UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

IN RE:	)	Case No. 13-11452 (MFW)
	)	Chapter 11
Triad Guaranty, Inc., et al.,	)	
	)	
Debtor.	)	
. . . . .	)	
Triad Guaranty, Inc.,	)	
	)	
Plaintiff,	)	Adv. Pro. No. 13-51749
	)	
v.	)	
	)	
Triad Guaranty Insurance Corp., Triad Guaranty Assurance Corp. And Andrew Boron, Director of Insurance of the State of Illinois acting as Rehabilitator Of Triad Guaranty Insurance Corp. and Triad Guaranty Insurance Corp.,	)	Courtroom No. 4 824 Market Street Wilmington, Delaware 19801
	)	May 28, 2014
Defendants.	)	11:31 a.m.
. . . . .	)	

TRANSCRIPT OF DEBTOR'S MOTION FOR SUMMARY JUDGMENT
BEFORE HONORABLE MARY F. WALRATH
UNITED STATES BANKRUPTCY JUDGE

APPEARANCES:

For Triad:	Womble Carlyle Sandridge & Rice, LLP By: FRANCIS MONACO, ESQ. THOMAS HORAN, ESQ. 222 Delaware Avenue, Suite 1501 Wilmington, Delaware 19801
ECRO:	By: BRANDON McCARTHY
Transcription Service:	Reliable 1007 N. Orange Street Wilmington, Delaware 19801 Telephone: (302) 654-8080 E-Mail: gmatthews@reliable-co.com

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transcript produced by transcription service.

APPEARANCES (Cont'd):

For Triad:	Womble Carlyle Sandridge & Rice, LLP By: PHILIP MOHR, ESQ. One West Fourth Street Winston Salem, North Carolina 27101
	Morrison & Foerster, LLP By: ANTHONY PRINCI, ESQ. JAMES NEWTON, ESQ. REMMELT A. REIGERSMAN, ESQ. 1290 Avenue of the Americas New York, New York 10104
For Illinois Department of Insurance:	Drinker Biddle & Reath, LLP By: HOWARD COHEN, ESQ. 1100 North Market Street Wilmington, Delaware 19801
For State of Illinois Insurance:	Kubasiak Fylstra Thorpe & Rotunno By: DOUGLAS G. HEWITT, ESQ. 20 South Clark Street Chicago, Illinois 60603
For the Defendants:	Quarles & Brady LLP By: FAYE B. FEINSTEIN, ESQ. 300 N. LaSalle Street, Suite 4000 Chicago, Illinois 60654

COURTROOM DEPUTY: All rise.

THE COURT: Good morning.

MR. MONACO: Good morning, Your Honor. For the record, Frank Monaco from Womble Carlyle on behalf of the debtor. Your Honor, this is the time set for the debtor's motion for partial summary judgment, but before we get started with that Mr. Princi will address the merits of our motion and a few housekeeping matters.

First of all, Your Honor, I'd like to introduce my partner, Phil Mohr, who's been involved in the case and has been admitted pro hac vice. I don't think he's appeared in front of Your Honor before.

The second thing, Your Honor, both the debtor and the defendants have filed motions that exceed the page limitation. I think they're still outstanding, but I just --

THE COURT: Are they still pending? I read all the pages.

MR. MONACO: Okay.

THE COURT: I'll put it that way.

MR. MONACO: All right. Thank you, Your Honor. Without further adieu I'll cede the podium to Mr. Princi who will address the merits of our argument.

MR. COHEN: Can we just hand up the orders on the brief limits?

MR. MONACO: Oh, sure.

THE COURT: Are those yours or --

MR. COHEN: Just mine.

THE COURT: All right. I'll enter them.

MR. COHEN: Thank you.

MR. PRINCI: Your Honor, may I bring a bottle of water to the podium?

THE COURT: You may.

MR. PRINCI: Thank you. Good morning, Your Honor. Anthony Princi of Morrison & Foerster on behalf of the debtors. As Mr. Monaco mentioned, Your Honor, I'll be addressing the debtor's motion for partial summary judgment in our adversary proceeding.

Let me start, Your Honor, by making clear what our motion seeks and then what is at issue. Our motion seeks an adjudication on two counts of the complaint, Your Honor, Count 6 and Count 8 as Count 8 refers to Count 6. So Count 6 seeks a declaration -- excuse me, a declaratory judgment from the Court and that the debtor has the exclusive right to take a worthless stock deduction, that that right is property of the estate and that -- and then Count 8 seeks a declaratory judgment that with respect to that right this Court has exclusive in rem jurisdiction.

The defendants in opposition to the motion, Your Honor, don't contest and, in fact, concede the debtor's prima facie assertion that the debtor has a exclusive right -- has an

exclusive right to take a worthless stock deduction of its TGIC stock. The defendants refer to that as the defendants' ability, but a rose by any other name. So that's not an issue that's in dispute. Also not in --

THE COURT: Well, is that all you're asking, that I state that you have that right? I mean is -- aren't you, in fact, asking me to say you can, in fact, exercise that right now?

MR. PRINCI: We are not, Your Honor. However, we understand from the Court --

THE COURT: Well, then is there a controversy here? Is this ripe for me to make any ruling?

MR. PRINCI: Yes, Your Honor, because the defendants, Your Honor, up until they filed their answer, (a) never conceded that we had an exclusive right to take a worthless stock deduction, but (b) is the defendants have asserted a number of affirmative defenses to that -- to Count 6.

Now, we believe that these are like two ships passing in the night, to Your Honor's point, because the defendants' affirmative defenses all go to the issue Your Honor raised, to wit putting aside that you have the ability/right, debtor, to take a worthless stock deduction, can you exercise that right. Now, all the --

THE COURT: Well, then answer my question, if you don't want me to answer that latter question is there a

ripeness problem here?

MR. PRINCI: Your Honor, there's not a ripeness problem because they do contest. What we're saying is that as a matter of law the Court can rule in our favor notwithstanding their affirmative defenses on our request for the declaratory judgment. So it's ripe for adjudication. It's just that their affirmative defenses don't -- aren't really affirmative defenses. So there's a judiciable controversy.

THE COURT: Do you just want me to rule that a parent has the exclusive right to take a worthless stock deduction?

MR. PRINCI: And that that is property of the debtor's estate and that the -- this Court has the exclusive interim jurisdiction over that right. Those are the matters --

THE COURT: But so what? If you're not exercising that right why is it ripe?

MR. PRINCI: Oh, it's -- okay, so I'll tell you why the debtor needs the Court to issue that ruling and then I'll tell you from a technical vantage point why it's a judiciable controversy. The reason the debtor needs that ruling from the Court is from the commencement of this case the defendants have argued in various ways, and it's been a bit of a moving target with respect to their arguments, but effectively they have argued that we don't have that right, and --

THE COURT: No, I think they're arguing you can't exercise it.

MR. PRINCI: Well, in their affirmative defenses they clearly do argue that we can't exercise that right, but from the commencement of the case, going back to when we had this in the form of a motion for a trading order and then in connection with their motion to dismiss the complaint initially, they have argued that we don't have that right. Yes, they also have argued that we cannot exercise that right.

But the reason that it's important for us to get clarity on this is we are not in a position to be able to have a discussion of any meaning with any either perspective third party investor or with the existing shareholders about recapitalizing the debtor and thereby allowing us to promulgate a plan that we can confirm unless and until it's clear that we have that right. If we have that right we don't have any concerns about our ability to exercise that right. We don't think any of the --

THE COURT: Well, isn't that what you're asking me to decide, whether the rehabilitation order or any other thing impedes your ability to exercise it?

MR. PRINCI: No, they are arguing that, Judge. We're just asking you for declaratory judgment on a right, but, Judge, I am happy though to either sit back and say, to be clear, that all we're seeking in our complaint is a declaratory judgment that we have the exclusive right to take a worthless stock deduction, that that right is property of the estate and

that this Court as opposed to, for example, the rehabilitation court has exclusive in rem jurisdiction over that, and we agree with the Court that the affirmative defenses don't address that issue.

We had understood Your Honor at a hearing in this court on our motion to stay discovery that it was -- that the Court wanted to have, I think as the Court put it, all of the issues addressed, and I understood that to mean that notwithstanding that technically their affirmative defenses don't address the issue of whether or not we have the right, in fact, they concede we have the right, but rather address the question of whether we can validly exercise that right.

THE COURT: Right.

MR. PRINCI: I had understood that the Court wanted us to address in essence the affirmative defenses. So I -- I'm not trying to not be direct with the Court. I just -- I'm just not clear if the Court is still -- wants us to address those affirmative defenses.

THE COURT: I do want you to address --

MR. PRINCI: Okay.

THE COURT: -- all the issues.

MR. PRINCI: Okay. Then, Your Honor, going to the defendant's opposition to our motion, it is based, Your Honor, on their affirmative defenses, all of which, as Your Honor correctly references, go to their argument that notwithstanding

that we have the right to take a worthless stock deduction for a number of reasons set forth in their affirmative defenses, we don't have -- our exercise of that right would be improper, and in making that argument, Your Honor, they argue that certain of their affirmative defenses would bar the relief we're seeking in the summary judgment motion as a matter of law.

And as to those arguments they state the following. They say that the rehabilitation order as a matter of law bars the debtor from exercising its right to take a worthless stock deduction. They also argue that the debtor is barred from arguing that the rehabilitation order does not enjoin the debtor from taking a worthless stock deduction under the doctrine of res judicata, and similarly argue that the debtor's assertion with respect to the proper interpretation of the rehabilitation order is an improper collateral attack on that order.

Another question of law that they claim should be adjudicated in their favor, which would bar the entry of summary judgment, is that they claim the right to take a worthless stock deduction is not property of the estate. And then, lastly, they argue that as a matter of law the Illinois Insurance Code reverse preempts the debtor from taking a worthless stock deduction under the Internal Revenue Code pursuant to the McCarran-Ferguson Act.

In the alternative they argue that certain of their

affirmative defenses at a minimum create issues of -- genuine issues of material fact, which would preclude the Court from granting the motion for summary judgment and they argue specifically -- excuse me -- that there's a genuine issue of material fact with respect to whether the debtor's TGIC stock is today worthless. And then, secondly, they argue that there's a question of fact with respect to whether the debtor can abandon its TGIC stock pursuant to bankruptcy code Section 554.

What I'd like to do, Judge, is first take the affirmative defenses in which they assert that as a matter of law summary judgment cannot be granted here and then I will address their arguments that alternatively there are questions of fact that arise from the counts for which we seek summary judgment that would preclude the Court from entering summary judgment at this stage.

And at the outset, Your Honor, let me just note that with respect to their arguments, of course, that the debtors bear the burden of proof and that will become particularly, Your Honor, germane when I address their arguments with respect to the alleged issues of fact that they assert bar the entry of summary judgment here.

Let me start with their argument with respect to the rehabilitation order. As a matter of law, Your Honor, on the face of the rehabilitation order it does not say what they say

it says. Specifically, it does not say that the debtor is enjoined from taking a worthless stock deduction. In fact, Your Honor, they ignore a provision under the injunction language that they point to. So they focus on language that says that parties are enjoined from wasting the property or assets of TGIC, but immediately thereunder, Your Honor, in Paragraph 11 of the rehabilitation order -- and, Your Honor, the rehabilitation order can be found as Exhibit A to our complaint.

THE COURT: All right.

MR. PRINCI: And in Paragraph 11 of the rehabilitation order the rehabilitation court especially states that the rights and liability of the debtor as the stockholder of TGIC are not fixed by entry of the order of rehabilitation. They simply ignore as if that provision has no affect, the fact that that provision exists. They simply --

THE COURT: What do you think it does?

MR. PRINCI: I beg your pardon, Your Honor.

THE COURT: What do you think the effect of that is?

MR. PRINCI: So this order, Your Honor, as we demonstrate by the samples that we gave you of other orders in other rehabilitation proceedings in Illinois under Director Boron, is literally a stock order and this language is in all of these orders, and I think the only thing one can do is read it for what it says. It says that neither the rights nor the

liabilities of the debtor and other parties are intended to be fixed by this order. This order is not seeking to determine the rights, fix the rights or the liabilities of any of those parties. So when you look at the general language of the injunction you have to read that with the other provision in mind.

