

COURT OF APPEALS OF WISCONSIN
DISTRICT IV
Appeal Nos. 2010-AP-1291 and 2010-AP-2022
(Consolidated)

In the Matter of the Rehabilitation of:

Segregated Account of
Ambac Assurance Corporation,

SEAN DILWEG and OFFICE OF THE
COMMISSIONER OF INSURANCE,

Plaintiffs/Respondents,

AMBAC ASSURANCE CORPORATION,

Interested Party/Respondent,

v.

Appeal No. 2010-AP-1291

WELLS FARGO BANK/Trustee of
Bondholders, BANK OF NEW YORK
MELLON and DEUTSCHE BANK
NATIONAL TRUST COMPANY,

Defendants,

FEDERAL HOME LOAN MORTGAGE
CORPORATION,

Defendant-Petitioner-Co-Appellant,

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-Petitioners-Appellants.

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BANK OF NEW YORK MELLON,
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COMPANY, FEDERAL HOME LOAN
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CAPITAL MASTER FUND, LTD.,
MONARCH ALTERNATIVE CAPITAL,
LP, STONEHILL CAPITAL
MANAGEMENT LLC,

Defendants,

EATON VANCE MANAGEMENT,
NUVEEN ASSET MANAGEMENT,
RESTORATION CAPITAL
MANAGEMENT, LLC, STONE LION
CAPITAL PARTNERS, LP,

Defendants/Appellants.

On Appeal from the Dane County Circuit Court, Case No. 2010-CV-1576
The Honorable William D. Johnston, Presiding

**JOINT CONSOLIDATED REPLY BRIEF OF APPELLANTS
THE LVM BONDHOLDERS AND WELLS FARGO BANK,
NATIONAL ASSOCIATION, AS TRUSTEE FOR THE LVM BONDS**

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PRELIMINARY STATEMENT¹

OCI and Ambac defend the allocation of the LVM Bond Policy to the Segregated Account in a few short pages, contending principally that the statutory language authorizing segregation of any “part” of an insurer’s “business” insulates OCI from *any* challenge to its allocation decisions. But Wisconsin’s segregated account statute is plainly intended to permit only segregation of *lines of business*, not individual “troubled” policies. The trial judge never explained why he thought it allowable to cherry-pick for allocation only policies with claims from within lines of business remaining in the General Account; instead, he merely cut and pasted proposed findings drafted by OCI and Ambac. And no prior case has ever blessed the dangerous idea that an insurer may wait and see which individual policies have large claims and then transfer such policies to a subordinated account on that ground alone. To the contrary, differential treatment of policies must be based on the relative risk characteristics of the type of insurance *when issued*. The treatment of the LVM Bond Policy is thus illegal and unconstitutional, requiring reversal of the Circuit Court’s July 16 Order.

¹ Citations to “Opening Br.” refer to appellants’ joint opening brief in Appeal No. 2010-AP-2022; “LVM Br.” refers to the LVM Bondholders’ brief in Appeal No. 2010-AP-1291; “Ambac Br.” refers to Ambac’s consolidated response brief; “OCI Br.” refers to OCI’s consolidated response brief. Other abbreviated terms have the meanings assigned in the Opening Brief and LVM Brief.

In the now-consolidated appeal challenging approval of the CDS Settlement, the Circuit Court's decision also should be reversed. As this Court has already held, the order appealed from was final and the appeal is not moot. On the merits, the Settlement was subject to judicial review because it required the consent of the Segregated Account. Under well-recognized bankruptcy standards that respondents themselves invoked below, the Circuit Court was obligated to independently assess the merits of the claims being settled. Instead, the court rubber-stamped the settlement, adopting verbatim proposed findings drafted by Ambac and OCI. The court compounded its error by ignoring crucial factual issues and by denying the LVM Bondholders the right to intervene and conduct discovery as to those issues. The court's mechanical approval of the CDS Settlement constituted an abdication of its responsibilities and should be reversed.

ARGUMENT

I. The Circuit Court Erred in Holding that Allocation of the LVM Bond Policy to the Segregated Account was Lawful²

A. The Segregated Account Statute Does Not Permit Segregation and Subordination of Individual Policies Based on Claim Status

As the Opening Brief explained, the text of and commentary to Wisconsin's segregated account statute, Wis. Stat. Section 611.24, make clear that the statute was intended to permit an insurer to segregate its business along specific business lines, but not to cherry-pick individual troubled policies for subordinated treatment.

