The annexed document contains confidentiality designations and redactions made at the request of the MBIA Respondents pursuant to the Confidentiality Stipulation and Orders in effect in this proceeding.

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

ABN AMRO BANK N.V., et al., Petitioners, - against - ERIC DINALLO, in his capacity as Superintendent of the New York State Insurance Department, the NEW YORK STATE INSURANCE DEPARTMENT, MBIA INC., MBIA INSURANCE CORPORATION, and NATIONAL PUBLIC FINANCE GUARANTEE CORPORATION (f/k/a MBIA INSURANCE CORP. OF ILLINOIS), Respondents.	Index No. 601846/09 IAS Part 39 Hon. Barbara R. Kapnick

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STATE RESPONDENTS' SUR-REPLY MEMORANDUM OF LAW IN OPPOSITION TO THE VERIFIED PETITION

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HIGHLY CONFIDENTIAL

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes & Regulations

Other Authorities

This sur-reply memorandum of law, along with the accompanying affirmation of Eric Dinallo, dated November 22, 2011 ("Dinallo Aff."), and the supplemental affidavit of Jack R. Buchmiller, sworn to December 21, 2011 ("Buchmiller Supp. Aff."), are submitted on behalf of respondents the New York State Insurance Department (the "Department")[1] and Mr. Dinallo, in his former official capacity as Superintendent of Insurance (collectively, the "State Respondents"), in response to petitioners' reply papers, and in further opposition to the Verified Petition in this proceeding.

PRELIMINARY STATEMENT

In late 2007, financial guaranty insurers ("FGIs") began to suffer significant losses as a result of their having insured structured finance products – in particular, securities backed by sub-prime and second-lien residential mortgages – issued by investment banks and financial institutions such as petitioners. As a result, most FGIs had to increase their loss reserve levels and/or cease writing new insurance business of any kind, and the market for municipal bond insurance came to a near standstill. This "freezing" of the municipal bond insurance market increased the cost of issuing debt offerings for municipalities and other public entities, and resulted in postponements and cancellations of important public infrastructure projects.

The Department developed and implemented a plan which included facilitating the injection of new capital into FGIs in order to preserve or restore their AAA credit ratings and thereby enable them to continue to write new municipal bond insurance policies, which would, in turn, restore liquidity to the municipal bond insurance market. MBIA Insurance Corp. ("MBIA

[1] On October 3, 2011, the newly-enacted Financial Services Law took effect, pursuant to which the New York State Insurance Department and the New York State Banking Department were consolidated into the New York State Department of Financial Services, an agency headed by the Superintendent of Financial Services. See 2011 N.Y. Laws, ch. 62. For the remainder of this brief, references to the "Superintendent," the "Department," and the "Insurance Law" should be understood as references to the Superintendent of Insurance, the Insurance Department, and the Insurance Law applicable as of the time of the review and approval of the "Transformation."

Corp.") appeared to be the best candidate among the FGIs to help achieve this goal while simultaneously further strengthening its own capital position.

On December 5, 2008, MBIA Corp. submitted a formal application to the Department for its approval and/or non-objection of a group of simultaneous transactions it referred to collectively as the "Transformation." The goal of the Transformation was to fairly divide MBIA Corp.'s assets into two separate, sufficiently capitalized entities, both of which were able to pay their claims as they came due. The first entity, MBIA Corp., would retain over $9 billion in claims-paying resources and focus on the international and structured finance markets, and the second entity, National Public Finance Guarantee Corporation (f/k/a MBIA Insurance Corporation of Illinois) ("National"), would be infused with approximately $5 billion in capital and cover only public finance policies, such as those on municipal bonds. The goal of the Transformation was to preserve the interests of all MBIA Corp. policyholders, while simultaneously easing the municipal credit crisis by establishing a well-capitalized FGI in the public finance market.

In considering MBIA Corp.'s application, the Department utilized a team of both internal and external experts to conduct a comprehensive and independent review and analysis of the proposed Transformation. The Department's primary concern in reviewing the application was that MBIA Corp. would remain solvent following the Transformation. On February 17, 2009, after a review and analysis lasting over two months, the Department issued a letter to MBIA Corp. granting its approval and non-objection of MBIA Corp.'s December 5, 2008 Transformation application (the "Approval Letter"). The Department granted this approval after determining, inter alia, that the Transformation complied with the various provisions of the Insurance Law at issue – including that post-Transformation, MBIA Corp. would remain able to

pay all of its claims as they came due – and would also serve the vitally important public interest of reinvigorating the municipal bond insurance market that had become paralyzed by the uncertainty surrounding the exposure of FGIs to structured finance products.

Petitioners, a group of MBIA Corp.'s structured finance insurance policyholders, have brought this Article 78 proceeding to challenge the Department's approval of the Transformation. The core allegations of the Verified Petition are that the Department, in issuing the approval, purportedly committed the following "errors," each involving a purported violation of the Insurance Law: (a) incorrectly finding that the Transformation was "fair and equitable" to MBIA Corp. and its policyholders under Insurance Law § 1505(a); (b) incorrectly approving MBIA Corp.'s payment of a dividend under Insurance Law § 4105(a) because the dividend supposedly exceeded MBIA Corp.'s earned surplus, or in any event, did not leave it with sufficient surplus; (c) incorrectly approving a stock redemption by MBIA Corp. under Insurance Law § 1411(d) because the redemption supposedly was either an unlawful dividend, or not "reasonable and equitable"; and (d) incorrectly approving a reinsurance agreement between MBIA Corp. and National under Insurance Law § 1505 because the agreement supposedly was not "fair and equitable," did not provide for "reasonable" fees, and adversely affected the interests of policyholders. See Verified Petition ("Pet."), ¶ 7. Petitioners have also asserted in their reply papers that the Department's approval of the transactions "did not have a rational basis" (see Petitioners' Reply and Memorandum of Law in Further Support of Their Verified Petition, dated March 11, 2011 ("Reply Mem."), at 135-60), and was motivated by Superintendent Dinallo's supposed "bias" against the structured finance policyholders. Id. at 160-67.[2]

[2] Conversely, although petitioners allege various constitutional violations in their Verified Petition, including under the Due Process Clause of the New York Constitution, and the Due Process, Contracts, and Takings Clauses of the United States Constitution, see Pet. ¶ 135, they do not address these allegations *in any way* in their reply papers. As set forth in the State Respondents' Memorandum of Law

The Verified Petition should be denied and dismissed in its entirety for at least the following reasons.

First, as a matter of Article 78 procedure, petitioners' citations throughout their reply papers to documents that were neither sent to nor seen by the Department in connection with its review and approval of the Transformation – including numerous documents that petitioners only obtained as the result of discovery in their plenary action against the MBIA entities – must be disregarded. It is well-settled that the evidence admissible in an Article 78 proceeding is limited to the facts and record that were actually before the administrative agency when it made the determination that is being challenged. See Point I, infra.

Second, petitioners' contention that the Department's interpretation and application of the various provisions of the Insurance Law at issue is "entitled to no deference" (Reply Mem. at 10, 110) is simply wrong. New York courts have consistently held that an administrative agency's reasonable interpretation and application of the statutes that it is charged with enforcing is entitled to substantial deference and should not be disturbed. See Point II, infra.

Third, petitioners' arguments that the Department's approval of the Transformation should be annulled because the Transformation violated the Insurance Law (see Reply Mem., at 113-35) are ill-founded. The Superintendent did not err when he determined, inter alia, that the "terms" of both the reinsurance agreement and the Transformation as a whole were "fair and equitable" pursuant to Insurance Law § 1505(a), that the share redemption was "reasonable and equitable"

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in Opposition to the Verified Petition, dated November 24, 2009 ("Answer Mem."), these allegations are meritless, because, inter alia: (i) the Insurance Law did not require the Department to give notice or hold a public hearing in connection with its consideration of the Transformation; (ii) the Due Process Clause does not protect the contended insurance contract rights; (iii) the Contracts Clause applies only to legislation and, in any case, petitioners' insurance policies were not substantially impaired; and (iv) the Takings Clause is not implicated by the State Respondents' alleged actions. See Answer Mem., at 42-44. Petitioners' silence in response to these arguments of the State Respondents should be deemed an abandonment of their own specious arguments.

pursuant to Insurance Law § 1411(d), and that MBIA Corp. would "retain sufficient surplus to support its obligations and writings" under Insurance Law § 4105(a). Furthermore, these reasonable interpretations and applications of the Insurance Law were not in excess of the Department's jurisdiction, and cannot be overcome by the impermissible legal conclusions of former superintendents submitted by petitioners as supposed "expert" witnesses. See Point III, infra.

Fourth, petitioners' arguments that the Department's approval lacked a rational basis (see Reply Mem., at 135-60) also lack merit. The Department conducted a thorough review and analysis that provided a "factual basis" for the approval; the Approval Letter was not required to set forth findings of fact; Mr. Buchmiller's review was sufficient, and resulted in conclusions regarding MBIA Corp.'s post-Transformation solvency upon which Superintendent Dinallo's approval was based; the Department's analysis of the Transformation was not based on misleading information; and petitioners' reliance on the affidavits of financial experts not only fails to acknowledge the imprecision and uncertainty inherent in predictions about the future, but ignores the applicable standard of review. See Point IV, infra.

Fifth, petitioners' contention that the Department's approval of the Transformation was motivated by "impermissible bias" (see Reply Mem., at 160-67) is baseless, particularly in light of the presumption of honesty and integrity given to administrative officials under New York law. Moreover, there is substantial evidence in the record of the Department's impartiality in reviewing and approving the Transformation, and petitioners have not adduced any evidence whatsoever of the Department's supposed bias. See Point V, infra.

Finally, the relief requested by petitioners (see Reply Mem., at 167-71) is improper and/or unwarranted. See Point VI, infra.

Therefore, the Court should dismiss the Verified Petition in its entirety.

STATEMENT OF FACTS

I. Statutory Framework[3]

The insurance industry is closely regulated and supervised by the states. See Stewart v. Citizens Casualty Co., 23 N.Y.2d 407, 412 (1968). In New York, the Legislature has entrusted the interpretation and application of the New York Insurance Law to the Superintendent. See, e.g., Raffellini v. State Farm Mut. Auto. Ins. Co., 9 N.Y.3d 196, 201 (2007) (holding that "the Legislature has vested the Superintendent of Insurance with broad power to interpret, clarify, and implement … legislative policy" in relation to the Insurance Law).

Pursuant to Insurance Law § 201, the Superintendent possesses the rights, powers, and duties in connection with the supervision and regulation of the business of insurance in the State of New York that are either "expressed or reasonably implied" by the Insurance Law or any other applicable New York law. The mission of the Department during the time relevant to this proceeding was to, inter alia: ensure the continued sound and prudent conduct of insurers' financial operations; provide fair, timely and equitable fulfillment of insurer obligations; protect policyholders from financially impaired or insolvent insurers; eliminate fraud, other criminal abuse and unethical conduct in the industry; and foster growth of the insurance industry in the State. See Dinallo Aff., ¶ 13.

The Superintendent regularly monitors the financial condition and business operations of New York-domiciled insurers (including FGIs), and is responsible for supervising and regulating all insurance business conducted in New York State. Most FGIs in the United States are

[3] For further discussion of the provisions of the Insurance Law applicable to the instant proceeding, the State Respondents respectfully refer the Court to the "Statement of the Case" within the State Respondents' answering brief. See Answer Mem., at 8-13.

domiciled in New York, and are thus subject to regulation by the Department under Article 69 of the Insurance Law. See Dinallo Aff., ¶ 14, and Ex. 1. FGIs are subject to all provisions of the Insurance Law that are "not inconsistent with" Article 69. See Ins. Law § 6908.

The Department, under the Superintendent's supervision, conducts an examination at least once every five years into the financial condition of every New York-domiciled insurer (including FGIs), and is authorized to make other examinations as often as the Superintendent deems it expedient "for the protection of the interests of the people of this state." See Ins. Law §§ 309, 310; Dinallo Aff., ¶ 15(b). A primary purpose of these examinations – which are conducted by Department staff and (for FGIs) typically take between 12 to 18 months to complete – is to confirm the solvency of the insurer under the Insurance Law, i.e., to confirm that the insurer does not have "an excess of required reserves and other liabilities over admitted assets," and will thus be able to pay all of its claims as they come due. See Ins. Law § 1309; Dinallo Aff., ¶ 15(b).

Pursuant to Article 15 of the Insurance Law, the Superintendent is responsible for the regulation of "controlled" insurers (such as MBIA Corp.) and their "holding company systems" (see Ins. Law § 1501 et seq.), including by requiring controlled insurers to file reports or other materials disclosing material information concerning their operations, management or financial condition (see Ins. Law § 1504), and by reviewing – and if appropriate, approving or not objecting to – certain transactions made between entities within the holding company system. See Ins. Law §§ 1505(c), (d); Dinallo Aff., ¶ 15(c).[4] In reviewing such transactions, which include reinsurance agreements pursuant to Insurance Law § 1308 between entities within a

[4] Department regulations require all "[r]equests for approval of transactions pursuant to Insurance Law, section 1505(c), and notices of proposed transactions pursuant to section 1505(d)," to "be accompanied by descriptions of the essential features of such transactions which are reasonably adequate to permit proper evaluation thereof by the superintendent." See 11 N.Y.C.R.R. § 80-1.5.

holding company system, the Superintendent is directed to "consider," inter alia, whether "the terms" of the transactions are "fair and equitable," as well as whether the transactions "may adversely affect policyholders." See Ins. Law §§ 1505(a)(1), (e).

Pursuant to Insurance Law § 1411(d), a "plan of stock redemption and retirement" by a "domestic stock insurer" pursuant to which it "purchase[s] its own capital shares" is permitted only if it is "approved by the superintendent as reasonable and equitable." Pursuant to Insurance Law § 4105(a), a domestic stock insurer, with certain exceptions, may declare or distribute a dividend to its shareholders only out of its "earned surplus," and may declare dividends within any given twelve-month period in excess of the lesser of 10% of its surplus to policyholders or 100% of its adjusted net investment income only with approval of the Superintendent upon his finding that the insurer "will retain sufficient surplus to support its obligations and writings."

II. The Financial Crisis and the FGI Industry

FGIs originated in the 1970s as "monoline" insurers engaged solely in the business of insuring debt offerings by states, municipalities and other public entities. See Dinallo Aff., ¶ 16. An incidental effect of municipal bond insurance is to enhance the credit rating of the underlying municipal bonds, thereby increasing the marketability of those bonds and reducing the cost to the public entities that issue them. Id.; see also Affidavit of Michael Moriarty, sworn to November 24, 2009 ("Moriarty Aff.") (previously submitted in opposition to the Verified Petition), ¶ 11. Historically, municipal debt has been perceived as low-risk, because municipalities and other public entities rarely default on their obligations. Nonetheless, the existence of insurance on municipal debt provides additional confidence to municipal bond investors, and thus increases liquidity in the municipal bond market. Dinallo Aff., ¶ 16.

In the 1980s, FGIs (including MBIA Corp.) began to insure asset-backed securities ("ABS"), such as residential mortgage-backed securities ("RMBS") and commercial mortgage-

backed securities ("CMBS"). During the 2000s, as the market for ABS expanded rapidly, FGIs' exposure as insurers of ABS, as well as collateralized debt obligations ("CDOs") backed by pools of ABS ("ABS CDO") and so-called "CDO-squareds" (CDOs backed by pools of CDOs), increased dramatically. Id. ¶ 17; Moriarty Aff., ¶ 12.

In the second quarter of 2007, many FGIs suffered significant losses as a result of unprecedented increases in delinquency and foreclosure rates on sub-prime and second-lien mortgages, which were the assets underlying many of the structured finance products they insured, including RMBS, ABS CDOs, and CDO-squareds. Dinallo Aff., ¶ 18. As a result, most FGIs were compelled to increase their loss reserve levels and/or to cease writing new insurance business of any kind. Id.; Moriarty Aff., ¶ 13. This had the effect of decreasing liquidity in the auction rate securities market that many municipalities and other public entities used to raise funds for public projects, thereby increasing the cost to public entities of servicing their outstanding debt and making it much more difficult for them to issue new debt. See Moriarty Aff., ¶ 14. Some public entities were forced to postpone key public projects the implementation of which was a key component of the federal government's efforts to provide stimulus to a then-faltering economy. Id. ¶ 15.[5]

Beginning in late 2007, the Department met with representatives from the principal FGIs

[5] See generally Moriarty Aff., ¶ 13 (explaining that, during 2008 and 2009, FGIs "suffered significant losses as a result of insuring ABS CDOs and residential mortgage-backed securities" because "[t]he pools of loans backing" these securities "experienced increases in delinquency and foreclosure rates," thus causing "major shortfalls in the cash flows supporting" the securities, and that, "[d]ue to these adverse developments, most FGIs … had to increase their reserve levels and/or cease writing new business"); id. ¶ 14 (explaining that "[t]he challenging environment in the mortgage and credit markets" had caused the "auction rate securities market – a market that many municipalities and government entities use as a vehicle to raise funds for public projects at low interest rates" – to "come to a standstill," and had "made it more difficult for municipalities … to obtain reasonable interest rates on [new] debt and … increased the cost at which [they] service their [existing] debt"); id. ¶ 15 (explaining that this increased "cost of financing ha[d] resulted in government entities postponing key public projects that would serve to benefit the people of the state of New York").

to discuss their financial condition, including their projected losses from structured finance exposure, and directed each of these FGIs to provide the Department with frequent updates as to their financial condition going forward. Dinallo Aff., ¶¶ 19-21. The Department also sought frequent input from other financial institutions, private equity investors, potential reinsurers, rating agencies, and federal regulators. Id. ¶ 22. In its discussions with the rating agencies, the Department learned that the rating agencies had specific guidelines as to the amounts of capital that FGIs needed to have to avoid being downgraded from AAA, a rating which, as a practical matter, any FGI needed to maintain in order to write new business. Id. ¶ 23 and Ex. 2.

On January 22, 2008, the Department announced a three-point plan to address the challenges faced by the FGI industry. This plan entailed: (i) facilitating the injection of new capital into FGIs; (ii) preparing to deal with any financially distressed insurers; and (iii) developing new regulations. Id. ¶ 25 and Ex. 3; see also Moriarty Aff., ¶¶ 17-18. The Department sought to facilitate capital infusions into FGIs in order to preserve their AAA credit ratings, thereby simultaneously protecting policyholders by further ensuring the solvency of the FGIs and protecting the municipal bond insurance market by enabling FGIs to continue to write new business. This would, in turn, protect the economy by allowing municipalities and other public entities to issue debt in order to fund infrastructure projects. Dinallo Aff., ¶¶ 25, 28 and Exs. 1, 2, and 6.

On January 23, 2008, the Department conducted a meeting with approximately a dozen of the nation's largest financial institutions (including some of the petitioners) that held structured finance policies issued by the FGIs. Dinallo Aff., ¶ 26. At this meeting, Superintendent Dinallo solicited the banks' thoughts on potential solutions to the challenges faced by the FGIs. He also proposed several potential solutions of his own, including capital

infusions[6] and the possibility of dividing the different business segments of an FGI (or "splitting its book") into two separate insurers – one providing municipal bond insurance and the other providing structured finance insurance – should the FGI suffer a significant ratings downgrade due to capital pressure. Id.[7] At that time, MBIA Corp. had not suffered a ratings downgrade from either Moody's or Standard & Poor's ("S&P"), the two chief rating agencies. Id. ¶ 34.

In early 2008, the Department retained Perella Weinberg Partners L.P. ("Perella") and the law firm of Fried, Frank, Harris, Shriver & Jacobson LLP ("Fried Frank") to provide advice on FGI industry issues. Id. ¶¶ 24, 27, and Ex. 5. The Department retained Perella because many of its principals – including Joseph Perella, the former Chairman of the Institutional Securities and Investment Banking Group at petitioner Morgan Stanley, where Mr. Dinallo had previously served as a Managing Director, and Peter Weinberg, former CEO of Goldman Sachs International – had been senior executives of financial institutions that were the primary structured finance policyholders of the FGIs, and had extensive experience and expertise in the structured finance products that the FGIs had insured. Id. ¶ 27. The Department retained Fried Frank because one of its partners, Bonnie Steingart, possessed extensive Insurance Law expertise, having previously served as Deputy Superintendent and General Counsel of the Department. Id. ¶ 24.

With the help of its outside consultants, the Department reviewed and analyzed the financial circumstances and potential exposures of each FGI under its jurisdiction, and

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[6] By July 2008, the Department had facilitated the infusion of approximately $10 billion in new capital into the FGI industry, and had successfully encouraged Berkshire Hathaway to start a new municipal bond insurer in New York. See Dinallo Aff., ¶ 29 and Exs. 4, 7.

[7] The Department's public statements were consistent with Superintendent Dinallo's statements at this meeting. See, e.g., Dinallo Aff., ¶ 30 and Ex. 2 (Mr. Dinallo stating, during February 14, 2008 Congressional testimony, that "all of the options" were on the table, including, "if necessary, … allowing the bond insurers to split themselves into two companies.").

formulated solutions that best fit the needs of each FGI and its policyholders and creditors, as well as the general public. Id. ¶ 31; see also Moriarty Aff., ¶¶ 18-20. It soon became apparent that not every FGI was in a similar financial condition, or equally capable of helping to address the market liquidity concerns presented by the financial crisis. Thus, the Department determined that the appropriate course of action would not necessarily be the same for every FGI. Dinallo Aff., ¶ 31, and Ex. 2. For instance, in some cases, the financial condition of the FGI was such that the most effective course of action was to effect a restructuring based on commutations with certain structured finance policyholders. Id. ¶ 32, and Ex. 7. In other cases, a reinsurance agreement was determined to be the best course of action. Id. ¶ 32, and Ex. 10. In still other cases, a combination of commutations and reinsurance agreements was determined to be appropriate. Id. ¶ 32, and Ex. 11.

III. Proposed Solutions Involving MBIA Corp.

With respect to MBIA Corp., the Department's analysis in early 2008 showed that it was in relatively stronger financial condition than the other FGIs, due in part to the fact that it had a longer history than other FGIs of building up capital by writing and collecting premiums from its municipal bond insurance policyholders. Id. ¶ 34. The Department thus believed that MBIA Corp. was a strong candidate for helping to "unfreeze" the municipal bond insurance market while simultaneously strengthening its capital position for the benefit of all of its policyholders. Id. ¶¶ 34-35; see also Moriarty Aff., ¶ 25. Indeed, in January and February 2008, MBIA Inc. and MBIA Corp. significantly strengthened their capital position by raising approximately $2.6 billion through several transactions, including MBIA Corp.'s issuance of surplus notes and a public offering of MBIA Inc. common stock. Dinallo Aff., ¶ 38, and Exs. 16-18.

In February 2008, MBIA Corp. and William Ackman of Pershing Square Capital

Management LP, a prominent short-seller who had long been publicly bearish on MBIA, separately proposed hypothetical restructurings for MBIA Corp. that would have split its book between municipal bond insurance policies and structured finance policies. Id. ¶ 36, and Ex. 13. While Mr. Ackman's proposal entailed leaving the structured finance policies with MBIA Corp. and creating a wholly-owned subsidiary of MBIA Corp. for the municipal bond insurance policies, under MBIA Corp.'s proposal, the newly-created municipal bond insurer would be a direct subsidiary of MBIA Inc., and thus an affiliate of MBIA Corp. rather than its wholly-owned subsidiary. Id. ¶¶ 36-37, and Ex. 14.

