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 |
| | : | Doris Ling-Cohan, J. |
| | : | Motion Sequence No. 16 |

**OMNIBUS REPLY MEMORANDUM OF LAW**
**IN FURTHER SUPPORT OF APPROVAL OF THE SETTLEMENT AGREEMENT**

Weil, Gotshal & Manges LLP
Gary T. Holtzer
Richard W. Slack
Joseph T. Verdesca
767 Fifth Avenue
New York, NY 10153

*Attorneys for the Superintendent of Financial Services of the State of New York, as Rehabilitator of Financial Guaranty Insurance Company*

## TABLE OF CONTENTS

**Page**

Benjamin M. Lawsky, Superintendent of Financial Services of the State of New York (the "**Superintendent**"), as the court-appointed rehabilitator (the "**Rehabilitator**") of Financial Guaranty Insurance Company ("**FGIC**"), respectfully submits this omnibus reply memorandum of law ("**Omnibus Reply**") (A) in further support of the Rehabilitator's motion (the "**Motion**") for an order (i) approving the settlement agreement (the "**Settlement**" or the "**Settlement Agreement**," a copy of which is attached as Exhibit B to the Affirmation of Gary T. Holtzer, dated May 29, 2013 (the "**Holtzer Affirmation**"), and filed in connection with the Motion) entered into among Residential Capital, LLC ("**ResCap**" and, together with its direct and indirect subsidiaries listed in Exhibit A to the Settlement Agreement, the "**Debtors**"), FGIC, The Bank of New York Mellon, The Bank of New York Mellon Trust Company, N.A., Law Debenture Trust Company of New York, U.S. Bank National Association and Wells Fargo Bank, N.A., each solely in their respective capacities as trustees, indenture trustees or separate trustees (collectively, the "**Trustees**") under the Trusts,[1] and certain Investors, dated May 23, 2013, (ii) approving the Plan Support Agreement (the "**Plan Support Agreement**," (a copy of which is attached to the Holtzer Affirmation as Exhibit C) entered into among the Debtors, Ally Financial Inc. ("**AFI**"), on its own behalf and on behalf of its direct and indirect subsidiaries excluding the Debtors, the Official Committee of Unsecured Creditors of the Debtors, FGIC, and the other Consenting Claimants (as defined in the Plan Support Agreement), dated May 13, 2013, to the extent that the Plan Support Agreement relates to FGIC, and (iii) granting such other and further relief as the Court may deem just and proper, and (B) in response to the arguments raised by the

[1] Capitalized or other identifying terms not defined herein have the meanings ascribed to them in the Holtzer Affirmation or the Settlement Agreement, as applicable. Specifically, the "Trusts" and "Policies" are defined and listed in Exhibit B of the Settlement Agreement.

Objectors.[2] In further support of the Omnibus Reply, the Rehabilitator also files herewith (i) the Affidavit of John S. Dubel, dated July 30, 2013 (the "**Dubel Affidavit**") and (ii) the Affirmation of Richard W. Slack in support of the Rehabilitator's Omnibus Reply (the "**Slack Affirmation**").

## PRELIMINARY STATEMENT

The Settlement Agreement is a fair compromise that will consensually resolve FGIC's obligations under Policies issued to the Trustees to insure securities backed by residential mortgage loans sold to the Trusts by ResCap. As a result of the Settlement Agreement, FGIC will be released from its payment obligations under the Policies; by paying a lump sum of $253.3 million now, forgiving the payment of future premiums and foregoing its right to receive any and all reimbursements from the Trusts pursuant to the waterfall provisions under the governing documents of the various Trusts, FGIC will avoid being called upon to make payments with respect to potentially $1.1 billion in received or anticipated policy claims over the next forty to forty-five years. The Rehabilitator, who is entirely without a financial or other interest in the Settlement, has determined in his judgment that the Settlement is in the best interests of FGIC and its policyholders as a whole.

The Settlement Agreement is the culmination of over five months of negotiations ordered by the United States Bankruptcy Court for the Southern District of New York (the "**Bankruptcy Court**") and led and mediated by the Honorable James M. Peck, a sitting and well-respected bankruptcy judge, in which ResCap, FGIC, the Trustees, and a group of investors in certain of

[2] The Objectors consist of Monarch Alternative Capital LP ("**Monarch**"), Stonehill Capital Management LLC ("**Stonehill**"), Bayview Fund Management LLC ("**Bayview**"), CQS ABS Master Fund Limited and CQS ABS Alpha Master Fund Limited ("**CQS**" and together with Monarch, Stonehill, and Bayview, the "**Fund Objectors**"), and (ii) Federal Home Loan Mortgage Corporation ("**Freddie Mac**"). The Fund Objectors written objection is referred to herein as the "**Fund Obj.**" and Freddie Mac's written objection is referred to as the "**FM Obj.**"

the Trusts,[3] among many other participants engaged in extensive arm's-length discussions, facilitated by financial advisors and legal counsel,[4] to resolve the current and future claims against FGIC under the relevant Policies and FGIC's claims against the ResCap Debtors in ResCap's bankruptcy proceeding currently pending in the Bankruptcy Court, Ch. 11 Case No. 12-12020 (MG) (the "**Bankruptcy Proceeding**"). The attached Affidavit of John S. Dubel, Chief Executive Officer of FGIC, describes in detail the mediation process, including why it was established, who participated, how the process worked and its results. Dubel Aff. at ¶¶ 3-16.

The Settlement Agreement before this Court is also being subjected to the scrutiny and approval of the Bankruptcy Court in ResCap's Bankruptcy Proceeding. The issues in the two proceedings are similar, but not identical. The differences are important. In the Bankruptcy Court, the Honorable Martin Glenn must consider whether the Settlement Agreement is in the best interests of the Debtors and their estates. In approving the Settlement Agreement, the Bankruptcy Court is also being asked to expressly conclude that the transactions contemplated by the Settlement Agreement "are in the best interests of the Investors and the Trusts and that the Trustees acted in good faith and in the best interests of the Investors and the Trusts in agreeing" to the Settlement. *See* Settlement Agreement at Section 1.03.

By contrast, this Court must determine whether the Rehabilitator acted arbitrarily or capriciously in approving the Settlement Agreement as in the best interests of FGIC and FGIC's policyholders as a whole. In this regard, this Court is being asked to conclude that the

---

[3] These Investors include a group of 18 sophisticated institutions known as the "Steering Committee" which includes banks and financial institutions such as Goldman Sachs, ING, BlackRock, Teachers Insurance and Annuity Association, TCW, Metropolitan Life, PIMCO, and Western Asset Management. Also participating in the negotiations was the "Talcott Franklin Group" a group of 57 banks, financial institutions, and funds, including CQS. Dubel Aff. at ¶ 5.

[4] The Trustees were represented by Dechert LLP, Alston & Bird LLP and Seward & Kissel LLP. The Trustees financial advisor was Duff & Phelps. Dubel Aff. at ¶ 9.

Rehabilitator did not act arbitrarily and capriciously in determining that a payment by FGIC of a lump sum today is preferable to FGIC remaining liable for expectedly larger payments in the future. The proposed findings before this Court only relate to whether the Trustees conducted themselves in a good faith, non-negligent manner in negotiating the Settlement with FGIC.