In response, Ambac and OCI contend that appellants have overlooked key differences between Subsections 1 and 2 of the statute, the language of and commentary to which, they claim, are "entirely different." (Ambac Br. at 66.) In the first place, however, it is simply not true that

² Ambac suggests that the order upholding allocation of the LVM Bond Policy to the Segregated Account is not final or appealable. (See Ambac Br. at 63.) However, the decision to leave the LVM Bond Policy in the Segregated Account is obviously final as to that issue and will have immediate consequences as Ambac's rehabilitation proceeds. Despite Ambac's protestations (*id.* at 52-53), the limited assets made available to pay claims in the Segregated Account render those consequences irreparable.

Additionally, while OCI recognizes that the issues of law presented on this appeal are subject to *de novo* review, it urges that OCI's statutory interpretation is entitled to deference, citing *Nat'l Motorists Ass'n v. Office of Comm'r of Ins.*, 2001 WI App 308, ¶¶ 10-13, 259 Wis. 2d 240, 655 N.W.2d 179. (See OCI Brief at 31.) However, *Nat'l Motorists Ass'n* provides for heightened deference where, among other factors, the agency's interpretation is "one of long standing." *Id.* at ¶ 11, 259 Wis. 2d at 250, 655 N.W.2d at 183. Here, there is no indication that the Commissioner's interpretation of Section 611.24(2) as permitting allocation based solely on claim status was ever advanced prior to this case.

Subsections 1 and 2 are “entirely different.” To the contrary, the purpose underlying both subsections is identical: to address the problem that “[s]ome branches of the insurance business are much riskier than others” by providing both mandatory and voluntary mechanisms so that “different *operations* can be kept independent.” Wis. Stat. § 611.24, Comments at L.1971, C.260, § 72 (2006) (emphasis added).

In certain specified instances where the differences are extreme (very high or very low risk), the Legislature has made segregation mandatory – *e.g.*, life insurance (low risk) or mortgage guarantee insurance (high risk). Wis. Stat. § 611.24 (1) (2006). Beyond these specific categories, the statute gives an insurer broad discretion, subject to OCI’s approval, to separate high risk parts of business from low risk – that is, to segregate “any part of its *business*.” Wis. Stat. § 611.24(2) (2006) (emphasis added).

OCI and Ambac argue that the statutory language (“any part of its business”) permits an insurer not just to separate business lines with differing risk profiles, but also to pluck *individual policies* from disparate lines of business and throw those individual policies into a single segregated account – separated from, and subordinated to, other policies in the same line of business. This interpretation tortures the words “any part of its business” (by interpreting those words to mean individual policies,

rather than lines of business), and completely disregards the legislative intent set forth expressly and unambiguously in the commentary.

Ambac's contention that the quoted commentary applies only to Subsection 1 (Ambac Br. at 66-67) ignores the overarching purpose of Section 611.24 as a whole. Ambac does not, and could not, identify any *different* purpose that Subsection 2 might have been intended to serve. Moreover, the commentary itself makes clear that the statute's overall purpose applies no less to its voluntary than to its mandatory provisions. *See* Wis. Stat. § 611.24, Comments at L.1971, C.260 § 72 (noting that insurers have often found it "desirable" to *voluntarily* separate "certain divisions of their business, even within a single line, and citing "[h]igh risk automobile insurance" as an example).

Moreover, the language quoted above regarding independent "operations" refers specifically to Section 611.24(3), which sets rules to maintain adequate capitalization, transparency, and fairness that apply to segregated accounts under Subsections 1 and 2 alike – additional confirmation that separating *lines of business* is the purpose of the whole statute. The intent to permit account segregation by business line is further demonstrated by the commentary's reference to former Section 206.385(1), which Ambac and OCI do not dispute was designed to permit life insurers to create segregated accounts for annuity funds free of the restrictions

placed on the investment of assets related to traditional life insurance policies. (See Opening Br. at 24-26.)³

Allocating “troubled” policies to the Segregated Account while leaving healthy ones in the “stable” General Account as the Commissioner has done here (see OCI Br. at 18) may have the general effect of isolating riskier lines of business – e.g., primarily RMBS and CDS. However, those policies are properly allocated to the Segregated Account not because they now have imminent *claims*, but only because those *lines of business* have different risk profiles than others left in the General Account. This crucial distinction goes to the heart of the concept of insurance and demonstrates why the LVM Bond Policy may not properly be allocated to the Segregated Account.