The Department did not seriously consider either of these hypothetical proposals at that time, not only because neither was a formal application before it, but because MBIA Corp. was still AAA-rated, and the Department expected that its recent capital infusions would allow it to retain this rating (and therefore to write new business, further improve its capital position, and, at the same time, help to unfreeze the municipal bond insurance market). Id. ¶ 37. The Department also believed that moving MBIA Corp.'s municipal bond insurance policies to a new company, whether an affiliate or a subsidiary, would have jeopardized its AAA rating, preventing MBIA Corp. from writing new business and increasing the likelihood that it would go into "run off." Id. Indeed, Mr. Ackman's proposal was particularly inadvisable, because if the new municipal bond insurer was a wholly-owned subsidiary of MBIA Corp. (as opposed to an affiliate), the rating agencies would never have given it a AAA rating and, as a result, it would not have been able to write new business and raise additional capital for the benefit of all MBIA policyholders. For this reason, in February 2008, a representative from the Department stated that Mr. Ackman's proposal, in particular, "would be bad for the banks." Id. ¶ 37, and Ex. 15.

On or about May 12, 2008, MBIA Inc. announced that it expected to contribute $900

million of its recently-raised capital to MBIA Corp. in order to help preserve its AAA credit rating and allow it to continue to write new business. Id. ¶ 38, and Ex. 17. However, on June 5, 2008, S&P downgraded MBIA Corp. two notches, from AAA to AA, and two weeks later, Moody's downgraded MBIA Corp. five notches, from Aaa to A2. Id. ¶ 39, and Exs. 19, 20. Shortly thereafter, MBIA informed the Department that these ratings downgrades had altered MBIA Inc.'s plans to inject new capital into MBIA Corp., because the planned injection would be insufficient to restore MBIA Corp.'s AAA rating. Id. ¶ 39.

Beginning in the summer of 2008 and continuing through the fall, Superintendent Dinallo had several conversations with Treasury officials regarding the possibility of federal relief being provided to the FGIs (such as MBIA Corp.), including relief pursuant to the Troubled Asset Relief Program ("TARP") after it was enacted in October 2008, following the collapse of Lehman Brothers. These officials included Anthony Ryan, Acting Under Secretary for Domestic Finance, Robert K. Steel, Mr. Ryan's predecessor as Under Secretary for Domestic Finance, and Timothy Geithner, President of the Federal Reserve Bank of New York. Superintendent Dinallo suggested that federal assistance to the FGIs could strengthen the capital position of their municipal bond insurance businesses and serve to "back-stop" their structured finance policies for the benefit of the structured finance policyholders (by restoring the credit ratings associated with those policies). Id. ¶¶ 33, 40-41.

During these conversations, Treasury officials made it clear to Superintendent Dinallo that TARP or other federal assistance to any FGI would not be provided if its book were not split between its municipal and structured finance policies, because Treasury could not otherwise be certain of the businesses to which federal assistance would be provided. Upon a split of an FGI's book, Treasury told Superintendent Dinallo, it would consider providing assistance to either or

both of its books. Id. ¶ 41; see generally id. ¶ 68, and Ex. 24 (February 26, 2009 letter from Governor David Paterson to Treasury, noting that Mr. Dinallo had "already discussed some preliminary ideas with Treasury staff under the prior Administration").

IV. MBIA Corp.'s Transformation Application

During the fall of 2008, the Department and its outside consultants discussed with MBIA executives the potential for restructuring MBIA Corp.'s liabilities in a way that would benefit all of its policyholders, in particular, by establishing an entity within MBIA's holding company system that could write new business and raise capital for the benefit of the entire system. Id. ¶ 42; see also Moriarty Aff., ¶¶ 25, 29, 66, 72, and Exs. L, M. In these discussions, MBIA Corp. proposed a restructuring similar to the one it had discussed with the Department in February 2008. As a result of the June 2008 ratings downgrades (which had mooted Superintendent Dinallo's concern about the effect a book-splitting would have on MBIA Corp.'s AAA rating),[8] and Superintendent Dinallo's conversations with Treasury regarding potential federal assistance to MBIA Corp., the Department was more willing to consider such a proposal at this time. MBIA Corp. thus submitted its Transformation application on December 5, 2008. Dinallo Aff., ¶¶ 43-44; see also Record at R 40-320, 397-508, and 530-623.

MBIA Corp.'s application sought: (a) approval pursuant to Insurance Law § 4105(a), for MBIA Corp. to declare and pay to MBIA Inc. (its sole shareholder) a dividend in the amount of $1.147 billion in cash and securities; (b) approval pursuant to Insurance Law § 1411(d), for MBIA Corp. to redeem from MBIA Inc. 32,064 shares of MBIA Corp. capital stock in exchange for approximately $938 million in cash and securities and all of the issued and outstanding shares of National, pursuant to a stock redemption and retirement plan; and (c) approval pursuant to

[8] Indeed, on November 7, 2008, Moody's downgraded MBIA Corp. two more notches, from A2 to Baa1. Dinallo Aff., ¶ 39, and Ex. 21.

Insurance Law § 1308(e), and non-objection pursuant to Insurance Law § 1505(d), for MBIA Corp. to enter into a reinsurance transaction with National with respect to MBIA Corp.'s municipal bond insurance policies. Dinallo Aff., ¶ 44. The application included, inter alia, financial statements showing expected future performance, loss projections, third party solvency and fairness opinions, and draft agreements for the transactions. See Moriarty Aff., ¶¶ 31-32.

V. The Department's Review and Approval of the Transformation Application

A. Determining the Process for the Review

Upon receiving MBIA Corp.'s application for the Transformation, Superintendent Dinallo asked Department staff, as well as certain outside consultants, to assist in the review and analysis of the application. Moriarty Aff., ¶¶ 41-44. To assist and advise him on the legal issues raised by the application, he enlisted senior lawyers within the Department's Office of General Counsel, including Scott Fischer (Senior Counsel), as well as the Department's outside counsel at Fried Frank. Dinallo Aff., ¶ 47.

Further, because MBIA Corp. had submitted statements of financial condition in support of its application (including statements confirming MBIA Corp.'s post-Transformation solvency under the Insurance Law) that were based, in part, on MBIA Corp.'s own loss modeling, Superintendent Dinallo decided to utilize the best expert resources of the Department to review and analyze MBIA Corp.'s loss modeling and the other financial aspects of the application. Id. ¶ 48; see generally Moriarty Aff., ¶¶ 40-46, 52-54, 57, 63; Affidavit of Jack R. Buchmiller, sworn to November 24, 2009 ("Buchmiller Aff.") (previously submitted in opposition to the Verified Petition), ¶¶ 19-55.

Superintendent Dinallo made this decision even though he knew that he could have simply presumed the accuracy of MBIA Corp.'s statements of financial condition and loss modeling, and relied upon the Department's authority to take punitive action against any

regulated entity that willfully provided false or misleading information to it. Dinallo Aff., ¶ 48; Affirmation of Mark E. Klein in Support of State Respondents' Sur-Reply and in Opposition to Verified Petition, dated November 22, 2011 ("Klein Aff."), Ex. B (transcript of the deposition of Michael Moriarty, dated September 2, 2010 ("Moriarty Dep. Tr.")), at 287:6 – 288:16; see generally Ins. Law § 109. He called on Mr. Buchmiller, Supervising Risk Management Specialist in the Capital Markets Bureau, and the Department's most experienced and knowledgeable employee with respect to structured finance products, to lead the review and analysis of the financial modeling issues pertinent to the Transformation application. See Dinallo Aff., ¶ 51; see also Moriarty Aff., ¶¶ 52-54; Buchmiller Aff., ¶ 22; Buchmiller Supp. Aff., ¶ 8.[9] Mr. Buchmiller – who is currently a Capital Markets Program Manager with the Capital Markets Bureau of the National Association of Insurance Commissioners ("NAIC"), where he focuses on analyzing insurers' investment and derivative portfolios – spent 22 years working at various commercial banks (where he developed expertise in commercial lending, derivatives and capital markets) before joining the Department in 2000 to help launch its Capital Markets Bureau. Prior to his review of the Transformation, Mr. Buchmiller had substantial experience in creating, analyzing, and comparing financial models and projections. See Buchmiller Supp. Aff., ¶¶ 2, 12 and Ex. 2; Klein Aff., Ex. A (Buchmiller Dep. Tr.), at 15:18 – 24:13; Klein Aff., Ex. B (Moriarty Dep. Tr.), at 256:2-22.

Superintendent Dinallo also asked Hampton Finer (Deputy Superintendent and Chief Economist) to oversee Mr. Buchmiller's review, and directed other senior officials of the Department, including Michael Moriarty (Deputy Superintendent for Property and Capital Markets) and Matti Peltonen (Chief of the Capital Markets Bureau), to assist in the supervision

[9] See also Klein Aff., Ex. A (transcript of the deposition of Jack R. Buchmiller, dated September 28, 2010 ("Buchmiller Dep. Tr.")), at 114:17 – 115:2; Klein Aff., Ex. B (Moriarty Dep. Tr.), at 248:8-17.

of this review. Dinallo Aff., ¶ 50; Klein Aff., Ex B (Moriarty Dep. Tr.), at 50:23 – 51:15.

Superintendent Dinallo concluded that the Department should not retain an outside financial advisor to undertake a review and analysis of MBIA Corp.'s loss modeling. Id. ¶ 53. Chief among his reasons for this conclusion was that Mr. Buchmiller had decades of experience with structured finance products, and both he and the Department had substantial familiarity with MBIA Corp.'s business, including through the Department's periodic financial examinations of the company, in which Mr. Buchmiller had participated. Id. ¶¶ 53-54; Buchmiller Aff., ¶¶ 4, 6, 12; Klein Aff., Ex. A (Buchmiller Dep. Tr.), at 124:22 – 125:5, 125:24 – 126:7; Klein Aff., Ex. B (Moriarty Dep. Tr.), at 255:17 – 256:23.[10] In addition, MBIA Corp. had already submitted with its application a solvency opinion from a well-respected outside financial advisor, Bridge Associates LLC ("Bridge"). Bridge had concluded, based on MBIA Corp.'s financial statements as of September 30, 2008, that MBIA Corp. would remain solvent and able to satisfy all policyholder claims post-Transformation, and that MBIA Corp.'s loss reserving methodologies were reasonable and in conformity with best practices among FGIs and financial institutions. Dinallo Aff., ¶ 55; Buchmiller Aff., ¶¶ 16-17 and Ex. 11; Klein Aff., Ex. B (Moriarty Dep. Tr.), at 290:6 – 291:7.[11] Further, Superintendent Dinallo did not believe that it was appropriate to outsource this essential regulatory function of the Department to outside financial advisors, many

[10] Indeed, simultaneous with the Transformation-related financial review, Mr. Buchmiller and several other Department professionals were conducting a statutory financial examination of MBIA Corp.'s financials as of December 31, 2008 (the "Examination"). Buchmiller Supp. Aff. ¶ 23. Moreover, Mr. Buchmiller and his colleagues in the Capital Markets Bureau frequently attended conferences and seminars, engaged in discussions with experts in structured finance modeling techniques, and studied various aspects of the FGI industry to develop and maintain an understanding of how insurers like MBIA Corp. monitored the performance of their structured finance policies and reserved for projected losses. Id. ¶¶ 4, 7.

[11] Moreover, in order to confirm that MBIA Corp.'s models were in conformity with FGI and other financial industry best practices, Mr. Buchmiller spoke generally with various outside financial consultants, including BlackRock Solutions, about how they modeled structured finance transactions. Buchmiller Supp. Aff., ¶ 15; Klein Aff., Ex. A (Buchmiller Dep. Tr.), at 124:5-18, 341:5 – 344:8.

of whom would have had conflicts of interest given their close relationships to the financial institutions that were structured finance policyholders of MBIA Corp. Dinallo Aff., ¶ 56.

Superintendent Dinallo delegated to Mr. Buchmiller (under the supervision of Deputy Superintendents Finer and Moriarty, and Mr. Peltonen) the responsibility of determining the scope of his review, with the understanding that Mr. Buchmiller's principal focus should be – and indeed, that Superintendent Dinallo's "paramount concern" was – confirming that MBIA Corp. would have sufficient claims-paying resources following the Transformation to pay all of its claims as they came due. Id. ¶¶ 51-52; Buchmiller Supp. Aff., ¶¶ 8-9; Klein Aff., Ex. A (Buchmiller Dep. Tr.), at 60:14 – 62:13, 70:12 – 71:3, 307:16-24, 310:21 – 311:22, 315:25 – 316:14, 422:25 – 423:6. Superintendent Dinallo gave Mr. Buchmiller no deadline for the completion of his work, and no pressure as to the desired result, but instead directed him to perform whatever inquiry and analysis necessary to address Superintendent Dinallo's paramount concern regarding MBIA Corp.'s post-Transformation solvency. Dinallo Aff., ¶ 58; Buchmiller Supp. Aff., ¶¶ 8-9; Klein Aff., Ex. A (Buchmiller Dep. Tr.), at 378:22 – 379:2, 381:7-14; Klein Aff., Ex. B (Moriarty Dep. Tr.), at 301:4-12, 302:3-8.[12] Nonetheless, Messrs. Dinallo and Buchmiller were both aware that the "freezing" of the municipal bond insurance market had persisted – and, in light of the deepening recession, was contributing to a national economic emergency – thus militating in favor of a review that was not only thorough, but conducted as expeditiously as possible. Dinallo Aff., ¶ 58; Buchmiller Supp. Aff., ¶¶ 8, 57, and Ex. 30; Klein

[12] Mr. Buchmiller has categorically stated that he was given as much time as he needed to complete what he deemed necessary for his review. Buchmiller Supp. Aff., ¶ 56; Klein Aff., Ex. A (Buchmiller Dep. Tr.), at 62:14 – 63:9, 65:16-23. Indeed, in Mr. Buchmiller's January 30, 2009 e-mail memorandum to Messrs. Finer, Moriarty and others, he emphasized that, although MBIA executives had expressed their desire for the Department to make a decision on the Transformation application by January 31, 2009, the Department's duty of care was "to all policyholders," and his review would not be truncated due to MBIA's "arbitrary" proposed deadline. Id. ¶ 56, and Ex. 30; Klein Aff., Ex. A (Buchmiller Dep. Tr.), at 227:8-16.

Aff., Ex. A (Buchmiller Dep. Tr.), at 241:4-22; Klein Aff., Ex. B (Moriarty Dep. Tr.), at 309:10 – 310:11.

B. Mr. Buchmiller's Review and Analysis

Following his initial review of MBIA Corp.'s application materials and his discussions with Department colleagues and MBIA executives, Mr. Buchmiller determined that it would neither be necessary nor appropriate for him to create his own loss models in order to evaluate MBIA Corp.'s post-Transformation financial condition. Buchmiller Supp. Aff., ¶ 10; Klein Aff., Ex. A (Buchmiller Dep. Tr.), at 52:9-16.[13] Instead, Mr. Buchmiller undertook a "risk focused" review of MBIA Corp.'s loss modeling methodologies in order to validate their analytical soundness. Buchmiller Supp. Aff., ¶¶ 10-11.[14]

Messrs. Dinallo and Buchmiller understood that MBIA Corp.'s loss models were, in essence, trying to predict the future, and that there would be inherent uncertainty both in the loss models themselves and, concomitantly, in Mr. Buchmiller's own analysis of the models. For that matter, they understood this would be true for *anyone's* predictions of MBIA Corp.'s future losses or analysis of those predictions. Dinallo Aff., ¶¶ 61, 74; Buchmiller Supp. Aff., ¶ 13; Klein Aff., Ex. A (Buchmiller Dep. Tr.), at 157:22 – 158:8, 338:7-23, 340:6 – 341:4. Thus, Mr. Buchmiller's task was understood to be not to decide whether MBIA Corp.'s predictions of future

[13] Although Mr. Buchmiller had the ability to reconstruct MBIA Corp.'s models, building models simply is not what the Department does. Instead, when financial statements are submitted to the Department based on loss modeling, the Department confirms and validates the analytical soundness of the methodologies underlying that loss modeling. Buchmiller Supp. Aff., ¶ 13.

[14] Mr. Buchmiller was involved in the Department's development of the risk focused approach to insurance company oversight and regulation (which has also been formally adopted by the NAIC), and has spoken several times on the use of this approach in the current economic crisis. Buchmiller Supp. Aff., ¶ 5, and Exs. 3-6. This approach focuses on an insurer's "enterprise risk management" practices and its ability to "identify, measure, aggregate, and manage risk exposures within predetermined guidelines," and uses evaluation criteria that assess and quantify aggregate risk across the company's "key activities." Buchmiller Supp. Aff., ¶¶ 5, 18, and Exs. 4, 5.

losses were "accurate," since such an assessment could be made only in hindsight, but rather to analyze the modeling methodologies used by MBIA Corp. to arrive at those predictions for their reasonableness and accord with best industry practices. Dinallo Aff., ¶ 61; Buchmiller Supp. Aff., ¶ 13.

By adopting a "risk focused" approach,[15] Mr. Buchmiller was able to concentrate his review on a sample of exposures within the sectors in which MBIA Corp. had already experienced losses and/or could possibly be expected to experience losses, and to extrapolate the results of that review to the remainder of the exposures in those sectors. See Buchmiller Supp. Aff., ¶ 11; Klein Aff., Ex. A (Buchmiller Dep. Tr.), at 50:6-21, 110:7-17. Such an analysis of MBIA Corp.'s loss modeling methodologies allowed Mr. Buchmiller "to form opinions on their veracity (ability to replicate reality), internal and external consistency, whether the assumptions used were reasonable at the time made and as fact-based as possible, and whether the results were robustly stress-tested for worse-than expected future results or development." See Buchmiller Supp. Aff., ¶ 11 and Ex. 7.[16]

Mr. Buchmiller thus determined to conduct his review starting with the most

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[15] A component of this approach was to assess MBIA's "enterprise risk" by conducting extensive interviews with MBIA management. Buchmiller Supp. Aff., ¶ 18; Klein Aff., Ex. A (Buchmiller Dep. Tr.), at 173:2-5. Thus, between December 15, 2008 and January 23, 2009, Mr. Buchmiller interviewed over a dozen MBIA employees, including most of the company's senior executives and its structured finance experts. Buchmiller Supp. Aff. ¶ 19; Dinallo Aff. ¶ 62. This allowed him to assess the company's risk management philosophy and procedures, and to conclude that MBIA's management team had correctly identified the most critical issues facing the company, and had developed a sound strategy to address these issues. Buchmiller Supp. Aff., ¶¶ 19-21 and Exs. 12-14.

[16] Superintendent Dinallo was aware of Mr. Buchmiller's decision to undertake an in-depth review of MBIA Corp.'s loss modeling methodologies in order to confirm their analytical soundness rather than create his own models, as well as Mr. Buchmiller's decision to focus on a sample of transactions in the "key" sectors in which MBIA Corp. had already experienced losses and/or had appreciable risk of experiencing losses. Dinallo Aff., ¶ 59. Superintendent Dinallo trusted and relied on the expertise of Mr. Buchmiller to make these decisions regarding the scope and level of detail of the review, and believed Mr. Buchmiller's decisions in this regard to have been reasonable. Id. ¶ 60.

underperforming structured finance sectors and ending with the least underperforming of these sectors, i.e., beginning with RMBS; then ABS CDOs made up of RMBS; then CDOs made up of commercial mortgage-backed securities ("CMBS CDOs"); and, if necessary, other remaining sectors. Buchmiller Supp. Aff., ¶ 22.[17]

Mr. Buchmiller personally selected sample RMBS and ABS CDO transactions for his review, and MBIA Corp. selected a sample CMBS CDO transaction which Mr. Buchmiller verified to be representative of the CMBS CDO portfolio in terms of expected performance. Id. ¶ 29. Mr. Buchmiller then performed a "bottom up" review of each of these sample transactions by following MBIA Corp.'s process for modeling losses step-by-step, from the raw third-party performance data, through to the company's loss projections on the transactions. Id. He used his review of these sample transactions to review and analyze the soundness of MBIA Corp.'s modeling methodologies for all of its transactions in these sectors, and thereby verify MBIA Corp.'s loss reserves and financial statements. Id. ¶¶ 29, 31-32, and Exs. 20, 21. MBIA provided all necessary assistance to Mr. Buchmiller and the Department during this review, including affording them complete access to the company's internal systems and data pertaining to its loss modeling methodologies. Dinallo Aff., ¶ 62; Buchmiller Supp. Aff., ¶ 27.

With respect to RMBS, Mr. Buchmiller performed a bottom up review of MBIA Corp.'s modeling of an RMBS transaction called "RFC 2007-HSA 2" (see Buchmiller Supp. Aff., ¶¶ 35-37, and Ex. 7),[18] which he selected because [redacted]

[17] Mr. Buchmiller began his risk-focused review with RMBS and ABS CDOs because those were the sectors in which MBIA Corp. was already experiencing losses. See Buchmiller Supp. Aff., ¶ 29. Mr. Buchmiller also chose to focus his review on CMBS CDOs because, although MBIA Corp. had not yet experienced losses in that sector, those exposures related to securities which were of a similar construction as ABS CDOs, and the underlying assets were also of the same general asset class (real estate) as RMBS and ABS CDOs. Id.

[18] Mr. Buchmiller critically analyzed the RFC 2007-HSA 2 transaction by studying the model's

[redacted]. Id. ¶ 36, and Ex. 7.[19] Mr. Buchmiller found MBIA Corp.'s loss projections for RFC 2007-HSA 2 to be reasonable. Id. ¶ 38 and Ex. 7. Mr. Buchmiller then reviewed several other RMBS transactions (primarily from the Countrywide and RFC series) to verify that the loss modeling methodologies MBIA Corp. used for RFC 2007-HSA 2 were applied consistently across its RMBS portfolio, and he determined that these methodologies were reasonable. Id. ¶ 38, and Ex. 7; Klein Aff., Ex. A (Buchmiller Dep. Tr.), at 141:11 – 143:8.

Mr. Buchmiller also performed a "bottom up" review of MBIA Corp.'s modeling of an ABS CDO transaction called [redacted], consisting primarily of RMBS first-lien and second-lien collateral, which he selected because [redacted] Buchmiller Supp. Aff., ¶¶ 34, 46, and Ex. 7. Mr. Buchmiller's analysis of [redacted] incorporated updated performance data from the fourth quarter of 2008. Id. ¶ 48, and Ex. 27. Mr. Buchmiller found that, as with its RMBS models, MBIA Corp. had made conservative assumptions regarding its projected losses from [redacted] Id. ¶¶ 34, 45-46, and Exs. 21, 26. Mr. Buchmiller then reviewed another [redacted] ABS CDO transactions to verify that MBIA Corp.'s loss modeling methodologies with respect to [redacted] were applied consistently throughout its entire ABS CDO portfolio, and

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"roll-rates" (the rates at which loans become delinquent, or more delinquent) for both current and delinquent loans, as well as its cash flow projections and assumptions with regard to macroeconomic variables. Buchmiller Supp. Aff., ¶ 37, and Ex. 7.

[19] Before selecting this RMBS transaction, Mr. Buchmiller reviewed MBIA Corp.'s model for a "second-lien" RMBS transaction securitized through Countrywide Bank ("Countrywide"), called "CWHEQ-2006-E." Buchmiller Supp. Aff., ¶ 33, and Ex. 20. Mr. Buchmiller concluded that MBIA Corp. had made conservative assumptions regarding its projected losses from that transaction, including the assumption of [redacted] and the assumption that MBIA Corp. would not make any recoveries through the "putback" litigation that it had recently commenced against Countrywide (in which MBIA Corp. alleged that Countrywide had included ineligible loans in its securitizations). Id.

concluded that these methodologies were reasonable and in accord with best practices. Id. ¶¶ 46, 49, and Ex. 7.

