

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,

Movants/Appellants,

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, WELLS FARGO
BANK, as Trustee of RMBS certificate
holders, WELLS FARGO BANK, as
Trustee of bondholders,

Movants.

**RMBS POLICYHOLDERS' MEMORANDUM
IN SUPPORT OF RENEWED EMERGENCY
MOTION FOR INJUNCTION PENDING 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, move the Court for an injunction preventing the consummation of a settlement and distribution of settlement funds from the General Account pending appeal of the Circuit Court’s order denying (1) the RMBS Policyholders’ Emergency Motion to Modify Order for Temporary Injunctive Relief, and (2) Motion to Intervene.

INTRODUCTION

The RMBS Policyholders need an injunction because Ambac Assurance Corporation (“AAC”) may, within a matter of hours or days, begin dissipating the only assets available to satisfy the RMBS Policyholders’ claims. If AAC is allowed to proceed, it will transfer \$4.6 billion of those assets – perhaps irretrievably – to at least 17 different financial institutions around the globe, all but one of which are headquartered in foreign countries or are owned by a foreign parent.¹ None of those financial institutions are presently subject to this Court’s

¹ According to the Affidavit of Roger A. Peterson, submitted to the Circuit Court on May 20, 2010, the Bank Group consists of the following 17 institutions: (1) Banco Bilbao Vizcaya Argentaria, S.A. (Spain); (2) Banco Santander, S.A. (Spain); (3) Barclays Bank plc (United Kingdom); (4) BNP Paribas (France); (5) Canadian Imperial Bank of Commerce (Canada); (footnote continued)

jurisdiction. Without an injunction, the RMBS Policyholders and other policyholders will be limited in their ability to recover the dissipated assets. And this will have occurred just over two months after AAC formed the Segregated Account and the Wisconsin Office of the Commissioner of Insurance (“OCI”) placed it into rehabilitation.

With the approval of OCI, 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 on which 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, App. 8; Plan of Operation, § IV, attached to the Rehabilitation Pet. as Tab 1, App. 17-19.)² 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. (*Id.*)

Simultaneously, OCI announced a transaction that would commute almost all of the credit default swap (“CDS”) contracts entered into by an AAC subsidiary

(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 Centrale Raiffeisen-Boerenleenbank B.A. (Netherlands); (15) The Royal Bank of Scotland plc (Scotland); (16) Société Générale (France); and (17) UBS AG, London Branch (Switzerland). (App. 384.)

² The designation “App.” represents a citation to the Appendix to RMBS Policyholders’ Renewed Emergency Motion for Injunction Pending Appeal.

in exchange for the immediate payment to the Bank Group of \$2.6 billion in cash and \$2 billion of surplus notes (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 an order requiring that the CDS Settlement not be consummated prior to review and approval of the Circuit Court, and to modify the Circuit Court’s *ex parte* Order for Temporary Injunctive Relief entered on March 24, 2010 (“Injunction Order”). To ensure that they could participate in discovery and pursue any additional relief relating to the Segregated Account, the RMBS Policyholders also filed a motion to intervene.

On May 25, 2010, the Circuit Court held a hearing on the RMBS Policyholders’ motions. During that hearing, the Circuit Court stated its intention to deny the RMBS Policyholders’ motions. Further, the Circuit Court denied the RMBS Policyholders’ request for an injunction pending appeal, despite the fact that the parties to the CDS Settlement had previously indicated that they would close after the hearing unless the closing was enjoined. The CDS Settlement – and the \$4.6 billion payment – is set to go forward.

Because the CDS Settlement could close at any moment, on May 26, 2010, the RMBS Policyholders filed a Preliminary Emergency Petition for Leave to Appeal and an accompanying Emergency Motion for Injunction Pending Appeal. On May 27, this Court denied the RMBS Policyholders’ emergency appeal as

premature because the Circuit Court had not yet entered its order. (May 27, 2010 App. Ct. Order at 3, App. 587.) The Court then invited the RMBS Policyholders to renew their request once the Circuit Court entered an order. (*Id.*)

That same day, the Circuit Court entered its written order, denying all of the RMBS Policyholders' requested relief, including their motion to intervene. The RMBS Policyholders have now filed a notice of appeal.

