF IS NECESSARY TO PREVENT THE IMPROPER DISTRIBUTION OF \$4.6 BILLION TO THE DETRIMENT OF AMBAC POLICYHOLDERS**

With the approval of the Wisconsin Office of the Commissioner of Insurance (the “OCI”), Ambac Assurance Corporation (“AAC”) established a Segregated Account, pursuant to Wis. Stat. § 611.24, which authorizes the creation of an account separate from the company as long as it is adequately capitalized. AAC transferred from its General Account certain policies that AAC “expected to suffer material losses,” including the RMBS policies, to the Segregated Account. (OCI’s Verified Pet. for Order of Rehabilitation (“Rehabilitation Pet.”), ¶ 9; Plan of Operation, § IV,

attached to Rehabilitation Pet. as Tab 1.) The principal funding source for the Segregated Account is AAC's General Account. OCI then petitioned the Circuit Court to enter an Order of Rehabilitation for the Segregated Account. (Rehabilitation Pet., at 1.) Simultaneously, OCI announced a transaction that would commute almost all of the credit default swap ("CDS") contracts entered into by an AAC subsidiary in exchange for the immediate payment of \$2.6 billion in cash and a \$2 billion note (the "CDS Settlement"), both to be paid from the General Account.

In order for there to be meaningful review of OCI's actions to determine their legality and appropriateness, and to assure that all policyholders be treated equitably and fairly, the RMBS Policyholders sought to prevent the CDS Settlement from closing until the Circuit Court was provided a reasonable opportunity to review the legality of the transaction and OCI's actions, and after the RMBS Policyholders (and the other interested parties) were provided sufficient notice and an opportunity to be heard and present evidence obtained through very targeted discovery. Alternatively, the RMBS Policyholders sought to modify an Order for Temporary Injunctive Relief entered by the Circuit Court on March 24, 2010 ("Injunction Order").

On May 25, 2010, the Circuit Court denied the RMBS Policyholders' motion to modify the Injunction Order, and the CDS Settlement – and its \$4.6 billion distribution – is set to go forward. Contrary to Wisconsin law and a Cooperation Agreement integral to the rehabilitation, the Circuit Court ruled that it lacked jurisdiction to review the CDS Settlement. This ruling was in error.

Immediately following the Circuit Court's ruling, the RMBS Policyholders sought to enjoin the consummation of the CDS Settlement and the distribution of settlement funds from the General Account pending an appeal of the Circuit Court's ruling. The Circuit Court denied that oral motion, even though the parties to the CDS Settlement previously indicated that they would close the transaction after the hearing unless the closing was enjoined by the Circuit Court. (*See* May 6, 2010 Letter from Michael B. Van Sicklen to the Honorable William D. Johnston at 2.)

The Circuit Court has not issued its final judgment. It indicated that it would issue findings of fact and conclusions of law “in several days.” Based on the Court's oral statements, however, we believe that order will be final and appealable.<sup>1</sup> Upon the filing of the Circuit Court's judgment,

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<sup>1</sup> In the event the Circuit Court only issues an interlocutory order, the RMBS Policyholders hereby request this Court's permission to supplement this Preliminary

the RMBS Policyholders will file a notice of appeal to invoke this Court's jurisdiction. Because of the immediacy of the CDS Settlement, however, the RMBS Policyholders have filed this petition for interlocutory review to invoke this Court's jurisdiction to permit them to file a motion to enjoin the CDS Settlement and the distribution of funds pending resolution of this appeal. Accordingly, in conjunction with filing this Preliminary Emergency Petition, the RMBS Policyholders are also filing a Motion for Injunction Pending Appeal.

