

**COURT OF APPEALS OF WISCONSIN
DISTRICT IV**

In the Matter of the Rehabilitation of:

Segregated Account of
Ambac Assurance Corporation,

Appeal No. 2011 AP 561

TED NICKEL and OFFICE OF THE
COMMISSIONER OF INSURANCE,

Petitioners-Respondents,

AMBAC ASSURANCE,

Interested Party-Respondent,

v.

DEPFA BANK, PLC,

Interested Party-Appellant,

ACCESS TO LOANS FOR LEARNING
STUDENT LOAN CORPORATION,
AURELIUS CAPITAL MANAGEMENT LP,
BANK OF AMERICA, N.A., CUSTOMER
ASSET PROTECTION COMPANY ("CAPCO"),
DEUTSCHE BANK NATIONAL TRUST
COMPANY, DEUTSCHE BANK TRUST
COMPANY AMERICAS, EATON VANCE,
FEDERAL HOME LOAN MORTGAGE
CORPORATION ("Freddie Mac"), FEDERAL
NATIONAL MORTGAGE ASSOCIATION
("Fannie Mae"), FIR TREE INC., KING STREET
CAPITAL MASTER FUND, LTD., KING
STREET CAPITAL, L.P., LLOYDS TSB BANK
PLC, MONARCH ALTERNATIVE CAPITAL
LP, ONE STATE STREET LLC, STONEHILL
CAPITAL MANAGEMENT LLC, U.S. BANK

NATIONAL ASSOCIATION, WELLS FARGO BANK, N.A., WELLS FARGO BANK, N.A., as Trustee for the LVM Bondholders, WILMINGTON TRUST COMPANY and WILMINGTON TRUST FSB,

Interested Parties-Co-Appellants.

ASSURED GUARANTY CORPORATION, BANK OF NEW YORK MELLON, COUNTRYWIDE HOME LOANS SERVICING L.P., GOLDMAN SACHS & CO., INC., HSBC BANK USA, NATIONAL ASSOCIATION, KNOWLEDGEWORKS FOUNDATION, ONE STATE STREET LLC, NUVEEN ASSET MANAGEMENT, PNC BANK, RESTORATION CAPITAL MANAGEMENT LCC, STONE LION CAPITAL PARTNERS LP and TREASURER OF THE STATE OF OHIO, and UNITED STATES OF AMERICA,

Interested Parties.

**APPEAL FROM THE ORDER OF THE CIRCUIT COURT
OF DANE COUNTY CASE NO. 10 CV 1576**

THE HONORABLE WILLIAM D. JOHNSTON PRESIDING

**BRIEF OF APPELLANTS EATON VANCE
MANAGEMENT, EATON VANCE MUNICIPAL INCOME
TRUST, EATON VANCE MUNICIPAL BOND FUND, AND
EATON VANCE MUNICIPAL BOND FUND II**

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Dated: July 5, 2011

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**Pro Hac Application
Pending*

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Appellants Eaton Vance Management, Eaton Vance Municipal Income Trust, Eaton Vance Municipal Bond Fund, and Eaton Vance Municipal Bond Fund II (collectively “Eaton Vance”) submit this brief pursuant to Section 809.19, Wisconsin Statutes, and the Court’s May 3, 2011 Order.

ISSUES PRESENTED FOR REVIEW

1. Did the Circuit Court err by including in the Ambac Assurance Corporation’s (“Ambac”) Segregated Account the Ambac insurance policies insuring payments for a municipal bond while allowing the General Account to retain all of Ambac’s policies insuring other municipal bonds?

The Circuit Court held that the placement of the policies into the Segregated Account was permissible.

2. Did the Circuit Court err by approving the Plan of Rehabilitation for the Segregated Account filed on October 8, 2010 (“Plan”) which requires municipal bondholders to assign their contractual right to receive bond payments to Ambac before Ambac pays the bondholders’ claims in full?

The Circuit Court approved the Plan, notwithstanding the objectionable subrogation provisions contained in the Plan.

3. Did the Circuit Court err by approving the Plan which discriminates against holders of long-dated claims by failing to ensure that they will be paid on equal terms as holders of short-dated claims?

The Circuit Court approved the Plan without requiring proper protections for holders of long-dated claims.