In addition to his bottom up review of RMBS and ABS CDO, Mr. Buchmiller also conducted a "top down" review of MBIA Corp.'s loss modeling of those sectors, in which he analyzed the performance of the overall sectors (and their impact on MBIA Corp.'s financials) based on various stress tests, including "base," "stress," and "extreme stress" scenarios. Buchmiller Supp. Aff., ¶¶ 39-43, 47, and Exs. 7, 22-25, 27.[20] Mr. Buchmiller had specifically requested the "extreme stress" scenario in order to find out how extreme MBIA Corp.'s assumptions of stress conditions needed to be to cause its post-Transformation surplus to policyholders to fall to zero or below, *regardless of the probability* of that scenario. Id. ¶ 42, and Ex. 25. Thus, MBIA Corp. ran an extreme stress scenario with the assumption that the peak loss activity that MBIA Corp. had been experiencing would continue unabated for a total of 36 months, an assumption that Mr. Buchmiller deemed unrealistic, but nonetheless useful to inform his opinion concerning MBIA Corp.'s ability to withstand potential additional future losses. Id. ¶ 43, and Ex. 7. MBIA Corp.'s presentation of the results of the "extreme stress" scenario reflected that its surplus to policyholders would only fall to approximately $350 million. Id. ¶ 43.[21]

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[20] Mr. Buchmiller's "top down" review of the RMBS and ABS CDO sectors also included an analysis of MBIA Corp.'s capital and long-term cash flow projections, the company's fourth quarter 2008 financial results, and the liquidity of its asset management portfolio. Id. ¶¶ 40-41, and Ex. 24.

[21] In its sur-reply papers, MBIA noted that it had made certain errors in its presentations regarding the "extreme stress" scenario, including that it incorrectly considered 100% of a deferred tax asset as an "admitted asset" rather than only a portion of it, as required by Insurance Law § 1301. Correcting the hypothetical "extreme stress" scenario for these errors would have resulted in MBIA Corp.'s surplus to policyholders falling to approximately negative $291 million for year end 2009, before becoming positive again in 2011. See MBIA Sur-Reply Brief, at 34 n.32; Sur-Reply Affidavit of C. Edward Chaplin, sworn to November 16, 2011 ("Chaplin Sur-Reply Aff."), ¶ 13, and Ex. 7; Buchmiller Supp. Aff., ¶ 84. However, Mr. Buchmiller has stated that this would not have led him to change his conclusion regarding MBIA Corp.'s post-Transformation solvency, because the treatment of the deferred tax asset was a

With respect to MBIA Corp.'s CMBS CDO portfolio, Mr. Buchmiller performed a "bottom up" review of MBIA Corp.'s modeling for a CDO transaction called [redacted] that included [redacted] underlying CMBS, totaling [redacted] of notional principal. Buchmiller Supp. Aff., ¶ 66. Mr. Buchmiller verified how MBIA Corp. translated underlying third-party performance data into MBIA Corp.'s loss and cash flow projections, and analyzed how MBIA Corp. arrived at those projections. Id. ¶ 66, and Exs. 38, 39. Mr. Buchmiller reviewed how MBIA Corp. incorporated stress assumptions into its modeling from general CMBS sector studies by S&P (which relied primarily on macroeconomic factors) and Lehman Brothers (which relied on both macroeconomic factors and other fundamentals, such as refinancing ability, demographics, geography, property type, regional employment rates, and sponsor equity). Id. ¶ 67, and Exs. 40, 41. MBIA Corp. informed Mr. Buchmiller that it was currently experiencing zero losses on the [redacted] transaction and the rest of its CMBS portfolio, because it had insured only the most senior tranches of the CDOs and losses at that time had only affected the more junior tranches. Id. ¶¶ 68-69, and Ex. 42.

Further, in connection with his "top down" review of the CMBS sector (see Buchmiller Supp. Aff., ¶¶ 63-64), Mr. Buchmiller found that "underwriting standards were maintained" for CMBS transactions as compared to RMBS and ABS CDOs, and that "systemic risk" had largely

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technical issue not reflecting the actual value of the asset, and MBIA Corp. had substantial contingency reserves of over $1.3 billion – more than *four times* the amount necessary to cover the hypothetical shortfall in the surplus to policyholders in the "extreme stress" scenario – that the Department would have allowed MBIA Corp. to release in order to account for this temporary accounting technicality. See Buchmiller Supp. Aff. ¶ 84; see generally MBIA Sur-Reply Brief, at 34 n.32; Chaplin Sur-Reply Aff., ¶ 13. Furthermore, as Messrs. Chaplin and Pastore informed Mr. Buchmiller at a January 27, 2009 meeting, 73% of MBIA Corp.'s loss reserves related to Countrywide and RFC transactions which were subject to potential recoveries from "putback" litigation brought by MBIA against Countrywide and RFC, and these potential recoveries had not yet been reflected in MBIA Corp.'s balance sheet. See Buchmiller Supp. Aff., ¶¶ 33, 44, and Ex. 25; Chaplin Sur-Reply Aff., ¶ 14.

been avoided in MBIA Corp.'s CMBS book. Id. ¶ 69, and Ex. 7.[22] Finally, Mr. Buchmiller found that various other factors suggested there would be fewer defaults in the CMBS sector and much lower loss severities on those loans that did default. For example, unlike RMBS collateral, the loans securitized in CMBS were more closely monitored and maintained by sophisticated borrowers and lenders. Id. ¶ 71, and Ex. 7. Indeed, Mr. Buchmiller found that, even among the worst-performing tranches of CMBS CDOs, the most recent February 2009 servicer reports showed no collateral foreclosures and very few delinquencies. Id. ¶ 72, and Ex. 7. Thus, Mr. Buchmiller concluded that there was no basis to project that MBIA Corp. would experience losses of any significance on its CMBS CDO exposures and that MBIA Corp.'s CMBS CDO loss modeling methodologies (and in particular, its "overrides" of certain large loan loss projections based on its loan-level analysis[23]) were reasonable. Id. ¶¶ 70-73, and Ex. 7.

With respect to the remaining sectors, including high-yield CDOs, collateralized loan obligations ("CLOs"), corporate finance, insurance, intellectual property, future cash flows, consumer finance, auto finance, student loans, and rental fleets, Mr. Buchmiller conducted a top down review, the results of which revealed that these sectors were not of significant concern. Id. ¶¶ 31, 65, and Ex. 37; Klein Aff., Ex. A (Buchmiller Dep. Tr.), at 136:10-18, 138:16 – 139:12, 386:4-8. In particular, Mr. Buchmiller found that these sectors, while experiencing isolated

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[22] Mr. Buchmiller understood that, unlike residential mortgages, which the bank counterparties often approved with little or no documentation or verification, the professional underwriting and surveillance of CMBS loans resulted in significantly better performance and lower losses. Id. ¶ 63, and Ex. 37. Mr. Buchmiller also understood that, unlike individual homeowners, the owners (mortgagors) of properties collateralized in CMBS often included developers and investors whose ability to generate income from the properties reduced their likelihood of default, and whose equity in their properties provided strong incentives for them not to default. Id.

[23] Mr. McKiernan has testified that, contrary to petitioners' assertions (see Reply Mem. at 69-70), he told Mr. Buchmiller about the precise financial impact of these overrides (i.e., the amount of losses that would have been projected in the absence of the overrides). See Klein Aff., Ex. C (excerpts from the transcript of the deposition of Anthony McKiernan, dated August 27, 2010 ("McKiernan Dep. Tr.")), at 304:20 – 306:24. Mr. Buchmiller has testified that, in any event, he believed that the overrides were proper. Buchmiller Supp. Aff., ¶ 26; Klein Aff., Ex. A (Buchmiller Dep. Tr.), at 179:13 – 185:10.

losses, generally were performing well, and that MBIA Corp.'s exposure to them was also much smaller than its exposure to RMBS, ABS CDOs and CMBS CDOs. Buchmiller Supp. Aff., ¶ 65. Mr. Buchmiller thus concluded that these sectors would not have a material impact on MBIA Corp.'s post-Transformation ability to pay claims as they came due, and a bottom up review of sample transactions from these sectors was unnecessary. Id. ¶¶ 31, 65.

C. Mr. Buchmiller's Reports to Department Officials Regarding His Review and Analysis

Mr. Buchmiller frequently communicated with senior Department officials regarding the progress and results of his review. Buchmiller Supp. Aff., ¶¶ 8, 52, 74; Klein Aff., Ex. B (Moriarty Dep. Tr.), at 58:12-21, 273:8-16, 278:23 – 279:9. For example, on January 30, 2009, upon finishing his bottom up and top down reviews of the RMBS and ABS CDO sectors (which constituted the majority of MBIA Corp.'s loss reserves as of the fourth quarter of 2008), Mr. Buchmiller sent an e-mail memorandum to Deputy Superintendents Finer and Moriarty (and others), regarding his preliminary conclusions from these reviews. Buchmiller Supp. Aff., ¶ 52, and Ex. 30. Mr. Buchmiller explained in that memorandum how he "followed the 'pig through the python'" with his bottom up review of sample transactions from those sectors, and analyzed the effect of various stress scenarios on MBIA Corp.'s financials. Id. Mr. Buchmiller further stated that, although he planned to review other sectors of MBIA Corp.'s book, including its CMBS CDO portfolio, his preliminary opinion (which he did not believe would change based on his further review) was that MBIA Corp. held adequate assets to pay all of its claims as they came due, even assuming substantial adverse developments, and thus would be solvent under the Insurance Law following Transformation. Id. ¶ 53, and Ex. 30. While noting that there were reasons for the Department to decide on MBIA's Transformation application without "waiting for a full-scale (full scope) examination report" (id. ¶ 54, and Ex. 30), including the need to unfreeze

the municipal debt insurance market in order to allow municipalities to secure debt financing through insured bond offerings, Mr. Buchmiller stated his belief that such a full-scale examination would not lead to a different conclusion. Id. ¶ 54.[24]

On February 11, 2009, Mr. Buchmiller sent another e-mail memorandum to Deputy Superintendents Finer and Moriarty (and others), in which he informed them of the results of his review of the CMBS CDO and other sectors and reaffirmed his preliminary conclusions. Buchmiller Supp. Aff., ¶¶ 74-76, and Ex. 45. In particular, Mr. Buchmiller noted that MBIA Corp.'s CMBS portfolio contained no losses "of significance," and therefore of any material concern to his analysis of MBIA Corp.'s post-Transformation solvency. Id. ¶ 76, and Ex. 45. Mr. Buchmiller further noted that he, like any other analyst, had "a limited ability to predict the future" with certainty, but given the present state of the CMBS portfolio, he agreed with MBIA Corp.'s conclusion that the sector did not require loss reserves at that time, due in part to the superior underwriting standards in the sector as compared to RMBS, and MBIA Corp.'s limitation of its exposure to only senior CMBS CDO tranches. Id.

Moreover, Mr. Buchmiller attended several meetings and otherwise communicated with Superintendent Dinallo, Deputy Superintendent Finer and other senior Department officials before the approval, through which Mr. Buchmiller provided direct updates regarding his review and analysis. Dinallo Aff., ¶¶ 57, 63; Klein Aff., Ex. A (Buchmiller Dep. Tr.), at 57:2 – 58:2; Klein Aff., Ex. B (Moriarty Dep. Tr.), at 58:12-21, 273:8-16, 278:23 – 279:9. At these meetings, Mr. Buchmiller informed Superintendent Dinallo that, after extensive review and analysis, Mr. Buchmiller had found no basis for questioning the analytical soundness of the methodologies

[24] Indeed, the Examination did not lead to a different conclusion, as the Department ultimately found, in its "Report on Examination of the MBIA Insurance Corporation as of December 31, 2008," dated May 17, 2010, that MBIA Corp. was both solvent and in material compliance with the provisions of the Insurance Law. Id. ¶ 55, and Ex. 31.

supporting MBIA Corp.'s loss modeling, and deemed them to be in line with best industry practices. Dinallo Aff. ¶ 63. Indeed, Mr. Dinallo would not have approved the Transformation had Mr. Buchmiller voiced any serious concerns about MBIA Corp.'s loss modeling methodologies. Id. ¶ 57.

As reflected in Mr. Buchmiller's memorandum to file, dated as of February 16, 2009 ("File Memorandum"), Mr. Buchmiller did not have such concerns. See Buchmiller Supp. Aff., ¶¶ 78-82, and Ex. 7; Klein Aff., Ex. A (Buchmiller Dep. Tr.), at 88:13-21.[25] By this date, Mr. Buchmiller had concluded his "risk focused" review of MBIA Corp.'s key activities – i.e., its exposures to RMBS, ABS CDOs and CMBS CDOs. See Buchmiller Supp. Aff., ¶ 78, and Ex. 7. Mr. Buchmiller's work in connection with the Department's review of the Transformation application had lasted over two months, and had included over a dozen visits to MBIA's offices and interviews and meetings with every MBIA executive and employee he deemed relevant to his analysis. Id. ¶ 80, and Ex. 7; Dinallo Aff. ¶ 62. During that period, Mr. Buchmiller had independently reviewed and confirmed the analytical soundness of MBIA Corp.'s loss modeling methodologies (upon which MBIA Corp.'s financial statements, reflecting that MBIA Corp. would remain solvent under the Insurance Law following Transformation, were based) and found them to be reasonable, consistently applied and consistent with best practices in the FGI industry. Buchmiller Supp. Aff., ¶ 81, and Ex. 7; Buchmiller Aff. ¶ 57; Klein Aff., Ex. A (Buchmiller Dep. Tr.), at 93:18 – 94:4, 95:9-20, 335:20 – 336:12.

Thus, as of February 16, 2009, Mr. Buchmiller had concluded (within the limits of

[25] Mr. Buchmiller did not complete his File Memorandum until several weeks after the Department approved the Transformation. However, as clearly stated in the File Memorandum itself, it was dated February 16, 2009 to reflect the fact that it contained Mr. Buchmiller's findings as of that date, and to document the work he had performed up to, but *not* beyond, that date. Id. ¶ 82, and Ex. 7; Klein Aff., Ex. A (Buchmiller Dep. Tr.), at 248:14-23, 249:12-17.

certainty inherent in forecasting future events) that MBIA Corp. would remain solvent under the Insurance Law even under scenarios of considerable distress, including an "extreme stress" scenario which required the assumption of stress conditions that he considered to be unrealistically pessimistic. Buchmiller Supp. Aff., ¶ 80, and Ex. 7; Klein Aff., Ex. A (Buchmiller Dep. Tr.), at 307:16-24, 310:21 – 311:22, 315:25 – 316:14, 422:25 – 423:6.[26] And Mr. Buchmiller had communicated to Department officials prior to the approval his opinion that, based on his financial review, there was no reason not to approve the Transformation. See Buchmiller Supp. Aff., ¶ 81; Klein Aff., Ex. A (Buchmiller Dep. Tr.), at 93:2-10, 95:2-8, 236:22 – 237:14.

D. The Department's Approval of the Transformation

On February 17, 2009, after what he determined was a reasonable and thorough review and analysis of the Transformation application (including MBIA Corp.'s loss modeling methodologies) by the Department, Superintendent Dinallo directed his staff to issue the approval of the Transformation, because, inter alia, it complied with all applicable provisions of the Insurance Law, and would aid in unfreezing the municipal bond insurance market and stabilizing the FGI industry. Dinallo Aff., ¶¶ 45, 64, 70; Moriarty Aff., ¶ 6, 72-74. The Department thus issued a letter to MBIA Corp. conveying its approval and/or non-objection to the group of simultaneous transactions comprising the Transformation. Dinallo Aff., ¶ 45, and

[26] While Mr. Buchmiller stated at his deposition that he had not reached any "final conclusions" regarding MBIA Corp.'s post-Transformation solvency by February 17, 2009, and did not recall anyone at the Department asking for a "final conclusion" from him, see Buchmiller Supp. Aff., Ex. 45, this did not mean that he had not sufficiently completed his Transformation review as of that date. What Mr. Buchmiller meant (and what he and his supervisors at the Department understood) was that, given that the nature of his review was to evaluate MBIA Corp.'s predictions of its future losses, and that the precise accuracy of those predictions could not be known in the present, it was impossible for Mr. Buchmiller – or *any* financial analyst, for that matter – to reach a truly "final" conclusion in the present with respect to MBIA Corp.'s future claims-paying ability. Id. ¶ 79; see also id. ¶¶ 13, 76, and Ex. 45; Dinallo Aff. ¶ 61.

Ex. 22; Buchmiller Supp. Aff., ¶ 78.

In issuing this approval, Superintendent Dinallo concluded that the "terms" of the Transformation (and its reinsurance component) were "fair and equitable" within the meaning of Insurance Law § 1505(a) based on his finding that, after the Transformation, all policyholders would be in a position such that their claims would be paid as they came due. Dinallo Aff., ¶ 65; Klein Aff., Ex. B (Moriarty Dep. Tr.), at 290:6 – 291:7, 381:12-17. For the same reason, Mr. Dinallo also concluded that the share redemption was "reasonable and equitable" within the meaning of Insurance Law § 1411(d), and that after the dividend, MBIA Corp. would "retain sufficient surplus to support its obligations and writings" under Insurance Law § 4105(a). See Dinallo Aff., ¶ 72.

Moreover, in considering, pursuant to Insurance Law § 1505(e), the effect the Transformation was likely to have on all of MBIA Corp.'s policyholders, Mr. Dinallo concluded that the Transformation would have a beneficial effect, because, inter alia: (i) the claims of the structured finance policyholders would be paid as they came due,[27] and the municipal bond insurance policyholders would no longer be subject to the volatility of the higher-risk structured finance policies (to which they had become subject through no fault of their own); (ii) it would create an MBIA entity that could write new business, allowing the MBIA companies to strengthen the capital position of the overall holding company system for the benefit of all MBIA policyholders; and (iii) both the municipal bond policyholders and the structured finance policyholders of MBIA Corp. would benefit from what Treasury officials had explained to Mr.

[27] In approving the Transformation application, Mr. Dinallo also considered the fact that both MBIA Corp. and National would remain subject to the Department's regulatory oversight following the Transformation, such that, if MBIA Corp.'s ability to pay its claims as they came due were ever to be called into question, the Department would be able to use its inherent regulatory oversight powers (including withholding approval of dividends and surplus note interest payments) to protect MBIA Corp.'s structured finance policyholders. Id. ¶ 71.

Dinallo was the potential for federal assistance if, and only if, the structured finance and municipal books were separated into two companies. Id. ¶¶ 66-67. Shortly after the Transformation was approved, Governor David Paterson and Mr. Dinallo formally requested assistance from Treasury to both the municipal *and* structured finance books of the FGIs. Id. ¶¶ 67-69, and Ex. 24.[28]

The Department issued its approval without issuing a public notice or holding a public hearing. It did so not only because neither procedure was required under the Insurance Law (see ABN AMRO Bank, N.V. v. MBIA, Inc., 17 N.Y.3d 208, 227 (2011) ("the Superintendent complied with lawful administrative procedure, in that the Insurance Law did not impose a requirement that he provide [petitioners with] notice before issuing his determination")),[29] but also because Superintendent Dinallo did not believe that such a hearing would have been constructive. Dinallo Aff., ¶ 73.[30]

VI. This Article 78 Proceeding

Petitioners filed their Verified Petition on June 15, 2009, seeking to, inter alia, nullify the

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[28] In this letter, dated February 26, 2009, Governor Paterson expressed concern over the "future health of the major commercial banks and other financial institutions," and noted that the FGIs had insured these banks' subprime-related structured finance products. Id. ¶ 68, and Ex. 24. He then proposed "a highly efficient alternative to [Treasury's] purchasing the [mortgage-backed] securities" that "have been hurting the banks['] balance sheets," specifically, having the federal government "back the insurance on the securities" in order to "strengthen the credit rating on the bonds so that they are no longer a drag on the banks' balance sheet[s]." Id. This suggestion was included in the letter at Mr. Dinallo's request. Id. ¶ 68.

[29] See also id. at 224 (noting that there is no provision in the Insurance Law "that required the Superintendent to provide notice and an opportunity to be heard to plaintiffs before he approved the Transformation").

[30] In particular, Superintendent Dinallo was aware of the concerns of the structured finance policyholders (in part due to his consultations with Perella), and had taken them into account. Dinallo Aff., ¶ 73. Further, he determined that receiving submissions or having a public debate over MBIA Corp.'s predicted future losses would extend the Department's review of the application for months (which he deemed unacceptable given the exigencies of the situation, id. ¶ 58), and, in any event, would not be helpful to his decision. Id. ¶ 73.

Department's approval of the Transformation. The respondents filed their Verified Answer, along with the administrative record (the "Record"), on November 24, 2009.[31]

On December 9, 2009, petitioners moved by Order to Show Cause for extensive discovery from the Department. On December 23, 2009, the Department cross-moved for a protective order precluding such discovery. At a conference held on January 13, 2010, this Court ruled that it would permit discovery of the Department limited to the "documents that [we]re referred to" in the affidavits of Messrs. Buchmiller and Moriarty submitted by the State Respondents in support of their Verified Answer.[32] Thereafter, the Court permitted additional discovery from the Department regarding the Transformation, though it declined to order "discovery of opinions, conclusions or internal discussions of [Department] employees." See Klein Aff., Ex. E (January 29, 2010 Discovery Order), at 2.[33]

As a result, petitioners have received from the Department thousands of pages of

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[31] The Record consists of nearly a thousand pages, and contains the Approval Letter which set forth the Department's final determinations with respect to MBIA Corp.'s Transformation application (see Record at R 971-80), as well as the application itself, the amendments and supplements thereto, financial statements and pro forma financial statements showing expected future performance, MBIA Corp.'s loss projections, solvency and fairness opinions from third parties, and draft agreements for the transactions. See Record at R 40-248; R 249-51; R 252-320; R 397-99; R 400-501; R 502-08; R 530-40; R 541-623. The State Respondents also submitted with their answering papers detailed affidavits from Mr. Buchmiller and Deputy Superintendent Moriarty explaining the methodologies used by the Department in its review.

[32] See Klein Aff., Ex. D (January 13, 2010 Conference Transcript), at 4:18-21.

[33] On October 1, 2010, petitioners served an informal document request letter upon the Department, seeking, inter alia, documents reflecting internal communications of Department officials and employees that petitioners purported would demonstrate "bias" on the part of the State Respondents. The State Respondents moved for a protective order on October 29, 2010, which was partially granted by the Court on November 23, 2010. See Klein Aff., Ex. F (Order of Justice James Yates, dated November 23, 2010). To the extent the State Respondents' motion for a protective order was not granted, the review process called for by the November 23, 2010 Order in order to identify documents potentially demonstrating "bias," conducted by Court-designated referee Hon. John A.K. Bradley, ultimately led to *zero* documents being ordered to be produced to petitioners. See Klein Aff., Ex. G (Order of Hon. John A.K. Bradley, dated June 23, 2011).

documents over and above the Record itself (R 1-980), including: documents referred to in the Buchmiller and Moriarty affidavits (NYSID 1-514); correspondence between the Department and its third-party financial consultant, Perella Weinberg Partners LP (NYSID 515-616, 2764-69); over 30 hours of recordings of Mr. Buchmiller's interviews with MBIA personnel in connection with the Transformation, as well as transcripts of these interviews that were prepared expressly for this proceeding (NYSID 617-2763); and various additional documents (NYSID 2770-2970). In addition, the MBIA respondents produced *tens of thousands* of documents to petitioners in this proceeding, including every document sent between the MBIA respondents and the Department in connection with the review process that led to the Department's approval of the Transformation. See Affidavit of Eugene Benger, dated February 18, 2011, at ¶¶ 2-4.[34] Finally, the Department's consultant, Perella, produced to petitioners thousands of pages of documents relating to its work on the Transformation review.

