

1 STATE OF WISCONSIN CIRCUIT COURT DANE COUNTY  
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 3 In the Matter of the  
 4 Rehabilitation of:  
 5 SEGREGATED ACCOUNT OF AMBAC Case No. 10-CV-1576  
 6 ASSURANCE CORPORATION  
 -----  
 7 HONORABLE WILLIAM D. JOHNSTON  
 8 CIRCUIT COURT JUDGE PRESIDING  
 9  
 10 PLACE: Lafayette County Courthouse  
 11 626 Main Street  
 12 Darlington, WI 53530  
 13  
 14 TIME: 9:07 a.m.  
 15  
 16 DATE: November 16, 2010  
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A P P E A R A N C E S

**MICHAEL B. VAN SICKLEN** and **MATTHEW R. LYNCH**,  
 Attorneys at Law, FOLEY & LARDNER LLP, 150 East Gilman  
 Street, Madison, Wisconsin, appeared on behalf of  
 Petitioner Sean Dilweg, Commissioner of Insurance of  
 the State of Wisconsin, and the Department of  
 Insurance of the State of Wisconsin.

**DANIEL W. STOLPER**, Attorney at Law, STAFFORD  
 ROSENBAUM LLP, Madison, Wisconsin, and **HENRY J.**  
**RICARDO, RICHARD REINTHALER, PETER IVANICK**, Attorneys  
 at Law, DEWEY & LE BOEUF LLP, New York, New York,  
 appeared on behalf of Ambac Assurance Corporation.

**DAVID M. GREENWALD**, Attorney at Law, JENNER &  
 BLOCK LLP, Chicago, Illinois, appeared on behalf of  
 RMBS Policyholders.

**THOMAS J. WELSH**, Attorney at Law, ORRICK,  
 HERRINGTON & SUTCLIFFE LLP, Sacramento, California,  
 and **GREGORY W. Lyons**, Attorney at Law, O'Neil Cannon  
 Hollman DeJong & Laing, Milwaukee, Wisconsin appeared  
 on behalf of Depfa Bank plc.

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A P P E A R A N C E S (cont'd)

**CRAIG S. BLOOMGARDEN**, Attorney at Law, MANATT,  
 PHELPS & PHILLIPS, Los Angeles, California, appeared  
 on behalf of Federal Home Loan Mortgage Corporation.

**ANDREW DEVORE**, Attorney at Law, ROPES & GRAY,  
 Boston, Massachusetts, and **ANNE M. BENSKY**, Attorney at  
 Law, GARVEY McNEIL & ASSOCIATES, S.C., Madison,  
 Wisconsin, appeared on behalf of One State Street.

**STEVEN T. WHITMER** and **KEVIN WISNIEWSKI**, Attorneys  
 at Law, LOCKE LORD BISSELL & LIDDELL LLP, Chicago,  
 Illinois, and **STEPHEN MORGAN**, Attorney at Law, Murphy  
 Desmond, Madison, Wisconsin, appeared on behalf of  
 Wells Fargo Bank as Trustee for the LVM Bondholders.

**CYNTHIA BUCHKO**, Attorney at Law, WHYTE HIRSCHBOECK  
 & DUDEK, Madison, Wisconsin, appeared on behalf of  
 Countrywide Home Loans, Inc.

**PHILIP BENTLEY** and **MATTHEW TEMKIN**, Attorneys at  
 Law, KRAMER LEVIN NAFTALIS & FRANKEL LLP, New York,  
 New York, and **NOREEN PARRETT**, Attorney at Law, PARRETT  
 & O'CONNELL, appeared on behalf of the LVM  
 Bondholders.

**LAURA GEIGER**, Attorney at Law, Reed Smith,  
 Chicago, Illinois, appeared on behalf of Federal and  
 National Mortgage Association, Fannie Mae.

**MICHAEL E. JOHNSON**, Attorney at Law, ALSTON & BIRD  
 LLP, New York, New York 10016, appeared telephonically  
 on behalf of Wells Fargo and Bank of America as  
 Trustee, Wilmington Trust Company, Wilmington Trust  
 FSB.

**PAUL LUCEY**, Attorney at Law, MICHAEL BEST &  
 FRIEDRICH, Milwaukee, Wisconsin, appeared on behalf of  
 Deutsche Bank Trust and U.S. Bank Trust.

**JAMES C. OWEN**, Attorney at Law, McCARTHY, LEONARD  
 & KAEMMERER, Chesterfield, Missouri, appeared on  
 behalf of ALL Student Loan Corporation and Lloyds TSB  
 Bank plc.

**THOMAS ROSS HOOPER**, Attorney at Law, Seward &  
 Kissel LLP, New York, New York, appeared  
 telephonically on behalf of Bank of New York Mellon as  
 Trustee.

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<b>PROCEEDINGS</b>		
09:07:48	9 THE COURT: All right. Be seated. The phone	
09:07:54	10 is connected for this proceeding? Hello.	
09:07:59	11 A VOICE: Yes, Your Honor.	
09:08:01	12 THE COURT: All right. Let's start by calling	
09:08:04	13 Dane County Court into session in the matter of	
09:08:10	14 10-CV-1576, <u>In The Matter of the Rehabilitation of the</u>	
09:08:17	15 <u>Segregated Account of Ambac Assurance Corporation and</u>	
09:08:20	16 <u>we'll start with appearances.</u>	
09:08:24	17 MR. VAN SICKLEN: Your Honor, on behalf of the	
09:08:24	18 Rehabilitator, the same appearances as yesterday so	
09:08:28	19 I'll be brief. It's Mike Van Sicklen and Matt Lynch	
09:08:33	20 on behalf of the Rehabilitator and the Office of the	
09:08:36	21 Commissioner of Insurance.	
09:08:39	22 Mr. STOLPER: Good morning, Your Honor.	
09:08:40	23 Appearing on behalf of Ambac Assurance Corporation,	
09:08:42	24 Daniel W. Stolper of Stafford Rosenbaum and to my	
09:08:45	25 right is Henry Ricardo, Richard Reinhaller, and Peter	

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09:08:54 1 Ivanick of Dewey Le Boeuf; and from Ambac is Cathleen

09:08:57 2 Matanle, managing director, and David Barranco,

09:09:01 3 managing director.

09:09:03 4 Mr. BLOOMGARDEN: Good morning, Your Honor.

09:09:07 5 Craig Bloomgarden, Manatt, Phelps & Phillips on behalf

09:09:08 6 of Freddie Mac, the Federal Home Loan Mortgage

09:09:08 7 Corporation.

09:09:11 8 MR. GREENWALD: Good morning. David Greenwald,

09:09:11 9 Jenner & Block on behalf of the group that we're

09:09:23 10 referring to as the RMBS Policyholders, five clients.

09:09:25 11 THE COURT: Does the court officer, do you have

09:09:27 12 that wireless mike?

09:09:32 13 THE BAILIFF: Do you want them to do that back

09:09:35 14 here, Judge, or --

09:09:35 15 THE COURT: Well, they don't have to come all

09:09:37 16 the way up, those who are up there, but catch them

09:09:39 17 back there. And we'll start with those who are here

09:09:43 18 yet.

09:09:43 19 MR. WELSH: Good morning, Your Honor. Tom

09:09:46 20 Welsh, Orrick, Herrington & Sutcliffe on behalf of

09:09:49 21 Depfa Bank, plc, and also with me is Gregory Lyons of

09:09:54 22 O'Neil Cannon.

09:09:54 23 MR. BENTLEY: Philip Bentley of Kramer Levin.

09:09:56 24 With me again are my colleague Matthew Temkin and

09:10:03 25 Noreen Parrett of the Parrett & O'Connell firm for the

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09:10:03 **1** LVM Bondholders.

09:10:06 **2** MR. DEVORE: Good morning, Your Honor, of Ropes

09:10:06 **3** & Gray and with me is Anne Bensky of Garvey McNeil &

09:10:14 **4** Associates representing One State Street LLC.

09:10:16 **5** MR. WHITMER: Good morning, Your Honor. Steven

09:10:18 **6** Whitmer of Locke Lord Bissell & Liddell on behalf of

09:10:22 **7** Wells Fargo as Trustee for the LVM Bondholders. Also

09:10:26 **8** with me is Kevin Wisniewski and Steve Morgan from

09:10:26 **9** Murphy Desmond.

09:10:33 **10** MR. OWEN: Jim Owen for ALL Student Loan and

09:10:36 **11** Lloyds Bank.

09:10:37 **12** MS. BUCHKO: Cynthia Buchko of Whyte Hirschboeck

09:10:43 **13** & Dudek for Countrywide Home Loans and Countrywide

09:10:47 **14** Home Loans Servicing LP.

09:10:47 **15** THE COURT: Just a moment. We'll check that and

09:10:50 **16** make sure that it's working.

09:11:03 **17** THE BAILIFF: Must be the batteries.

09:11:05 **18** MS. BUCHKO: Cynthia Buchko of Whyte Hirschboeck

09:11:17 **19** & Dudek on behalf of Countrywide Home Loans Inc. and

09:11:22 **20** Countrywide Home Loans Servicing LP.

09:11:22 **21** MR. JOHNSON: Good morning, Your Honor.

09:11:23 **22** Michael Johnson of Alston & Bird. I'm here on behalf

09:11:25 **23** of Bank of America NA, Wells Fargo Bank NA,

09:11:32 **24** Wilmington Trust Company, Wilmington Trust FSB, all in

09:11:33 **25** their capacities as Trustees and in similar roles for

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09:11:39 **1** certain securitization trusts.

09:11:42 **2** MS. GEIGER: Good morning, Your Honor. Laura

09:11:44 **3** Geieger, G-E-I-G-E-R, of Reed Smith on behalf of the

09:11:48 **4** Federal and National Mortgage Association, Fannie Mae.

09:11:53 **5** MR. LUCEY: Your Honor, Paul Lucey of Michael

09:11:55 **6** Best & Friedrich on behalf of Deutsche Bank National

09:11:57 **7** Trust Company, Deutsche Bank Trust Company of Americas

09:12:00 **8** and US Bank National Association all in their -- each

09:12:04 **9** in their capacity as trustee of certain securitization

09:12:09 **10** trusts.

09:12:09 **11** THE COURT: All right. Anyone else want their

09:12:10 **12** appearance noted?

09:12:13 **13** MR. HOOPER: Yes, Your Honor. Thomas Ross

09:12:16 **14** Hooper of Seward & Kissel on behalf of the Bank of New

09:12:21 **15** York Mellon in its capacity of Trustee, Indenture

09:12:22 **16** Trustee or collateral agent for the benefit of holders

09:12:24 **17** and secured parties of certain mortgage-backed

09:12:24 **18** securities, other asset-backed securities,

09:12:24 **19** collateralized loan obligations and collateralized

09:12:35 **20** debt obligations.

09:12:35 **21** THE COURT: Anyone else on the phone?

09:12:38 **22** All right. Hearing no other request to have

09:12:41 **23** their appearance noted, we had Mr. Dilweg was on the

09:12:47 **24** stand. Mr. Dilweg, will you come back to the stand

09:12:50 **25** for the start of today's proceeding. Again before

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09:12:54 **1** being seated, raise your hand and receive the witness

09:12:57 **2** oath.

09:12:59 **3** **SEAN ARMOUR DILWEG**

09:12:59 **4** was duly sworn by the Clerk and was examined and

09:12:59 **5** testified as follows:

09:13:06 **6** THE COURT: All right. Be seated. All right.

09:13:11 **7** Counsel, you may proceed.

09:13:11 **8**

09:13:11 **9** **CROSS-EXAMINATION**

09:13:12 **10** **BY MR. BLOOMGARDEN:**

09:13:12 **11** **Q.** Thank you, Your Honor. Good morning, Commissioner.

09:13:15 **12** **A.** Good morning.

09:13:17 **13** **Q.** My name again is Craig Bloomgarden on behalf of

09:13:21 **14** Freddie Mac. Sir, you would agree that the Plan that

09:13:25 **15** you have proposed needs to comply with applicable law?

09:13:30 **16** **A.** That is correct.

09:13:32 **17** **Q.** And that if the Plan in its current form contains

09:13:37 **18** provisions that violate the law, then the Plan should

09:13:42 **19** be modified before it is presented to the Court for

09:13:45 **20** approval?

09:13:46 **21** MR. VAN SICKLEN: I'd object. It just seems

09:13:48 **22** like argumentative. These are judge's issues not

09:13:52 **23** useful fact gathering.

09:13:53 **24** THE COURT: I'll sustain that objection.

09:13:58 **25** MR. BLOOMGARDEN: Sir, would you agree that if

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09:14:00 **1** the Plan fails to contain provisions that comply with

09:14:08 **2** applicable law, then the Plan should be modified

09:14:11 **3** before it is approved by the Court?

09:14:13 **4** MR. VAN SICKLEN: Same objection. This is

09:14:15 **5** closing argument.

09:14:16 **6** THE COURT: Sustained.

09:14:31 **7** MR. BLOOMGARDEN: Then let me ask you this

09:14:32 **8** question: Commissioner, you would agree that if a

09:14:36 **9** plan contains a provision that is unfair and

09:14:40 **10** inequitable to policyholders, it should be modified

09:14:44 **11** before it is presented to the court for approval,

09:14:48 **12** correct?

09:14:49 **13** MR. VAN SICKLEN: Same objection.

09:14:51 **14** THE COURT: Sustained.

09:14:53 **15** MR. BLOOMGARDEN: Commissioner, have you

09:14:53 **16** endeavored to ensure that the plan -- Let me withdraw

09:15:00 **17** the question. Can you take a look at Exhibit 26 in

09:15:09 **18** the binder. The binders, they're behind you.

09:15:49 **19** THE COURT: All right. The witness has that

09:15:51 **20** exhibit now, Exhibit 26.

09:15:57 **21** **Q.** Sir, you recognize this document?

09:15:59 **22** **A.** Yes.

09:15:59 **23** **Q.** Okay. What is it?

09:16:01 **24** **A.** It's a Plan of Rehabilitation.

09:16:05 **25** **Q.** And this is the Plan you have presented to the Court

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09:16:07 **1** for approval?

09:16:08 **2 A. That is correct.**

09:16:10 **3 Q.** Would you take a look at Article 9, beginning on page

09:16:15 **4** 28. What is that article entitled?

09:16:24 **5 A. Immunity and Indemnification of the Rehabilitator,**

09:16:30 **6 Employees and Consultants.**

09:16:32 **7 Q.** Are you familiar with this provision -- or this

09:16:34 **8** article?

09:16:34 **9 A. I haven't reviewed it.**

09:16:36 **10 Q.** I'm sorry. You have not reviewed it?

09:16:38 **11 A. No. It's standard immunities, I assume, but I haven't**

09:16:41 **12 spent time on it.**

09:16:42 **13 Q.** Let's take a look at it, if you will, and I have a

09:16:45 **14** couple of questions about it. In Section 9.01 it

09:16:49 **15** provides that following persons are entitled to

09:16:53 **16** protection under this part of the plan: The OCI, the

09:16:57 **17** Rehabilitator, the Special Deputy Commissioner. Do

09:17:01 **18** you see that?

09:17:01 **19 A. I do.**

09:17:02 **20 Q.** And that would all refer to people in your office,

09:17:05 **21** correct?

09:17:06 **22 A. It appears to refer to our office and advisors to our**

09:17:13 **23 office.**

09:17:13 **24 Q.** Okay. And then it goes on to say that benefits --

09:17:17 **25** that the persons are entitled to protection under this

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09:17:21 **1** Plan also include the Segregated Account. Do you see

09:17:28 **2** that?

09:17:28 **3 A. I do.**

09:17:28 **4 Q.** That's the Ambac Segregated Account, correct?