STATEMENT ON ORAL ARGUMENT AND PUBLICATION

Eaton Vance incorporates the Statement on Oral Argument and Publication set forth in the June 17, 2011 Appellants' Consolidated Opening Brief ("Appellants' Brief").¹

STATEMENT OF THE CASE

The Appellants' Brief sets forth numerous errors committed by the Circuit Court in overseeing the proceedings relating to the Ambac Segregated Account and in entering its Decision and Final Order Confirming the Rehabilitator's Plan of Rehabilitation on January 24, 2011 ("Confirmation Order"). The general factual background and procedural history of this matter is described in the Appellants' Brief. Eaton Vance incorporates the Statement of the Case as set forth in the Appellants' Brief, but sets forth the

¹ Unless otherwise indicated, Eaton Vance uses the terms as identified in the Appellants' Brief and adopts the same method for identifying the Record and Joint Appendix.

following statement of the case to highlight the issues and facts as they specifically relate to Eaton Vance and its claims on appeal.

I. NATURE OF THE CASE

The Appellants' Brief sets forth numerous errors committed by the Circuit Court in approving the Plan. Further, the Plan unfairly and illegally treats Eaton Vance and other holders of Las Vegas Monorail Project Revenue Bonds ("LVM Bonds") because the insurance policies that insured these defaulted bonds should not be in the Segregated Account. This appeal highlights three fundamental errors committed by the Circuit Court.

First, by placing only the insurance policies relating to the defaulted LVM Bonds in the Segregated Account while leaving other municipal bonds policies in the General Account, the Plan improperly discriminates against the holders of LVM Bonds based on the claim status (defaulted bond) rather than the type of policy (municipal bonds). This treatment violates Wisconsin law and is unconstitutional. Second, the Plan would require Eaton Vance to assign its contractual rights to Ambac for LVM Bond payments upon receipt of a mixture of cash payments and surplus notes. This assignment (1) violates Eaton Vance's contractual rights, (2) violates the Wisconsin "made whole" doctrine, (3) exceeds the

authority of the Wisconsin Office of the Commissioner of Insurance (“Commissioner”), and (4) constitutes an unconstitutional taking. Finally, the Plan unfairly discriminates against Eaton Vance and other holders of long-dated claims by failing to ensure that they will be paid on equal terms to holders of short-dated claims.

II. PROCEDURAL HISTORY

Eaton Vance incorporates the Procedural History set forth in the Appellants’ Brief.

III. STATEMENT OF FACTS

A. Eaton Vance’s Ownership of LVM Bonds.

In 2000, the director of the State of Nevada Department of Business and Industry issued the LVM Bonds in the initial principal amount of approximately \$451 million. (R.17:26) The LVM Bonds were issued to finance the construction and operation of a monorail system in Las Vegas, Nevada by the Las Vegas Monorail Company (“LVMC”). (R.17:20) The LVM Bonds were initially rated AAA and marketed as conservative municipal bonds. (R.17:21) They were sold to, and purchased by, investing bondholders (“LVM Bondholders”), including Eaton Vance.

Under the terms of the Senior Trust Indenture dated September 1, 2000 (“Trust Indenture”) (R.465:4-122), LVM Bondholders were to receive interest, principal and accreted interest payments on the LVM Bonds. Payments were scheduled to be made beginning in 2001 and continuing through 2040. Payments due generally increased annually with, for example, over \$19 million due in 2002, over \$30 million due in 2016, and over \$50 million due in 2040. Payments due on the LVM Bonds were made beginning in 2001 and continuing through January, 2010.

Ambac issued a Municipal Bond Insurance Policy dated September 20, 2000, and a First Tier Surety Reserve Bond (collectively “Ambac LVM Policies”) to insure payments on the LVM Bonds. (R.17:20-21, 26) Ambac received significant premiums for issuing the Ambac LVM Policies. (*Id.*)

On January 13, 2010, LVMC filed for Chapter 11 bankruptcy protection in the United States Bankruptcy Court for the District of Nevada. (R.17:20) That bankruptcy case remains pending. The LVM Bonds are currently in default. Recovery from the LVMC bankruptcy is uncertain. Payment of past due and future principal and interest on the LVM Bonds is an obligation of Ambac under the Ambac LVM Policies. Ambac has estimated that

its exposure under the Ambac LVM Policies is over \$1.1 billion.