On March 11, 2011, petitioners submitted their reply papers, including a Reply Memorandum of Law ("Reply Mem."), and supporting affidavits from seven purported experts; specifically, four former superintendents of the Department and three financial consultants. The affidavits of the former superintendents offer what are essentially a series of legal conclusions: (i) that the Transformation violated the Insurance Law, including because it was "not fair and equitable to MBIA [Corp.]'s structured-finance policyholders," see Affidavit of James J. Corcoran, sworn to March 7, 2011 ("Corcoran Aff."), ¶ 4(a), or was "unfair to MBIA [Corp.] and its remaining policyholders," see Affidavit of Richard E. Stewart, sworn to March 3, 2011 ("Stewart Aff."), ¶ 8; (ii) that, by approving the Transformation, the Department "violated fundamental principles of insurance regulation by favoring one group of policyholders over

[34] Petitioners, who are the plaintiffs in the context of the plenary action, ABN AMRO Bank, N.A. v. MBIA, Inc., Index No. 601475/09 (Sup. Ct. N.Y. Co.), have also received in that action millions of pages of documents from MBIA.

another," see Affidavit of Edward J. Muhl, sworn to March 5, 2011 ("Muhl Aff."), ¶ 16; and (iii) that the process by which the Department reviewed MBIA Corp.'s Transformation application deviated from supposedly established Department policies and procedures, see, e.g., Affidavit of Gregory V. Serio, sworn to March 5, 2011 ("Serio Aff."), ¶ 6.

ARGUMENT

POINT I

PETITIONERS IMPROPERLY RELY ON MATERIALS THAT WERE NOT BEFORE THE DEPARTMENT WHEN IT APPROVED THE TRANSFORMATION

It is well-settled that an Article 78 proceeding to review the determination of an administrative agency "is confined to the facts and record adduced before the agency." Yarbough v. Franco, 95 N.Y.2d 342, 347 (2000); Featherstone v. Franco, 95 N.Y.2d 550, 554 (2000); Kelly v. Safir, 96 N.Y.2d 32, 39 (2001). Thus, "the court may *not* rely on evidentiary submissions that were not before the agency" at the time of the determination. Lamar Central Outdoor, LLC v. State, 64 A.D.3d 944, 948 (3d Dep't 2009) (emphasis added); see also Dolan v. N.Y.S. Dep't of Civil Serv., 304 A.D.2d 1037, 1039 (3d Dep't 2003) ("Proof outside the administrative record should not be considered."); Dunlop Development Corp. v. Spitzer, 26 A.D.3d 180, 182 (1st Dep't 2006) (noting that "judicial review of an administrative determination is limited to the facts adduced and record made before the administrative agency and judicial review of additional evidentiary submissions would violate this fundamental tenet") (citing Yarbough); Piasecki v. Dep't of Soc. Servs., 225 A.D.2d 310, 311 (1st Dep't 1996); see generally Answer Mem. at 25.

For this reason, much of the documentary "evidence" cited and submitted by petitioners in their reply papers is not properly considered in this proceeding, because the documents were *never* "before the agency," let alone before it at the time of its determination. Petitioners' reply

papers improperly cite to documents obtained in discovery from MBIA and third parties in the plenary action reflecting internal MBIA communications or communications between MBIA and third parties, as opposed to documents reflecting communications between MBIA and the Department regarding the Transformation (all of which were produced in this proceeding). See, e.g., Affirmation of Robert J. Giuffra, Jr., dated March 11, 2011 ("Giuffra Aff."), Exs. 4, 30, 40, 44-45, 48-49, 71, 75-76, 88, 97-101, 108, 111, 113-15, and 117. Petitioners' reply papers also improperly cite to documents that post-date the Department's approval of the Transformation and/or do not relate to the Transformation at all. See, e.g., id., Exs. 34, 37, 53, 56, 73, 83, 102, 105-07, 109-10, 122, 128, and 134.

Many of the documents that petitioners have improperly cited and submitted only relate – if at all – to petitioners' assertions that MBIA engaged in fraudulent conduct in connection with the Transformation. See, e.g., id., Exs. 4, 48-49, 75-76, 97, 107-10, 114, and 117. These assertions are *not* at issue in this proceeding.[35] Indeed, the Court of Appeals, in its opinion reversing dismissal of petitioners' plenary action against MBIA, confirmed that petitioners' fraud-based claims against MBIA are *not* part of this Article 78 proceeding. See ABN AMRO Bank, N.V., 17 N.Y.3d at 225 (holding that "[t]he Superintendent's determinations … have never included the adjudication of claims like those plaintiffs have put forward in this action" – i.e., claims of, inter alia, fraudulent conveyance against MBIA – "[n]or can these claims be properly raised and adjudicated in an article 78 proceeding").[36] Moreover, as Justice Yates noted in his

[35] The Verified Petition contains only a passing reference to unidentified and hypothetical "misrepresentations and omissions by MBIA … concerning [MBIA Corp.'s] true financial condition." See Verified Petition, at ¶ 105. Further, petitioners concede that the Department "did not review the transfers challenged in the [plenary action] under applicable principles of common law or the Debtor and Creditor Law," and instead "only approved or declined to disapprove certain components of a proposal by MBIA under discrete provisions of the Insurance Law." Id. ¶ 14.

[36] The dissenting opinion in ABN AMRO Bank, N.V. noted that the effect of the majority's opinion

opinion denying MBIA's motion to dismiss, petitioners themselves have maintained that this Article 78 proceeding has just such a limited scope. See ABN AMRO Bank, N.V. v. MBIA Inc., 2010 WL 549074, at *10 (Sup. Ct. N.Y. Co. Feb. 17, 2010) (noting that "parties disagree about the scope of the Superintendent's approval"), reversed, 81 A.D.3d 237, aff'd as modified, 17 N.Y.3d 208 (2011). As Justice Yates stated:

> According to plaintiffs [petitioners in this proceeding], *the Superintendent of Insurance acted only to approve certain aspects of the Transformation under specific statutory provisions of the Insurance Law*. He was called upon to resolve issues, which under a regulatory scheme, have been placed within the special competence of the state Insurance Department. *The Superintendent was not called upon to examine whether defendants intended to defraud policyholders* or all the other legal or financial consequences of the Transformation upon policy holders.

Id. at *10 (emphasis added).

In short, this Court's review of the Department's Transformation approval in this Article 78 proceeding may not rely on petitioners' extraneous evidentiary submissions consisting of documents relevant only to their plenary action against MBIA, and this Court should therefore exclude these documents (and all references to them in petitioners' reply papers) from its consideration of the instant petition. Yarbough, 95 N.Y.2d at 347; Lamar Central Outdoor, LLC, 64 A.D.3d at 948.[37]

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was to drastically limit the scope of the Article 78 proceeding, since, "after today's decision, there is no reason for" plaintiffs "who claim that [a] transaction is fraudulent under other state statutes and common law" to "bring a CPLR article 78 proceeding in addition to their plenary actions." Id. at 236 (Read, J., dissenting).

[37] The State Respondents respectfully submit that the Verified Petition can be denied and dismissed in its entirety on the papers alone. However, should the Court deem a trial necessary on any issues of fact pursuant to CPLR § 7804(h), the State Respondents intend to bring a motion *in limine* to exclude these extraneous and irrelevant evidentiary submissions from trial. See generally State v. Metz, 241 A.D.2d 192, 198 (1st Dep't 1998) ("the function of a motion *in limine* is to permit a party to obtain a preliminary order before or during trial excluding the introduction of anticipated inadmissible, immaterial, or prejudicial evidence or limiting its use").

POINT II

THE DEPARTMENT'S APPROVAL MUST BE AFFIRMED IF SUPPORTED BY A RATIONAL BASIS AND IS NOT SUBJECT TO *DE NOVO* REVIEW

As set forth in the State Respondents' answering memorandum of law (see generally Answer Mem., at 16-18), where, as here, an administrative determination made without a hearing is under judicial review pursuant to CPLR § 7803(3), a reviewing court's "inquiry is limited *strictly* to a determination of whether a rational basis exists for the agency's actions." Pereira v. Nassau County Civil Serv. Comm'n, 2010 WL 2754436, at *2 (Sup. Ct. Nassau Co. June 14, 2010) (emphasis added). Thus, "[i]f the court finds that the determination is supported by a rational basis, it must sustain the determination even if the court concludes that it would have reached a different result than the one reached by the agency." Matter of Peckham v. Calogero, 12 N.Y.3d 424, 431 (2009) (citing Matter of Pell v. Bd. of Educ. of Union Free School Dist. No. 1, 34 N.Y.2d 222, 230 (1974)); see also Hughes v. Doherty, 5 N.Y.3d 100, 105 (2005) (agency's decision must be upheld under CPLR 7803 if it had a "rational basis"); Gramercy North Assoc. v. Biderman, 169 A.D.2d 345, 349 (1st Dep't 1991) ("the judicial review provided by CPLR article 78 is a limited one," and the reviewing court's "duty is not to second-guess the wisdom of what an administrative agency has done, nor to reform the procedures and methods used by that agency"); Tomanio v. Bd. of Regents, 43 A.D.2d 643, 644 (3d Dep't 1973); People ex rel. Hudson-Harlem Valley Title & Mortg. Co. v. Walker, 282 N.Y. 400, 405 (1940).

Furthermore, "[i]t is well settled that the construction given statutes and regulations by the agency responsible for their administration, if not irrational or unreasonable, should be upheld." Howard v. Wyman, 28 N.Y.2d 434, 438 (1971). Indeed, "[w]here the interpretation of a statute or its application involves knowledge and understanding of underlying operational practices or entails an evaluation of factual data and inferences to be drawn therefrom the courts

regularly defer to the governmental agency charged with the responsibility for administration of the statute." Kurcsics v. Merchants Mut. Ins. Co., 49 N.Y.2d 451, 459 (1980) (citing Howard, 28 N.Y.2d at 438 ("where the question is one of specific application of a broad statutory term in a proceeding in which the agency administering the statute must determine it initially, the reviewing court's function is limited")); see also In re Mounting & Finishing Co. v. McGoldrick, 294 N.Y. 104, 108 (1945) (same).

Such deference has consistently been afforded to the Superintendent of Insurance, who, pursuant to Sections 201 and 301 of the Insurance Law, possesses all the "rights, powers, and duties … expressed or reasonably implied by" the Insurance Law, including the power to prescribe regulations pursuant to it. See Ins. Law §§ 201, 301. "The courts have consistently recognized that these provisions vest the [S]uperintendent 'with broad power to interpret, clarify, and implement the legislative policy'" of the Insurance Law, and thus "[t]he interpretation given a statute" by the Superintendent, "if not irrational or unreasonable, should be upheld." Ostrer v. Schenck, 41 N.Y.2d 782, 785 (1977) (citing Breen v. Cunard Lines Steamship Co., Ltd., 33 N.Y.2d 508, 511 (1974), and Howard, 28 N.Y.2d at 438).[38]

Here, the Department's approval of the Transformation involved interpretation and application of various provisions of the Insurance Law, including the "fair and equitable" standard of Insurance Law § 1505(a), the "reasonable and equitable" standard of Insurance Law § 1411(d), and the "will retain sufficient surplus to support its obligations and writings" standard

[38] See also LMK Psychological Servs., P.C. v. State Farm Mut. Auto. Ins. Co., 12 N.Y.3d 217, 223 (2009); Med. Malpractice Ins. Assoc. v. Superintendent of Ins., 72 N.Y.2d 753 (1988); Matter of N.Y. Pub. Interest Research Group v. N.Y.S. Dept. of Ins., 66 N.Y.2d 444, 449-50 (1985) (recognizing discretion of Superintendent of Insurance to interpret requirement that "profit" be computed under Insurance Law § 2329 "in accordance with" the computation method under Insurance Law § 2323 to mean "in harmony with" or "not inconsistent with" rather than "in strict conformity with"); Matter of Schwartz v. Corcoran, 118 A.D.2d 355, 361 (1st Dep't 1986).

of Insurance Law § 4105(a). Neither the Legislature nor any case law has expressly defined any of these provisions. Further, the Department's interpretation and application of these provisions was unquestionably based on: its "knowledge and understanding of underlying operational practices" of both MBIA Corp. and the FGI industry which it closely regulates; its "evaluation of factual data" regarding the proposed Transformation and MBIA Corp.'s municipal and structured finance exposures; and "the inferences to be drawn therefrom," including with respect to the solvency of MBIA Corp. following the Transformation. Kurcsics, 49 N.Y.2d at 459. Thus, the Department's interpretation and application of these broad provisions of the Insurance Law is entitled to substantial deference, and should not be disturbed unless it is "irrational or unreasonable." Id.[39]

Accordingly, petitioners' argument that the Department's interpretation and application of the Insurance Law is "entitled to no deference" (Reply Mem. at 10, 110) is unfounded. Indeed, *none* of the cases cited by petitioners support this contention. For example, in In re Gruber, 89 N.Y.2d 225 (1996) (see Reply Mem. at 10, 110), the Court of Appeals reaffirmed its ruling in Kurcsics that courts must not disturb an agency's reasonable interpretation or application of a statutory provision where such interpretation or application "involves knowledge and understanding of underlying operational practices or entails an evaluation of factual data and inferences to be drawn therefrom." Id. at 231. The Court also strongly suggested that only where a statutory term has been explicitly defined in the statute has the Legislature "withdrawn that policy-laden determination from the agency" itself. Id. at 231-32 (finding that Legislature

[39] See generally Answer Mem., at 18-20 (citing, inter alia, Matter of Peckham,12 N.Y.3d at 431 ("courts must defer to an administrative agency's rational interpretation of its own regulations"); Lamar Central Outdoor, LLC, 64 A.D.3d at 947; Koultukis v Phillips, 285 A.D.2d 433, 436 (1st Dep't 2001); Matter of Tommy & Tina, Inc. v. Dep't of Consumer Affairs, 95 A.D.2d 724 (1st Dep't 1983), aff'd, 62 N.Y.2d 671 (1984)).

had defined term "employment" in statute "[b]y defining the specific classes of employment … and by directing the manner in which the definitional provisions are to be applied," and thus, "there is no 'interpretative gap' left to be filled by the agency") (citing Chevron USA, Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 843 (1984) ("if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute")).[40]

Here, of course, the statutory terms applicable to the Department's approval – such as "fair and equitable," "reasonable and equitable," and "will retain sufficient surplus to support its obligations and writings" – have not been defined by the Legislature, and thus leave an "'interpretative gap' left to be filled by" the Department. In re Gruber, 89 N.Y.2d at 232. Indeed, these provisions are precisely the sort of "broad statutory term[s]" as to which the Court of Appeals has made clear an agency should be afforded substantial deference in its interpretation and application. Howard, 28 N.Y.2d at 438.

Petitioners' reliance on Toys "R" Us v. Silva, 89 N.Y.2d 411 (1996), in support of their contention that the Department is entitled to no deference (See Reply Mem. at 110) is also misplaced. In Toys "R" Us, the Court of Appeals held that, where an agency "is the ultimate administrative authority charged with enforcing" a statute, its "interpretation of the statute's terms must be 'given great weight and judicial deference, so long as the interpretation is neither irrational, unreasonable nor inconsistent with the governing statute.'" Id. at 418-19 (citing, inter alia, Applebaum v. Deutsch, 66 N.Y.2d 975, 977 (1985) (finding that "[i]t was reasonable" for agency to "construe" term in statute that was "not defined" in the statute "in light of both its own

[40] See also INS v. Cardoza-Fonseca, 480 U.S. 421, 454 (1987) ("courts must give effect to a reasonable agency interpretation of a statute unless that interpretation is inconsistent with a clearly expressed congressional intent"); see generally Adler v. Education Dep't of the State of N.Y., 760 F.2d 454, 458 (2d Cir. 1985) ("Article 78 review closely resembles review under the federal Administrative Procedure Act.").

experience and the stated purposes of the" statute)).

Finally, petitioners mistakenly rely upon Polan v. State Ins. Dep't, 3 N.Y.3d 54 (2004) (see Reply Mem. at 10, 110). In Polan, the Court of Appeals acknowledged the general principle of "deference to an administrative agency's 'special competence or expertise'" in interpreting and applying the statutes it enforces, and affirmed the Insurance Department's interpretation and application of a particular statutory provision in rejecting the petitioner's administrative complaint against an insurer. While the Court did not defer to the Department's expertise, this was only because the legislative intent with respect to the provision was manifest, and, as a result, the Department's expertise did "not come into play." Id. at 56.

In short, unless the Department's interpretation or application of the Insurance Law is irrational or unreasonable or runs counter to the clear command of a statutory provision, its actions and determinations must be upheld. Kurcsics, 49 N.Y.2d at 459; Ostrer, 41 N.Y.2d at 785; Howard, 28 N.Y.2d at 438. As shown in Point III, infra, the application and interpretation of the Insurance Law by the Department and Superintendent Dinallo was not irrational, unreasonable, or contrary to its clear wording, and thus, should be upheld.

POINT III

THE DEPARTMENT'S APPROVAL OF THE TRANSFORMATION WAS NOT AFFECTED BY ANY ERRORS OF LAW

Applying the appropriate deference to the interpretation and application of the Insurance Law by the Superintendent and the Department, see Point II, supra, their approval of the Transformation was not "affected" by any "errors of law" and thus, should not be set aside pursuant to CPLR § 7803(3).

In particular, the Superintendent did not err in determining that the "terms" of both the reinsurance agreement and the Transformation as a whole were "fair and equitable" pursuant to

Insurance Law § 1505(a) (see Point III.A, infra), that the share redemption was "reasonable and equitable" pursuant to Insurance Law § 1411(d) (see Point III.B, infra), and that MBIA Corp. would "retain sufficient surplus to support its obligations and writings" under Insurance Law § 4105(a). See Point III.C, infra.

Moreover, petitioners' argument that the Department somehow exceeded its "statutory authority" in approving MBIA Corp.'s Transformation application by considering public policy goals such as restoring liquidity to the municipal bond insurance market and helping public entities obtain easier and less costly access to credit is simply wrong as a matter of law. See Point III.D, infra. Finally, the "expert" affidavits of four former superintendents of the Department submitted by petitioners offer nothing more than impermissible legal conclusions regarding these issues of statutory interpretation and application, and must be excluded, or, to the extent they purport to function as affidavits of fact witnesses, are of such questionable credibility that they should be disregarded. See Point III.E, infra.

A. The Transformation Complied With Insurance Law § 1505

As the Department noted in its Approval Letter, "Insurance Law § 1505(a) sets forth the standard for approval of transactions within a holding company system to which a controlled insurer [such as MBIA Corp.] is a party," including, inter alia, that its "terms shall be fair and equitable." See Dinallo Aff., Ex. 22, at 7. The Department also recognized that "Insurance Law § 1505(d)" permits such a transaction "if the Superintendent does not disapprove the transaction after applying the factors set forth in Insurance Law § 1505(a) and considering [pursuant to Insurance Law § 1505(e)] whether the transaction may adversely affect the interests of policyholders." Id. The Department then granted its non-objection to both the reinsurance agreement and the Transformation. It did so based on "the factors set forth in Insurance Law

§§ 1505(a) and 1505(d), … the representations made in [MBIA Corp.'s a]pplication and its supporting submissions[,] the Department's examination of the MBIA Entities' financial condition [both] prior to" and "after the consummation of" the transactions, and "the Department's expertise and knowledge about insurance companies, the business of insurance and reinsurance, and the market for reinsurance." Id.

Petitioners argue that the Department's non-objections violated Insurance Law § 1505(a), because the Transformation, and the reinsurance agreement in particular, were not "fair and equitable." See Reply Mem., at 128-35. Petitioners are wrong. First, neither Insurance Law § 1505(a) nor any provision of the Insurance Law defines "fair and equitable," or provides criteria for the Superintendent to use when making a determination of whether a particular transaction is "fair and equitable." Nor has any New York court defined "fair and equitable" under Insurance Law 1505(a). Thus, the interpretation and application of this statutory language has been left to the discretion of the Superintendent. See Kurcsics, 49 N.Y.2d at 459; Ostrer, 41 N.Y.2d at 785; Howard, 28 N.Y.2d at 438; see generally Point II, supra.[41]

Superintendent Dinallo determined that the Transformation would be "fair and equitable" to MBIA Corp.'s policyholders within the meaning of Insurance Law § 1505(a) as long as, after the Transformation, all policyholders were in a position such that their claims would be paid as they came due. See Dinallo Aff., ¶ 65. Having concluded, based on, inter alia, Mr. Buchmiller's extensive review and analysis, that MBIA Corp. had made a sufficient demonstration of its post-

[41] Indeed, petitioners' own expert, former superintendent Stewart, testified that he agreed that "fairness, as a standard within which the Department has to work, is a vague concept," and that "the superintendent has the power and authority to interpret those vague concepts." See Klein Aff., Ex. I (excerpts from the transcript of the deposition of Richard E. Stewart ("Stewart Dep. Tr.")), at 245:22 – 246:21 ("The minute you try to make it a clear line, it starts to get messed up. … And usually the decision [of the legislature] has been, leave some wiggle room and trust that whoever is administering it will get it right.").

Transformation solvency under the Insurance Law, Superintendent Dinallo deemed the "fair and equitable" standard to be met. Id. ¶¶ 64-65, 70.[42] The Superintendent's reading of Insurance Law § 1505(a), far from being "inconsistent with the governing statute" (cf. Toys "R" Us, 89 N.Y.2d at 418-19), comported with its plain meaning, in that "equitable" means just in light of all the surrounding circumstances.

Further, Superintendent Dinallo properly interpreted and applied Insurance Law § 1505(e), which, by its plain language provides only that he must "consider" whether the Transformation, and the reinsurance agreement in particular, "may adversely affect policyholders," and not – as petitioners contend (see Reply Mem., at128) – that he must disapprove the transactions if he finds that policyholders would be adversely affected. See Ins. Law § 1505(e); Dinallo Aff., ¶ 66-70; Moriarty Aff., ¶¶ 35, 58-65. Indeed, the Superintendent did consider the effect the transactions would have on all of MBIA Corp.'s policyholders, and ultimately found that the benefits to policyholders far outweighed any adverse effects. In particular, he concluded that:

(i) the municipal bond insurance policyholders of MBIA Corp. would benefit from having their much lower-risk policies no longer be subject to the volatility of the higher-risk structured finance policies, to which they had become subject through no fault of their own (see Dinallo Aff., ¶ 66);

(ii) the claims of MBIA Corp.'s structured finance policyholders would be paid as they came due because MBIA Corp. would remain solvent following the Transformation (id.; Moriarty Aff., ¶ 65; Klein Aff., Ex. B (Moriarty Dep. Tr.), at 290:6 – 291:7);

(iii) MBIA Corp. (and thus, the structured finance policyholders) would benefit from the Transformation because it reduced MBIA Corp.'s liabilities by reinsuring, on a

[42] With respect to the reinsurance agreement in particular, the Department also determined it to be "fair and equitable" within the meaning of Insurance Law § 1505(a) based on its review of the reinsurance transaction between MBIA Corp. and FGIC (two unaffiliated parties) that it had previously approved, and which had similar terms. See Moriarty Aff. ¶ 63, and Ex. I. Further, MBIA Corp. had submitted with its application a "fairness" opinion of Raymond James & Associates, Inc. ("Raymond James") regarding the reinsurance agreement. See Record at R 224-28.

cut-through basis, public finance policies for which MBIA Corp. had previously been solely responsible (see Moriarty Aff., ¶¶ 35, 65; Klein Aff., Ex. A (Buchmiller Dep. Tr.), at 242:7-19; Klein Aff., Ex. B (Moriarty Dep. Tr.), at 206:10-19, 207:5-15; see also ABN AMRO Bank, N.V., 17 N.Y.3d at 235 (Read, J., dissenting) ("One can hardly say that MBIA [Corp.] derives no benefit whatsoever from the fact that one of its sister companies is now jointly liable for its entire municipal bond portfolio."));

(iv) the Transformation could allow National to begin writing new municipal bond insurance business, thereby generating future revenue that could benefit all of the policyholders within the MBIA holding company system (see Dinallo Aff., ¶¶ 42, 66; see also Moriarty Aff., ¶¶ 25, 66, 72); and

(v) all MBIA Corp. policyholders would benefit from the Transformation because separation of MBIA Corp.'s books of business created a possibility that either or both of the books would be able to obtain federal assistance. See Dinallo Aff., ¶¶ 67-69.

