SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

In the Matter of the Rehabilitation of FINANCIAL GUARANTY INSURANCE COMPANY.	:	Index No.: 401265/2012 Motion Sequence #004

AMENDED OBJECTION OF TRUSTEES DEUTSCHE BANK NATIONAL TRUST COMPANY AND DEUTSCHE BANK TRUST COMPANY AMERICAS TO THE FIRST AMENDED PROPOSED PLAN OF REHABILITATION FOR FINANCIAL GUARANTY INSURANCE COMPANY

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Deutsche Bank National Trust Company and Deutsche Bank Trust Company Americas, each acting solely in its capacity as trustee (collectively the "Trustees") for certain asset-backed securities trusts (collectively the "Trusts") insured by financial guaranty policies (the "Trust Policies") issued by Financial Guaranty Insurance Company ("FGIC"), respectfully submit this Amended Objection to the First Amended Proposed Plan of Rehabilitation for Financial Guaranty Insurance Company (the "Proposed Plan"), in accordance with the Court's order dated December 19, 2012, requiring all objectors to the Proposed Plan to submit "'amended objections,' stating their remaining objections."

INTRODUCTION

Each of the Trusts was established pursuant to separate documentation (the "Transaction Documents") for the purpose of issuing multiple classes of mortgage-backed securities (the "Certificates"), which together represent the entire beneficial ownership interest in the assets deposited into the Trusts.[1] The assets deposited into and currently held by the Trusts primarily comprise residential mortgage loans, the proceeds of which are used to make distributions of principal and interest to holders of the Certificates (the "Trust Investors"). The Trusts administered by the Trustees represent billions of dollars in face amount of Certificates.

With respect to each of the Trusts, FGIC issued Trust Policies and entered into Insurance and Indemnity Agreements (collectively, the "Insurance Documents") pursuant to which FGIC is required to pay amounts due to holders of *certain*, but not all, classes of

[1] The Transaction Documents for each of the Trusts typically include a pooling and service agreement, indenture, trust agreement, and/or servicing agreement and related documents. For the Court's reference, attached hereto as Exhibit A is a copy of the Pooling and Servicing Agreement for the INDB Series 2006-L2 Trust (the "INDB Series 2006-L2 PSA"). The INDB Series 2006-LS PSA is an exemplar pooling and servicing agreement and representational of the common provisions in the Transaction Documents.

Certificates (the "Insured Certificates") if the cash flows generated by the Trusts are insufficient to pay the amounts due with respect to the Insured Certificates.

The Transaction Documents generally allocate to the Trust Investors broad "control and direction" rights (the "Holder Rights"), including, for example: (i) rights to consent to, or withhold consent to, amendments, modifications, or waivers of the terms of the transactions or actions under the Transaction Documents; (ii) rights to declare or waive events of default, termination events, rapid amortization events, or similar events; and (iii) rights to direct the exercise of remedies following an event of default with respect to the Trusts (*see, e.g.,* INDB Series 2006-L2 PSA). Under the Transaction Documents, Holder Rights with respect to the Insured Certificates may be temporarily transferred to FGIC, as the Certificate insurer—but *only for so long as* FGIC satisfies its payment obligations under the Trust Policies (*id.* at § 11.16 [d], [e]). Once FGIC fails to make required payments under the Trust Policies or a condition of default occurs, the Holder Rights *automatically* revert to the Trust Investors according to the terms of the Transaction Documents (*id.*).

Regardless of who exercises any Holder Rights at any particular point in time, the Transaction Documents require that a party, who wishes to direct the Trustee to take a specific action, indemnify the Trustee (*see e.g.* INDB Series 2006-L2 PSA §§ 8.01, 8.02, 11.03). The Transaction Documents generally provide that the indemnification take the form of an indemnity or security against the costs, expenses and liabilities that may be incurred by the taking of the directed action, which indemnity or security must be acceptable to the Trustee (*id.*). The Proposed Plan would impermissibly rewrite the Transaction Documents to strip the Holder Rights from the Trust Investors and to strip certain indemnification rights from the Trustees.

In addition, the Proposed Plan would unlawfully abrogate the Trustees' set-off rights and recoupment rights and would impermissibly rewrite the Transaction Documents to impose upon the Trustees and Trust Investors significant additional obligations to FGIC, while conferring upon FGIC certain other rights to which it is not entitled.