(R.17:27)

B. Creation of the Segregated Account and the Proceedings in the Circuit Court.

The Appellants' Brief sets forth the background of Ambac's financial difficulties, the creation of the Segregated Account, the filing of the Plan and its approval by the Circuit Court. Eaton Vance incorporates that factual background herein.

Ambac and the Commissioner chose what policies to include in the Segregated Account. Among the policies assigned to the Segregated Account were certain high risk structured-finance obligations that were the principal cause of Ambac's financial difficulties, including policies covering residential mortgage-backed securities, credit default swap agreements, and certain student loan policies. (R.372:10-11) In addition to assigning these high risk structured-finance obligations to the Segregated Account, Ambac and the Commissioner also assigned the Ambac LVM Policies to the Segregated Account, notwithstanding the fact that Ambac's other municipal bond policies were not assigned to the Segregated Account but instead remained in the General Account. (R.372:24) The principal rationale expressed by the Commissioner

and Ambac for assigning the Ambac LVM Policies to the Segregated Account was that the Ambac LVM Policies were already in default and had substantial projected claims. (R.372:24) However, the Commissioner and Ambac did not assign other defaulted municipal bond policies to the Segregated Account. (R.372:58-61)

On June 9, 2010, the LVM Bondholders (including Eaton Vance) filed a motion in the Circuit Court objecting to the assignment of the Ambac LVM Policies to the Segregated Account. (R.146) On July 16, 2010, the Circuit Court issued an order denying the LVM Bondholders' motion in its entirety. (R.252) The LVM Bondholders filed a notice of appeal from the Circuit Court's July 16, 2010 order denying their motion. That appeal (10-AP-2022) has been fully briefed and has now been consolidated with this appeal.

On October 8, 2010, the Commissioner filed the Plan (R.371) and the Motion (R.370) seeking confirmation of the Plan along with the Disclosure Statement which contained projected financial and operating results with respect to four different scenarios under four different sets of financial and operational assumptions. (R.372:99-170)

The Plan provides that, as of the Effective Date, holders of Permitted Policy Claims are to receive, on account of those claims, cash equal to 25 percent of the permitted claim amount, and notes (“Surplus Notes”) equal to 75 percent of the permitted claim amount. (R.371:6, 14-15) Under the Plan, Eaton Vance and the other LVM Bondholders would receive a combination of cash and Surplus Notes for amounts currently due on the LVM Bonds and in the future would receive additional cash and Surplus Notes every year through 2040 for amounts then due.

The Surplus Notes pay interest annually and mature 10 years from when they are issued. However, the Surplus Notes provide that no payment can be made without the Commissioner’s prior approval, effectively permitting the Commissioner to pay interest in kind and to extend the maturities of the Surplus Notes *ad infinitum*. (R.371:74)

The Disclosure Statement states that “payment of principal of and interest on the Surplus Notes will be expressly subordinate in right of payment to the prior payment in full” of, among other things, all existing and future Policy Claims. (R.372:52-53, R.371:79) The Disclosure Statement does not explain, however, how the Commissioner intends to give effect to that subordination

if some Surplus Notes mature in 2020 and other senior Policy Claims (such as a majority of the claims of Eaton Vance and other LVM Bondholders) will not mature until after 2020.

Moreover, the Plan does not create any reserves to assure payment on the future amounts due on the LVM Bonds. It does not assure that payment of amounts due on the LVM Bonds in the future through 2040 will be made on the same terms as payments to the holders of permitted claims on the Plan's Effective Date.

In exchange for receipt of cash and Surplus Notes, policyholders must give up virtually all other rights as bondholders and policyholders. They must relinquish their claims against not only the Segregated Account, but also against the General Account, Ambac, and any of Ambac's successors, members or shareholders. Specifically, Section 4.04(g) of the Plan provides, in relevant part, that notwithstanding "the satisfaction of permitted policy claims with Surplus Notes in lieu of cash, [Ambac] shall be entitled to recover the full amount of all recoveries, reimbursements and other payments" (R.371:23) Also, Section 4.04(h) states that "upon receipt of a payment with respect to a permitted policy claim, each . . . holder shall be deemed to have assigned its rights relating to payment under the underlying instrument(s) or contracts [to

Ambac].” (R.371:24) Thus, these provisions require the LVM Bondholders to assign their LVM Bonds, and any recoveries thereon, to Ambac upon receipt of the cash and Surplus Notes received under the Plan.