THE COURT: And what do you think it means?

MR. PRINCI: Well, as that provision applies to the debtor's right to take a worthless stock deduction, it means that this order isn't intended --

THE COURT: -- to enjoin that.

MR. PRINCI: Yes, Your Honor.

THE COURT: Even though it may waste the assets of TGIC?

MR. PRINCI: Correct, Your Honor, because, Your Honor, the defendants didn't submit to the Court in the opposition to the summary judgment motion any evidence that in connection with the complaint that they put before the rehabilitation court seeking the issuance of that order that they were seeking protection of any tax rights or, or, to bar the debtor from exercising a right that has -- that is not property of that estate. So the right --

THE COURT: All right.

MR. PRINCI: -- to take a worthless stock deduction, right, is admittedly not a right of that estate, and they don't

put into the record here in the summary judgment motion any evidence that they ever asked the Court by virtue of that stock language to make sure it was barring the debtor from exercising an independent right. There's no evidence that would suggest that the Court ever considered that. There's no evidence to suggest that the Court intended for this to bar the debtor from exercising a right that is not co-joined with the TGIC estate. This is an exclusive independent right that the debtor has.

Whatever the -- whatever, by operation of tax law, occurs when the debtor exercises that right it's clear that the Court wanted to make sure that it was clear that the order, the injunction provisions were not intended to affect parties' rights.

THE COURT: But then what is the import of the injunction at all? It's not to affect any other third party's rights?

MR. PRINCI: Well, Your Honor, if you're taking an action --

THE COURT: Aren't you eliminating the injunction completely then?

MR. PRINCI: No, of course not, Your Honor. If you -- I mean, you have to read -- like in any order, right, Your Honor, we have to read provisions in a way that (a) doesn't make any provision superfluous, okay, and (b) doesn't make the provisions in conflict with one another. Okay. So clearly the

injunction provisions are not superfluous. Clearly if you're --

THE COURT: Why?

MR. PRINCI: I beg your pardon, Your Honor.

THE COURT: Why? It enjoins what then?

MR. PRINCI: It enjoins an act, Your Honor, that would -- just what it says.

THE COURT: Waste the assets.

MR. PRINCI: Correct.

THE COURT: As long as it's not an act that the party had a right to take --

MR. PRINCI: No, Your Honor. The --

THE COURT: -- is that what you're saying?

MR. PRINCI: No, Your Honor. The right -- when a Court says we're not attempting to otherwise fix rights, okay --

THE COURT: Okay.

MR. PRINCI: -- this is a classic example of what that necessarily has to mean unless you make that provision superfluous, Your Honor. It can't be the case, for other reasons that I'm going to address in a moment, that a right that the debtor has and had the day before, Your Honor, the rehabilitation proceeding was commenced --

THE COURT: I know.

MR. PRINCI: -- an independent right under federal

law to take a worthless stock deduction. It can't be the case that the conditions that attach to the -- to TGIC's ability to use the NOLs of the consolidated tax group, okay, were intended under that order to bar the debtor from taking a worthless stock deduction. That's an independent separate right. When you exercise that right your exercise of --

THE COURT: I understand, but actions that a party may be taking which are -- you admit are within the scope of the injunction presumably are based on rights parties may have.

MR. PRINCI: Sure, but, Judge, it's not exercise, Judge, of the right to take a worthless stock deduction --

THE COURT: Why is that different?

MR. PRINCI: -- that has an affect on their assets. That's --

THE COURT: Why is that different?

MR. PRINCI: Because it's not the exercise of our -- of the debtor's right to take a worthless stock deduction that has the affect on any property of their estate. The --

THE COURT: Really, it does not waste the NOLs?

MR. PRINCI: Not at all. Not in the least.

THE COURT: And tell me why.

MR. PRINCI: Because when the -- because when you can use -- when a member of a consolidated tax group cannot use or take advantage of NOL carry forwards it's subject to a host of statutory limitations and conditions. So --

THE COURT: Isn't one of them whether or not you're part of the consolidated tax group?

MR. PRINCI: I think --

THE COURT: Isn't that one of the conditions?

MR. PRINCI: I think, Your Honor, that you can be deconsolidated and in certain circumstances one or the other of the members of the consolidated tax group can potentially still use the NOLs that were formally on the property or owned by the consolidated tax group.

So the NOL -- this is not in dispute by the way, Judge, the NOLs are owned by the consolidated tax group. If there's a deconsolidation, depending upon what leads to the deconsolidation, it is sometimes the case that the parent company could potentially use those NOLs. It's sometimes the case that the subsidiary could use those NOLs.

THE COURT: Let's talk about our specific situation.

MR. PRINCI: Okay.

THE COURT: If the debtor takes a worthless tax deduction can TGIC continue to use the however many millions of consolidated NOLs that exist as of this date?

MR. PRINCI: I don't believe the Treasury Regulations would allow TGIC to do that in that circumstance, Your Honor, and that is operation of law. That is the condition, Your Honor, that those -- that the use of those NOLs have always been subject to. So let's --

THE COURT: Okay.

MR. PRINCI: -- take a snapshot of the rights that the parties had a nanosecond before the rehabilitation proceeding was filed.

THE COURT: Okay.

MR. PRINCI: Okay. So in that moment the debtor had an exclusive right to take a worthless stock deduction.

THE COURT: But it had not exercised that right.

MR. PRINCI: Correct.

THE COURT: Okay.

MR. PRINCI: Correct. Okay. And it could have then, and if it did then, right, a nanosecond before the rehabilitation proceeding was filed, it would have been validly exercising a right that Congress gave to it exclusively and it would have violated no right of TGIC. Okay. And why is that? Well, that's because the Treasury Regulations make clear when the subsidiary can or can't utilize a net operating loss that's owned by the consolidated tax group. That all comes from Congress. That's operation of law. Okay.

So when TGIC went into its rehabilitation proceeding it had an indirect, highly conditional right to potentially use the NOLs owned by the consolidated tax group. Okay. That right -- if one were to accept the interpretation that the defendants would ascribe to the rehabilitation order what that would mean is that the rehabilitation order serves to enhance

TGIC's right, that rather than being subject to all these conditions the rehabilitation order eliminates all those conditions and provides TGIC with something it didn't have the day before it entered the rehabilitation proceeding, to wit an unconditional direct right to use the NOLs for as long as its rehabilitation proceeding would continue. That could be 10 years, 20 years.

Now, that's not the right that came into the rehabilitation proceeding with --

THE COURT: However --

MR. PRINCI: -- so that can't be what the rehabilitation order does for them.

THE COURT: Really? The injunction is not similar to the automatic stay?

MR. PRINCI: I have --

THE COURT: You get your rights as of the date of the rehabilitation and as of that date, once the rehabilitation order was entered and the stay went into effect, the debtor was precluded from taking an action that would diminish their property rights because it was as of that moment they had the right to use all the NOLs.

MR. PRINCI: Okay. So, Your Honor, let's be clear on the law. In a federally authorized estate, like this Chapter 11 estate, we have very clear statutory provision under Section 541 that defines what is property of the estate. We have an

abundance of case law that has clarified the scope and extent of those provisions, so that's one. Number two, we have another provision of the bankruptcy code, Section 362, that provides statutory protection of those property interest for the debtor. Okay. Now, that's the law for this federal Chapter 11 estate.

Now, let's look at what law, if any, applies with respect to the Illinois rehabilitation proceeding and how that law, if any, would assist the Court in making a determination as to whether or not that rehabilitation order should be interpreted so broadly as to (a) enhance the rights of TGIC beyond what it had when it started, (b) result in a prohibition of the debtor being able to exercise its federally authorized right in violation of the supremacy clause.

THE COURT: All right. Let's look at the --

MR. PRINCI: Okay.

THE COURT: -- law under --

MR. PRINCI: So in Illinois --

THE COURT: Let's look at case law under Illinois law.

MR. PRINCI: Sure. And --

THE COURT: Is there any that says that an injunction issued by a rehabilitation court does not preclude a third party from exercising a federally granted right?

MR. PRINCI: I'm sorry, Your Honor. Can you repeat

the question, please?

THE COURT: Is there any Illinois state law that says that a rehabilitation court's injunction does not preclude a third party from exercising federally granted rights, even though they may waste the assets of the party in rehabilitation?

MR. PRINCI: No, Your -- I'm not aware, Your Honor, of any Illinois statute to that effect, but obviously there could be no Illinois statute that the --

THE COURT: Not statute, case law.

MR. PRINCI: Okay. So I'm not aware, Judge, of any case to that effect either, but there can't be, Your Honor, either a statute or a case that would -- under state law that would stand for the proposition that if Congress grants a party a right to do something it's the intent of Congress to give a party a right to do something, that state, either through statute or through judicial fiat, can bar the party from exercising the right that Congress gave it. That is a violation of the supremacy clause, and we have cited --

THE COURT: But doesn't the supremacy clause deal with the enactment of laws that deal with the same subject matter as the federal law? They do not stand for the proposition that simply having some affect on a federally grant right is barred by the supremacy clause.

MR. PRINCI: So what the case law makes clear, Your

Honor, is that in the event you have a state statute or state court order that the application of which would defeat the objective that Congress had in connection with the issue in question, that that statute or state court order violates the supremacy clause. That is the standard. That's not in dispute, and you won't see in their summary judgment objection a dispute with respect to that standard. That is the standard that applies to determine whether or not a state law violates the supremacy clause.

You had asked an earlier question, Your Honor, that I want to address because I think it's spot on and it's important, and that is does -- doesn't the law that's applicable to a Chapter 11 estate, 541 and then the protections of 362, apply to the rehabilitation proceeding, and the answer is no. I mean, by definition obviously it doesn't. But beyond that, Your Honor, they have cited -- and we are not aware -- it's not simply that they haven't cited any legal support, we've looked, we're not aware of any case law and they've provided none for the proposition, Judge, that there is intended to be, you know, those protections under 362 for those -- for that proceeding.

So when you look at the rehabilitation order you don't have, Your Honor, a statutory framework like you do if you're looking at an order issued by this Court or any other bankruptcy court in which you can get guidance or that you

could look at the common law, you know, that has interpreted and elucidated the protections provided by 362.

There are literally no cases cited by the defendants for the proposition that Your Honor suggested earlier, that when you go into rehabilitation proceeding and you have some conditional right and that condition is a matter of federal statute, it's not contractual, it's federally mandated, right, and you go into a rehabilitation proceeding with that limitation that by virtue of the stock order that you see that was issued in this case that that means that the right -- that the condition that attached to that -- condition that attaches to that right is eliminated or eviscerated to the effect that you'd be enhancing it. It's a dramatic, dramatic --

THE COURT: It's not eliminated. You're enjoined from exercising it if it adversely affects the value of their assets.

MR. PRINCI: It doesn't say that, Judge. The rehabilitation --

THE COURT: Well, it does say that.

MR. PRINCI: The rehabilitation order does not say parties cannot exercise a federal right if under the federal law the consequence of that would be that the condition that attached to that -- the exercise of that right in the first place is effectuated. That order clearly doesn't say that. So --

THE COURT: It says that you can't take any actions, any actions, it's broader than this, that would result in waste of the assets of TGIC.

MR. PRINCI: Correct, and just to be clear, we're not taking an action that results in waste. When we take a worthless stock deduction, okay, their property doesn't get affected, okay, other than the fact that they never had the right in the first place to utilize the NOLs --

THE COURT: They did as of the --

MR. PRINCI: -- if --

THE COURT: -- nanosecond before the rehab order was entered.

MR. PRINCI: Incorrect, Your Honor. What they had was subject to our right to take the worthless stock deduction which would mean they wouldn't have the right to utilize the NOLs. They never had a --

THE COURT: But you didn't exercise that right. So as of the date of the rehabilitation order they had the right to use the NOLs.

MR. PRINCI: Correct, subject to all the conditions, one of which -- and there's a host of them. Your Honor, the implication of what you're saying is dramatic, and I want to just point something out. There are people -- this is a -- the debtor is a public company. There are people who own more than -- there are people who own stock of the debtor's company in

the public. Okay. If those people when the debtor -- right now we have a trading order in place. Okay. Now, let's think of either before they filed for bankruptcy or after this bankruptcy proceeding terminates. Okay. Those people when they pick up that order, right, and if they read it, they're not going to see anything that bars their trading, okay, in that stock. And so they're going to go forward and trade the stock. It's otherwise publically tradeable. Okay. And they're going to do that to the point, Judge, where they could effectuate a change in control.