09:17:31 **5 A. Yes.**

09:17:31 **6 Q.** AAC, that's Ambac, right?

09:17:34 **7 A. That's the Assurance subsidiary.**

09:17:38 **8 Q.** And the General Account of the insurance subsidiary

09:17:43 **9** Ambac, correct?

09:17:43 **10 A. Correct.**

09:17:44 **11 Q.** In addition, the Management Services Provider is

09:17:48 **12** entitled to protections of this part of the Plan, do

09:17:52 **13** you see that?

09:17:52 **14 A. That is -- That is correct.**

09:17:53 **15 Q.** Okay. And the Management Services Provider is Ambac?

09:17:57 **16 A. It is currently Ambac.**

09:17:59 **17 Q.** Okay. And in addition to those entities, all of those

09:18:04 **18** Ambac entities, each of their respective current and

09:18:07 **19** former members, shareholders, affiliates, officers,

09:18:12 **20** directors, employees and agents parenthetically

09:18:16 **21** including any attorneys, financial advisors,

09:18:18 **22** investment bankers, consultants and other

09:18:20 **23** professionals retained by such persons are also

09:18:25 **24** entitled to protection of this part of the Plan as

09:18:29 **25** currently written, correct?

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09:18:30 **1 A. That is correct.**

09:18:31 **2 Q.** Okay. Now, look down at that paragraph nine -- or

09:18:34 **3** section 9.02 which is entitled "Immunity and

09:18:39 **4** Indemnification" and that reads: "All persons that

09:18:42 **5** are identified in Section 9.01 shall have official

09:18:46 **6** immunity and shall be immune from suit and liability."

09:18:50 **7** Do you see that?

09:18:51 **8 A. I do.**

09:18:51 **9 Q.** Okay. And that's both personally and in their

09:18:54 **10** official capacities, for any act or omission made in

09:18:58 **11** connection with, or arising out of, the Segregated

09:19:02 **12** Account, AAC or the General Account with respect to

09:19:05 **13** the Segregated Account, the proceeding, this Plan

09:19:11 **14** consummation of the Plan or the administration of the

09:19:15 **15** Plan. Do you see that?

09:19:20 **16 A. I did.**

09:19:21 **17 Q.** Okay. And that is with the sole exception of acts or

09:19:25 **18** omissions arising from intentional fraud or willful

09:19:30 **19** misconduct as determined by final order, do you see

09:19:33 **20** that?

09:19:33 **21 A. I do.**

09:19:34 **22 Q.** Okay. So -- So under the Plan as currently written

09:19:39 **23** with the exception of intentional fraud or willful

09:19:42 **24** misconduct, Ambac in its capacities as Ambac the

09:19:50 **25** General Account, and Segregated Account, the

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09:19:53 **1** Management Services Provider and all the other related

09:19:56 **2** Ambac individuals and entities in Section 901 are

09:19:59 **3** entitled to immunity and indemnification under this

09:20:04 **4** Plan with the sole exception of acts or omissions

09:20:08 **5** resulting from intentional fraud or willful

09:20:09 **6** misconduct?

09:20:09 **7** MR. VAN SICKLEN: I would interpose another

09:20:11 **8** objection, Your Honor. This witness says he has no

09:20:13 **9** foundation about this provision, it just seems like

09:20:16 **10** argument. It says what it says and counsel can read

09:20:19 **11** it in at closing argument. This witness indicated

09:20:22 **12** he's not familiar with it.

09:20:25 **13** Mr. BLOOMGARDEN: Foundational question, Your

09:20:26 **14** honor.

09:20:26 **15** THE COURT: Foundation.

09:20:27 **16** MR. VAN SICKLEN: This document is in evidence.

09:20:28 **17** THE COURT: For what?

09:20:30 **18** MR. BLOOMGARDEN: For the questions I'm next

09:20:32 **19** going to ask him.

09:20:34 **20** THE COURT: Sustain the objection. The Plan

09:20:37 **21** says -- or the document says what it says. I think

09:20:41 **22** your questions need to be asked and then again this is

09:20:44 **23** argument as to how those assumed facts that you're

09:20:48 **24** going to raise by your questions interrelate with

09:20:51 **25** these principles.

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09:20:53 **1** MR. BLOOMGARDEN: Okay. I'll ask another  
09:20:55 **2** question. My next question. So, Commissioner, under  
09:20:58 **3** Section 901 or Article 9 in its current form if Ambac  
09:21:05 **4** in its management of the Segregated Account is grossly  
09:21:08 **5** negligent, it is provided with immunity and indemnity  
09:21:15 **6** under this provision; isn't that correct?  
09:21:17 **7** MR. VAN SICKLEN: Objection, foundation and  
09:21:18 **8** speculation.  
09:21:19 **9** THE COURT: Also you're asking for legal  
09:21:22 **10** conclusions. Sustain those objections.  
09:21:24 **11** MR. BLOOMGARDEN: Sir, do you have an  
09:21:25 **12** understanding of what the words intentional fraud or  
09:21:28 **13** willful misconduct refer to?  
09:21:31 **14** MR. VAN SICKLEN: Same objection. Calls for  
09:21:34 **15** legal conclusion as used on the document.  
09:21:36 **16** THE COURT: Sustained.  
09:21:36 **17** BY MR. BLOOMGARDEN:  
09:21:39 **18** **Q.** Commissioner Dilweg, let me ask you this: Do you  
09:21:43 **19** think that it is fair and equitable for this Plan to  
09:21:50 **20** provide Ambac with immunity and indemnification for  
09:21:56 **21** all acts other than resulting from intentional fraud  
09:22:02 **22** or willful misconduct?  
09:22:04 **23** **A.** **The Plan is a very simple plan, is it Craig? Craig,**  
09:22:12 **24** **is that your name?**  
09:22:13 **25** **Q.** Yes.

13

09:22:14 **1** **A.** **And I don't see how it could function without the**  
09:22:18 **2** **participation of the existing company and, as I stated**  
09:22:22 **3** **yesterday you need the expertise of the employees.**  
09:22:27 **4** **You're making decisions in regard to the Plan and you**  
09:22:31 **5** **don't want their advice or the advise of their**  
09:22:39 **6** **counsel. We may rely on their counsel at times, not**  
09:22:43 **7** **our counsel, depending on the fact situation. So, you**  
09:22:46 **8** **know, how those people participate in a Plan that is**  
09:22:50 **9** **filed with this Court, they need to feel secure that**  
09:22:55 **10** **their voice and expertise is not going to land them in**  
09:22:58 **11** **front of another court of law is my rough view and**  
09:23:02 **12** **understanding, and that's the only way you can come**  
09:23:05 **13** **back to treating the policyholders fairly and**  
09:23:09 **14** **equitably.**  
09:23:10 **15** **Q.** So you believe then that it is fair and equitable to  
09:23:15 **16** provide an exception for grossly negligent conduct  
09:23:18 **17** that might cause damage to the Segregated Account?  
09:23:24 **18** MR. VAN SICKLEN: Objection. It  
09:23:24 **19** mischaracterizes the document. It's just further  
09:23:26 **20** argument.  
09:23:26 **21** THE COURT: Sustained. It does.  
09:23:29 **22** MR. BLOOMGARDEN: And, sir, if the Court should  
09:23:32 **23** conclude that this provision violates applicable law,  
09:23:37 **24** you would agree that it would need to be circumscribed  
09:23:43 **25** to be consistent with applicable law, correct?

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09:23:45 **1** MR. VAN SICKLEN: Same objection we started  
09:23:47 **2** with.  
09:23:47 **3** THE COURT: Sustained.  
09:23:52 **4** **Q.** Commissioner, you testified yesterday as to why you  
09:23:58 **5** didn't want to liquidate Ambac and why you chose to  
09:24:01 **6** pursue a rehabilitation of a Segregated Account  
09:24:06 **7** instead; do you recall that testimony?  
09:24:08 **8** **A.** **I do.**  
09:24:08 **9** **Q.** Are you familiar in your experience with  
09:24:13 **10** Rehabilitation Plans that provide policyholders with  
09:24:17 **11** the option to opt out of the plan and receive the  
09:24:19 **12** liquidation value of their claims instead?  
09:24:22 **13** **A.** **I haven't spent time on those plans but I am aware**  
09:24:27 **14** **that they have existed in the past.**  
09:24:29 **15** **Q.** And what -- If you have an understanding, what is  
09:24:33 **16** your understanding of the purpose of such a provision  
09:24:38 **17** in a plan to provide policyholders with the option to  
09:24:44 **18** opt out of the plan and receive the liquidation value  
09:24:46 **19** of the claims?  
09:24:48 **20** MR. VAN SICKLEN: Objection, foundation. It  
09:24:49 **21** calls for the witness also to speculate about some  
09:24:52 **22** other rehabilitators and some other state's purpose in  
09:24:58 **23** preparing such an option.  
09:25:00 **24** THE COURT: Mr. Bloomberg (sic).  
09:25:03 **25** Mr. BLOOMGARDEN: Just asking if he has an

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09:25:04 **1** understanding. If he has no understanding as to the  
09:25:06 **2** purpose of such a provision he can say so and I'll  
09:25:09 **3** move on.  
09:25:10 **4** THE COURT: Do you have any understanding of  
09:25:11 **5** that purpose?  
09:25:12 **6** THE WITNESS: As I said I have not reviewed  
09:25:13 **7** other rehabilitation plans at this time.  
09:25:17 **8** THE COURT: All right. Proceed.  
09:25:19 **9** MR. BLOOMGARDEN: Okay. Sir, do you have --  
09:25:22 **10** Let me ask you this: It's true, is it not, that you  
09:25:26 **11** can provide -- provide in a rehabilitation plan for a  
09:25:31 **12** liquidation value option without actually putting the  
09:25:37 **13** company into liquidation; isn't that correct?  
09:25:40 **14** MR. VAN SICKLEN: Objection. Calls for legal  
09:25:42 **15** conclusion. There is no foundation this witness is  
09:25:44 **16** competent to answer that.  
09:25:46 **17** THE COURT: Mr. Bloomberg?  
09:25:48 **18** MR. BLOOMGARDEN: I'll rephrase the question,  
09:25:53 **19** Your Honor. Commissioner, do you have an  
09:25:54 **20** understanding as to whether you can provide in a  
09:25:58 **21** rehabilitation plan a liquidation value opt-out for  
09:26:01 **22** policyholders without actually putting the company in  
09:26:08 **23** liquidation?  
09:26:09 **24** MR. VAN SICKLEN: Calls for a legal conclusion,  
09:26:11 **25** objection.

16

09:26:11 **1** THE COURT: Mr. Bloomberg?

09:26:13 **2** Mr. BLOOMGARDEN: Just ask for his

09:26:14 **3** understanding. If he has no understanding he can say

09:26:16 **4** so and I'll move on.

09:26:17 **5** THE COURT: Do you have any understanding of

09:26:19 **6** that principle?

09:26:24 **7** THE WITNESS: No, Your Honor, as I said before I

09:26:26 **8** have not reviewed the liquidation analysis, so that's

09:26:30 **9** not an area where I've spent time on.

09:26:32 **10** THE COURT: Let's move on.

09:26:34 **11** **Q.** The Plan does not in its current form provide

09:26:37 **12** policyholders with the option to opt out of the Plan

09:26:41 **13** and receive the liquidation value of their claims;

09:26:44 **14** isn't that correct?

09:26:45 **15** **A.** **As I said, I haven't reviewed this analysis at this**

09:26:49 **16** **time.**

09:26:50 **17** **Q.** I'm not asking you, sir, about the liquidation value

09:26:53 **18** analysis in the Disclosure Statement but just whether

09:26:56 **19** the Plan contains a provision that would allow

09:27:00 **20** policyholders to opt out and receive the liquidation

09:27:04 **21** value of their claims?

09:27:05 **22** **A.** **The Plan involves some optionality for the**

09:27:12 **23** **policyholders but how it relates to liquidation I have**

09:27:15 **24** **not reviewed.**

09:27:19 **25** **Q.** So you testified yesterday that if the CDS bank

17

09:27:23 **1** settlement, which was the terms of which were agreed

09:27:30 **2** to in March I believe -- Let me back up. You recall

09:27:34 **3** testimony yesterday about the CDS bank settlement?

09:27:36 **4** **A.** **Yes, I do.**

09:27:37 **5** **Q.** And am I correct that you testified that the terms of

09:27:40 **6** that settlement were agreed to in March of this year?

09:27:43 **7** **A.** **That is correct.**

09:27:45 **8** **Q.** And that's the same time that the Segregated Account

09:27:49 **9** was created and the rehabilitation was commenced,

09:27:53 **10** correct?

09:27:53 **11** **A.** **That is correct.**

09:27:54 **12** **Q.** And you -- I believe you testified yesterday that if

09:27:57 **13** that CDS bank settlement had not occurred, there would

09:28:01 **14** have been litigation with the banks over what is a CDS

09:28:07 **15** contract; do you recall that testimony?

09:28:08 **16** **A.** **Yes, sir.**

09:28:09 **17** **Q.** What did you mean by that?

09:28:14 **18** **A.** **Basically you would be spending time on the**

09:28:17 **19** **policyholder preference of the CDS contracts, Your**

09:28:20 **20** **Honor, you would have been risking the loss of 12 to**

09:28:27 **21** **16 billion dollars, depending on the mark-to-market**

09:28:34 **22** **claims by the entities and potentially placing them in**

09:28:38 **23** **front of other policyholders, including both RMBS,**

09:28:44 **24** **municipal, commercial, ABS, and that was not**

09:28:50 **25** **acceptable to our approach, so --**

18

09:28:54 **1** **Q.** And by you just mentioned you would be litigating over

09:28:58 **2** policyholder preference, do you mean by that you would

09:29:01 **3** be litigating over whether the -- whether CDS

09:29:06 **4** counterparties are policyholders with loss claims and

09:29:11 **5** therefore entitled to the policyholder priority as

09:29:16 **6** opposed to being general creditors entitled to a lower

09:29:21 **7** priority?

09:29:22 **8** **A.** **I think the issue becomes, Your Honor, and I have a**

09:29:26 **9** **high level of understanding of the relationship that**

09:29:28 **10** **this company had a number of offshore transformers**

09:29:33 **11** **that then fed back into and were backed by the**

09:29:36 **12** **insurance subsidiary. A lot of those have collapsed**

09:29:41 **13** **in subsequent years, and I think that's something that**

09:29:44 **14** **Roger Peterson will be up later this week can spend**

09:29:48 **15** **more time on for you, but, you know, needless to say**

09:29:54 **16** **the claims-paying ability of the company was lodged in**

09:30:00 **17** **the insurance company and everything fed back to that**

09:30:04 **18** **insurance company, so how we viewed policyholders and**

09:30:08 **19** **policies fed into that.**

09:30:10 **20** **Q.** And, sir, if I can -- Let me try it again. You

09:30:16 **21** indicated that you would be litigating over

09:30:18 **22** policyholders -- over policyholder preference. By

09:30:21 **23** that do you mean that you would be litigating over

09:30:25 **24** whether the guaranties that had been issued by Ambac

09:30:29 **25** of the obligations of its subsidiary ACP to

19

09:30:33 **1** counterparties under this credit default swaps were

09:30:39 **2** insurance policies insuring insurable loss as opposed

09:30:44 **3** to a parent company guarantee?

09:30:47 **4** MR. VAN SICKLEN: Objection foundation and calls

09:30:49 **5** for expertise outside this witness' demonstrated

09:30:52 **6** knowledge.

09:30:53 **7** THE COURT: Sustained.

09:30:56 **8** MR. BLOOMGARDEN: Sir, it's an open -- You

09:30:57 **9** would have been litigating over whether the CDS banks

09:31:01 **10** were entitled to policyholder preference because

09:31:04 **11** that's an open question; is it not?