C. **Circuit Court’s Confirmation of Rehabilitation Plan and Subsequent Appeal.**

On January 24, 2011, the Circuit Court, following hearing and arguments in November, 2010, issued its Confirmation Order confirming the Plan, along with Findings of Fact and Conclusions of Law. (R.556) In its Confirmation Order, the Circuit Court granted the Commissioner’s motion for confirmation of the Plan and entered verbatim the findings of fact and conclusions of law which had been proposed by the Commissioner. In particular, the Circuit Court reaffirmed its prior ruling approving the allocation of the Ambac LVM Policies to the Segregated Account on the basis of the default status of the bonds. (R.556:52-53) The Court also rubber-stamped the provisions requiring the assignment of claims prior to the receipt of full payment and failed to protect holders of long-dated claims. This appeal followed.

ARGUMENT

A. The Ambac LVM Policies Should Not Be Allocated To The Segregated Account

The allocation of the Ambac LVM Policies to the Segregated Account, while leaving all or almost all of Ambac's other municipal bond policies in the General Account, is legally impermissible.

This error was raised and briefed in Appeal No. 2010-AP-2022, even before the Plan was approved by the Circuit Court. The Plan perpetuates this error. Eaton Vance incorporates all of the arguments set forth in the Appellants' Briefs in Appeal No. 2010-AP-2022. The various Orders of the Circuit Court permitting the allocation of the Ambac LVM Policies to the Segregated Account, including the Confirmation Order, should be reversed.

B. The Plan Impermissibly Requires Policyholders To Assign Contractual Rights To Ambac

One of the Plan's most egregious flaws is its purported taking of Policyholders' contractual and other claims against third parties, including the LVM Bondholders' contractual claims against LVMC under the LVM Bonds. The Plan improperly requires the LVM Bondholders to assign their LVM Bonds, and

any recoveries thereon, to Ambac upon receipt of the cash and Surplus Notes that they will receive under the Plan. See Sections 4.04(g) and 4.04(h) of Plan. (R.371:23-24)

This forced assignment of the LVM Bondholders' claims against LVMC is unlawful for multiple independent reasons. It is inconsistent with the terms of the LVM Policy; it violates the "made whole" doctrine under Wisconsin law; it is an unconstitutional taking of the property of the LVM Bondholders; and it exceeds the Commissioner's statutory authority.

1. **The Forced Assignment of the LVM Bondholders' Rights Contravenes the Terms of the Ambac LVM Policies and the Trust Indenture**

The pertinent provisions of the Ambac LVM Policies and the Trust Indenture governing the LVM Bonds are unambiguous: an LVM Bondholder need not surrender the LVM Bonds, or any recoveries thereunder, to Ambac unless and until Ambac pays the LVM Bondholders in full and in cash. The Ambac Municipal Bond Policy provides, in relevant part, as follows:

Ambac . . . agrees to pay . . . for the benefit of [LVM] Bondholders, that portion of the principal of and interest on . . . [the LVM Bonds] which shall become Due for Payment but shall be unpaid by reason of Nonpayment by [LVMC] Upon a Bondholder's presentation and surrender to the Insurance

Trustee of such unpaid Bonds or appurtenant coupons . . . the Insurance Trustee will disburse to the Bondholder the face amount of principal and interest which is then Due for Payment but is unpaid. *Upon such disbursement*, Ambac shall become the owner of the surrendered Bonds and coupons and shall be fully subrogated to all of the Bondholder's right to payment.

(R.465:148) (emphasis added).

Ambac does not own the LVM Bonds and does not become subrogated to the LVM Bondholders unless and until Ambac pays the LVM Bondholders 100% of the face amount of any unpaid principal or interest due on the LVM Bonds. The LVM Bond Indenture is clear that such principal and interest must be paid in cash - not a combination of cash and Surplus Notes.² Accordingly, payment by the Segregated Account in a combination of cash and Surplus Notes does not trigger the obligation of the LVM Bondholders to surrender or assign to Ambac their rights under the LVM Bonds. Thus, substituting a small down payment of cash and Surplus Notes of dubious collectability rewrites the policy and does so in a way which impermissibly discriminates against the LVM

² The form of LVM Bonds specifies that the payment of interest, principal, and premium "shall be made in lawful money of the United States of America." (R.465:95)

Bondholders and in favor of Ambac's other creditors, shareholders and policyholders.