The only way to avoid irreparable harm to Ambac policyholders, including the RMBS Policyholders, and the public is a review of the Circuit Court's order denying the RMBS Policyholders' motion. If the CDS Settlement closes without the Circuit Court first determining whether the CDS Settlement is proper or the Segregated Account is adequately capitalized, the money needed to adequately capitalize the Segregated Account will have been dissipated. The relief the RMBS Policyholders request – that this Court direct the Circuit Court to allow the RMBS Policyholders to conduct discovery and hold a hearing on the

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Emergency Petition with an amended and more comprehensive petition within 14 days of the Circuit Court's order in accordance with Wis. Stat. § 808.03(2).

appropriateness and legality of the transactions – is not only consistent with, but required by, Wisconsin law.

### **ISSUES FOR REVIEW**

Did the Circuit Court err by holding it did not have jurisdiction as part of a rehabilitation proceeding to review a \$4.6 billion transaction that will likely deplete the Segregated Account's principal source of funding in violation of Wisconsin and federal laws?

Did the Circuit Court err by finding it did not have the authority to address whether the CDS Settlement should proceed without any judicial review of: (i) whether the transaction improperly benefits owners of the CDS contracts over policyholders in violation of Wisconsin's priority scheme; or (ii) whether the Segregated Account has been properly established and adequately capitalized pursuant to the Wisconsin Insurance Code?

Did the Circuit Court err by holding it did not have the authority to permit expedited discovery and a subsequent evidentiary hearing to determine whether a pending \$4.6 billion transaction violated Wisconsin's statutory priority scheme by prioritizing the claims of a creditor over a policyholder?

## STATEMENT OF FACTS

**AAC Rehabilitation.** AAC is a Wisconsin-domiciled insurer that provides financial guaranty insurance. Among other financial guaranty products, AAC insures structured finance obligations, such as RMBS, collateralized debt obligations, and credit default swaps. According to OCI's Rehabilitation Petition (at ¶¶ 5-7), over the past three years AAC's financial position has deteriorated.

On March 21, 2010, AAC's Board of Directors, with the approval of OCI, voted to establish a Segregated Account, to which AAC would transfer certain policies, including the RMBS policies, from AAC's General Account. (Rehabilitation Pet., ¶ 9.) The Board then voted to place the Segregated Account into rehabilitation. (*Id.*) Three days later, on March 24, 2010, OCI petitioned the Circuit Court to enter the proposed Order of Rehabilitation for the Ambac policies and liabilities assigned to the Segregated Account. That same day, the Circuit Court also entered an Order for Temporary Injunctive Relief at OCI's request.

Under the Rehabilitation Order, the Segregated Account was capitalized with a \$2 billion note and a reinsurance agreement with AAC, both of which are entirely dependent on the assets of AAC's General Account. The terms of the note and the reinsurance agreement provide that

AAC is not obligated to make payments from the General Account to the Segregated Account if AAC's statutory surplus amount is below \$100 million. (Secured Note, at 3, attached to Rehabilitation Pet. as Ex. G; Aggregate Excess of Loss Reinsurance Agreement, at 2, attached to Rehabilitation Pet. as Ex. H.) The RMBS Policyholders own, or are managers of entities that own, approximately \$1 billion face amount of RMBS policies and other liabilities that have been allocated to the Segregated Account.<sup>2</sup>

AAC is now on the verge of finalizing a Statement of Intent and related transactions with 17 financial institutions, all but one of which are headquartered in foreign countries or are owned by a foreign parent (the "Bank Group"),<sup>3</sup> that are scattered all over the globe. (See OCI's Proposed

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<sup>2</sup> As of the May 25, 2010 hearing, the following interested parties – representing in excess of \$20 billion in Ambac's policies – filed papers in the Circuit Court in response to the Rehabilitation Order: Wells Fargo Bank, National Association; RMBS Policyholders; LVM bondholders; Deutsche Bank National Trust Company and Deutsche Bank Trust; Company Americas; U.S. National Bank Association; Bank of New York Mellon; Bank Insureds; and Freddie Mac.

