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SUPREME COURT OF THE STATE OF NEW YORK - NEW YORK COUNTY
PRESENT: Hon. Doris Ling-Cohan, Justice **Part 36**

In the Matter of
The Rehabilitation of
FINANCIAL GUARANTY INSURANCE COMPANY

INDEX NO. 401265/12
MOTION SEQ. NO. 016

The following papers, numbered ___ were considered on this order to show cause:

PAPERS	NUMBERED
Notice of Motion/Order to Show Cause, — Affidavits — Exhibits ____	1, 2, 3
Opposing Affidavits — Exhibits ____	4, 5, 6
Replying Affidavits ____	7, 8
Cross-Motion: [ ] Yes [X] No	____

After oral argument on August 6, 2013, the court grants the Rehabilitator's order to show cause (OSC), dated June 11, 2013, seeking approval of the Settlement Agreement, dated May 23, 2013, and the Plan Support Agreement, dated May 13, 2013.

Procedural History

The instant special proceeding, brought under New York Insurance Law (NYIL) Article 74, is a rehabilitation proceeding. By order dated June 28, 2012, Benjamin M. Lawsky, Superintendent of Financial Services of the State of New York, was appointed rehabilitator (Rehabilitator) of Financial Guaranty Insurance Company (FGIC), without objection. The Rehabilitator proposed the Plan of Rehabilitation, and subsequently the First Amended Plan of Rehabilitation, both of which were objected to by interested parties. Thereafter, the Rehabilitator and the objectors of the proposed plan settled all objections. The First Amended Plan of Rehabilitation (Amended Plan) was approved, without objection, by order dated June 11, 2013.

Currently before the Court is the OSC, brought by the Rehabilitator, *inter alia*, for an order of approval of the Settlement Agreement and the Plan Support Agreement. Both agreements were negotiated and entered into as part of a global settlement in the Residential Capital, LLC (ResCap) bankruptcy case (Bankruptcy case) presided over by Honorable Martin Glenn. The Settlement Agreement, a product of an intense five month mediation, mediated by another Bankruptcy Judge, Honorable James M. Peck, *inter alia*, releases FGIC from actual and potential claims in exchange for a one-time payment (Commutation Payment) by FGIC. In addition, the Rehabilitator seeks a finding that the Trustees have

acted reasonably and in good faith in entering into the Settlement Agreement, and that the Trustees have not acted negligently in performing their duties with respect to the Settlement Agreement.

On July 16, 2013, two interested groups, Federal Home Loan Mortgage Corporation (Freddie Mac), and Monarch Alternative Capital LP, Stonehill Capital Management LLC, Bayview Fund Management LLC, CQS ABS Master Fund Limited, and CQS ABS Alpha Master Fund Limited (the "Monarch Group") (collectively, the "Objecting Investors" or "Objectors"), representing certain investors in Trusts, with investments in such Trusts totaling approximately $1.2 billion, filed objections to the instant OSC; such Trusts are FGIC policyholders. FGIC filed a reply to such objections on July 30, 2013. On the same date, the Bank of New York Mellon, The Bank of New York Trust Company, N.A., U.S. Bank National Association, Wells Fargo Bank, N.A., and Law Debenture Trust Company of New York (the "Trustees") jointly filed a reply in support of the relief sought by the Rehabilitator. In addition, as explained further, FYI Ltd., FFI Fund Ltd., and Olifant Fund, Ltd. (the "Funds") filed a Limited Objection as to computation, which is being separately resolved.

Discussion

The submissions failed to raise a relevant issue of fact which warrants a full evidentiary hearing and, thus, the Court heard oral argument on the legal issues raised. *See* CPLR 409(b); *Karr v Black*, 55 AD3d 82, 86 (1st Dep't 2008), *In Matter of Financial Guaranty Ins. Co.*, 958 NYS2d 585 (Sup. Ct. NY Cty 2013).

It is undisputed that, to approve the Settlement Agreement, this Court must determine whether the Rehabilitator acted arbitrarily and capriciously in entering into the Settlement Agreement. *See Corcoran v Hall & Co., Inc.*, 149 AD2d 165, 171 (1st Dep't 1989); *Callon Petroleum Co. v Superintendent of Ins.*, 53 AD3d 845, 845 (3d Dep't 2008). In so doing, 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. *See Corcoran*, 149 AD2d at 171.

The Funds filed a limited objection to the instant OSC, seeking to obtain the information used to calculate the Trust Payment Amount set forth in the Settlement Agreement. The Funds contend that there is a calculation error which must be corrected. In its reply, the Trustees state that they are working with the Funds to resolve the limited objection. At oral argument, the Rehabilitator represented to the Court that the Funds withdrew its objection.