2. **The Forced Assignment Also Violates the "Made Whole" Doctrine**

In addition to violating the unambiguous terms of the Ambac LVM Policies and the governing Trust Indenture, the Plan's forced assignment of the LVM Bondholders' rights and recoveries against LVMC violates basic principles of subrogation law, and specifically Wisconsin's adoption of the "made whole" doctrine:

The made whole doctrine in an insurance context is discussed in *Couch on Insurance*, which describes it as a "traditional equity principle" under which a party claiming subrogation rights may not recover until the insured is fully compensated for his or her losses "The burden of loss should rest on the party paid to assume the risk, and not on an inadequately compensated insured. . . ." Once the insured has been fully compensated, however, any additional recovery by the insured would constitute unjust enrichment. The subrogated party is therefore entitled to assert its subrogation claim once the insured has been made whole.

Ruckel v. Gassner, 2002 WI 67, ¶ 17, 253 Wis. 2d 280, 287-88, 646 N.W.2d 11, 15 (Wis. 2002) (quoting *Couch on Insurance*, §§ 223:133, 223:136 (3d ed. 2000)). See also *Garrity v. Rural Mut. Life Ins. Co.*, 77 Wis. 2d 537, 541, 253 N.W.2d 512, 514 (Wis. 1977); *Rimes v. State Farm Mut. Auto. Ins. Co.*, 106 Wis. 2d 263,

272, 316 N.W.2d 348, 353 (Wis. 1982). The Wisconsin Supreme Court has ruled that the “made whole” doctrine is inviolate and cannot be overridden by contract. In *Ruckel*, the Court specifically stated that “an insurer is not entitled to subrogation against its insured unless and until the insured is made whole, regardless of contractual language to the contrary.” *Ruckel*, 2002 WI 67, at ¶ 43, 253 Wis. at 296, 646 N.W.2d at 19.

Based on this long-standing principle of insurance and subrogation law, even if the language of the Ambac LVM Policies could somehow be read to require the assignment of rights upon Ambac's partial payment of amounts due (and it cannot), such provision would be unenforceable as a matter of law. Requiring the LVM Bondholders to assign their rights and recoveries under the LVM Bonds to Ambac before they are made whole would turn the subrogation and “made whole” doctrines on their heads. Indeed, the Plan's forced assignment provision rewrites the policies in a manner which does not comply with the made whole doctrine and, in fact, blatantly violates it. No rule of law or public policy can possibly justify such an action, particularly by the government agency charged with protecting the rights of the insured.

The Circuit Court’s Confirmation Order did not specifically address the objections of the LVM Bondholders that the forced assignment provisions of the Plan violated the “made-whole” doctrine. However, in the Circuit Court proceedings which preceded Plan confirmation, the Commissioner contended that the LVM Bondholders are “made whole” through the receipt of a combination of cash and Surplus Notes. (R.482:19). In assessing the validity of that assertion, it is important to note that the LVM Bondholders purchased insurance from Ambac that insured the periodic *cash* payments of interest and principal under the LVM Bonds. Contrary to the Commissioner’s assertions, the LVM Bondholders are simply not “made whole” by receiving a 25% cash payment, plus Surplus Notes that are not projected to be paid until 2050 and that, even then, are not expected to be paid in full under most of the Commissioner’s own projections.³

As the foregoing makes clear, requiring the LVM Bondholders to assign their rights under the LVM Bonds to Ambac based on the payment of Ambac LVM Policies claims in

³ The Second Circuit recently rejected a similar argument in the Delta Air Lines bankruptcy proceeding. *See Northwestern Mutual Life Ins. Co. v. Delta Air Lines, Inc. (In re Delta Air Lines, Inc.)*, 608 F.3d 139, 147 (2d Cir. 2010) (ruling that payment of obligations under original debt instruments with diminished “bankruptcy dollars” did not satisfy “made whole” doctrine).

“rehabilitation dollars” - a combination of cash and notes of uncertain value - is entirely unsupported by the law. For this reason alone, the Circuit Court’s Confirmation Order should be reversed.