As explained in the Opening Brief, insurance is based on the concept of spreading risk over a pool of similarly situated policyholders, which pay premiums calculated on the expected claims in the overall pool. See Opening Brief at 22 (citing *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 211 (1979)). The pooled premiums are intended to cover all losses that are actually experienced, with every policyholder

³ Ambac and OCI focus on the irrelevant fact that the successor statute to Section 206.385(1), now codified at Section 611.25(2), grants discretion as to which *portion* of the annuity business (i.e., annuity contracts and accompanying assets) are segregated to permit more liberal investment. But nothing in Section 611.25(2) permits an insurer to allocate and subordinate individual traditional life insurance policies on the basis that particular insureds have become gravely ill – which would be more analogous to what OCI has done here and is also, as noted in the Opening Brief, utterly unthinkable.

understanding that if *it* realizes a loss, reimbursement will be available from the aggregated premiums. To treat a particular policyholder adversely simply because it turned out to *need* the coverage would be an unprecedented violation of this shared risk principle.

It would also be unfairly discriminatory. Wisconsin law bars insurers from discriminating among policyholders “by charging different premiums or by offering different terms of coverage except on the basis of classifications related to *the nature and the degree of the risk covered* or the expenses involved.” Wis. Stat. § 628.34(3) (2004) (emphasis added). OCI violated the policy underlying this anti-discrimination provision by, in essence, permitting Ambac to retroactively impose different terms and treatment on the LVM Bond Policy based on factors other than the nature and degree of the *risk covered* when the insurance was issued.

Thus, RMBS and CDS policies may properly be allocated to the Segregated Account not because any particular individual policies resulted in large claims, but because *the lines of business as a whole* were unduly risky. In contrast, Ambac and OCI have never claimed that municipal bond policies as a group, or even any identifiable subset of policies that includes the LVM Bond Policy, were incorrectly priced or especially risky. In fact, they acknowledge that virtually the entire insured municipal portfolio was left in the General Account. (*See* Opening Br. at 12-13.) Cherry-picking individual policies having *claims* does not

segregate the lines of business that caused Ambac's decline. It merely punishes individual policyholders for actually needing their insurance. This is no more acceptable here than it would be in the example (to which respondents offer no answer) of a life insurer that attempted to subordinate the policies of those particular claimants who had developed fatal diseases.

Ambac's statement that the large claims under the LVM Bond Policy render it "high-risk" by any definition" (Ambac Br. at 64) ignores these fundamental insurance principles, particularly the principle that insurance risk is assessed *prospectively*. See *Marten Transport Ltd. v. Hartford Specialty Co.*, 194 Wis. 2d 1, 10 n.2, 533 N.W.2d 452, 454 n.2 (1995) ("[I]nsurance premiums are calculated prospectively, that is, they are based upon an actuarial projection of the risk of loss before any loss is actually incurred."). Lightning strikes are rare, but a policy that insures against damage by lightning does not magically convert into a "high risk" policy after the fact simply because a lightning bolt struck. Thus, a relatively low-risk policy like the LVM Bond Policy does not become high risk just because the event insured against – unexpected though it may have been – has actually occurred.

Tellingly, neither Ambac nor OCI even attempts to explain how disfavoring policies based solely on claim status can possibly be

squared with the underlying purpose of buying insurance. Instead, they muddy the waters with irrelevant factual arguments.⁴

First, OCI argues that the LVM Bond Policy was not singled out for unfair treatment, because other policies with “public-finance components,” including “over forty-two direct public finance policies” and “over 150 swap surety policies” involving public finance issuers, were allocated to the Segregated Account. (OCI Br. at 21.) However, even if these latter swap policies were deemed similar to municipal bond policies despite their obvious differences, it is undisputed that (i) the vast majority of municipal bond policies remain in the General Account (Opening Br. at 12-13), and (ii) policies were selected for allocation to the Segregated Account based not on the initial risk profile of their line of business, but solely on current factors, such as whether they now have actual or expected claims (*id.* at 12). Having left the overwhelming bulk of the municipal bond policies in the General Account, Ambac may not allocate *any* such policies – whether one (the LVM Bond Policy) or 200 – to the Segregated Account for reasons of this sort.