Now, that change in control -- and I know Your Honor has had cases before, so I know the 382 proposition is one Your Honor is familiar with, right, so under Section 302 of the Internal Revenue Code just that regular trading by the public could effectuate a change in control that would -- that's yet another condition that attaches to the interest that TGIC has in its -- the day before it filed for rehabilitation and the day after. It was always a highly qualified, highly conditional right, as admitted the chief financial officer of the defendants, who was their 30(b)(6) witness.

Now, it can't be the case, Judge, that that activity, that trading activity, okay, violates the rehabilitation order, and yet the implication from the issue Your Honor raises would be to the effect that that too violates the trading order and there are a host of related conditions. All of these are by

operation of law.

And the one thing, Your Honor, I don't think can be debated is if you interpret the rehabilitation order such that the conditions that form whatever that right is, I mean, you know, it's obviously not a tangible right and then when we look at what it is it is highly conditional, you would be dramatically -- if one were to interpret that rehabilitation order in that fashion you'd be dramatically enhancing that right.

You have, Judge -- I think the parties have -- don't dispute this, there's approximately I think 700 million or so of NOLs that the consolidated tax group owns. An unconditional right mean you ignore everything that Congress said about when you can and if you can use those NOLs. You just by the magic of the entry of a stock rehabilitation order for 10, 12, 15 years, 20 years, suddenly TGIC has this absolute unconditional right. You're talking about taking something that at best has nominal value because it's so highly conditional, okay, and turning it into an enormously valuable asset.

Now, the entry of an order by a judge in a state proceeding without ever being advised or requested by the party seeking the order that that's what they want him or her to do, without any evidence that that judge was intending that effect, with there being an expressed provision that says this order is not intended to fix the rights or liabilities of third parties,

to ascribe that interpretation, Your Honor, you know, simply doesn't pass muster.

The other reasons, Your Honor, you can't interpret it in that fashion -- excuse me, Your Honor -- is that if you were to interpret it like that you'd end up having a violation of the automatic stay. So in our motion for summary judgment at Paragraphs 78 to 81 we cite Your Honor to cases that stand for the proposition that if you have a right -- excuse me -- that is property of the estate, an action like this, which would interfere with our right, right, we wouldn't be able to use our right, okay, so if an estate has a right to do something, right, has that property interest, and there's some judicial degree --

THE COURT: But all those cases deal with a post-bankruptcy judicial decree. They don't deal with a pre-bankruptcy judicial decree.

MR. PRINCI: I have to --

THE COURT: AC&F clearly was a post-bankruptcy arbitration award.

MR. PRINCI: It was. The only -- Your Honor, I apologize, I don't know, as I stand here, whether all the cases, you know, that stand for that proposition are with respect to post-petition orders, but I don't --

THE COURT: But let's -- if your suggestion is that it applies to pre-bankruptcy orders I'd be shocked at that

because don't you get your rights as of the bankruptcy date --

MR. PRINCI: You do, Judge.

THE COURT: -- and validly entered orders --

MR. PRINCI: You do.

THE COURT: -- pre-bankruptcy --

MR. PRINCI: And that's where, Judge --

THE COURT: -- are valid?

MR. PRINCI: -- this entire thing is circular, right, because if the order actually said, you know, wherefore the -- wherefore TGIC is a member of a consolidated tax group together with its parent company, TGI, and wherefore the consolidated tax group has valuable NOLs of which TGIC has an indirect qualified and conditional interest and wherefore the Court seeks to protect that interest is hereby ordered, and the order goes on to say that TGI shall not exercise its right to take a worthless stock deduction and shareholders shall not -- the public shareholders of TGI shall not trade their stock so as to result in the condition that attaches to TGIC's right being realized, let's just say that was the order, okay, well, I would agree then with the defendants' argument that were we to come to you if that was the order and say, Your Honor, if you allow that order to be enforced against this estate, (a), Judge, it would violate the automatic stay, (b), Judge, it would be violative of the supremacy clause, you'd say to me, Mr. Princi, you're in front of the wrong judge. That's a

collateral attack. You may be right, Mr. Princi, it may indeed violate the supremacy clause, but I am not the judge, okay, you got to go and take your argument there. And I understand that, Judge.

But the reason this is all circular, Judge, is that what we're talking about is what the interpretation of this order should be. None of us -- I don't hear the Court to suggest that the order obviously says that. I understand how Your Honor is analyzing whether or not the exercise by us of the right to take a worthless stock deduction can properly be interpreted as what the Court was intending to enjoin when it used the words, don't waste -- you can't waste property of TGIC.

Of course, by the way, Judge, it's not their property, right. I mean the property, like the CNOLs -- and we don't have a dispute on this, the parties agree the CNOLs are owned by a entity created under tax law called a consolidated tax group, but therein lies the issue in front of the Court, what is the proper interpretation. Can you, as they're asking you to, right, adopt that interpretation? If you adopt that interpretation would that violate law? Yes, it would. It would --

THE COURT: Well, shouldn't we ask rehabilitation court what it intended with that order and if it intended this?

MR. PRINCI: The debtor, Your Honor, doesn't have and

shouldn't have the imposition of having to go to the rehabilitation court when, in fact, Your Honor, the rehabilitation order can't do that. That would be to violate -- it would --

THE COURT: But you're saying if it can't do that that really it is something the -- you should go to the rehabilitation court and suggest.

MR. PRINCI: Your Honor, the fact that the defendants argue this doesn't make it so. Right. If when you look at the order, right, and you sit there and you go, well, it doesn't say this, so let me see if a state court judge was intending this, you don't ascribe to an order an intent by the state court judge to violate the supremacy clause if the state court judge had said what I said before. So I gave you a hypothetical where there would be undeniable clarity, that wrong or right the state court judge was intending to stop a party that Congress gave -- that it was the objective of Congress to say, you can write off your stock when you meet these conditions, you can write your stock off. Now, Congress gave companies, holding companies and other parties that right. Okay.

THE COURT: But didn't you just say any attack on this order under the supremacy clause --

MR. PRINCI: I beg your pardon, Your Honor.

THE COURT: -- is something that the rehab court

should itself decide?

MR. PRINCI: No, Judge, what's in front of you is what interpretation this Court, okay, should give. If you send us to Illinois, Judge, okay, what you're doing is ascribing the potential for that order to be -- to violate law, and the law is clear, you don't interpret an order in a way that would violate law.

So the threshold issue for this Court is since the order doesn't say we can't take a worthless stock deduction can it be legally interpreted like that, and there are a number of reasons why it cannot be -- it cannot provide for that. So you don't ascribe an interpretation that would lead the order to violate law and that's what -- if you ascribe that interpretation to this order, if you say, you know, there is the possibility that, you know, this order was intended to violate law -- by way of interpretation of judicial orders you don't ascribe an interpretation that would lead to the order being violative of law. That's just an undeniable tenant, Your Honor.

THE COURT: So --

MR. PRINCI: We cite cases for that.

THE COURT: -- we're back to your argument that the injunction only enjoined taking actions that are not legal because if you had the legal right to take the action they couldn't enjoin it.

MR. PRINCI: No, Judge, what's I'm saying is in front of -- for you for this Court is a question of interpretation.

THE COURT: Yes.

MR. PRINCI: But if, in fact, you had an order in front of you that doesn't present a question of interpretation because it says you cannot take a worthless stock deduction then that would be a collateral attack and that's impermissible.

So we cite cases, Your Honor, that make clear that where the question is the proper interpretation of an order a federal judge can -- or another judge, okay, even if it's another state court judge, can properly as a matter of law, okay, determine what the order says and what it doesn't say.

However, if you go to a federal judge and you bring an order in front of a federal judge where it's not a question of interpretation, you're simply arguing that the expressed provision violates law and you say to the federal judge, please effectively repeal that, please enjoin that court from enforcing that order because it violates some constitutional right I have, that's an impermissible effect. That's not what we have here.

We clearly have a question of interpretation, Judge. That's I don't think a matter of debate and that's properly a question that this Court for this estate needs to answer in the first instance, Judge. And what I'm telling you when you look

at the cases we cite for you, Judge, you will see that the law is very clear that when you go through that exercise you don't ascribe an interpretation to it that will violate law.

So the question for the Court, Your Honor, with respect to the interpretation is is the debtor correct with respect to our assertion that if you were to accept their interpretation of the rehabilitation order it would violate the supremacy clause? We say, yes.

You have to also answer the question, is this order, Your Honor, sufficiently specific and clear enough to allow us or a shareholder, okay, to be subject to the remedy of contempt for violation? Because if, in fact, you accept your interpretation then not only can we not exercise our federal right to take a worthless stock deduction, but shareholders can't really trade the stock, unbeknownst to them by the way. And we submit, Your Honor, that as a matter of fundamental due process when you look at the standards for injunctions the party who's potentially enjoined isn't supposed to be going through a guessing game.

We cite to you in our motion, Your Honor, their various interpretations of the rehabilitation order that are facially inconsistent. Let me tell you one thing they have said which shows you how this rehabilitation, (a) wasn't intended to cover what they're saying, and (b) they can't even figure out how to interpret it. So in -- and we cite this to

you in our papers, in an earlier submission to this Court they said, okay, so the rehabilitation order bars the debtor from utilizing our NOLs without paying for it, but it's okay if the debtor -- I'm sorry. Let me take a step back. They argue that the rehabilitation order bars the debtor from de-consolidating because that would diminish their rights but waste their assets. Okay? So that's the interpretation they say is applicable to the rehabilitation order.

In the same sentence or the very next sentence -- and again, this is laid out for you in our summary judgment papers, Your Honor. They say, but we're not arguing that if the estate -- if the consolidated tax group remains consolidated, that the debtor can't use the NOLs. So Judge, I'm terribly confused by their own interpretation of that rehabilitation order. On the one hand, we're supposed to know when we read that order that we can't deconsolidate.

And the reason we're supposed to know that is because of the interpretation they give to the words, property and waste. And we're supposed to know from that that we can't deconsolidate when their 30(b)(6) witness testified that the tax surety agreement doesn't prohibit us from taking a worthless stock deduction. But we're supposed to know that. Okay.

But on the other hand, somehow we're simultaneously supposed to know that provided that we don't deconsolidate, we can use those NOLs 'til the cows come home. So just think

about that for a second. If we were to reinvest, okay, we do a shareholders rights offering, right? And we recapitalize and we stay consolidated, and we blow through those NOLs thereby leaving them with zero to use, that somehow is permitted by the rehabilitation order. And we're supposed to know that's okay. But we're also supposed to know that if we deconsolidate, it's not okay.

It is manifestly clear, Judge, that not only could we be expected to know that that's what's intended -- by the way, absolutely no evidence do they submit in opposition to this summary judgment motion to suggest, to infer, to warrant the debate we're even having, Judge, because there is no evidence that the rehabilitation court was intending to bar us from exercising this right. They never said anything about any of these things to the rehabilitation court.

And there has to be an intention when you're talking about something like this on the court to bar or exercise the right. There has to be an intention to bar all the shareholders. Clearly, Judge, from a due process vantage point, how do our public shareholders who are our stakeholders for whom we have fiduciary duty, how are they supposed to know that they're not potentially going to be acting in contempt of this rehabilitation order? Well, the answer is simple, they don't know that because no one would ever know that by reading that order.

And the cases make clear, Judge, that if you want to

enjoin a party from engaging in an specific act, you can't put the party who's enjoined in a guessing game about what they can and can't do. So that's another reason, Your Honor, why that order as a matter of law just simply cannot be interpreted like that.

The other question of law, Your Honor, that they raise is that they argue that we shouldn't be able to even have this -- we shouldn't even be able to have the Court adjudicate what the proper interpretation of the order is because they say the doctrine of res judicata bars us from doing that. Again, very circular.

The doctrine of res judicata couldn't even be argued unless you first accept their interpretation of the rehabilitation order. So you can't invoke the doctrine of res judicata to say, ah, you can't ask the bankruptcy judge for -- to accept your interpretation of the order because you know under the standards for res judicata, you know, this was fully in front of the Court when the Court issued the order that bars you from taking a worthless stock deduction. Well, that's circular. It doesn't -- you first have to answer whether or not it does bar us from taking a worthless stock deduction before you can even argue that res judicata applies.