3. **The Forced Assignment Exceeds the Commissioner’s Authority Under Wisconsin’s Rehabilitation Statute**

Nothing in Wisconsin's rehabilitation statute empowers the Commissioner to modify or overrule the “made whole” doctrine. Chapter 645 of the Wisconsin Statutes establishes the position of the rehabilitator, identifies the property over which a rehabilitator exercises authority, and outlines the manner in which that authority may be exercised. More specifically, Wis. Stat. § 645.33 provides that the “rehabilitator shall have the full power to direct and manage, to hire and discharge employees subject to any contract rights they may have, and to deal *with the property and business of the insurer.*” Wis. Stat. § 645.33(2) (emphasis added). Nothing in the statute authorizes the Commissioner to exercise control over the personal property or contract rights of individual policyholders.⁴

⁴ Indeed, courts have recognized that a rehabilitator can exercise authority only over claims common to all creditors and not over those personal to creditors. See, e.g., *Selcke v. Hartford Fire Ins. Co. (In re Rehabilitation of Centaur Ins. Co.)*, 606 N.E.2d 291, 295 (Ill. App. Ct. 1992) aff’d, 632 N.E.2d 1015 (Ill. 1994) (holding that rehabilitator cannot exercise authority over individual

Here, rights under the LVM Bonds are inherently personal to the LVM Bondholders, as they reflect a separately enforceable contract directly between the LVM Bondholders (represented by the LVM Bond Trustee) and LVMC. Accordingly, there is no basis under the Wisconsin rehabilitation statute to confiscate those rights for the benefit of Ambac.

4. **Even if the Wisconsin Statute Authorized the Forced Assignment (Which It Plainly Does Not), the Assignment Would Constitute an Unconstitutional Taking of the LVM Bondholders' Property**

Even if the Wisconsin rehabilitation statute could somehow be read to authorize the Plan's forced assignment of the LVM Bondholders' rights against LVMC, this result would constitute a taking of the LVM Bondholders' property in violation of the Fifth and Fourteenth Amendments to the United States Constitution, as well as Article 1, § 13, of the Wisconsin Constitution. The rehabilitation statute should be construed to avoid such an unconstitutional result. *See, e.g., Milwaukee Journal Sentinel v.*

creditor claims); *Ins. Comm'r of Michigan v. Arcilio*, 561 N.W.2d 412, 419 (Mich. Ct. App. 1997) (affirming injunction that did not interfere with creditors' ability to pursue personal claims); *In re Liquidation of Am. Mut. Liability Ins. Co.*, 632 N.E.2d 1209, 1213 (Mass. 1994) (holding that statutory receiver cannot bring claims personal to creditors).

Wis. Dep't of Admin., 2009 WI 79, ¶ 41, 319 Wis. 2d 439, 469, 768 N.W.2d 700, 715; *Kenosha County Dep't of Human Servs. v. Jodie W*, 2006 WI 93, ¶ 50, 293 Wis. 2d 530, 560, 716 N.W.2d 845, 860.

The Fifth Amendment to the United States Constitution provides that private property shall not be taken without just compensation. This prohibition binds the states through the Fourteenth Amendment's mandate that no state shall deprive any person of property without due process of law. *See Chicago, Burlington & Quincy R.R. Co. v. City of Chicago*, 166 U.S. 226, 235-41 (1897). Similarly, Article 1, § 13 of the Wisconsin Constitution forbids the governmental taking of private property without just compensation. *See, e.g., Wisconsin Retired Teachers Ass'n, Inc. v. Wisconsin Educ. Ass'n. Council*, 297 Wis. 2d 1, 17, 558 N.W.2d 83, 90 (Wis. 1997).

Prior to the rehabilitation, Ambac would be subrogated to the rights of the LVM Bondholders only when the LVM Bondholders were actually “made whole” under the LVM Bonds. That plain meaning of the Ambac LVM Policies was consistent with the parties’ expectations and understanding. Moreover, this result was required by Wisconsin’s “made whole” doctrine *regardless* of the parties’ intent. Consequently, even if

Wisconsin's rehabilitation statute could somehow be read to alter these established legal principles (and it plainly cannot), the Commissioner's taking, through the Plan, of the LVM Bondholders' rights against LVMC without compensation would constitute an unconstitutional taking by the Commissioner under the Fifth and Fourteenth Amendments to the United States Constitution, as well as the Wisconsin Constitution. Under established principles of statutory construction, the Wisconsin statute should not be construed to yield such an unconstitutional result.