Not one FGIC policyholder has objected to the Settlement. Rather, in response to the Motion, two substantive objections[5] to the Settlement Agreement were filed by a small number of investors in the Trusts seeking to advance their own economic interests, rather than the interests of FGIC and its policyholders. These Objectors are not in privity with FGIC and have failed to even attempt to direct their Trustees – FGIC's actual policyholders – not to enter into the Settlement Agreement. Nevertheless, the Objectors contend that the Settlement was too good a deal for FGIC and its policyholders and was not a good enough deal for the Trusts in which they invested. To reach this conclusion, the Objectors mischaracterize the significant consideration the Trusts are receiving as a result of the Settlement. But, even assuming that the Court credits the Objectors' argument, that would merely confirm that this Court should approve the Settlement as beneficial to FGIC – which is the only consideration at issue in this proceeding.

The Objectors make a number of arguments in an attempt to support the objections. First, they contend that the Court should not approve the Settlement because it is not in their own self-interest as investors in those Trusts. The Objectors therefore posit a standard of review that would require the Rehabilitator to reject a policy settlement unless he determines that the settling policyholders – *i.e.*, the counterparties in the negotiations – would receive the same or better

[5] FYI Ltd., FFI Fund Ltd. and Olifant Fund, Ltd. (collectively "**FYI**") filed a limited objection to the Settlement, seeking clarification regarding the proposed allocation of settlement proceeds to one of the Trusts. FYI specifically states that it is not opposing the Settlement, but would like additional information regarding how the Bank of New York Mellon Trust Company, N.A., ("**BNY**"), one of the Trustees, calculated the settlement payment to be distributed to the GMACM Home Equity Loan Trust 2006-HE1. The Rehabilitator has been informed that BNY and its advisors are communicating with these objectors and their advisors, in an attempt to resolve their questions prior to the August 6 hearing date.

treatment as non-settling policyholders. To adopt this absurd position would mean, as a practical matter, that the Rehabilitator could never consensually settle or compromise the liabilities of an insurer in a rehabilitation proceeding because the Rehabilitator would have to believe that the settlement would increase the returns for the non-settling policyholders while at the same time believe that it would increase the recoveries of the consenting settling policyholders. The proposed standard is untenable and, in any event, the express concerns of the Objectors are being addressed, since whether the Settlement is in the best interest of the investors is explicitly being considered by the Bankruptcy Court. In the Bankruptcy Proceeding, the Objectors have had the opportunity to take extensive expedited discovery and will have the opportunity at an evidentiary hearing to raise precisely the issues that the Objectors also seek to raise in this Court but are not properly at issue here. *See* Points I and II, *infra*.

Second, the Objectors argue that the Trustees did not have the authority under the governing documents of their particular Trusts to enter into the Settlement. Disputes between a policyholder and its constituents – such as the Objectors here – concerning matters relating to governance of the Trusts are not appropriately considered by this Court. The Trustees,[6] represented by experienced counsel, expressly represented and warranted to the Rehabilitator, FGIC and others that they had the power and authority to enter into the Settlement Agreement and consummate the transactions contemplated thereby. The only question for this Court in this regard is whether the Rehabilitator acted arbitrarily and capriciously in relying on the Trustees' representations and warranties in approving the Settlement, which he clearly did not. *See* Point III, *infra*.

[6] The Rehabilitator understands that the Trustees intend to submit a response to the Objectors concerns as to the Trustees' authority to enter into the Settlement Agreement.

Third, the Objectors' argument that this Court must consider whether the Settlement is in the best interest of investors in the Trusts based on the reverse-preemption doctrine is wrong as both a legal and practical matter. As noted above, the Bankruptcy Court will hear the issue of whether the Trustees acted in the best interest of their investors, including the Objectors, in entering into the Settlement based on a full evidentiary record pursuant to the 9019 Motion[7] filed by the Debtors in that court; nothing in the Objectors' objections requires this Court to do so. *See* Point IV, *infra*.

Fourth, the Objectors do not have standing to appear in this special proceeding. The Objectors concede that they are not parties to the proceeding and are not policyholders in privity with FGIC. Instead, the Objectors are merely investors in the Trusts. In each case, the Trustee of the Trust and not any of the Objectors is the policyholder. Every court that has addressed the issue in identical or similar situations has held that investors such as the Objectors here do not have standing to challenge a settlement made by the company or trust in which they invested. *See* Point V, *infra*.

Lastly, Freddie Mac is not entitled to discovery or an evidentiary hearing. Freddie Mac cannot meet the high standard for discovery in a special proceeding. More to the point, Freddie Mac seeks discovery to prove that the deal was too good for FGIC,[8] a fact that even if proven true would support rather than counter the Rehabilitator's judgment that the Settlement benefits

---

[7] *Debtors' Motion Pursuant to Fed. R. Bankr. P. 9019 For Approval Of The Settlement Agreement Among The Debtors, FGIC, The FGIC Trustees And Certain Individual Investors*, Ch. 11 Case No. 12-12020 (MG) (Bankr S.D.N.Y. June 7, 22013) [Docket No. 3929], a copy of which is attached as Exhibit A to the Slack Affirmation.

[8] While not necessarily relevant to this Court's determination, the Rehabilitator believes that this compromise was in fact simply a fair compromise for all parties. The Settlement payment being made provides certainty for FGIC as to what it is paying, and likewise provides certainty for the settling policyholders as to what they will receive now, in cash, instead of waiting for payments over an extended period of time, during which the ultimate amount of actual losses and resulting policy claims could vary from what is projected now. There were significant risks to all parties, and the potential for years of expensive and uncertain litigation in the absence of the Settlement. In addition, as set forth in the Dubel Affidavit, the investors in the Trusts, including the Objectors here, will receive in excess of $90 million from the ResCap estate that they would not otherwise receive but for this Settlement. Dubel Aff. ¶ 17, 22.

FGIC and its policyholders as a whole. Freddie Mac should not be permitted to delay the consummation of the Settlement which the Rehabilitator has reasonably determined is in the best interests of FGIC and its policyholders, particularly in light of the August 19, 2013 deadline for the Settlement to obtain Court Approval.[9] *See* Point VI, infra.

## ARGUMENT

### I. The Court's Standard of Review is Whether the Rehabilitator Acted Arbitrarily and Capriciously in Approving the Settlement Agreement

New York Insurance Law Section 7428 allows the Rehabilitator to settle claims against the insurer's estate without Court approval if the amount at issue is below $2,500. N.Y. Ins. Law § 7428. Because the amount involved in the Settlement Agreement is greater than $2,500, the Rehabilitator has approved the Settlement Agreement subject to the Court's approval.

In considering the Settlement, the Court ***must*** give great weight and deference to the Rehabilitator's judgment that the Settlement Agreement is in the best interests of FGIC and its policyholders as a whole,[10] and consider only whether the Rehabilitator acted arbitrarily or capriciously and abused his discretion in making that determination. *See Callon Petroleum Co. v. Superintendent of Ins.*, 53 A.D.3d 845, 863 N.Y.S. 2d 92, 93-4 (App. Div. 2d Dep't 2008) (recognizing that "[t]he courts will generally defer to the rehabilitator's business judgment and disapprove the rehabilitator's actions only when they are shown to be arbitrary, capricious or an

---

[9] The Settlement Agreement provides that it must be approved before August 19, 2013:

> This Agreement shall terminate:
>
> (a) August 19, 2013, if the Rehabilitation Court Order has not been signed...

Settlement Agreement, Section 7.01 (entitled "Termination Events").

