DEPARTMENT OF CORPORATIONS

Business Services and Consumer and Investor Protection

Preston DuFauchard
California Corporations Commissioner
Sacramento, California

June 8, 2011

IN REPLY REFER TO:
FILE NO: OP 7153

COMMISSIONER'S OPINION 11/1C

THIS INTERPRETIVE OPINION IS ISSUED BY THE CALIFORNIA CORPORATIONS COMMISSIONER PURSUANT TO CORPORATIONS CODE SECTION 25618 OF THE CORPORATE SECURITIES LAW OF 1968. IT IS APPLICABLE ONLY TO THE TRANSACTION IDENTIFIED IN THIS OPINION REQUEST, AND MAY NOT BE RELIED UPON IN CONNECTION WITH ANY OTHER TRANSACTION.

Mr. Terry D. Nelson
Foley & Lardner LLP
VEREX Plaza
Post Office Box 1497
Madison, WI 53701-1497

Dear Mr. Nelson:

Your request for an interpretive opinion by letter dated November 4, 2010, and supplemented by letters dated December 10, 2010, and January 27, 2011, has been considered by the California Corporations Commissioner. Your letters raise the issue of whether the issuance of certain securities to claimholders in the context of a rehabilitation conducted under the supervision of a Wisconsin state court represent a form of judicially-approved "transaction" or "reorganization," and thus does not constitute a "sale" for purposes of Section 25017 of the Corporate Securities Law of 1968, as amended ("CSL").

We hereby grant your request for an interpretive opinion, and we concur that the proposed transaction does not constitute a "sale" of a security under the limited circumstances, described in your letters, as set forth below.

BACKGROUND

You represent that Ambac Assurance ("Ambac") is a Wisconsin-domiciled insurer authorized under the laws of the State of Wisconsin to transact surety and financial guaranty insurance. Among other business activities, Ambac offered financial guaranty insurance on investment grade municipal finance, project finance and structured-finance

debt obligations, including credit-default swaps on municipal bonds and residential mortgage-backed securities. As stated in your letter, financial guaranty insurance provides an unconditional and irrevocable guarantee that protects the holder of a fixed-income obligation against non-payment of principal and interest.

You also represent that Ambac's financial condition has deteriorated due to losses in its insured portfolio and the resulting downgrades of Ambac's financial strength ratings that have made it impossible for it to write new business. As a result of this deterioration, on March 24, 2010, the Office of the Commissioner of Insurance of the State of Wisconsin (OCI) requested that Ambac establish a segregated account (the "Segregated Account") for financial guarantees that it is not able to satisfy, pursuant to Wis. Stat. Sec. 611.24(2). Also on March 24, 2010, the OCI filed a petition in the Dane County Circuit Court of the State of Wisconsin (the "Court") to rehabilitate the Segregated Account (the "Rehabilitation"). The Rehabilitation is not being conducted pursuant to federal bankruptcy law, since insurance companies are not eligible debtors under the Bankruptcy code. (United States Bankruptcy Code Section 109(b)(2), 11 U.S.C. § 109(b)(2).) The Court granted the petition and appointed the Wisconsin Commissioner of Insurance as the rehabilitator (the "Rehabilitator") of the Segregated Account. As contemplated by Wis. Stat. Sec. 645.33(5), the Rehabilitator filed a plan of rehabilitation for the Segregated Account which the Court approved on January 24, 2011; the section authorizes the Rehabilitator to prepare a "*plan for reorganization, consolidation, conversion, reinsurance, merger or other transformation for the insurer*."

The plan of Rehabilitation was posted on a public Internet website to provide claimants, as well as all interested parties, access to relevant disclosure materials in connection with the Rehabilitation. The Rehabilitation proposes to issue surplus notes (the "Notes" or the "Securities"), under the circumstances described in you letter, to the holders of permitted claims in partial satisfaction of these claims.

On January 24, 2011, the Court found that the Plan of Rehabilitation was procedurally and substantively fair to policyholders. (*Decision and Final Order Confirming the Rehabilitator's Plan of Rehabilitation, With Findings of Fact and Conclusions of Law; In the Matter of the Rehabilitation of: Segregated Account of Ambac Assurance Corporation*, Case No. 10 CV 1576.)