The Court now turns to the arguments raised by the Objecting Investors, as they are the only remaining objections. The Objecting Investors argue that due to the commutation in the Settlement Agreement, the

Objectors would receive a less favorable recovery than other beneficiaries of FGIC policies with the same priority and, thus, it is not fair and equitable to the Objectors. According to the Objectors, the Settlement Agreement impermissibly amends the Amended Plan, as the Objectors would receive a higher recovery under the Amended Plan than under the Settlement Agreement. The Objectors further argue that the Trustees did not have the authority to enter into the commutation in the Settlement Agreement, and that the Trust Indenture Act governs. Thus, the Objectors contend that limited discovery and a full evidentiary hearing is needed, as FGIC has failed to provide economic justification for the Settlement Agreement and to demonstrate that the Trustees acted in good faith in entering into the Settlement Agreement.

At oral argument, with regard to the request for a finding of good faith as to the Trustees, Objector Freddie Mac argued that the Trustees failed to provide any evidence to support a finding that they acted in good faith, and Objector Monarch Group argued that this Court lacked the jurisdiction to make such a determination, but if such a determination were to be considered, that the Court lacks an evidentiary basis to determine whether the Trustees acted reasonably, in good faith, and not negligently.

In reply, FGIC and the Trustees both argue that the appropriate standard of review for this Court is whether the Settlement Agreement is in the best interests of the FGIC policyholders as a whole, and whether the Rehabilitator acted arbitrarily and capriciously, and abused its discretion in entering into the Settlement Agreement. FGIC and the Trustees concede that the Settlement Agreement limits the amount of FGIC's distribution to the policyholders based on the Commutation Payment of $253.3 million. However, they contend that the Settlement Agreement also extinguishes FGIC's actual and potential liability for claims totaling over one billion dollars, and, thus, the Settlement Agreement is beneficial for FGIC policyholders as a whole. Furthermore, according to FGIC and the Trustees, the Objectors do not have standing to object to the instant OSC, as the Objectors are not FGIC policyholders, rather they are mere investors/creditors of FGIC policyholders. They point out that no FGIC policyholder has objected; nor, were these Objectors able to persuade the Trusts involved to object. FGIC and the Trustees also contend that there has been no showing that the Rehabilitator acted arbitrarily and capriciously. Additionally, FGIC and the Trustees argue that no discovery is necessary, as extensive discovery was exchanged in the Bankruptcy case, and the Objectors have failed to show that discovery in this special proceeding is necessary and material to any alleged factual issue.

At oral argument, FGIC and the Trustees argued that the findings this Court and the Bankruptcy Court are being asked to make are different. They contend that the finding sought from this Court, that the Trustees acted in good faith in entering into the Settlement Agreement, was tailored for this Court, whereas the finding that the Trustees acted in the best interests of the Objectors was specifically reserved

for the Bankruptcy Court. The Trustees argue that their actions in entering into the Settlement Agreement (including their participation in court mandated mediation in the Bankruptcy case, receiving a settlement offer, engaging a financial advisor, taking such advisor's advice, and entering into the Settlement Agreement) are all reasonable, and done in good faith, and demonstrates lack of negligence.

Although the Objectors contend that the Settlement Agreement is not fair and equitable to them and that FGIC obtained the better bargain, the Objectors concede that the standard under which this Court must evaluate the Settlement Agreement is whether the Rehabilitator's actions are arbitrary, capricious, or an abuse of discretion. The fact that the Objectors complain that the Settlement Agreement is more beneficial to FGIC is evidence that the Rehabilitator's actions were beneficial to the FGIC policyholders as a whole, and was not arbitrary, capricious, or an abuse of discretion.

Significantly, the Court notes that the Objectors are not policyholders, and, indeed, no FGIC policyholder has objected to the Settlement Agreement. Nor are the Objectors FGIC's credit holders or stockholders. Notwithstanding this, the Objectors complain that they were not consulted about the settlement and were not aware of the settlement negotiations. However, the Objectors are no more than mere creditors of certain FGIC's creditors and their consent is simply not required to consummate a settlement of policy claims. *See In Re Refco, Inc.*, 505 F3d 109, 117 (2nd Cir 2007). If the Rehabilitator were required to negotiate with extended parties who are not FGIC's policyholders, and with whom FGIC does not have privity, the rehabilitation would be more complicated, and would serve to delay the rehabilitation. *Id.* at 118.

Furthermore, the Objectors' claim that the Trustees have no authority to enter into the Settlement Agreement, and their argument with regards to the Trust Indenture Act, are not proper issues before this Court. The Rehabilitator negotiated the Settlement Agreement with its policyholders, the Trustees, who represent the trusts. For the purposes of this Court's limited scope of review, as to whether the Rehabilitator acted arbitrarily and capriciously in settling, it is sufficient that the Rehabilitator properly relied on the warranties and representations of the Trustees, which are FGIC policyholders (unlike the Objectors), that they have the authority to enter into the Settlement Agreement. *See* Settlement Agreement, §5.01(b). Given such representations and warranties, and the undisputed fact that such Trustees are FGIC's policyholders, the Rehabilitator has no reason to question whether additional consents are necessary, and did not act arbitrarily or capriciously in approving the settlement. Similarly, whether under the Trust Indenture Act, the policies were materially changed, and, thus, necessitated the Objectors' consent (as argued by the Objectors), are issues which should more properly be raised in the Bankruptcy Court, which is addressing, *inter alia*, whether the Trustees acted in the best interests of the trusts' beneficiaries, including such Objecting Investors.