09:31:07 **12** MR. VAN SICKLEN: Same objection, same question.

09:31:09 **13** THE COURT: Sustained.

09:31:11 **14** MR. BLOOMGARDEN: Do have an understanding, sir,

09:31:13 **15** as to whether or not that's an open question?

09:31:16 **16** MR. VAN SICKLEN: Same objection.

09:31:17 **17** THE COURT: Sustained.

09:31:20 **18** **Q.** Sir, are there -- Leaving aside the CDS banks, are you

09:31:26 **19** aware of whether or not there are any CDS

09:31:30 **20** counterparties in the Segregated Account?

09:31:34 **21** **A.** **It's my understanding we have a few but the extent of**

09:31:37 **22** **that is, like I said, left much better up to Mr.**

09:31:42 **23** **Peterson.**

09:31:43 **24** **Q.** And do you know, sir, how the CDS counterparties in

09:31:48 **25** the Segregated Account are treated under the plan,

20

09:31:50 **1** what priority they are given?

09:31:52 **2 A. No, I do not.**

09:32:15 **3** Mr. BLOOMGARDEN: I have no further questions,

09:32:16 **4** Your Honor. Mr. Welsh?

09:32:16 **5** THE COURT: All right. Next objector.

09:32:24 **6** MR. VAN SICKLEN: Your Honor, while we're

09:32:25 **7** waiting for the next objecting lawyer, Mr.

09:32:29 **8** Bloomgarden -- I'm sorry. We have -- Some of the

09:32:33 **9** objectors asked me to clarify on the record that, you

09:32:36 **10** know, testimony elicited by one of the lawyers for one

09:32:40 **11** of the objecting parties, given that's in the record,

09:32:43 **12** would stand as testimony for the other objectors such

09:32:46 **13** that they didn't have to all ask the same question,

09:32:49 **14** you know, multiple times, and of course we're

09:32:52 **15** agreeable to that.

09:32:52 **16** THE COURT: All right. That was my

09:32:54 **17** understanding from yesterday as well from your

09:32:57 **18** remarks. Mr. Bloomgarden might want to take his book

09:33:13 **19** there.

09:33:15 **20** **CROSS-EXAMINATION**

09:33:15 **21** **BY MR. WELSH:**

09:33:18 **22 Q.** Good morning, Commissioner. My name is Tom Welsh.

09:33:21 **23** I'm the lawyer for Depfa Bank, one of the

09:33:24 **24** policyholders. I had a much longer set of questions I

09:33:29 **25** was going to ask, but I've tempered it down quite a

21

09:33:34 **1** bit and I hope to be able to just run quickly through

09:33:38 **2** just some general issues, nothing extraordinarily

09:33:42 **3** specific about the Plan.

09:33:43 **4** The first place I'd like to start is following

09:33:46 **5** up on some testimony from yesterday about your review

09:33:49 **6** of the MBIA reorganization that was handled by the New

09:33:54 **7** York department, do you remember that testimony from

09:33:55 **8** yesterday?

09:33:56 **9 A. I do.**

09:33:57 **10 Q.** Okay. And as I recall one of the things that you said

09:34:00 **11** was that you didn't like the way MBIA was handled in

09:34:10 **12** part because it lacked a judicial oversight process,

09:34:14 **13** is that -- did I understand that correctly?

09:34:16 **14 A. Yes.**

09:34:17 **15 Q.** Okay. And do I understand that -- that the sentiment

09:34:23 **16** that you were expressing was the durability of a plan

09:34:26 **17** like this is actually really enhanced by the presence

09:34:30 **18** of judicial oversight and review, was that --

09:34:35 **19 A. That is correct.**

09:34:36 **20 Q.** Okay. And you cited, as I recall, one aspect of MBIA

09:34:44 **21** that you found unappealing which was the fact that

09:34:48 **22** absent the judicial process you had litigation against

09:34:51 **23** MBIA scattered all over the country, right?

09:34:54 **24 A. That's correct.**

09:34:56 **25 Q.** And so really the only beneficiary of that kind of a

22

09:35:03 **1** program are the lawyers?

09:35:04 **2 A. That is one view.**

09:35:07 **3 Q.** I have mixed emotions about that. Now, you do

09:35:13 **4** understand that part of the judicial process that

09:35:17 **5** enhances durability of a plan is not just the circuit

09:35:22 **6** court's review but also the ability of the Court of

09:35:27 **7** Appeals to review activities and proceedings in this

09:35:30 **8** lower court on the merits, right?

09:35:32 **9 A. That is correct.**

09:35:33 **10 Q.** So if this Plan is confirmed here, goes up to the

09:35:37 **11** Court of Appeals, is upheld there, you actually have a

09:35:41 **12** more durable and -- well durable is a good word --

09:35:46 **13** you have a more durable plan that's going to endure

09:35:49 **14** against collateral attacks, correct?

09:35:52 **15 A. Correct.**

09:35:53 **16** MR. VAN SICKLEN: I object. It calls for a

09:35:55 **17** legal conclusion. If it's not appealed the finality

09:35:57 **18** of this Court's order is any different than if it were

09:36:00 **19** appealed and affirmed. This is the wrong witness for

09:36:03 **20** that.

09:36:04 **21** MR. WELSH: But in general you do understand

09:36:05 **22** that what comes with judicial oversight is not just a

09:36:09 **23** single layer of judicial oversight but also parties'

09:36:13 **24** opportunities to appeal and get review of the circuit

09:36:18 **25** court's rulings on the merits, correct?

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09:36:21 **1** MR. VAN SICKLEN: Same objection.

09:36:23 **2** THE COURT: Sustained.

09:36:25 **3** MR. WELSH: All right.

09:36:25 **4** THE COURT: I'm not sure that's relevant in any

09:36:28 **5** fashion.

09:36:28 **6** MR. WELSH: Let me hone in on what prompts me to

09:36:34 **7** ask these questions. The concern of a lot of the

09:36:36 **8** parties who are objecting is that the Plan will go

09:36:38 **9** effective so quickly after the Circuit Court approves

09:36:42 **10** it that it might give rise to arguments in the Court

09:36:47 **11** of Appeals that any appeal from the things that have

09:36:51 **12** happened here become moot and that the Court of

09:36:55 **13** Appeals can no longer look at -- at issues raised

09:37:00 **14** here on the merits because things have moved too

09:37:05 **15** quickly.

09:37:06 **16** MR. VAN SICKLEN: Is that a question or just

09:37:08 **17** some argument?

09:37:08 **18** MR. WELSH: Well, the question is, have -- Let

09:37:14 **19** me ask this: In order to allow the objectors a fair

09:37:19 **20** opportunity to get Court of Appeals to look at issues

09:37:22 **21** that are raised here and review them on the merits,

09:37:26 **22** which I think actually provides benefit to you and to

09:37:31 **23** the public by making it more durable, would you be

09:37:35 **24** willing to provide the parties with a short window of

09:37:37 **25** time before you let the Plan go effective, because

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09:37:40 **1** that's your decision, would you be willing to provide  
09:37:43 **2** the parties with a short window of time in which to  
09:37:46 **3** approach the Court of Appeals and start that review  
09:37:49 **4** process?  
09:37:51 **5** MR. VAN SICKLEN: Objection. This is not the  
09:37:52 **6** right witness or the right forum, you know, to be  
09:37:55 **7** pursuing that. It's not a fact question, it's  
09:37:57 **8** argument.  
09:37:57 **9** THE COURT: I agree. Sustain the objection.  
09:38:00 **10** MR. WELSH: Okay. I had to ask. Let me move on  
09:38:10 **11** to some of your background. As I recall you testified  
09:38:12 **12** that you worked for the Department of Administration  
09:38:16 **13** for the State of Wisconsin?  
09:38:17 **14** **A. That is correct.**  
09:38:18 **15** **Q.** And in that role you were involved in agency issuances  
09:38:23 **16** of municipal bond debt to fund projects here in  
09:38:26 **17** Wisconsin?  
09:38:27 **18** **A. That is correct. One of our divisions was the Capital**  
09:38:32 **19** **Finance Division for the State which I oversaw.**  
09:38:36 **20** **Q.** And were some of those deals credit enhanced through  
09:38:41 **21** financial guarantee insurance like the type that is  
09:38:44 **22** provided by Ambac?  
09:38:46 **23** **A. Some were through Ambac, the State of Wisconsin had**  
09:38:49 **24** **the first MBIA GIC ever issued, for example, so they**  
09:38:54 **25** **used a variety of financial guarantee insurers.**

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09:38:58 **1** **Q.** And the reason I'm asking is I want to hone in on your  
09:39:03 **2** experience on the issuers' side of being involved in  
09:39:09 **3** bond deals where credit enhancement is being provided.  
09:39:12 **4** And you do understand that the reason you go out and  
09:39:15 **5** get credit enhancement is to increase the rating on  
09:39:18 **6** the debt that's being issued and lower the interest  
09:39:21 **7** rate, correct?  
09:39:22 **8** **A. That is correct.**  
09:39:23 **9** **Q.** And the reason that the interest rate goes down and  
09:39:28 **10** the credit rating goes up is because investors are  
09:39:31 **11** actually looking to not the issuer per se but to the  
09:39:37 **12** guarantor, the strength of the guarantor to pay in the  
09:39:41 **13** event of default; is that your basic understanding?  
09:39:44 **14** **A. That's the basic understanding. Typically the issuers**  
09:39:49 **15** **would bring the bond insurer to the state or local**  
09:39:53 **16** **government as a part of the deal.**  
09:39:55 **17** **Q.** All right. And in your capacity there at the  
09:40:00 **18** Department of Administration you did understand that  
09:40:04 **19** in paying for bond insurance you were expecting to  
09:40:11 **20** have the entirety of the assets of the bond insurer  
09:40:15 **21** available in the event of a default?  
09:40:20 **22** MR. VAN SICKLEN: I object. There is lots of  
09:40:21 **23** different structures, all of which have different  
09:40:23 **24** provisions. I think it's a very vague and ambiguous  
09:40:29 **25** question.

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09:40:29 **1** THE COURT: Mr. Welsh, maybe you want to respond  
09:40:35 **2** to the objection.  
09:40:36 **3** MR. WELSH: I was -- No. I'll -- Let me move  
09:40:40 **4** on.  
09:40:40 **5** THE COURT: All right. Sustain the objection.  
09:40:47 **6** **Q.** Yesterday you testified that the ability to use a  
09:40:54 **7** Segregated Account across all lines of insurance is  
09:40:57 **8** unique to Wisconsin; do you recall that part of your  
09:40:59 **9** testimony?  
09:40:59 **10** **A. Yes.**  
09:41:00 **11** **Q.** Okay. Can any insurance company domiciled in  
09:41:11 **12** Wisconsin take advantage of that unique Segregated  
09:41:16 **13** Account statutory power?  
09:41:18 **14** **A. It depends on the fact situation. It's up to the**  
09:41:24 **15** **Commissioner at the time and -- but if you are -- it**  
09:41:29 **16** **has come out of years of legislative history, so that**  
09:41:35 **17** **is correct.**  
09:41:37 **18** **Q.** So you're not aware of any part of the statute that  
09:41:39 **19** prohibits any particular Wisconsin insurance -- type  
09:41:44 **20** of Wisconsin insurance company from relying on it if  
09:41:47 **21** they choose to?  
09:41:48 **22** MR. VAN SICKLEN: Objection, calls for legal  
09:41:50 **23** conclusion, lack of foundation.  
09:41:53 **24** THE COURT: Sustained.  
09:41:55 **25** **Q.** Part of your responsibilities as the regulator is to

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09:41:57 **1** review policy forms, correct?  
09:42:00 **2** **A. That is correct.**  
09:42:05 **3** **Q.** Are you aware of any policy forms that have been  
09:42:08 **4** approved by your department that contain disclosures  
09:42:13 **5** to policyholders about the Segregated Account statute?  
09:42:17 **6** **A. None has been brought to my attention.**  
09:42:20 **7** **Q.** Prior to taking action to create the Segregated  
09:42:37 **8** Account was Ambac Assurance engaged in trying to raise  
09:42:41 **9** additional capital?  
09:42:43 **10** **A. Yes.**  
09:42:44 **11** **Q.** And it is true, correct, that there are multiple ways  
09:42:52 **12** to raise capital through an insurance company, one is  
09:42:55 **13** through the issuance of stock?  
09:42:56 **14** **A. There are multiple ways, that is one.**  
09:42:59 **15** **Q.** And one is also the sale of surplus notes?  
09:43:03 **16** **A. That is correct.**  
09:43:04 **17** **Q.** Okay. You know if Ambac Assurance had been successful  
09:43:12 **18** in those earlier efforts to generate some additional  
09:43:15 **19** capital, we might not be sitting here, correct?  
09:43:19 **20** **A. As I stated yesterday that was one of our concerns**  
09:43:23 **21** **early on, so that is correct.**  
09:43:26 **22** **Q.** You also have testified that one of the reasons you  
09:43:33 **23** pursued this particular strategy was to bridge a gap  
09:43:38 **24** between the funds necessary to pay short-tail  
09:43:42 **25** liabilities and the desire to preserve sufficient

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09:43:46 **1** claims paying assets to take care of policyholders  
09:43:49 **2** with longer term exposures; is that right?  
09:43:53 **3 A. As I testified I -- you were looking for durable**  
09:43:56 **4 coverage for all policyholders.**  
09:44:00 **5 Q.** And you probably couldn't get that kind of durable  
09:44:05 **6** coverage if you used up all your cash flow to pay the  
09:44:07 **7** RMBS guys and any other people who had immediate  
09:44:11 **8** claims, that would --  
09:44:13 **9 A. That's the premise. That is correct.**  
09:44:14 **10 Q.** And a capital infusion from some independent source  
09:44:19 **11** might have been a tool to bridge that cash flow gap,  
09:44:22 **12** correct?  
09:44:22 **13 A. It was always a possibility.**  
09:44:25 **14 Q.** The end result of course was that they weren't able to  
09:44:33 **15** generate external additional capital to fill the gap  
09:44:36 **16** here?  
09:44:37 **17 A. I think, Your Honor, as I talked through it yesterday,**  
09:44:40 **18 we obviously were brought in on all of these ways in**  
09:44:45 **19 which to infuse capital, whether it was the Treasury**  
09:44:49 **20 Department with tarp money, whether it was outside**  
09:44:53 **21 investor interest, and, you know, we -- that did not**  
09:45:00 **22 dissuade our stress testing of the company, we would**  
09:45:04 **23 have added that capital to our stress testing;**  
09:45:06 **24 however, none of that ever came to fruition.**  
09:45:09 **25 Q.** And so we ended up with this Segregated Account and

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09:45:14 **1** the Rehabilitation Plan that we're discussing today,  
09:45:17 **2** correct?  
09:45:17 **3 A. Correct.**  
09:45:18 **4 Q.** All right. Is it a fair characterization then to look  
09:45:22 **5** at what's happening in the Rehabilitation Plan and  
09:45:25 **6** imposing on claimants an obligation to take surplus  
09:45:30 **7** notes, essentially a form of capital, and give up  
09:45:37 **8** their policy claims? Is it fair to characterize that  
09:45:40 **9** as essentially asking the short-term policyholders to  
09:45:43 **10** finance the capital needs of Ambac so that we can  
09:45:49 **11** bridge -- bridge the cash flow shortfall and get the  
09:45:57 **12** durable coverage that you need; is that a fair  
09:46:00 **13** characterization in your mind?  
09:46:01 **14** MR. VAN SICKLEN: I object on foundation. I  
09:46:03 **15** suspect the next witness will be much more qualified  
09:46:06 **16** to deal with these issues.  
09:46:08 **17** THE COURT: Mr. Welsh?  
09:46:09 **18** MR. WELSH: All I'm asking, Your Honor, is if  
09:46:11 **19** it's fair for clients like mine to look at the Plan  
09:46:15 **20** and say we're being asked to loan the General Account  
09:46:20 **21** money for the benefit of other policyholders. And if  
09:46:27 **22** you don't think that's a fair characterization, you  
09:46:30 **23** can say so, but structurally it feels like --  
09:46:35 **24** THE COURT: Can you answer that or not?  
09:46:37 **25** THE WITNESS: I mean I can discuss it, Your