ARGUMENT

A. The Proposed Plan Would Unlawfully Abrogate the Trustees' Set-Off and Recoupment Rights[2]

The Proposed Plan would unlawfully abrogate *all* of the Trustees' set-off rights, while preserving *all* of FGIC's set-off rights (*compare* Proposed Plan §§ 3.5, 7.8 [stripping the Trustees of their set-off rights][3] *with* Proposed Plan § 4.9 [preserving FGIC's set-off rights]).[4] The Rehabilitator's attempt to abrogate the Trustees' set-off rights is clearly prohibited by New York law, which grants policyholders both a statutory and common-law right of set-off that permits their premium and other payment obligations to be reduced by the amount of payments owed by the insurer. Specifically, NYIL §7427 provides, in relevant part: "In all cases of mutual debts or mutual credits between the insurer and another person in connection with any action or

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[2] Although the Trustees may have rights to offset amounts owed to FGIC under doctrines of set-off and recoupment, in the interest of brevity, the Trustees will refer to their rights under both doctrines collectively as set-off rights. For the avoidance of doubt, the Trustees also object to any provisions in the Proposed Plan that would abrogate the Trustees' rights under the doctrine of recoupment.

[3] Section 7.8 of the Proposed Plan prohibits all Persons from taking a number of actions after the Effective Date, including, among other things… (ii) withholding or setting-off any FGIC Payments or reinsurance obligations owed (or that would be owed but for the Rehabilitation or Rehabilitation Circumstances).(Proposed Plan § 7.8; *see also* Disclosure Statement for Plan of Rehabilitation of Financial Guaranty Insurance Company ("Disclosure Statement") §VI.B.8 at p. 38). Section 3.5 of the Proposed Plan, further states that neither the Rehabilitation nor the Rehabilitation Circumstances shall "in any manner relieve or limit any obligation of any Person to the FGIC Parties, including for payment of premiums, recoveries, reimbursements, settlements and other amounts that would otherwise be due and owing to the FGIC Parties under any FGIC Contract, Transaction Document or other agreement in the absence of the Rehabilitation and the Rehabilitation Circumstances" (Proposed Plan § 3.5; *see also* Disclosure Statement § VI.B.6 at p. 32).

[4] Section 4.9 of the Plan authorizes FGIC to set off a Permitted Claim, or distributions owed under the Plan on account of such Permitted Claim, against any amounts FGIC reasonably determines to be owed to it under Causes of Action FGIC may have against the holder of such Permitted Claim (Proposed Plan §4.9; *see also* Disclosure Statement §7 at p. 32; *see also* Proposed Plan §1.4 and Disclosure Statement § VI.B.1.[d] at p. 25).

proceeding under [NYIL Article 74], such credits and debts shall be set off and the balance only shall be allowed or paid" (NYIL §7427[a]). In addition, New York courts have long recognized the right of setoff in insolvency proceedings (*see Canale v. N.Y. State Dep't of Taxation & Fin.*, 84 Misc 2d 786, 789 [Ct Cl 1975] ["[I]t is usually true that where two persons have mutual claims against each other and one becomes insolvent, the other may set off any debt due him from the insolvent and account for the balance only."]; *In re Midland Ins. Co.*, 79 NY2d 253, 260 n 2 [Ct App 1992] ["The general rule, recognized by courts and commentators alike, holds that mutual debts and credits between parties may be set off . . . even in cases involving insolvent insurance companies."]).

The facts presented in *Van Schaick v. Astor,* 154 Misc 543 [App Div 1935], are analogous to those at issue here. In *Astor*, the Superintendent of Insurance, in his capacity as conservator of the assets of Union Indemnity Company, sued to recover premiums on two policies issued by Union to Astor, "based on the ground that [Astor] was not entitled to offset the demands pleaded" by Astor's demands against Union (*id.* at 544). The court disagreed, concluding that Astor was entitled to set-off his premium obligations against Union's outstanding claims payments, citing Article 11, Section 420 of the New York Insurance Law (now § 7427) in support, which, like the common law, provides: "In all cases of mutual debts or mutual credits between the insurer and another person, such credits and debts shall be set off and the balance only shall be allowed or paid" (*id.* at 544, 546). A subsequent opinion from the Court of Appeals similarly held that a policyholder "may set off against the amount of premiums due the sums which it has been obliged to pay" for insured claims due and owing by the insurer (*Pink v. Isle Theatrical Corp.*, 271 NY 390, 390 [Ct App 1936]).