The Circuit Court's ruling was in error. If an injunction is not entered by this Court, the RMBS Policyholders, other Ambac policyholders, and the general public will be irreparably harmed. Without an injunction, if a court later concludes that the CDS Settlement is improper or the Segregated Account is inadequately capitalized, the money needed to adequately capitalize the Segregated Account will have been dissipated to at least 17 different financial institutions spread across the globe. The relief the RMBS Policyholders request – to enjoin the consummation of the CDS Settlement and the distribution of funds to the holders of the CDS contracts until the Court has resolved the RMBS Policyholders' appeal – will not harm any of the involved parties. An injunction is needed to maintain the *status quo* of assets presently available to satisfy policyholders' claims until this appeal is resolved.

BACKGROUND

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 residential mortgage-backed

securities (“RMBS”), collateralized debt obligations, and credit default swaps.

According to the Rehabilitation Petition (at ¶¶ 5-7, App. 3-4), over the past three years AAC’s financial position has deteriorated.

On or about 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, App. 8.) 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 *ex parte* 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 in 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 the Rehabilitation Pet. as Ex. G, App. 72; Aggregate Excess of Loss Reinsurance Agreement, at 2, attached to the Rehabilitation Pet. at Ex. H, App. 88.) 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.³

AAC is now on the verge of consummating the CDS Settlement with 17 foreign financial institutions (the “Bank Group”). (See OCI’s Proposed Findings of Fact, ¶¶ 7, 14, App. 353, 355-56; R. Peterson Aff., ¶ 24, App. 384.) 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 May 25, 2010. (See May 6, 2010 Letter from Michael B. Van Sicklen to the Honorable William D. Johnston at 1, App. 301.) Once the CDS Settlement closes, AAC will (i) pay \$2.6 billion from the General Account to the Bank Group, and (ii) issue \$2 billion of surplus notes payable to the Bank Group. (See Nowicki Aff., Ex. A at 6, App. 276.)

RMBS Policyholders Requested The Circuit Court To Review The CDS Settlement. As soon as they learned of the proposed CDS Settlement, the

³ As of the May 25, 2010 hearing, the following additional interested parties – representing more than \$20 billion in Ambac’s policies – filed papers in the Circuit Court and expressed concerns about the CDS Settlement: Wells Fargo Bank, National Association (in excess of \$3.5 billion); LVM bondholders (\$500 million); Deutsche Bank National Trust Company, Deutsche Bank Trust Company Americas, and U.S. National Bank Association (collectively, \$12 billion); Bank of New York Mellon (158 policies, totaling 15% of the policies in the Segregated Account); and Federal Home Loan Mortgage Corporation (approximately \$2 billion in the Segregated Account and \$2.5 billion in the General Account).

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 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. On May 14, 2010, the RMBS Policyholders moved to intervene in the matter. (App. 303-06.)

In response, OCI and AAC filed lengthy briefs, and attached factual affidavits and documents just days before the Circuit Court's May 25, 2010 hearing. OCI also submitted proposed findings of fact and conclusions of law. Although thereby conceding that the propriety of the settlement turned on factual issues, they refused to provide any factual information in response to specific discovery requests propounded by the RMBS Policyholders and others. In short, they disclosed only what they were willing to disclose, on their terms, on the eve of the May 25 hearing, 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, 2010.⁴ Agreeing with OCI and AAC, the court denied the movants’ request to intervene and refused to permit factual discovery. The court refused to permit the other parties, including the RMBS Policyholders, to develop factual support for their positions in response to OCI’s last minute proposed findings of fact. The Circuit Court heard no testimony, and admitted no evidence, during the proceedings.

During the hearing, the Circuit Court indicated that it was denying the RMBS Policyholders’ motion on purely legal grounds. Specifically, the Circuit Court stated that it lacked authority to review the transaction because it involved the General Account which was not in rehabilitation. The Circuit Court repeatedly emphasized that OCI’s actions relating to the CDS Settlement were “not under the authority of the court” and the Circuit Court cannot “dip into the activities and try to overview the activities of the Office of the Commissioner of Insurance.” (May 25, 2010 Hrg. Tr. at 14, 125-26, App. 465, 576-77.)