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09:46:39 **1** Honor, it's just a mischaracterization.  
09:46:42 **2** THE COURT: Sustain the objection.  
09:46:45 **3 Q.** Okay. Yesterday you were asked to respond to a  
09:47:20 **4** statement that was contained in one of the briefs that  
09:47:23 **5** we filed on behalf of Depfa and it had to do with the  
09:47:27 **6** risk that there might not be oversight of Ambac to  
09:47:31 **7** ensure that Ambac would deal with their business in a  
09:47:36 **8** way to maximize the likelihood that they would be in a  
09:47:39 **9** position to pay on the surplus notes. Do you recall  
09:47:41 **10** that part of your testimony -- your direct testimony?  
09:47:45 **11 A. I would appreciate hearing the quote back, if you want**  
09:47:48 **12 to read back through it.**  
09:47:50 **13 Q.** Okay. What was read to you said nothing in the plan  
09:47:53 **14** provides a mechanism for the Segregated Account  
09:47:55 **15** policyholders as holders of surplus notes to restrain  
09:47:59 **16** Ambac from rendering itself unable or unwilling to pay  
09:48:02 **17** the surplus notes. And it goes on -- I can't  
09:48:06 **18** remember if this was read as well but policyholders  
09:48:09 **19** can take no comfort whatsoever in the Commissioner's  
09:48:12 **20** claim that he will continue to supervise Ambac to  
09:48:14 **21** maximize payments on the surplus notes.  
09:48:17 **22 A. I do recall that.**  
09:48:18 **23 Q.** All right. In the preceding sentence that you were  
09:48:24 **24** not read we were raising an issue related to the  
09:48:27 **25** Court's jurisdiction over assets in rehabilitation

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09:48:33 **1** plans and I'd like to ask you just a question or two  
09:48:36 **2** about that. You do understand in your capacity as the  
09:48:38 **3** Rehabilitator that the Court has jurisdiction over the  
09:48:43 **4** assets of the company, the legal entity that is placed  
09:48:48 **5** into rehabilitation, correct?  
09:48:51 **6** MR. VAN SICKLEN: Well, I guess I would object.  
09:48:52 **7** This is a technical area of law as to the Court's  
09:48:55 **8** extent of jurisdiction over which of the accounts, and  
09:48:58 **9** I don't think this witness is a lawyer and has  
09:49:01 **10** foundation to answer that.  
09:49:03 **11** THE COURT: Mr. Welsh?  
09:49:05 **12** MR. WELSH: Well, Your Honor, he has been  
09:49:06 **13** appointed as the Rehabilitator and -- and I'm simply  
09:49:12 **14** seeking to gain his understanding of what control  
09:49:20 **15** rights he exercises over what assets, assets in the  
09:49:23 **16** Segregated Account or assets in the General Account  
09:49:26 **17** and in what capacity and --  
09:49:29 **18** THE COURT: Answer that. Can you answer that  
09:49:30 **19** question? What control do you have over assets in  
09:49:34 **20** those accounts?  
09:49:38 **21** THE WITNESS: This gets into really two -- the  
09:49:40 **22** two hats that I wear, Your Honor, obviously as  
09:49:43 **23** Commissioner overseeing the General Account and as  
09:49:46 **24** Rehabilitator overseeing the Segregated Account. As  
09:49:50 **25** I've discussed before there are no assets in the

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09:49:52 **1** Segregated Account, only liabilities. We have a  
09:49:57 **2** cooperation agreement in place which Roger Peterson  
09:50:03 **3** can discuss at length. We have any action moving --  
09:50:09 **4** you know, any monetary action moving out of the  
09:50:12 **5** General Account as Commissioner as it's considered  
09:50:15 **6** extraordinary outside the ordinary course of business,  
09:50:18 **7** we have oversight as Commissioner, but you're getting  
09:50:21 **8** into kind of two hats that -- that any Commissioner  
09:50:28 **9** wears sitting in this position.  
09:50:32 **10** **Q.** And that was actually exactly the euphemism I was  
09:50:36 **11** going to use. With your hat on as Rehabilitator of  
09:50:43 **12** the Segregated Account -- Well, strike that. That  
09:50:50 **13** really was principally what I was focused on. In your  
09:50:58 **14** mind when you're exercising regulatory control over  
09:51:05 **15** Ambac's General Account, you're doing that with your  
09:51:09 **16** regulator hat on as opposed to your rehabilitator hat  
09:51:14 **17** on?  
09:51:15 **18** **A. That is correct.**  
09:51:16 **19** **Q.** Just -- Just a one final question: Have you taken  
09:51:32 **20** any steps to create contingency plans in the event  
09:51:37 **21** that this Plan is either not confirmed by the Circuit  
09:51:41 **22** Court or the confirmation is overturned in the Court  
09:51:45 **23** of Appeals and you have to go back and unwind large  
09:51:49 **24** settlements like the CDS settlement?  
09:51:51 **25** **A. Yes.**

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09:51:52 **1** **Q.** So there are -- Can you describe what those  
09:51:55 **2** contingency plans entail?  
09:51:58 **3** **A. There is a variety of options that we could pursue,**  
09:52:02 **4** **and I -- I always prefer to have a Plan B on the**  
09:52:06 **5** **shelf.**  
09:52:07 **6** MR. WELSH: So we'll jump off that bridge when  
09:52:10 **7** we get to it. Okay. Your Honor, I have nothing  
09:52:12 **8** further. Thank you, Commissioner.  
09:52:15 **9** THE COURT: All right. Next objector.  
09:52:15 **10**  
09:52:15 **11**  
09:52:22 **12** **CROSS-EXAMINATION**  
09:52:22 **13** **BY MR. OWEN:**  
09:52:26 **14** **Q.** Good morning, Commissioner, Jim Owen, ALL Student  
09:52:31 **15** Loans and Lloyds Bank.  
09:52:31 **16** THE COURT: O-W-E-N?  
09:52:33 **17** MR. OWEN: Sorry?  
09:52:35 **18** THE COURT: Spelling of your last name.  
09:52:35 **19** MR. OWEN: O-W-E-N with no S.  
09:52:37 **20** THE COURT: Thank you.  
09:52:43 **21** **Q.** Commissioner, I'd like to ask you first with respect  
09:52:45 **22** to Exhibit 1.  
09:52:46 **23** **A. I'm sorry, Jim. Who do you represent again?**  
09:52:48 **24** **Q.** ALL Student Loan and Lloyds Bank, the student loan  
09:52:53 **25** pool.

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09:52:53 **1** **A. Thank you.**  
09:52:53 **2** **Q.** The verified petition, Exhibit 1, if you can take a  
09:52:57 **3** look at that. Just one second, Jim, we're catching  
09:53:13 **4** up. On the verification page there, the final page of  
09:53:17 **5** that is a verification page signed by you. Are you  
09:53:20 **6** familiar with that page?  
09:53:21 **7** **A. That is correct.**  
09:53:22 **8** **Q.** And you said you have read the petition and to the  
09:53:24 **9** best of my knowledge, information, and belief it is  
09:53:28 **10** true and correct?  
09:53:29 **11** **A. Yes.**  
09:53:30 **12** **Q.** And you signed that under oath?  
09:53:32 **13** **A. That is correct.**  
09:53:33 **14** **Q.** And I'm going to ask you some questions about the  
09:53:36 **15** petition. If at any time you feel you relied on the  
09:53:40 **16** advice of others, just tell me what your understanding  
09:53:42 **17** of those allegations and statements in the petition  
09:53:45 **18** are as opposed to whether or not you believe they were  
09:53:48 **19** your specific understanding or your knowledge; is that  
09:53:51 **20** fair? In other words, if you think it was not your  
09:53:55 **21** specific understanding, because I think we came across  
09:53:58 **22** some testimony in the last few days where you said you  
09:54:00 **23** were relying on the advice of others as opposed to  
09:54:03 **24** your specific knowledge. Is that fair, you'll tell me  
09:54:05 **25** whether or not it was your understanding or whether or

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09:54:07 **1** not it was something that you gained knowledge of from  
09:54:09 **2** the advice of others?  
09:54:10 **3** MR. VAN SICKLEN: Let's take his questions one  
09:54:13 **4** at a time.  
09:54:14 **5** MR. OWEN: I'm just giving you some  
09:54:18 **6** preparatory --  
09:54:18 **7** THE COURT: Well, why don't we simply ask the  
09:54:20 **8** questions and then he'll know the context of whether  
09:54:22 **9** he had the knowledge or whether he relied on others  
09:54:25 **10** for information in that area.  
09:54:28 **11** MR. OWEN: That's fair. On the first page of  
09:54:32 **12** the verified petition it talks about the Segregated  
09:54:35 **13** Account being a separate insurer. What is your  
09:54:37 **14** understanding of how the Segregated Account is a  
09:54:39 **15** separate insurer?  
09:54:41 **16** MR. VAN SICKLEN: Objection. That calls for  
09:54:42 **17** legal conclusions.  
09:54:44 **18** THE COURT: Mr. Owen?  
09:54:45 **19** MR. OWEN: Your Honor, we're trying to establish  
09:54:47 **20** in this case how the covered policies are policies of  
09:54:51 **21** either the Segregated Account and how those policies  
09:54:55 **22** will be administered, and I'm trying to understand  
09:54:58 **23** that -- understand if the -- if the Segregated  
09:55:02 **24** Account is a separate insurer, who administers that  
09:55:05 **25** separate insurance company?

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09:55:06 **1** THE COURT: All right. Then I think the  
09:55:09 **2** question was if the Segregated -- Segregated Account  
09:55:12 **3** is a separate insurer, who administers it?  
09:55:17 **4** MR. OWEN: Yes.  
09:55:17 **5** THE COURT: That would be yourself.  
09:55:18 **6** THE WITNESS: And we administer it. It files a  
09:55:21 **7** separate annual statement. It's basically, my  
09:55:25 **8** understanding, Your Honor, is under insurance law it  
09:55:27 **9** is treated as a separate insurance entity.  
09:55:30 **10** **Q.** Doesn't have a board of directors, does it?  
09:55:32 **11** **A. It uses the same officers -- Under our current**  
09:55:35 **12** **agreement it uses the same officers as the company.**  
09:55:38 **13** **Q.** But that's under Management Service Provider. Under  
09:55:41 **14** -- why don't you flip to page -- paragraph 18 on page  
09:55:53 **15** 13. Isn't it true that the Commission --  
09:56:02 **16** Commissioner conducts the business of the Segregated  
09:56:04 **17** Account?  
09:56:08 **18** MR. VAN SICKLEN: Objection. This is calling  
09:56:10 **19** for legal conclusions of the Commissioner, the  
09:56:15 **20** Rehabilitator, what the statute means. This is not  
09:56:16 **21** the right witness for this line of questioning.  
09:56:19 **22** MR. OWEN: Your Honor, he's filed a petition in  
09:56:22 **23** this court and he said it's true and accurate to the  
09:56:24 **24** best of his knowledge, just the same as he answered  
09:56:28 **25** questions under direct examination from Mr. Van

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09:56:30 **1** Sicklen. I believe if he's filed this petition and  
09:56:32 **2** sworn in your court that it's true and accurate to the  
09:56:34 **3** best of his knowledge, that he can either answer my  
09:56:36 **4** questions or tell me that this information came to him  
09:56:39 **5** through someone else's understanding.  
09:56:40 **6** THE COURT: And the document should speak for  
09:56:43 **7** itself.  
09:56:43 **8** MR. OWEN: So I can't examine him on a document  
09:56:45 **9** filed in your court?  
09:56:46 **10** THE WITNESS: You can question him but again it  
09:56:48 **11** has to be within that context.  
09:56:51 **12** MR. OWEN: I'm trying to find out the context.  
09:56:53 **13** He swore that this information was true and accurate  
09:56:55 **14** and I'm trying to ask him questions about a document  
09:56:58 **15** and statements in the document that he swore in your  
09:57:00 **16** court was true and accurate. I think I can at least  
09:57:03 **17** ask him his understanding of the statements that he  
09:57:06 **18** swore were accurate in your court, otherwise, my  
09:57:10 **19** examination is completely for naught.  
09:57:13 **20** THE COURT: Mr. Van Sicklen?  
09:57:15 **21** MR. VAN SICKLEN: By the Commissioner signing as  
09:57:17 **22** he's required to by law to start a rehabilitation on a  
09:57:21 **23** verified petition, there is a mix of fact statements  
09:57:24 **24** and legal matters that are prepared with the advice of  
09:57:28 **25** counsel, both outside counsel and general counsel. It

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09:57:31 **1** doesn't make suddenly the Commissioner an expert on  
09:57:34 **2** these type of statutory interpretation questions.  
09:57:37 **3** He's not required in signing the verification page to  
09:57:42 **4** suddenly become a lawyer about what these types of  
09:57:44 **5** matters means.  
09:57:46 **6** MR. OWEN: Mr. Van Sicklen just made my case.  
09:57:49 **7** He said he's required by law to sign this, therefore,  
09:57:52 **8** the legislature has made a very specific mandate that  
09:57:56 **9** requires him to sign this and verify that the facts  
09:58:00 **10** are true and accurate, therefore, the legislature has  
09:58:03 **11** mandated to Your Honor and all of us in the public  
09:58:05 **12** that this is true and accurate and therefore I have  
09:58:08 **13** the right to cross-examine him as to what the  
09:58:10 **14** legislature has mandated must be in a petition to file  
09:58:14 **15** in every court.  
09:58:15 **16** THE COURT: Can you answer that question?  
09:58:17 **17** THE WITNESS: Your Honor, as I said in my  
09:58:22 **18** testimony yesterday, you know, there -- obviously I  
09:58:26 **19** read through everything I file but my duties are more  
09:58:31 **20** than just a rehabilitator monoline insurer. I've been  
09:58:36 **21** spending an extraordinary amount of time on the  
09:58:40 **22** federal healthcare reform, which occurred the day  
09:58:43 **23** before the filing of the Ambac petition, and so my  
09:58:48 **24** duties are -- Whereas I would say Roger Peterson has  
09:58:53 **25** spent 80 to 90 percent of his time on this, I have

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09:58:56 **1** not, so although I read through these I have not  
09:58:59 **2** reviewed this section recently and would be happy to  
09:59:02 **3** review it, but --  
09:59:06 **4** THE COURT: All right. Proceed.  
09:59:08 **5** **Q.** So will someone other than you in the department --  
09:59:11 **6** in the Commissioner's office would know who conducts  
09:59:14 **7** the business of the Segregated Account?  
09:59:17 **8** **A. My understanding is that we have -- The officers of**  
09:59:22 **9** **the company are the officers of the Segregated**  
09:59:25 **10** **Account. The CFO of the company is our CFO, handles**  
09:59:31 **11** **all of our filings for -- for our annual statement.**  
09:59:35 **12** **If we are dissatisfied with his work or her work, then**  
09:59:42 **13** **we can bring on our own CFO. If I felt at this time**  
09:59:46 **14** **that you'd have a publicly-traded company that is**  
09:59:49 **15** **perfectly capable of handling the reporting**  
09:59:54 **16** **requirements of the Segregated Account, if I or anyone**  
09:59:58 **17** **who replaces me in the future finds that problematic,**  
10:00:02 **18** **they have every right to bring in a duplicate CFO, for**  
10:00:02 **19** **example.**  
10:00:08 **20** **Q.** But the CFO in the company to which you refer is  
10:00:13 **21** Ambac, AAC?  
10:00:14 **22** **A. That is correct.**  
10:00:15 **23** **Q.** And has this separate insurer known as the Segregated  
10:00:20 **24** Account, does it have a certificate of authority?  
10:00:23 **25** **A. I mean -- you know, I would have to -- There are**

40

10:00:27 **1** many insurance companies, Your Honor, that have

10:00:30 **2** subsidiary insurance companies that may use a CFO from

10:00:35 **3** a holding company, so I do not see this as an unusual

10:00:39 **4** arrangement.

