STATE OF WISCONSIN
OFFICE OF THE COMMISSIONER OF INSURANCE

In the Matter of the Acquisition of Control of
Ambac Assurance Corporation, the "Domestic Insurer"

by

American Acorn Corporation (American Acorn),
American Acorn Holdings LLC,
Oaktree Opportunities Fund XII Holdings (Delaware), L.P., Oaktree Fund GP, LLC,
Oaktree Fund GP I, LP, Oaktree Capital I GP, LLC,
Oaktree Capital Holdings, LLC,
Oaktree Capital Group Holdings, LP,
Oaktree Capital Group Holdings GP, LLC,
Bruce Karsh, Howard Marks, and Sheldon Stone

Petitioner.

OCI Case No. 25-C46550

BRIEF IN SUPPORT OF MOTION BY ESM MANAGEMENT LLC AND ALIGN PRIVATE CAPITAL TO INTERVENE

INTRODUCTION

Between 2010 and 2018, as part of its rehabilitation, Domestic Insurer Ambac Assurance Corporation ("AAC") settled certain of its then-unpaid policyholder insurance claims by issuing notes. Known as "Surplus Notes," they made receiving policyholders into quasi-equity holders of AAC. Although Surplus Notes are for fixed sums (like traditional notes), they can be paid only from AAC's capital surplus (as is true of dividends paid to traditional equity holders). While AAC needs the approval of the Office of the Commissioner of Insurance ("OCI") to pay down the Surplus Notes (to ensure that AAC maintains a sufficient capital cushion), the notes themselves expressly require that AAC take "best efforts" to ensure that happens.[1]

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[1] *See* Ambac Financial Group, Inc., Annual Report 2024, (Form 10-K) (Mar. 6, 2025) at 23 ("Pursuant to the terms of the Settlement Agreement, dated as of June 7, 2010, as amended (the "Settlement Agreement"), by and among AAC, Ambac Credit Products LLC ("ACP"), AFG and certain counterparties to credit default swaps with ACP that were guaranteed by AAC, and the Stipulation and Order among the OCI, AFG and AAC that became effective on February

Since the initial issuance of the Surplus Notes in June 2010, however, AAC has made payments only twice—and not at all since 2018, including at the Notes' June 2020 maturity. As a result, AAC currently has more than $1.0 billion in Surplus Note obligations outstanding, including principal, capitalized interest, and accrued interest.[2] And that amount continues to grow at 5.1% per annum until AAC commences payments.

The Proposed Intervenors hold approximately 27% of the Surplus Notes. Whether they are *ever* paid for losses created by AAC years ago (and counting) turns in significant part on the Proposed Acquirer's plans for AAC. To date, however, those plans remain entirely opaque; no disclosures have been made to holders of Surplus Notes, let alone to the public. It may well be that the Proposed Acquirer will use its contractually required "best efforts" to pay the Surplus Notes. But the current record provides no such assurances, and this alone should give the Commissioner pause in approving the acquisition. At the very least, it illustrates the Proposed Intervenors' "substantial interest" in this proceeding.

To be clear, that interest is more than just parochial. The Commissioner and the public have an interest in facilitating the fair treatment and timely payment of the Surplus Notes. Those notes were issued to partially satisfy the claims of *policyholders*, who received them in lieu of cash payment in AAC's rehabilitation. While there was no guaranty of payment, the Surplus Notes effectively represent a promise of payment *to policyholders* at a future date—provided that AAC's

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22, 2024 (the "Stipulation and Order"), AAC must seek prior approval by OCI of certain corporate actions. The Settlement Agreement and Stipulation and Order also includes covenants that restrict the operations of AAC which (i) in the case of the Settlement Agreement, remain in force until the surplus notes that were issued pursuant to the Settlement Agreement have been redeemed, repurchased or repaid in full . . . .").