<sup>3</sup> According to the Affidavit of Roger Peterson, submitted to the Circuit Court on May 20, 2010, the Bank Group consists of the following 17 institutions, all but one of which are headquartered in foreign countries or are owned by a foreign parent: (1) Banco Bilbao Vizcaya Argentaria, S.A. (Spain); (2) Banco Santander, S.A. (Spain); (3) Barclays Bank plc (England); (4) BNP Paribas (France); (5) Canadian Imperial Bank of Commerce (Canada); (6) Citibank, N.A. (United States); (7) Citigroup Global Markets Limited (United Kingdom); (8) Commerzbank AG London Branch (Germany); (9) Credit Agricole Corporate and Investment Bank (France); (10) Deutsche Bank AG London Branch (Germany); (11) Deutsche Bank AG New York Branch (Germany); (12) Natixis (France); (13) Natixis Financial Products, Inc. (United States); (14) Coöperatieve

Findings of Fact, ¶¶ 7, 14; R. Peterson Aff., ¶ 24.) The proposed settlement will permit a large portion of the General Account to be disbursed now, thereby endangering the ability of the Segregated Account to be adequately capitalized. Under the terms of the agreement, AAC would commute one class of its liabilities – substantially all of the CDS contracts, which it chose not to include in the Segregated Account. The Commissioner indicated that the transaction could close as early as yesterday. (See May 6, 2006 Letter from Michael B. Van Sicklen to the Honorable William D. Johnston, at 1.) Once the CDS Settlement closes, AAC will (i) pay \$2.6 billion from the General Account to the Bank Group, and (ii) issue a \$2 billion note payable to the Bank Group. (See Nowicki Aff., Ex. A at 6.)

#### **RMBS Policyholders Requested The Court Review The CDS**

**Settlement.** As soon as they learned of the Statement of Intent, the RMBS Policyholders sought to obtain more information about the proposed transaction. They feared that the proposed settlement would transfer funds from AAC's General Account and undermine AAC's ability to comply with its obligation to fund the Segregated Account. In addition, the transaction could prefer one group of AAC's creditors – the holders of CDS

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Centrale Raiffeisen-Boerenleenbank B.A. "Rabobank International" (Netherlands); (15) The Royal Bank of Scotland plc (Scotland); (16) Société Générale (France); and (17)

contracts – to the detriment of policyholders, a preference that Wisconsin law does not permit. AAC and OCI refused to provide the requested information, and the RMBS Policyholders filed an emergency motion to prevent the CDS Settlement from closing until the Circuit Court was provided a reasonable opportunity to review the legality of the transaction and OCI's actions. Alternatively, the RMBS Policyholders sought to modify the Injunction Order.

In response, OCI and AAC filed lengthy briefs, each supported by factual affidavits and documents. OCI also submitted proposed findings of fact. Although thereby conceding that the propriety of the settlement turned on factual issues, they continued to resist factual discovery. In short, they disclosed only what they were willing to disclose, on their terms, and opposed a fair exchange of factual materials.

**Proceedings In The Circuit Court.** The Circuit Court conducted a hearing on the RMBS Policyholders' motion on May 25, 2010. Agreeing with OCI and AAC, the court refused to permit factual discovery. The court also refused to delay the hearing to permit the other parties, including the RMBS Policyholders, to develop additional factual support for their positions.

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UBS AG, London Branch (Switzerland).

The Circuit Court indicated that it intended to deny the RMBS Policyholders' motion on purely legal grounds. The Court stated that it lacked jurisdiction to review the transaction because it involved the General Account which was not in rehabilitation. The Circuit Court indicated that it would enter written findings of fact and conclusions of law "in several days." Based on the Circuit Court's oral statements, the RMBS Policyholders believe that its order will constitute a final, appealable order. Upon the filing of the Circuit Court judgment, the RMBS Policyholders will file a notice of appeal to invoke this Court's jurisdiction. Until the Circuit Court enters its final order, however, the RMBS Policyholders have filed herewith a petition for interlocutory review to invoke this Court's jurisdiction.