See also Answer Mem., at 14-15, 24, 31-32. Given that Insurance Law § 1505(e) only requires the Superintendent to "consider" the effect a transaction has on policyholders, Superintendent Dinallo and the Department more than satisfied this requirement, just as they rationally concluded that the "terms" of the Transformation (and the reinsurance agreement) were "fair and equitable."

B. The Transformation Complied With Insurance Law § 1411(d)

In its Approval Letter, the Department also approved the share redemption portion of the Transformation, by which MBIA Corp. transferred approximately $938 million in cash and securities and all the outstanding shares of National to its sole shareholder, MBIA Inc. The Department found the share redemption to be "reasonable and equitable" within the meaning of Insurance Law § 1411(d), based on "the representations contained in [MBIA Corp.'s a]pplication and its supporting submissions[, and] the Department's examination of the MBIA Entities' financial condition [both] prior to" and "after the effectuation of the Transformation." See Dinallo Aff., Ex. 22, at 6-7.

Petitioners incorrectly assert that this finding by the Department was also in error. See

Reply Mem., at 118-28. Again, neither Insurance Law § 1411(d) nor any provision of the Insurance Law – or any case law – defines "reasonable and equitable," or provides criteria for the Superintendent to use when making a determination of whether a particular share redemption is "reasonable and equitable." Thus, the interpretation and application of this broadly worded provision has been left to the discretion of the Superintendent. See Kurcsics, 49 N.Y.2d at 459; Ostrer, 41 N.Y.2d at 785; Howard, 28 N.Y.2d at 438; see generally Point II, supra.[43]

Superintendent Dinallo considered whether the share redemption was "reasonable and equitable" in light of the Transformation as a whole, and determined that, so long as MBIA Corp. was able to pay its claims as they came due following the Transformation, the share redemption would indeed be "reasonable and equitable." See Dinallo Aff., ¶ 72**;** see also Moriarty Aff. ¶¶ 6, 51, 55-56; Buchmiller ¶¶ 8-9, 57. Again, this reading, far from being inconsistent with the governing statute, comported with its plain language.

Furthermore, Superintendent Dinallo concluded that the share redemption had to be considered as a component of the larger Transformation. See Dinallo Aff., ¶¶ 65, 72; see also Moriarty Aff., ¶ 51. Specifically, even though the Approval Letter discussed each component of the Transformation seriatim and, in particular, discussed the dividend and stock redemption components before it discussed the reinsurance agreement component (see Dinallo Aff., Ex. 22), Superintendent Dinallo reasonably understood the Transformation to have contemplated contingent and interrelated transactions, all of which occur simultaneously, rather than a series of independent transactions occurring sequentially. Id. ¶¶ 65, 72; see also Klein Aff., Ex. B (Moriarty Dep. Tr.), at 93:17 – 94:2, 121:6-18, 148:6-16.

Indeed, Superintendent Dinallo never would have approved the share redemption

[43] See generally Klein Aff., Ex. I (Stewart Dep. Tr.), at 89:11-12 ("Reasonable is what I would consider an ultimate term. It's a term like 'beautiful.'"), and 95:10-12 ("certain terms, such as reasonable and beautiful … are terms that you can't further define").

component of the Transformation in the absence of the reinsurance agreement component, the latter of which provided substantial benefits to MBIA Corp. See Dinallo Aff., ¶ 72. Thus, contrary to petitioners' argument that the share redemption lacked a "legitimate business purpose" (see Reply Mem., at 124), one of the purposes of the redemption was the patently "legitimate" purpose of making the reinsurance agreement (and the Transformation as a whole) possible, thus providing the various benefits to MBIA Corp. and all of its policyholders discussed in Point III.A, supra. See generally Answer Mem., at 30-31.

Finally, and as set forth in the State Respondents' answering brief, the share redemption to MBIA Inc. was not a dividend. See Answer Mem., at 28-30 (citing Moriarty Aff., ¶ 33; Record at R 973, 976). Citing no controlling legal precedent in their reply brief, petitioners again merely assert that the share redemption is a "disguised illegal dividend" (see Reply Mem., at 122). Petitioners make this assertion despite the fact that dividends and share redemptions are expressly governed by distinct provisions of the Insurance Law, and are subject to different accounting requirements. Compare Ins. Law § 1411(d) (permitting share redemptions to be made out of paid in and contributed surplus) with Ins. Law § 4105(a) (permitting dividends to be paid out of "earned surplus"); see also Klein Aff., Ex. L (Serio Dep. Tr.), at 385:13 – 390:15 (acknowledging that, during his tenure as Superintendent, the Department approved an application for a simultaneous extraordinary dividend pursuant to Insurance Law § 4105 and a share redemption pursuant to Insurance Law § 1411). Simply put, the fact that the Insurance Law expressly permits money to be paid to an insurer's shareholder in exchange for some or all of its shares in a manner that may, in certain circumstances (such as when the insurer's parent is its sole shareholder), have the functional equivalence of a dividend declaration in the same amount does not change the fact that the Insurance Law expressly permits it.

For all these reasons, petitioners' contentions that the share redemption violated Insurance Law § 1411(d) are simply unsupportable.

C. The Transformation Complied With Insurance Law § 4105(a)

In the Approval Letter, the Department also approved the dividend component of the Transformation, by which MBIA Corp. paid a dividend of approximately $1.147 billion to its sole shareholder, MBIA, Inc. The Department approved the dividend after finding "that MBIA Corp. will retain sufficient surplus to support its obligations and writings following the payment of the" dividend, based on "the representations contained in [MBIA Corp.'s a]pplication and its supporting submissions[, and] the Department's examination of the MBIA Entities' financial condition prior to the Transformation, and … after the effectuation of the Transformation." See generally Dinallo Aff., Ex. 22, at 6.

Petitioners assert that this finding by the Department was also in error. See Reply Mem., at 114-18. Once again, petitioners are wrong. Although "surplus" is defined by Insurance Law § 4105, neither that provision nor any other provision of the Insurance Law – nor any applicable case law – defines what it means for an insurer to "retain sufficient" surplus "to support its obligations and writings," nor specifies any time period during which the insurer must "retain" this surplus before paying a dividend. Indeed, Insurance Law § 4105(a) focuses only on the requirement that the insurer "retain" this surplus *after* the dividend is paid. Thus, the Legislature left the interpretation and application of this provision to the discretion of the Superintendent. See Kurcsics, 49 N.Y.2d at 459; Ostrer, 41 N.Y.2d at 785; Howard, 28 N.Y.2d at 438; see generally Point II, supra.

Here, again, because the Transformation consisted of a group of simultaneous and contingent transactions, rather than a series of independent and unrelated ones (see Dinallo Aff.,

¶¶ 65, 72; Klein Aff., Ex. B (Moriarty Dep. Tr.), at 93:17 – 94:2, 121:6-18, 148:6-16), the Department and the Superintendent reasonably determined that following the dividend *and the rest of the Transformation*, MBIA Corp. would be able to pay its claims as they came due, and thus would "retain sufficient surplus to support its obligations and writings." Dinallo Aff., ¶ 72; see also Moriarty Aff., ¶¶ 6, 51, 55-56; Buchmiller Supp. Aff., ¶¶ 8-9, 57. Nothing more was required under Insurance Law § 4105(a).[44]

Petitioners' arguments that the transactions comprising the Transformation could not have happened simultaneously (see Reply Mem., at 116-18) simply ignore the reality of complex financial transactions with which petitioners – indeed, all sophisticated financial institutions – should be well familiar. Specifically, as petitioners are aware, the simultaneity of several components of a particular transaction can, in essence, make possible that which would not be possible if the components were to occur separately. Indeed, every residential real estate closing where the purchase price is paid in part by a mortgage loan fits this description: a mortgage bank provides funds to the purchaser so that the purchaser may purchase the home, but does so only in exchange for a lien on the home being purchased. The purchaser cannot pledge the home as collateral for the loan until she purchases (and thus owns) the home, and yet the bank cannot provide the funds for the purchase until the purchaser pledges the home as collateral. Neither can happen *first*. Remarkably, however, residential real estate closings continue to occur each year. They do so because of the understanding among the parties that all of the component transactions of the closing (e.g., the execution of the note, obligating the buyer to repay the loan amount; the execution of the mortgage, giving the lender a security interest in the property being

[44] Indeed, petitioners have ignored the argument in the State Respondents' answering brief that Insurance Law § 4105(a) does not envision the insurer paying the dividend – here, MBIA Corp. – receiving any benefit from the payment, as a dividend represents a return to shareholders on the value of their investments. See Answer Mem., at 28.

pledged for the loan; and the payment of the loan proceeds to the seller) occur *simultaneously*. Corporations and investors regularly enter into complex, multi-component financial transactions, such as leveraged buyouts,[45] with the same understanding.

The Transformation approved by the Department is no different. Thus, the simultaneous nature of the various transactions comprising the Transformation reveals petitioners' arguments as to the illegality of the various transactions, and in particular the dividend pursuant to Insurance Law § 4105(a), to be entirely without merit.

D. The Department Did Not Exceed Its Authority In Approving the Transformation

Petitioners argue that the Department somehow exceeded its "statutory authority" in approving MBIA Corp.'s Transformation application by considering public policy goals, such as restoring liquidity to the municipal bond insurance market and helping public entities obtain easier and less costly access to credit. See Reply Mem., at 161-64 (arguing that "[n]othing in the Insurance Law authorizes the [Department] to consider these policy objectives") (citing Boreali v. Axelrod, 71 N.Y.2d 1 (1987), and Health Insurance Ass'n of America v. Corcoran, 154 A.D.2d 61 (3d Dep't 1990)); see also Reply Mem., at 110 (arguing that the Department acted "without or in excess of jurisdiction" pursuant to CPLR § 7803(2)). This argument is meritless for several reasons.

First, all of the cases relied on by petitioners involve the *promulgation of regulations* by an administrative agency that were inconsistent with a particular legislative mandate. See, e.g., Boreali, 71 N.Y.2d at 12 (striking down regulations of Public Health Council ("PHC") regarding exemptions for smoking ban and finding that PHC "transgressed the line that separates

[45] See generally Brandt v. Wand Partners, 242 F.3d 6, 10 (1st Cir. 2001) ("A leveraged buyout is a transaction to acquire a corporation 'in which a substantial portion of the purchase price paid for the stock of a target corporation is borrowed and where the loan is secured by the target corporation's assets.'") (citation omitted).

administrative rule making from legislating"); Health Ins. Ass'n of America, 154 A.D.2d at 64, 67 (upholding challenge to "the validity of a … regulation promulgated by" the Insurance Department "barring HIV testing" of insurance policy applicants). Here, no such promulgation of a regulation has been, or *could be*, alleged by petitioners. Rather, the Department received an application for approval and/or non-objection of a group of proposed transactions, all of which are expressly authorized under various already-existing provisions of the Insurance Law, and the Department issued its approval after interpreting and applying these provisions to the specific application at hand.

Furthermore, this case is readily distinguishable from Boreali, where the Court's conclusion that the agency's rulemaking exceeded its statutory authority "rested on the coalescence of four circumstances." See Motor Vehicle Mfrs. Ass'n of U.S. Inc. v. Jorling, 181 A.D.2d 83, 87 (3d Dep't 1992) (citing Boreali, 71 N.Y.2d at 11-14). The first and most "compelling" of these circumstances was that "the focus" of the rules promulgated by the agency was on "administratively created exemptions rather than on rules that promote the legislatively expressed goals." Boreali, 71 N.Y.2d at 12 (finding that this factor supported overruling the regulation, "since exemptions ordinarily run counter to such goals and, consequently, cannot be justified as simple implementations of legislative values").[46] Here, petitioners have not asserted – because they cannot – that the Department's approval "created exemptions" that "run counter" to any "legislatively expressed goals." Thus, the Department has not exceeded its authority. See Rent Stabilization Ass'n of New York City, Inc. v. Higgins, 83 N.Y.2d 156, 170 (1993) (ruling that Division of Housing and Community Renewal ("DHCR") did not exceed its authority "in defining the persons to be afforded non[-]eviction protection in an ongoing housing crisis" to

[46] See also Health Ins. Ass'n of America, 154 A.D.2d at 75 (declaring agency's regulations invalid upon finding that they "make[] unlawful what the Legislature chose to make fully lawful").

"include those who [DHCR determined we]re most in need of protection against loss of their homes in a continuing housing emergency," and finding that "unlike the [agency] in Boreali, DHCR has not enacted categorical exemptions reflecting accommodations to special interest groups").[47]

Moreover, in Boreali, the Court also found that "no special expertise or technical competence in the field of health was involved in the development of the antismoking regulations challenged." Boreali, 71 N.Y.2d at 13-14. Here, the Department's approval was manifestly based on its special expertise in the field of insurance regulation. See Dinallo Aff., ¶ 53-54; Buchmiller Aff., ¶¶ 4, 6, 12; Buchmiller Supp. Aff., ¶¶ 4, 7, 23. Therefore, petitioners' reliance on Boreali is unavailing, because the Department's approval, unlike the PHC's rulemaking, required "technical competence." Boreali, 71 N.Y.2d at 13-14; cf. Rent Stabilization Ass'n, 83 N.Y.2d at 170 (recognizing that DHCR's rulemaking was based on its "experience as sole administrator of residential rent regulation and adjudicator of eviction disputes," and finding that its "[a]djustment of the existing [statutory] scheme in light of the agency's technical competence is well within the proper rule-making function of this agency").

Finally, the Court in Boreali also found that the agency "did not merely fill in the details of broad legislation describing the over-all policies to be implemented," but rather "wrote on a clean slate, creating its own comprehensive set of rules without benefit of legislative guidance."

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[47] Indeed, petitioners' own expert, former superintendent Stewart, testified that the Department's goal of restoring liquidity to the municipal bond insurance market, was entirely proper. In particular, he agreed that it is "a proper aim for a sitting superintendent, to promote what that superintendent determines to be in the public interest," and that, in particular, "Superintendent Dinallo's stated goal of reinvigorating the market for municipal bonds by making insurance for those bonds available was within the mission of the [Department]." See Klein Aff., Ex. I (Stewart Dep. Tr.), at 115:20-24, 121:6-12; see also id. at 111:18 – 113:20 (agreeing that the Department's mission is not "confined" to "policyholders getting paid," and "includes promoting the continued development of a sound, fair, and robust insurance industry"); id. at 128:4-8 (agreeing that "insurance has too important a public role not to be affected by changes in the surrounding society"); id. at 132:20-25 (agreeing that "[t]he superintendent can take account of external circumstances like a financial crisis in determining whether to approve a transaction").

Id. at 13. In contrast, here, the Department acted directly pursuant to "legislative guidance," specifically, the "broad" standards set forth in, inter alia, Insurance Law §§ 1411(d), 1505(a), (e), and 4105(a). Indeed, petitioners themselves have conceded that "the Superintendent of Insurance acted only to approve certain aspects of the Transformation under specific statutory provisions of the Insurance Law." See ABN AMRO Bank, N.V., 2010 WL 549074, at *10 (Yates, J.). Far from creating a set of rules outside the bounds of these statutes, the Department "fill[ed] in the details" of these "broad" provisions by interpreting and applying them. See Rent Stabilization Ass'n, 83 N.Y.2d at 170 (finding that agency had properly "'fill[ed] in the interstices' of the legislative mandate").[48]

For all of these reasons, the Department did not act "without or in excess of its jurisdiction" under CPLR § 7803(2).

E. The Affidavits of the Former Superintendents Should Be Excluded and/or Disregarded

It is the exceedingly rare Article 78 proceeding in which the testimony of expert witnesses is considered. Indeed, New York courts have repeatedly held in the Article 78 context that "[i]t is not for the courts to choose between … diverse professional opinions"; rather, "that is the function of the proper department heads and as long as they act reasonably and responsibly, the courts will not interfere." McCabe v. Haberman, 33 A.D.2d 547 (1st Dep't 1969) (citations omitted); see also Palozzolo v. Nadel, 83 A.D.2d 539 (2d Dep't 1981); Brussel v. LoGrande, 137

[48] See generally McKinney v. Commissioner of the N.Y.S. Dep't of Health, 15 Misc. 3d 743, 753 (Sup. Ct. Bronx Co. 2007) (noting that "the lines of demarcation for the legislative and administrative branches cannot be easily drawn," and that "[t]he Courts have recognized the necessity of some overlap among the branches of government as well as the great flexibility to be accorded the administrative official in determining the methods for achieving the legislative mandates," with "the degree of flexibility var[ying] according to the nature of the problem sought to be remedied by the legislature") (citing Bourquin v. Cuomo, 85 N.Y.2d 781, 785 (1995), and Broidrick v. Lindsay, 39 N.Y.2d 641, 646 (1976) ("[w]here it is impracticable for the legislative body to fix specific standards[,] broad flexibility in determining the proper methods" by an administrative agency will be permitted)).

A.D.2d 686 (2d Dep't 1988); Rivera v. New York State Div. of Human Rights, 2008 WL 441902, at *4 (Sup. Ct. N.Y. Co. Feb. 13, 2008) ("Judicial review is not intended to weigh the merits of competing professional opinions because doing so undermines the function, authority and expertise of administrative agencies."); Murray v. County of Nassau Civil Service Comm'n, 2007 WL 1309728, at *1-2 (Sup. Ct. Nassau Co. Mar. 16, 2007). Indeed, even when considering expert testimony at an underlying administrative hearing, New York courts have held that "[t]he fact that the opinion of [a] petitioner's privately retained expert is contrary to that of respondent's expert is not controlling," because, "where there is any rational basis or credible evidence in support of an agency's determination, the decision will be upheld." See Murray, 2007 WL 1309728, at *1.[49]

Nonetheless, and in disregard of the deference to be applied to the rational interpretation and application of the Insurance Law by the Superintendent who actually made the determination at issue (see Point II, supra), petitioners have offered so-called "expert" affidavits of four former superintendents (James J. Corcoran, Edward J. Muhl, Gregory V. Serio, and Richard E. Stewart) in an effort to convince this Court to apply no such deference. See Reply Mem., at 18-22. However, these affidavits must be excluded, as they offer nothing more than impermissible legal conclusions. See Point IV.D.1, infra. Alternatively, to the extent the testimony of these witnesses could constitute anything other than legal conclusions, it would be testimony from fact witnesses that is of questionable credibility due to the substantial sums of money paid to these witnesses by petitioners. See Point IV.D.2, infra.

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[49] Med. Malpractice Ins. Ass'n, cited by petitioners (see Reply Mem., at 18), is in accord. There, the Court of Appeals found that "[a] disagreement among actuaries [at an underlying administrative hearing] is *not evidence* that the Superintendent [of Insurance]'s acceptance of one set of conclusions was arbitrary." Med. Malpractice Ins. Ass'n, 72 N.Y.2d at 763 ("It is axiomatic that a court reviewing the determination of an agency may not substitute its judgment for that of the agency and must confine itself to resolving whether the determination was rationally based.") (emphasis added).

1. The Former Superintendents' Affidavits Consist of Impermissible Legal Conclusions and Should Be Excluded

It is well-settled under New York law that an expert witness may not offer testimony regarding legal conclusions. See Russo v. Feder, Kaszovitz, Isaacson, Weber, Skala & Bass LLP, 301 A.D.2d 63, 68-69 (1st Dep't 2002) ("[a]n expert may not be utilized to offer opinion as to the legal standards which he believes should have governed a party's conduct"); Measom v. Greenwich & Perry St. Housing Corp., 268 A.D.2d 156, 159 (1st Dep't 2000) ("[e]xpert testimony as to a legal conclusion is impermissible"); Rodriguez v. New York City Housing Auth., 209 A.D.2d 260, 260-61 (1st Dep't 1994).

In Russo, a legal malpractice case, the plaintiff offered an affidavit of an attorney expert to "establish why [the defendant law firm's] strategy and performance were incompetent." See Russo, 301 A.D.2d at 68. As the First Department recognized, "[e]ssentially, the affiant-attorney was offering a legal opinion as to what performance or absence thereof constitutes legal malpractice," and "making those determinations is the function of a court," not an expert witness. Id. at 68-69. Similarly, the First Department in Measom held that the trial court had erred in relying on expert testimony as to "whether the subject apartment was legal according to the Multiple Dwelling Law or the New York City Administrative Code." See Measom, 7268 A.D.2d at 159. Finally, in Rodriguez, the First Department held that it was "reversible error" for the trial court to allow plaintiff's "expert witness … to testify as to the application and interpretation of certain statutes and regulations," because it was improper to "permit a party to attempt to prove negligence by expert testimony regarding the meaning and applicability of a statute imposing a standard of care." See Rodriguez, 209 A.D.2d at 260-61.

The affidavits of the four former superintendents offered by petitioners offer nothing more than impermissible legal conclusions concerning "the application and interpretation" of

various provisions of the Insurance Law, and are merely petitioners' attempt at "imposing a standard of care" under the Insurance Law that is in no way grounded in the statutory provisions at issue. Id.

For instance, each of the former superintendents offer opinions that the Transformation application should not have been approved because it purportedly "discriminated" against MBIA Corp.'s structured finance policyholders in violation of Insurance Law § 1505(a). See, e.g., Corcoran Aff., ¶ 4(a) (opining that Transformation transactions "were improper attempts to circumvent the express requirements of the New York Insurance Law" because they "were not fair and equitable to MBIA [Corp.]'s structured-finance policyholders"); Muhl Aff., ¶¶ 16, 64 (opining that Superintendent "Dinallo's approval of MBIA's 'Transformation' violated the NYID's core mission – the protection of all existing policyholders of MBIA [Corp.]," and that Mr. Dinallo "abandoned his paramount duty to protect MBIA [Corp.]'s structured-finance policyholders"); Serio Aff., ¶ 16 (opining that Transformation approval "violated fundamental principles of insurance regulation by favoring one group of policyholders over another"); Stewart Aff., ¶¶ 8, 10 (opining that he would not have approved Transformation transactions because they "were unfair to MBIA [Corp.] and its remaining policyholders," and that, in approving the Transformation, "the Department improperly attempted to save an insurer by discriminating between two classes of policyholders"). All of these assertions are mere variations on a single theme: petitioners' erroneous legal contention that the "fair and equitable" standard of Insurance Law § 1505(a) of the Insurance Law prohibits the Superintendent, under any circumstances, from approving a transaction within a holding company system that treats different groups of policyholders differently.[50]

[50] As Superintendent Dinallo has stated, his interpretation of Insurance Law § 1505(a) was that it permitted approval of such a transaction so long as all policyholders' claims would be paid as they came

Similarly, Messrs. Corcoran and Stewart both offer conclusory opinions that the share redemption and dividend components of the Transformation somehow violated Insurance Law §§ 1411(d) and 4105(a). See Corcoran Aff., ¶ 12 (arguing that Department's approval of dividend ignored the "express requirements of the Insurance Law"), ¶ 14 (arguing that share redemption violated Insurance Law) and ¶ 20 (same); Stewart Aff., ¶ 8 (asserting that share redemption was in violation of Insurance Law § 1411(d), and that dividend was a "blatant and improper attempt to avoid the earned surplus requirement of" Insurance Law § 4105). These, too, are impermissible legal conclusions, and must be excluded.