The Court of Appeals reaffirmed its position in *In the Matter of the Liquidation of Midland Insurance Co.* (79 NY2d 253 [Ct App 1992]). Specifically at issue in Midland was a reinsurer's right to setoff claims payments against outstanding premium obligations of the reinsured. At the time Midland was placed into liquidation, "Kemper Re owed Midland approximately three quarters of a million dollars in reinsurance proceeds for underwriting losses . . . while Midland owed Kemper Re unpaid premiums allegedly exceeding that amount under the [reinsurance] treaty" (*id.* at 257). In holding that Kemper Re was entitled to offset amounts it owed to Midland against Midland's outstanding premium payments, the Court of Appeals concluded that "[t]he general rule, recognized by courts and commentators alike, hold[ing] that mutual debts and credits between parties may be set off" applies "even in cases involving insolvent insurance companies" (*id.* at 260 n 2). Thus, in addition to a statutory right to setoff, New York courts clearly recognize the common law tenet that "[c]ontracting principals, who are debtors and creditors of each other by virtue of entry into a contract or contracts, have the same legal capacity and may set off debts against each other" (*id.* at 264).

Set-off rights allow entities—such as the Trusts and FGIC—"that owe each other money to apply their mutual debts against each other, thereby avoiding the absurdity of making A pay B when B owes A" (*Citizens Bank of Md. v. Strumpf,* 516 US 16, 18 [1995] [internal citation and quotation marks omitted]; *Pink v. Isle Theatrical Corp.*, 271 NY 390, 390 [Ct App 1936]). The Proposed Plan, however, would compel the Trustees to remit unearned premiums and "other payments"—including recoveries, reimbursements, interest, deferred interest and default interest—owed to FGIC *in full*, without any set-off for the millions of dollars owed monthly by FGIC to the Trusts (Proposed Plan §§ 3.5, 7.8; Proposed Plan, Exhibit B [Restructured Policy Terms] ["RPT"] § 1.4[A]).

The Proposed Plan goes so far as to condition future payment of claims on the Trustees' compliance with these provisions (*see, e.g.*, RPT §§ 2.1, 2.2). And, it does not stop there. The Proposed Plan also attempts to reach back years into the past and *retroactively* void the Trustees' set-off rights[5] by requiring the Trustees to pay FGIC monies *previously* withheld by the Trustees through the *prior* exercise of set-off rights *before* the commencement of the rehabilitation proceeding (*see* RPT §1.4[A]).[6] Contrary to law, once the Trustees are forced to remit premiums and other payments to FGIC as specified by the Proposed Plan, they will no longer have *any* viable set-off right to exercise.

Accordingly, the Rehabilitator's attempt to abrogate the Trustees' set-off and recoupment rights in sections 3.5, 4.9 and 7.8 of the Proposed Plan clearly violates NYIL section 7427 and common law. Thus, the Court should not confirm the Proposed Plan in a form that includes these provisions.

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[5] Section 1.4(A) of the Restructured Policy Terms requires all FGIC Payment Payors to pay in Cash to the FGIC Parties all FGIC Payments that would have been payable had the Plan been in effect at all times dating back to the issuance of the 1310 Order in November 2009, *more than two and a half years prior to the commencement of the Rehabilitation Proceeding*. That Section further provides that if FGIC determines that all or a portion of any FGIC Payment has not been paid to the FGIC Parties when due, then (i) Cash payments that would otherwise be payable by FGIC in respect of the applicable Policy shall be reduced by the amount of such unpaid FGIC Payment; (ii) the DPO for that Policy shall be reduced at the time of FGIC's determination that all or a portion of a FGIC Payment was not paid by the amount of such unpaid FGIC Payment; and (iii) the DPO shall be increased as Cash payments are reduced pursuant to clause (i) (RPT §1.4[A]; s*ee also* Disclosure Statement §VI.B.1[d] at p. 25).

[6] Section 1.4(A) of the Restructured Policy Terms also improperly allows FGIC to reduce "*Cash payments* that would otherwise be payable by FGIC in respect of the applicable Policy" by any amounts previously withheld by the Trustees in the exercise of their setoff rights (RPT §1.4[A]; s*ee also* Disclosure Statement §VI.B.1[d] at p. 25). Even if the Court were to allow FGIC to retroactively strip the Trustees of their prior setoffs rights, those funds should, at most, be used by FGIC to offset future ***Claim*** amounts owed by FGIC to the Trusts, not partial *Cash* payments with respect to such Claims.

