IN THE UNITED STATES DISTRICT COURT

FOR THE WESTERN DISTRICT OF WISCONSIN

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IN THE MATTER OF THE REHABILITATION
OF THE SEGREGATED ACCOUNT OF AMBAC
ASSURANCE CORPORATION,

OPINION AND ORDER

13-cv-325-bbc

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In 2010, the Wisconsin Office of the Commissioner of Insurance began rehabilitation proceedings in the Circuit Court for Dane County, Wisconsin, for Ambac Assurance Company, a Wisconsin insurance company that insured financial products. In the course of the proceedings, the Commissioner has taken various actions to reduce Ambac's losses, beginning with the broad injunction issued at the outset that authorized him to exercise contractual rights possessed by Ambac. Recently, he filed a formal motion, asking the State Rehabilitation Court to approve and give force to his right to direct the trustee of certain trusts that issued bonds insured by Ambac, Deutsche Bank, to replace OneWest Bank, the current servicer for the mortgage loans held by the trusts, and served notice of the motion on both Deutsche Bank and OneWest.

OneWest responded to the Commissioner's motion by removing the matter to this court on its own, without joining Deutsche Bank or obtaining its consent. OneWest alleged that jurisdiction was present under 28 U.S.C. § 1441(b) because the parties are of diverse citizenship. The Commissioner then moved to remand the dispute to the state circuit

court, contending that it had not been removed properly. Citing 28 U.S.C. § 1446, which provides that a case cannot be removed from state to federal court unless all the defendants join in or consent to the removal and do so within 30 days, the Commissioner argues that Deutsche Bank is an indispensable party whose absence from the notice of removal renders the attempt to remove ineffective, and that it is too late to add the bank to the notice. In addition, he asserts that the dispute is an integral part of the rehabilitation proceeding that would not be subject to removal even if OneWest had filed a valid notice and that the McCarran-Ferguson Act and Burford v. Sun Oil Co., 319 U.S. 315 (1943), require this court to grant his request for remand. OneWest maintains that it is the only real defendant in this particular controversy, that the controversy is independent of the rehabilitation proceeding and that neither the McCarran-Ferguson Act nor Burford deprives this court of jurisdiction to hear the dispute.

I conclude that OneWest's failure to join Deutsche Bank is fatal to its attempt to remove the servicing dispute to federal court because Deutsche Bank is an indispensable party. Moreover, the dispute is not an independent controversy. In addition, the McCarran-Ferguson Act "reverse preempts" federal jurisdictional statutes such as 28 U.S.C. § 1441 that were not enacted specifically to govern or relate to the business of insurance and Burford v. Sun Oil Co. supports abstention by federal courts when a state court is administering a specialized, ongoing action to rehabilitate an insurance company. Accordingly, I will grant the Commissioner's motion for remand.

BACKGROUND

Ambac Assurance Corporation is a Wisconsin insurance corporation with headquarters in New York. For many years, it was one of the two largest insurers of financial guarantees, providing financial guaranty insurance on financial products such as residential mortgage-backed securities, credit default swaps, commercial asset-backed securities and other substantial financial transactions. In late 2007, however, its financial condition began to deteriorate as many of the transactions it had insured proved to be worth less than they had been held out to be. The company stopped writing new policies and began a functional run-off of its policies in force.

At the same time, the Wisconsin Office of the Commissioner of Insurance began increasing its oversight of Ambac. When it concluded in 2010 that formal regulatory action was necessary, it implemented the provisions of Wis. Stat. ch. 645, which applies to the rehabilitation and liquidation of insurance companies operating in Wisconsin.

For various reasons, the Commissioner decided not to undertake a full rehabilitation of the company. Instead, the Commissioner took advantage of Wis. Stat. §611.24(2), which permits an insurer to establish a segregated account for any part of its business, with the Commissioner's approval. The Commissioner reviewed Ambac's business to evaluate its exposure under its policies, determined that about 1,000 out of Ambac's 15,000 policies had material projected losses, structural problems with the underlying transactions and contractual triggers that could not be avoided except by court action. It assigned all of these to a Segregated Account. The remaining policies went into Ambac's general account, where

they would not be subject to acceleration, early termination or other triggers. The Segregated Account has no claim-paying assets of its own, but is capitalized by a $2 billion secured note issued by Ambac to the account and an aggregate excess of loss reinsurance agreement provided by Ambac.