C. The Plan Is Not Fair And Equitable To, And Impermissibly Discriminates Against, Holders Of Long-Dated Claims

Under Chapter 645 of the Wisconsin Statutes, the Commissioner's most essential mandate in connection with the rehabilitation of an insurer is to ensure the "protection of the interests of insureds, creditors, and the public generally, ... through ... *[e]quitable apportionment of any unavoidable loss.*" Wis. Stat. § 645.01(4)(d) (emphasis added); see also Wis. Stat. § 601.01(2) (purpose of insurance statutes is "[t]o ensure that policyholders,

claimants and insurers are *treated fairly and equitably*") (emphasis added).

"Equitable apportionment of loss" requires the protection of "long-dated" claims – i.e., claims not likely to ripen until well into the future. Such protection includes the reservation of sufficient funds to ensure that holders of projected future claims will receive payment on par with "short-dated" claims. Where the authorities in the insurance rehabilitation context are sparse, it is appropriate for courts to look to federal bankruptcy law for guidance.⁵

On this issue, bankruptcy law is very clear: Where a plan of reorganization provides for payment of certain creditors in the future, the plan must also appropriately reserve for such future claims so as to ensure that, when the claims are ripe for payment, there will be sufficient resources to provide future claimants with the same percentage payment as earlier-qualifying claimants. *See, e.g., In re Western Asbestos Co.*, 313 B.R. 832, 842-43 (Bankr. N.D. Cal. 2003) ("It is not necessary to make liquidated claims

⁵ The Commissioner and Ambac have acknowledged this throughout this proceeding. (See R.7:16-19 and R.69:35). *See also, e.g., Aria v. Ingram Micro, Inc.*, 965 A.2d 1194, 1203 (Pa. 2009) (it is common and proper to look to bankruptcy law for guidance in interpreting state insurance insolvency laws); *Pine Top Ins. Co. v. Bank of Am. Nat'l Trust & Sav. Ass'n*, 969 F.2d 321, 323-24 (7th Cir. 1992) (it is customary to look to bankruptcy law when interpreting state insurance rehabilitation laws).

wait for payment until all disputed and unliquidated claims have been resolved. All that is necessary is to reserve a sufficient amount from any distribution made to liquidated claims so that an equivalent percentage payment may be made to any claims liquidated in the future.”); *In re Edwards*, 228 B.R. 552, 557 (Bankr. E.D. Pa. 1998) (“Bankruptcy Code [does] not allow the Trustee to make a distribution to some creditors (those holding undisputed claims) without assurance that there were sufficient assets to pay other creditors (those holding disputed claims)”).

The Commissioner has acknowledged that the Plan must “ensure equitable treatment for all policyholders.” (R.392:5) To achieve this equality, long-dated claims must receive the same treatment as short-dated claims. However, the Commissioner has acknowledged that future events could result in less favorable treatment of long-dated claims.

The Rehabilitator believes that the best way to reasonably ensure equitable treatment for all policyholders is to set the initial cash percentage at a level the Segregated Account should be able to continue to pay throughout the life of the exposures allocated to the Segregated Account. If the Segregated Account were unable to continue paying the initial cash percentage at some point during the administration of the Plan, holders of long-dated policy claims might be treated less favorably than holders of short-dated policy claims.

(R.392:5)

Notwithstanding the need to treat all claimants equitably, the Plan fails to do so by not creating any reserve for known future claims. The Plan relies on a mere hope that funds will be available in the future to pay long-dated claims. There are no provisions that amounts due in the future to Eaton Vance and other LVM Bondholders (every year through 2040) will be paid or will be paid on the same basis as claimants who will be paid on the Effective Date. Equitable treatment requires that the Plan “reserve a sufficient amount . . . so that an equivalent percentage payment may be made to” long-dated claims. *In re Western Asbestos Co.*, 313 B.R. at 842-43.

With respect to policies like the Ambac LVM Policies, where Ambac has already projected substantial liabilities, these principles require Ambac to set aside (a) at the outset, an amount of cash equal to 25% of the projected future liabilities, and (b) thereafter, a pro rata share of any cash distributions that Ambac makes under the Surplus Notes. Since Ambac acknowledges that future claims under the Ambac LVM Policies will be approximately \$1.163 billion (R.17:23), it must reserve approximately \$290 million at the outset on account of the Ambac

LVM Policies plus additional amounts when it makes distributions under the Surplus Notes.