B. The Proposed Plan Would Unilaterally Rewrite Private Contracts to Strip from the Trustees and Trust Investors Certain Contractual Rights

1. The Proposed Plan Would Unlawfully and Impermissibly Strip the Trust Investors of their Control Rights

The Proposed Plan would unlawfully and impermissibly strip the Trust Investors of their Holder Rights and would confer upon FGIC rights it does not have under the Trust Policies (*see* Proposed Plan § 3.5; *see also* Disclosure Statement § VI.B.1[d] at p. 25).[7]

The Transaction Documents make clear that the Holder Rights belong to the Trust Investors (*see, e.g.*, INDB Series 2006-L2 PSA § 11.16).[8] The Transaction Documents also make clear that the Holder Rights are *temporarily* transferred to FGIC only for so long as FGIC satisfies its payment obligations under the Trust Policies (*id.*). Once FGIC fails to make payments under the Trust Policies or a condition of default occurs, both of which have occurred

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[7] Section 3.5 of the Proposed Plan provides, in relevant part: "... upon the Effective Date, any default, event of default or other event or circumstance relating to the FGIC Parties then existing... under any FGIC Contract or Transaction Document, as a result of (whether directly or indirectly) the Rehabilitation or the Rehabilitation Circumstances shall be deemed not to have occurred (including, for the avoidance of doubt, any default, event of default or other event or circumstance that has arisen (or that may otherwise arise with the passing of time or the giving of notice or both) due to a lack of payment or performance of or by the FGIC Parties under any FGIC Contract or Transaction Document).... Neither the Rehabilitation nor the Rehabilitation Circumstances shall ...prevent the FGIC Parties from exercising all [control rights] in the same manner and to the same extent as FGIC Parties would have been able to retain and exercise such rights in the absence of the Rehabilitation and the Rehabilitation Circumstances."

[8] Section 11.16(d) of the INDB Series 2006-L2 PSA provides, in relevant part: "So long as there does not exist a *failure* by the Certificate Insurer *to make a required payment* under the Policy, the Certificate Insurer shall have the right to exercise all *rights of the Holders of the Insured Certificates* under this Agreement including but not limited to the exercise of all voting rights in respect of the Holders of the Insured Certificates without any consent of such Holders, and such Holders may exercise such rights only with the prior written consent of the Certificate Insurer, except as provided herein" (INDB Series 2006-L2 PSA § 11.16[d] [*emphasis added*]). Section 4.06 of the PSA (i) provides, in relevant part: "By accepting its Insured Certificate, each holder of an Insured Certificate agrees that, *unless a Certificate Insurer Default exists*, the Certificate Insurer shall be deemed to be the holder of the Insured Certificate for all purposes (other than with respect to the receipt of payment on the Insured Certificates) and shall have the right to *exercise all rights ...of the holders of the Insured Certificates* under this Agreement and under the Insured Certificates without any further consent of the holders of the Insured Certificates" (*id.* § 4.06 [*emphasis added*]). Section 11.16(e) of the INDB Series 2006-L2 PSA provides: "The Certificate Insurer shall *not* be entitled to exercise any of its rights hereunder so long as there exists a *failure* by the Certificate Insurer *to make a required payment* under the Policy" (*id.* § 11.16[e] [*emphasis added*]).

here, the Holder Rights automatically revert to the Trust Investors according to the terms of the Transaction Documents.

In November 2009, FGIC stopped performing its duties and consequently lost its right to exercise Holder Rights under the Transaction Documents. Pursuant to the terms of the Transaction Documents, that event expressly entitled the Trust Investors to reacquire the Holder Rights. The Proposed Plan, however, would permit FGIC—a defaulted, non-performing party—to continue exercising the Holder Rights nonetheless (*see* Proposed Plan § 3.5; *see also* Disclosure Statement § VI.B.1[d] at p. 25). The Proposed Plan would thus provide rights to FGIC beyond those set forth in the Trust Policies, while stripping the Trust Investors' of their rights.

The Rehabilitator admits that the Transaction Documents include the Holder Rights provisions (the "Holder Rights Provisions") and that FGIC has defaulted and will continue to default going forward under the applicable insurance policies (*see* the Rehabilitator's *Memorandum of Law in Support of Approval of Plan of Rehabilitation for Financial Guaranty Insurance Company*, 26-30 [hereinafter the "Memo of Law"]). However, the Rehabilitator argues that FGIC should nonetheless be permitted to continue exercising the Holder Rights because the Holder Rights Provisions are so-called *ipso facto* provisions, which would not be enforceable under certain "foreign" statutes. The Rehabilitator's argument on this point is unavailing for two reasons: (i) the Holder Rights Provisions are not *ipso facto* provisions; and (ii) even if they were, NYIL Article 74 does not include a prohibition on the enforcement of *ipso facto* provisions.