10:00:41 **5** **Q.** My question is real simple: Does this Segregated

10:00:46 **6** Account have the certificate authority?

10:00:47 **7** **A.** I don't know that answer.

10:00:48 **8** **Q.** Are you aware that under Section 611.24, the

10:00:54 **9** Segregated Account statute, that for optional

10:00:58 **10** Segregated Account it requires that it shall be

10:01:02 **11** established after a certificate of authority has been

10:01:04 **12** issued, so do you know whether a certificate of

10:01:07 **13** authority has been issued for this separate Segregated

10:01:10 **14** Account by the Commissioner's office?

10:01:12 **15** MR. VAN SICKLEN: Object. The Commissioner just

10:01:13 **16** answered he didn't know. I'd also indicate that in

10:01:16 **17** the evidence the Court's already admitted he gave a

10:01:19 **18** specific answer to this question is yes, there is a

10:01:22 **19** certificate of authority that was issued.

10:01:24 **20** MR. OWEN: Mr. Van Sicklen is testifying again.

10:01:27 **21** I'd like to hear --

10:01:27 **22** MR. VAN SICKLEN: It's already in evidence and

10:01:29 **23** you're mischaracterizing something that you know is a

10:01:32 **24** fact with a witness that has no foundation, it's just

10:01:35 **25** improper argument.

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10:01:36 **1** THE COURT: All right. Move on then, Mr. Owen.

10:01:40 **2** **Q.** Do you know if the Segregated Account is licensed in

10:01:44 **3** other states since it is transacting business in other

10:01:46 **4** states?

10:01:47 **5** **A.** That's something that Roger Peterson can discuss. I

10:01:53 **6** know we always look at licensure of the company

10:01:58 **7** itself. How that relates to the Segregated Account,

10:02:01 **8** that's something I can't answer.

10:02:02 **9** **Q.** Exhibit 2, please. If you'll look on page four,

10:02:31 **10** second to last paragraph. It states that all assets

10:02:41 **11** within the Segregated Account will be available

10:02:43 **12** exclusively for satisfying liabilities attributed to

10:02:46 **13** the Segregated Account. The company will ensure that

10:02:49 **14** all assets in the Segregated Account including any

10:02:52 **15** income earned thereon remain identifiable within the

10:02:55 **16** Segregated Account. Your testimony today is that

10:02:58 **17** there are no assets in the Segregated Account, so to

10:03:01 **18** what assets is this paragraph of the plan of operation

10:03:04 **19** referring?

10:03:05 **20** **A.** I don't know.

10:03:14 **21** **Q.** And are there any risks in the Segregated Account?

10:03:21 **22** **A.** There are liabilities in the Segregated Account.

10:03:25 **23** **Q.** Well, I'll ask the question again: Are there any

10:03:27 **24** risks in the Segregated Account?

10:03:29 **25** MR. VAN SICKLEN: Objection, vague and

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10:03:30 **1** indefinite.

10:03:31 **2** THE COURT: Can you define risks?

10:03:35 **3** **Q.** I'll show you what's been previously filed by your

10:03:38 **4** counsel a brief of August 17th. This was the

10:04:09 **5** Rehabilitator's Consolidated Brief in Opposition to

10:04:10 **6** All Motions Scheduled For Hearing on September 9th.

10:04:15 **7** Your counsel stated but if -- this is referring to

10:04:19 **8** the Segregated Account -- if it carries no risks not

10:04:24 **9** assumed by the corporation's General Account as is the

10:04:26 **10** case here, the Commissioner may set the required

10:04:29 **11** figure at zero under Section 611.19(1). Do you

10:04:35 **12** believe that this corporation, the Segregated Account,

10:04:38 **13** has no risks?

10:04:40 **14** MR. VAN SICKLEN: Same objection. I'm sorry.

10:04:42 **15** Are you done?

10:04:43 **16** MR. OWEN: Yes.

10:04:43 **17** MR. VAN SICKLEN: Same objection. The witness

10:04:47 **18** is not a lawyer. He doesn't have foundation to answer

10:04:49 **19** this. There is no showing he's ever seen this brief

10:04:53 **20** before. The next witness as we've made clear from the

10:04:56 **21** outset and in his witness designation is the one much

10:05:00 **22** better, you know, fitted by way of background and

10:05:05 **23** experience to answer these types of questions.

10:05:08 **24** MR. OWEN: If the witness has no understanding

10:05:10 **25** on this given answer, then he can so state, but I'd

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10:05:13 **1** like to find out if he has an understanding if this

10:05:15 **2** corporation has any risks or if he's authorized this

10:05:18 **3** brief to be filed.

10:05:19 **4** THE COURT: Could you define risk?

10:05:22 **5** MR. OWEN: A risk would be whether or not the --

10:05:26 **6** whether or not the Segregated Account has at the end

10:05:28 **7** of the day any true liability.

10:05:33 **8** MR. VAN SICKLEN: Same objection. I'm not sure

10:05:35 **9** what a true liability means.

10:05:39 **10** MR. OWEN: Your counsel's brief.

10:05:42 **11** MR. VAN SICKLEN: It's just -- The witness is

10:05:43 **12** not a lawyer, he's the Commissioner of Insurance. If

10:05:47 **13** counsel wants to argue --

10:05:48 **14** MR. OWEN: That's a good point, Mike.

10:05:50 **15** MR. VAN SICKLEN: If counsel wants to argue this

10:05:51 **16** in closing arguments, he can.

10:05:53 **17** THE COURT: One at a time. Did you understand

10:05:55 **18** counsel's definition of risk around which he is basing

10:06:00 **19** his questions?

10:06:01 **20** THE WITNESS: No.

10:06:03 **21** THE COURT: All right. He doesn't. The answer

10:06:05 **22** is no.

10:06:07 **23** MR. OWEN: Did you authorize the briefs to be

10:06:09 **24** filled by your counsel in this case?

10:06:11 **25** MR. VAN SICKLEN: Objection, it's privileged.

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10:06:14 **1** THE COURT: I'll sustain that objection.

10:06:25 **2** MR. OWEN: Do you have any understanding as to

10:06:27 **3** whether or not the Segregated Account is capitalized?

10:06:31 **4** MR. VAN SICKLEN: Same objection on foundation.

10:06:35 **5** It's the wrong witness.

10:06:37 **6** THE COURT: Sustained.

10:06:41 **7** Mr. OWEN: Do you have any understanding as to

10:06:43 **8** whether or not the Segregated Account has surplus?

10:06:46 **9** MR. VAN SICKLEN: Same objection.

10:06:47 **10** THE COURT: Sustained.

10:07:22 **11 Q.** Who in the Commissioner's office has knowledge as to

10:07:25 **12** whether or not the Segregated Account has adequate

10:07:27 **13** capital and surplus?

10:07:30 **14 A.** **As I've said before our Chief Financial Bureau**

10:07:36 **15 Director -- I think I'm giving you too many titles**

10:07:39 **16 here, Roger -- but Roger Peterson will be testifying**

10:07:43 **17 later this week, so --**

10:08:11 **18 Q.** Do you have any experience working in the reinsurance

10:08:14 **19** area, looking at reinsurance agreements?

10:08:21 **20 A.** **I periodically review reinsurance agreements.**

10:08:25 **21 Q.** Did you review the reinsurance agreements that's here

10:08:32 **22** in this case that is listed as the aggregate excess of

10:08:37 **23** loss reinsurance agreement that is designed to protect

10:08:39 **24** the Segregated Account?

10:08:41 **25 A.** **I have a high-level understanding of the relationship**

45

10:08:44 **1** **it creates with the Segregated Account.**

10:08:46 **2 Q.** What is that high-level understanding?

10:08:49 **3 A.** **That it will cover Segregated Account liabilities and**

10:08:56 **4 payments until up to a hundred million dollars being**

10:09:02 **5 left in the General Account.**

10:09:04 **6 Q.** And do you know whether that reinsurance agreement

10:09:08 **7** attaches at a certain point above a secured note of

10:09:13 **8** two billion dollars?

10:09:13 **9** MR. VAN SICKLEN: I object. This is the wrong

10:09:15 **10** witness. There is no foundation.

10:09:16 **11** THE COURT: Let's find out. Do you know?

10:09:18 **12** THE WITNESS: I just have that high-level

10:09:20 **13** understanding as I've described. It's direct

10:09:23 **14** attachment point. That would make sense but I haven't

10:09:27 **15** reviewed the document.

10:09:29 **16 Q.** Do you know if you looked at any other options for

10:09:32 **17** securing the liabilities in the Segregated Account

10:09:35 **18** other than the aggregate excess of loss reinsurance

10:09:39 **19** agreement that was ultimately executed, any other

10:09:43 **20** types of reinsurance?

10:09:44 **21 A.** **I'd have to have Mr. Peterson answer that. Your**

10:09:49 **22 Honor, obviously we have very well qualified people in**

10:09:53 **23 the department that I delegate responsibility to, and**

10:09:56 **24 a number of options were looked at and one was**

10:10:00 **25 recommended to me, so I think Roger Peterson would be**

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10:10:03 **1** **a better individual on this.**

10:10:05 **2 Q.** On paragraph 6 of the verified petition Mr. Greenwald

10:10:15 **3** discussed this with you, page four. You discussed

10:10:35 **4** this yesterday, the statutory surplus and contingency

10:10:39 **5** reserves at the -- by the third quarter of 2009 they

10:10:44 **6** dropped -- they have gone from \$6.4 billion in the

10:10:47 **7** fourth quarter 2007 to \$1.16 billion in the third

10:10:52 **8** quarter of 2009. Do you know what they were on

10:10:56 **9** March 24th of 2010, the date the verified petition was

10:11:00 **10** filed?

10:11:00 **11 A.** **No, I do not.**

10:11:01 **12 Q.** Do you know whether there was any surplus in the

10:11:04 **13** account as of March 24th, 2009?

10:11:08 **14 A.** **No, I do not.**

10:11:11 **15 Q.** Do you know whether Ambac was insolvent March 24th,

10:11:17 **16** 2010?

10:11:17 **17** MR. VAN SICKLEN: He just answered the question,

10:11:19 **18** Your Honor. No foundation.

10:11:20 **19** MR. OWEN: No, because that continues to reserve

10:11:23 **20** was included in that question. The question is

10:11:26 **21** whether it was insolvent.

10:11:27 **22** THE COURT: Do you know?

10:11:28 **23** THE WITNESS: The company was financially

10:11:30 **24** hazardous. That's not -- That includes a range of

10:11:33 **25** issues and so that was my view and that was a view

47

10:11:38 **1** from the fall of '09.

10:11:41 **2** MR. OWEN: Based on your two years of

10:11:43 **3** examination of the company on March 24th when you

10:11:45 **4** filed the verified petition for order of

10:11:47 **5** rehabilitation of just the Segregated Account did you

10:11:50 **6** have an opinion as to whether or not Ambac, the entire

10:11:53 **7** company, was insolvent?

10:11:54 **8** MR. VAN SICKLEN: Objection. It again calls for

10:11:57 **9** a financial conclusion. The witness is not qualified

10:12:00 **10** to answer. If there is various ways in which you can

10:12:03 **11** measure that test, stat accounting, gaap accounting

10:12:06 **12** and the like, and this is just the wrong witness for

10:12:08 **13** that.

10:12:09 **14** MR. OWEN: Your Honor, the witness has testified

10:12:11 **15** that he has gone over and met with people all over the

10:12:14 **16** United States, pulled together a staff, made various

10:12:18 **17** determinations of all alternatives. I'm asking you

10:12:21 **18** one alternative that a regulator should make, was the

10:12:24 **19** company insolvent?

10:12:25 **20** THE COURT: Do you know?

10:12:26 **21** MR. VAN SICKLEN: That's not an alternative,

10:12:28 **22** that's a statement of accounting. It's a very

10:12:33 **23** different matter.

10:12:33 **24** THE COURT: Well, let's find out. He probably

10:12:36 **25** doesn't know if he wasn't doing the accounting. Do

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10:12:39 **1** you know?

10:12:39 **2** THE WITNESS: The company was financially

10:12:41 **3** hazardous. Whether it was insolvent or not, it's not

10:12:44 **4** something I was aware of.

10:13:00 **5** **Q.** You mentioned yesterday that you instructed your staff

10:13:04 **6** that they were guided by the statutes. Is that

10:13:08 **7** something that you feel you were guided by as well?

10:13:11 **8** **A. That is correct.**

10:13:12 **9** **Q.** Did you review the statutes and question the

10:13:16 **10** Segregated Account before you signed the verified

10:13:18 **11** petition?

10:13:19 **12** **A. No, I did not.**

10:13:21 **13** **Q.** Did you believe at the time you signed the verified

10:13:45 **14** petition that you were fairly and equitably treating

10:13:48 **15** the policyholders that were in this Segregated

10:13:51 **16** Account?

10:13:51 **17** **A. Yes.**

10:13:51 **18** **Q.** Can you describe for me what you believe was the

10:13:58 **19** difference between the policyholders that were put in

10:14:00 **20** the Segregated Account and the policyholders that were

10:14:02 **21** put in the General Account?

10:14:04 **22** **A. As I discussed yesterday, Your Honor, we were trying**

10:14:10 **23** **to bring the present value exposures of the company**

10:14:15 **24** **into sync. One option for the Commissioner is to have**

10:14:24 **25** **a cash note split as a claim. You had a company that**

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10:14:31 **1** **had lost the ability to control its own destiny based**

10:14:36 **2** **on the economic situation of the country, and we had**

10:14:41 **3** **to look at ways to really take a time out and reorder**

10:14:46 **4** **the liabilities, and we settled on the cash -- you**

10:14:52 **5** **know, very simple approach of segregating out our**

10:14:55 **6** **short-term policyholders and providing full payment**

10:15:01 **7** **through a cash note split.**

10:15:03 **8** **Q.** And you said yesterday that you were trying to -- the

10:15:10 **9** wording you had was the difference between the

10:15:11 **10** long-tail and the short-tail policies. What is your

10:15:14 **11** definition between a long-tail policy versus a

10:15:17 **12** short-tail policy?

10:15:19 **13** **A. This situation -- Each situation would be different.**

10:15:25 **14** **You know, when you look at this company overall you**

10:15:27 **15** **had 40 years of exposure with over -- up to 15,000**

10:15:33 **16** **policies at the time holding various -- facing the**

10:15:39 **17** **company in various manners through various**

10:15:44 **18** **instruments, so it was -- it just depends on the**

10:15:49 **19** **policy and the issue.**

10:15:50 **20** **Q.** But you said you were striking a balance between the

10:15:53 **21** long-tail and the short-tails. In what way did you

10:15:56 **22** strike that balance in establishing the Segregated

10:15:59 **23** Account?

10:15:59 **24** **A. By simply bringing the exposures into sync as far as**

10:16:06 **25** **the present value of money and making sure that the**

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10:16:11 **1** **6.8 billion that was in the General Account could**

10:16:15 **2** **cover all the policyholders and provide durable**

10:16:22 **3** **coverage.**

10:16:22 **4** **Q.** Is it your opinion that you put short-tail in one

10:16:26 **5** account and long tail in another account? I'm trying

10:16:29 **6** to understand how you struck that balance?