[10] *See Corcoran v. Hall & Co., Inc.*, 149 A.D.2d 165, 171, 545 N.Y.S.2d 278, 281 (App. Div. 1st Dep't 1989) ("the paramount purpose of article 74 'is the preservation and enhancement of [the estate's] assets to the end that the interests of all its creditors, policyholders, stockholders and the public will be served'") (citing *Knickerbocker Agency, Inc. v. Holz*, 4 N.Y.2d 245, 253, 149 A.D.2d at 171, 545 N.Y.S.2d at 281 (1958)); *Serio v. Hevesi*, 40 A.D.3d 72, 74, 831 N.Y.S.2d 160 (1st Dep't. 2007) (the Rehabilitator acts as a court-appointed receiver and "undertakes to fulfill the distressed company's obligations to its policy holders").

abuse of discretion" in approving a rehabilitator's decision to enter into a settlement); *see also Mills v. Florida Asset Fin. Corp.*, 31 A.D.3d 849, 850, 818 N.Y.S.2d 333, 334 (App. Div. 3d Dep't 2006) (in approving a settlement into which the Rehabilitator entered, the Court held that the "Legislature has granted [the Rehabilitator] plenary powers and broad discretion to manage as a fiduciary, the affairs of an insolvent insurer"); *In re New York Title & Mortg. Co.*, 170 Misc. 109, 116 (N.Y. Sup. Ct. 1939) ("[t]he judgment of the Superintendent of Insurance, an administrative officer of the State, as to the advisability of a proposed compromise, is entitled to great weight and is not lightly to be set aside").

The Objectors acknowledge the above standard. *See* Fund Obj. at ¶¶ 14-15; FM Obj. at ¶ 21. The Objectors argue that the Rehabilitator has arbitrarily discriminated against a subset of policyholders and abused his discretion by entering into a policy settlement that allegedly provides a worse recovery to certain ***policyholders*** than others. Fund Obj. ¶ 15; *see also id.* at ¶¶ 14-20; FM Obj. at ¶¶ 22-28. This argument entirely misses the mark. Here, the policyholders themselves – the Trustees – have agreed to the Settlement and therefore have consensually ***elected*** to be treated differently than FGIC's other policyholders. The Trustees have exercised their judgment in opting for a lump sum payment of $253.3 million in cash from FGIC now (as well as a release of the obligation to pay future premiums, reimbursements and other amounts to FGIC) in satisfaction of claims that the settling policyholders may or may not have a basis to assert in the future, rather than the "long term payout, which may or may not exceed the net present value of the lump sum payment today" that they would receive pursuant to the First Amended Plan of Rehabilitation for FGIC, dated June 4, 2013 (the "**Plan**"). *In re Residential Capital, LLC, et al.*, Ch. 11 Case No. 12-12020 (MG) status conference re: FGIC

9019 Settlement, held on July 17, 2013 (hereinafter "**Bankr. Ct. 7/17 Tr.**") 70:1-5.[11] It is not and cannot be the Rehabilitator's job to second guess the decisions that these sophisticated, well-represented policyholders have made as the result of a five-month mediation led by a federal bankruptcy judge.

To adopt the Objectors' position would mean, as a practical matter, that the Rehabilitator could never settle or compromise the liabilities of an insurer in a rehabilitation proceeding. *See In re New York Title*, 170 Misc. at 117 ("If it were necessary for the Superintendent, in order to justify judicial approval of the proposed Settlement, to show definitely that the trust claimants could otherwise actually recover a considerable sum in excess of [the amount they settled for], the trust claimants would obviously refuse to consent to the proposed settlement, for they would be able to recover a much larger amount on the basis of the admissions thus contained in the Superintendent's papers. In such a situation the trust claimants would naturally possess no incentive to give their approval to the proposed settlement."). As *In re New York Title* suggests, this would lead to the disastrous result of leaving the Rehabilitator without a key tool to remediate an insurer's obligations and discharge his statutorily mandated duty of removing the causes and conditions that lead to the rehabilitation proceeding in the first place. Doing so would also be contrary to existing precedent, including the prior orders of this Court, as well as defying common sense.

In other words, the Rehabilitator's focus is not, nor should it be, on the narrow, particular economic interests of five non-policyholders who invested in the Trusts, whose interests were and continue to be represented by the Trustees. Indeed, the Trustees represent all investors in the Trust, not just the few who have chosen to object to the Settlement. Thus, it is particularly

[11] A copy of the Bankr. Ct. 7/17 Tr. is attached as Exhibit B to the Slack Affirmation.

appropriate that the investors' interests are all represented by independent Trustees, and not by each subset of investors raising their own claims and objections.

Here, the Rehabilitator's focus should be on the interests of policyholders as a whole because the Rehabilitator "is the best qualified to perform the rehabilitation . . . process [because] he has no special interest in the outcome except to administer the matter for the maximum benefit of all interested parties." *Minor v. Stephens*, 898 S.W.2d 71, 76 (Ky. 1995) (citing *Matter of Liquidation of Integrity Ins. Co.*, 555 A.2d 50, 53 (N.J. Super Ct. Ch. Div. 1988)). Absent a showing that the Rehabilitator acted arbitrarily and capriciously when he entered into the Settlement Agreement, there is no basis on which to deny the Motion. *See Callon Petroleum*, 53 A.D.3d at 845, 863 N.Y.S.2d at 94 ("a party contesting the rehabilitator's *actions* bears the burden of showing arbitrary conduct by the rehabilitator"). No such showing has been or can be made here.

### A. The Settlement is Unquestionably in the Best Interests of FGIC and Its Policyholders as a Whole

The Rehabilitator has justifiably concluded that the Settlement is a fair one for FGIC and its non-settling policyholders. Absent the Settlement, FGIC would be potentially liable for very substantial actual and future claims under the Policies: as of March 31, 2013, (i) the securities covered by the Policies had an aggregate par amount outstanding of approximately $4.9 billion; (ii) FGIC had paid approximately $343.2 million of claims under the Polices for which it had not (and still has not) yet been reimbursed; (iii) approximately $789 million of additional claims had been asserted against FGIC that remained (and still remain) unpaid; and (iv) the present value of losses FGIC projects to arise under the Policies exceeded $400 million.[12] Holtzer Aff. ¶ 5.

[12] To be clear, the $400 million is not the present value of the amount FGIC anticipates will be ***paid*** as claims, but the present value of the total amount of projected claims, some smaller amount of which will likely ultimately be paid.

The Settlement does away with all of those risks for the up front price of $253.3 million (and the forgiving of approximately $18.3 million in premiums as well as reimbursements for certain paid claims), which, although a very significant amount in light of FGIC's financial condition, is significantly less than the amount of existing unpaid claims under the Policies and the present value of the losses FGIC currently expects to arise thereunder (in the absence of the Settlement Agreement). Holtzer Aff. ¶ 21.