The necessity of such a reserve is underscored by the Commissioner's failure to show that sufficient funds will be available to pay long-dated claims on par with near-term claims. In fact, the Commissioner's financial projections cast serious doubt on whether adequate resources will be available to pay holders of long-dated claims, such as Eaton Vance and the other LVM Bondholders.

In all four of the potential financial scenarios projected by the Commissioner, there will be no cash payments of interest or principal on the Surplus Notes until at least 2050. *See* (Scenario One) (cash flow statement projecting no interest expense and no principal amortization until 2050) (R.372:108-111); (Scenario Two) (R.372:126-129); (Scenario Three) (R.372:144-147); (Scenario Four) (R.372:162-165).

Indeed, three of the four scenarios project that there will be insufficient funds *even in 2050* to pay the Surplus Notes in full. *See* Disclosure Statement Amendment Ex. E (Scenario Two) (projecting \$38 billion in total claims-paying resources available to pay \$45 billion in Surplus Notes for a total recovery on Surplus

Notes of 85%) (R.372:134); Ex. F (Scenario Three) (projecting \$41 billion of total claims-paying resources available to pay \$58 billion in Surplus Notes for a total recovery on Surplus Notes of 71 %) (R.372:152); Ex. G (Scenario Four) (projecting \$26 billion of claims-paying resources available to pay \$58 billion of claims for a total recovery on Surplus Notes of 45%) (R.327:170). Nevertheless, the Plan admits of the possibility that payments on the Surplus Notes could be made in 2020.

The Plan does not even “address the treatment of permitted policy claims expected to arise after June 1, 2020.” (R.392:5) All the Plan promises to long-dated claim holders is that the “Rehabilitator will seek amendment to the Plan prior to June 1, 2020” to address the treatment of those claims. (Id.) The Plan cannot purport to treat short-dated and long-dated claims equally when the Commissioner itself admits it has not yet considered what it will do or how it will treat claims arising after June 1, 2020. Unfortunately, the vast majority of the payments to Eaton Vance and the LVM Bondholders under the Ambac LVM Policies will not become due until after 2020.

Because the Plan permits the possibility of inequitable treatment of long-dated claims, the Circuit Court improperly

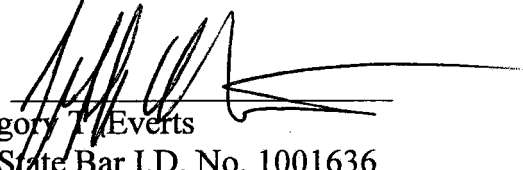
approved the Plan without providing for the necessary reserves for long-dated claims. Accordingly, the Order confirming the Plan should be reversed.

CONCLUSION

For the reasons set forth above, and the reasons set forth in the Appellants' Brief, the Circuit Court's Orders approving the creation of the Segregated Account, approving the allocation of the Ambac LVM Policies to the Segregated Account, and approving the Plan should be reversed and the matter should be remanded.

Dated this 5th day of July, 2011.

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FORM AND LENGTH CERTIFICATION

I hereby certify that this brief conforms to the rules contained in § 809.19(8)(b) and (c) of the Wisconsin Statutes for a brief and appendix produced with a proportional serif font. The length of this brief is 5,043 words.

Dated this 5th day of July, 2011.

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**CERTIFICATION OF COMPLIANCE WITH § (RULE)
809.19(12)**

I hereby certify that I have submitted an electronic copy of
this brief under Wis. Stat. § (Rule) 809.19(12). I further certify
that the text of the electronic copy of the brief is identical to the
text of the paper copy of the brief filed on this date.

Dated this 5th day of July, 2011.

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I hereby certify that the Joint Appendix filed on May 26,
2011, contains all the materials required under Wis. Stat. §
809.19(2)(b). Pursuant to this Court's Order dated May 3, 2011,

which requires the parties to avoid duplicating appendix materials,
no appendix is being submitted in connection with this brief.

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CERTIFICATE OF SERVICE

I hereby certify that on July 5, 2011, I caused three true and
correct copies of this brief to be served by first class mail, postage
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