When you look at the rest of the standards for res judicata, particularly, Judge, keeping in mind that the defendants can't just throw things against the wall here in opposition to a summary judgment motion, okay? If there was

any sort of a record, Judge, that would have suggested that that order means what they say, it should have been part of Your Honor. Supposition, speculation is not sufficient to deny the entry of summary judgment.

And if there was any evidence, Judge, that would indicate that it was intended by the Court to bar the debtors from exercising its right to take a worthless stock deduction, bar our shareholders from trading that stock, this is the time when they should have in opposition to our summary judgment motion submitted that evidence to you. They didn't because there is none. And for that same reason, you don't meet the standards of res judicata.

The other reason res judicata doesn't imply is, we the debtor are clearly not in privity with TGIC. Their entire res judicata argument is predicated on the motion that TGIC, the company that's in the rehabilitation proceeding had a full and fair opportunity to litigate these issues and that we are in privity with TGIC and hence res judicata should be applied to us. For the reasons we set forth, I think very clearly, Your Honor, in our reply, I think the Court will see that there is no basis whatsoever --

THE COURT: Are you suggesting you had no standing to be heard on what the rehabilitation order said?

MR. PRINCI: I'm not suggesting that, Your Honor.

THE COURT: All right.

MR. PRINCI: I think, Your Honor, the other point

that they argue is that -- and I already I think referred to this, so I'll move past it, is that this is a collateral attack, an impermissible collateral attack on the rehabilitation order. And to Your Honor's earlier point, again, Judge, when you have an opportunity to look at the cases that we cite in our reply brief, you will see that the cases are very clear. If you are seeking to have another Court, the Court that didn't issue the order in question, excuse me, prohibit the enforcement of some other Court's order or find it invalid, okay, and that's the phrase you'll see in all the cases, okay, if the impermissible collateral attack occurs, when you go to a separate Court to have that Court rule that the order issued by some other Court's invalid and that is an impermissible attack.

That is not what we're doing. We don't believe that the rehabilitation court order is invalid. We don't contest its validity. We don't contest the authority of the Court to have issued that order. It is simply our position, Judge, that the interpretation that they would ascribe to that rehabilitation order is not only on its face not called for, it's not only minimally highly questionable by virtue of an expressed provision that says that this order is not intended to fix the rights, but for the other reasons I argued, you can't ascribe that interpretation because it would violate law. So it's a question of interpretation that is not a collateral attack.

The other legal issue that they raise, Judge, is they argue that under Majestic Star and Fruehauf Corp., the Third Circuit has held, they argue, that the right to take a worthless stock deduction is not property of the estate because it's not transferrable. And they say that Majestic Star holds -- stands for that proposition. And they state Fruehauf stands for that proposition. They're wrong both times. I know Your Honor's familiar with the cases, so I won't belabor the point. Those cases, that is not the holding of either case. Those cases don't stand for that proposition.

In fact, Your Honor, in fact, not only are there legion of cases which we cite in our brief in which Courts have found that rights which are not transferrable are property of an estate, of a Chapter 11 estate. But the very argument, Your Honor, they're advancing with respect to what they allege the Majestic Star case held and what they allege the Fruehauf Corporation case held, is necessarily incorrect because it would be in direct conflict with 541(c)(1)(a) of the Bankruptcy Code which makes clear that notwithstanding any provision in an agreement, transfer instrument, or applicable non-bankruptcy law that restricts or conditions transfer of such interest by the debtor, nonetheless, the interest is still property of the estate. So to assert that the Third Circuit in those cases was holding to the contrary, Your Honor, has no basis in law.

The last legal argument they make, Your Honor, is that the McCarran-Ferguson Act serves in this case to have the

Illinois Insurance Code reverse preempt the provisions of the Internal Revenue Code that provide the debtor and other holding companies with an exclusive right to take a worthless stock deduction of the stock of their subsidiaries. Of course, you've heard that argument before because they made -- that was their primary argument. When they sought to dismiss the complaint, Your Honor, ruled expressly on that. And as we point out in our reply brief, Your Honor, when you look at the law of the case doctrine, there is absolutely no basis for this attempt to reargue the decision of the Court. The cases are clear that the only exception to the law of the case doctrine is if there are extraordinary circumstances that would warrant the Court reconsidering it.

They never filed a motion for reconsideration. They don't argue in their opposition let alone provide any evidence in their opposition to our summary judgment motion that there are any extraordinary circumstances. Rather, Your Honor, this is just the simple case of somebody trying to take a second bite of the apple. That's not the law.

They then, Your Honor, after making those arguments which are all questions of law for this Court -- I should note, Your Honor, for the Court, that if Your Honor -- that the case of U.S. v. Spallone, which is a 2005 Second Circuit case and can be found at 399 F.3d 415 stands amongst other things for the proposition that a Court as a matter of law can interpret an order. And so these are -- the entire colloquy that I've

had with the Court, Your Honor, with respect to the interpretation that they argue should be given to the rehabilitation order, all involves ultimately a question of law for Your Honor to determine.

They do however, Your Honor, in the alternative say even if these legal arguments don't serve to lead the Court to conclude that the debtor cannot exercise its federally granted exclusive right to take a worthless stock deduction, there are questions of fact with respect to the motion for summary judgment that require that the Court deny the motion.

And specifically, Your Honor, they raise two questions of fact. The first, Your Honor, is that they argue that in order for the Court to adjudicate that we have a right to take a worthless stock deduction and then going to the question of you know can we exercise that right, the Court would first have to adjudicate the question of whether or not the stock is worthless. That's incorrect. That clearly is an issue that is not ripe and could not be ripe. So as Your Honor knows here's how a -- the issue of whether once a tax payer takes a deduction, any deduction, including a worthless stock deduction, here's how and when that question of fact becomes potentially a judiciable controversy.

First, you have to have the taxpayer take the deduction. It's only at that point when the factual predicates for the exercise of that deduction, the right to take the deduction are fixed. Until then, it's a moving target.

Obviously, the law is very clear that that ripeness is all about timing. So you can't be deciding a moving target, okay? Until a party takes the deduction and you don't have the facts necessary, neither a Court nor in the first instance, the Internal Revenue Service to determine whether the deduction is valid.

What happens next? The Internal Revenue Service, for their to be a judiciable controversy, would have to assess the taxpayer on the basis that they believe the deduction was invalidly taken. If the Service doesn't assess the taxpayer, okay, then you don't have a question about validity of the deduction that was taken. So that only comes up, (a) if you take a conduction and (b) the Service has to assess the taxpayer. After the Service assesses the taxpayer, there's an audit. And then if the Service continues to press the assessment, it is at that point where you can go into a Court to have a Court adjudicate the question of whether or not the taking of that deduction was valid. That is why, Judge, this Court today couldn't adjudicate that question. You could find today, hypothetically, you could look at this and say, I don't believe today the stock is worthless for the purposes of the debtor taking a worthless stock deduction. And that ruling would have no bearing on whether eight months from now if we wanted to take the worthless stock deduction, the stock would be worthless then.

So first and foremost, Judge, that argument that they

advance with respect to why there's an issue of fact is both irrelevant and not right.

Furthermore, Judge, if you were to look at their second argument which they claim is a question of fact, they say, you the debtor are going to seek to take the worthless stock deduction by abandoning the stock because under the Internal Revenue Code and the Treasury Regs related to them, and the parties don't disagree on this, there are two ways in which a taxpayer can take a worthless stock deduction. One is that you have worthlessness in fact. And two it's you have deemed worthlessness. And stock of a subsidiary is deemed worthless for the purpose of taking a worthless stock deduction.

If the taxpayer has a abandoned the stock such that there's no reversionary interest in that stock, it's forever gone and they argue that we're not going to be able to show without issues of facts arising -- excuse me. They argue that our contention by our abandoning the stock under Section 554 of the code, there are genuine issues of material code.

Okay. First, it's for the defendants in opposition to a summary judgment motion to first offer evidence that creates a genuine issue of material fact. This is not a -- the case law doesn't obviously doesn't allow the non-moving party to just throw allegations against the wall. You have to submit evidence that would support the proposition for which you say there is a question of fact. That is their burden of proof.

And they have not met their burden of proof.

They have submitted no evidence to suggest that we would not be able to satisfy the 554 standard of either showing that continuing to own the stock is burdensome -- by the way, we spent a year in bankruptcy that I think demonstrates manifestly that our owning the stock is burdensome -- and/or that the stock is of inconsequential value to the estate. They have offered no evidence to create any basis for the Court to believe that they have established that we would not be able to meet that burden. So they have failed to carry their burden of proof manifestly with respect to that.

But if the Court wanted to look past that, Judge, you have uncontested facts that the rehabilitator has submitted to the rehabilitation court an application for an order finding TGIC insolvent. That's the rehabilitator's position. And the rehabilitation court accepted the rehabilitator's submission and issued an order finding that TGIC is insolvent. That is an undisputed fact. They have submitted no evidence to suggest that that is in question.

I think just on that alone, Your Honor, that the Court could accept as a matter of law that there is no genuine issue, genuine issue of material fact as to whether or not the TGIC stock for this estate is inconsequential. Different than worthless. Inconsequential as one of the two predicates for us being able to abandon the stock under Section 554.

And lastly, Judge, let me boil down the overarching

reason with respect to both of these alleged issues of fact, why they have failed demonstrably to carry their burden of proof with respect to their affirmative defenses in opposition to our motion for summary judgment. What they are effectively asking the Court for and whether it's for the purposes for getting the Court to deny the summary judgment motion or were the Court to deny the summary judgment motion, and Your Honor believed that there are factual issues that you need to determine in order to rule on Count 6, they are arguing to this Court, they are submitting that the Court ultimately should find that the debtor cannot take forever and a day a worthless stock deduction.

That is what they ultimately are arguing. They're arguing now as a basis for denying the summary judgment motion. And were the Court to deny this, that that will continue to be their affirmative defense. That is injunction.

THE COURT: Yeah.

MR. PRINCI: And they would need, Your Honor, to carry their burden of proof with respect to that injunctive relief for which they seek.

THE COURT: Well, they're saying there already is an injunction in place that bars that.

MR. PRINCI: Okay. Your Honor, given that they've submitted to this Court not one scintilla of evidence --

THE COURT: But they have -- they're not seeking an injunction from me, they are --

MR. PRINCI: Yes, they are, Your Honor. They are seeking to have you enjoin us --

THE COURT: They are seeking to have me interpret the rehabilitation order as an injunction of that action.

MR. PRINCI: Understood. Understood, Your Honor. And on that basis, on that interpretation, right, they are then asking this Court to enjoin the debtor in possession --

THE COURT: They don't need a second order if they're correct. There's already an order in place.

MR. PRINCI: But Your Honor, for the purposes of this adversary proceeding, okay, Your Honor's going to have to you know adjudicate the issue one way or the other, right?

THE COURT: Right.

MR. PRINCI: And the effect of which -- the effect of which if you rule against the debtor in the adversary proceeding, then this Court, okay, would be -- this Court would be accepting the defendant's contention that they have a basis for this Court to then enjoin the debtor because that would be the effect of this Court not granting us the relief we're seeking.

We're asking, Judge -- you've asked for all the issues to be decided --

THE COURT: I under -- yes.

MR. PRINCI: -- affirmative defense, so that one of their affirmative defense is is that as you point out, the rehabilitation order bars us.

THE COURT: Right.

MR. PRINCI: And what I'm saying, Judge, is that they have to submit some evidence, Judge, to allow you to reach the conclusion that that position that they're taking is correct. And they've offered nothing other, Judge, nothing other than an order, it's a stock order it's issued in virtually identical terms in every case that they've offered nothing to this Court that would allow this Court to conclude that that order stands -- should be interpreted in the manner in which they state.

In any event, the point being this, Judge, it is their burden of proof. And I submit to you, Judge, that they have not come close to meeting that burden of proof. Your Honor asked me up front and then I'll end on this, Judge, Your Honor asked me early on what does that provision in Paragraph 11 mean. So I'm trying to do what I understand from the case law needs to be done. Read that in a way that doesn't make that provision superfluous and yet in a way that it doesn't pit that provision in conflict with the earlier injunction language.