On March 24, 2010, the Commissioner asked the Circuit Court for Dane County, Wisconsin, to rehabilitate the segregated account. An injunction issued by the State Rehabilitation Court prevents entities with an interest in the Segregated Account from taking actions that might lessen the value of the insurer's assets or prejudice the rights of policyholders, creditors or shareholders or the administration of the proceeding. Wis. Stat. § 645.05(1)(a). The first paragraph of the injunction bars all entities from commencing or prosecuting any . . . formal legal proceedings" pertaining to the segregated account outside the State Rehabilitation Court, which has "exclusive jurisdiction over any such actions, claims, or lawsuits." Lynch Decl., dkt. #6, Order for Temp. Inj. Relief, exh. 1, ¶ 1. The injunction also authorizes the Commissioner to exercise contractual rights possessed by Ambac that relate to Segregated Account policies and enjoins parties from interfering with or refusing the exercise of these rights. Id. at ¶ 6. It devotes an entire section to residential mortgage-backed securities, id., ¶ 9(B), enjoins the parties from failing to take actions directed by the Commissioner, including the transfer of servicing, id. at ¶ 9(B)(2), authorizes the court to enjoin the exercise of automatic termination proceedings, id. at ¶ 4, preserve insurer rights to premiums and other payments in spite of contractual defaults, id. at ¶ 7, and choose the forum for determination of breach of contract claims, id. at ¶ 1.

The Commissioner disseminated court-approved notice to all the known entities with an interest in the Segregated Account by mail, publication of notices in the Wall Street Journal and USA Today and posting all substantive filings and other information on the rehabilitation website, http://ambacpolicyholders.com. OneWest received notice by mail as one of the known entities with an interest in the Segregated Account by virtue of its role as servicer for mortgage loans held by two trusts (the "IndyMac Trusts") that issued bonds insured by Ambac. (OneWest was not the original servicer of the loans, but received the mortgage servicing rights by transfer from the Federal Deposit Insurance Corporation after IndyMac became insolvent.) Also receiving notice was Deutsche Bank, trustee of the IndyMac trusts. Notice of Mot., dkt. #12-4, at ¶ 4. The Pooling and Servicing Agreements between Deutsche Bank and OneWest grant third-party beneficiary status to Ambac and give the Commissioner, acting in place of Ambac, the right to direct Deutsche Bank as Indenture Trustee to terminate OneWest as a servicer and appoint a replacement servicer under certain conditions. Notice of Removal, dkt. #1-10, exh. D, § 7.01.

Both OneWest and Deutsche were mailed notice of the rehabilitation and injunction immediately after the rehabilitation began; the notice advised them that they had 90 days in which to raise any objections. Lynch Decl., dkt. #6, exh. 1, ¶ 12. Deutsche and others appeared and challenged parts of the injunction. Id. at ¶ 5. OneWest did not raise any objections at that time, id., or after the Plan was posted on the website and the State Rehabilitation Court set a schedule for any person to object to the plan and participate in evidentiary hearings on its merits. Id. at ¶¶ 6, 8.

The annual report filed by the Commissioner in June 2013 includes a section on "Improving Mortgage Loan Servicing," in which he discusses the steps he has taken to improve the quality of service performed by third parties for mortgage loans through efforts such as the replacement of mortgage loan servicers in certain instances. Annual Rep., dkt. #9, at 8. According to the report, he has done this "either through voluntary agreements or through the exercise of control rights provided in the transactional documents governing the insured securities." Id.

Sometime before April 5, 2013, the Commissioner determined that OneWest had a high level of "charge-off amounts" that were leading to unnecessarily large losses on the associated residential mortgage-backed securities and resulting in high policy claims against the Segregated Account. In other words, he believed that OneWest was not taking sufficient steps to avoid prolonged delinquencies in loans or uncollectible loans, such as by working with borrowers to restructure their loans or engaging in efforts to maximize the value of the collateral. On April 5, he filed the Servicing Termination Motion at issue, asking the State Rehabilitation Court to approve and give force to his right to direct Deutsche Bank to terminate and replace OneWest as its servicer for the IndyMac trusts. He asked the court to (1) confirm that he has the right to direct Deutsche Bank under the pooling and servicing agreement (in this instance, to terminate and replace OneWest Bank as the servicer of certain trusts); (2) compel Deutsche Bank to effectuate the Commissioner's directives; and (3) enjoin OneWest from interfering with Deutsche's implementation of the change in servicers. Heartney decl., dkt. #12-4, at 4-12.