An *ipso facto* provision provides for the modification of contract parties' relationships due to the insolvency or commencement of insolvency proceedings by one of the contract parties

(*see, e.g., In re Lehman Bros. Holdings Inc.*, 452 BR 31, 38 [Bkrtcy SDNY 2011]; *see also* 11 USC § 365[e][1]).[9] However, a provision in a contract that simply conditions the performance by one party on the performance of a counterparty is *not* an *ipso facto* provision (*see, e.g., In re C.A.F. Bindery, Inc.*, 199 BR 828, [Bkrtcy SDNY 1996] [The prohibition on the enforcement of *ipso facto* provisions, "does not, however, relieve the debtor of every contract or lease default. If the debtor's default arises for some reason other than those set forth in section 365[e][1] [(*i.e.* insolvency or the commencement of an insolvency proceeding)], the prohibition against *ipso facto* clauses does not apply."]).

The Holder Rights Provisions do not solely provide for the modification of FGIC's rights on account of FGIC's insolvency or the commencement of an Article 74 proceeding against FGIC. Rather, the Holder Rights Provisions condition FGIC's exercise of the Holder Rights on full performance of FGIC's obligations under the Trust Policies. Accordingly, the Holder Rights Provisions are clearly not *ipso facto* provisions.

Although not controlling in this proceeding, the Bankruptcy Code's treatment of contracts, upon which the Rehabilitator relies, is particularly instructive. Under the Bankruptcy Code, *ipso facto* provisions in contracts, *to which a debtor is a party,* are unenforceable against the debtor (*see* 11 USC § 365[e][1] [governing "an executory contract or unexpired lease *of the*

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[9] Bankruptcy Code §365(e)(1) provides:

> Notwithstanding a provision in an executory contract or unexpired lease, or in applicable law, an executory contract or unexpired lease of the debtor may not be terminated or modified, and any right or obligation under such contract or lease may not be terminated or modified, at any time after the commencement of the case solely because of a provision in such contract or lease that is conditioned on—
>
> (A) the insolvency or financial condition of the debtor at any time before the closing of the case;
>
> (B) the commencement of a case under this title; or
>
> (C) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement

(11 USC § 365[e][1]).

debtor" [emphasis added]]). In addition, a debtor has broad authority under the Bankruptcy Code to assume contracts, after which it may compel performance from a counterparty (*see* 11 USC § 365[a], [b]). However, the Bankruptcy Code imposes several conditions and restrictions on a debtor's ability to assume a contract. First, if the debtor has defaulted under a contract, it may assume such contract only after it has cured all defaults and provided "adequate assurance of future performance under such contract" (11 USC § 365[b][1]). Second, the debtor must assume a contract *cum onere*, "taking the bad with the good" (Norton Bankruptcy Law and Practice 2d § 46:11 [2012], citing *N.L.R.B. v. Bildisco and Bildisco*, 465 US 513, 531 [1984]).

The treatment of the Holder Rights in the Proposed Plan would not pass muster under the Bankruptcy Code. First, the Bankruptcy Code only prohibits the enforcement of *ipso facto* provisions in contracts "of the debtor" and only permits assumption of contracts "of the debtor" (11 USC § 365[a], [e][1]). FGIC is not a party to the Transaction Documents, which actually contain the Holder Rights Provisions. Accordingly, even if the Holder Rights Provisions were *ipso facto* provisions, which they are not, the prohibition on the enforcement of *ipso facto* provisions under the Bankruptcy Code would not apply. Second, assuming *arguendo* that FGIC were a party to the Transaction Documents, in order for the Rehabilitator to exercise the Holder Rights, it must first assume the Transaction Documents, which would require that FGIC cure existing defaults and provide adequate assurance of future performance of FGIC's obligations under the Trust Policies. Rather than curing existing defaults and providing adequate assurance of future performance, the Rehabilitator actually makes clear in the Proposed Plan and its Memo of Law that he does not intend to cure existing defaults and intends to continue to default going forward. Accordingly, if the Bankruptcy Code were to apply, which it does not, the Rehabilitator

could not exercise the Holder Rights absent performance of all of its obligations under the Trust Policies.