What can't be debated, Judge, is is that that provision minimally, minimally, creates a question that Your Honor raised, what does it mean? What does that mean? That does that in fact, Your Honor, mean what I said? Does it not mean what I said? What was it intended to mean? That, Your Honor, is the burden that they have to carry. That -- it's not for us, the debtor, to try to prove a negative. It's for the

proponent of that affirmative defense, the party who sought from the rehabilitation court that order to give you evidence that would allow you to believe that unquestionably that order should be interpreted like that. And that is a failing on their part. And they're the only party, Judge, who could have shed any light on this.

And the reason you don't have any evidence to support their interpretation is because none exists. And with that, Your Honor, we would ask that the Court grant our summary judgment motion. Thank you, Judge.

THE COURT: Thank you.

MR. HEWITT: Good morning, Your Honor. For the record, my name is Douglas Hewitt with my co-counsel, Faye Feinstein. We represent the defendant respondents. With the Court's permission, we'd like to divide the responsibility for the defendant's presentation in response to the motion. If that's permissible, Ms. Feinstein will respond to the summary -- to the supreme -- supremacy clause arguments and the McCarran-Ferguson arguments as well as the effect that the abandonment of the stock would have on the Court's jurisdiction to decide whether the defendants have the right to take a worthless stock deduction and whether the alleged right is also a property of the estate. Is that acceptable to the Court?

THE COURT: Okay.

MR. HEWITT: Thank you. Summary judgment is only

appropriate where the movant demonstrates an entitlement to judgment that is clear and free from doubt. In light of myriad genuine issues of fact as to threshold issues relating to the debtor's claims, as well as frankly the lack of clarity as to the relief sought by the debtors and debtor's utter failure to address the impact that the relief which they seek will have on the parties interest in the NOLs, it's evident this is not an appropriate case for summary judgment.

Your Honor raised questions regarding ripeness. I think that is actually one of the dispositive issues here. The evidence demonstrates that the debtor has not established a present right to take a worthless stock deduction because it cannot prove as a matter of law that the TGIC stock is presently worthless under the Revenue Code or Treasury Regulations.

Debtor's reply effectively concedes this point and contends that the debtor is merely seeking a declaration that it has the exclusive right to take a deduction in a future return. Therefore, they are allegedly not required to prove a present right or that the stock is presently worthless.

Setting aside for the moment the issues of ripeness which Your Honor raises and obviously exist, unless and until the debtor can provide evidence that establishes that they have met the statutory prerequisites to the existence of a right to take a worthless deduction, they haven't proven if they either have a present or a future right to take a worthless stock

deduction. A worthless stock deduction is a matter of legislative grace. It is not an inherent right.

Furthermore, the debtor's motion purports to seek only a declaration that it has the exclusive right to take a worthless stock deduction. But a worthless stock deduction is the last step in a series of steps that are preconditions to and prerequisites to their ability to take a worthless stock deduction. Therefore, the motion necessarily requires the Court to determine whether the debtor has also demonstrated a present right to take the predicate acts, including abandonment under the Internal Revenue Code and Bankruptcy Code. Each of these determinations require resolution of fact intensive issues that preclude summary judgment.

The reply concedes that they have not even determined whether they will abandon the stock. And the issue of abandonment is not ripe.

Furthermore, the motion, as I said earlier, doesn't even address the impact that the relief which the debtor seeks would have on the parties' interest in the NOLs. A worthless stock deduction would affect a change in ownership of the TGI and TGIC that depending on the various factors which the debtor hasn't addressed will either diminish or eliminate TGIC's ability to utilize the NOL carried forwards in the future.

TGIC has a property interest in the NOLs that it generated. And the destruction or elimination of that interest would constitute waste prohibited by the rehabilitation order

which is an independent basis for denying the motion for summary judgment.

We do not concede that the debtor has the right to take a worthless stock deduction. The complaint seeks a declaration that the debtor has; i.e., the present tense, exclusive right to take a worthless stock deduction. A worthless stock deduction is not an inherent right. It is a matter of legislative grace. Any party such as the debtor does not have a right to take a worthless stock deduction unless and until they have satisfied the statutory prerequisites which would include demonstrating that the stock is worthless under the IRC and Treasury Regulations. Therefore, the Court cannot declare that the debtor has the right to take a worthless stock deduction unless and until the debtor has proven that the TGIC stock is worthless.

Worthlessness is a, under the IRC Regs -- under the IRC and the Regs is a question of fact in which the debtor has the burden of proof. The debtor has not proven that the TGIC stock is presently worthless as a matter of law and apparently doesn’t even concede that. At a minimum, there is a genuine issue of fact as to whether the TGIC stock is presently worthless and therefore, the debtor is not entitled to summary judgment.

Now in their opening brief, the debtor argued that it’s undisputed that the stock is presently worthless. But now in their reply, they seek a declaration that they will -- can

take worthless stock deduction in the future. And they argue to the Court that they don't need to establish for this Court that the stock is presently worthless before they can take the worthless stock deduction, that they only need to demonstrate worthlessness if the IRS challenges the deduction.

Respectfully, we believe that argument misses the point. The debtors are asking this Court to enter a declaratory judgment that the debtor has the right to take a worthless stock deduction. In order to obtain the relief that the debtor seeks from this Court, the debtor must prove that it is entitled to the relief sought. They may not have to establish anything before they put a deduction on their tax return, but they need to establish the existence of a right in order to obtain declaratory judgment from this Court.

I said in order to obtain a declaratory relief, they have to prove that they have met the statutory prerequisites including demonstrating worthlessness. The debtor has said the validity of a future exercise and alleged right is presently indeterminable and therefore the Court should not adjudicate the validity of a future exercise of the alleged right. Same is true for the existence of a future right. Whether the debtor will be able to satisfy the preconditions to a right to take a worthless stock deduction in the future is also presently indeterminable and will depend on future events and circumstances including frankly potential changes in the tax laws.

Any adjudication regarding the existence of future rights is inherently based on hypothetical facts and is an advisory opinion and not a proper topic of declaratory relief. Here, the debtor is seeking a declaration that they can take a worthless stock deduction in the future. But they haven't even determined whether they're going to take that deduction. It's inherently premature and hypothetical.

To obtain a relief they seek, they've got to prove worthlessness. Worthlessness -- the only evidence of worthlessness that they've offered is the finding of insolvency in the rehabilitation proceeding.

Under the authority cited in our brief, insolvency alone is insufficient to establish that TGIC stock is worthless within the Revenue Code or Treasury Regulations. Under the case law, as long as the stock has any value whether present or potential, it's not worthless under Section 165.

Treasure Regulation 1.1502-80 cited in our brief, sets forth the criteria to determine worthlessness under Section 165. There are basically two steps. First, a stock is worthless -- is not worthless until immediately before all of the subsidiaries assets are treated as having been disposed of, abandoned, or destroyed. Second criterion is the subsidiary ceases to be a member of a consolidated tax group.

The undisputed evidence that we have submitted to the Court in our appendix in support of our opposition to the motion for summary judgment demonstrates that TGIC and the

rehabilitator have not disposed of, abandoned, or destroyed all of TGIC's assets. TGIC continues to operate. The policies at issue remain in effect. The company or rehabilitator is collecting premiums and is generating substantial revenues. We estimate $270 million over the next six years. We clearly have not abandoned, destroyed, or disposed of our assets.

Interesting, the debtor asked its tax advisor, Ernst & Young, for guidance on the issue of when they could take a worthless stock deduction. And there's an e-mail chain which is included in the appendix. And I'd direct the Court to Appendix Exhibit Number 27. Ernst & Young opined that TGIC stock may not be worthless unless and until TGIC has been placed in liquidation. Obviously, that has not occurred. For these reasons, the debtor has not demonstrated worthlessness under the first test under 1502-80.

The debtor has also not demonstrated that TGIC has ceased to be a member of a consolidated tax group. And therefore, the stock is not worthless under the second criterion.

The debtor argues that TGIC will cease to be a member once the debtor abandons the stock, but it's undisputed that the debtor has not yet abandoned the stock. And according to Mr. Ratliff has not even determined whether they will abandon the stock.

Furthermore, even if the debtor had decided to abandon the stock, abandonment under the Revenue Code is

distinct from abandonment under Section 554 of the Bankruptcy Code. An abandonment under the IRC and applicable Treasury Regulations require the debtor to permanently surrender and relinquish all rights in the security and receive no consideration in exchange for the security. Under the evidence that we have submitted to the Court, it's clear the debtor has not abandoned pursuant to the Revenue Code.

The law requires the Court examine all the facts and circumstances to determine whether abandonment has occurred. Here, the evidence demonstrates that the debtor has not permanently relinquished all rights that it might have in the TGIC stock. Indeed, the debtor has not even committed to doing so in the future.

Specifically, the debtor has reserved the right to allocate the NOLs and the right to take a worthless stock deduction. And therefore, has not relinquished all rights that it may have in a stock.

Furthermore, even if the debtor had abandoned the stock and elected not to retain any rights, if they were to take a worthless stock deduction, they would have received consideration for the stock and therefore cannot meet abandonment under the IRC.

THE COURT: Isn't that circular? I mean you can't take a worthless stock deduction unless it's abandoned. That's one of the conditions. But you're saying, they can't abandon it because by taking the worthless stock deduction, they're

getting consideration.

MR. HEWITT: There are other ways that they're also retaining as well, Your Honor. It is somewhat confusing, I will be candid with you. But there are two criteria. And one requires that TGIC cease to be a member of the group. And the critical point is, we're still a member of the group. The group is -- the band is still together. And so they haven't demonstrated abandonment under the IRC and therefore have not demonstrated a present right to take a worthless stock deduction. They haven't even committed to taking -- to abandoning the stock in the future, as well.

So it really is a very hypothetical, premature adjudication of rights that puts the Court in a very difficult position at this point. Given the value of the assets that we're talking about, I think it, I think that it's entirely unfair to put the Court in that position.

Abandonment under the Bankruptcy Code, different standard, the Court is far more familiar than I am with what is required to demonstrate abandonment. The point is here that they have not abandoned and therefore cannot establish the right to take a worthless stock deduction.

We're saying that abandonment of the Bankruptcy Code is going to be a precondition to their election. Page 2 of their memorandum describes the course of action that they intend to take. And the last step is a worthless stock deduction.

Our interpretation of that, Your Honor, is that it's implicitly requiring or requesting the Court to make the determination or a finding that they also have the right to abandon under 554. Obviously, that's not ripe. They haven't declared the intent to abandon. They have not served notice of an abandonment. And according to their own papers, the issue is not properly before the Court. At a minimum, they have not established as a matter of law, a right to abandon under Section 554 which we interpret as a precondition to taking a worthless stock deduction. And that would be an independent basis for denying the motion for summary judgment.

Secondarily, even if the debtor had established a present right to take a worthless stock deduction or to abandon the stock, the rehabilitation order enjoins the debtor from doing so. Obviously, the order enjoins any party from taking any action that would waste TGIC's property or assets. I don't think it can be fairly disputed that TGIC has a property interest in the NOLs that is subject to protection.

At the time of the entry of the rehabilitation order, TGIC and the debtor were members of a consolidated tax group and parties to a tax allocation agreement. A substantial net operating loss carried forward existed primarily as result of TGIC's operations. And the debtor had not taken any action to take a worthless stock deduction or any of the other conditional acts that they've described in court today.

Furthermore, according to the complaint, the NOL was

owned by the consolidated tax group, TGIC was a member of the group. It has an interest on that basis alone.

There's substantial evidence in the record that TGIC had a property interest in the NOL carried forward including admissions the debtor's directors and officers made concerning the fact that the NOLs belong to TGIC which are included in the appendix. There's also evidence that we have offered and substantiated in the appendix that the members of the group compensated TGIC for the use of the NOLs that TGIC generated. In one instance, TGAC, TGIC's subsidiary paid TGIC $1.2 million for the use NOLs generated by TGIC to reduce TGAC's taxable income.

In a later instance, the group sought and obtained a refund of approximately $11 million. And as a result of the use of TGIC's NOLs, the group then issued TGIC issued a check for the other million dollars that arose from the use of the NOLs.