⁴ As explained in the Opening Brief (at 14-15 & n.3), these assertions are mainly based on material introduced for the first time only in the Commissioner’s responsive papers below, as to which Wells Fargo and the LVM Bondholders submitted responsive documents that were erroneously excluded from evidence. In any event, the relevant facts are a matter of undisputed public record, of which this Court can take judicial notice. (*See* n.5, *infra.*)

Second, OCI repeats its already refuted argument (*see* Opening Br. at 23-24) that requiring it to segregate policies by type of insurance would bar any use of a segregated account because it is a “monoline” insurer offering only one class of insurance – namely, financial guarantee insurance. (*See* OCI Br. at 78-79.) But Ambac’s own publicly filed financial statements show that it routinely segments its financial guarantee policies into multiple business lines – principally, public finance (*e.g.*, municipal bond policies), structured finance (*e.g.*, RMBS and CDS) and international finance. (*See* R. 236, Ex. R at 11-14, 19; Ex. S at 12, 18, 20; Ex. T at 6-10, 12-16.)⁵ Nothing in Section 611.24(2) bars Ambac from allocating any of these business lines to the Segregated Account – and, as noted above, it has indeed done so, by allocating all RMBS and all non-settling CDS policies to that account.

Nor does anything turn on Ambac’s argument that the LVM Bonds, as so-called revenue bonds, are riskier than “typical” municipal bonds, *i.e.*, general obligation bonds. (Ambac Br. at 68.) The LVM Bond Policy is just one of many revenue bond policies that Ambac has written,

⁵ The Court may take judicial notice of these documents. *See* Wis. Stat. Section 902.01(6) (“Judicial notice may be taken at any stage of the proceeding.”); *Sisson v. Hansen Storage Co.*, 2008 WI App 111, ¶ 11, 313 Wis. 2d 411, 424, 756 N.W. 2d 667, 674 (Ct. App. 2008) (Section 902.01(6) “means that an appellate court may take judicial notice when that is appropriate”). Judicial notice is appropriate for publicly filed documents whose content is “not subject to reasonable dispute.” *See* Wis. Stat. Section 902.01(2); *Sisson*, 2008 WI App 111, ¶ 10(2) 313 Wis. 2d at 425, 756 N.W.2d at 674.

and it appears that Ambac has left every one of those policies – other than the LVM Bond Policy – in the General Account.⁶

Finally, Ambac’s passing suggestion, in a section of its brief addressing the RMBS Funds’ appeal, that policies allocated to the Segregated Account are not “realistically disadvantaged” (Ambac Br. at 43 n.32) is mightily disingenuous. Claims against policies in the Segregated Account have been enjoined since March 2010, and only a fraction of each of those claims will be paid in cash. The remainder will be paid in surplus notes, payable decades in the future, which may prove to be worthless.⁷ In contrast, claims in the General Account are paid in full in cash as they come due. If the General Account runs out of money and enters liquidation, most of the funds paid out at 100% will not be recoverable (*see* Wis. Stat. § 645.54(1)(b)(2004) (providing for avoidance of preferential payments only if made within four months of filing of liquidation petition)). Moreover, the Segregated Account’s claims in that liquidation based on the Reinsurance Policy will be subordinated to the claims of policyholders in the General

⁶ Ambac’s most recent Form 10-K indicates that, of its ten largest public finance exposures, only five involve general obligation bonds – the other five involve revenue bonds. (R. 236, Ex. R at 12; *see also* R. 236, Exs. C through O (official statements for thirteen revenue bond offerings insured by Ambac)). There is no indication that any of these revenue bond policies have been allocated to the Segregated Account.

⁷ *See, e.g.*, Nov. 17, 2010 Hearing Tr. at 61, where Roger Peterson admitted that surplus notes issued by Ambac in connection with the CDS Settlement are trading “for cents on the dollar.” Mr. Peterson also admitted that there is “no material difference” between these notes and those that will be issued to Segregated Account policyholders under the plan. Nov. 16, 2010 Hearing Tr. at 184-85.