As further described in the Holtzer Affirmation, in exchange for extinguishing the more than a billion dollars of actual and potential liability under the Policies, FGIC will pay $253.3 million and receive, in the Bankruptcy Proceeding, allowed claims against each of ResCap, GMACM, and RFC in the aggregate amount of no less than $596.5 million, and potentially approximately $934 million, depending on whether ResCap's Proposed Chapter 11 Plan goes effective. Holtzer Aff. ¶ 21. Importantly, ***not one*** of FGIC's policyholders (signatories to the Settlement Agreement or otherwise) has objected to the Settlement Agreement, presumably because they all recognize that the material mitigation of FGIC liabilities contemplated by the Settlement Agreement is in the best interests of FGIC's policyholders.[13]

The Objectors also mischaracterize what they will be receiving as a result of the Settlement. As described in the Dubel Affidavit, in addition to the $253.3 million FGIC will pay to the Trusts as part of the Settlement, FGIC is foregoing its right to collect approximately $18.3 million in net present value of future policy premiums that it estimates the Trusts would otherwise be obligated to pay to FGIC over the life of FGIC's insurance policies as well as reimbursements for certain paid claims that would otherwise have been paid to FGIC. In

[13] Moreover, there were no objections to the Plan Support Agreement filed in this proceeding and already approved by the Bankruptcy Court. *See In re Residential Capital LLC*, Ch. 11 Case No. 12–12020, slip op. 2013 WL 3286198 (Bankr. S.D.N.Y. June 26, 2013)

addition, if the Settlement Agreement is approved by both this Court and the Bankruptcy Court and ResCap's Proposed Chapter 11 Plan goes effective, then AFI (ResCap's parent) will pay the ResCap bankruptcy estate $2.1 billion and the Trusts will receive approximately an ***additional*** amount in excess of $90 million from these proceeds in accordance with the trust allocation protocol as a result of the Settlement. Therefore, the Trusts stand to receive at least a total of $364.6 million in consideration as a result of the Settlement. Dubel Aff. at ¶¶ 17, 20-22.

### B. The Settlement Agreement Is Entirely Consistent with the Plan

Although it is unclear how the argument fits into the standard at issue in the Motion to approve the Settlement, the Objectors make unsupported statements that the Settlement somehow alters the terms of the Plan, and that the Rehabilitator played some sort of timing game to deprive them of their rights under the Plan. Fund Obj. at ¶ 18, FM Obj. at ¶¶ 12, 41.

In the first instance, because the Plan is not yet in effect, the authority to settle policy claims is expressly permitted by the Order of Rehabilitation, entered more than a year ago, which grants the Rehabilitator broad powers throughout the duration of the rehabilitation proceeding, including the power to operate and conduct FGIC's business (which is in wind down), and take steps toward the removal of the causes and conditions that made this proceeding necessary. *See, e.g.*, Order of Rehabilitation, ¶¶ 2-13. *See also Tirobio v. Mendez*, No. 0121619/2002, slip op. 2007 WL 2815388 (N.Y. Sup. Ct. July 27, 2007) ("Indeed, when the Superintendent of Insurance is appointed as a rehabilitator of an insolvent insurance company, he or she steps in to 'conduct its business.'") (quoting *Matter of All City Ins. Co.*, 66 A.D.2d 531, 534, 413 N.Y.S.2d 929 (1st Dep't 1979)). As the Court and the Objectors are aware, the Rehabilitator previously has exercised this authority to authorize FGIC's entry into nine policy settlements over the course of

this proceeding, all of which this Court approved. The Settlement is merely another example of the Rehabilitator's remediation efforts on behalf of FGIC's policyholders.

In any event, even if the Plan were in effect, the terms of the Plan itself expressly contemplate and allow FGIC to enter into settlements of potential claims. Section 4.8 of the Plan provides that FGIC has the ability to extinguish or reduce FGIC's liability in respect of all or part of any policy through a consensual termination, settlement, or commutation, subject only to the conditions that (i) FGIC determine, in its reasonable business judgment, that the resolution is fair and equitable to the interests of policyholders generally and not reasonably likely to result in a reduction of the CPP, and (ii) if the resolution involves more than $25 million in total economic cost to FGIC, then FGIC must (once the Plan is effective) provide thirty days' notice to its regulator, the New York State Department of Financial Services. Section 4.8 (even if applicable here, which it is not) would not require FGIC to obtain the consent of investors holding securities of policyholders whose policies are being settled; the "consensual arrangement" contemplated by the provision refers only to the consent of the policyholder(s). Neither the Objectors nor any policyholder ever opposed the Plan on these grounds, and any attempt now to object to this Plan provision would be untimely and barred.

### C. The Objectors Are Neither Policyholders Nor Creditors of FGIC

It is the Rehabilitator's duty to look out for the FGIC estate, comprised of its creditors, policyholders, and stockholders. *See supra* at 7 (citing *Corcoran*, 149 A.D.2d at 171, 545 N.Y.S.2d at 281). The Objectors are not FGIC's creditors, policyholders, or stockholders – a fact never denied by the Objectors. [14] Notwithstanding this, the Objectors complain that they

[14] Freddie Mac, however, disingenuously replaces the term "policyholders" with "FGIC ResCap Security Holders" when summarizing statements made in the Disclosure Statement, the Plan, and the Miller Affidavit concerning treatment of ***policyholders*** in an apparent attempt to change the plain meaning of the Rehabilitator's statements that spoke only of "policyholders." *Id.* at ¶¶ 22, 24-26.

should have been consulted about the Settlement and were not aware of the Settlement negotiations. The Objectors are no more than creditors of certain of FGIC's creditors, and as such, their consent is not required to consummate a settlement of policy claims. *See In re Refco Inc.*, 505 F.3d 109, 117 (2d Cir. 2007) ("By investing in Sphinx, Investors placed control of their funds entirely within the hands of the Sphinx directors . . . . ***only Sphinx was permitted to negotiate a settlement with the Committee.***") (emphasis added).[15]

The Rehabilitator negotiated the Settlement Agreement with its policyholders – the Trustees – who represented (and continue to represent) the Trusts. The substance of the negotiations among the Settlement parties was not disclosed to the Objectors for a very simple reason: the negotiations were covered by a court-ordered mediation privilege preventing such disclosure.[16] As the Bankruptcy Court observed: "[m]any or most settlements [of this kind] are negotiated without disclosure to third parties." Bankr. Ct. 7/17 Tr. at 70: 19-20. In fact, the Fund Objectors have conceded before the Bankruptcy Court that no requirement exists for the disclosure of the confidential settlement negotiations.[17]

---

[15] Indeed, a requirement forcing the Rehabilitator to negotiate with extended parties who are not FGIC's policyholders and with whom FGIC does not have privity would serve only to complicate and delay the rehabilitation proceeding. *Cf. Refco*, 505 F.3d at 118 (cautioning that allowing multiple parties with whom the debtor was not in privity to force themselves into the reorganization proceeding would "potentially over-burden the reorganization process by allowing numerous parties to interject themselves into the case on every issue, thereby thwarting the goal of a speedy and efficient reorganization"); *In re Innkeepers USA Trust*, 448 B.R. 131, 144 (Bankr. S.D.N.Y. 2011) (warning that granting standing to certificate holders would "embolden other certificateholders to hire their own counsel . . . to advance their individual and conflicting pecuniary interests," which would "inevitably serve to delay and complicate bankruptcy cases as debtors are forced to litigate issues with additional parties").

[16] *Order Appointing Mediator*, Ch. 11 Case No. 12-12020 (MG) (Bankr. S.D.N.Y. Dec. 26, 2013) [Docket no. 2519], a copy of which is attached as Exhibit C to the Slack Affirmation.

[17] As stated by the Bankruptcy Court and conceded by the Fund Objectors:

> THE COURT: Where do you find an obligation that the trustee tell you before it signs a settlement agreement that requirements [sic] court approval that they're negotiating? You've cited no authority for that. You're complaining about it. That's fine, okay. But there's no legal authority that says the trustee can't go ahead and negotiate a settlement where it – I mean, any putback claims belong to the trustees' they don't belong to investors.... other than complaining about it, you've pointed to no authority that says they had to tell you before they did it. Do you have any authority for that?