[2] *See* Letter from David Trick, AAC Chief Financial Officer, to Nathan Houdeck, Commissioner of Wisconsin Office of the Commissioner of Insurance, (Nov. 27, 2024) (on file with the Petitioners) (stipulating that the then "current principal amount outstanding of the Surplus Notes [was] $1,096,254,494, of which AAC holds $577,019,342" and that the "accrued interest amount through … September 30, 2024, [was] $1,081,442,539 of which $586,948,672 [was] payable to AAC as the holder of $577,019,342 in current principal amount of the Surplus Notes.").

financial condition improved, *which it has*. Former policyholders who still hold Surplus Notes have been, and will continue to be, harmed by AAC's ongoing failure to pay them. And the insurance industry writ large is poorly served by issuers who disregard their obligations to surplus noteholders, potentially threatening future sources of capital.

The Proposed Intervenors are not here to scuttle the sale of AAC. They are here to ensure that the transaction is in the best interest of AAC's former policyholders (currently in their capacity as Surplus Noteholders), inclusive of AAC's obligation to make "best efforts" to pay off the Surplus Notes. As long-term investors in the Surplus Notes, Proposed Intervenors are committed to the success of AAC—but whether the transaction under review will so result depends on transparency and participation. Since no other party adequately represents the Proposed Intervenors' interests (along with the thousands of retail investors who depend on the Surplus Notes), Proposed Intervenors respectfully request that their intervention be granted.

BACKGROUND

Origin of Proposed Intervenors' Interests

In 2010, with OCI's approval, AAC established a segregated account pursuant to Wis. Stat. § 611.24(2) for the purpose of segregating certain segments of its liabilities and consenting to their subsequent rehabilitation under Chapter 645 of the Wisconsin Statutes.[3]

In connection with that plan of rehabilitation and thereafter, AAC settled certain financial guaranty insurance policy claims by issuing Surplus Notes to unpaid policyholders, among others. For example, in 2018, AAC used Surplus Notes to satisfy certain policyholders' claims and as consideration in an exchange transaction reducing AAC's exposure to so-called Auction Market

[3] *See* https://oci.wi.gov/Documents/AboutOCI/RehabLiquid2016.pdf.

Preferred Shares.[4] Through these settlements, policyholders, among others, contributed to the restructuring of AAC, functionally rendering holders of Surplus Notes successors by exchange to the original policies.

The Surplus Notes were issued pursuant to, and are governed by, a Fiscal Agency Agreement between AAC, as Issuer, and the Bank of New York Mellon, as Fiscal Agent, dated as of June 7, 2010 (as amended, the "FAA").[5] AAC currently has more than $1 billion in Surplus Notes outstanding, including unpaid capitalized and accrued interest.[6]

The Surplus Notes are, by contract and by AAC's own admission, "senior to the preferred and common shareholders."[7]

AAC's Obligations to Proposed Intervenors

ESM Management LLC ("ESM") is an investment manager for Surplus Noteholder Rational Special Situations Income Fund, a series of the Mutual Fund & Variable Interest Trust, which is a Delaware trust with its principal place of business in Huntington, New York.

Align Private Capital ("Align") is an investment manager for Surplus Noteholder Current I LP, a limited partnership with its principal place of business in Sarasota, Florida.

Together, ESM and Align are the Proposed Intervenors. The Proposed Intervenors are managers of the beneficial holders of approximately 27% of the Surplus Notes that are outstanding (excluding holdings by AAC itself).

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[4] *See* https://oci.wi.gov/Pages/PressReleases/012218SignedConfirmationOrder.pdf; *see also* https://ambac.com/newsroom/news/news-details/2017/Ambac-Assurance-Reaches-Definitive-Agreement-On-and-Receives-Confirmation-of-OCI-Support-for-a-Transformational-Plan-to-Conclude-the-Segregated-Account-Rehabilitation/default.aspx.

[5] *See* June 7, 2010 FAA, https://www.sec.gov/Archives/edgar/data/874501/000119312510134440/dex103.htm.

[6] *See supra* n.2.

[7] *See* Ambac Assurance Corporation's Annual Statement for the Year Ended December 31, 2022, at 14, *available at* https://s202.q4cdn.com/597253230/files/doc_downloads/Statutory_Filings/Ambac-Assurance-Annual-Statutory-Statement-2022-FINAL-1.pdf.