At the conclusion of the hearing, the RMBS Policyholders orally moved to enjoin the CDS Settlement pending appeal of the Circuit Court's order. Alternatively, the RMBS Policyholders requested that the Circuit Court at least enjoin the CDS Settlement until this Court could rule on a motion for an injunction. The Circuit Court denied both requests and declined to permit any relief. Accordingly, in conjunction with this Preliminary Emergency Petition, the RMBS Policyholders are filing a motion seeking an order enjoining the consummation of the CDS

Settlement and the distribution of funds to the Bank Group pending this Court's review.

The Circuit Court's ruling was in error and unless the RMBS Policyholders' appeal is heard on an emergency basis, the RMBS Policyholders and other policyholders will be irreparably injured as detailed below.

### **STANDARD OF REVIEW**

The appellate court's review of questions of law underlying the Circuit Court's decision is *de novo*. *Kocken v. Wis. Council 40, AFSCME, AFL-CIO*, 301 Wis. 2d 266, 278-79, 732 N.W.2d 828, 835 (2007). The standard of review for a circuit court's order granting, denying, or modifying injunctive relief is an abuse of discretion. *Wis. Ass'n of Food Dealers v. City of Madison*, 97 Wis. 2d 426, 428, 293 N.W.2d 540, 542 (1980). Here, the Circuit Court erred by finding it did not have the authority to address whether the CDS Settlement should proceed without any judicial review of: the rehabilitation plan; whether the transaction improperly benefits owners of the CDS contracts over policyholders in violation of Wisconsin's priority scheme; or whether the Segregated Account has been properly established and adequately capitalized pursuant to the Wisconsin Insurance Code. *See Wis. Stat. § 611.24(3)(a)*. In short,

the Circuit Court abandoned its role in the rehabilitation process, thereby bestowing limitless authority on OCI in violation of the plain language of a statutory mandate requiring judicial involvement. *See* Wis. Stat. § 645.33(2).

**APPELLATE REVIEW IS NECESSARY TO PROTECT  
THE INTERESTS OF AMBAC'S POLICYHOLDERS**

Wisconsin Statute § 808.03 provides that the Court of Appeals may review the Circuit Court's denial of the RMBS Policyholders' motion to modify the Injunction Order, even though it is a non-final order, where an immediate appeal will:

- (a) Materially advance the termination of the litigation or clarify further proceedings in the litigation;
- (b) Protect the petitioner from substantial or irreparable injury; or
- (c) Clarify an issue of general importance in the administration of justice.

Wis. Stat. § 808.03(2). An immediate appeal in this case will not only clarify further proceedings in the litigation, it will protect the RMBS Policyholders, the indenture trustees, and other holders of Ambac insurance policies from irreparable harm.

**I. AN IMMEDIATE APPEAL WILL CLARIFY FURTHER PROCEEDINGS IN THE LITIGATION.**

An immediate appeal is necessary in the interest of judicial economy. This is a complicated case that involves many parties and depends on the resolution of multiple factual issues. The Circuit Court has improperly abandoned its statutory obligation to review the CDS Settlement, and instead has deferred its authority to OCI. If the CDS Settlement is consummated without first examining whether the transaction is even lawful, all of the policyholders whose policies were transferred – less than 1,000 policies representing \$67 billion in net par outstanding – to the Segregated Account will be affected. (OCI's Proposed Findings of Fact ¶ 27.) The multitude of interests in this case is evident based on the sheer number of interested parties that filed motions in the Circuit Court in response to the Rehabilitation Order. (*See supra* note 2.)

In the absence of expedited review, the affected parties will be required to wait until they have already been irreparably damaged, and \$4.6 billion has been dissipated from the General Account. A reversal of the Circuit Court's May 25 order will simply require the court to perform its statutory duty to review the CDS Settlement and the capital adequacy of the Segregated Account. If judicial review of the CDS Settlement is postponed

until some indefinite point after the transaction closes, and it is determined that the CDS Settlement was unlawful, OCI will be forced to start the rehabilitation process from scratch.