Account. See Wis. Stat. § 645.68 (2004) (“loss claims” under insurance policies are paid ahead of general creditor claims); see also, e.g., *In re Liquidation of Sussex Mut. Ins. Co.*, 301 N.J. Super. 595, 606, 694 A.2d 312, 317 (Super. Ct. App. Div. 1997) (noting “wide-spread and long-standing policy of distinguishing direct insureds from reinsureds for the purpose of determining priorities of claims against insolvent insurance companies”); *Peerless Ins. Co. v. Manson*, 27 Wis. 2d 601, 607-08, 135 N.W.2d 258, 261 (1965) (overruling decision treating reinsured as policyholder in context of liquidation of its reinsurer: “legislature treated reinsurance differently from insurance”); Plan of Rehabilitation dated Oct. 8, 2010, Case No. 10 CV 1576, Docket No. 461, § 1.28 (subordinating reinsurance claims against Segregated Account to payment of policy claims).

For all of these reasons, policies relegated to the Segregated Account face the prospect of grievous harm, which Ambac has inflicted on them in contravention of the Legislature’s clear intent.

B. Allocation and Subordination of Individual Policies Based on Claim Status Violates the Equal Protection Clauses of the United States and Wisconsin Constitutions

While the issue may be avoided through appropriate statutory construction, reading Section 611.24(2) to permit subordination of policies based on claim status would be patently unconstitutional. Ambac and OCI stress the generally deferential standard of review applicable to

constitutional challenges (*see* OCI Br. at 80-81; Ambac Br. at 69), giving short shrift to the specific authority barring discriminatory treatment of similarly situated insurance policies (*see* Opening Br. at 27-32).

Ambac and OCI grossly distort the principal authority in this area, *Carpenter v. Pacific Mutual Life Ins. Co. of Cal.*, 10 Cal. 2d 307 (1937), *aff'd sub nom. Neblett v. Carpenter*, 305 U.S. 297 (1938). They note that *Carpenter* blessed disparate treatment for insurance policies that were “draining the old company to disaster,” *id.* at 336, arguing that this was determined in “hindsight” in the same manner as the Commissioner’s decision to cherry-pick policies having large claims. (*See* Ambac Br. at 71-72; OCI Br. at 82.) But as explained in the Opening Brief at 28 n.9, *Carpenter* involved a particular *type* of policy – so-called “non-can” policies – recognized to have been underpriced as a group: “The non-can policyholders were not paying adequate premiums, and this fact was the primary cause of the difficulties of the old company.” 10 Cal. 2d at 336. Thus, the only “hindsight” involved the recognition of the riskiness of the *overall line of insurance* when issued, not the identification of individual policies that turned out to have claims.

Here, in stark contrast, Ambac has left the great bulk of its municipal bond policies in the General Account, while allocating only a small subset of such policies to the Segregated Account, based on current

claim status. *Carpenter* and its progeny do not permit this kind of *post-hoc* discrimination against individual policies within a class.

OCI and Ambac attempt to factually distinguish the other leading constitutional cases, but they all stand for the same principle: holders of substantially identical policies may not be treated disparately for reasons unrelated to the relative risks associated with those policies at the time of issuance. Indeed, Ambac recognizes that *Commercial National Bank v. Superior Court*, 17 Cal. Rptr. 2d 884 (Ct. App. 1993), bars “differential treatment of policyholders” absent some showing that the penalized policies had “jeopardized the health of the insurer.” (See Ambac Br. at 71.) But there has been no such showing here. The LVM Bondholders are being penalized here *not* because they were part of a line of business that “caused the problem” (*id.* at 71) – but merely because they have a claim. This is arbitrary, irrational and unconstitutional.

OCI misses the mark when it offers, as a purported “rational basis” for allocating the LVM Bond Policy to the Segregated Account, the goal of protecting the majority of Ambac’s policyholders by insulating them from the LVM Bond Policy’s “material projected losses.” (R. 2 at 3-4.) Wisconsin law does not permit OCI to try to protect the greater good by using the LVM Bondholders as sacrificial lambs.