Petitioners will no doubt contend that the former superintendents' affidavits are not limited to legal conclusions, but also offer testimony regarding how the process by which the Department reviewed MBIA Corp.'s Transformation application improperly deviated from established Department practice and policy. To be sure, the former superintendents' affidavits are replete with just such testimony, as they variously contend that the Department: (i) was required to retain a third party consultant to conduct the financial review of the Transformation (see Corcoran Aff., ¶ 68; Muhl Aff., ¶ 37; Serio Aff., ¶¶ 22-33); (ii) did not sufficiently employ its own career staff in its review (see Corcoran Aff., ¶ 65; Serio Aff., ¶¶ 34-41); (iii) did not follow proper procedures in analyzing MBIA Corp.'s loss modeling and statements of financial condition, including "guidance" from the NAIC (see Corcoran Aff., ¶¶ 4(d), 69; Muhl Aff., ¶ 38; Serio Aff., ¶¶ 6, 42-51); and (iv) should have given notice to MBIA Corp.'s structured finance policyholders before approving the Transformation transactions. See Serio Aff., ¶¶ 84-93.

These contentions are all thinly-disguised attempts to "impos[e] a standard of care" upon Superintendent Dinallo and the Department that simply does not exist under the Insurance Law.

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due following the Transformation. See Dinallo Aff., ¶ 65.

See Rodriguez, 209 A.D.2d at 260-61. For instance, the Court of Appeals has already held that the Department was not required to give notice to MBIA Corp.'s structured finance policyholders before issuing its approval. See ABN AMRO Bank, N.V., 17 N.Y.3d at 227 ("the Superintendent complied with lawful administrative procedure, in that the Insurance Law did not impose a requirement that he provide plaintiffs notice before issuing his determination"). Moreover, the former superintendents conceded the absence of any Insurance Law provisions or regulations requiring specific processes to be employed by the Department in its review of the Transformation, and that even the NAIC "guidance" which they cited is entirely *non-binding*.[51] The fact that the former superintendents' conclusions of law regarding the "standards which [they] believe[] should have governed [the Department's] conduct" are erroneous does not make them any less conclusions of law. See Russo, 301 A.D.2d at 68. As with their conclusions regarding the meaning of the various Insurance Law provisions at issue, these opinions are both wrong *and* inadmissible.

In short, the affidavits of the former superintendents submitted by petitioners should be excluded in their entirety, as they contain nothing but impermissible legal conclusions. Id. at 68-69; Measom, 268 A.D.2d at 159; Rodriguez, 209 A.D.2d at 260-61.

2. As Witnesses For Hire, the Former Superintendents Lack Credibility to the Extent They Attest to Factual Matters

Petitioners may contend that the former superintendents are not impermissibly testifying as to the standards which they believe should have governed the Department's conduct, but, rather, are simply testifying as a matter of fact regarding their own "experience," and the policies

[51] See Klein Aff., Ex. J (excerpts from the transcript of the deposition of James Corcoran, dated September 8, 2011 ("Corcoran Dep. Tr.")), at 297:7 – 299:3, 301:23 – 303:25, 328:9 – 331:21; Klein Aff., Ex. K (excerpts from the transcript of the deposition of Edward J. Muhl, dated August 5, 2011 ("Muhl Dep. Tr.")), at 237:13 – 241:21, 242:19 – 247:18, 276:3 – 277:21; Klein Aff., Ex. L (excerpts from the transcript of the deposition of Gregory V. Serio, dated July 26, 2011 ("Serio Dep. Tr."), at 200:10 – 201:22, 233:24 – 239:20.

and procedures employed by them and the Insurance Department during their respective tenures as superintendent. To the extent this is the case, however, any such fact testimony of the former superintendents should be severely discounted – or indeed, entirely *disregarded* – by this Court as lacking credibility, given the substantial sums of money paid to each of them by petitioners.[52]

In a recent opinion, the Second Department held that a "[p]ayment to a fact witness which bears no relation to the witness's reasonable losses … is nothing more than a fee for testifying that permits 'strangers to [the] litigation' to 'profit' from it." See Caldwell v. Cablevision Systems Corp., 86 A.D.3d 46, 51-52 (2d Dep't 2011) (quoting Goldstein v. Exxon Research & Engineering Co., 1997 WL 580599, at *2 (D.N.J. Feb. 28, 1997)). The court further found that the "substantial payment" of $10,000 made by the defendant to a fact witness warranted a specific jury instruction pertaining to the witness's bias. Id. at 48-49, 55 (holding that "trial court failed to adequately charge the jury" regarding "*the suspect credibility of factual testimony by a paid fact witness*") (emphasis added) (citing, inter alia, ABA Formal Op. 96-402; N.Y.S. Bar Ass'n Comm. On Prof. Ethics, Op. No. 668 (1994) ("We must attempt to draw the line between compensation that enhances the truth seeking process by easing the burden of testifying witnesses, and compensation that serves to hinder the truth seeking process because it tends to 'influence' witnesses to 'remember' things in a way favorable to the side paying them.")).

The personal injury defendant in Caldwell argued that its payment far in excess of the

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[52] Indeed, as of March 2011 – and thus, *not* counting payments for their time spent preparing for their depositions and testifying at their depositions – petitioners had paid over eight hundred thousand dollars to the former Superintendents, including $491,891 to former Superintendent Corcoran, $247,065.48 to former Superintendent Muhl, and $76,300 to former Superintendent Stewart. See Klein Aff., Ex. M (PET 20819). In addition, former Superintendent Serio testified at his deposition that, beyond a retainer fee of $10,000, he had not yet been paid for his work in preparing his affidavit because he had not yet submitted a bill to petitioners. See Klein Aff., Ex. L (Serio Dep. Tr.), at 376:17 – 377:3, 380:19 – 381:5. Nonetheless, Mr. Serio testified that he had spent an inestimable number of hours preparing his affidavit – as he characterized it, "a big workload" – and his retainer agreement with petitioners reflects that his billing rate is $650 per hour. See Klein Aff., Ex. L (Serio Dep. Tr.), at 376:7-16; Klein Aff., Ex. N (PET 237-38).

statutory witness fee (see CPLR § 8001(a) ("fifteen dollars" per day)) to a fact witness – a doctor who had treated the plaintiff and spoken to her regarding the cause of her injury – was permissible because it "was entitled to compensate [the witness] for his time away from his practice '[j]ust as if he was an expert coming in' to testify." Caldwell, 86 A.D.3d at 53. The court rejected this argument out of hand, and explained:

> There are … important differences between expert witnesses and fact witnesses. Experts are under no public duty, nor can they be compelled, to testify. Their opinion testimony involves "special knowledge and skill ... and often requires examination and study upon a particular branch of science ... about which they are to testify." … Thus, while *fact witnesses have a public duty to testify and are limited to receipt of statutory fees and compensation for lost time*, expert witnesses are justified in receiving compensation for their efforts. … [B]ecause no special knowledge or examination and study was required for the testimony given by [this witness], the defendant's suggestion that the payment to [the witness] was commensurate with his normal expert fees detracts from its assertion that the payment was merely reasonable compensation for time lost testifying.

Id. (emphasis added) (citations omitted).[53] The Second Department also noted that the "propriety" of payments to fact witnesses in excess of the statutory witness fee of CPLR § 8001 was "questionable from a public policy standpoint,"[54] and that "[a]greements of this nature, under which witnesses might be permitted 'to extort unreasonable fees for their testimony,' *portend to erode equal access to justice, create an incentive, even unconscious, toward biased testimony, and threaten the integrity of the judicial system by giving the appearance that justice is a commodity*." Id. at 50-51 (emphasis added) (citations omitted).

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[53] See also Goldstein, 1997 WL 580599, at *4-5 (noting that "the essential difference between one giving lay opinion testimony and one giving expert evidence hinges on the fact that lay opinion testimony must be based on one's own personal knowledge and observations, " and rejecting defendant's argument that its witness was "entitled to be compensated for his testimony" as an "expert witness," because his "opinions, and *his unique value as a witness*, are the result of *his own personal knowledge and observations*") (emphasis added).

[54] Id. at 50 (citing, inter alia, Clifford v. Hughes, 139 A.D. 730, 731 (2d Dep't 1910) ("[w]here a witness who is not interested in the result of the controversy resides within this State, and is amenable to process therein, an agreement to compensate him in an amount in excess of the legal fees for attending as a witness and testifying only as to facts within his knowledge, is contrary to public policy and void")).

To the extent that petitioners intend to offer any of the affidavits of the former superintendents as evidence, based on their "personal knowledge and observations," of what the Department did or did not do during their respective tenures, this would make these former superintendents fact witnesses who will have been paid, cumulatively, over a *million dollars* by petitioners for their testimony (far more than the amount at issue in Caldwell). The credibility of such testimony would be so suspect as to lack any probative value. Caldwell, 86 A.D.3d at 55.

POINT IV

THE DEPARTMENT'S APPROVAL OF THE TRANSFORMATION HAD A RATIONAL BASIS AND WAS NOT ARBITRARY AND CAPRICIOUS

In their answering memorandum of law and affidavits filed in support of it, the State Respondents set forth the extensive efforts that the Department undertook to review and analyze the issues surrounding MBIA Corp.'s Transformation application. See Answer Mem., at 13-15, 20-23. Petitioners' contentions that the Department lacked a rational basis to approve the Transformation are wrong for the following reasons, which are discussed in detail below.

First, petitioners' argument that the approval had no "factual basis" is erroneous, because the approval was based on a thorough review and analysis and, in any event, the Approval Letter was not required to set forth findings of fact. See Point IV.A, infra.

Second, petitioners' arguments that Mr. Buchmiller's review was incomplete and conducted without sufficient resources are directly contradicted by both Superintendent Dinallo and Mr. Buchmiller. See Point IV.B, infra.

Third, petitioners' contentions that Mr. Buchmiller did not come to a conclusion regarding MBIA Corp.'s post-Transformation solvency, and that the Department's approval was not based on Mr. Buchmiller's review and analysis, are similarly baseless. See Point IV.C, infra.

Finally, petitioners' suggestions that the Department's analysis was based on misleading

information, because MBIA supposedly failed to disclose information about "overrides," and utilized an improper discount rate and flawed stress tests, are belied by both the documentary and testimonial evidence in the record. See Point IV.D, infra.

A. The Department's Approval of the Transformation Had More Than Sufficient "Factual Basis"

In connection with its review of MBIA Corp.'s Transformation application, the Department received thousands of pages of documents, including, for example: the draft agreements for each of the transactions comprising the Transformation (see Record at R 141-222, 257-318, 407-96, 546-623, 687-98, 777-825); supplemental information from MBIA requested by the Department (see Record at R 645-51, 659-73, 685-86, 703-09, 725-36, 768-73), including supplemental information regarding the terms of the reinsurance agreement and related administrative services agreement between MBIA Corp. and National (see Record at R 224-28); pro forma balance sheets of MBIA Corp. reflecting year-end 2008 financial information (see Record at R 645-51, 945-53, 956-70); a solvency opinion from Bridge (see Record at R 67-133); a fairness opinion from Raymond James (see Record at R 224-28); and documents relating to MBIA Corp.'s loss models for its various exposures, including the inputs and assumptions for those models, and the results of various stress scenarios (see Buchmiller Aff. ¶¶ 18-20, 22, 33-37, 39, 41-49, 50-55; Record at R 368-396; 870-917, 920-944). See also Answer Mem., at 13-15.

To review and analyze MBIA Corp.'s application and these supporting materials from both a legal and financial perspective, Superintendent Dinallo enlisted both Department staff and outside consultants, including outside counsel Fried Frank and outside financial advisor Perella. Dinallo Aff., ¶¶ 47, 50; Moriarty Aff., ¶¶ 41-44; Klein Aff., Ex. B (Moriarty Dep. Tr.), at 166-12 – 167:10. Indeed, despite being entitled to presume the accuracy of the financial materials

submitted by MBIA Corp. (including its statements of financial condition and loss models), Superintendent Dinallo, in an abundance of caution, enlisted the best expert resources of the Department – including Mr. Buchmiller (who had substantial expertise in structured finance products), as well as Deputy Superintendents Finer and Moriarty, and Mr. Peltonen – to closely scrutinize the financial issues relating to the Transformation. See generally Dinallo Aff., ¶¶ 48, 50-51; Moriarty Aff., ¶ 40-46, 52-54, 57, 63; Buchmiller Aff., ¶¶ 19-55; Buchmiller Supp. Aff., ¶¶ 2, 8, 12, and Ex. 2. Superintendent Dinallo specifically instructed Mr. Buchmiller and Department staff that the principal focus of the financial review and analysis should be to address Superintendent Dinallo's "paramount concern," which was that, following the Transformation, MBIA Corp. would be able to pay its claims as they came due (and thus be solvent under the Insurance Law). Dinallo Aff., ¶¶ 51-52, 58; Buchmiller Supp. Aff., ¶¶ 8-9.

With this directive in mind, Mr. Buchmiller conducted a "risk focused" review of MBIA Corp.'s statements of financial condition and loss modeling methodologies in order to evaluate them for their analytical soundness, a review that included interviews and meetings with MBIA executives and a review of presentations, inputs and assumptions, outputs, and other information relating to MBIA Corp.'s loss modeling, over the span of nearly two months. See Point IV.B, infra; Buchmiller Aff., ¶ 19-55; Buchmiller Supp. Aff., ¶¶ 10-49, 57-73.

As a result of Mr. Buchmiller's extensive review and analysis, in which he determined that MBIA Corp.'s loss modeling methodologies were analytically sound and consistent with industry best practices (see Buchmiller Aff., ¶¶ 22, 38, 55; Buchmiller Supp. Aff., ¶¶ 38, 49, 73, 77, 81), the Department unquestionably had a "factual basis" for approving the Transformation.

Furthermore, petitioners' argument that the Department's Approval Letter must be annulled "because it contains no 'findings of fact … which demonstrated the basis for its

conclusion"'[55] lacks merit. *Every one* of the cases relied upon by petitioners involve administrative determinations made in an adjudicatory or quasi-judicial context after an evidentiary hearing, and thus are reviewed under the "substantial evidence" standard of CPLR § 7803(4) ("whether a determination made as a result of a hearing held, and at which evidence was taken, pursuant to direction by law is, on the entire record, supported by substantial evidence").[56] Those cases have no application here.

As the Court of Appeals recently noted, "there was nothing 'quasi-judicial' about the Superintendent's approval" of the Transformation, and "[t]he Superintendent did not conduct public hearings or provide public notice before rendering his determination." ABN AMRO Bank, N.V., 17 N.Y.3d at 227.[57] Such a determination is reviewed under the "arbitrary and capricious" standard of CPLR § 7803(3), and simply does not require formal findings of fact. See, e.g., Mid-Island Hospital v. Wyman, 25 A.D.2d 765, 767 (2d Dep't 1966); Lloyd Harbor Study Group, Inc. v. Diamond, 78 Misc.2d 135, 138 (Sup. Ct. N.Y. Co. 1973) (finding that Commissioner of Environmental Conservation had "not acted arbitrarily nor capriciously" in making determination without a hearing even though "the Commissioner made no findings of fact"). Indeed, in Mid-Island Hospital, the Second Department noted that a determination by the Insurance Department made where the Insurance Law contains "no requirement for a hearing or

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[55] See Reply Mem., at 139 (quoting Montauk Improvement, Inc. v. Proccacino, 41 N.Y.2d 913, 914 (1977)).

[56] See Reply Mem., at 138-39 (citing Montauk Improvement, 41 N.Y.2d at 913-14 (reviewing whether "determination of the State Tax Commission, acting in a quasi-judicial capacity," was "supported by substantial evidence"); Simpson v. Wolansky, 38 N.Y.2d 391, 394 (1975) (reviewing whether "hearing officer's report" was supported by "substantial evidence"); Gitlin v. Hostetter, 27 N.Y.2d 934, 935 (1970) (same); N.Y. Water Serv. Corp. v. Water Power & Control Comm'n, 283 N.Y. 23, 30 (1940) (reviewing whether commission's determination after hearing had "substantial support in the evidence")).

[57] Nor, as the Court of Appeals noted (and as discussed at Point III.D, supra), was the Superintendent required to conduct such hearings or provide such notice. See ABN AMRO Bank, N.V., 17 N.Y.3d at 227.

for the making of findings of fact or conclusions of law" is not quasi-judicial, and "[i]t is only where an administrative body or officer is acting in a quasi-judicial capacity that specific findings are required of him." Mid-Island Hospital, 25 A.D.2d at 767.[58]

Finally, petitioners' argument that the Department's approval of the Transformation was somehow a "policy reversal[]," simply because the Department had publicly stated its unwillingness to consider a splitting of MBIA Corp.'s books at an earlier date (see Reply Mem., at 140-41) is similarly misguided. As Superintendent Dinallo has explained, in February 2008, when both MBIA and Mr. Ackman discussed restructuring proposals for MBIA Corp. with the Department, MBIA Corp. was still rated AAA, and Mr. Dinallo believed that capital infusions could preserve this rating and allow MBIA Corp. to write new business and help to unfreeze the municipal bond insurance market. See Dinallo Aff., ¶¶ 36-37, and Ex. 14. Mr. Dinallo also believed that splitting the book at that time could jeopardize MBIA Corp.'s AAA rating, "which would be bad for the banks" because it might put the company into "run off." Id. ¶ 37, and Ex. 15. By February 2009, however, MBIA Corp. had no longer been AAA rated for several months, capital infusions had proven inadequate to allow it to write new business, and the "run off" concern on behalf of the banks had been mooted. Id. ¶¶ 39, 43, and Exs. 19-21. In short, by the time of the Department's approval in February 2009, circumstances had dramatically changed from February 2008. Moreover, there was no formal application for a restructuring before the Department in February 2008, and thus the Department had not made any final administrative determination regarding any such proposal at that time. Id. ¶ 37. The cases cited by

[58] See also 6A N.Y. Jur. 2d Article 78 § 371 ("If the act under attack is a discretionary act and no hearing is required by law, the failure to make specific findings furnishes no ground for annulling the determination, the court's inquiry being limited to whether the record shows facts which leave no possible scope for the reasonable exercise of discretion.") (citing Mid-Island Hospital). Nonetheless, the Approval Letter did contain extensive findings of fact, including with respect to the precise structure of the proposed Transformation. See Dinallo Aff., Ex. 22, at 3-6.

petitioners,[59] therefore, have no application to this proceeding.

B. Mr. Buchmiller Conducted a Thorough Review and Analysis of MBIA Corp.'s Statements of Financial Condition and Loss Modeling Methodologies

Petitioners' arguments with regard to the supposed insufficiency of Mr. Buchmiller's review and analysis (see Reply Mem., at 144-50), and Superintendent Dinallo's supposed failure to take Mr. Buchmiller's analysis into account when determining to approve the Transformation (see id. at 142), are also baseless.

First, petitioners' suggestion that the Department did not have sufficient resources to review the financial issues surrounding the Transformation, but instead was required to retain outside financial consultants to perform this review (see Reply Mem., at 145-58), is an affront not only to the Department, but to all state and federal administrative agencies, whose role in overseeing the various industries they regulate ought not be privatized. Indeed, Superintendent Dinallo considered the financial review of the Transformation, much like the Department's periodic statutory financial examinations of insurers, to be an essential regulatory function of the Department, one which he did not consider appropriate for outsourcing to private parties. Dinallo Aff., ¶ 56.[60] Moreover, MBIA Corp. had already submitted with its application a

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[59] See Reply Mem. at 140-41 (citing, inter alia, In re Charles A. Field Delivery Serv., Inc., 66 N.Y.2d 516, 521 (1985) (noting "impossibility of distinguishing" challenged decision from prior decision); Knight v. Amelkin, 68 N.Y.2d 975, 978 (1986) (remanding for further review where "petitioners [had] shown earlier determinations of the Board reaching contrary results on essentially the same facts"); Civic Ass'n of the Setaukets v. Trotta, 8 A.D.3d 482, 483 (2d Dep't 2004); Buffalo Civic Auto Ramps, Inc. v. Serio, 21 A.D.3d 722, 725 (1st Dep't 2005)).

[60] Mr. Dinallo also recognized that many private financial consultants would have had conflicts of interest given their close relationships to the financial institutions that were structured finance policyholders of MBIA Corp. Id. In fact, petitioners repeatedly argue that the Department should have "drawn upon the expertise and horsepower" of one financial advisor in particular, "BlackRock." See Reply Mem., at 147. However, at the time of the Transformation application, petitioner Merrill Lynch (which was acquired by petitioner Bank of America in 2009), owned nearly half of the outstanding shares of BlackRock. See Klein Aff., Ex. O (Merrill Lynch Press Release, dated September 15, 2008 (available at http://mediaroom.bankofamerica.com/phoenix.zhtml?c=234503&p=irol-newsArticle&ID=1390130)).

solvency opinion from a well-respected outside financial advisor, Bridge (see id. ¶ 55; Buchmiller Aff., ¶¶ 16-17 and Ex. 11), Mr. Buchmiller consulted informally with various outside financial consultants during his review (see Buchmiller Supp. Aff., ¶ 15), and in any event, Superintendent Dinallo had concluded that Mr. Buchmiller and other Department staff (who were simultaneously involved in a statutory financial examination of MBIA Corp.) had sufficient expertise and familiarity with MBIA Corp.'s business to perform the review. See Dinallo Aff., ¶ 53-54; Buchmiller Aff., ¶¶ 4, 6, 12; Buchmiller Supp. Aff., ¶¶ 4, 7, 23.

Second, petitioners' contention that Mr. Buchmiller's review of the Transformation was "rushed" (see Reply Mem., at 4, 12, 19, 93) is false. Superintendent Dinallo gave Mr. Buchmiller no deadline for the completion of his work; to the contrary, Mr. Buchmiller was given as much time as he needed to complete what he deemed necessary for his review. Dinallo Aff., ¶ 58; Buchmiller Supp. Aff., ¶¶ 8-9, 56, 59; Klein Aff., Ex. A (Buchmiller Dep. Tr.), at 378:22 – 379:2, 381:7-14; Klein Aff., Ex. B (Moriarty Dep. Tr.), at 301:4-12, 302:3-8. Indeed, in Mr. Buchmiller's January 30, 2009 e-mail memorandum to Messrs. Finer, Moriarty and others, he emphasized, in discussing the timing of his review, that the Department's duty of care was "to all policyholders," and his review would not be cut short due to any "arbitrary" proposed deadline. See Buchmiller Supp. Aff., ¶ 56, and Ex. 30; Klein Aff., Ex. A (Buchmiller Dep. Tr.), at 227:8-16.

Similarly unavailing is petitioners' suggestion that Mr. Buchmiller's review of the Transformation was somehow "incomplete." See Reply Mem., at 142, 148. Mr. Buchmiller conducted a "risk focused" review of MBIA Corp.'s financial condition. At the outset of his review, he interviewed over a dozen MBIA employees, including most of the company's senior executives, and its structured finance experts. Buchmiller Supp. Aff., ¶¶ 18-21, and Exs. 12-14;

Dinallo Aff., ¶ 62. He then concentrated his review of MBIA Corp.'s loss modeling on a sample of exposures within MBIA Corp.'s "key" sectors (where the company was already experiencing or could potentially experience losses), and extrapolated the results of that review to the remainder of MBIA Corp.'s exposures within those sectors, which allowed him to form opinions regarding the "veracity," "consistency," "reasonable[ness]," and "robust[ness]" of the company's loss modeling methodologies. Buchmiller Supp. Aff., ¶¶ 11, 29, and Ex. 7. Specifically, he conducted both a "bottom up" review of sample transactions from MBIA Corp.'s RMBS, ABS CDO and CMBS CDO sectors, as well as a "top down" review of these sectors, in order confirm the soundness of MBIA Corp.'s loss modeling methodologies and thereby verify its statements of financial condition. Id. ¶¶ 22, 29, 31-32, and Exs. 20, 21.