**II. AN IMMEDIATE APPEAL WILL PROTECT THE RMBS POLICYHOLDERS FROM SUBSTANTIAL OR IRREPARABLE INJURY.**

If an immediate appeal is not granted, AAC and the Bank Group will consummate the CDS Settlement. AAC would immediately withdraw \$2.6 billion in cash from the General Account and issue \$2 billion in notes. The \$2.6 billion withdrawal comprises a significant portion – 30% – of the \$8.5 billion of assets remaining in the General Account. The \$2.6 billion would be dispersed amongst the 17 members of the Bank Group, all but one of which are headquartered in foreign countries or are owned by a foreign parent, and OCI and the RMBS Policyholders will find recovery of those amounts difficult or impossible for at least three reasons.

First, if the RMBS Policyholders are forced to postpone an appeal until after the CDS Settlement has been consummated, and they are ultimately successful on appeal, it would be difficult, if not impossible, to recover the \$4.6 billion at that time. Pursuant to the CDS Settlement, at least 17 CDS counterparties would have their claims commuted in exchange for \$4.6 billion in consideration. OCI and AAC have provided no

information or documentation relating to the CDS Settlement, including how much money each CDS counterparty is to receive, or which of their agreements would be covered in the settlement. Once the CDS Settlement is effectuated, the lack of information and costs of litigation will make it very difficult, if not impossible, for OCI or the RMBS Policyholders to recover any funds from these parties, let alone be made whole.

Second, the RMBS Policyholders are prohibited from suing the parties who are actually at fault for any improper release of the CDS Counterparties' claims. The Injunction Order prohibits all persons and entities from commencing any actions against: (1) the Segregated Account; (2) AAC in respect of the Segregated Account or any policies allocated thereto; (3) subsidiaries of AAC, including ACP; and (4) the Commissioner. (*See* Injunction Order, ¶ 1.) As a result, the RMBS Policyholders could not sue the Segregated Account (which must approve the CDS Settlement), ACP (which is a counterparty to the CDS transactions at issue), or the Commissioner (who must sign off on the CDS Settlement in his role as rehabilitator) to challenge the CDS Settlement in a separate proceeding. Further, the CDS Settlement is inextricably linked to the Segregated Account, so the RMBS Policyholders could not sue AAC in a separate action to challenge the CDS Settlement. This leaves the RMBS

Policyholders with no appreciable recourse against the parties who plan to close the CDS Settlement, thereby making recovery of monetary damages to redress the harm they will have suffered very unlikely.

Third, no other party can adequately represent the RMBS Policyholders' interests in challenging the CDS Settlement after it closes. While Wisconsin statutes would permit a liquidator to avoid the CDS Settlement as a preferential transfer if the liquidation were commenced within one year of the settlement's consummation, there is no guarantee that the Commissioner or other liquidator would initiate such proceedings in a timely manner so as to permit such a recovery. *See Wis. Stat. § 645.54(1)*. Similarly, if the CDS Settlement is permitted to close but the court later finds the creation of the Segregated Account to be invalid, AAC likely would enter rehabilitation and OCI would have to pursue a fraudulent transfer action within one year of the initiation of AAC's entry into liquidation or rehabilitation. *Wis. Stat. § 645.52(1)*. Again, there is no guarantee that OCI would put AAC into rehabilitation or liquidation within one year of the consummation of the CDS Settlement. Moreover, the proposed findings of fact and conclusions of law that OCI tendered to the Circuit Court on May 20, 2010 contain comprehensive findings and

conclusions that may render a later challenge difficult. (See OCI's Proposed Findings of Fact, ¶¶ 5-18.)

Without a guarantee of the full recovery of the \$4.6 billion without further expenditures of cash, the RMBS Policyholders will be irreparably harmed.