Moreover, while the substance of the discussions during the mediation was confidential, the fact that the mediation was taking place was public, and well known to the Objectors. There were literally dozens of pleadings filed in the Bankruptcy Court and served on the Objectors' counsel that mentioned the mediation, along with extensive discussion at hearings, as well as substantial press coverage. This was a five-month mediation involving over 20 different groups of creditors, and approximately 140 participants; it was far from a secret or clandestine process. In fact, the Federal Housing Finance Agency, the conservator for Freddie Mac, participated in some of the large group mediation sessions. Dubel Aff. at ¶ 15.

Finally, some investors chose to have their counsel sign confidentiality agreements that allowed them to receive information regarding the Settlement negotiations, but these Objectors chose not to sign any such agreement. As investors often do, the Objectors might have made an economic decision to maintain their ability to trade in the securities of the Trusts rather than have their trading restricted by participating in the confidential negotiations.

## II. The Trustee Findings in the Proposed Order Do Not Alter the Standard to Be Applied by the Court in Approving the Settlement

The Court is being asked only to find that "[t]he Trustees have acted reasonably and in good faith in entering into the Settlement Agreement, and the Trustees have not acted negligently in performing their duties in respect of the Settlement Agreement." Court Order ¶ b. That finding is amply supported by the uncontested facts.[18]

---

MS. EATON (Counsel for Fund Objectors): No, not – no, I don't, Your Honor.

Bankr. Ct. 7/17 Tr. 58:12-19, 24-25, 59:1-2.

[18] The findings in the proposed Order are unremarkable and virtually identical to the findings the Court previously entered in its June 11, 2013 Order Approving the Plan, which states that "The Court finds that the Trustees have acted reasonably and in good faith in withdrawing their objections [to the Plan] and the Trustees have not acted negligently in performing their duties in respect of the objections." June 11, 2013 Order Approving the Plan at ¶ d.

The Objectors have attempted to twist the plain meaning of the findings. The Objectors assert that the proposed findings relate to the Trustees' conduct towards them as investors. FM Obj. at ¶ 38 ("[T]here is no evidentiary record before this Court to support the Rehabilitator's requested findings that the FGIC Trustee acted "reasonably," in "good faith" and in the "best interests" of the **FGIC ResCap Security Holders**.") (emphasis added). In contrast, however, the proposed Order here evaluates the Trustees' actions in negotiating the Settlement Agreement with FGIC, and whether the Trustees acted reasonably, in good faith and without negligence in the negotiations with FGIC. The finding that the Objectors try to shoehorn into the order before this Court ***is*** being sought, however, from the Bankruptcy Court. The Settlement Agreement expressly requires that the Bankruptcy Court Order contain a finding that "[t]he Trustees acted reasonably, in good faith and ***in the best interests of the Investors in each Trust and each such Trust*** in Agreeing to the Settlement Agreement." Bankruptcy Court Order at ¶ D (emphasis added).[19] The distinction in the proposed orders is purposeful. As opposed to the Bankruptcy Court Order, the proposed Court Order before this Court does not require a finding that the Trustees acted in the best interests of their investors. The Objectors are improperly trying to get two bites at the apple by litigating whether the Settlement is in the best interests of investors in this Court when that issue is already squarely before the Bankruptcy Court.

The Court is being asked to reach the same conclusions here as in regard to the Plan. Namely, in order to make the required "good faith" and "negligence" findings, the Court should consider whether the Trustees, acting with care, exercised their independent judgment, did not act collusively with the Rehabilitator or FGIC in reaching the Settlement, and obtained and considered the advice of legal and financial experts, in agreeing to the Settlement. *See Holland*

[19] A copy of which is attached as Exhibit D to the Settlement Agreement.

*v. United States*, 918 F. Supp. 87, 89 (S.D.N.Y. 1996) ("In New York, negligence is conduct below that of a reasonably prudent person under similar circumstances judged at the time of the conduct at issue."); *In re Salander*, 450 B.R. 37, 47 (Bankr. S.D.N.Y. 2011) (in determining whether a trustee of the debtor, appointed under Chapter 7 of the Bankruptcy Code (11 U.S.C. § 701 *et al.*) properly met his duties in entering into a settlement "the applicable test is whether the Trustee has exercised due care, diligence, and skill as measured by a reasonable person standard, *i.e.*, whether the Trustee has acted as an ordinarily prudent person would have acted under similar circumstances and with a similar purpose."). As further described in the Dubel Affidavit, it is undisputed that the discussions over the Settlement occurred over many months under the supervision of a sitting federal bankruptcy judge as mediator and that the Trustees were aided by experienced counsel and a financial advisor. *See* Dubel Aff. at ¶¶ 7-16. While the Objectors might disagree with the ultimate business judgment of the Trustees (and their advisors) as to the merits of the Settlement, this difference in judgment does not alter the conclusion that the Trustees acted reasonably and with care in connection with the Settlement.

Even if more was required (which it is not) to prove "reasonableness" and "good faith" for purposes of the Court Order, it is notable that the Bankruptcy Court, has acknowledged, as a preliminary matter, that the Trustees acted free of any conflicts of interest or self-dealing. In fact, the Bankruptcy Court made this determination when these same Objectors sought to attack the independence of the Trustees in the Bankruptcy Court in connection with a motion seeking to obtain the Trustees' privileged communications under the fiduciary exception to the attorney client privilege. This exception required the Objectors to show that the Trustees were conflicted in exercising their fiduciary duties on behalf of the Trusts. The Bankruptcy Court rejected this argument, stating that:

> I don't believe that the issue establishes a conflict of interest on part of the trustees or any self-dealing on the part of the trustees. There's no – and I should say, Ms. Eaton [counsel for Fund Obj.] did not identify any alleged self-dealing on the part of the trustees.

Bankr. Ct. 7/17 Tr. at 70:7-11.

In fact, the Bankruptcy Court already determined that the Trustees acted in good faith in entering into the Plan Support Agreement, which is part of the same global resolution as the Settlement Agreement, finding that the Trustees "participated fully and actively in the mediation process," "obtained expert advice," "acted prudently, considered the advice of [experts] and the RMBS legal advisors," and "considered the potential litigation outcomes if no settlement was reached." *In re Residential Capital LLC*, Ch. 11 Case No. 12–12020, slip op. 2013 WL 3286198 (Bankr. S.D.N.Y. June 26, 2013) ("the [Bankruptcy] Court has no difficulty in concluding that the Trustees reached their decisions to sign and support the [Plan Support Agreement] in good faith and in what they believed was the best interests of the investors"). A finding of good faith conduct on the part of the Trustees with respect to the Settlement Agreement that was part of the same negotiations should be no different.

## III. The Trustees' Authority To Enter the Settlement is Not a Proper Issue Before This Court

The Trustees, which (unlike the Objectors) are FGIC policyholders, represented and warranted to the Rehabilitator that that they had the authority to enter into the Settlement Agreement and consummate the transactions contemplated thereby. Settlement Agreement, Section 5.01 (b). Given these representations and warranties (by sophisticated entities represented by experienced counsel) and the undisputed fact that the Trustees are FGIC's policyholders, the Rehabilitator had no reason to challenge or question whether additional consents were needed, and did not act arbitrarily or capriciously in approving the Settlement.

The Objectors allege that the Trustees were supposedly required to obtain the consent of investors and therefore did not have authority to agree to the settlements and releases contained in the Settlement Agreement. *See* FM Obj. at ¶ 21 *et seq.* Whether the Trustees' representation of authority is valid, however, is not an issue this Court must determine in order to approve the Settlement Agreement. Moreover, the Objectors suggest that they have the power to direct the Trustees to act in accordance with their wishes, yet also concede that they have not even attempted to do so.[20] Nevertheless, the Rehabilitator understands that the Trustees intend to submit a response to the Objectors' concerns as to the Trustees' authority to enter into the Settlement Agreement.