With respect to RMBS, Mr. Buchmiller conducted a bottom up review of MBIA Corp.'s modeling for the RFC 2007-HSA 2 transaction [redacted], and then reviewed several additional transactions within the RMBS sector to ensure that MBIA Corp.'s methodologies were being applied consistently. Id. ¶¶ 35-38, and Ex. 7. Similarly, he conducted a bottom up review of MBIA Corp.'s modeling for the [redacted] ABS CDO transaction, and then reviewed an additional [redacted] ABS CDO transactions to confirm modeling consistency. Id. ¶¶ 34, 45-49, and Exs. 7, 21, 26, 27. In both cases, he concluded that MBIA Corp.'s loss modeling methodologies were reasonable and in accord with best practices. Id. ¶¶ 38-39, 46, 49, and Ex. 7.[61]

Mr. Buchmiller's top down review of MBIA Corp.'s RMBS and ABS CDO loss modeling

[61] Mr. Buchmiller also found that MBIA Corp. had made conservative assumptions in its loss modeling for these sectors, including by assuming that it would not be able to offset any losses from certain RMBS exposures as a result of "putback" litigation that it had recently commenced, and by [redacted] Id. ¶¶ 33-34, 45, 47, and Exs. 20, 21, 26.

involved an analysis of the performance of the overall sectors (and their impact on MBIA Corp.'s financials) based on various assumptions of stress conditions, including "base," "stress," and "extreme stress" scenarios. Id. ¶¶ 39-44, 48 and Exs. 7, 22-25, 27. From this review, Mr. Buchmiller concluded that only under unrealistic and, indeed, near apocalyptic, stress assumptions would MBIA Corp.'s surplus to policyholders fall to zero or below. Id. ¶ 42-43, and Exs. 7, 25.

Mr. Buchmiller also conducted a bottom up review of MBIA Corp.'s modeling for the [redacted] CMBS CDO transaction, which incorporated both macroeconomic and transaction-level stress assumptions from third party models. Id. ¶¶ 66-69, and Exs. 38-42.[62] And, as a result of his top down review of the CMBS CDO sector, Mr. Buchmiller concluded that, unlike RMBS and ABS CDOs, "underwriting standards were maintained" for CMBS CDOs, and that "systemic risk" had largely been avoided in MBIA Corp.'s CMBS book. Mr. Buchmiller thus concluded that MBIA Corp.'s CMBS CDO loss modeling methodologies (including its "overrides" of certain large loan loss projections) were reasonable. Id. ¶¶ 63-64, 69-73, and Exs. 7, 37.[63]

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[62] Petitioners rely heavily on a February 5, 2009 e-mail from Mr. Buchmiller to Messrs. McKiernan and Chaplin in which he suggests that they schedule a meeting to discuss his review plan for MBIA Corp.'s CMBS CDO and remaining sectors, and states, "cue up music from Mission Impossible." See Buchmiller Supp. Aff., ¶ 60, and Ex. 34, at 4998. In a tortured reading of this e-mail, petitioners assert that it demonstrates that Mr. Buchmiller felt overwhelmed in conducting the Transformation review without the assistance of a third-party consultant. See, e.g., Reply Mem. at 146-47. To the contrary, Mr. Buchmiller has stated that this reading is "obviously incorrect," and that instead, he was merely "referring to the fact that MBIA Corp. – much like the team of agents from the "Mission: Impossible" television series – had a series of difficult tasks it needed to complete in short order to convince me as to the analytical soundness of its loss modeling methodologies with respect to CMBS CDOs and the other remaining sectors." Buchmiller Supp. Aff., ¶ 60.

[63] Mr. Buchmiller sent an e-mail Messrs. McKiernan and Chaplin on February 6, 2009, in which he shared some brief thoughts on the inherent limitations of certain modeling techniques, including "value at risk" or "VaR" methodology, which he likened to a "drunk looking for his car keys under the street light." See Buchmiller Supp. Aff., ¶ 61, and Ex. 35, at 5010. Petitioners contend that this somehow demonstrates that Mr. Buchmiller "expressed doubt about the scope of his work" (see Reply Mem. at 50), but this is, once again, a gross mischaracterization of the e-mail. As Mr. Buchmiller himself explains, "the 'drunk' analogy … had nothing to do with MBIA Corp.'s loss models or my review of the

Finally, Mr. Buchmiller performed a top down review of MBIA Corp.'s remaining sectors, and concluded that these sectors would not have a material impact on MBIA Corp.'s post-Transformation ability to pay claims as they came due. Id. ¶¶ 31, 62, 65, and Ex. 37.

Thus, petitioners' argument that Mr. Buchmiller's review was "limited and incomplete" (see Reply Mem. at 148) is belied by the facts.

C. Mr. Buchmiller Reached Conclusions Regarding MBIA Corp.'s Post-Transformation Solvency, and Superintendent Dinallo Relied on Mr. Buchmiller's Conclusions

Petitioners contend that, despite all of the aforementioned work by Mr. Buchmiller, which took place over a nearly two-month review of MBIA Corp.'s financial condition (see Buchmiller Supp. Aff., ¶ 80 and Ex. 7; Dinallo Aff. ¶ 63), his analysis was nonetheless "incomplete" because he supposedly failed to reach any conclusions regarding MBIA Corp.'s post-Transformation solvency (see Reply Mem., at 150-52), and that, in any event, Superintendent Dinallo failed to apprise himself of the results of Mr. Buchmiller's review and analysis. Id. at 142-44. Petitioners are wrong on both counts.

First, Superintendent Dinallo was fully apprised regarding Mr. Buchmiller's review and analysis of the financial issues surrounding the Transformation, even with respect to Mr. Buchmiller's decisions at the outset of his review regarding its scope and level of detail. Dinallo Aff., ¶ 59. Superintendent Dinallo trusted and relied on Mr. Buchmiller's expertise to make these decisions, but also believed them to have been reasonable. Id. ¶ 60.

Second, Mr. Buchmiller provided frequent reports to Superintendent Dinallo and other

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Transformation," and indeed, "was a reference to the well-known limitations of *any* modeling which relies exclusively on quantitative data (such as VaR)." See Buchmiller Supp. Aff., ¶ 61, and Ex. 35, at 5010; Klein Aff., Ex. A (Buchmiller Dep. Tr.), at 397:11 – 398:2. Indeed, contrary to petitioners' contentions, this e-mail actually supports Mr. Buchmiller's acceptance of MBIA Corp.'s CMBS CDO loss modeling, which incorporated various qualitative factors to reflect the unique traits of these exposures. See Klein Aff., Ex. A (Buchmiller Dep. Tr.), at 399:3-11.

Department officials regarding the progress and results of his review. Buchmiller Supp. Aff., ¶ 8. These reports were sometimes provided as lengthy e-mail memoranda (see, e.g., Buchmiller Supp. Aff., ¶¶ 52-54, 56, 74-76, and Exs. 30, 45), and other times at in-person meetings which included Superintendent Dinallo. See, e.g., Dinallo Aff., ¶¶ 57, 63; Klein Aff., Ex. A (Buchmiller Dep. Tr.), at 57:2 – 58:2; Klein Aff., Ex. B (Moriarty Dep. Tr.), at 58:12-21, 273:8-16, 278:23 – 279:9. With these reports, and as reflected in Mr. Buchmiller's File Memorandum (which reflected all of the work Mr. Buchmiller had performed up to the date the Transformation was approved, see Buchmiller Supp. Aff., ¶ 82), Mr. Buchmiller relayed to Superintendent Dinallo and other Department officials his conclusions that:

(i) based on his analysis of MBIA Corp.'s RMBS and ABS CDO sectors, MBIA Corp. held adequate assets to pay all of its claims as they came due (and thus would be solvent under the Insurance Law) following Transformation, even in an "extreme stress" scenario which required the assumption of stress conditions that he considered to be unrealistically pessimistic, see Buchmiller Supp. Aff., ¶¶ 43, 52-53, 80 and Exs. 7, 30; Klein Aff., Ex. A (Buchmiller Dep. Tr.), at 307:16-24, 310:21 – 311:22, 315:25 – 316:14, 422:25 – 423:6;

(ii) MBIA Corp.'s CMBS CDO portfolio contained no losses "of significance" or of material concern to his analysis of the company's post-Transformation solvency, see Buchmiller Supp. Aff., ¶ 76, and Ex. 45;

(iii) he had found no basis for questioning the analytical soundness of the methodologies supporting MBIA Corp.'s loss modeling, and, to the contrary, he had found them to be reasonable, consistently applied and in line with best industry practices, see Dinallo Aff. ¶ 63; Buchmiller Supp. Aff., ¶ 81 and Ex. 7; Buchmiller Aff., ¶ 57; Klein Aff., Ex. A (Buchmiller Dep. Tr.), at 93:18 – 94:4, 95:9-20, 335:20 – 336:12; Klein Aff., Ex. B (Moriarty Dep. Tr.), at 251:22 – 252:10, 290:6 – 291:17; and

(iv) based on his financial review, there was no reason not to approve the Transformation. See Buchmiller Supp. Aff., ¶ 81; Klein Aff., Ex. A (Buchmiller Dep. Tr.), at 93:2-10, 95:2-8, 236:22 – 237:14.

Therefore, the notion that Mr. Buchmiller did not communicate the results of his review and analysis to Department officials (including Superintendent Dinallo) prior to the Department's approval of the Transformation is unfounded.

Petitioners' repeated reliance upon Mr. Buchmiller's testimony at deposition that he had not reached any "final conclusions" regarding MBIA Corp.'s post-Transformation solvency by February 17, 2009, and did not recall anyone at the Department asking for such a final conclusion from him, to argue that Mr. Buchmiller had not sufficiently completed his review before the Transformation was approved, is misplaced. See Reply Mem., at 4, 13, 21, 22, 74-76, 112, 143-45, 150, 165. To the contrary, Mr. Buchmiller's testimony reflected what both he and his supervisors (including Mr. Dinallo) understood: that, because the nature of his review was to evaluate MBIA Corp.'s predictions of its future losses, and the precise accuracy of those predictions could not be known in the present, it was impossible for Mr. Buchmiller – or *any* financial analyst, for that matter – to reach a truly "final" conclusion in the present with respect to MBIA Corp.'s future claims-paying ability. See Buchmiller Supp. Aff., ¶¶ 13, 76, 79, and Ex. 45; Dinallo Aff., ¶ 61.

Finally, Superintendent Dinallo has specifically stated that he relied on Mr. Buchmiller's extensive review and analysis in determining to approve the Transformation. The Approval Letter itself makes this reliance clear. See Dinallo Aff., Ex. 22, at 6 (stating that approvals of dividend and stock redemption were "based upon … the Department's examination of the MBIA Entities' financial condition prior to the Transformation, and … the Department's analysis of the MBIA Entities' financial condition after the effectuation of the Transformation"); id. at 7-8 (stating that approval of the reinsurance agreement was "[b]ased upon … the Department's examination of the MBIA Entities' financial condition prior to the Reinsurance Transaction [and] the Department's analysis of the MBIA Entities' financial condition after the consummation of the Reinsurance Transaction"). Indeed, Mr. Dinallo has categorically stated that he would not have approved the Transformation had Mr. Buchmiller voiced any serious concerns about the

analytical soundness of MBIA Corp.'s loss modeling methodologies. See Dinallo Aff., ¶ 57.

D. The Department's Analysis Was Not Based On "Misleading" Information or Flawed Models

Petitioners' argument that the Department's analysis of the Transformation was based on misleading information or flawed modeling from MBIA Corp. (see Reply Mem., at 152-59) is also ill-founded.

First, the argument is based upon a faulty premise. Specifically, petitioners presume that it was somehow possible for MBIA Corp. to predict its future losses on its structured finance exposures with absolute precision, or for Mr. Buchmiller to be able to assess MBIA Corp.'s modeling predictions of its future losses for their "accuracy" rather than for their reasonableness and accordance with best industry practices. To the contrary, both Messrs. Dinallo and Buchmiller understood what was undeniably true: that there was inherent uncertainty both in MBIA Corp.'s loss models and in Mr. Buchmiller's analysis of them – as there would have been with *anyone's* predictions of MBIA Corp.'s future losses, or analysis of those predictions – and that the "accuracy" of those predictions could only be assessed in hindsight. See Dinallo Aff., ¶¶ 61, 74; Buchmiller Supp. Aff., ¶ 13, 76, 79; Buchmiller Aff. ¶¶ 4-5, 12-16, 57. Thus, the suggestion that the loss models created and used by MBIA Corp. and analyzed by the Department were somehow "inaccurate" misconstrues the very nature of MBIA Corp.'s modeling and the Department's analysis. Simply put, the Superintendent is entitled to base his determinations on estimates or future predictions, and doing so "does not render [his] conclusions irrational." See Med. Malpractice Ins. Ass'n, 72 N.Y.2d at 764; see also Procaccino v. Stewart, 25 N.Y.2d 301, 306 (1969).

Moreover, MBIA provided all necessary assistance to Mr. Buchmiller and the Department during their Transformation review, including affording them complete access to the

company's internal systems and data pertaining to its loss modeling methodologies, and allowing Mr. Buchmiller to interview any MBIA employees he deemed relevant to his analysis. See Dinallo Aff. ¶ 62; Buchmiller Supp. Aff., ¶¶ 19, 27. From these interviews, Mr. Buchmiller was able to assess the company's "enterprise risk management" practices, and in this regard, concluded that MBIA's management was competent and able to "identify, measure, aggregate, and manage" the company's "risk exposures." See Buchmiller Supp. Aff., ¶¶ 5, 18-21, and Exs. 4-5, 12-14.

Further, the particular instances of "misleading" information cited by petitioners establish nothing of the sort.[64] For example, petitioners claim that MBIA Corp.'s modeling set its loss reserves using an "illegal" discount rate pursuant to Insurance Law § 6903(b)(1) (see Reply Mem., at 62-67, 155-57), despite the fact that the Department specifically declined to conclude that the discount rate calculation was illegal. See, e.g., Buchmiller Supp. Aff., ¶ 88, and Ex. 30, at 15.[65] Indeed, as Mr. Buchmiller has noted, at the time of his review, he reasonably believed that the discount rate used by MBIA Corp. in connection with its Transformation application was reasonable. Id. ¶¶ 86-87, and Ex. 7. Mr. Buchmiller also believed that MBIA Corp.'s methodology was entirely consistent with the general principle underlying Insurance Law § 6903(b), that an insurer should be permitted to make "[a] deduction from loss reserves" to account for "the time value of money." Id. ¶ 88; Klein Aff., Ex. A (Buchmiller Dep. Tr.), at 408:16 – 409:2, 417:17 – 418:15.

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[64] As noted supra, MBIA Corp. did make certain errors in one of its presentations to Mr. Buchmiller regarding the hypothetical "extreme stress" scenario, but Mr. Buchmiller has stated that correction of these errors at the time of his review would not have led him to change his conclusion regarding MBIA Corp.'s post-Transformation solvency. See Buchmiller Supp. Aff., ¶ 84. Further, Mr. Dinallo has stated that he would have trusted and relied on Mr. Buchmiller's opinion in this regard. See Dinallo Aff., ¶ 75.

[65] As discussed in Point II, supra, the Department's reasonable interpretation and application of the Insurance Law should be upheld.

Petitioners' contention that MBIA Corp.'s stress tests somehow did not comply with Department policy (see Reply Mem., at 72-73, 159-60) is also incorrect. Petitioners accurately quote the applicable circular letter, which states that "stress scenarios and the resulting impact must be continuously monitored, assessed and updated," and should incorporate certain factors such as interest rate shocks or rating agency downgrades. See Department Circular Letter No. 25 (Nov. 18, 2008). However, as Mr. Buchmiller has stated, the guidance of this circular letter was not in any way inconsistent with MBIA Corp.'s loss modeling methodologies. See Buchmiller Supp. Aff., ¶¶ 89-91. In particular, MBIA Corp.'s stress tests modified the assumptions with respect to the company's ABS CDO portfolio based on performance data from the fourth quarter of 2008. Id. ¶ 90. The fact that MBIA Corp. did not increase its loss reserves in the fourth quarter of 2008 was attributable to the fact that the fourth quarter performance data was in line with the company's third quarter projections. Id. Similarly, the fact that MBIA Corp. was not projecting its losses to extend to its entire book of business (beyond RMBS and ABS CDOs) was also not inconsistent with the circular letter, because there were no signs of systemic distress in those other sectors. Id. ¶ 91.[66]

Finally, as the State Respondents accurately predicted in the answering brief, petitioners have submitted affidavits of three financial "experts" challenging the "accuracy" of MBIA

[66] For the same reason, petitioners' contention that the Department relied on "stale" data from MBIA Corp. (see Reply Mem., at 153-55), is incorrect. In the course of its review, the Department received from MBIA Corp. the most current financial information available, including pro forma financial statements as of December 31, 2008, which would not be finalized and filed until weeks after the Transformation was approved. See Buchmiller Aff., ¶ 31; Moriarty Aff., ¶ 57; Buchmiller Supp. Aff., ¶ 90; Record at R 703-09, 725-36, 945-53, 956-70; Klein Aff., Ex. B (Moriarty Dep. Tr.), at 309:10-25. Similarly, petitioners' suggestion that MBIA Corp. failed to disclose the financial impact of the "overrides" employed with respect to certain large loan losses (see Reply Mem., at 69-70, 157-59), is contrary to Mr. McKiernan's testimony that he advised Mr. Buchmiller of this fact. See Klein Aff., Ex. C (McKiernan Dep. Tr.), at 304:20 – 306:24. In any event, Mr. Buchmiller has testified that he believed that the overrides were proper. See Buchmiller Supp. Aff., ¶ 26.

Corp.'s loss models, and the Department's decision to accept MBIA Corp.'s statements of financial condition based on these models.[67] Not only do these submissions disregard the uncertainty inherent in predictions of future events (see Med. Malpractice Ins. Ass'n, 72 N.Y.2d at 764), they also should be excluded in their entirety. As stated in Point II, supra, the Department's approval of the Transformation cannot be annulled on Article 78 review simply by a finding that some alternative models would have been superior to MBIA Corp.'s models, but instead only by a finding that it was *irrational* for the Department to have relied upon MBIA Corp.'s models.[68] A reviewing court is not permitted "to second-guess the wisdom of what an administrative agency has done, nor to reform the procedures and methods used by that agency" (see Gramercy North Assoc., 169 A.D.2d at 349), and, instead, "must sustain" an agency's rational "determination even if the court concludes that it would have reached a different result." See Matter of Peckham, 12 N.Y.3d at 431. If the reviewing court itself is so constrained, then hired experts should also not be permitted to "second-guess" an agency's determinations in an Article 78 proceeding. Indeed, as discussed at Point III.D, supra, it is "not for the courts to choose between … diverse professional opinions." See McCabe, 33 A.D.2d at 547; see also Palozzolo, 83 A.D.2d at 539; Brussel, 137 A.D.2d at 686; Rivera, 2008 WL 441902, at *4; Murray, 2007 WL 1309728, at *1-2; Med. Malpractice Ins. Ass'n, 72 N.Y.2d at 763.[69]

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[67] See Affidavit of Mark Paltrowitz, sworn to March 4, 2011; Affidavit of Rene Stulz, sworn to March 9, 2011, corrected on March 23, 2011; Affidavit of Ronald Greenspan, sworn to March 10, 2011, corrected on March 23, 2011.

[68] See Answer Mem., at 22, 26 (citing, inter alia, Med. Malpractice Ins. Ass'n, 72 N.Y.2d at 767 ("[a] disagreement among actuaries … is not evidence that the Superintendent [of Insurance]'s acceptance of one set of conclusions was arbitrary"); Matter of N.Y.S. Council of Retail Merchants v Pub. Serv. Comm'n, 45 N.Y.2d 661, 672-674 (1978); Montgomery v Daniels, 38 N.Y.2d 41, 53 (1975)).

[69] Petitioners contend in their reply brief that one of their financial experts, Mr. Paltrowitz and BlackRock, "employed the same methods and assumptions that it would have used in February 2009 if the NYID had asked BlackRock to value these positions and used only data that was available then." See

In short, the Department had a "rational basis" for its approval of the Transformation, and the Verified Petition should therefore be denied and dismissed in its entirety. Matter of Pell, 34 N.Y.2d at 231; Matter of N.Y.S. Council of Retail Merchants, 45 N.Y.2d at 672.

POINT V

THE DEPARTMENT'S APPROVAL OF THE TRANSFORMATION WAS NOT "BIASED" OR IMPROPERLY MOTIVATED

Petitioners have asserted in their reply papers that the Department's approval of the Transformation was based on a "prejudgment or biased evaluation" and, in particular, that Superintendent Dinallo supposedly "sought to benefit certain favored constituencies – existing municipal-bond policyholders, government bond issuers in New York and elsewhere nationwide, and even MBIA Inc. and its shareholders and executives – at the expense of" the structured finance policyholders of MBIA Corp. See Reply Mem., at 161, 164. Petitioners' assertions are baseless.

First, as discussed at Point II, supra, "in an Article 78 proceeding" brought under CPLR § 7803(3), a reviewing court's "inquiry is limited strictly to a determination of whether a rational basis exists for the agency's actions," Pereira, 2010 WL 2754436, at *2. The agency's subjective motivation for its actions is irrelevant to this analysis, because "[t]he assignment of an improper motive or reason for doing an act which [a public entity is] authorized to perform could not make that act illegal." See Town of Hempstead v. Goldblatt, 19 Misc. 2d 176, 186-87 (Sup. Ct.

Reply Mem., at 79; see also id. at 147 ("if the NYID had drawn upon the expertise and horsepower of BlackRock to analyze MBIA's expected losses on its portfolio, the NYID would have realized that an independent analysis predicted jaw-dropping losses"). However, to the extent petitioners are offering the testimony of Mr. Paltrowitz and BlackRock as *fact* evidence of what BlackRock's loss modeling methodologies were at the time of the Transformation, rather than what its methodologies were in preparing the so-called "expert" report for petitioners, such testimony should be completely discredited due to the *$7 million* petitioners paid to BlackRock. See Caldwell, 83 A.D.3d at 55; Klein Aff., Ex. P ("Advisory Services Agreement" between BlackRock and petitioners) (PET 263-95), at 294 ; see generally Point III.D.2, supra.

Nassau Co. 1959) (quoting Chase-Hibbard Milling Co. v. City of Elmira, 207 N.Y. 460, 467 (1913) ("[i]f the public authorities were authorized to do what they did do," then "the reasons that moved them do not concern the plaintiff"), and Waterloo W. Mfg. Co. v. Shanahan, 128 N.Y. 345, 362 (1891) ("If the state has the right ... then the motives that underlie the act are not material.")). Accordingly, we respectfully submit that this Court need not even address petitioners' "bias" argument.

Even if "bias" were a permissible ground for challenging the approval, however, petitioners' claims of bias should still be rejected. First, petitioners' contention that the concept of bias can encompass "prejudgment" (see Reply Mem., at 164) is beside the point in this proceeding, because there can be no "prejudgment" where there is no adjudicatory or quasi-judicial proceeding at issue from which a judgment is rendered. Indeed, in the case upon which petitioners rely, 1616 Second Ave. Restaurant Inc. v. N.Y.S. Liquor Auth., 75 N.Y.2d 158 (1990), the Court of Appeals was clear in stating that its conception of "prejudgment" as "bias" applies only to a due process claim made in the context of "adjudicatory proceedings before administrative agencies." Id. at 161. As the Court of Appeals categorically held in the plenary action between petitioners and MBIA, "there was nothing 'quasi-judicial'" – let alone adjudicatory – "about the Superintendent's approval process" with respect to the Transformation. ABN AMRO Bank, N.V., 17 N.Y.3d at 226-27. Thus, the concept of "prejudgment" has no coherence in this case.