**III. THERE IS A SUBSTANTIAL LIKELIHOOD THAT THE RMBS POLICYHOLDERS WILL SUCCEED ON THE MERITS OF THE APPEAL.**

To succeed on a petition for an immediate appeal, a petitioner must show that it is likely to succeed on the merits. *Wis. Ass'n of Food Dealers*, 97 Wis. 2d at 428-30, 293 N.W.2d at 542-43. Here, a grant of review is necessary to, at a minimum, protect the Ambac policyholders from the irreparable harm that would result if the planned \$4.6 billion payment is made by AAC to the Bank Group. The RMBS Policyholders submit that the Circuit Court's decision should be reversed on the following grounds.

**1. The Circuit Court Erred In Finding It Lacked Jurisdiction To Review The CDS Settlement.**

The RMBS Policyholders will demonstrate on appeal that the Circuit Court erred as a matter of law when it ruled that it lacked jurisdiction to review the CDS Settlement. The Circuit Court stated that the CDS Settlement was an action taken by OCI as a regulator, not as rehabilitator,

and therefore was not within the Circuit Court's power to review. The Circuit Court's legal ruling was in error.

OCI may not consent to a \$4.6 billion settlement without court approval. (*See* RMBS Policyholders' Emergency Br. to Modify Inj., at 19-22.) The rehabilitator's authority is not unlimited, as Wis. Stat. § 645.33(2) makes clear. The statute provides that in rehabilitation proceedings, “[s]ubject 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). The Circuit Court abdicated this responsibility and gave OCI unfettered discretion to enter into extraordinary transactions.

The Circuit Court stated that it lacked authority to question OCI's approval of the CDS Settlement with the General Account, because OCI was acting only in its capacity as a regulator. Yet, the CDS Settlement with the General Account is inextricably intertwined with the rehabilitation. The General Account is the principal source of funding for the company in rehabilitation. The General Account is no longer obligated to contribute to the rehabilitation if AAC's statutory surplus falls below \$100 million.

(Secured Note at 3; Aggregate Excess of Loss Reinsurance Agreement, at 2.) The CDS Settlement will cause the immediate transfer of \$4.6 billion

of cash and notes out of the General Account, thereby affecting – if not endangering – the rehabilitation. Thus, the arbitrary and unreviewed separation of AAC into Segregated and General Accounts does not deprive the Circuit Court of the power to review OCI's actions.

As courts in other states have recognized, a rehabilitator's ability to make decisions is "circumscribed by [the Courts'] mandate to act as a check on potential discretionary abuse and *to ensure equitable apportionment of loss.*" *Grode v. Mut. Fire, Marine & Inland Ins. Co.*, 572 A.2d 798, 804 (Pa. Commw. Ct. 1990) (emphasis added), *aff'd in part sub nom.*, *Foster v. Mut. Fire, Marine & Inland Ins. Co.*, 614 A.2d 1086 (Pa. 1992). For example, courts may review rehabilitation orders to ensure that policyholders do not receive worse treatment in rehabilitation than they would get in liquidation, and that rehabilitation plans do not discriminate unfairly among different classes of policyholders and creditors. *See id.*; *In re Conservation of Alpine Ins. Co.*, 741 N.E.2d 663, 665-68 (Ill. App. Ct. 2000).

The RMBS Policyholders do not contend that the Commissioner, as rehabilitator, is required to seek court approval for each and every decision made in the course of the rehabilitation. Rather, Wis. Stat. § 645.33(2) imposes the requirement of court approval upon "action[s] he or she deems

necessary or expedient to reform and revitalize the insurer.” However this phrase might be applied in other circumstances, there can be no doubt here that OCI deems the CDS Settlement to be an action that is “necessary or expedient to reform or revitalize” the Segregated Account because the claims addressed by the CDS Settlement would otherwise be allocated to the Segregated Account. Consequently, it falls within the requirement of prior court approval under the plain language of Wis. Stat. § 645.33(2).