2. *The Proposed Plan Would Impermissibly Modify the Trustees' Rights with Respect to Repurchase Obligations*

The Transaction Documents generally include provisions governing the process for providing notification to and enforcement of various third-parties' obligations to repurchase certain mortgage loans deposited in the Trusts as a result of breaches of representations and warranties made by such third-parties (the "Repurchase Obligations") (*see, e.g.,* INDB Series 2006-L2 PSA §§ 2.01, 2.03). The Proposed Plan, however, attempts to unilaterally rewrite these provisions by imposing upon the Trustees and Trust Investors significant additional notice and reporting obligations to FGIC, while conferring upon FGIC certain other rights to which it is not entitled (*see* Proposed Plan §3.7; Disclosure Statement § VI.B.8 at p. 32).

For example, the Proposed Plan would require the Trustees and Trust Investors to provide prior written notice to FGIC before making a repurchase demand or pursuing actions to enforce a Repurchase Obligation—a right that FGIC may not have under the Transaction Documents (*see* Proposed Plan §3.7 [a][i]). The Proposed Plan would require the Trustees and Trust Investors to allow FGIC to join in any formal action that they file with respect to enforcement of Repurchase Obligations—a right that FGIC may not have under the Transaction Documents (*see* Proposed Plan §3.7 [a][ii]). The Proposed Plan would prohibit the Trustees and Trust Investors from settling or releasing any claims they may have unless they (i) provide 45 days prior notice to FGIC and (ii) disclose to FGIC potentially confidential settlement information—rights that FGIC does not have under the Transaction Documents (*see* Proposed Plan §3.7 [a][iv]). Finally, the Proposed Plan would entitle FGIC to direct the Trustees, notwithstanding FGIC's ongoing default and failure to pay claims under the Trust Policies, to settle and release Repurchase

Obligations as directed by FGIC, unless holders of at least 25% of the outstanding principal amount of Insured Securities object to such actions—a right that FGIC does not have under the Transaction Documents (*see* Proposed Plan § 3.7 [b][iii]).

The Rehabilitator is bound by the same constraints as the insurer and has no greater rights than would the insurer (*see* 1 Couch on Ins. § 5:22 [3rd ed 2011]; *see also Texas Commerce Bank-El Paso, N.A. v. Garamendi,* 28 Cal App 4th 1234, 1245 [1994]). Here, however, the Rehabilitator is not only attempting to abrogate the rights of the Trust Investors and the Trustees, but also grant rights to FGIC that it did not have prior to insolvency. Providing FGIC with such additional rights is not in the best interests of the Trustees or Trust Investors. In many instances, the Trustees conduct due diligence and bear significant costs in time and money to pursue Repurchase Obligations, including in some instances through formal legal proceedings, on behalf of Trust Investors who may not even hold securities insured by FGIC or whose interests may not be aligned with those of FGIC. Moreover, if Trust Investors—for whom the Repurchase Obligations are intended to benefit—believed their best interests would be served by permitting insurers to maintain control of their efforts to enforce Repurchase Obligations, they could—and would—have negotiated contractual terms to that effect.

3. *The Proposed Plan Would Unfairly and Impermissibly Limit the Trustees' Indemnification Rights*

Under the Transaction Documents, the Trustees cannot be required to expend or risk their own funds or otherwise incur financial liability in the performance of any of their duties, if there is reasonable ground for believing that the repayment of such funds or adequate indemnity against such risk or liability is not reasonably assured to them (*see, e.g.*, INDB Series 2006-L2 PSA § 8.01). Further, the Trustees are under no obligation to exercise any of the rights or powers vested in them or to institute, conduct or defend any litigation in relation thereto at the

direction of Trust Investors or at the direction of an insurer exercising Holder Rights, unless the directing party offers to the Trustees such reasonable indemnity *as the Trustees may require* against the costs, expenses and liabilities to be incurred therein (*see, e.g., id.* at §§ 11.03, 8.02[iii] [emphasis added]). In addition, neither the Trustees nor the Trust Investors shall have any obligation to consent to any amendments or modifications of the Transaction Documents unless they have been provided reasonable security or indemnity against their out-of-pocket expenses (including reasonable attorneys' fees) to be incurred in connection therewith (*see, e.g., id.* at § 11.09).