The Surplus Notes matured in June 2020 (FAA at 1), but OCI has not approved any payments to Proposed Intervenors since February 2018—allegedly due to AAC's financial condition.[8]

The Surplus Notes impose important obligations on AAC. Among other things, AAC is required to "use its best efforts . . . to obtain the approval of the Commissioner for the payment by [AAC] of interest on and principal of the Notes on the scheduled payment dates or scheduled maturity dates thereof." The covenant is an ongoing one. Thus, "in the event any such approval [from OCI] has not been obtained for any such payment [of interest or principal] at or prior to the scheduled payment date or scheduled maturity date thereof, as the case may be," AAC must "continue to use its best efforts . . . to obtain such approval promptly thereafter." FAA at B-12.

Separate and apart from this "best efforts" covenant, the Form of Note also requires AAC to "seek the approval of the Commissioner to make each payment of interest on and principal of the Notes" by a date "[n]ot less than 45 days prior to the scheduled payment date or scheduled maturity date thereof." *Id.* The Form of Note thus requires that AAC make particular requests for approval and *also* requires that AAC use its best efforts to obtain such approval.

AAC's Proposed Sale

AAC is a direct, wholly-owned subsidiary of Ambac Financial Group, Inc ("AFG"). Petitioners in the instant action, American Acorn Corporation, *et al.*, (the "Proposed Acquirers") seek approval to purchase AAC from AFG for $420,000,000 plus any adjustments (the "Proposed Acquisition"). Oaktree Form A, Exhibit A at Art. 1, § 1.2(a).

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[8] *See* Ambac Financial Group, Inc., Annual Report 2017, (Form 10-K) (Feb. 28, 2018) at 55 ("In connection with the consummation of the Rehabilitation Exit Transactions, Ambac Assurance received the approval of the OCI to make a one-time current interest payment of $13.5 million on surplus notes outstanding after the Rehabilitation Exit Transactions (other than junior surplus notes) in 2018.").

On September 6, 2024, AAC filed with the SEC a definitive proxy statement related to the Proposed Acquisition.[9] In it, AAC's financial forecasts reflected planned payments on outstanding Surplus Notes (although there have been none since that forecast). Specifically, the proxy statement states in reference to AAC's financial modeling that "[t]o the extent the model shows risk-adjusted assets in excess of risk-adjusted liabilities, Ambac management assumes the difference, subject to a cushion, will be distributed from AAC to stakeholders" with a key forecast assumption being that "surplus note principal and interest payments [would be] approved by OCI" and that, while there would be no distributions that year, "[s]urplus notes [would be] first to receive distributions from AAC (ahead of the Auction Market Preferred Shares (AMPS) and common equity) in the waterfall, and [would be] repaid in full." September 6, 2024, Proxy at 41-42.

While these were representations made to AFG's shareholders in soliciting support for the sale, the present record filed with OCI on behalf of the Proposed Acquirers is largely confidential and not accessible to members of the public (including Proposed Intervenors). Proposed Intervenors presently have no way of knowing whether the Proposed Acquisition of AAC undermines AAC's ability to comply with its obligations to Proposed Intervenors and other Surplus Note holders or otherwise subordinates the Proposed Intervenors' interests to those of Proposed Acquirers.

LEGAL STANDARDS

Any proposed plan for a merger or acquisition of control of any domestic stock insurance corporation must be approved by the Commissioner of Insurance. Wis. Stat. § 611.72(2).

Wisconsin Stat. § 611.72(3)(am) creates a five-part test for the Commissioner to use when evaluating the acquisition by a proposed acquirer. This includes required findings that (a) "[t]he

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[9] *See* September 6, 2024 Proxy, *available at* https://www.sec.gov/Archives/edgar/data/874501/000119312524214664/d844490ddefm14a.htm.

financial condition of any acquiring party is not likely to jeopardize the financial stability of the domestic stock insurance corporation or its parent insurance holding corporation, or prejudice the interests of its Wisconsin policyholders" and (b) "[t]he plans or proposals which the acquiring party has to liquidate the domestic stock insurance corporation or its parent insurance holding corporation, sell its assets, merge it with any person or make any other material change in its business or corporate structure or management, are fair and reasonable to policyholders of the domestic stock insurance corporation or in the public interest." Wis. Stat. § 611.72(3)(am)(3)-(4).