Moreover, the Cooperation Agreement between AAC and the Segregated Account, which establishes the relationship of the accounts during the rehabilitation, requires the Segregated Account’s written consent to consummate any transaction by AAC that involves consideration or other proceeds in excess of \$5,000,000. (*See* Cooperation Agreement, § 1.02.) The \$4.6 billion CDS Settlement would, of course, exceed that threshold many times over. The need for the Segregated Account’s consent for such transactions is understandable because the Segregated Account’s principal source of funding, and its lifeblood for its reformation or revitalization, is AAC. Given the magnitude of the CDS Settlement, however, the Commissioner, acting on behalf of the Segregated Account as rehabilitator, cannot give his consent without the Circuit Court’s review. *See* Wis. Stat. § 645.33(2).

## **2. The Circuit Court Erred In Refusing Discovery.**

The Circuit Court erred in not permitting discovery or conducting a hearing to evaluate whether the CDS Settlement is in compliance with the Wisconsin Insurance Code provision requiring that distributions to AAC's general creditors be subordinated to policyholders' claims. (*See Reply of RMBS Policyholders at 6-11.*) Indeed, as is the situation here, "an abuse of discretion may occur [when the] trial judge [fails] to consider and make a record of factors relevant to a discretionary determination in a particular case." *Wis. Ass'n of Food Dealers*, 97 Wis. 2d at 430, 293 N.W.2d at 542. Because the question of whether OCI's actions are fair and equitable to all policyholders is a fact based question that necessarily requires discovery, discovery is needed to review the lawfulness of OCI's actions. The RMBS Policyholders are entitled to conduct limited discovery into the capitalization of the Segregated Account and the appropriateness of the CDS Settlement to provide the Circuit Court with sufficient information to review and determine whether to approve the actions of OCI.

The RMBS Policyholders seek discovery to ensure that the parties are treated fairly and equitably as the law requires. Among other things,

the RMBS Policyholders contend that the Bank Group may not be insured parties, but should be subordinated and treated as general creditors. If the Bank Group's interests are ultimately determined to be subordinate to the policyholders, the CDS settlement will disburse \$4.6 billion to parties that should not receive any funds. Discovery is necessary to ensure that the CDS Settlement does not afford preferential treatment to the Bank Group in violation of the Wisconsin Insurance Code's purpose "[t]o ensure that policyholders, claimants and insurers are treated fairly and equitably." Wis. Stat. § 601.01(2); *see* RMBS Policyholders' Emergency Br. to Modify Inj. at 22-23; Reply of RMBS Policyholders at 6-11.

Discovery will further reveal whether the Segregated Account is adequately capitalized, which is a statutory prerequisite to its creation. *See* Wis. Stat. § 611.24(3)(a). OCI presented no factual support to the Circuit Court for its conclusory assertion that there is an adequate amount of capital and surplus for the Segregated Account. (*See* Plan of Operation, § V.) OCI only asserted that the Segregated Account is adequately capitalized and, without providing any underlying data or analysis, requested that the Circuit Court simply accept as true OCI's assertion. The AAC General Account is the principal source of capital and funding for the Segregated Account. The CDS Settlement will have a major impact on the

AAC General Account – depleting 30% of its funds – and would significantly decrease the assets available to support the Segregated Account’s liabilities and to fund the rehabilitation plan. Thus, the CDS Settlement will further imperil the capitalization of the Segregated Account, and thereby injure the RMBS Policyholders. Discovery and further proceedings in the Circuit Court will permit a reasoned evaluation of these important issues.