Although the Proposed Plan would provide a *limited* indemnification from FGIC to the Trustees for certain "Losses" incurred by the Trustees arising from their "compliance with the express terms and conditions of the [Proposed] Plan or with any direction given to it by FGIC pursuant to... the relevant Transaction Document," the Proposed Plan would thereafter eliminate the Trustees' broader contractual indemnification rights including, without limitation, those described in the foregoing paragraph, by forcing the Trustees to accept *a priori*, a *de facto* determination that the Proposed Plan's limited indemnification provision necessarily satisfies "for *all* purposes *any* requirement under *any* provisions of a Transaction Document that the Indemnified Trustee be provided with an indemnity to or for its benefit (including any requirement that such indemnity be "adequate," "sufficient," "reasonable," "acceptable" or similar terms) prior to performing *any* action required under the Plan, including complying with *any* direction given to it by FGIC pursuant to the relevant...Transaction Document, and including provisions that allow the Indemnified Trustee to refrain from performing any action in the absence of such an indemnity" (*see* Proposed Plan § 7.5 [emphasis added]). The Proposed Plan thus erroneously presumes that the terms "adequate," "sufficient," "reasonable," and

"acceptable" can be determined in a vacuum without reference to the facts and circumstances arising in various contexts, at future times, and involving unknown parties.

While some actions taken under the Proposed Plan or pursuant to a direction by FGIC might involve minimal expense or liability, others (for example, funds distributions or prospective litigation) may involve millions—or even billions—of dollars in expenses or liability exposure. Given the risks and potential liability, and the wide variety and unpredictable nature of the circumstances in which Trustees might be directed to take action, the parties to the Transaction Documents wisely left the structuring of the requisite indemnity flexible, to be determined on a case-by-case basis by the Trustee, subject only to a requirement that the Trustee's judgment be reasonable. Accordingly, this Court cannot fairly enter an order that, in essence, determines that an unsecured indemnity from an insolvent insurer will necessarily be "adequate," "sufficient," "reasonable," and "acceptable" to cover *any* and *all* such expenses or liability in *any* and *all* circumstances.

In addition, section 7.5(b) of Proposed Plan provides that the Trustees must first seek indemnity from the Trusts for all losses arising from the Trustees' compliance with the Proposed Plan or any direction by FGIC and that the Trustees may only seek indemnity from FGIC to the extent that the Trusts are not able to provide sufficient indemnity. In other words, the Rehabilitator is attempting to shift the burden of providing indemnity onto the Trust Investors, even for directions from FGIC that might conflict with the interests of the Trust Investors, many of whom do not even hold Certificates that are insured by FGIC.

4. The Rehabilitator Has No Authority to Unilaterally Rewrite Private Contracts, Including Trust Policies and the Transaction Documents

As discussed above, pursuant to the Proposed Plan, the Rehabilitator is attempting to unilaterally rewrite a variety of private contracts—some insurance policies to which FGIC is a

party and some non-insurance agreements to which FGIC is not a party, including the Transaction Documents. In the Memo of Law, the Rehabilitator labors greatly to find some legal authority for such extreme relief. The Rehabilitator does not begin his quest for authority, as one might expect, with NYIL Article 74—the sole statutory authority for the Proposed Plan. Such inability to cite Article 74 is quite understandable from the Rehabilitator's perspective, because the statute clearly does not authorize the Rehabilitator to rewrite any contracts, let alone contracts to which FGIC is not a party. Thus, without any statutory authority to unilaterally rewrite private contracts, the Rehabilitator misstates and misapplies legal authority from foreign jurisdictions.

The Rehabilitator begins by misstating and misapplying the "seminal case," *Carpenter v. Pacific Mutual Life Ins. Co* (Memo of Law, 17, citing *Carpenter v. Pacific Mutual Life Ins. Co.*, 74 P2d 761, 768 [Cal 1938], *aff'd sub nom. Neblett v. Carpenter*, 305 US 297 [1938]). Although the Rehabilitator is correct that *Carpenter* (and more precisely, the decision of the Supreme Court of the United States) is a seminal case, the Rehabilitator completely misstates the rule of law established in *Carpenter*. The rehabilitation plan that was approved in *Carpenter* did *not* unilaterally rewrite private contracts—a point that was essential to the United States Supreme Court's opinion upholding the California Supreme Court's approval of the plan (*see Carpenter*, 305 US at 305). Specifically, the United States Supreme Court held: "As has been pointed out, [policyholders] are *not* [compelled to accept the new company as insurer on the terms set out in the rehabilitation agreement] *but are given the option* of a liquidation which on this record appears as favorable to them as that which would result from the sale of the assets and pro rata distribution in solution of all resulting claims for breach of outstanding policies" (*id.* [emphasis added]). Here, the Rehabilitator is not offering any such option.