Pursuant to Wis. Stat. § 227.44(2m), "[a]ny person whose substantial interest may be affected by the decision following the hearing shall, upon the person's request, be admitted as a party." Wis. Stat. § 227.44(2m). Although "substantial interest" is not defined, the same phrase is used elsewhere in the statute (*see* Wis. Stat. § 227.52, relating to petitions for judicial review), and in that context has been interpreted to set forth a two-part test: that the party "sustained the alleged injury due to the agency decision, and that the injury is to an interest which the law recognizes or seeks to regulate or protect." *Waste Management of Wisconsin, Inc. v. Dep't of Nat. Res.*, 144 Wis. 2d 499, 505, 424 N.W.2d 685. The injury may be a threatened one. *See Foley-Ciccantelli v. Bishop's Grove Condo. Ass'n,* 2011 WI 36, ¶49, 333 Wis. 2d 402, 797 N.W.2d 789. "[E]ven an injury to a trifling interest may suffice" for standing. *Friends of Blue Mound State Park v. Wis. Dep't of Nat. Res.,* 2023 WI App 38, ¶25, 408 Wis. 2d 763, 993 N.W.2d 788 (internal citations and quotations omitted).

ARGUMENT

I. Proposed Intervenors Have A Substantial Interest In AAC's Acquisition And Are Therefore Entitled To Intervene

A. AAC's Acquisition Threatens To Harm Proposed Intervenors' Interests

Approval of the Proposed Acquisition threatens to harm Proposed Intervenors' legal and financial interests in two ways.

First, the structure of the proposed transaction ensures that the value being paid by the Potential Acquirers goes exclusively to AFG, and not to AAC. This means that none of the more than $400 million being paid by the buyers to AFG benefits any of AAC's creditors (including the Proposed Intervenors). Thus, AAC appears to be taking action designed to benefit its parent (AFG) at the expense of its creditors (the Surplus Noteholders), notwithstanding that the Surplus Notes have remained unpaid for more than 5 years since their scheduled maturity and prior AFG disclosures disclaim the possibility of AFG realizing value *prior to* those senior obligations being satisfied.[10]

Second, and relatedly, approval of the Proposed Acquisition threatens to impair Proposed Intervenors' legal and financial interests to the extent the acquisition itself and/or the Potential Acquirers' future plans for AAC would not comply with the FAA—including by improperly subordinating Proposed Intervenors' interests to those of AFG or the Proposed Acquirers. Given the confidential designations placed on the vast majority of Proposed Acquirers' OCI submissions, Proposed Intervenors have no way of knowing to what degree their financial interests are compromised as a consequence of the Proposed Acquisition; they only know that while communications to AFG shareholders in advance of the acquisition stated a commitment to

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[10] *See* Ambac Financial Group, Inc., Annual Report 2013 (Form 10-K) (Mar. 3, 2014) at 92 (providing "[t]hese surplus notes and junior surplus notes, as well as preferred stock issued by Ambac Assurance, are obligations of Ambac Assurance that *must be satisfied prior to Ambac realizing residual value from Ambac Assurance.*" (emphasis added)).

satisfying Surplus Note obligations, that has yet to be borne out in the publicly available records submitted to the Commissioner as part of its review.

Both harms are sufficient to establish standing under the first prong of the administrative intervention analysis. "[A]n injury alleged, which is remote in time or which will only occur as an end result of a sequence of events set in motion by the agency action challenged, can be a sufficiently direct result of the agency's decision to serve as a basis for standing" so long as the injury is "neither hypothetical nor conjectural." *Friends of the Black River Forest v. Kohler Co.*, 2022 WI 52, ¶21, 402 Wis. 2d 587, 977 N.W.2d 342. Here, if OCI authorizes an acquisition that compromises AAC's ability to make good on its financial obligations to Proposed Intervenors, the harm is neither hypothetical nor conjectural; it is assured.