⁴ In their emergency motion, and in a letter to the Circuit Court, the RMBS Policyholders made it clear that the sole relief sought in their emergency motion, and the sole issue that they requested the Circuit Court to address on May 25, 2010, was their request for an order maintaining the *status quo* pending expedited discovery and a subsequent evidentiary hearing on the remainder of the RMBS Policyholders’ claims. In its response brief, AAC agreed that issues other than the requested emergency relief were not properly before the Circuit Court and should be resolved at a later time, pursuant to a briefing schedule previously established for a motion filed by Wells Fargo Bank, N.A. Despite the clear intent of the emergency motion, and AAC’s agreement with the RMBS Policyholders’ position on this issue, the Circuit Court granted OCI’s request that the Circuit Court address all claims – even those already scheduled for later briefing and hearing — despite the fact that the RMBS Policyholders and others had not yet even fully briefed those issues or had an opportunity to take discovery.

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 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.

Concerned that the CDS Settlement would close prior to the Circuit Court issuing its written order, on May 26, 2010, the RMBS Policyholders filed a Preliminary Emergency Petition for Leave to Appeal and an accompanying Emergency Motion for Injunction Pending Appeal, seeking to enjoin the consummation of the CDS Settlement and the distribution of settlement funds from the General Account pending appeal of the Circuit Court's order denying the RMBS Policyholders' motions. On May 27, this Court denied the RMBS Policyholders' emergency appeal, noting that the petition for leave to appeal and request for injunction were premature because the Circuit Court had not yet entered its order. (May 27, 2010 App. Ct. Order at 3, App. 587.) The Court invited the RMBS Policyholders to renew their request for an injunction once the Circuit Court entered an order. (*Id.*)

That same day, shortly after receiving this Court's order, the RMBS Policyholders received the Circuit Court's written order, denying all of the RMBS Policyholders' requested relief, including their petition to intervene. Inconsistent with the Circuit Court's stated ruling at the May 25 hearing that the Circuit Court does not have authority to order the relief requested by the RMBS Policyholders

(May 25, 2010 Hrg. Tr. at 14, 125-26, App. 465, 576-77), the Circuit Court's order contains 13 pages of "findings of fact," adopting virtually wholesale OCI's proposed findings of fact even though no evidence was admitted at the hearing. Because of the Circuit Court's order, the CDS Settlement is still set to close at any time.

Accordingly, as set forth herein, the RMBS Policyholders seek an order enjoining the consummation of the CDS Settlement and the distribution of funds to the Bank Group pending this Court's review. Unless the transaction is enjoined pending review, the RMBS Policyholders may be irreparably injured as detailed below.

AN INJUNCTION SHOULD BE GRANTED

I. The RMBS Policyholders Seek An Order Preventing The Improper Distribution Of Funds To The Holders Of The CDS Contracts.

The RMBS Policyholders seek temporary relief to enjoin the consummation of the CDS Settlement and the distribution of funds from the General Account to the holders of the CDS contracts pending appeal. If those funds are distributed, and the Circuit Court or this Court later agrees with the RMBS Policyholders that the settlement was approved in error, it may be difficult, costly, or even impossible to restore the *status quo*. To avoid this harm, the RMBS Policyholders request the Court direct that the CDS Settlement be enjoined and the distribution of any funds to the holders of the CDS contracts be withheld so that they may be retained in the General Account if this Court later concludes

the settlement is unlawful. The RMBS Policyholders request that this injunction remain in place until the Court decides the appeal.

II. The RMBS Policyholders Will Be Substantially And Irreparably Harmed If An Injunction Is Not Entered.

Section 808.07 of the Wisconsin Statutes empowers this Court to “suspend, modify, restore or grant an injunction” during the pendency of an appeal.

Section 808.07 also authorizes the Court to enter a stay to preserve the *status quo* while a party pursues an appeal: “During the pendency of an appeal, a trial court or an appellate court may . . . [m]ake any order appropriate to preserve the existing state of affairs or the effectiveness of the judgment subsequently to be entered.”

Wis. Stat. § 808.07(2)(a)(3). A court should grant an injunction pending appeal when it is necessary to preserve the existing state of affairs, where the appeal presents debatable questions of law, where substantial rights are affected, and where it can be granted without depriving the parties of a substantial right.

Banach v. City of Milwaukee, 31 Wis. 2d 320, 331, 143 N.W.2d 13, 18 (1966).