The Objectors concede that the Bankruptcy Court has already approved the Plan Support Agreement, and in doing so, has determined that the "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". *In re Residential Capital, LLC*, 2013 WL 3286198 (Bankr. S.D.N.Y. June 26, 2013). The Bankruptcy Court made this finding after discovery and a full evidentiary hearing. While the Bankruptcy Court's finding that the Trustees acted in good faith relate to the Plan Support Agreement, such agreement was negotiated in conjunction with the Settlement Agreement, in contemplation of a global settlement, during the mediation in the Bankruptcy case. Moreover, the Objectors have failed to provide any proof in its submissions that the Trustees acted unreasonably, negligently, or in bad faith in entering into the Settlement Agreement. Significantly, none of the Objectors' three affirmations raise any issue of fact as to the Trustees' actions, nor do they even allege that the Trustees did not act in good faith. The Court notes that the only affidavit, which addresses any facts, merely alleges that the Settlement Agreement is not in the best interests of Objector Freddie Mac. *See* Healy Affidavit in Support of the Freddie Mac Objection, ¶¶ 6 and 8. However, it is uncontested that the finding of whether the Settlement Agreement is in the best interests of the Objectors is an issue reserved for the Bankruptcy Court. Further, whether the Settlement Agreement is in the best interests of Objector Freddie Mac, is simply not relevant to this Court's narrow inquiry of whether the Rehabilitator acted arbitrarily or capriciously.

In support of the finding set forth in the proposed order, that the Trustees acted in good faith, reasonably, and were not negligent in entering into the Settlement Agreement, the Rehabilitator proffers the affidavit of John S. Dubel (Dubel), the Chief Executive Officer of FGIC. Dubel participated in the lengthy and complicated mediation process, which was negotiated at arm's-length and in good faith amongst the parties involved, including the Trustees. *See* Dubel Affidavit, ¶ 8. Further, according to the Dubel Affidavit, the Trustees were represented by counsel and received advice from Duff & Phelps, a financial advisory firm who served as the Trustees' expert during the mediation. *Id.* at ¶ 9. Notably, at oral argument, counsel for the Trustees opined that, somehow, the Rehabilitator would be held in breach of the settlement, if such finding were not issued. While the Objectors strenuously object in their briefs and at oral argument that such finding should not be issued, such facts were unrefuted in the Objectors' submissions by any competent evidence; no affidavit has been submitted to rebut such finding. Thus, as such has been unrefuted, and given that the Rehabilitator has indicated that in his business judgment that such finding is necessary, and as it is in the interests of all FGIC policyholders as a whole that the Settlement Agreement be approved, for the sole purpose of approval of the Settlement Agreement, in the limited context of this Rehabilitation proceeding, the Court issues this finding, and limits this finding to

this proceeding, given the sparse record before this Court, as there has been no discovery[1].

Here, the Objectors have failed to show that the Rehabilitator acted arbitrarily and capriciously, or abused its discretion, in entering into the Settlement Agreement. *See Callon Petroleum Co. v Superintendent of Ins.*, 53 AD3d 845, 845 (3d Dep't 2008) ("A party contesting the rehabilitator's actions bears the burden of showing arbitrary conduct by the rehabilitator."). The NYIL grants authority to the Rehabilitator to settle claims against the insurer's estate, and in some cases, even without court approval. *See* NYIL §7428. The Rehabilitator has broad authority to settle policy claims to rehabilitate FGIC under both the order appointing the Rehabilitator, dated June 28, 2012, and under the Amended Plan. Although the Commutation Payment limits distribution to certain FGIC policyholders, significantly, the FGIC policyholders affected by the Commutation Payment are the *same* policyholders that voluntarily negotiated and entered into the Settlement Agreement (through the Trustees) and have not filed objections. In fact, as noted, the Trustees have filed a reply in support of the relief sought in the Rehabilitator's OSC.

Accordingly, over the objections asserted, the Court determines that the Rehabilitator did not act arbitrarily or capriciously in entering into the Settlement Agreement. The Court notes that there are no objections to the approval of the Plan Support Agreement, and, thus, the Settlement Agreement and the Plan Support Agreement are approved. In the limited context of this Rehabilitation proceeding, as the Rehabilitator has indicated that in his business judgment that such finding is necessary, and as it is in the interest of all FGIC policyholders as a whole that the Settlement Agreement be approved, the Court grants the Rehabilitator's application for a finding that the Trustees acted in good faith and without negligence in entering into the Settlement Agreement; such finding is for the sole purpose of approval of the Settlement Agreement, and limited to this proceeding.

Dated: 8/16/13

DORIS LING-COHAN, J.S.C.

Check one: [X] **FINAL DISPOSITION** [ ] **NON-FINAL DISPOSITION**

Check if Appropriate: [ ] **DO NOT POST**

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[1] As previously indicated, this is a special proceeding and discovery was not permitted.