The debtor also sought and obtained a waiver from the department of insurance that's perceived obligation to reimburse TGIC for the use of NOLs that were needed to offset taxable income from -- arising from the forgiveness of debt and did so premised on representations that the debtor had an obligation to repay TGIC for the use of the NOLs.

Aside from the evidence that we've offered, the conclusion that TGIC has a property interest in the NOLs resulting from its own operations is consistent with the

decision in Prudential Alliance. And I'm sure the Court's familiar with that. And we cited that in our brief. In that instance, the subsidiary was in bankruptcy. The pre-bankruptcy generated substantial NOLs. And the Court analyzed the issue and concluded that the NOL carried forward generated by the subsidiary was property of the subsidiary's bankruptcy estate. And furthermore that the parent's attempt to take a worthless stock deduction wasn't an attempt to exercise control over the property of a subsidiary's estate in violation of the automatic stay. And in fact the Bankruptcy Court entered a permanent injunction.

At a minimum, based on the evidence and under Prudential Alliance and the other matters we cited in our brief, including admissions by the debtors Ds and Os or directors and officers, there's clearly a question of fact as to whether TGIC has a property interest in the NOLs. The debtor argues that TGIC's interests are derivative and conditional. TGI generated -- TGIC generated the NOLs. And so it's really not derivative. Even if it were, it really wouldn't make any difference because there was a property right that existed at the time of the entry of the rehabilitation order. And therefore, it is subject to protection.

Our property interest is not presently subject to the debtor's alleged right to take a worthless stock deduction because they haven't demonstrated that they have that right. And we're not arguing that the rehabilitation order destroys or

eliminates the debtor's right to take a worthless stock deduction. The rehabilitation order merely preserves TGIC's interest in jointly owned property. It prevents the destruction of TGIC's assets without a Court order. The order does limit the debtor's ability to take actions that waste our property.

And frankly, we're not seeking a declaration that we have an absolute and unconditional right to utilize the NOLs in perpetuity. We're not the debtor. It's not our complaint. We're simply responding to their allegations. So we're not seeking an injunction. We're not seeking affirmative relief. We're simply asking the Court to deny this motion today.

And at some point in time, they maybe able to use the NOLs. And that's why this declaratory relief is inherently raising an issue that is not ripe for adjudication. If they find another company that generates substantial taxable income consistent with the practice of the parties, then we start a consolidated group and one member can use the other member's NOL. In fact, that was what was done with the 2012 return.

So as long as the group remains together, as long as there's not a deconsolidation, then the debtor will be able to use the NOLs.

What's interesting, I don't now that it's particularly dispositive in this instance, but the debtor's right to utilize the NOLs is in fact derivative and conditional as well. They're right to utilize the NOLs that were generated

by TGIC is derived from the parties' election to file a consolidated return. In the absence of that election, TGI -- the debtor would have absolutely no right to utilize NOLs generated by its subsidiary.

Their right is also subject to our rights. Our right to deconsolidate. Now we gave up that right temporarily in this Court. But we've been stayed and the rehabilitation order, we submit is the same thing to them. We have intertwined rights, dueling estates, and they can't take an action that would destroy our property.

And clearly, the elimination or diminution of the NOLs or TGI's interest in the NOLs would violate the rehabilitation order. Their motion kind of skirts the issue. And now they've actually conceded it today, I believe, in court and the transcript will reflect precisely what was said, but the precise impact that a worthless stock deduction would have on the parties' interest will depend on various factors that haven't occurred and haven't been addressed by the debtor.

The impact will depend on future events including whether the debtor will retain ownership of the stock, whether TGIC remains a member of the consolidated tax group at the end of the year in which our stock supposedly becomes worthless. And it's clear however, that a worthless stock deduction would result in changes in ownership that would permit or provide the debtor with the ability to eliminate or diminish TGIC's interest in the NOLs.

In the Prudential Alliance case, again, the Court noted the effect of a parent taking a worthless stock deduction in appropriate circumstances may be to eliminate the subsidiary's ability to utilize NOLs carry forwards in the future. And to that extent, that would clearly violate the stay in the Prudential case and would result in the entry of permanent injunction and in our view would result in a wasting of our assets in violation of the rehabilitation order.

And Ernst & Young -- and again, Exhibit 28, Ernst & Young was asked to provide further counsel concerning the utilization of a worthless stock deduction. And risk partner told Mr. Ratliff that TGI could cause the NOLs to become worthless by causing a change of ownership of the TGI group to occur and then raised the possibility of whether the threat of the so-called nuclear option could be used as leverage to extract a concession from the department.

The elimination of TGIC's interest in the NOLs -- the nuclear option referred to by Ernst & Young as a source of leverage in negotiations with the rehabilitator would be a clear wasting of TGIC's assets.

We believe that it's clear that the injunctive provisions of the rehabilitation order are enforceable. In our view, the argument that the supremacy clause precludes the enforcements of the rehabilitation order is a clear collateral attack. It's not just the –- our interpretation of the order

that's at issue. Really the cases that the debtor cites themselves, Burlington Data Processing case District of Vermont a collateral attack is an attempt to avoid, defeat or evade a judicial decree or to deny its force and effect. I don't think there's anything more clear as to what the debtor is attempting to do by this declaration. They are trying to get a comfort order to go around the bend and avoid having to go back to Chicago and address whether their actions are appropriate under the rehabilitation order.

In fact, this was the collateral attack under the case -- the very cases cited by the debtor. The debtor also contends that the order is vague. The order is derived explicitly from the provisions of the Illinois Insurance Code. And that is why that same language is used in every order. It is drawn from the statute. The order restricts and precludes a party from wasting assets. I don't think that there's any ambiguity there. I think that it is clear enough that they can't engage in one-sided or unfair transactions with a subsidiary. More importantly, Your Honor, if the debtor is confused they should go to the rehabilitation court and ask for clarification.

Now, the debtor argues that the rehabilitation order can't enlarge TGIC's property rights or can't convert a conditional interest into an absolute right to control the debtor's property. We don't interpret it that way and that's

not what we're asking for. The order does not enlarge or modify TGIC's property, it merely preserves and protects that property from waste. We are not arguing that the order converts or modifies our property rights, only that it preserves and prevents its waste.

The argument that the order does not fix the debtor's rights is also irrelevant. We're not saying that we have the right to control the debtor's rights. The order limits the debtor's ability to take actions that would waste jointly owned property. The NOL's are jointly owned property and therefore are subject to the rehabilitation order under the Prudential Alliance case where the court –- in which the court enjoined the parent from taking a worthless stock deduction because it would diminish a subsidiary's interest in the NOLs and therefore violate the automatic stay. It's the same issue here.

And again, if it's unclear to them as to what they can permissively do they should go to the rehabilitation court and ask. And they made the decision not to do that. Mr. Jones wrote e-mails to other board members that are cited in our appendix where he said the fact that the rehabilitation proceedings may be to eliminate our interest in the tax attributes we should go to the department and discuss with them and try and reach an agreement as to what impact the order might have on our property interest. That was done in PMI.

They could have done it here. They made a conscious decision not to appear before the rehabilitation court. As a consequence they waived their right to make the arguments concerning the supremacy clause and other arguments that are here.

Again, they are essentially asking the Court to grant a comfort order. The debtor's actions can't be deemed to violate another court's order. They made a conscious decision not to try to negotiate a solution with the department before the rehabilitation proceedings. They made a conscious decision not to intervene in or seek to modify the rehabilitation order. Whether you call it waiver, whether you call it collateral attack, whether you call it res judicata the debtor is responsible for the choices that they made.

Now I'll turn the matter over to Ms. Feinstein.

THE COURT: Thank you.

MS. FEINSTEIN: Thank you, Your Honor, for allowing me to speak as well today. I will try not to reiterate anything that Mr. Hewitt has already said. Although we have divided up the arguments he's frankly hit quite a few of our major points. But if Your Honor will allow me, I know we've been here for a long time I'll do my best --

THE COURT: All right.

MS. FEINSTEIN: –- to be brief. We do believe that the supremacy clause argument is simply another way of

collaterally attacking the rehabilitation order. What Mr. Princi said is clearly the rehab order can't mean what we say it means, because that would violate the supremacy clause. But if Your Honor were to find that it does means what we say it means then the next response is but the supremacy clause would require Your Honor to invalidate the provision that contains the injunction as it may affect the debtor's right to take a worthless stock deduction.

What they're really doing is pitting the Illinois Insurance Code section that allows a rehabilitation court to enter orders in aid of its role in preserving and protecting assets of the estate. They're pitting that provision of the insurance code directly against a provision of the Internal Revenue Code that allows the taxpayer to diminish its tax obligation. As Your Honor noted the cases under the supremacy clause deal with laws that deal with the same subject area. So frankly I don't see the conflict here at all.

In the Third Circuit as well as in the supreme court there is a strong presumption against preemption. So notwithstanding the debtor's attempt to shift the burden to us it is the debtor's burden to establish that preemption applies. And we believe the debtor's failed in that burden. There's no dispute that the regulation and rehabilitation of insurance companies fall solely within the province of state regulation and the state court. There's no dispute that the Illinois

Insurance Code section being challenged does not address payment of taxes by an insurance holding company or deductions against income tax.

Absent expressed preemption which we all concede we don't have here conflict preemption only applies when it's impossible for a party to comply with state and federal requirements, or state law stands as an obstacle to accomplishing the full purpose and objective of congress. But the debtor has presented no suggestion of congress' intent in including the worthless stock provision of the Internal Revenue Code. Debtor only states that, and I quote, congress' objectives are self-evident. But it's certainly not self-evident that the worthless stock deduction provisions were ever intended to override a state court's ability to enter orders to protect and preserve the assets of an insurance company in rehabilitation.

As the debtor points out in its opening memorandum Section 165(a) allows -- the word the debtor used -- allows the taxpayer to take certain deductions against income. There's no requirement that a taxpayer take a worthless stock deduction in order to satisfy its tax obligation. Yes, the debtor's required to pay taxes. The debtor has no right, absolute right, under the tax code to reduce its tax obligation.

The debtor also indicates that it won't take the worthless tax deduction unless and until TGIC ceases to become

a member of the consolidated group. But deconsolidation isn't automatic. It would require an affirmative act by either the debtor or TGIC the timing of which is totally within the control of the parties, and is not regulated at all by the Internal Revenue Code. There's nothing in the Internal Revenue Code that requires the debtor to take any action under 165.

There's nothing on the face of the Internal Revenue Code section at issue or in any case or legislative history that indicates that congress intended the Internal Revenue Code to interfere with the state's ability to regulate the rehabilitation of insurance companies including by allowing for injunctive relief. The worthless stock deduction as Mr. Hewitt pointed out is not a right, it's really a description of how a transaction can be accounted for on a tax return. The debtor cites no law to the contrary.

The debtor cites and supports the Frederickson case but we don't believe that supports the debtor's position. There the court found that the Star Bucks estimated employees' tips in order to comply with what it believed was its obligation to withhold and remit tax to the government. The court found that the employees' exclusive remedy was to seek a refund of the taxes paid and that congress intended the Internal Revenue Service to occupy the field of tax refunds and therefore it preempted the employees' ability to make a claim against their employer. They were talking about taxes and

taxes.

The court went on to state that when a state law specifically prohibits an activity that a federal law authorizes state law must give way. But here the insurance codes doesn't prohibit or even address the debtor's ability to take a worthless stock deduction. There's simply no conflict between the two statutes. But even if there were an argument viable that there is a conflict we believe that it's too late for the debtor to raise that argument. Debtor says it was our burden to come into the injunction court, the rehab court and present evidence as to whether or not the parent should be able to take a worthless stock deduction.

We don't believe it was our burden. We believe it was the debtor's burden if it believed that an order was being entered that might adversely affect their ability to take an action that it should have spoken up. We're not talking about any third party that might have gotten notice of a hearing. We're talking about the parent company. The parent company that saw the drafts of the order, the parent company that saw the drafts of the plan, the parent company that agreed to the filing of the rehabilitation complaint and the entry of the order for relief.

So we believe it was their burden to assert the way they did in PMI a reservation of rights that this order that says you can't waste that, our assets, doesn't mean that we

can't take a worthless stock deduction. They knew that the NOLs were a huge asset to both companies. They chose to stay quite, but now they're coming here and asking for Your Honor for after the fact relief.