Accordingly, the Wisconsin Supreme Court has found that an injunction pending appeal is appropriate where, as here, the moving party shows that: (1) it is likely to succeed on the merits of the appeal; (2) it will suffer irreparable injury unless an injunction is granted; (3) no substantial harm will come to the other interested parties; and (4) an injunction will do no harm to the public interest. *See, e.g., State v. Gudenschwager*, 191 Wis. 2d 431, 440, 529 N.W.2d 225, 229 (1995).

Here, a balancing of the factors supports an injunction of the CDS Settlement. The RMBS Policyholders will suffer irreparable injury if an injunction is not granted, while little to no harm will result to AAC or the Bank Group if an injunction is granted. *See Banach*, 31 Wis. 2d at 330, 143 N.W.2d at 18 (finding that the court’s “inherent equitable power should be allowed to preserve the status quo to insure that equity will not be denied plaintiffs if they should be successful on appeal”).

A. The RMBS Policyholders Will Suffer Irreparable Harm Unless The Distribution Is Enjoined.

A party can satisfy the irreparable harm factor to obtain an injunction pending appeal by showing that the money paid pending appeal could not later be recovered. *See Scullion v. Wis. Power & Light Co.*, 237 Wis. 2d 498, 515, 614 N.W.2d 565, 574 (Wis. Ct. App. 2000).

In this case, if AAC is permitted to consummate the CDS Settlement, AAC will immediately distribute \$2.6 billion in cash from the General Account and issue \$2 billion in notes. The \$2.6 billion cash distribution comprises a significant portion – nearly 30% – of the \$9 billion of assets remaining in the General Account. Upon execution, the \$2.6 billion in cash would be dispersed amongst 17 members of an almost entirely foreign Bank Group. If the RMBS Policyholders are ultimately successful on appeal, it would be time-consuming and expensive for OCI to attempt to recover the \$2.6 billion, which, given potential jurisdiction

issues over the foreign entities, would likely face significant hurdles.⁵ Indeed, OCI could be forced to expend time and money to litigate against the Bank Group to recover the transferred funds. Litigation with the Bank Group would divert OCI's attention from the rehabilitation to the detriment of AAC and its policyholders. Even if OCI were successful in the litigation, it is unrealistic to believe OCI could recover the total amount disbursed without undue burden.

The loss of some or all of the \$2.6 billion in cash and \$2 billion in notes could irreparably harm the RMBS Policyholders. Although OCI and the Circuit Court assert the General and Segregated Accounts are distinct, they remain intertwined. Under the Rehabilitation Order, the RMBS Policyholders and other policyholders must look to the Segregated Account, which has been capitalized with a \$2 billion note and a reinsurance agreement with AAC, for payment of their claims. Both the note and the reinsurance agreement are supported by AAC's General Account. However, pursuant to the terms of the note and the reinsurance agreement, neither may respond to claims in the Segregated Account if AAC's surplus falls below \$100 million, or such higher amount as determined by OCI. Transactions that deplete the General Account will limit the recovery by the RMBS Policyholders and other policyholders, and put at risk not only the rehabilitation of the Segregated Account but also the viability of the General

⁵ The Bank Group did not appear as a party in the Circuit Court. Rather, it sought, and was given leave by the Circuit Court, to appear solely as *amicus curiae*. (May 25, 2010 Hrg. Tr. at 97-98, App. 548-49.)

Account. Moreover, there is nothing in the Circuit Court's current orders that prevents AAC from engaging in additional transactions that materially impact the General Account, effectively stripping the RMBS Policyholders of the opportunity to receive a fair distribution as required by Wisconsin law. In the absence of an injunction, the RMBS Policyholders will suffer irreparable harm.

B. The RMBS Policyholders Are Likely To Succeed On The Merits Of Their Appeal.

Under Wisconsin law, a moving party need not show a high probability of success on appeal. *Scullion*, 237 Wis. 2d at 513, 614 N.W.2d at 573. Instead, the likelihood of success "that must be demonstrated is inversely proportional to the amount of irreparable injury the plaintiff will suffer absent the stay."

Gudenschwager, 191 Wis. 2d at 441, 529 N.W.2d at 229.

It is likely the RMBS Policyholders will prevail on appeal. An injunction is needed to protect the 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 this Court is likely to reverse the Circuit Court's decision on the following grounds.

1. The Circuit Court Erred In Finding It Lacked Authority 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 authority to review the CDS Settlement, and instead adopted wholesale OCI's proposed findings of facts and conclusions of law without the admission of any evidence. The Circuit Court

stated that the CDS Settlement was an action taken by OCI as regulator, not as rehabilitator, and therefore was not within the Circuit Court's power to review. (May 25, 2010 Hrg. Tr. at 14, 125-26, App. 465, 576-77.)