The Servicing Termination Motion raises the issue of the need to reform the servicing agreement between Deutsche Bank and OneWest. Id. at ¶ 6. As drafted, the contract contains an obvious drafting error allowing termination of the servicer if its net charge-offs are *less* than specific applicable percentages, instead of *more* than those percentages. Id.

To give OneWest an opportunity to object, the Commissioner served the Servicing Termination Motion on OneWest's registered agent and scheduled a hearing, which was rescheduled at OneWest's request for May 24, 2013. On May 9, 2013, OneWest filed its removal action in this court. The State Rehabilitation Court postponed the hearing indefinitely, pending this court's resolution of the propriety of the removal, rather than proceed with only Deutsche Bank participating. Lynch Decl., dkt. #6, ¶¶ 15 & 16.

OPINION

A. Validity of OneWest's Notice of Removal

28 U.S.C. § 1446 makes it plain that a case cannot be removed to federal court under § 1441 unless all defendants join in or consent to removal. This would appear to doom the attempted removal that does not include Deutsche Bank, but OneWest contends that it is the only real defendant in the Servicer Termination Proceeding, because Deutsche Bank's interests are aligned with the Commissioner's. OneWest's only arguments in support of that position are that (1) federal law determines who is plaintiff and who is defendant for the purposes of removal and what is determinative "is the alignment of the

parties' interests," GE Betz v. Zee Co., 2013 WL 1846541 at *13 (7th Cir. May 3, 2013), and (2) at most Deutsche Bank is a nominal party in interest, which means that OneWest can amend its notice of removal to include it or may disregard the bank's interests for removal purposes. Northern Illinois Gas Co. v. Airco Industrial Gases, 676 F.2d 270, 273 (7th Cir 1982) (holding that, in dispute over arbitrability of contract, American Arbitration Association was merely nominal defendant in state court action filed by Airco seeking arbitration so that its absence from notice of removal did not prevent removal to federal court).

Neither argument is persuasive. Deutsche Bank is a defendant so far as the Commissioner's Servicing Termination Motion is concerned not only because it is named as a defendant but because it stands in the position of a defendant as the subject of the Commissioner's motion. GE Betz does not help OneWest because Deutsche Bank's interests are not aligned in all respects with those of the Commissioner. In fact, as the subject of the motion, Deutsche Bank stands between the Commissioner and OneWest. Even if it does not oppose the change in servicers, it does not want to be in a position in which it is facing conflicting orders from two different courts. This is a sufficient interest to give it a stake in the outcome of the removal dispute.

B. Independence of Servicing Dispute

Even if OneWest's notice of removal were not defective because it omitted Deutsche Bank, OneWest runs up against the provisions of 28 U.S.C. § 1441(a), which allows removal

only of "independent suits," not "ancillary or supplemental proceedings." GE Betz, 2013 WL 1846541 at *6 (citing Travelers Property Casualty v. Good, 689 F.3d 714, 724 (7th Cir. 2012) (quoting Federal Savings & Loan Insurance Corp. v. Quinn, 419 F.2d 1014, 1018 (7th Cir.1969)). This longstanding interpretation of § 1441(a) is intended to avoid the waste of having federal courts entertain satellite elements of pending state suits and judgments. Id.