10:16:31 **7** **A. There were various policies looked at and there was**

10:16:36 **8** **obviously in the Plan a discussion of how student loan**

10:16:42 **9** **policies would be subsequently settled, being more**

10:16:46 **10** **unique policies than some of the others. And that**

10:16:50 **11** **provides some insight to the approach that we took, so**

10:16:56 **12** **it just -- you know, it depended on the policies at**

10:16:59 **13** **the time.**

10:17:00 **14** **Q.** What is your definition of short-tail?

10:17:04 **15** **A. We did not draw a line in the sand.**

10:17:11 **16** **Q.** But you said you struck a balance and you put some in

10:17:14 **17** one account and some in another. I need to have some

10:17:17 **18** idea what definition you used when you chose to strike

10:17:20 **19** that balance. Short-tail means ten years, long tail

10:17:24 **20** means 40 years? Give me just an idea. It was your

10:17:28 **21** testimony.

10:17:28 **22** THE COURT: If you used that type of

10:17:30 **23** distinction.

10:17:32 **24** THE WITNESS: Right. There were a variety of

10:17:34 **25** distinctions used, obviously policies that were eating

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10:17:40 **1** away at the reserve of the company were, you know, the

10:17:45 **2** first five years of exposure roughly. We obviously

10:17:49 **3** put other policies into the Segregated Account as well

10:17:53 **4** as reinsurance contracts.

10:17:56 **5** **Q.** My client's policies, the Lloyds policies in specific

10:18:01 **6** would mature in arguably June of 2013. Would you

10:18:06 **7** consider that short-tail policy?

10:18:09 **8** **A. If we put -- You know, we put a variety of policies**

10:18:14 **9** **into the Segregated Account. I have not reviewed your**

10:18:18 **10** **policy.**

10:18:18 **11** **Q.** What -- How would -- I'm trying to understand, the

10:18:21 **12** short-term policies -- the short-tailed policies and

10:18:25 **13** the long-tailed policies which ones went into which

10:18:29 **14** account when you struck that balance?

10:18:30 **15** **A. You have, you know -- you have other short-tailed**

10:18:34 **16** **policies in the General Account as well some of the**

10:18:37 **17** **commercial asset-backed securities, so --**

10:18:40 **18** **Q.** What were you doing when you struck the balance?

10:18:43 **19** Please explain how you struck the balance.

10:18:45 **20** **A. As I explained yesterday you're simply reordering,**

10:18:56 **21** **giving a time out to make sure that the claims paying**

10:19:05 **22** **resources of the company can be there for all**

10:19:07 **23** **policyholders. And in striking that balance of a fair**

10:19:10 **24** **equitable result, we needed to move some of the**

10:19:16 **25** **policyholders that were rupturing due to a variety of**

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10:19:23 **1 economic pressures into the Segregated Account.**  
10:19:25 **2 Q.** Which -- Which ones were short-tail, which ones were  
10:19:29 **3** long-tail that you moved into the Segregated Account?  
10:19:32 **4 A.** **There -- There were a variety of different policies**  
10:19:35 **5 that were put in. You had -- you had RMBS policies,**  
10:19:40 **6 you had reinsurance contract, you had the Las Vegas**  
10:19:46 **7 Mono Rail, the Weinstein Security.**  
10:19:49 **8 Q.** So some could be long-tail and some could be  
10:19:52 **9** short-tail, didn't matter, any of those could be moved  
10:19:54 **10** into the Segregated Account according to what you just  
10:19:57 **11** testified?  
10:19:57 **12 A.** **They were all having short-term claims that were**  
10:20:01 **13 eating up the long-tail policyholders' equity.**  
10:20:05 **14 Q.** Thank you. I'm glad you said that because I looked at  
10:20:09 **15** your testimony and you said you wanted to have the  
10:20:11 **16** opportunity to reorder the liabilities in the company,  
10:20:14 **17** correct?  
10:20:14 **18 A.** **That's correct.**  
10:20:14 **19 Q.** And by the company at that point you meant Ambac, the  
10:20:19 **20** entire company, before you did the Segregated Account?  
10:20:21 **21 A.** **That is correct.**  
10:20:22 **22 Q.** And when you reordered the liabilities in the company  
10:20:26 **23** you reorder the liabilities to put the policies with  
10:20:30 **24** the quote material projected losses into the  
10:20:34 **25** Segregated Account and the policies without the

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10:20:35 **1** material projected losses in the General Account,  
10:20:38 **2** correct? That's how you reordered them?  
10:20:42 **3 A.** **We sequestered a number of policies in the -- in the**  
10:20:49 **4 Segregated Account and hoped to be paying claims in**  
10:20:53 **5 the near future after going through this process.**  
10:20:56 **6 Q.** But the basis for the reordering was based on those  
10:21:01 **7** policies that had material projected losses; is that  
10:21:04 **8** not correct?  
10:21:04 **9 A.** **That would --**  
10:21:06 **10** MR. VAN SICKLEN: Objection foundation. This is  
10:21:08 **11** detailed in all the filings we've made and the next  
10:21:11 **12** witness is the person that was directly involved in  
10:21:14 **13** that process and I would suggest he's a better person  
10:21:18 **14** to answer these questions, and the question's  
10:21:22 **15** mischaracterizing the written descriptions of the  
10:21:24 **16** allocation process and criteria.  
10:21:26 **17** THE COURT: Mr. Owen.  
10:21:28 **18** MR. OWEN: Your Honor, he's told me that he  
10:21:30 **19** wanted to reorder liabilities in the company. I'm  
10:21:33 **20** asking him upon what basis, and I understand the basis  
10:21:37 **21** in their filings is based on material projected  
10:21:41 **22** losses. I'm trying to ask him what his -- if that is  
10:21:44 **23** the basis upon how he reordered the liabilities in the  
10:21:47 **24** company. If it's not he can tell me what the other  
10:21:49 **25** basis might have been, but he has to explain his own

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10:21:54 **1** testimony of how he reordered the liabilities. If I'm  
10:21:58 **2** incorrect that it wasn't based on material projected  
10:22:01 **3** losses, then he can explain what it was that basis.  
10:22:05 **4** MR. VAN SICKLEN: That mischaracterizes the  
10:22:07 **5** typed explanation all the documents from the first day  
10:22:10 **6** about the criteria used. And Mr. Peterson would be a  
10:22:13 **7** much better person to get into that, so the question  
10:22:16 **8** mischaracterizes the evidence.  
10:22:18 **9** THE COURT: Sustain the objection. Let's move  
10:22:20 **10** on.  
10:22:21 **11** MR. OWEN: I'm sorry?  
10:22:23 **12** THE COURT: Sustain the objection.  
10:22:24 **13** MR. OWEN: Then please tell me what was the  
10:22:26 **14** basis for your reordering the liabilities in the  
10:22:30 **15** company?  
10:22:31 **16** THE WITNESS: As I've --  
10:22:33 **17** MR. VAN SICKLEN: It's the same objection, Your  
10:22:35 **18** Honor, this witness --  
10:22:36 **19** THE COURT: Same ruling. Sustain the objection.  
10:22:40 **20** Let's move on.  
10:22:43 **21 Q.** You were not trying to get either Ambac or the  
10:22:48 **22** Segregated Account back in business, were you? This  
10:22:52 **23** is purely runoff?  
10:22:55 **24 A.** **As I described yesterday, Your Honor, this was the**  
10:23:00 **25 view of how to -- an orderly runoff to the company, so**

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10:23:05 **1 that is correct.**  
10:23:06 **2 Q.** Both General Account and Segregated Account?  
10:23:08 **3 A.** **Right. That is correct.**  
10:23:10 **4 Q.** Is it your opinion that you've protected the interest  
10:23:52 **5** of the creditors of the General Account?  
10:23:55 **6** MR. VAN SICKLEN: In what respect, over the last  
10:23:57 **7** couple years or --  
10:24:02 **8** MR. OWEN: It doesn't matter. Is that an  
10:24:03 **9** objection?  
10:24:03 **10** MR. VAN SICKLEN: Yes, it is. It's vague.  
10:24:05 **11** THE COURT: Mr. Owen.  
10:24:06 **12** MR. OWEN: I don't think it's a vague question  
10:24:09 **13** whatsoever.  
10:24:09 **14** THE COURT: Of course not, you asked it, but I  
10:24:11 **15** believe it is. Can you be more specific?  
10:24:23 **16 Q.** Well, look at paragraph 11 of the verified petition  
10:24:31 **17** again, Exhibit 1. There it states that the  
10:24:52 **18** Commissioner, yourself, believes that the Segregated  
10:24:54 **19** Account may be successfully rehabilitated without  
10:24:57 **20** substantial increase in risk of loss to the creditors  
10:25:00 **21** of the insurer or the public. Is it your belief that  
10:25:03 **22** there is no increase of loss to the creditors of the  
10:25:05 **23** Segregated Account?  
10:25:13 **24 A.** **Our goal here was to bring stability to the company,**  
10:25:18 **25 and whether that's the creditors, the policyholders or**

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10:25:21 **1** the public, I mean that's the ultimate goal of this

10:25:24 **2** Plan of Rehabilitation, so that stability is enclosed

10:25:30 **3** in this approach for our Plan of Rehabilitation.

10:25:34 **4** Q. Well, there is no increase of loss right now to the

10:25:37 **5** creditors of the General Account, they're still going

10:25:39 **6** to get paid a hundred percent on their claims,

10:25:41 **7** correct?

10:25:42 **8** MR. VAN SICKLEN: Objection argumentative.

10:25:45 **9** THE COURT: Overruled.

10:25:47 **10** THE WITNESS: Do you mean policyholders,

10:25:49 **11** creditors, what specific --

10:25:51 **12** Q. Policyholders of the General Account.

10:25:53 **13** A. Currently we provide a durable coverage in the General

10:25:56 **14** Account, and so the policyholder has a claim -- a

10:26:00 **15** valid claim it would be paid -- paid out and has been

10:26:03 **16** paid out over the last six months.

10:26:04 **17** Q. And under the Plan the policyholders of the Segregated

10:26:08 **18** Account -- under the current plan as written,

10:26:11 **19** 25 percent in cash and 75 percent in surplus note?

10:26:15 **20** A. Then that's -- As I've said before that's considered a

10:26:19 **21** claim and full payment.

10:26:25 **22** Q. And full payment?

10:26:25 **23** A. Correct.

10:26:26 **24** Q. And can I have Exhibit 27? I'll ask you to assume

10:27:03 **25** that pages 67 and 68 of the Disclosure Statement calls

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10:27:08 **1** for four scenarios that call for projected payout of

10:27:13 **2** 100 percent, 85 percent, 71 percent and 45 percent

10:27:17 **3** respectively for the surplus notes. Are you familiar

10:27:21 **4** with those projected percentage payouts on the surplus

10:27:25 **5** notes?

10:27:26 **6** A. I haven't looked at these in a few months.

10:27:30 **7** Q. Are you familiar with those projected payout

10:27:32 **8** percentages?

10:27:34 **9** A. Somewhat familiar. This was done for demonstrative

10:27:39 **10** purposes.

10:27:39 **11** Q. So in other words, there is no assurance that even

10:27:44 **12** those percentages would be paid out?

10:27:47 **13** A. The -- The issue, and as we've discussed is, you

10:27:54 **14** know, as we look at payments on the surplus notes

10:28:00 **15** we'll look at them each year, what the cash notes

10:28:04 **16** splits should be, we will take the same standards that

10:28:08 **17** we currently take to treat all policyholders fairly

10:28:15 **18** and equitably and look at what the cash note split

10:28:19 **19** should be. We have a conservative approach and have

10:28:26 **20** wanted to take a conservative approach to this

10:28:29 **21** company.

10:28:29 **22** Q. Is there any assurance whatsoever that even those

10:28:33 **23** percentages will be paid out on the surplus notes to

10:28:36 **24** the -- to the policyholders of the Segregated

10:28:38 **25** Account?

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10:28:39 **1** MR. VAN SICKLEN: Objection on the vague as to

10:28:43 **2** assurances. All of this evidence is -- is aimed at

10:28:46 **3** trying to give some information which people can draw

10:28:50 **4** this conclusion, so it's --

10:28:52 **5** THE COURT: All right. I guess you need to

10:28:55 **6** define what assurances are you looking at.

10:28:59 **7** MR. OWEN: If he's saying that this is -- He

10:29:02 **8** just said that they will pay us equal amounts to the

10:29:05 **9** creditors in the General Account, that the surplus

10:29:07 **10** notes -- the 25 percent cash and the 75 percent

10:29:10 **11** surplus notes will pay us equal to the creditors in

10:29:13 **12** the General Account, and now I get to ask him if

10:29:15 **13** that's true, if his prior testimony is true, then what

10:29:19 **14** assurances are there that 75 percent payout will

10:29:22 **15** actually occur.

10:29:23 **16** THE COURT: You still have to tell him so he

10:29:25 **17** understands the context of the answer you're seeking,

10:29:28 **18** what assurances you need. What is the gold bar? Is

10:29:37 **19** it silver? Is it paper? What type of assurance is

10:29:43 **20** your question referring to?

10:29:46 **21** MR. OWEN: A guarantee of any sort.

10:29:49 **22** THE COURT: All right. Is there any guarantee

10:29:51 **23** of any sort, is that what you're saying?

10:29:56 **24** MR. OWEN: Yes.

10:29:56 **25** THE COURT: Other than the Plan?

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10:29:58 **1** MR. OWEN: The Plan gives no -- We just

10:30:01 **2** established -- Well, let me go back. Let's look on

10:30:04 **3** page Roman Numeral II, the third page of Exhibit 27.

10:30:28 **4** Look at the final paragraph on there. It starts out

10:30:31 **5** in the middle of that paragraph states: Although the

10:30:36 **6** Rehabilitator believes that any such forward-looking

10:30:38 **7** statements are reasonable, no assurance can be given

10:30:41 **8** that such expectation will prove to be correct -- to

10:30:44 **9** have been correct. I'm sorry.

10:30:46 **10** A. I'm sorry. I'm not on the --

10:30:46 **11** Q. Okay.

10:30:48 **12** A. You're Roman Numeral II?

10:30:51 **13** Q. Yes.

10:30:51 **14** A. Okay. My apologies. Which paragraph?

10:30:54 **15** Q. Middle of the final paragraph. The Judge just said

10:31:01 **16** let's look at the Disclosure Statement, so now let's

10:31:03 **17** look at the Disclosure Statement. And the words

10:31:07 **18** assurance are your words. Although the Rehabilitator

10:31:11 **19** believes that any such forward-looking statements are

10:31:13 **20** reasonable, no assurance can be given that such

10:31:16 **21** expectations will prove to have been correct. Is that

10:31:17 **22** your understanding of what the Rehabilitator is

10:31:21 **23** telling the creditors of the Segregated Account?

10:31:25 **24** MR. VAN SICKLEN: Objection. The document

10:31:26 **25** speaks for itself. This is just argument.

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10:31:29 **1** THE COURT: Sustained.

10:31:31 **2** MR. OWEN: Let me ask you again. Is there any

10:31:33 **3** guarantee that any of the projected payments on the

10:31:36 **4** secured notes will ever be made?

10:31:39 **5** THE COURT: Other than the Plan.

10:31:43 **6** MR. OWEN: The Plan -- He just told us, Your

10:31:46 **7** Honor, the Plan has no assurances. So I'm asking now

10:31:48 **8** does he have any independent guarantee. Since the

10:31:51 **9** Plan has told us there is no assurance, does the

10:31:53 **10** Commissioner himself have any guarantee?