Contrary to the Circuit Court's statement, it is clear that OCI's approval of the CDS Settlement was required as a rehabilitator – not solely as a regulator. 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, attached to Rehabilitation Pet. as Ex. B, App. 36.) 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 sole source of funding, and its lifeblood for its reformation or revitalization, is the General Account. 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).

Even if the Cooperation Agreement were not in place, OCI may not consent to a \$4.6 billion settlement without court approval. (*See* RMBS Policyholders' Emergency Br. to Modify Inj., at 19-22, App. 238-41; Reply of RMBS Policyholders, at 2-6, App. 430-34.) 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 or revitalize the insurer.” Wis. Stat. § 645.33(2) (emphasis added). The Circuit Court abdicated this responsibility and gave OCI unfettered discretion to enter into an extraordinary transaction when it failed independently to review the transaction. Indeed, at no point in the hearing did OCI or AAC proffer to the Circuit Court the documentation for the proposed transaction or even a term sheet.

The Circuit Court stated that it lacked authority to limit OCI’s approval of the CDS Settlement with the General Account, because in that capacity OCI was acting only in its capacity as a regulator. (May 25, 2010 Hrg. Tr. at 14, 125-26, App. 465, 576-77.) 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, App. 72; Aggregate Excess of Loss Reinsurance Agreement, at 2, App. 88.) The CDS Settlement will cause the immediate transfer of \$4.6 billion of cash and notes out of the General Account, thereby negatively affecting the rehabilitation. Thus, the arbitrary and unreviewed separation of AAC into a Segregated Account and a General Account does not deprive the Circuit Court of the power or statutory obligation 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 insure 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 or 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).

2. The Circuit Court Erred In Refusing Discovery And By Issuing Written Findings Of Fact When No Evidence Had Been Admitted.

The Circuit Court erred in not permitting discovery or conducting an evidentiary hearing to evaluate whether the CDS Settlement is in compliance with the Wisconsin Insurance Code provision requiring that distributions to AAC general creditors be subordinated to policyholders' claims. (*See Reply of RMBS Policyholders*, at 6-11, App. 434-39.) Instead, the Circuit Court issued 13 pages of findings of fact, despite the fact that it did not receive any testimony or admit any evidence, and refused to allow the parties to conduct any discovery. The Circuit Court simply adopted OCI's findings of fact and conclusions of law. (*Compare* May 27, 2010 Cir. Ct. Order, App. 589, *with* OCI's Proposed Findings, App. 350.)

A trial court commits reversible error where, as here, it simply adopts one party's findings of fact and fails to articulate the factors upon which it based its decision. *See Trieschmann v. Trieschmann*, 178 Wis. 2d 538, 541-42, 504 N.W.2d 433, 434 (Wis. Ct. App. 1993) (reversing the trial court judgment and remanding with directions "to consider all of the facts and relevant law related to each issue"). Indeed, "[t]he trial court's decision must be the product of a rational mental process by which the facts of record and law relied upon are stated and are considered together for the purpose of achieving a reasoned and reasonable determination." *Id.* (internal citations and quotations omitted). The Circuit Court's adoption of OCI's proposed findings of fact and conclusions of law

without any analysis or admission of evidence was in error. Because the question of whether OCI's actions are fair and equitable to all policyholders is a fact based question, 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 equitably and fairly as the law requires. Among other things, the RMBS Policyholders contend that the Bank Group may not be insured parties that have suffered any loss, and therefore 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 and consideration of an adequate record 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 Emergency Br. to Modify Inj., at 22-23, App. 241-42; Reply of RMBS Policyholders, at 6-11, App. 434-39.

Discovery may further address whether the Segregated Account is adequately capitalized, which is a statutory prerequisite to its creation. *See* Wis.

Stat. § 611.24(3)(a). OCI presented absolutely 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, App. 19-20.) OCI only asserted that the Segregated Account is adequately capitalized and, without providing any underlying data or analysis of any kind, requested that the Circuit Court simply accept as true OCI's assertion. The Circuit Court did just that, without any evidence first being submitted and concluded as a matter of law that "[t]he Segregated Account was formed in compliance with Wisconsin law." (May 27, 2010 Cir. Ct. Order, at 14, App. 602.) 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 nearly 30% of its funds – and will 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.