Even if the debtor were correct that the insurance code directly conflicts with the Internal Revenue Code, let's assume for the minute that that's correct, we do believe that the McCarran-Ferguson Act would reverse preempt the debtor's ability to take a worthless stock deduction. With all due respects to Your Honor this issue was not addressed before. The issue we addressed was whether Your Honor should hear this adversary case or whether it should go back to the State Court. Now we're arguing -- and Your Honor found that the NOLs that were being addressed and whether those constitute property of the estate really should be determined by Your Honor.

Now what we're talking about is -- since Your Honor ruled that –- the debtor's saying well, now Your Honor also has to find that this federal law that has nothing to do with the state statute primes, trumps the state law. This is not an issue that Your Honor decided, and law of the case simply doesn't apply. But even if Your Honor felt that you had considered it before the Third Circuit has reiterated that you always have the ability to revisit your own interlocutory orders without restriction by the law of the case doctrine. So the focus now is on the power of the State Court to take action

in full conformity with the state's statute that that would enjoin actions that have a negative affect on an insurance company in rehabilitation.

The McCarran-Ferguson Act provides that federal law cannot invalidate a state law, and I'm quoting, enacted for the purpose of regulating the business of insurance. And that's in Section 1012(b). The Supreme Court in Fave (phonetic) held that the broad category of laws enacted for the purpose of regulating the business of insurance is broader than just the business of insurance. And that the primary purpose of a state statute that distributes an insolvent insures assets to policyholders is identical to the primary purpose of the insurance company itself which is the payment of claims against the policies. Fave also found that if a federal and state statute conflict federal law must yield to the extent the state's statute furthers the interest of policyholders.

Now granted in Fave they were talking about the priorities that were afforded under the distributive provisions of the Ohio State statute versus the federal priorities that might be afforded to the government, but the principle is the same. Absent the power to issue an injunction the assets of the rehabilitation estate would be dissipated. They'd be diminished, they'd be destroyed, NOLs would be gone with a direct effect on the ability of the rehabilitator to make payments on the claims of policyholders. The state statute at

issue therefore –- the specific provision that the debtor has placed at issue is in fact a law enacted for the purpose of regulating the business of insurance.

We then address the prongs of the humana test in our briefs. We believe that they're satisfied here. The worthless stock deduction provision does not relate to the business of insurance it's addressed to all taxpayers. The Illinois Insurance Code was enacted for the purpose of regulating the business of insurance including insurance companies and rehabilitation and reading the worthless stock deduction provision in a way that allows a debtor to destroy TGIC's interest in NOLs would invalidate. It would invalidate the injunctive provisions of the state statute and the rehabilitation order which is just what they're asking for.

I would like to address briefly our position that it's not clear at all, and I don't know the answer to this, Your Honor, but we're suggesting Your Honor look at the spectrum of what is and what isn't property of the estate. Because we're really not talking about NOLs per se. If we were talking about whether TGIC could usurp all of the NOLs for itself we might be talking also about the debtor's interests in the NOLs. But we're talking about a right, debtor refers to is as a separate right, a right to take the worthless stock deduction. And we think it's worth considering whether that is even property of the estate. Then this would be a case of

first impression. Property of the estate is broadly construed, but there are limits to what constitutes property of the estate. 541 doesn't say everything and anything. The Third Circuit has recognized in Majestic Star that there are limits.

The Third Circuit explained that it's not true that every contingent tax attribute can necessarily be labeled as property of the estate. In that case the issue, of course, was whether a tax status, QSub status was property of the debtor or property of the non-debtor parent. The court noted there that the Internal Revenue Code does not create any property rights. The court there also focused on what the debtor's rights were at the commencement of the case. The court found that the Internal Revenue Code does not guarantee the right to S Corp status or the unrestricted right to use, enjoy or dispose of that status. Hereto the ability to take a worthless stock deduction is not a right guaranteed by the Internal Revenue Code. It is also subject to conditions including –- and it's worth emphasizing that TGIC also has a right to be consolidated.

Let's remember one thing, the debtor is asking for two different, but related, forms of relief. The debtor is asking that Your Honor find that they can take the worthless stock deduction without being enjoined by the provisions of the injunctive order. But the debtor is also asking that once Your Honor finds that that Your Honor prohibit TGIC from taking any

action including selling stock and affecting our own deconsolidation that would affect the debtor's rights to take the worthless stock deduction.

That right we had as Mr. Hewitt pointed out, temporarily agreed to stay, but we are asking that if Your Honor were to find that the debtor has the right to take a worthless stock deduction the stay should be modified so that we also have the right to take whatever action we think is appropriate to potentially affect the deconsolidation first. Because who takes –- who reconsolidates first? It is a race to divvy up those NOLs. So not only do they want to strip us, but then they want to keep us from taking any action in contravention of Your Honor's order.

In Majestic Star the court did find that as a practical matter the debtor's property rights must be readily alienable and assignable, and the ability to take a worthless stock deduction is neither. Of particular significance is that in Majestic Star the Third Circuit did address the unfairness of the result that the trustee was seeking and the effect that the consequences of reversing the QSub erection were to have on non-debtor parties. Hereto, it's a court of equity, Your Honor certainly can and should consider because that's the essence of the rehabilitation order, the effect, is this going to waste our assets? The consequences of taking the worthless stock deduction could mean elimination of TGIC's right to access the

NOLs that it generated.

In Majestic Star the court also refused to place a restriction on the non-debtor party that did not exist pre-bankruptcy. Here again the debtor is seeking not only a determination that it can affect a worthless stock deduction, but that the trading order be made final and that we be restricted from taking any action that effect the deconsolidation first.

So we're suggesting, Your Honor, that the cases present a spectrum for what is property of the estate. At one end you have real estate, you have tangible assets, and at the other end you have tax status like QSub or S Corp. Somewhere in the middle you have NOL carry forwards. The Section Circuit says those are property of the estate. The Third Circuit says we're not so sure. We believe that the right to take a worthless stock deduction falls further to the we're not so sure line than the absolute right. And if we're right then Your Honor doesn't have jurisdiction to address this alleged right to take a worthless stock deduction.

And the cases that the debtor cited do have characteristics of property that are not like tax status or worthless stock deduction. They're talking about FCC license which can be used to generate income for the license holder and would be valuable no matter who holds it. FAA operating certificate like a taxi medallion you can generate value from

that. Tort, personal injury, RICO claims, claims under Title 7, those made be contingent, but they represent valuable rights to obtain money from a third party, or a right to an actual post of cash like a tax refund. The worthless stock deduction doesn't share any of those characteristics.

I would say, Your Honor, that the analogy is a little like mortgage interest deduction. I can –- I own a house and I can take an interest on my mortgage payments. I can sell the house, but I can't sell the right to take the mortgage interest deductions, because that's a right that's personal to me. I can't sell it, I can't generate income from it like a license or a cause of action, but –- so I believe that the right to take a mortgage interest deduction if I filed a bankruptcy that it would not be property of my bankruptcy estate.

And one final point, we do believe that –- the debtor is trying to have its cake and eat it, too. They want to abandon -- what they're saying is the first step in taking the worthless stock deduction is abandonment which is –- I don't know if it's before Your Honor, I don't know if it's not before Your Honor, but it's a predicate act to take in the worthless stock deduction. And what we do know it was only until the rely brief came through that the debtor conceded that if it abandons the stock it would not abandon it to itself.

Most of them –- that actually was a little surprise to us, because most of the time, in fact, the majority of the

time an abandonment results in property being returned to the debtor. It's very rare to see that in a Chapter 11. You mostly see it in Chapter 7. Is is also not the norm to abandon the stock to a third party. In fact, it's very rare. You only -- to abandon any asset to a third party. A third party has to have some possessory right or some security interest or some other right in that asset.

And so what the debtor is suggesting is that they can abandon the property which we don't believe there's a challenge. That takes the stock out of this estate. Your Honor would no longer have jurisdiction over the stock. The automatic stay wouldn't apply anymore. But they want to keep the right to take the worthless stock deduction. And we don't believe that the debtor can have its cake and eat it, too. Relying on abandonment to achieve a financial benefit to the debtor's shareholders to the detriment of TGIC would be exactly the type of maneuvering that the rehabilitation order was intended to protect against. Thank you.

MR. PRINCI: Your Honor, I'll be brief. Your Honor, I think Mr. Hewitt has indicated to the Court in the most succinct way what I was trying to assert and what the debtor has been trying to assert. He stated that the rehabilitation order doesn't prevent the debtor from taking the worthless stock deduction. When you go back and look at the record you will see that that is the position of the defendants. It is

also our position that the rehabilitation order doesn't prevent the debtor from taking the worthless stock deduction. So I actually believe that you now have the concession that moots the debate.

But let me go further, because what he also said was that the way the rehabilitation order works, however, is if you do take the worthless stock deduction, which the rehabilitation order doesn't prevent you from taking, it would diminish or eliminate TGIC's ability to utility NOLs and that constitutes waste.

Your Honor, we're going to give you examples of how absurd a result it is, how utterly incongruous it is to interpret the word waste to mean that the debtor can't take a worthless stock deduction. Because the collateral consequence of that that occurs by operation of federal law has a negative impact on TGIC's ability to utilize the NOLs going forward. If you take a look at Paragraph 86 of our motion we point to the fact that in their answer on Page 7 in response to Paragraph 10 of our complaint the defendants admit that the debtor has the right to liquidate the assets of the debtor's estate under plan of liquidation. So notwithstanding the argument that's being made about –- from the defendants about the interpretation that should be given to the order they admit that we have the right to liquidate the assets of the debtor's estate under plan of liquidation.

Under the Internal Revenue Code Section 382(b) if we do that the result will be that there's a change in control that eliminates the ability of the members of the consolidated tax group, and the consolidated tax group itself from further utilizing the NOLs. So on the one hand we have an argument that the rehabilitation order a) doesn't prevent us from taking the worthless stock deduction, but b) the word waste means that were we to do so we would be wasting the assets, and that the rehabilitation order somehow under that interpretation allows us in this court to file with the court a plan of liquidation, have this court confirm that, and eliminate the ability of the NOLs to go forward.

When you look at the incongruity of all the various positions they've taken about what this order means it highlights how –- it highlights the points they've been making, Judge which –- and that we've been making from day one. This is all post hoc. As Mr. Hewitt admitted there was nothing other than taking the language from the statute like they do in every case and putting it in the order. And when you look at that statute there's no reference, Judge, or suggestion that the statute, the state's statue is looking to go this far afield and prevent stockholders from either abandoning the stock, taking the deduction, dissolving the company. Here's how incongruous this is if you accept their interpretation.

They said in their reply papers to their motion to

dismiss at Page 2 they said the rehabilitator does not allege that he has the right to deny debtor the opportunity to utilize the CNOLs to offset debtor's taxable income so long as TGIC and the debtor are members of the affiliated tax group. As I said before that means that under their interpretation of the order we could go through all the NOLs thereby doing the thing they say the order prevents us from doing, to wit, diminish or eliminate TGIC's ability to utility NOLs. And if they say we can do that though. We can do that provided we stay consolidated. Where do you get that from that order? It gets even sillier, Judge.

At the hearing on the motion to dismiss the rehabilitator counsel further asserted that very same thing and said so long as the group remains a consolidated group, the NOLs are applied to offset a group member's income on a first come, first serve basis. Then how can you allege that the rehabilitation order should be interpreted as preventing us from doing anything that would eliminate or diminish the NOLs? Where is this distinction to be found that we were supposed to know of that it means this but not this? It gets even more absurd.

On the –- the first time the rehabilitator was in this courtroom was August 21st. There was a hearing on our trading order motion. With respect to the rehabilitation order the rehabilitator's counsel said –- and I'm quoting from the

transcript of that hearing –- frankly Mr. Ratliff was enjoined from filing the petition. So they're saying that under their interpretation it was the intention of the court to prevent the debtor from filing for bankruptcy. That's what you have to accept from them, Judge. But they want you to accept more.

