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January 22, 2013

BY HAND DELIVERY

Hon. Doris Ling-Cohan
Attn: Monica Cheng, Esq.
Supreme Court New York County, IAS Part 36
60 Centre Street
New York, New York 10007

Re: *In the Matter of the Rehabilitation of Financial Guaranty Insurance Company*, Index No. 401265/2012, Motion Sequence # 04
Trustee Objectors' Submission on Standard for Approval of a Plan of Rehabilitation

Dear Justice Ling-Cohan:

At the January 15, 2013 discovery conference the parties were asked to submit letter briefs addressing the legal standard to be applied by the Court in determining whether it should approve the Plan of Rehabilitation filed by the Rehabilitator.[1] This firm represents The Bank of New York Mellon and The Bank of New York Mellon Trust Company, N.A., as Trustee (collectively "BNYM"), one of the remaining Objectors to the Proposed Plan. This letter is submitted on behalf of BNYM and the other trustee bank Objectors: Deutsche Bank National Trust Company, Deutsche Bank Trust Company Americas (collectively "Deutsche Bank")[2], Wells Fargo Bank, N.A., U.S. Bank National Association and U.S. Bank Trust National Association, each in their respective capacities as trustees (collectively, with BNYM, the "Trustees").

1. Fair and equitable: no unfair discrimination; recovery at least as much as in a liquidation; consistent with law

Both the Rehabilitator[3] and the Objectors have looked to the "fair and equitable" standard articulated in *Carpenter v. Pac. Mut. Life Ins. Co. of Cal.*, 10 Cal. 2d 307, 317 (1937), *aff'd sub*

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1 As requested, all cases cited herein can be found in the accompanying appendix.

2 Deutsche Bank does not join in Point 3 of this letter.

3 Memorandum of Law in Support of Approval of Plan of Rehabilitation for Financial Guaranty Insurance Company dated October 25, 2012, at 11 and *passim*; Verified Petition dated June 11, 2012, ¶ 23 at 10-11; Disclosure Statement for Plan of Rehabilitation for Financial Guaranty Insurance Company, dated September 27, 2012, at 49.

nom. Neblett v. Carpenter, 305 U.S. 297 (1938)[4] as the applicable standard as to whether the substantive terms of the Plan may be approved. That standard does not permit the Rehabilitator to propose any plan that he believes to be reasonable. The words "fair and equitable" as used in the *Carpenter* case and applied in subsequent cases in New York and other jurisdictions in reviewing plans of rehabilitation for insurance companies have a specific meaning derived from the developed law of receiverships. As explained contemporaneously by the U.S. Supreme Court in the context of a plan of reorganization for a corporation under Section 77B of the Bankruptcy Act: "The words 'fair and equitable' as used in § 77B(f) are words of art which prior to the advent of § 77B had acquired a fixed meaning through judicial interpretations in the field of equity receivership reorganizations." *Case v. L.A. Lumber Prods. Co.*, 308 U.S. 106, 115 (1939). *Case* addressed the requirement that creditors be paid in full before shareholders are entitled to retain an interest in the reorganized company, not an issue in this proceeding. The cases applying the standard in insurance rehabilitation have highlighted the other aspects of the concept important here: (1) the Plan may not discriminate unfairly between claimants with the same legal rights (*Matter of People by Van Schaick (Nat. Surety Co.)*, 239 A.D. 490, 496 (1st Dep't 1933), *aff'd*, 269 N.Y. 473 (1934); *Carpenter*, 10 Cal.2d at 331, 337); (2) the parties receive at least as much as they would recover in a liquidation (*Carpenter*, 10 Cal. 2d at 335); and (3) the terms of the Plan must be authorized by law. *See Matter of the Rehabilitation of Frontier Ins. Co.*, 36 Misc. 3d 529, 542 (Sup. Ct. Albany Co. 2012) ("[A] plan of rehabilitation cannot be approved where it is inconsistent with the law."). Thus, a plan of rehabilitation must not only comply with legal and constitutional precepts it must also be fair and equitable to all interested parties.

2. Limits on the exercise of the rehabilitator's discretion; scope of deference to the rehabilitator's business judgments;