3. The Circuit Court Erred In Denying The RMBS Policyholders The Right To Intervene Or Otherwise To Be Heard.

The Circuit Court erred as a matter of law when it concluded without any analysis that the RMBS Policyholders have not satisfied the requirements for intervention under Wisconsin law. The Wisconsin Supreme Court has stated that,

to intervene as a matter of right under Wis. Stat. § 803.09(1), the movant must show: “(A) that the movant’s motion to intervene is timely; (B) that the movant claims an interest sufficiently related to the subject of the action; (C) that the disposition of the action may as a practical matter impair or impede the movant’s ability to protect that interest; and (D) that the existing parties do not adequately represent the movant’s interests.” *Helgeland v. Wis. Municipalities*, 307 Wis. 2d 1, 20-21, 745 N.W.2d 1, 10 (2008).

Each of these requirements is satisfied here for the RMBS Policyholders. First, the RMBS Policyholders acted promptly in the rehabilitation proceedings after discovering that their interests were at risk. Second, the RMBS Policyholders have a beneficial ownership of approximately \$1 billion of residential mortgage-backed securities that have been allocated to the Segregated Account that has been placed into rehabilitation. Third, the resolution of whether the Segregated Account is valid and whether the CDS Settlement should be approved impairs the RMBS Policyholders’ ability to protect their interests in the residential mortgage-backed securities. Finally, in light of OCI’s decision to approve the creation of the Segregated Account and to proceed with the CDS Settlement despite the RMBS Policyholders’ challenges to the Segregated Account and CDS Settlement, the RMBS Policyholders’ interests are not “adequately represented” by OCI.

Independently of intervention, because the Wisconsin Insurance Code mandates court review of OCI's actions, parties whose rights are substantially and directly affected should be provided a meaningful opportunity to be heard.

Accordingly, as owners or managers of funds that own approximately \$1 billion face amount of RMBS policies and other liabilities that have been allocated to the Segregated Account, the RMBS Policyholders qualify as interested parties in the Segregated Account's rehabilitation proceedings and have the right to participate therein.

C. An Injunction Will Not Cause Substantial Harm To Any Interested Party.

In evaluating the substantial harm factor, a court should "consider the substantiality of harm asserted, the likelihood of its occurrence, the adequacy of the proof provided and whether it truly is a harm that cannot be remedied by the later collection of the judgment plus interest." *Scullion*, 237 Wis. 2d at 516, 614 N.W.2d at 574. Irreparable harm to the moving party and the risk of substantial harm to the non-moving party should be balanced; injury to one frequently means a lack of harm to the other. Here, the balance heavily favors an injunction.

An injunction of the action will not cause substantial harm to any interested party. To protect the other parties' interests, the RMBS Policyholders have proposed that AAC and the Bank Group may tender the Bank Group's policies and the \$2.6 billion in cash and \$2 billion in notes to an escrow agent. If the settlement is ultimately found to be appropriate, the parties can consummate the

settlement and the escrow agent can distribute the money and notes to the Bank Group. Conversely, in the event the Court ultimately finds that the settlement cannot proceed, the funds would be returned to the General Account.

Undoubtedly, the potential harm to the Bank Group in placing the \$2.6 billion into escrow for a brief period of time pales in comparison to the irreparable and substantial injury faced by the RMBS Policyholders if the settlement is overturned and entities are permitted to dissipate the funds they receive. Moreover, any potential harm to interested parties will be minimized because the RMBS Policyholders are pursuing an expedited appeal.

On balance, the harm, if any, caused by the delay in litigating this lawsuit is insubstantial when compared to the substantial and irreparable harm facing the RMBS Policyholders.

D. An Injunction Will Serve The Public's Interest.

The public has an interest in ensuring that a proposed rehabilitation plan is fair and equitable. *See* Wis. Stats. §§ 645.33(5); 601.01(2). If in fact the Bank Group is not entitled to be paid, it is contrary to the public interest to permit a windfall of \$4.6 billion for the benefit of the Bank Group when policyholders are not fully paid.