If we –- if you accept their interpretation, Judge, we couldn't even buy a slow death in this case if we convert to Chapter 7. Because if we convert to Chapter 7 the same thing happens as would happen if we filed a plan of liquidation. The NOLs, Judge, would be transferred –- excuse me –- the stock which is an asset of this Chapter 7 estate would get transferred. That would lead to a change in control under Section 382(b) of Internal Revenue Code. So if you're going to accept their interpretation that we can't do that, that the rehabilitation court's order was intended to stop us from doing anything that could lead to that, that's what –- if you accept their interpretation of what waste means, right, then we can't file the Chapter 7.

It would also mean that under Section 363 of the Code we can't sell the stock. Why can't we sell the stock? Because if we sell more than 50 percent of the stock once again, we would have a change in control under Section 382 of the Code. And that would mean the NOLs could not be utilized by any member of the consolidated tax group including them. It means, according to them, that we can't abandon the stock. It also

must necessarily mean, Judge, that we can't dissolve the company. This debtor cannot ever get dissolved. If we dissolve we're going to end up with the same result, the same change in control.

According to them we have to keep this carcass alive for as long as they stay in the rehabilitation proceeding. Because if we don't do that, if we go into Chapter 7 there's a change of control. And so according to them the way this rehabilitation order has to be interpreted we couldn't ever go out of business. We just have to stay alive, because otherwise we'd be eliminating or diminishing their ability to utilize the NOLs. According to them the rehabilitation order should be read to eliminate all those conditions, all of them, that the –- that are expressed and explicit in the Internal Revenue Code about when NOLs can be used by members of a consolidated tax group. You just eliminate them for as long as they say in the rehabilitation proceeding. Rehabilitation proceeding is as Your Honor probably is aware is not like a Chapter 11 case. This has gone 20 years, but for as long as they say.

They're saying that it was the intention and you have to read those words, the word waste, read that to include all the absurd things I just mentioned. The incongruity that comes out of their positions, and also the fact that for ten, 20, however many years that rehabilitation proceeding continues that all of those conditions are effectively eliminated as to

them notwithstanding that that's the law. That's how they're telling you the word waste has to be interpreted. They're telling you the word waste has to result in all the public shareholders being enjoined from selling their stock.

And if they don't they're in violation of the rehabilitation order. Because if they do that for a three year period that creates a 50 percent change in –- a 50 percent transfer of stock that's a change of control under Section 382. That would eliminate or diminish –- actually eliminate the ability of any members of the consolidated tax group to use the NOLs and that's what waste means. That's what the judge meant. That's how you should interpret the word waste.

Waste, Your Honor, cannot mean that. It is absurd the results you reach when you interpret it that way. Waste has to mean something, Your Honor, that makes sense particularly when you look at that other express provision in the rehabilitation order. I would submit to the Court that waste has to mean, Your Honor, something that's direct and not a collateral consequence that arises by operation of law. Because if it means, if the word waste includes the collateral consequences that arise by operation of law when you have all of these absurd prohibitions we wouldn't be able to abandon stock, we wouldn't be dissolve, people can't sell their stock. You cannot reasonably posit.

And that's why they're so confused about their

positions, Judge. Because if one actually intended that you wouldn't be that confused about what it means and you'd see something in the statute from which they drew the language in all these orders that they filed, or you would have seen something in the record. And I say this and I know Your Honor will accept this, I do not believe there is a judge in the United States that would issue that order intending for the word waste to be applied like that in the absence of expressly making clear what that judge didn't want people to do. Again, we can't deconsolidate.

According to them we have to stay subject to the control of this regulator for 20 years. Under their theory if Mr. Ratliff believes it's in the best interest of shareholders to divorce, to get rid of this company that is insolvent he can't do so. He has to make sure he keeps it alive because of the collateral consequence that arises just by operation of law. That can't be what the word waste means or was intended to mean. And the suggestion, Judge, that we were trying to bypass the overhead court who would pick that order up and think that that's what it means?

And the suggestion that we should go there now, a couple of points on that, Judge. Number one, in the context of this motion certainly they have not provided any basis to suggest that the automatic stay should be lifted to force the debtor to go to Chicago to make some application which if then

denied would result in the debtor needing to assert an appeal all the while this place, I guess wasn't the free (indiscernible). There's no basis for lifting the stay to do that. These arguments aren't credible, they're absurd.

The other point about that suggestion is that the court's already ruled, and the court obviously understands that this Court and only this Court has the exclusive jurisdiction to decide property interest of this estate. That was the earlier decision that Your Honor rendered in connection with denying their motion to dismiss. There were two –- there were I should say three fundamental issues in front of the court then. Does McCarran-Ferguson apply? No. Are there issues ripe for adjudication? Yes. And is it this court or the other court that has the jurisdiction to decide these issues? This court.

The issue as we talked about at that motion, at the hearing on that motion as they once again say in their papers this is one coin and two sides. If the Illinois court decides it they're deciding their rights and our rights. If you decide it, you're deciding our rights and their rights. But the only court that has the jurisdiction to decide our property rights is this court.

One final point, Judge –- premature. Two last points. I don't understand the basis for the allegation about what happened to PMI. I was the committee's counsel in PMI in

front of Judge Shannon. That case was never –- the stay was never lifted there with respect to a simultaneous proceeding going on in the State of Arizona. That case was decided in this court, and the litigation with respect to that matter that was commenced but ultimately resolved through a settlement was a litigation in this court. So I don't know what the reference is or the basis is for the reference that in PMI there was a different position. There wasn't at all.

The last point is this, Judge, like so many other cases we want –- it is likely we are going to seek for the benefit of our stakeholders to disengage from the control of the regulator. That is prudent, that makes sense for multiple reasons. And it's likely therefore to effectuate that like in so many other cases where you have a clothing company that owns a regulated entity when that entity ends up becoming insolvent it is a provident and value additive decision to no longer remain under the control of the regulator. Take a worthless stock deduction so that you can disengage from the control of the regulator, and then simultaneously by doing so try to maximize the value of your tax attributes for your stakeholders. That's all we want to do here.

To the extent that the collateral consequence by operation of law is that they no longer can utilize the NOLs which is the right that they've always had, no more, that does not in any way, shape, or form mean that our rights should be

diminished or that there's any basis for our rights to be curtailed, or that that order can be read in the way that leads either to the absurd results or the creation of arguments for which you have to use both sides of your mouth to make when it comes to the interpretation of that order. Thank you, Judge.

THE COURT: Any response?

MR. HEWITT: Your Honor, there is a very narrow issue before the Court and that is whether the debtor has established as a matter of law that they are entitled to the relief that they seek. For the reasons we've already stated we don't believe they've sustained that burden. The litany of hypotheticals that counsel has just described in the reply regarding plan of reorganization, et cetera that's not before the Court. There's only one narrow issue before the Court and we think that's been adequately addressed. Thank you.

THE COURT: Well, I do agree with the rehabilitator that this is a narrow issue. What the debtor asks, and I tried to press the debtor on this, the debtor is not simply asking me to find or state the legal proposition that only a parent can take a worthless stock deduction for its sub-stock. That is apparent. What the debtor is asking me is to rule that this debtor does have the exclusive right to take a worthless stock deduction for its ownership in TGIC, and that that is property of the estate. And I just think that issue is not ripe here. There are conditions to taking a worthless stock deduction.

Stock has to be worthless. And there is a genuine issue of material fact on this. Insolvency alone is not enough to be worthless. The debtor's expert itself opined that the debtor could not do that at this stage.

Another condition is abandonment of the stock. Apparently under the Internal Revenue Code it's somewhat different from abandonment under Section 544. But even if 544 were the standard the debtor would have to show that the stock is burdensome to the estate. And simply stating that its bankruptcy is bogged down because this issue is not decided does not show a burden. The debtor came into bankruptcy knowing of the rehabilitation order and knowing of these issues being present. The debtor has no operations so continuing in bankruptcy other than litigating this issue is not necessarily a burden.

The debtor also has to show that the stock is of inconsequential value to the estate. Again there's a genuine issue of material fact on that point. The debtor presently as part of the consolidated group has an interest in NOLs, and I'm not prepared to state that being part of that consolidated group has no value based on the record before me. Even if it were ripe I think that the rehabilitation order does prohibit the debtor from taking the action it seeks authority to take. That is to abandon the stock. Because it is clear that taking the worthless stock deduction would waste or eliminate the

ability of TGIC to use the –- I think you said, over $700 million in NOLs. That's significant. I can't state whether any other action is prohibited by that order, but I think that that action is.

To be effective an injunction does not have to list every single possible action that a party can take that would violate the injunction. But I think that it was clear to the debtor that the enter of the rehabilitation order which sought to preserve TGIC's property a major part of which was the NOLs would prohibit the action which the debtor is now seeking authority to take.

The Prudential Alliance case I think is directly on point. And there the bankruptcy court enjoined a non-debtor parent from taking a worthless stock deduction because it would in fact adversely affect the debtor's property interest in the NOLs. The converse is true here. It would adversely affect or waste TGIC's interest as a member of the consolidated group in the NOLs. The Second Circuit in Prudential Alliance rejected the argument that the parent alone had control over the NOLs of the consolidated tax group, and specifically held that the sub had a property interest in them as of the bankruptcy date.

I think that what is lost in the debtor's arguments is that the debtor's rights as of the petition date are only those it has as of the petition date. And as of the petition date its rights were limited by the rehabilitation order.

With respect to the debtor's arguments that the supremacy clause precludes this, I think that is a collateral attack on the rehabilitation order. And even if not I think the supremacy clause does not apply. The Illinois insurance law on which the injunction was based almost verbatim is not dealing with an area of law that is preempted by either the bankruptcy code or the Internal Revenue Code. And the fact that the order or that statute has some affect on the debtor's rights is not enough to say that that law is preempted by the bankruptcy code or by the Internal Revenue Code. The Crisp and Miramax cases are clearly distinguishable. They dealt with state laws that overlapped specific areas of federal law, copyright and FDC regulations and that is not the case with respect to the Illinois insurance law.

So for that reason I will deny the debtor's motion for summary judgment.

MR. PRINCI: Thank you, Your Honor.

THE COURT: I'll look for a form of order being presented after circulating it with counsel for the debtor.

MR. PRINCI: Thank you, Your Honor. I have one question. The scheduling order does provide for a trial date on July 21. There is no provision for the filing of what I'm familiar with is a pre-trial order. Is there any guidance that the Court can give to us as far as his preference for preparation of an order that would identify witnesses, exhibits

and the like?

THE COURT: Normally there is. And I didn't include that in the scheduling order?

MR. PRINCI: Well, Your Honor, in fairness to the Court we –- it was an order we jointly submitted. So if you will we didn't –- but let me suggest this, Judge. I think based on Your Honor's ruling there may not be a need for the trial. What I'd like to suggest is let us have an opportunity to consider the impact of the Court's decision. We will reach out to counsel. If the debtor believes that it wants to continue to prosecute the adversary in the face of the Court's decision we'll either, you know, seek the Court's guidance with respect to trial procedures or, you know, we'll otherwise advise the Court in the event that we don't go forward with the adversary and whatever else we may do here.

THE COURT: All right.

MR. PRINCI: Arnie.

MR. HEWITT: That makes sense. But could we have a date by which we're to report back to the Court?

THE COURT: Do we have another hearing date in this case? Let me see. Other than the trial dates, no. How long does the debtor wish?

MR. PRINCI: Just give me –- may I confer with my colleagues, Your Honor?

THE COURT: Yes. You may.

MR. PRINCI: Your Honor, if we could have two weeks from today?

THE COURT: All right. That's sufficient. And I'll ask the parties to submit a certification of counsel advising the Court of what the –- what you're going to do.

MR. PRINCI: Thank you, Your Honor.

MR. HEWITT: Thank you, Your Honor.

THE COURT: Okay. All right. We'll stand adjourned then. Thank you.

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C E R T I F I C A T I O N

We, COLETTE MEHESKI, VIDHYA VEERAPPAN and KIMBERLY UPSHUR, court approved transcribers, certify that the foregoing is a correct transcript from the official electronic sound recording of the proceedings in the above-entitled matter, and to the best of our ability.

/s/ Colette Meheski DATE: May 29, 2014

COLETTE MEHESKI

/s/ Vidhya Veerappan

VIDHYA VEERAPPAN

/s/ Kimberly Uphsur

KIMBERLY UPSHUR

RELIABLE