Further, New York courts have repeatedly acknowledged the "presumption of honesty and integrity accorded to administrative body members," a presumption that is not overcome by mere allegations of bias unsupported by concrete factual proof. See Sunnen v. Administrative Review Bd. for Professional Medical Conduct, 244 A.D.2d 790, 792 (3d Dep't 1997); see also

Goodstein Constr. Corp. v. Gliedman, 117 A.D.2d 170 (1st Dep't 1986) (rejecting petitioner's claim that determination of board on which deputy mayor participated was "reached in bad faith or for improper purposes" merely because successful bidder had made campaign contribution to mayor's reelection campaign). Indeed, "[i]n the sphere of administrative law, state administrators are assumed to be men of conscience and intellectual discipline, capable of judging a particular controversy fairly on the basis of its own circumstances," and "[c]onsequently, absent a demonstrable conflict of interest or record evidence of real bias, the determination of the challenged tribunal should not be set aside." See Grant v. Senkowski, 146 A.D.2d 948, 949-50 (3d Dep't 1989) (internal citations and quotations omitted);.

In rejecting a petitioner's bald assertions of bias, the First Department in Goodstein Constr. Corp. explained:

> In substance, petitioner seeks a trial in which the fact finder would be required to make a speculative psychological judgment as to whether a participant in a governmental decision was influenced by a desire to discharge a personal obligation to a firm whose principals had contributed to a campaign whose fundraising efforts he headed, in recommending policies that a responsible public official in his position could reasonably have recommended on the merits…. Our attention has been invited to no decision in which so nebulous an issue affecting the good faith of a governmental decision was found to justify a trial.

Goodstein Constr. Corp., 117 A.D.2d at 179.

In short, it is the extraordinary Article 78 proceeding that legitimately calls into question an agency's subjective intent. This is not such a proceeding. Indeed, petitioners' Verified Petition is practically devoid of allegations of "bias" or improper motive on the part of the State Respondents. See generally Verified Petition, ¶¶ 58-105.[70] Nonetheless, petitioners argue at

[70] The lone exception is petitioners' allegation "[o]n information and belief" that the State Respondents' approval "was motivated by an impermissible desire to discriminatorily favor the financial interests of MBIA Inc., government issuers of municipal bonds, and municipal bondholders over those of

length in their reply brief that the Transformation "impermissibly favors" MBIA Corp.'s municipal policyholders over its structured finance policyholders, and that the Department's approval reflected "impermissible bias" against the structured finance policyholders. See Reply Mem., at 14-15, 82-93, 160-67.

Petitioners' newly-concocted arguments are wholly unsupported by any evidence whatsoever. New York courts have repeatedly and summarily rejected challenges to administrative determinations based on such unsupported allegations or assertions. See Daxor Corp. v. State Dep't of Health, 90 N.Y.2d 89, 101 (1999) (rejecting Article 78 petitioners' unsupported allegations of agency's "bias" and "an elaborate regulatory conspiracy against them" in denying their license applications, and finding that, because "the record reveals independent reasons that fully support [the agency's] determination," petitioners could not possibly show that the "alleged bias was the cause" of the determination); Warder v. Bd. of Regents of the University of the State of New York, 53 N.Y.2d 186, 197-98 (1981) (cited by petitioners, see Reply Mem., at 164) (finding that no "question of fact [was] raised as to bias by the isolated statement" made by an agency employee "that the controversy was political rather than academic and that the team had come to 'find' a basis for the decision about to be made by the board," because "[s]uch a bare assertion does not establish a fact question warranting denial of summary judgment"); Hamlet v. Whalen, 300 A.D.2d 152, 152 (1st Dep't 2002) (rejecting "bare claims of bias" against administrative agency); Dunlop Development Corp., 26 A.D.3d at 182 (affirming trial court's rejection of petitioner's claim of "bias based on campaign contributions made to the Attorney General" by a real estate developer who had received a favorable ruling on an application to the Attorney General's office) (citing Yarbough, 95 N.Y.2d at 347); Yoonessi v. State Bd. For Professional Medical Conduct, 2 A.D.3d 1070, 1071-72 (3d Dep't 1993) ("absent

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MBIA [Corp.'s] structured-finance policyholders (including Petitioners)." See Verified Petition, ¶ 128.

concrete evidence of actual bias, petitioner's unsubstantiated allegations were insufficient" to "overcome 'the presumption of honesty and integrity accorded to administrative body members'") (citing Sunnen).[71]

Indeed, the thousands of documents produced in this proceeding by the Department and others, as well as the affidavits submitted by the Department, show that the Department's approval of the Transformation was based not on any sort of "impermissible" motive, but rather on entirely proper motives, including the advancement of important public interests. First and foremost, the Department took great lengths to confirm that, following the Transformation, both National and MBIA Corp. would be able to pay their claims as they came due (and thus, be solvent under the Insurance Law), thus preserving the interests of all MBIA policyholders. See Dinallo Aff. ¶¶ 52, 58, 64-66, 70; Moriarty Aff. ¶ 25; Buchmiller Aff., ¶¶ 19-55; Buchmiller Supp. Aff., ¶¶ 8, 9, 82; Klein Aff., Ex. A (Buchmiller Dep. Tr.), at 307:16-24, 310:21 – 311:22, 315:25 – 316:14, 422:25 – 423:6; Klein Aff., Ex. B (Moriarty Dep. Tr.), at 251:22 – 252:10, 380:24 – 381:17. In this regard, Superintendent Dinallo directed Mr. Buchmiller "to undertake a fair, dispassionate and unbiased review and analysis" of MBIA Corp.'s statements of financial condition and loss modeling (see Dinallo Aff., ¶ 52), and Mr. Buchmiller did exactly that. As Mr. Buchmiller states in his supplemental affidavit:

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[71] New York courts have required not only "concrete evidence of actual bias," Yoonessi, 2 A.D.3d at 1072, but proof that the challenged outcome "flowed" from such bias. See Sarfo v. Glass, 243 A.D.2d 824, 826 (3d Dep't 1997) (rejecting petitioner's "contention that respondent's determination must be annulled because it acted with extreme animus and was predisposed against him," and holding that "mere allegations of bias are not enough to set aside an administrative determination; instead there must be a factual demonstration supporting the allegation and proof that the outcome flowed from it"); see also Helmer v. New York State & Local Employees' Retirement System, 305 A.D.2d 949, 950 (3d Dep't 2003) (noting that mere "appearance of impropriety will not constitute a sufficient basis to set aside an administrative determination"); Modern Med. Lab., Inc. v. Dowling, 232 A.D.2d 901, 901 (3d Dep't 1996) ("[m]ere allegations of bias are not enough to set aside an administrative determination; instead there must be a factual demonstration supporting the allegation and proof that the outcome flowed from it"); Mauro v. Div. of Hous. & Community Renewal, 250 A.D.2d 392, 392 (1st Dep't 1998).

> "[I]n my capacity as a non-appointed civil servant, I reviewed the transactions of and conducted examinations of numerous Department-regulated entities with diligence and impartiality. My review of the Transformation was no different, as my conclusions regarding the analytical soundness of MBIA Corp.'s loss modeling were the result of a rigorous, measured and neutral review process that was unburdened by any political considerations."

See Buchmiller Supp. Aff., ¶ 83.

The Department also concluded that, by creating an MBIA entity that was able to write new business, the Transformation would allow the MBIA companies to further strengthen the capital position of the overall holding company system for the ultimate benefit of all MBIA policyholders, including the structured finance policyholders. See Dinallo Aff., ¶¶ 42, 66; Moriarty Aff., ¶¶ 25, 66, 72. Furthermore, Superintendent Dinallo reasonably believed, based on his conversations with Treasury officials, that approval of the Transformation would help facilitate federal assistance to *all* of MBIA Corp.'s policyholders. See Dinallo Aff., ¶ 33, 40-41, 67-69. [72]

Finally, the Department concluded that the Transformation served the vital public interest of reinvigorating the municipal bond insurance market through the establishment of a well-capitalized insurer that would be able to write new municipal bond insurance and allow municipalities to fund various public infrastructure projects, which, in turn, would help to stimulate the then-faltering economy. See Dinallo Aff., ¶¶ 28, 58; Moriarty Aff., ¶¶ 13-17, 25; Klein Aff., Ex. B (Moriarty Dep. Tr.), at 309:10 – 310:11. Indeed, the Department had explored various potential solutions for MBIA Corp. and other FGIs throughout 2008 that would simultaneously help strengthen the capital positions of the FGIs and help restore liquidity to the

[72] Superintendent Dinallo also knew that the Department could further protect MBIA Corp.'s structured finance policyholders in the future by virtue of its continued regulatory oversight of both MBIA Corp. and National. See Dinallo Aff., ¶ 71.

municipal bond insurance market. The Transformation was explored only after other capital infusion efforts had proven inadequate to address these concerns. Dinallo Aff., ¶¶ 28-29, 34-38.

In contrast, the purported "evidence" cited by petitioners of the State Respondents' improper motivations is nothing of the sort, as petitioners have, in each case, taken statements out of context or otherwise misleadingly characterized them to suit their fanciful "bias" argument. For example, petitioners cite an e-mail from Jay Brown, the CEO of MBIA Inc., in which Mr. Brown references a statement from President Obama "about wall street versus main street." See Giuffra Aff., Ex. 140; Reply Mem., at 166-67. It is beyond argument that a statement by the CEO of the *applicant*, MBIA, advocating for approval of his company's application with reference to a statement by the President, is not evidence of "bias" on the part of the *Department* in reviewing the application.[73] For the same reason, petitioners' citations to various other statements of MBIA executives, many of which were not even made *to* the Department, let alone by the Department, ring equally hollow. See Giuffra Aff., Exs. 113, 115-16, 119, and 141.

Petitioners also take completely out of context the February 26, 2009 letter request from Governor Paterson to the U.S. Treasury Department, and the statement of Superintendent Dinallo during a February 27, 2009 CNBC interview that "[w]e split the book at the Department last

[73] Petitioners misleadingly suggest that Superintendent Dinallo found Mr. Brown's comment about how the Transformation related to President Obama's statement to be "very helpful," when in fact, the full context of the e-mail reveals that Superintendent Dinallo was simply thanking Mr. Brown for relaying information to him regarding developments in the industry and the federal government's response to the financial crisis. See Giuffra Aff., Ex. 140. Indeed, the record reveals that Superintendent Dinallo never expressed to Mr. Brown any agreement with President Obama's statement or with Mr. Brown's suggestion of its relevance to the Transformation. Indeed, Mr. Brown has stated that Superintendent Dinallo had never expressed *any* views regarding the Transformation to him. See Klein Aff., Ex. Q (excerpts from the transcript of the deposition of Joseph W. Brown, dated October 15, 2010), at 186:10-11 (stating that Superintendent Dinallo "never discussed his views of the [Transformation] transaction with me"); 186:18-19 ("I don't recall [Superintendent Dinallo] ever making a comment about the [Transformation] transaction with me.").

week, so that we could make this request to the federal government this week," arguing that they somehow demonstrate a bias against the structured finance policyholders of MBIA Corp. See Giuffra Aff., Exs. 43, 121. Based on this supposed evidence, petitioners contend that Mr. Dinallo "admitted that he had approved the Transformation to facilitate a personal request by the Governor asking the U.S. Treasury to invest in MBIA Illinois to support the municipal-bond market," and that Mr. Dinallo "disclosed" that the Governor's request to Treasury was "the rationale for the timing of his decision to split" MBIA Corp.'s books. See Reply Mem. at 33, 92.

To the contrary, the letter from Governor Paterson specifically made requests for federal assistance *to the structured finance policyholders*, and did so at Superintendent Dinallo's behest. See Dinallo Aff., ¶ 68 and Ex. 24. Specifically, the letter expressed concern over the "future health of the major commercial banks and other financial institutions," and proposed having the federal government "back the insurance on the [mortgage-backed] securities" in order to "strengthen the credit rating on the bonds so that they are no longer a drag on the banks' balance sheet[s]," as this would be "a highly efficient alternative to [Treasury's] purchasing the securities" outright. Id. Thus, Superintendent Dinallo's statement during his CNBC interview in support of this letter request, far from showing bias against MBIA Corp.'s structured finance policyholders, shows that Superintendent Dinallo was trying to help these policyholders by approving the Transformation. See generally Dinallo Aff. ¶¶ 33, 40-41, 67-69, and Ex. 24.[74]

[74] Similarly, the draft talking points prepared by Department public relations official David Neustadt, in which he characterized the Transformation as a "[p]rivate sector solution for public sector problems" (see Giuffra Aff., Ex. 120; Reply Mem. at 166) does not show bias against the structured finance policyholders, but instead merely reflects that one of the purposes of the Transformation was to restore liquidity to the municipal bond insurance market, thus allowing municipalities to fund public infrastructure projects that would help provide an economic stimulus during a rapidly-deepening recession. Moreover, Mr. Neustadt's reference to the federal government's protection of the "banks" merely reflects the reality of TARP, which to that point had been used almost exclusively for the benefit of the nation's largest banks.

Petitioners' reliance on a statement from Superintendent Dinallo during congressional testimony in February 2008, over a year before the Transformation was approved (and many months before it had even been proposed), that his "first priority will be to protect the municipal bondholders and issuers" from "los[ing] money because of subprime excesses," is also misplaced. See Giuffra Aff., Ex. 24; Reply Mem. at 88-89. Not only did this statement not relate to the Transformation or to MBIA Corp. specifically, it did not even relate to any actual event, but rather, the hypothetical event of an FGI's impending insolvency. Thus, Superintendent Dinallo's statement during his congressional testimony has nothing to do with the Department's approval of the Transformation.[75]

Petitioners also cite a February 11, 2009 e-mail from Mr. Buchmiller updating Department officials on the status of his Transformation review as evidence of bias, due to Mr. Buchmiller's use of the phrase "shortcut to get to the decision on Transformation." See Giuffra Aff., Ex. 60; Reply Mem. at 164-65. Again, petitioners have taken an innocuous statement completely out of context. As Mr. Buchmiller has explained, his use of the term "shortcut" was simply a reference to the "risk focused" approach he had employed in his review and analysis of

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[75] Similarly unavailing is petitioners' citation to a statement from Deputy Superintendent Finer in August 2008 that the Department did not "want the money going out the door to the structured credits." See Giuffra Aff., Ex. 38; Reply Mem. at 166. This is a gross mischaracterization of both the timing and context of his statement, which was made months before the Transformation application had even been submitted, and in fact had nothing to do with the Transformation or MBIA Corp.'s structured finance policyholders.

The statement Mr. Dinallo made during a debate 19 months *after* the Transformation, and over a year after he resigned as Superintendent in order to run for the Democratic nomination for New York State Attorney General (see Giuffra Aff., Ex. 122; Reply Mem. at 92), in which he attempted to explain why petitioners had brought this proceeding, cannot possibly demonstrate bias at the time he approved the Transformation. Indeed, the subject was not even affirmatively raised by Mr. Dinallo, but rather by a debate moderator who asked him: "Have you ever been arrested or sued? And if so, what was it about, and how did it turn out?" In a time-limited format, and in the heat of a political campaign, Mr. Dinallo tried to summarize this proceeding not only in terms that voters might be able to understand, but in a way that might minimize the stigma that potential voters could (however unfairly) place on him merely for having been sued.

MBIA Corp.'s loss modeling, pursuant to which he performed a bottom up analysis of a sample of transactions within MBIA Corp.'s key sectors and extrapolated the results of that analysis, rather than performing a bottom up analysis of every single transaction. See Buchmiller Supp. Aff., ¶ 75; Klein Aff., Ex. A (Buchmiller Dep. Tr.), at 260:5-14, 387:6-13. Indeed, Mr. Buchmiller had used this same term in the same context during his meetings with MBIA personnel. See Buchmiller Supp. Aff., Ex. 27, at 2641.

Finally, petitioners cite to an e-mail from Perella to MBIA stating that "neither they nor the NYID have a problem with effectively treating policyholders differently." See Giuffra Aff., Ex. 139; Reply Mem. at 166. This, too, fails to establish bias on the part of the Department. As discussed in Point III, supra, it is entirely possible to treat different groups of policyholders differently in a given circumstance without treating any group of policyholders *unfairly*. Superintendent Dinallo concluded that the Transformation would be "fair and equitable" under Insurance Law § 1505(a) because it left all MBIA policyholders in a position such that their claims would be paid as they came due, even though the Transformation treated different groups of MBIA policyholders differently. See Dinallo Aff., ¶ 65. Superintendent Dinallo also knew that an insurer's obtaining "cut through" reinsurance with respect to only a particular segment of its book (and thereby benefiting only some of its policyholders) was a fairly commonplace action that was permitted under the Insurance Law. Id. ¶ 49 (citing Insurance Law §§ 1308(a), (b)(1)). Thus, Perella's statement to MBIA did not demonstrate bias, but rather, reflected an uncontroversial truth.[76]

[76] Indeed, during the tenure of former superintendent Edward Muhl (one of petitioners' "experts"), the Department approved a major restructuring transaction that treated certain Lloyd's policyholders differently than others, yet, as best as could be determined at the time, provided for all policyholders' claims to be paid as they came due. See Klein Aff., Ex. R ("But Questions Persist on Risks of Reinsurance," New York Times (August 22, 1996) (available at http://www.nytimes.com/1996/08/22/business/but-questions-persist-on-risks-of-

On November 23, 2010, this Court ordered that all internal Department e-mails between and among Messrs. Dinallo, Finer, Moriarty, Buchmiller, and Fischer relating to the Transformation should be reviewed by a court-designated referee, the Honorable John A.K. Bradley, who was instructed to order the production of any non-privileged documents that could potentially demonstrate "bias" on the part of the State Respondents. See Klein Aff., Ex. F. Justice Bradley's review led to *zero* documents being produced to petitioners. Id., Ex. G.

In short, having put forth absolutely no evidence of the State Respondents' bias against petitioners, much less any proof that the Department's approval flowed from any such bias, petitioners' assertions of bias must be rejected. Daxor Corp., 90 N.Y.2d at 101; Warder, 53 N.Y.2d at 197-98; Dunlop Development Corp., 26 A.D.3d at 182; Sarfo, 243 A.D.2d at 826.

POINT VI

PETITIONERS ARE NOT ENTITLED TO THE RELIEF REQUESTED

As set forth in Points I-V, supra, the Verified Petition should be denied and dismissed in its entirety. If this Court should decline to dismiss the Verified Petition in its entirety, however, petitioners' various requests for relief remain unwarranted.

First, petitioners' request for this Court to annul the Department's Approval Letter, and set aside or declare null and void the various transactions comprising the Transformation, should be denied. As argued in the State Respondents' answer memorandum of law (see Answer Mem., at 48 n.10), to the extent this Court finds any error in the Department's approval of the Transformation, it should remand this matter to the Department for further proceedings rather than reverse or annul the approval. See Ansonia Assoc. v. State Div. of Housing & Community Renewal, 147 A.D.2d 420, 421 (1st Dep't 1989) ("The appropriate procedure upon a finding that

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reinsurance.html?pagewanted=print&src=pm)).

an agency acted arbitrarily is to remand to the agency for further proceedings in accordance with the opinion.").

Second, and as set forth in the State Respondents' answering memorandum of law, petitioners' request for the Court to impose a constructive trust for the benefit of MBIA Corp.'s structured finance policyholders is also unwarranted. Petitioners do not meet the requirements for imposing a constructive trust, both because there were no "unlawfully paid dividends" as they allege (Pet. ¶ 115), and because petitioners cannot satisfy the four elements necessary to obtain that form of relief, including the existence of a confidential and fiduciary relationship. See Answer Mem., at 44-46. Petitioners devote a mere footnote in their 174-page reply brief to respond to these arguments, citing Simonds v. Simonds, 45 N.Y.2d 233, 241 (1978), for the proposition that the imposition of a constructive trust is not limited to circumstances "where a four-factor test is satisfied and a fiduciary relationship exists." See Reply Mem, at 170, n. 243. However, "[w]ith respect to constructive trusts specifically, New York courts have clarified that '[a]s an equitable remedy, a constructive trust should not be imposed unless it is demonstrated that a legal remedy is inadequate.'" In re First Central Fin. Corp., 377 F.3d 209, 215-16 (2d Cir. 2004) (noting that "[i]t is well-established under New York law that 'equity will not entertain jurisdiction where there is an adequate remedy at law,'" and that no such remedy existed in Simonds) (quoting Boyle v. Kelley, 42 N.Y.2d 88, 91 (1977), and Bertoni v. Catucci, 117 A.D.2d 892, 895 (1986)). Petitioners, whose plenary action against MBIA has been reinstated by the Court of Appeals (see ABN AMRO Bank, N.V., 17 N.Y.3d at 229), are being afforded their opportunity for a remedy at law, and thus cannot demonstrate their entitlement to a constructive trust.[77] In short, because petitioners cannot meet

[77] Furthermore, the Court in Simonds expressly found that the "four factors" *were* present in the case before it, so the language cited by petitioners is arguably dicta. Simonds, 45 N.Y.2d at 241-42. In addition, the only example suggested by the Simonds court of when the four-factor test need not be satisfied was where "one who wrongfully prevents a testator from executing a new will eliminating him

the requirements for the imposition of a constructive trust, their request for such relief should be rejected.

Finally, the State Respondents demonstrated in their answering memorandum that petitioners' request to compel the Department to restore the dividend and share redemption to MBIA Corp. is improper. See Answer Mem., at 46-48. Again, petitioners devote a mere footnote in their reply brief to these arguments, suggesting that "[i]f the Court concludes that only the NYID may assert a Section 4105(b) claim, it should declare the Dividend and Stock Redemption to be illegal and order the NYID to assert that claim." See Reply Mem., at 169, n. 242 (citing Cortlandt Nursing Home v. Axelrod, 66 N.Y.2d 169 (1985)). Petitioners ignore that ordering the Department to assert a claim is, as their own case makes clear, an Article 78 proceeding "in the nature of mandamus." Cortlandt Nursing Home, 66 N.Y.2d at 183. As the State Respondents have already demonstrated in their answering brief: (i) Article 78 relief in the form of mandamus to compel is available "only to enforce a clear legal right where the public official has failed to perform a duty enjoined by law" and "does not lie to enforce the performance of a duty that is discretionary, as opposed to ministerial"; and (ii) restoring to MBIA Corp. the amounts transferred to MBIA Inc. via the dividend and share redemption (and/or suing MBIA Inc. or MBIA Corp.'s directors) would be a discretionary, not a ministerial, act. See Answer Mem., at 47-48 (citing N.Y. Civil Liberties Union v. State, 4 N.Y.3d 175, 184 (2005), and DiBlasio v. Novello, 28 A.D.3d 339, 342 (1st Dep't 2006) ("Fundamentally, mandamus is an extraordinary remedy, available, as against an administrative officer, only to compel the performance of a duty enjoined by law . . . [and] only where a petitioner establishes a clear legal right to the relief requested.")). Therefore, relief in the nature of mandamus is

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as beneficiary will be held as a constructive trustee." Id. This has no application here, or indeed, in any case where "no suggestion has been made of bad faith or malfeasance." In re First Central Fin. Corp., 377 F.3d at 215 (distinguishing Simonds).

unavailable to petitioners here, and their request for this alternative relief should be denied.

Petitioners are thus not entitled to any of the relief requested in the Verified Petition.

CONCLUSION

For all the foregoing reasons, the State Respondents respectfully request that the Court deny and dismiss the Verified Petition in its entirety, and grant such further and other relief as the Court deems just and proper.

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