Moreover, a segregated account must be adequately capitalized under Wisconsin law. *See* Wis. Stat. § 611.24(3)(a). An undercapitalized segregated account is illegal. *Id.* Wisconsin law is structured to grant OCI authority to approve a segregated account when certain statutory safeguards are met. OCI

cannot isolate what it considers to be “bad” policies from a company without adhering to the necessary statutory safeguards, which in the case of a rehabilitation provide for court approval.

Without assurances that a segregated account is adequately capitalized, OCI would be permitted to circumvent the statutory safeguards and arbitrarily remove bad policies of a disfavored policyholder into a segregated account. The adequate capitalization requirement prevents OCI from removing “bad” assets to create a bad-company/good-company structure. OCI’s attempt to abdicate the responsibility to ensure adequate capitalization in rehabilitation proceedings will jeopardize Wisconsin’s policy of promoting business growth. There would be a serious disincentive for anyone to purchase policies through Wisconsin insurance companies if their policies can be arbitrarily relegated into a segregated account that is undercapitalized, resulting in large losses to the insureds whose policies are classified in that disfavored group. The Wisconsin Legislature permits the use of segregated accounts only when they are adequately funded. The disregard of that standard would create a significant disincentive to obtain insurance from insurance companies domiciled in Wisconsin. The need for the Circuit Court’s careful review of the Segregated Account’s capital adequacy protects Wisconsin from becoming hostile to business interests to the detriment of the public.

III. A Bond Is Not Appropriate.

A court has the discretion to condition the granting of an injunction pending appeal on the filing of an undertaking or bond with the court. Wis. Stat.

§ 808.07(2)(b). The court's authority to condition a bond corresponds to the goal of "preserv[ing] the existing state of affairs or the effectiveness of the judgment subsequently to be entered." Wis. Stat. § 808.07(2)(a). In this case, requiring a bond is not only unnecessary, but would prejudice the rights of the RMBS Policyholders for three reasons.

First, a bond is not necessary to preserve the effectiveness of the judgment on appeal because the parties' interests are fully protected. If the CDS Settlement is upheld, the funds can be distributed. The escrow arrangement described above will fully protect the parties if the RMBS Policyholders' appeal is unsuccessful.

Second, the Circuit Court's initial injunction order reflects that a bond is not needed in this case. In that order, the Circuit Court, in its discretion under Wis. Stat. § 645.08, declined to require OCI to post a bond. (Order for Temporary Injunctive Relief, ¶ 11, App. 173.) The Circuit Court recognized that requiring a bond could act as an impediment to the efficient rehabilitation of AAC. The same reasoning applies to the present circumstance. If the Court agrees that the settlement should be blocked, the result will be the return to AAC of \$2.6 billion in cash and a \$2 billion note. The RMBS Policyholders believe that payment will assist OCI's efforts to rehabilitate AAC. Requiring a bond will impede that result.

Third, a bond would be inappropriate because the RMBS Policyholders are merely seeking to hold OCI to its statutory obligations in the interest of all policyholders.

Fourth, a bond in this case would be a practical impediment for the RMBS Policyholders to obtain review. In the Circuit Court, OCI argued that a \$9.3 billion bond would have been appropriate if the Circuit Court granted RMBS Policyholders' Motion to Modify the Order for Injunctive Relief. (OCI's Brief in Opposition, at 13-14, App. 328-29.) Even the statutory maximum bond of \$100 million (Wis. Stat. § 808.07(2m)) will deter the RMBS Policyholders from obtaining review of this case. Courts have held that a party should not be precluded from obtaining judicial review because of circumstances outside of their control. *See, e.g., City of Williamsport v. U.S.*, 273 F. Supp. 899, 904 (M.D. Pa. 1967) (“[U]nder the circumstances of this case, a requirement that plaintiffs post security would stifle and, indeed, take away their right to judicial review . . . They should not be denied effective judicial review because of circumstances outside their control.”).

For these reasons, the RMBS Policyholders should not be required to obtain a bond so that they can appeal the Circuit Court's ruling.

CONCLUSION

The RMBS Policyholders respectfully request that the Court enjoin the consummation of the CDS Settlement and the distribution of settlement funds from the General Account pending the appeal of the Circuit Court's order denying (1) the RMBS Policyholders' Emergency Motion to Modify Order for Temporary Injunctive Relief, and (2) the RMBS Policyholders' Motion to Intervene. The RMBS Policyholders further request that the Court find a bond is not required.

Dated this 28th day of May, 2010.

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