That is the lesson of *Ferdon ex rel. Petrucelli v. Wisconsin Patients Compensation Fund*, 2005 WI 125, 284 Wis. 2d 573, 701 N.W.2d

440, in which the Wisconsin Supreme Court held that the Legislature's \$350,000 cap on noneconomic medical-malpractice damages violated equal protection. The court recognized the Legislature's laudable goals in enacting the cap, including reducing the cost of medical malpractice insurance and thus the overall cost of health care in Wisconsin. But the Legislature could not achieve those ends consistent with equal protection by placing the largest burden on the backs of the most vulnerable – those who have actually suffered injury: “[W]hen the legislature shifts the economic burden of medical malpractice from insurance companies and negligent health care providers to a small group of vulnerable, injured patients, the legislative action does not appear rational.” *Id.* at ¶ 101, 284 Wis. 2d at 825, 701 N.W.2d at 446.

Likewise, OCI's goal of protecting Ambac's policyholders is, in itself, laudable. But OCI may not achieve that goal by foisting the burden of nonrecovery on those most in need of insurance – insureds that have actually suffered losses and made claims under particular policies. That is discrimination and a denial of equal protection, and it does not satisfy rational-basis review.

II. The Circuit Court Erred in Approving the CDS Settlement

The LVM Bondholders showed in their initial brief that court approval of the CDS Settlement was required under Wis. Stat. § 645.33(2)(2004), because the Rehabilitator's consent to the Settlement on

behalf of the Segregated Account was required under the Cooperation Agreement between the Segregated Account and Ambac. (LVM Br. at 17-20.) OCI's suggestion that such consent was not necessary because the settlement was not entered into to "reform and revitalize" the Segregated Account but only to benefit the General Account (*see* OCI Br. at 48, 50) ignores OCI's own repeated assertions that the Settlement "benefits *all* policyholders in both the General Account and the Segregated Account" (R. 74 at 21; *see also* LVM App. 30; R. 127 at 14). In any event, as Ambac acknowledges (Ambac Br. at 31 n.23), it makes little difference at this point whether such approval was required, because OCI *did* ultimately seek and obtain the Circuit Court's approval of the Settlement in the May 27 Order.

Having established that court approval was required, the LVM Bondholders further showed (*see* LVM Br. at 21-32) that the Circuit Court was obligated to conduct a meaningful review and reach an informed and independent judgment regarding the fairness of the Settlement – under standards that OCI and Ambac themselves cited below. (*See* R. 69 at 27.) The court utterly abdicated this responsibility by adopting OCI's proposed findings and conclusions verbatim, without explanation. Respondents cite no Wisconsin case holding that the court may adopt a party's proposed findings and conclusions without some explanation *in its own words* of why it is doing so. The Circuit Court's blind deference to OCI constituted an abuse of discretion.

The Circuit Court's failure to apprise itself of key facts bearing on the Settlement's fairness was an equally clear abuse of discretion. As noted in the Opening Brief, the Settlement's fairness hinged centrally on whether the CDS Banks were entitled to policyholder priority – an issue that itself turned on several key facts as to which the Circuit Court required no evidence and did not even permit discovery. Ambac now appears to concede two of these pivotal factual issues: *first*, that the CDS contracts between ACP and the Banks are not insurance (*see* Ambac Br. at 27), and *second*, that ACP has no significant assets of its own.⁸ In light of these concessions, the distinction between (i) the CDS contracts between ACP and the Banks and (ii) the *guaranties* of those contracts by Ambac has no practical significance. As noted in our initial brief, this suggests that the CDS guaranties are little more than disguised CDS between the Banks and Ambac, and that claims under those guaranties are not insurance and are therefore not entitled to policyholder priority under Wis. Stat. § 645.68(3). (*See* LVM Br. at 30-31.)

Ambac further fails to establish that the swaps covered by the guaranties are anything other than “naked” swaps, in which banks do not own the underlying reference obligations (Ambac Br. at 27-28), and which

⁸ At the recent plan confirmation hearing in the Circuit Court, Ambac's principal witness testified that ACP had only a “nominal amount of capital.” (Nov. 17, 2010 Hearing Tr. at 112; *see also id.* at 111 (acknowledging that “instead of putting capital directly into ACP, Ambac . . . provided a financial guaranty”))

could not form the basis for a genuine “loss,” as required by Wis. Stat. § 645.68(3) for policyholder priority. (See LVM Br. at 29-30.) Again, no evidence was presented, and no discovery was allowed, on this crucial issue.