The parties also recognize a second principle - deference within the proper bounds to the Rehabilitator's discretion and exercise of reasonable business judgment. But this concept must also be understood within its proper constraints. A rehabilitator makes business judgments as to whether to pursue rehabilitation or liquidation of an insurance company and in a myriad of decisions in the course of the case such as decisions on when and whether to settle or pay claims, or dispose of assets of the insurance company. The Rehabilitator has no discretion to impose terms of a plan of rehabilitation inconsistent with applicable law and to enlarge the jurisdiction of the Court. While "[t]he courts will generally defer to the rehabilitator's business judgment[,]" the scope of this Court's jurisdiction over parties or contracts other than an insurer's policies and the determination of what are permissible terms of a plan of rehabilitation are not business decisions, but matters of law for the Court. Courts defer to a rehabilitator's business judgment exercised within legal parameters, but must disapprove actions by a rehabilitator that are "arbitrary, capricious or an abuse of discretion." *Callon Petroleum Co. v. Superintendent of Ins. of State*, 53 A.D.3d 845, 845 (3d Dep't 2008); *Mills v. Florida Asset Fin. Corp.*, 31 A.D.3d 849, 850 (3d Dep't 2006); *New York Title & Mortgage. Co. v. Irving Trust Co.*, 241 A.D. 246 (1st Dep't 1934) (an injunction which purported to deprive the claimant of the right to setoff would be invalid since it would exceed the powers conferred upon the court by the statute); *Van Schaick*

[4] The California Supreme Court noted that California's rehabilitation statute was "copied, substantially from similar provisions in the New York Insurance Law" and relied on New York authorities in making its ruling. *Carpenter*, 10 Cal. 2d at 328, 332.

v. Pa. Exch. Bank, 236 A.D. 453 (1st Dep't 1932); *Matter of Liquidation of State Title & Mortgage Co.*, 160 Misc. 106, 111 (Sup. Ct. N.Y. Co. 1936) (The New York Insurance Law "clearly imposes upon the court the ultimate responsibility [to insure that] holders are properly . . .protected"); *Grode v. Mut. Fire, Marine, & Inland Ins. Co.*, 572 A.2d 798, 804 (Pa. Commw. Ct. 1990) (the court must act as a "check on potential discretionary abuse to insure equitable apportionment of loss"); *Van Schaick (Nat. Surety Co.)*, 239 A.D. at 496 (statute permitting rehabilitation places "great responsibility" on superintendent of insurance such that any abuse of power should be checked by the courts).

3. Proper record

Approval of a plan of rehabilitation must be based on a proper record. Section 7.6 of the Plan provides that the Rehabilitation Proceeding will terminate on the Effective Date whereupon "FGIC shall resume possession of its property and the conduct of its business" without a further hearing before this Court or entry of a subsequent order. As pointed out by counsel for the Jefferson County Warrantholders at the hearing on January 15, 2013, Section 7403(d) of the New York Insurance Law provides that no order terminating the rehabilitation proceeding and permitting the insurer to resume possession of its property and the conduct of its business shall be granted "except when, after a full hearing, the court shall determine that the purposes of the proceeding have been fully accomplished." The determination of whether a rehabilitator's actions are arbitrary, capricious or an abuse of discretion necessarily requires that the Court consider and weigh the facts surrounding the Rehabilitator's actions, such as the conditions giving rise to the rehabilitation, the means chosen to address those conditions, and the effect such actions have on policyholders and third parties. The affidavits submitted by the Trustees and expected to be submitted by the other Objectors in support of their respective objections raise issues of fact, particularly with respect to the impact that the proposed Plan of Rehabilitation would have on Trustees, the holders of securities issued in the transactions in which the Trustees were appointed, other policyholders, and other parties involved in the transactions. There are contested issues of fact in the affidavits already submitted by the Rehabilitator and the Trustees. For example, there is a contested issue of fact with respect to which entity, FGIC or any given trustee or group of holders, is in the best position to exercise rights of direction and control under the Transaction Documents. *Compare* Affidavit of John S. Dubel in Further Support of Approval of First Amended Plan of Rehabilitation, ¶ 8, sworn to December 12, 2012, *with* Affidavit of Gerard F. Facendola, ¶¶ 4-5, sworn to November 19, 2012. Summary determination of this proceeding is proper only "to the extent that no triable issues of fact are raised." CPLR 409(b). Thus, Insurance Law Section 7403(d) as well as CPLR 410 both mandate a hearing.

In addition to the statutory mandate of Section 7403(d) and CPLR 410, CPLR 409(a) gives the Court discretion to require the submission of additional proof. CPLR 409(a). The Court should exercise its discretion to do so in view of the substantial magnitude of the financial interests involved in this proceeding and the expectation of the parties – both the Rehabilitator and the Objectors – that oral testimony would be entertained at the hearing on approval of the Plan.

4. Burden of Persuasion

Finally, as the party moving for approval of the Plan, the Rehabilitator plainly has the burden of establishing than the Plan meets the standard for approval.

As set forth in the Trustees' Amended Objections, portions of the proposed Plan are unfair and inequitable, inconsistent with applicable law, and exceed this Court's jurisdiction. Thus, applying the applicable standard, the proposed Plan should not be confirmed absent modifications to address the Trustees' objections.

Respectfully submitted,

James Gadsden

JG:mc

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