Any rights the investors have regarding the Policies are merely derivative of the Trustees' rights under the Policies. *See Refco*, 505 F.3d at 117, 119 ("By investing in Sphinx, Investors placed control of their funds entirely within the hands of the Sphinx directors (or managers acting on behalf of the directors). Only Sphinx, not individual Investors, or even Investors as a group, could assert a claim against the Refco estate, and only Sphinx was permitted to negotiate a settlement with the Committee . . . We note that although [the Investors] are not parties in interest entitled to object to the Settlement and conduct discovery, Investors may still have remedies for fraud perpetrated by their fiduciaries [by filing a separate suit against the Sphinx Directors].") Because the Trustees, as policyholders, have bound the Trusts, the investors whose rights flow through the Trusts are bound. Accordingly, any concerns the investors in the Trusts have as to the terms of the Settlement negotiated between the Trustees and FGIC should

[20] FM Obj. at ¶ 32, n. 16 ("Moreover, major holders such as Freddie Mac have the right to direct the FGIC Trustee not to enter the Settlement Agreement. Freddie Mac has informed the FGIC that it does not want the FGIC Trustee to support the Settlement Agreement and reserves [the right] to send the FGIC Trustee a formal direction letter on this point").

be raised in the Bankruptcy Court, which is addressing whether to issue an Order with a finding that the Trustees acted in the best interests of the Trusts' beneficiaries.

## IV. Freddie Mac's "Reverse Preemption" Argument is Wrong

Freddie Mac argues that under the "reverse-preemption" doctrine, the Bankruptcy Court is not able to decide issues concerning an insurer such as FGIC. It then concludes, *ipse dixit*, that this Court (instead of the Bankruptcy Court) must address whether non-policyholders such as Freddie Mac are being unfairly treated by the Trustees who entered into the Settlement. Whether or not the Bankruptcy Court has the power to make a finding that the Trustees have acted in the best interests of the investors in the Trusts, it does not follow that this Court must address that issue. As noted above, the standard to be applied by this Court in reviewing the Settlement looks to whether the Rehabilitator acted arbitrarily or capriciously in approving the Settlement. The intra-mural issues between the Trustees and investors in the Trusts arising out of the Trust's governing documents (to which FGIC is not a party) are not matters for this Court to address. Moreover, the Objectors have not pointed to any provision in the McCarran Ferguson Act, *codified as* 15 U.S.C. 1011-1015, that would prevent the Bankruptcy Court from deciding the issues before that Court.

Contrary to Freddie Mac's suggestion that the Bankruptcy Court is concerned only with ResCap and its creditors, the proposed language in the Bankruptcy Court Order (unlike here) specifically ***requires*** the Bankruptcy Court to enter a finding that the Trustees acted in the best interests of the investors: "The Trustees acted reasonably, in good faith and ***in the best interests of the Investors in each Trust and each such Trust*** in Agreeing to the Settlement Agreement." Bankruptcy Court Order at ¶ D (emphasis added).[21] In any event, the

[21] In fact, the Settlement is conditioned on the Bankruptcy Court's ability to make the required findings called for in Section 1.03 of the Settlement Agreement; if, for some reason, the Bankruptcy Court alters its expressed intention to

Bankruptcy Court has already specifically acknowledged (and counsel for the Objectors begrudgingly acknowledged) that, because of the specific language in the Bankruptcy Court Order, the issue of whether the Settlement Agreement is in the best interest of the investors is squarely before it.[22] Because the Bankruptcy Court will determine whether to issue an Order with a finding that the Trustees acted in the best interests of the Trusts' beneficiaries, including the Objectors, and has ordered discovery to aid its determination, Freddie Mac's argument is wholly without merit.

## V. The Objectors Lack Standing To Object to the Settlement Agreement in this Proceeding

### 1. The Objectors Are Neither Policyholders nor Creditors of FGIC and Lack Standing

The Objectors are admittedly not parties to the rehabilitation proceeding and, as non-party "FGIC-wrapped ResCap security holder[s]," they lack standing to seek the relief requested.[23] The Objectors are merely creditors of the Trusts – creditors of FGIC creditors – and are not in privity with FGIC.

The one court to address the issue of standing in a monoline insurer rehabilitation proceeding has held that creditors of trusts did not have standing to object to matters in that

---

consider the investors' best interests or determines that it lacks the jurisdiction to make the findings, then the Settlement Agreement will terminate upon its own terms. *See* Settlement Agreement at Section 7.01(b) ("Termination Events") (providing that the Settlement agreement will terminate if the Bankruptcy Court does not sign an order with the language required by Section 1.03).

[22] *See* Bankr. Ct. 7/17 Tr. at 29:5-11:

> MS. EATON: . . . no real mechanism has been put in place to allow investors a full and fair opportunity to object to the [Settlement] agreement.
>
> THE COURT: What are you doing here?
>
> MS. EATON: This is the only mechanism there is, Your Honor, and –
>
> THE COURT: What's wrong with this mechanism?

[23] FGIC and the Superintendent were the only two parties when this proceeding commenced. Once the Court issued the Order of Rehabilitation on June 28, 2012, appointing the Superintendent as Rehabilitator of FGIC, the Rehabilitator stepped into FGIC's shoes and achieved party standing in this proceeding.

proceeding. The Wisconsin Court of Appeals in *In re Rehab. of Segregated Account of Ambac Assurance Corp.* concluded that most of the very same persons seeking to object here, namely Monarch, Stonehill, and Freddie Mac, lacked standing to object to the *Ambac* rehabilitator's decision to enter into a settlement among Ambac, Ambac's parent corporation, and the parent corporation's official creditors' committee. *Ted Nickel v. Aurelius Capital Mgmt. LP*, 2011-AP-2708, at *7 (Wis. Ct. App. Mar. 1, 2013) (dismissing a challenge filed by Monarch, Stonehill, Freddie Mac, and other similarly situated security holders to the settlement because, among other reasons, these security holders were not "direct creditors" of Ambac), *available at* http://ambacpolicyholders.com/court-filings/.

Other courts that have addressed the issue in situations almost identical to those here consistently have found that investors do not have standing to challenge settlements or other actions made by the companies or trusts in which they hold securities. For instance, in *In re Refco Inc.*, 505 F.3d 109 (2d Cir. 2007), the Second Circuit held that investors in a creditor of a bankruptcy debtor did not have standing to object to a settlement between the debtor and the creditor – a matter strikingly similar here. In *Refco*, the creditor's committee of the debtor, Refco, sued a company ("**Sphinx**") claiming that $300 million transferred to Sphinx was a fraudulent conveyance. Sphinx settled and returned $263 million to the Refco estate. Investors in Sphinx objected to the settlement and argued it was the product of "collusion and fraud" between Refco and Sphinx. In response to these objections, the bankruptcy court and the district court both determined that those investors – who are similarly situated to the Objectors here – did not have standing to object to the settlement and the Second Circuit affirmed. The Second Circuit held that only Sphinx had standing to object to the settlement:

> Investors cannot claim that they seek to enforce any rights distinct from those of Sphinx as a creditor and a defendant in an adversary proceeding.