ANALYSIS

Among other terms, Section 25017 of the CSL defines the term "sale," in relevant part, as, "every contract of sale of, contract to sell, or disposition of, a security or interest in a security for value [and] includes any exchange of securities..." However, Section 25017(f)(3) of the CSL excludes from the definition of "sale" of a security: "*any act incident to a transaction or reorganization approved by a state or federal court in which securities are issued in exchange for one or more outstanding securities, claims, or property interests, or partly in that exchange and partly for cash[*.]" (Emphasis added).

In applying this exclusion to the Ambac Rehabilitation, with regard to the "approv[al] by state or federal" element of the exclusion, the Rehabilitation was approved by a Wisconsin state court, and therefore this element is satisfied.

This leaves the "exchange" element requirement that the act involve a "transaction or reorganization...in which securities are issued in exchange for…claims." This raises the question of whether a "rehabilitation" under Wisconsin law constitutes a "reorganization" under the CSL. Importantly, the term "reorganization" is not defined in the CSL. However, as stated in your letter, *Black's Law Dictionary, Ninth Edition,* defines "rehabilitation" to include the process of "reorganizing" a debtor's financial affairs under Chapter 11, 12, or 13 of the Bankruptcy Code. As discussed in your letter, insurance companies are not eligible debtors under federal bankruptcy law. Instead, insurance companies are regulated, reorganized, or liquidated at the state level.[1]

Moreover, as stated earlier, Wis. Stat. Sec. 645.33(5) authorizes the Rehabilitator to prepare a "*plan for reorganization, consolidation, conversion, reinsurance, merger or other transformation for the insurer*." It is apparent that the ultimate purpose of a rehabilitation appears analogous to that of reorganization proceedings under federal bankruptcy law.

Legislative history also supports this expanded interpretation, as Section 25017(f) was amended in 1980 to substitute the term "*transaction or reorganization approved by a state or federal court*" for "*judicially approved arrangement or reorganization*" (emphasis added). (Stats. 1980, c. 579.) Thus, the 1980 amendment expanded the scope of the exclusion to specifically include state courts.[2]

However, we also emphasize that this definitional exclusion should be read narrowly. As stated in Commissioner's Opinion No. 72/175C, in the context of analyzing Section 25102(k) of the CSL, "*[t]he California Corporate Securities Law of 1968 contemplates administrative scrutiny of the sale of securities by the Commissioner of Corporations, and judicial approval, in our opinion, is not intended to be generally available as an alternative to such scrutiny."* (Commissioner's Opinion No. 72/175C*.)*

CONCLUSION

Based on the limited facts set forth above, it appears that the transaction is a form of judicially-approved reorganization, conducted in order to protect Ambac's financial guarantees to claimholders, and thus does not involve a sale for purposes of the CSL.[3]

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[1] The secondary literature sheds light on this differing treatment, *"in this regard, it is important to recognize the reason why these exclusions are made, i.e., that the excluded entities are those types for which there commonly are provided state or other federal statutory methods of liquidation and rehabilitation."* (*Emphasis added*) *2-109 Collier on Bankruptcy, P 109.3*.

[2] Prior interpretive guidance, including Commissioner's Opinion No. 72/174C, interpreted the pre-1980 statutory language to be limited to arrangements contemplated by the provisions of the National Bankruptcy Act.

[3] Your letters also request confirmation that persons representing the Segregated Account would not be required to register as "agents" as that term is used in Section 25003 of the CSL. Since such persons do not appear to be

With regard to your supplemental letter dated January 27, 2011, regarding surplus notes to be issued under a separate settlement agreement, such issuance requires approval by the Court in order to be excluded pursuant to Section 25017(f)(3). This opinion is limited to the facts as specifically represented to the Commissioner in your correspondence. Any change in the facts as represented in your correspondence may compel a different conclusion.

Sincerely,

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Colleen E. Monahan
Deputy Commissioner
Office of Legislation and Policy and
Securities Regulations Division.
Qualifications and Registrations Unit
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IG:kf

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involved in "purchases or sales" of securities" they do not appear to fall within the definition of the term "agent." (*See* CSL Section 25003.)