10:31:55 **11** THE COURT: I think the question is independent

10:31:57 **12** of the Plan do you have any guarantee?

10:32:00 **13 Q.** Yes.

10:32:01 **14 A.** **The -- As we've talked about before the General**

10:32:07 **15 Account is under the auspices of the Commissioner's**

10:32:11 **16 Office. The Commissioners will act as we have acted.**

10:32:19 **17 We'll have the same staff, civil service staff sitting**

10:32:24 **18 across from you in ten years -- I guess I don't want**

10:32:27 **19 to speak for them -- but that we've had for the last**

10:32:29 **20 ten years. We still have the hearing examiner from**

10:32:36 **21 the breakup of Baldwin United that created Ambac and**

10:32:41 **22 MGIC. We have come to this Court to find and provide**

10:32:49 **23 assurances, and we've tried not to make these**

10:32:52 **24 decisions in a vacuum, and it goes back to our guiding**

10:32:58 **25 statutes of treating the policyholders, creditors,**

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10:33:00 **1 public, fair and equitably. This is a public**

10:33:08 **2 insurance department that has no self interest.**

10:33:12 **3 Q.** So is it fair and equitable to not -- to segregate an

10:33:16 **4** account where you're giving people 25 percent cash and

10:33:19 **5** no guarantee whatsoever and no assurance that the 75

10:33:25 **6** percent will be paid while you're paying the people in

10:33:27 **7** the General Account a hundred percent?

10:33:29 **8** MR. VAN SICKLEN: Asked and answer, and also

10:33:30 **9** just further argumentation.

10:33:32 **10** THE COURT: Sustained. It has been asked and

10:33:34 **11** answered.

10:33:34 **12** MR. OWEN: I don't think he has at all answered,

10:33:37 **13** Your Honor, whether it's fair and equitable.

10:33:39 **14** THE COURT: I believe he has on numerous

10:33:41 **15** occasions. Let's proceed.

10:33:44 **16 Q.** Do you know if there has been any specific analysis

10:33:48 **17** regarding the payment of the surplus notes?

10:33:52 **18 A.** Yes.

10:34:05 **19 Q.** What has the specific analysis entailed?

10:34:12 **20 A.** **We feel at this time that the General Account can pay**

10:34:18 **21 \$0.25 cash and \$0.75 in notes. We'll review the**

10:34:22 **22 ability for the company to pay the same split on**

10:34:26 **23 June 1st of 2011 and review it with this Court.**

10:34:32 **24 Q.** In the Rehabilitator's Supplementations to the

10:34:37 **25** October 8th Disclosure Statement filed on the 12th of

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10:34:40 **1** November the question was asked on page 16 by

10:34:46 **2** ALL/Lloyds for documents containing a specific

10:34:50 **3** analysis regarding surplus -- payment of principal

10:34:54 **4** amount on the surplus notes on or about June 7, 2020,

10:34:59 **5** the answer was no specific analyses have been created

10:35:02 **6** regarding the payment of the surplus notes on or about

10:35:05 **7** June 7, 2020, nor has OCI reached a conclusion

10:35:10 **8** regarding the payment of surplus notes at that time.

10:35:13 **9** Do you agree with that statement?

10:35:15 **10** MR. VAN SICKLEN: Objection, foundation. If

10:35:16 **11** counsel would be patient the next witness is the

10:35:20 **12** appropriate person to ask these types of questions to.

10:35:22 **13** MR. OWEN: He just answered, Your Honor, there

10:35:24 **14** was some analysis and I'm trying to impeach the

10:35:27 **15** witness by the harrowing statement.

10:35:28 **16** THE COURT: I don't think his answer went to

10:35:31 **17** 2020, I think it was referenced 2011.

10:35:35 **18** MR. OWEN: No. I asked an open-ended question

10:35:37 **19** about whether they'd done an analysis of the surplus

10:35:40 **20** notes, Your Honor.

10:35:41 **21** THE COURT: The answer was yes, and then he

10:35:43 **22** explained it. If this is more on the expertise --

10:35:48 **23** technical expertise of Mr. Peterson, who I'm surprised

10:35:54 **24** hasn't fled from the courtroom with all the

10:35:57 **25** responsibility being placed upon him, I think it's

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10:36:01 **1** appropriate that the technical person to testify give

10:36:06 **2** that testimony.

10:36:07 **3 Q.** That's fine, Your Honor. I'll move on. You mentioned

10:36:21 **4** yesterday that creditors in the General Account Sonic

10:36:27 **5** and Dunkin' Donuts and they all had filed briefs in

10:36:29 **6** support of the Segregated Account, are you sure of

10:36:30 **7** that or do you know that they just filed affidavits

10:36:33 **8** with respect to a contest over the confirmation of the

10:36:41 **9** bank notes approved?

10:36:44 **10 A.** **My understanding was they were in support of our plan**

10:36:48 **11 and the bank settlement.**

10:36:50 **12 Q.** Okay. You're not sure of that or do you know?

10:36:52 **13 A.** **That's my understanding.**

10:36:53 **14 Q.** Thank you. You testified also yesterday about the

10:36:59 **15** fact that there was potential for other claims to be

10:37:07 **16** moved from the General Account to the Segregated

10:37:11 **17** Account. Do you know whether the verified petition

10:37:14 **18** provides that no other claims other than a CDS claims

10:37:18 **19** and student loan claims can be moved from the General

10:37:21 **20** Account to the Segregated Account?

10:37:22 **21** MR. VAN SICKLEN: Objection. That

10:37:24 **22** mischaracterizes the statement. It's between policies

10:37:27 **23** and claims.

10:37:28 **24** MR. OWEN: I'm sorry. Policies. Let's look at

10:37:32 **25** the verified petition again, paragraph 13, page ten.

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10:37:53 **1** It says: Upon the grant of this petition, and entry  
 10:37:55 **2** of order of rehabilitation of the Segregated Account,  
 10:37:56 **3** there will be no further allocation of policies  
 10:38:00 **4** from the General Account to the Segregated Account  
 10:38:01 **5** with two specific exceptions. Did you know what those  
 10:38:05 **6** specific exceptions are?  
 10:38:06 **7 A. Yes.**  
 10:38:06 **8 Q.** What are they?  
 10:38:08 **9 A. The CDS contracts and the student loans, I believe.**  
 10:38:12 **10 Q.** Okay. And do you know if any other CDS contracts have  
 10:38:16 **11** been moved to the Segregated Account?  
 10:38:18 **12 A. I don't believe they have.**  
 10:38:20 **13 Q.** So those Credit Default Swap contracts are still in  
 10:38:24 **14** the General Account?  
 10:38:25 **15 A. I don't have knowledge of where they reside.**  
 10:38:28 **16 Q.** How about the other student loan pools, those have  
 10:38:32 **17** been moved, have they not, or most of them?  
 10:38:35 **18 A. I believe there were five that may not have.**  
 10:38:37 **19 Q.** Okay. That's what I meant by most of them.  
 10:38:40 **20 A. Right.**  
 10:38:41 **21 Q.** Other than that you signed a verified petition saying  
 10:38:44 **22** that no further allocation of policies would occur  
 10:38:48 **23** from the General Account to the Segregated Account; is  
 10:38:50 **24** that correct?  
 10:38:51 **25 A. Any action we've taken under this Plan of**

10:38:56 **1 Rehabilitation, this is our view of the General**  
 10:39:02 **2 Account/Segregated Account. We obviously filed -- We**  
 10:39:06 **3 brought further liabilities to the Segregated Account**  
 10:39:08 **4 on November 8th, but I believe you're talking about**  
 10:39:10 **5 policies.**  
 10:39:11 **6 Q.** Right. So if there are policies in the General  
 10:39:15 **7** Account that have material projected losses, you're  
 10:39:19 **8** not going to move them to the Segregated Account?  
 10:39:21 **9 A. Our expectation is and we have been paying claims in**  
 10:39:25 **10 the General Account.**  
 10:39:27 **11 Q.** How are you going to differentiate between those  
 10:39:31 **12** policies in the General Account that now have material  
 10:39:34 **13** projected losses and those that have been moved to the  
 10:39:38 **14** Segregated Account that have material projected  
 10:39:39 **15** losses?  
 10:39:40 **16 MR. VAN SICKLEN:** Objection. Mischaracterized  
 10:39:42 **17** what's in the General Account. And if he wants to  
 10:39:44 **18** talk to the next witness at the risk of Mr. Peterson  
 10:39:47 **19** leaving, it might be more appropriate. There is no  
 10:39:49 **20** foundation for the witness to answer these.  
 10:39:51 **21 MR. OWEN:** Other than he filed the verified  
 10:39:53 **22** petition and swore to it.  
 10:39:55 **23 THE COURT:** Sustain the objection.  
 10:40:15 **24 MR. OWEN:** Yesterday you testified that you  
 10:40:16 **25** provided notice to the bank creditors prior to putting

10:40:21 **1** them in the Segregated Account. Did you also provide  
 10:40:23 **2** notice to my clients prior to putting them in the  
 10:40:27 **3** Segregated Account?  
 10:40:29 **4 MR. VAN SICKLEN:** Objection. That  
 10:40:30 **5** mischaracterizes the testimony. I don't think the  
 10:40:32 **6** banks were put in the Segregated Account.  
 10:40:34 **7 Q.** I'm sorry. Prior to potentially putting them in the  
 10:40:38 **8** Segregated Account.  
 10:40:39 **9 A. Repeat the question.**  
 10:40:41 **10 Q.** You provided notice to the banks before your  
 10:40:44 **11** settlement with them that you may put them in the  
 10:40:47 **12** Segregated Account. Did you at any time provide  
 10:40:49 **13** notice to my client before they were put in the  
 10:40:52 **14** Segregated Account?  
 10:40:53 **15 A. You're correct. We did provide notice to the banks,**  
 10:40:57 **16 but I don't know on your clients.**  
 10:40:59 **17 Q.** Did you provide notice to any other of the  
 10:41:03 **18** policyholders in the Segregated Account before placing  
 10:41:06 **19** them in the Segregated Account?  
 10:41:08 **20 A. I'm not aware of what notice was given.**  
 10:41:12 **21 Q.** You said yesterday that there was some \$989 million in  
 10:41:19 **22** pending claims in the Segregated Account, is that  
 10:41:21 **23** correct, or did I get that wrong?  
 10:41:23 **24 A. That's my understanding.**  
 10:41:24 **25 Q.** And you said your goal was to start paying that next

10:41:27 **1** year. Would you be paying them at that 25 percent  
 10:41:30 **2** cash/75 percent surplus note ratio?  
 10:41:33 **3 A. Under the current plan.**  
 10:41:35 **4 Q.** That's your goal?  
 10:41:36 **5 A. Right.**  
 10:41:36 **6 Q.** And when next year would you -- do you anticipate  
 10:41:42 **7** making those payments?  
 10:41:44 **8 A. It's dependent upon the confirmation of the Plan.**  
 10:41:48 **9 Q.** Do you have any idea how long it would take to get  
 10:41:58 **10** those payments going?  
 10:42:00 **11 A. As I think I said in yesterday's testimony my goal**  
 10:42:06 **12 would be to do it as soon as possible but I don't have**  
 10:42:08 **13 the knowledge of how the DTC Trustee works and how**  
 10:42:12 **14 that will operationalize. I know Mr. Peterson does**  
 10:42:16 **15 and could talk through some of the operational issues**  
 10:42:19 **16 that you're seeking answers to.**  
 10:42:21 **17 Q.** All right. Thank you. On the policies that were left  
 10:42:31 **18** in the General Account you mention the collateral  
 10:42:34 **19** damage and the triggers that might have triggered --  
 10:42:37 **20** if people had exercised those triggers it might have  
 10:42:41 **21** caused that collateral damage; is that correct?  
 10:42:44 **22 THE COURT:** Mr. Owen, this may be the  
 10:42:46 **23** appropriate time to take the morning recess, so just  
 10:42:48 **24** hold that thought and we'll come back to that at the  
 10:42:52 **25** end of the recess. We'll be in recess for 15 minutes.

10:43:09 **1** (Break taken at 10:43 a.m.)

10:43:09 **2** (End of Reporter Flakne's Section.)

09:46:59 **3** (Start of Reporter Albert's Section.)

09:46:59 **4** (Proceedings continuing at 11:00 a.m.)

11:02:14 **5** THE COURT: All right. Be seated.

11:02:15 **6** And Mr. Dilweg, we'll have you back on the

11:02:19 **7** witness chair.

11:02:55 **8** All right. The Circuit Court for Dane County

11:02:57 **9** will be in session again in The Matter of The

11:03:02 **10** Rehabilitation of the Segregated Account of Ambac

11:03:04 **11** Assurance Corporation, 10 CV 1576. And Mr. Owen, you

11:03:11 **12** were in the process of cross.

11:03:14 **13** MR. OWEN: Yes, sir. Thank you, your Honor.

11:03:14 **14** **CONTINUED CROSS EXAMINATION**

11:03:15 **15** **BY MR. OWEN:**

11:03:15 **16** **Q.** Commissioner, a few more questions. I was asking you

11:03:21 **17** about the collateral damage issue for the General

11:03:25 **18** Account, policyholders like Sonic. Would it not have

11:03:34 **19** been possible to issue an injunction that would have

11:03:41 **20** been able to stop the exercise of those?

11:03:50 **21** THE COURT: Just a moment. We have some rubbing

11:03:52 **22** of the mic or something.

11:03:52 **23** MR. HOOPER (speaking via telephone): I

11:03:58 **24** apologize.

11:03:58 **25** THE COURT: Try that again, Mr. Owen. There was

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11:04:01 **1** an interruption.

11:04:01 **2** BY MR. OWEN:

11:04:01 **3** **Q.** On the collateral damage issue for the policies that

11:04:05 **4** were in the General Account, would it not have been

11:04:08 **5** possible for you to issue an injunction that would

11:04:11 **6** have stopped the exercise of those triggers that you

11:04:14 **7** were concerned with?

11:04:15 **8** MR. VAN SICKLEN: Objection. Calls for a legal

11:04:17 **9** conclusion. No foundation this witness is qualified

11:04:20 **10** to answer that.

11:04:21 **11** THE COURT: Sustained.

11:04:23 **12** **Q.** Did you not just ask for an injunction recently

11:04:26 **13** against the IRS?

11:04:29 **14** **A.** That is correct.

11:04:30 **15** **Q.** Do you know whether you had the power to issue

11:04:33 **16** injunctions against third parties exercising certain

11:04:36 **17** -- taking certain actions that would impair the

11:04:39 **18** obligations of the policies in the General Account?

11:04:42 **19** MR. VAN SICKLEN: Objection. Calls for a legal

11:04:44 **20** conclusion.

11:04:45 **21** THE COURT: Sustained.

11:04:47 **22** **Q.** Are there injunctions right now affecting the

11:04:56 **23** policyholders in the Segregated Account and third

11:04:58 **24** parties that have an effect on the policyholders in

11:05:03 **25** the Segregated Account?

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11:05:03 **1** THE COURT: Other than what's already been

11:05:05 **2** issued.

11:05:05 **3** MR. OWEN: I'm asking him if he has knowledge of

11:05:08 **4** the effects of those injunctions.

11:05:10 **5** MR. VAN SICKLEN: Objection. Legal conclusion.

11:05:12 **6** An injunction is a matter of public record.

11:05:15 **7** THE COURT: Sustained.

11:05:18 **8** **Q.** Did you consider alternatives with which to deal with

11:05:26 **9** those triggers that may have caused potential

11:05:29 **10** collateral damage in the General Account policies?

11:05:33 **11** **A.** As I believe I stated before, we looked at all options

11:05:39 **12** before approaching this plan of operation.