Proposed Intervenors' threatened harm is unique. As long-term holders of the Surplus Notes—and staunch believers of the financial wherewithal of AAC to satisfy its obligations under the Surplus Notes based on a financial picture that continues to improve—they have held the notes through the course of multiple other transactions, and therefore have a unique and important perspective on this latest transaction. In addition, in contrast to other entities that have sought to intervene in this matter, the Proposed Intervenors' investment primarily resides within a publicly traded mutual fund, with many ordinary, non-hedge-fund investors, whose interests deserve to be heard. To the Proposed Intervenors, the Surplus Notes are an investment, not merely a trade. Without Proposed Intervenors, there is no interested party acting on behalf of AAC's creditors and the record in this matter will lack input from, among others, Proposed Intervenor ESM, which is likely the largest holder of Surplus Notes.

B. Proposed Intervenor's Interests Are Recognized by Law

Proposed Intervenors' interests are of the type "recognized, regulated, or sought to be protected" under Wisconsin law. *Waste Management of Wisconsin, Inc.*, 144 Wis. 2d at 506. That is because the Wisconsin law governing OCI's review of the Proposed Acquisition expressly requires it to consider both the interests of the public and the interests of policyholders, both of which are implicated here.

As stated above, Wis. Stat. § 611.72(3)(am) creates a five-part test for the Commissioner to use when evaluating the acquisition by a proposed acquirer. This includes required findings that (a) "[t]he financial condition of any acquiring party is not likely to jeopardize the financial stability of [AAC], or prejudice the interests of its Wisconsin policyholders" and that (b) "[t]he plans or proposals which the acquiring party has to . . . material[ly] change [AAC] business or corporate structure or management, are fair and reasonable to policyholders of [ACC's] or in the public interest." Wis. Stat. § 611.72(3)(am)(3)-(4).

Under governing law, it is incumbent on OCI to consider, and make findings as to, the public interest and policyholders. Proposed Intervenors meet this standard for several reasons.

First, at the threshold, AAC is contractually obligated to "use its best efforts . . . to obtain the approval of the Commissioner for the payment by [AAC]" to Proposed Intervenors, at a particular cadence. FAA at B-12. Payments, however, have only been authorized twice since the issuance of the Surplus Notes and none since 2018. The Proposed Acquisition is premised on—and, indeed, requires—compliance with these terms (FAA at § 8), yet the Proposed Acquirers' plan for complying with the same remains opaque, at least to Proposed Intervenors. The law recognizes the importance of a party's contractual obligations, and in turn, potential impairment of a contractual right is a sufficient substantial interest for purposes of intervention. *State v. Rippentrop*, 2023 WI App 15,

¶68, 406 Wis. 2d 692, 987 N.W.2d 801 ("Generally speaking, public policy favors the enforcement of contracts").

Second, while Proposed Intervenors are not "policyholders" in the traditional sense, the likes of which are expressly protected under Wis. Stat. § 611.72(3)(am)(3)-(4), they are *successors* to such policyholders, who received Surplus Notes in connection with AAC's rehabilitation.

As an additional point, Proposed Intervenors have no intention of needlessly complicating these proceedings if granted intervention. Proposed Intervenors do not intend to seek authority to conduct wide-ranging discovery or introduce any evidence beyond that introduced via the instant motion or otherwise filed with the OCI, including information currently filed on a confidential basis assuming that designation is lifted. Proposed Intervenors merely intend to ensure the proposed transaction satisfies the public interest standard and financial integrity safeguards required under Wis. Stat. § 611.72, and once in possession of that knowledge, more comprehensively participate on the merits.

CONCLUSION

WHEREFORE, ESM Management LLC and Align Private Capital request an order under Wis. Stat. § 227.44(2m) granting their motion to intervene.

Dated: August 8, 2025

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