OneWest argues that removal was proper because its dispute with the Commissioner fits the definition of an independent suit: it is a newly filed action brought against a new and different party and it raises substantive issues outside the scope of the rehabilitation proceedings, rather than routine issues pertaining to the management of the business of the insurer. Its characterization does not fit the facts. True, the action is newly filed, but it is filed within the confines of the ongoing rehabilitation proceedings. OneWest is not a newly added party or even what it terms a "remote third party" with no monetary claims against the Segregated Account. It holds rights to service the IndyMac trusts and in that capacity, it has been a party from the beginning, as demonstrated by its receipt of mailed notice at the outset of the rehabilitation proceeding. As a servicer of mortgage loans backing securities insured by Ambac, it is in no position to argue that it had no connection to the rehabilitation proceeding before the Commissioner filed his motion to direct Deutsche Bank to replace its mortgage servicer. Nor can it argue with any plausibility that the issue of transfer is a new issue it could not have anticipated at the outset of the proceedings. The injunction makes it clear that servicing is an integral part of the rehabilitation. It devotes

an entire section to residential mortgage-backed securities and includes a provision enjoining the parties from failing to take actions directed by the Commissioner, including the transfer of servicing. Even if OneWest did not know in 2010 that its specific servicing work might be an issue in the future, it could not have assumed that it would never be. In short, when it received a separate notice three years later, its status did not change from non-party to party.

Because the Commissioner has stated that he wants the State Rehabilitation Court to reform the servicing contracts as part of the action to terminate OneWest's servicing rights, OneWest characterizes the Commissioner's action against it as an attempt by him to seek a "substantive adjudication of a disputed matter that would reform OneWest's contract rights." OneWest's Resp. Br., dkt. #11, at 17. The characterization is accurate but the OneWest is wrong when it says that such a dispute is not one of the "few types of legal proceedings provided by the Wisconsin Insurers and Liquidation Act." Id. at 16. Rather, it is an integral aspect of the Commissioner's management task.

Although the issue is a disputed one that will require a development of the facts, it does not follow that the issue is outside the scope of the rehabilitation court's authority. The issue is whether the Commissioner's motion can obtain reformation of the provision in § 7.01(ix) of the original servicing agreements that the agreement could be terminated if the servicer's net charge-off amounts were less than specific applicable percentages, instead of more than those percentages. (This reformation argument seems to emphasize the necessity of including Deutsche Bank as a party to the litigation, but OneWest does not acknowledge

the apparent inconsistency in its position.). A review of the authorizing documents shows that the rehabilitation court is authorized to resolve disputes involving contract rights that do not differ in any relevant particular from OneWest's. The court may enjoin the exercise of automatic termination proceedings, preserve insurer rights to premiums and other payments in spite of contractual defaults and choose the forum for determination of breach of contract claims. Questions involving the reformation of contracts are staples of contract law, e.g., Asset Managements & Capital, Inc. v. Nugent, 85 A.D. 3d 947, 925 N.Y.S.2d 653 (2011); John John, LLC v. Exit 63 Development LLC, 35 A.D. 538, 826 N.Y.S. 2d 656 (2006), as is OneWest's argument that the statute of limitations bars the Commissioner from reforming the contract.

In sum, the dispute over OneWest's servicing rights is not an independent controversy but a relatively routine aspect of the management of the rehabilitation proceedings. Contrary to OneWest's argument, allowing removal of its dispute would jeopardize the integrity of the ongoing rehabilitation proceedings and the comprehensive statutory structure the state has created to handle the rehabilitation of failing insurance companies. Resolving the servicing motion in the rehabilitation proceedings advances the purpose of those proceedings, which is to manage Ambac's business for the benefit of the policyholders.

C. The McCarran-Ferguson Act and Burford v. Sun Oil Co.

OneWest's failure to join Deutsche Bank in its removal notice and to show that the dispute it seeks to remove is independent of the rehabilitation proceedings are reasons enough to grant the Commissioner's motion to remand. However, the McCarran-Ferguson Act and Burford v. Sun Oil Co. 319 U.S. 315 (1943), provide additional reasons for reaching the same result.

1. The McCarran-Ferguson Act

The McCarran-Ferguson Act, 15 U.S.C. § 1011-15, provides that the states are responsible for the regulation of insurance. "No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose or regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance." 15 U.S.C. § 1012. The "business of insurance" extends to proceedings to liquidate or rehabilitate an insurance company. United States Department of the Treasury v. Fabe, 508 U.S. 491 (1993).