Next, the Rehabilitator relies on decisions from Pennsylvania, Kentucky and New Jersey (*see* Memo of Law, 17-18, citing *Vickodil v. Commonwealth*, 559 A2d 1010, 1013 [Pa Commw Ct 1989]; *Minor v. Stephens*, 898 SW2d 71, 76 [Ky 1995]; *In re Mutual Benefit Life Ins. Co.*, 1993 NJ Super Lexis 940, at *20-21, *132-33 [NJ Ch Aug 12, 1993]).[10] Those decisions are equally unavailing because, among other reasons, none of those decisions actually considers whether a rehabilitator can unilaterally rewrite private contracts.

In *Vickodil*, the Court considered whether the Pennsylvania Insurance Department owed a fiduciary duty to a tort victim with a claim against an insurance company in an insolvency proceeding. The Court did not consider whether the Pennsylvania Insurance Department, as rehabilitator, could unilaterally rewrite private contracts. In *Minor*, the Court only considered the rights of shareholders during an insurance rehabilitation proceeding—not whether a rehabilitator could unilaterally rewrite private contracts. In *Mutual Benefit*, the Court considered whether a plan of rehabilitation complied with a statutory priority scheme and whether such scheme was Constitutional. The Court did not consider whether the plan of rehabilitation could unilaterally rewrite private contracts.

Finally, the Rehabilitator cites a sole New York decision, *In re National Surety Co.* (239 AD 490, 492 [App Div 1933], *aff'd*, 254 NY 473 [Ct App 1934]). Like the other cases the Rehabilitator cites, the Court in *National Surety* did *not* hold that a rehabilitation plan could

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[10] The Rehabilitator also relies on the Wisconsin Circuit Court's decision in *In re Rehab. of Segregated Account of Ambac Assurance Corp.* (the "Ambac Proceeding") (*see* Memo of Law 19, citing Decision and Final Order Confirming the Rehabilitator's Plan of Rehabilitation, With Findings of Fact and Conclusions of Law, Case No. 10-CV-1576, ¶104 [Wis Cir Ct Jan 21, 2011] [appeals pending]).The rehabilitation plan in that case was so problematic that nearly two years after it was approved by the Wisconsin Court it has still not been made effective by the Ambac rehabilitator. Moreover, as the Rehabilitator correctly acknowledges, the decision confirming the rehabilitation plan in the Ambac Proceeding is subject to *numerous* pending appeals. The Trustees respectfully request that this Court not give any precedential effect to any decisions from the Ambac Proceeding, unless and until such decisions are affirmed on appeal.

unilaterally rewrite private contracts. Rather, the Court simply approved a rehabilitation plan that effectively allocated an insolvent insurer's limited assets among its policyholders.

Even if the foreign decisions and sole New York decision relied on by the Rehabilitator actually held that a rehabilitator has *carte blanche* to rewrite insurance policies, which those cases do not, the Rehabilitator seeks even more extreme relief in the Proposed Plan than simply restructuring insurance policies. Specifically, the Rehabilitator actually attempts to rewrite, for FGIC's sole benefit, non-insurance contracts, to which FGIC is not a party. In particular, and as discussed above, FGIC is not a party to the Transaction Documents, which are agreements between third-parties, only some of whom have any contractual relationship with FGIC. Quite simply, the Rehabilitator has no authority and cites none, domestic or foreign, for rewriting third-party, non-insurance contracts, such as the Transaction Documents.

CONCLUSION

For all the reasons stated above, the Court should not approve the following provisions in the Proposed Plan:

- Proposed Plan §§ 3.5, 4.9 & 7.8(c) and RPT § 1.4A (stripping the Trustees of their set-off rights);
- Proposed Plan § 3.5 & 7.8(e) (stripping the Trust Investors of their control rights and conferring upon FGIC control rights it does not have in the Trust Policies);
- Proposed Plan §3.7 (creating, out of whole cloth, new restrictions on the Trustees and Trust Investors with respect to Repurchase Obligations); and

- Proposed Plan § 7.5(b)(i), (iv)(last sentence) (limiting the Trustees' indemnification rights).

Respectfully submitted,

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