> The record establishes that Sphinx is a single legal entity, and that the individual cells are not legally separate entities from Sphinx. ***By investing in Sphinx, Investors placed control of their funds entirely within the hands of the Sphinx directors (or managers acting on behalf of the directors). Only Sphinx, not individual Investors, or even Investors as a group, could assert a claim against the Refco estate, and only Sphinx was permitted to negotiate a settlement with the Committee. Investors maintain a financial "interest" in Sphinx, but they are not a "party in interest" within the meaning of the Bankruptcy Code. The party in interest in the bankruptcy sense, representing the Investors' financial interest, is Sphinx.***

*Id.* at 117 (emphasis added). In reaching this holding, the Second Circuit warned against the dangers of granting standing to peripheral parties in insolvency and reorganization proceedings:

> [I]t is important that a bankruptcy court is not too facile in granting applications for standing. Overly lenient standards may potentially over-burden the reorganization process by allowing numerous parties to interject themselves into the case on every issue, thereby thwarting the goal of a speedy and efficient reorganization . . . . Granting peripheral parties status as parties in interest thwarts the traditional purpose of bankruptcy laws which is to provide reasonably expeditious rehabilitation of financially distressed debtors with a consequent distribution to creditors who have acted diligently.

*Id.* at 118-119 (quoting in its entirety *In re Ionosphere Clubs, Inc.*, 101 B.R. 844, 850-51 (Bankr. S.D.N.Y. 1989)).

Similarly, in a case the Fund Objectors cite in their objection (*see* Fund Obj. at ¶ 25), *In re Innkeepers USA Trust*, 448 B.R. 131 (Bankr. S.D.N.Y. 2011), the court held that certificate holders of beneficial trusts, which in turn held notes collateralized by a debtor's real property, did not have standing to object to the debtor's motion to establish procedures for receiving bids for its assets. In *Innkeepers*, an objection was filed by a hedge fund that held certificates in "real estate mortgage investment conduits" – a type of trust known as a "REMIC."[24] The

[24] REMICs are one of the types of investment entities to which FGIC issued policies and, in general, are similar to the sorts of RMBS trusts that FGIC insured. REMICs are investment vehicles that hold mortgage loans and residential and commercial mortgaged-backed securities in trust. *Innkeepers*, 448 B.R. at 139. The REMICs then issue certificates to investors in the secondary mortgage market. *Id.*

REMICs in turn held notes collateralized by the debtor's real property. The *Innkeepers* court held that the hedge fund's status as a certificate holder was insufficient to confer standing to object in the bankruptcy proceedings because "the investors' relationship is with the special purpose vehicle [REMIC] holding the assets . . . and the right to payment comes from the cash generated by the assets, not from the debtor as the originator of the assets itself." *Id.* at 144. In so holding, the court warned that giving standing to certificate holders would:

> encourage and embolden other certificateholders to hire their own counsel to challenge [the REMICs' special servicer] and to advance their individual and conflicting pecuniary interests . . . . [This] would inevitably serve to delay and complicate bankruptcy cases as debtors are forced to litigate issues with additional parties who previously were contractually obligated to speak with one voice . . . .

*Id.* at 144-45. *See also In re Lehman Bros. Holdings Inc.*, No. 11 Civ. 3760 (RJS), 2012 WL 1057952 (March 26, 2012, S.D.N.Y.) (investors in a special purpose vehicle ("SPV") did not have standing to challenge the decision by the SPV to enter into a settlement with the Lehman estate.)[25]

Additionally, the Fund Objectors, who identify themselves as entities that, "either directly or as **investment advisors** to certain funds [hold FGIC-wrapped securities]" (Fund Obj. at ¶ 10) (emphasis added), lack standing for the additional reason that investment advisors lack standing to assert claims belonging to their advisees, which are the funds actually holding the securities at issue. *See Huff Asset Mgmt. Co. v. Deloitte & Touch LLP*, 549 F.3d 100 (2d Cir. 2008) (holding that investment advisors lack constitutional standing to bring a suit for violations of the federal securities laws on behalf of the beneficial owners of the securities at issue).

---

[25] In *Lehman*, plaintiffs were investors in structured finance notes known as "minibonds" issued by the SPV, with HSBC Bank USA, National Association ("HSBC") appointed as trustee over the SPV's collateral. The SPV and HSBC sought to enter into a settlement with the debtor, to which the plaintiffs objected. *Id.* at *1-2. Citing *Refco*, the court held that because the plaintiffs "are merely investors in [the SPV]" that was itself the creditor, they lacked the standing to object to a settlement between the SPV, its trustee, and the debtor. *Id.* at *6.

This Court should not allow entities that do not have standing to object to the Settlement Agreement, seek discovery or an evidentiary hearing, or make other demands of the Court.

### 2. The Holtzer Affirmation Filed in Support of the Settlement Agreement Does not Concede any Applicable Legal Defenses, Including that the Objectors Lack Standing

Because of letters that the Rehabilitator previously wrote to this Court,[26] the Objectors are well aware of the arguments described above and raise the issue of standing in their objections. Fund Obj. at ¶ 33, FM Obj. at ¶¶ 17-18. But instead of addressing the well-settled case law that holds that they do not have standing, the Objectors misconstrue one sentence from the Holtzer Affirmation to support their standing argument. This sentence, however, was not intended to abrogate the well-settled law cited above. The Holtzer Affirmation provides:

> Giving all Investors notice and an opportunity to be heard at the Hearing pursuant to the Order to Show Cause ensures that the Settlement Agreement (if approved), including the release of FGIC from all present and future obligations and liabilities with respect to the Policies, will bind any Investors that may in the future attempt to assert claims against FGIC for payment under the Policies and dilute recoveries to FGIC's policyholders as a whole.

Holtzer Affirmation, ¶ 29 (emphasis added).

In the unique situation where the settling policyholders are Trustees acting on behalf of Trusts for the benefit of others, the Rehabilitator prudently advised the Trusts' beneficiaries of the proposed Settlement. The Objectors therefore have the opportunity to attempt to direct their Trustees to object on their behalf (which they have not done) or take it upon themselves to appear, subject to all defenses including standing.

Moreover, the statement in the Holtzer Affirmation cited above does not concede that the investors have standing to challenge the Settlement. That statement and the notices provided

[26] Freddie Mac sent letters to this Court dated July 3, 2013, and July 11, 2013. The Rehabilitator sent letters responding to Freddie Mac's letters to this Court on July 9, 2013, and July 15, 2013.

warning to the investors, including the Objectors, that the Trusts through which their interests flow, are taking actions that will affect those interests. The investors whose interests flow through the Trusts will be bound as against FGIC by any settlement the Trustees entered with FGIC. *See supra* at 19-20.

## VI. FREDDIE MAC HAS NOT DEMONSTRATED THAT IT IS ENTITLED TO DISCOVERY AND AN EVIDENTIARY HEARING

Freddie Mac alone requests that the Court permit it to obtain discovery against the Rehabilitator and his advisors, postpone the hearing concerning the Settlement Agreement, and conduct a full evidentiary hearing; yet Freddie Mac has not made the necessary showing with respect to even one of these requests.

As this Court previously recognized, "[a]s a special proceeding there is no automatic right to discovery" here. 12/18/12 Tr. at 21:25-22;[27] *see also* CPLR 408 ("Leave of court shall be required for disclosure."). This Court further recognized that "discovery is disfavored" in special proceedings. 1/15/13 Tr. at 45:2;[28] *see also* 1/15/13 Tr. at 46:23-26 ("to the extent that they are willing to give you documents, you're ahead of the game"). This is because discovery "tends to prolong an action and is therefore inconsistent with the expeditious nature of a special proceeding." *Rice v. Belfiore*, No. 10274/06, 15 Misc.3d 1105(A), *8 (West. Sup. Ct. March 19, 2007) (Lippman, J.) (denying petitioner's requests for discovery because there was no showing of how discovery was "material and necessary to the issues present in this proceeding") (quoting *Plaza Operating Partners Ltd. v. IRM (U.S.A.) Inc.*, 143 Misc.2d 22, 23–24 (1989)); *see also Matter of City of Glen Cove Indus. Dev. Agency*, 2009 N.Y. Misc. LEXIS 6045 at *12, 2009 NY

[27] A copy of the 12/18/12 Tr. is attached as Exhibit D to the Slack Affirmation.