Finally, with respect to the denial of the LVM Bondholders’ intervention motion, OCI and Ambac argue that intervention was unnecessary because the bondholders “ha[d] a basic right to be heard.” (OCI Br. at 36-37.) The LVM Bondholders agree wholeheartedly; they sought to intervene in the rehabilitation proceeding only as an additional, independent means of ensuring their right to take discovery on the merits of the CDS Settlement. (LVM Br. at 32.) The Circuit Court permitted the LVM Bondholders a limited “right to be heard” but erroneously refused to allow discovery, and denied the intervention motion that would have facilitated it. Thus, the assertion that the LVM Bondholders were allowed to “actively participat[e]” in the rehabilitation proceeding (OCI Br. at 38) is inaccurate.

To the extent the Circuit Court concluded that intervention *was* necessary – at least to confer “standing as parties to seek discovery” (LVM App. 50; R. 127 at 16) – the LVM Bondholders have already shown that the denial of intervention was in error. Respondents’ contention that intervention and discovery are not permitted because Chapter 645 does not mention them is defeated by Wis. Stat. § 801.01(2), which provides that the

procedural rules set forth in Chapters 801 to 847 apply in *all* civil proceedings unless expressly overridden. (LVM Br. at 35-36.) Their additional argument that the LVM Bondholders do not meet the “interest” requirement under Wis. Stat. § 803.09(1)(A) fails because unlike the proposed intervenors in *Helgeland v. Wis. Municipalities*, 2008 WI 9, ¶ 7, 307 Wis. 2d 1, 10, 745 N.W.2d 1, 5 – who were able to make “only generalized claims that they have interests related to the subject of the action” – the LVM Bondholders plainly have such an interest, due to the profound effect that the Settlement will have on their ability to recover under their policy. (LVM Br. at 9.) Finally, the LVM Bondholders amply satisfy the “minimal” burden of showing that OCI does not adequately represent their interests, *see Helgeland*, 2008 WI 9, ¶ 85, because OCI has taken a position on the Settlement that is directly contrary to the LVM Bondholders’ interest in obtaining full payment under the LVM Bond Policy. (LVM Br. at 34-35 & n.12.)

CONCLUSION

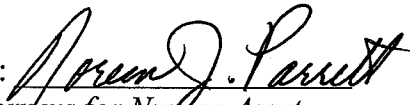
For the reasons discussed above and in our initial briefs, the LVM Bondholders and Wells Fargo (with regard to Appeal No. 2010-AP-2022) respectfully request that the Court (i) reverse the Circuit Court’s July 16 Order and rule that the allocation of the LVM Bond Policy to the Segregated Account was unlawful; and (ii) reverse the May 27 Order and rule that the Circuit Court’s approval of the CDS Settlement was error or,

alternatively, remand for further proceedings, including discovery and the development of a full factual record.

Dated this 20th day of December, 2010.

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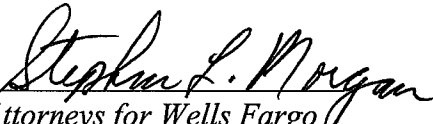
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⁹ On December 1, 2010, the Circuit Court issued an Order granting a motion by Parrett & O'Connell, LLP and Kramer Levin Naftalis & Frankel LLP to withdraw as counsel for appellant Eaton Vance Management, formerly a member of the LVM Bondholder group.

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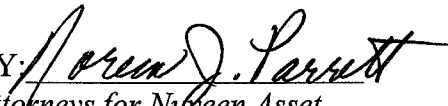
FORM AND LENGTH CERTIFICATION

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 produced with a proportional serif font. The length of this brief is 4,678 words.

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CERTIFICATION OF COMPLIANCE WITH RULE 809.19(12)

I hereby certify that:

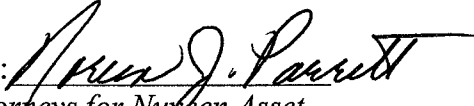
I have submitted an electronic copy of this brief, which complies with the requirements of s 809.19(12). I further certify that:

This electronic brief is identical in content and format to the printed form of the brief filed as of this date. A copy of this certificate has been served with the paper copies of the brief filed with the court and served on all opposing parties.

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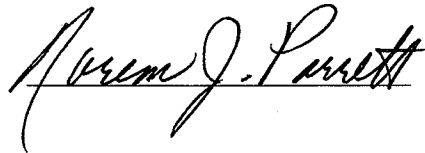
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