### CONCLUSION

In light of the foregoing, the RMBS Policyholders respectfully request that the Court of Appeals grant the RMBS Policyholders’ Petition for Leave to Appeal and reverse the Circuit Court’s order denying the RMBS Policyholders’ motion to modify the temporary injunctive order to prevent the consummation of the CDS Settlement and the distribution of \$4.6 billion from Ambac’s General Account to the detriment of Ambac’s policyholders. In the event that the Circuit Court enters a final and appealable judgment, the RMBS Policyholders intend to file a notice of appeal. However, in the event the Circuit Court only issues an interlocutory order, the RMBS Policyholders hereby request this Court’s permission to supplement this Preliminary Emergency Petition with an

amended and more comprehensive petition within 14 days of the Circuit

Court's order.

Dated this 26th day of May, 2010.

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COURT OF APPEALS OF WISCONSIN  
DISTRICT IV

---

In the Matter of the Rehabilitation of:

Segregated Account of  
Ambac Assurance Corporation,

Case No. 10 CV 1576

Appeal No. \_\_\_\_\_

OFFICE OF THE COMMISSIONER OF  
INSURANCE OF THE STATE OF  
WISCONSIN,

Plaintiff/Respondent,

SEAN DILWEG, Commissioner of  
Insurance of the State of Wisconsin,

Petitioner/Respondent;

AMBAC ASSURANCE  
CORPORATION,

Other Interested Party/Respondent,

v.

AURELIUS CAPITAL  
MANAGEMENT, LP, FIR TREE, INC.,  
KING STREET CAPITAL, L.P., KING  
STREET CAPITAL MASTER FUND,  
LTD., MONARCH ALTERNATIVE  
CAPITAL, LP, STONEHILL CAPITAL  
MANAGEMENT LLC,

Defendants/Appellants,

WELLS FARGO BANK, EATON  
VANCE MANAGEMENT, NUVEEN

ASSET MANAGEMENT,  
RESTORATION CAPITAL  
MANAGEMENT, LLC, STONE LION  
CAPITAL PARTNERS, LP, THE  
BANK OF NEW YORK MELLON,  
FEDERAL HOME LOAN MORTGAGE  
CORPORATION,

Defendants.

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**FORM AND LENGTH CERTIFICATION**

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I hereby certify that the attached Petition for Leave to Appeal Non-Final Order conforms to the rules contained in § 809.50(4) of the Wisconsin Statutes for a brief produced with a proportional serif font. The length of this petition is 4,806 words.

Dated this 26th day of May, 2010.

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FEDERAL HOME LOAN MORTGAGE  
CORPORATION,

Defendants.

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**CERTIFICATE OF SERVICE**

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I hereby certify that on May 26, 2010, I served by first class mail, postage prepaid, upon counsel listed below the following documents: Petitioner RMBS Policyholder's' Preliminary Emergency Petition for Leave to Appeal Non-Final Order, Appendix to Petition for Leave to Appeal, and RMBS Policyholders' Emergency Motion for Injunction Pending Appeal, with the supporting brief.

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BANK OF NEW YORK MELLON,  
FEDERAL HOME LOAN MORTGAGE  
CORPORATION,

Defendants.

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**CERTIFICATION**

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I hereby certify that filed with this brief, either as a separate document or as a part of this brief, is an appendix that complies with s. 809.19(2)(a) and that contains: (1) a table of contents; (2) relevant trial record entries; (3) the findings or opinion of the trial court; and (4) portions of the record essential to an understanding of the issues raised, including oral or written rulings or decisions showing the trial court's reasoning regarding those issues.

I further certify that if the record is required by law to be confidential, the portions of the record included in the appendix are reproduced using first names and last initials instead of full names of persons, specifically including juveniles and parents of juveniles, with a notation that the portions of the record have been so reproduced to preserve confidentiality and with appropriate references to the record.

Dated this 26th day of May, 2010.

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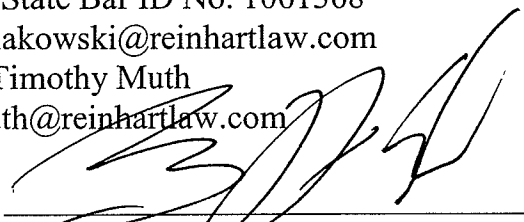
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