[28] A copy of the 1/15/13 Tr. is attached as Exhibit E to the Slack Affirmation.

Slip Op 31568(U) (N.Y. Sup. Ct. July 6, 2009) ("disclosure is discouraged in a special proceeding since it is "inconsistent with [its] expeditious nature.")) (citing *Belfiore*).

The conclusion the Court reached in denying discovery in connection with the Rehabilitator's motion to approve the Plan should guide the Court here. *See* 1/15/13 Tr. at 44:24-26, 45:2-18. As was the case with its motion to approve the Plan, where this Court denied discovery based upon the Rehabilitator's submission of a disclosure statement and affidavits (*see* 1/15/13 Tr. at 45:7-11 ("the Court notes that having dealt with other special proceedings, there's been an enormous amount of information given to opposing counsel in this special proceeding by way of affidavits [and] the disclosure statement"), ample information is likewise available with respect to the Motion in the form of the Disclosure Statement, the Miller Affidavit,[29] and the Holtzer Affirmation. In fact, both objections repeatedly refer to such information. *See* Fund Obj. at ¶¶ 3, 16, 19-20; FM Obj. at ¶¶ 10, 22, 25-26.

Freddie Mac argues that it needs to undertake discovery in this proceeding to acquire "meaningful information as to the economic justification for the terms of the Settlement Agreement" and "to shed some light on why the [Settlement Agreement] was in Freddie Mac's best interest." FM Obj. at ¶¶ 43-44. As discussed above, whether the Settlement is in the best interests of the Trusts (and derivatively the Objectors) is not before this Court. Freddie Mac is trying to force these issues into this proceeding – effectively forcing a square peg into a round hole – merely as a means to further its own economic interests with the effect of burdening the Rehabilitator with time-consuming, expensive discovery.

Its lack of standing and all other reasons aside, Freddie Mac does not and cannot demonstrate, as required by the CPLR 408, that discovery is "material and necessary" to the

[29] *Affidavit of Michael W. Miller in Further Support of Approval of First Amended Plan of Rehabilitation* (the "**Miller Affidavit**"), signed December 12, 2012.

issues presented in this special proceeding – the question is whether this Settlement is in the best interests of FGIC and its policyholders as a whole, not whether it is a good deal for the Trusts (and derivatively for the Objectors). *See Stapleton Studios, LLC v. City of New York*, 7 A.D.3d 273, 274-275, 776 N.Y.S.2d 46, 47 (1st Dep't 2004) (reversing trial court's grant of discovery in a special proceeding because the party seeking discovery must show that the discovery is "material and necessary" to the prosecution or defense of the proceeding); *Baptiste v. City University of New York*, No. 112666/09, 2010 WL 4155279 (N.Y. Sup. Ct. Oct. 8, 2010) (denying petitioner's cross-motion for discovery because petitioners did not show that the discovery sought was "material and necessary" to the successful prosecution of the special proceeding); *Belfiore*, 15 Misc.3d 1105(A), *8 (denying petitioner's requests for discovery because there was no showing of how discovery was "material and necessary to the issues present in this proceeding"). The party moving to take discovery has the burden of demonstrating the necessity of it. *Belfiore*, 15 Misc.3d 1105(A), *8; *Glen Cove*, 2009 N.Y. Misc. LEXIS 6045 at *12 (discovery demands should be "carefully tailored and . . . . the movant carries the burden of showing, *inter alia*, ample need for the requested materials . . . .") (citations and quotations omitted); *Matter of Tivoli Stock LLC v. New York City Dept. of Hous. Preserv. & Dev.*, 14 Misc. 3d 1207(A) *26, 831 N.Y.S.2d 363 (N.Y. Sup. Ct. 2006) (denying request for discovery in special proceeding because movant did not show "ample need" for it).

In truth, any facts that are necessary to the Court's determination that the Trustees acted in good faith, in an arm's-length manner in their negotiations with FGIC are not in dispute: the Trustees participated in the mediation over many months with the guidance of experienced counsel and a financial advisor under the careful supervision of a federal bankruptcy judge acting as mediator. An attack on the ***judgment*** of the Trustees that the Settlement is fair does not go to

the good faith of the Trustees and, as discussed above, is an issue for the Bankruptcy Court to decide.

In sum, Freddie Mac has neither provided this Court any basis to question the Rehabilitator's determinations nor explained why additional information from the Rehabilitator is necessary. The fact that the Bankruptcy Court – which is tasked with examining different issues (including a specific finding that the Trustees acted in the best interest of the investors) and is governed by different discovery rules than this special proceeding – permitted the parties to engage in discovery is not relevant.[30]

Finally, because Freddie Mac has not set forth a prima facie factual dispute, there is no basis for this Court to hold an evidentiary hearing. Freddie Mac has not put in any disputed evidence or factual allegations requiring an evidentiary hearing on the issues that this Court must decide under the relevant standard. *See* Court Order of Jan 24, 2013 (cancelling the evidentiary hearing scheduled to consider approval of the Plan because no "material issues of fact" requiring an evidentiary hearing regarding the proposed Plan were identified). For example, Freddie Mac alleges that it would receive higher payments from the Trusts if the Settlement Agreement was not approved, but admits that these are estimated payments that will be "adjusted over time" (FM Obj. at ¶ 10), as opposed to the guaranteed payments that would be made under the Settlement Agreement. FM Obj. at ¶ 12. In other words, Freddie Mac "think[s it would] do better under the previously approved FGIC rehabilitation plan than [it] would [under the Settlement Agreement]," which is, as the Bankruptcy Court recognized, "something of a bet." Bankr. Ct. 7/17 Tr. at 10:2-5. Putting aside that the fact that the issue raised by this assertion is not before

[30] To the extent Freddie Mac was dissatisfied with the Rehabilitator's response to Freddie Mac's discovery requests in the Bankruptcy Court, Freddie Mac had the opportunity, but did not raise the issue in that proceeding. *See* FM Obj. at ¶ 43. Discovery in the Bankruptcy Proceeding has now concluded.

this Court, Freddie Mac's argument that the Settlement Agreement discriminates against it (FM Obj. at ¶ 28), or that the Trustees were legally required to obtain Freddie Mac's consent to enter into the Settlement Agreement, is not factual, but legal. *Id.* at ¶¶ 29-36. As the Court previously has recognized, "conclusory assertions that issues of fact exist are insufficient" to warrant an evidentiary hearing. Court Order of Jan 24, 2013 at 2.

## CONCLUSION

For the reasons set forth above, this Court should deny Freddie Mac's request for discovery and an evidentiary hearing, approve the Settlement Agreement and the Plan Support Agreement (as such agreement relates to FGIC), and sign the proposed Court Order approving the Settlement.

Dated: July 30, 2013
New York, New York

Weil, Gotshal & Manges LLP

*Attorneys for the Superintendent of Financial Services of the State of New York, as the Rehabilitator of Financial Guaranty Insurance Company*

By: 

Gary T. Holtzer
Richard W. Slack
Joseph T. Verdesca
767 Fifth Avenue
New York, NY 10153
(212) 310-8000