In this case, Wis. Stat. ch. 645 vests jurisdiction in the state rehabilitation court over matters related to the rehabilitation of a state insurance company. Wis. Stat. § 645.04. The state court can enjoin any action that threatens to interfere with the rehabilitation or "lessen the value of the insurer's assets or prejudice the rights of policyholders, creditors or shareholders, or the administration of the proceeding." Wis. Stat. § 645.05. Allowing OneWest to use the federal removal statutes would impair the operation of chapter 645.

Denying removal gives deference to the state rehabilitation proceeding in accordance with Congress's purpose in enacting the McCarran-Ferguson Act, which is to recognize and support the States as the preeminent regulators of insurance. Munich American Reinsurance Co. v Crawford, 741 F.3d 585, 595 (5th Cir. 1998).

2. Burford v. Sun Oil Co.

Burford v. Sun Oil Co., 319 U.S. 315, holds that federal courts should abstain from interfering with specialized, ongoing state regulatory schemes. Such abstention is appropriate in two situations: (1) when the issue is a difficult question of state law bearing on substantial policy problems and (2), as relevant to this case, when the exercise of federal review would be disruptive of state efforts "to establish a coherent policy with respect to matters of substantial public concern." International College of Surgeons v. City of Chicago, 153 F.3d 356, 362 (7th Cir. 1998). The Court of Appeals for the Seventh Circuit has applied this second type of abstention in cases involving state insurance rehabilitation proceedings, Hartford Casualty Insurance Co. v. Borg-Warner Corp., 913 F.3d 419, 425-27 (7th Cir. 1990), as have district courts within the circuit. E.g., Mountain Funding Inc. v. Frontier Insurance Co., 329 F. Supp. 2d 994 (N.D. Ill. 2004); Metropolitan Life Insurance Co. v. Board of Directors of Wisconsin Insurance Security Fund, 572 F. Supp. 460 (W.D. Wis. 1983). In certain circumstances, abstention is not proper, such as when the state does not offer a forum in which the case can be litigated or the forum does not stand "in a special relationship of technical oversight or concentrated review to the valuation of those claims."

Property & Casualty Insurance Ltd. v. Central Insurance Co. of Omaha, 936 F.32d 319, 323 (7th Cir. 1991). Neither of these circumstances is present in this case,

Wisconsin has a significant interest in its uniform insurance rehabilitation process and providing strong protection to policyholders. Property & Casualty Insurance Ltd., 936 F.2d at 323. See also In re All-Star Insurance, 481 F. Supp. 623, 626 (W.D. Wis. 1980) ("The regulation and liquidation of state domestic insurance corporations is a matter of substantial public concern . . .") Allowing removal of OneWest's dispute with the Commissioner would disrupt the state's rehabilitation process. Therefore, abstention would be required even if OneWest had met the prerequisites to removal.

D. Fees and Costs

The Commissioner has asked the court to award it the attorney fees and costs it has incurred in bringing its motion for remand. OneWest does not oppose the motion, beyond arguing that it should not be granted because its attempt to remove the dispute was appropriate. 28 U.S.C. § 1447(c) authorizes courts to award "just costs and any actual expenses, including attorney fees incurred as a result of the removal." In this case, the removing party "lacked an objectively reasonable basis" for removing the case. The clearly established law foreclosed its arguments that it was a new and different party, that the Commissioner's Servicer Termination Motion raised an independent controversy that had to be resolved outside the rehabilitation proceeding, or that its motion was barred by either the McCarran-Ferguson Act or Burford v. Sun Oil.

The Commissioner will be given until July 31, 2013, in which to submit his itemized request for fees and costs. OneWest will have until August 14, 2013, in which to object to the amount of fees and costs requested.

ORDER

IT IS ORDERED that the motion for remand filed by petitioner Theodore K. Nickel, Commissioner of Insurance, dkt. #4, is GRANTED and this case is REMANDED to the Circuit Court for Dane County, Wisconsin. The clerk of court is directed to transmit the file to the Circuit Court for Dane County.

FURTHER, IT IS ORDERED that petitioner Theodore K. Nickel may have until July 31, 2013, in which to submit his itemized request for fees and costs. OneWest may have until August 14, 2013, in which to file its objections to the amount of fees and costs requested.

Entered this 8th day of July, 2013.

BY THE COURT:
/s/
BARBARA B. CRABB
District Judge