11:05:42 **13** **Q.** What alternatives did you consider with respect to

11:05:45 **14** those triggers?

11:05:46 **15** **A.** Each policyholder, 13,000 now policyholders, has a

11:05:55 **16** different covenant, different trigger. And, you know,

11:06:01 **17** it's something that I know the company could discuss,

11:06:06 **18** Kathy Matanle or Dave Barranco. But it became clear

11:06:12 **19** to me that it would be difficult to craft something

11:06:14 **20** that would affect and adjoin all of those covenants

11:06:19 **21** and triggers.

11:06:24 **22** **Q.** With respect to the current staff of the managing

11:06:29 **23** service provider, Ambac, how does the staff differ

11:06:32 **24** compared to the staff that was there before, other

11:06:34 **25** than the CFO and the CEO no longer exist?

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11:06:40 **1** **A.** As far as the current Ambac staff?

11:06:43 **2** **Q.** Yes.

11:06:44 **3** **A.** I believe we have -- there's about 250 people at

11:06:53 **4** Ambac.

11:06:55 **5** We have a variety of different departments

11:06:58 **6** ranging from HR to IT to municipal policies, so, you

11:07:09 **7** know, the whole gamut of the company and the officers.

11:07:14 **8** My understanding is since we started to examine

11:07:22 **9** Ambac closely in early 2008, you've had a number of

11:07:27 **10** the officers have left, and you now have only a few

11:07:32 **11** officers that had a role in the company prior to my

11:07:38 **12** attention to the company in early 2008.

11:07:40 **13** **Q.** You don't know the numbers. Would somebody else in

11:07:46 **14** your office know the different makeup of the people in

11:07:49 **15** senior management?

11:07:50 **16** **A.** I think if -- my understanding is a number have left.

11:07:56 **17** Obviously, the CEO, Bob Jenader, departed, and who he

11:08:02 **18** took with him was unclear to me.

11:08:04 **19** And I think you can compare annual statements

11:08:10 **20** over the years. It's not something I've done.

11:08:14 **21** **Q.** If you were given the option of taking your salary

11:08:17 **22** over the next few years in the 25 percent cash and 75

11:08:21 **23** percent surplus notes that you're giving the option to

11:08:26 **24** the Segregated Account policyholders, would you take

11:08:29 **25** that same option?

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11:08:29 **1** MR. VAN SICKLEN: I object. That's  
11:08:30 **2** argumentative.  
11:08:30 **3** THE COURT: Sustained.  
11:08:32 **4** MR. OWEN: I have no further questions.  
11:08:33 **5** THE COURT: All right.  
11:08:42 **6** State your name, please.  
11:08:46 **7** MR. WHITMER: Good afternoon, your Honor. Good  
11:08:50 **8** morning. Steven Whitmer on behalf of Wells Fargo.  
11:08:56 **9** THE COURT: I hope that wasn't a hint,  
11:08:56 **10** Mr. Whitmer.  
11:08:57 **11** MR. WHITMER: And I'm here as trustee,  
11:09:00 **12** representing the trustee for the LVM bondholders.  
11:09:05 **13** THE COURT: Proceed.  
11:09:05 **14** **CROSS EXAMINATION**  
11:09:06 **15** **BY MR. WHITMER:**  
11:09:06 **16** **Q.** Good morning, Mr. Commissioner.  
11:09:08 **17** A follow-up on something that I believe you said  
11:09:11 **18** this morning. And I think I'm quoting you accurately.  
11:09:14 **19** One of the purposes for this proceeding is to  
11:09:20 **20** "make sure that claims-paying resources will be there  
11:09:24 **21** for all policyholders." Is that an accurate  
11:09:28 **22** statement?  
11:09:29 **23** **A.** That's accurate.  
11:09:30 **24** **Q.** And that's an important statement too; right?  
11:09:33 **25** **A.** That is correct.

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11:09:35 **1** **Q.** And why is that?  
11:09:36 **2** **A.** It's our role as the Rehabilitator and Commissioner to  
11:09:45 **3** make sure that claims-paying resources are there for  
11:09:48 **4** policyholders.  
11:09:49 **5** **Q.** And when you say that, you're not referring to just in  
11:09:52 **6** the short term, but you're referring throughout the  
11:09:55 **7** length of this Rehabilitation; correct?  
11:09:59 **8** **A.** That is correct.  
11:09:59 **9** **Q.** Mr. Commissioner, you're familiar with the LVM  
11:10:07 **10** bondholders' claim at issue in this proceeding?  
11:10:09 **11** **A.** I am.  
11:10:10 **12** **Q.** And sir, you're aware that OCI has determined that the  
11:10:13 **13** LVM exposure represents one of the highest projected  
11:10:19 **14** individual deal losses in the Segregated Account?  
11:10:22 **15** **A.** That is correct.  
11:10:23 **16** **Q.** And I assume you're also aware that the bulk of the  
11:10:29 **17** LVM claims will arise after 2030?  
11:10:34 **18** **A.** It has a long exposure. And it's not clear to me, you  
11:10:39 **19** know, what all the exposures are.  
11:10:41 **20** **Q.** So as you were earlier today referring to the  
11:10:44 **21** differences between long-tail and short-tail policies,  
11:10:48 **22** would the LVM policy fall in the long-tail category in  
11:10:53 **23** your view?  
11:10:53 **24** **A.** Yes.  
11:10:54 **25** **Q.** I'd like to follow up on a comment made by OCI's

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11:11:05 **1** counsel yesterday.  
11:11:07 **2** On page 106 of the transcript --- I'm glad to  
11:11:10 **3** provide a copy for you if you need it -- and what OCI  
11:11:15 **4** counsel said, "At the heart of our Plan is really not  
11:11:18 **5** certainty because it's not a certain future."  
11:11:22 **6** You would agree with that statement?  
11:11:23 **7** **A.** That is correct.  
11:11:24 **8** **Q.** And in your own words, why is it that you agree with  
11:11:28 **9** that statement?  
11:11:29 **10** **A.** I watched the projections of the company over the last  
11:11:37 **11** two and a half years successfully or unsuccessfully  
11:11:41 **12** fail. I watched the economy go into one of its  
11:11:46 **13** greatest recessions that it's been in, and I've  
11:11:48 **14** decided that, as we all have, that to take a  
11:11:51 **15** conservative approach to rehabilitating this company  
11:11:55 **16** is the best route.  
11:11:56 **17** **Q.** So in a nutshell, would you agree that this matter in  
11:11:59 **18** any view presents many uncertainties?  
11:12:03 **19** **A.** That is correct.  
11:12:04 **20** **Q.** And to take it a step further, you'd also agree that  
11:12:08 **21** the Rehabilitation Plan needs to be prepared to  
11:12:11 **22** address those future uncertainties?  
11:12:14 **23** **A.** We've tried to create a flexible plan.  
11:12:17 **24** **Q.** Let's discuss one of those uncertainties. I'm going  
11:12:22 **25** to propose to you that one of them would be what Ambac

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11:12:26 **1** 's claim-paying resources will be in the future. You  
11:12:30 **2** would agree that that falls in the category of  
11:12:32 **3** uncertain?  
11:12:33 **4** **A.** That is correct.  
11:12:34 **5** **Q.** For example, no one knows for certain, including  
11:12:39 **6** anyone in this room, what those claim-paying resources  
11:12:42 **7** will be in five years?  
11:12:47 **8** **A.** Do I? Or no one?  
11:12:48 **9** **Q.** I'm just asking would you agree that no one in this  
11:12:51 **10** room, including yourself, knows for certain what the  
11:12:54 **11** Ambac claim-paying resources will be in five years?  
11:12:57 **12** **A.** That is correct.  
11:12:57 **13** **Q.** And certainly you'd agree that the same would apply if  
11:13:02 **14** we're talking about a 10-year or a 20-year spectrum?  
11:13:05 **15** **A.** That is correct.  
11:13:06 **16** **Q.** And would you also agree that the further we go out in  
11:13:09 **17** time, the more uncertainty there would be with respect  
11:13:12 **18** to what Ambac's claim-paying resources will be?  
11:13:16 **19** **A.** That is correct.  
11:13:18 **20** **Q.** I'd like to turn to a discussion about the projections  
11:13:22 **21** that Mr. Owen was just discussing with you a little  
11:13:26 **22** bit ago, and I'm going to ask Mr. Wisniewski to  
11:13:31 **23** provide you with a copy of Exhibit 27 from the binders  
11:13:37 **24** behind you. And this is a Disclosure Statement we've  
11:13:40 **25** been discussing.

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11:13:41 **1** I'd like to direct your attention to page 47 at  
 11:14:00 **2** paragraph O.  
 11:14:08 **3** Page 47, paragraph O.  
 11:14:12 **4** MR. VAN SICKLEN: Thank you.  
 11:14:18 **5 Q.** Sir, you've testified about this Disclosure Statement  
 11:14:21 **6** both yesterday and today; right?  
 11:14:23 **7 A. That is correct.**  
 11:14:23 **8 Q.** And you are familiar with at least generally how the  
 11:14:28 **9** Disclosure Statement is set forth?  
 11:14:29 **10 A. That is correct.**  
 11:14:30 **11 Q.** And you would agree with me that the projections that  
 11:14:39 **12** OCI has presented to the Court in this case are merely  
 11:14:43 **13** estimates of future developments?  
 11:14:47 **14 A. That is correct.**  
 11:14:47 **15 Q.** And to take it a step further, you would agree that  
 11:14:51 **16** the assumptions and the estimates underlying the  
 11:14:56 **17** Rehabilitator's financial projections are inherently  
 11:15:00 **18** uncertain?  
 11:15:03 **19 A. These are the estimates of the best information we**  
 11:15:07 **20 have available today.**  
 11:15:08 **21 Q.** I understand, sir. But my question is would you agree  
 11:15:11 **22** with me that those estimates are by their nature  
 11:15:16 **23** inherently uncertain?  
 11:15:17 **24 A. Correct.**  
 11:15:18 **25 Q.** And you'd also agree with me that the projections are

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11:15:22 **1** not necessarily indicative of the future financial  
 11:15:27 **2** position of the Segregated Account?  
 11:15:32 **3** MR. VAN SICKLEN: Objection as to form. It's  
 11:15:36 **4** vague.  
 11:15:36 **5** THE COURT: As to what?  
 11:15:36 **6** MR. VAN SICKLEN: Vague.  
 11:15:48 **7** (Question read back.)  
 11:15:49 **8** THE COURT: Response?  
 11:15:51 **9** MR. WHITMER: Your Honor, I can change my  
 11:15:53 **10** question and just redirect it. I think it will move  
 11:15:57 **11** things along.  
 11:15:58 **12** THE COURT: All right. Sustain the objection.  
 11:16:00 **13 Q.** Sir, I'm going to ask that you take a look at the  
 11:16:03 **14** second sentence OF paragraph O. I'm gonna read it and  
 11:16:06 **15** see if you agree with it.  
 11:16:07 **16** "The Rehabilitator's financial projections are not  
 11:16:11 **17** necessarily indicative of the future financial  
 11:16:14 **18** position or results of operations of the Segregated  
 11:16:19 **19** Account which may vary significantly from those set  
 11:16:22 **20** forth in the Rehabilitator's financial projections."  
 11:16:26 **21** Would you agree, sir, that that is the -- an  
 11:16:30 **22** accurate statement?  
 11:16:31 **23 A. That is correct.**  
 11:16:32 **24 Q.** You would also agree with me that OCI and you, sir,  
 11:16:39 **25** here today through your testimony are not -- are not

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11:16:44 **1** representing to this Court that the projections before  
 11:16:47 **2** this Court either can or will be achieved?  
 11:16:59 **3** MR. VAN SICKLEN: I guess I object on compound  
 11:17:01 **4** to start with. I have no idea what counsel is asking  
 11:17:04 **5** here.  
 11:17:05 **6** THE COURT: Well, I always wait in intrigue when  
 11:17:10 **7** I hear questions prefaced "would you agree with me,"  
 11:17:14 **8** which immediately assumes that the person would know  
 11:17:18 **9** your mental processes. I think you could drop that  
 11:17:20 **10** and just ask the question direct. It might help.  
 11:17:24 **11** MR. VAN SICKLEN: The other problem, your Honor,  
 11:17:25 **12** is there's four different sets of projections all with  
 11:17:28 **13** different scenarios and assumptions. So the question  
 11:17:31 **14** is inherently misleading.  
 11:17:35 **15** MR. WHITMER: Your Honor, I can restate it.  
 11:17:37 **16** THE COURT: All right.  
 11:17:37 **17 Q.** Mr. Dilweg, I'd like to direct you to the very next  
 11:17:41 **18** sentence, paragraph O, from where we just were, which  
 11:17:45 **19** starts with the word "consequently."  
 11:17:46 **20** "The Rehabilitator's financial projections  
 11:17:50 **21** contained herein should not be regarded as a  
 11:17:53 **22** representation by the Rehabilitator or the Segregated  
 11:17:59 **23** Account or their advisors or any other person that the  
 11:18:03 **24** projected financial position or results of operations  
 11:18:06 **25** can or will be achieved."

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11:18:08 **1** Do you agree with that statement?  
 11:18:13 **2 A. Yes.**  
 11:18:13 **3 Q.** And you'd agree that that statement applies to all of  
 11:18:16 **4** the projections that have been submitted to the Court,  
 11:18:19 **5** not just a subset of those projections?  
 11:18:24 **6 A. We've submitted a variety of scenarios. All**  
 11:18:29 **7 projections have inherent uncertainty. If I knew the**  
 11:18:33 **8 future economics of our country, I wouldn't be sitting**  
 11:18:37 **9 here today.**  
 11:18:37 **10 Q.** Actually, I just want to clarify for the record that  
 11:18:40 **11** the statement that you just agreed to, you understand  
 11:18:42 **12** that that applies to all of the OCI projections, not  
 11:18:45 **13** just a subset; right?  
 11:18:47 **14** MR. VAN SICKLEN: I object as argumentative.  
 11:18:48 **15** And I don't understand the relevance even of the line  
 11:18:52 **16** of questioning, given the witness's last answer.  
 11:18:56 **17** THE COURT: Mr. Whitmer?  
 11:18:59 **18** THE ATTORNEY: It's directly relevant to the  
 11:19:02 **19** beginning of our examination, which is Mr. Dilweg's  
 11:19:05 **20** statement that it's important to make sure that  
 11:19:08 **21** claims-paying resources will be there for all  
 11:19:10 **22** policyholders throughout the proceeding.  
 11:19:12 **23** THE COURT: Well, you know, it's interesting,  
 11:19:14 **24** and we can become semantical and have a great  
 11:19:18 **25** philosophical discussion about the future. But it's

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11:19:22 **1** unknown.

11:19:23 **2** He's already indicated factors that could come

11:19:26 **3** into play. Um, maybe you've got a computer program

11:19:29 **4** that has all the variables in. You can run out any

11:19:34 **5** kind of scenarios. But I think we can move on.

11:19:38 **6** He's indicated that this is what it is. He

11:19:41 **7** doesn't know what's gonna happen in the future. It

11:19:45 **8** could go either way I think he said at one point. You

11:19:49 **9** don't know whether it's going to go good or going to

11:19:52 **10** go bad. But they are trying to be flexible to adjust

11:19:55 **11** and monitor and manage this thing as it goes along as

11:19:59 **12** these circumstances occur. That's about all you can

11:20:02 **13** really do.

11:20:03 **14** MR. WHITMER: Your Honor, may we proceed?

11:20:05 **15** THE COURT: Yes. Let's move on.

11:20:07 **16** **Q.** Mr. Dilweg, one of the things that is certain in this

11:20:10 **17** Plan, however, is that the Plan intends to begin

11:20:14 **18** paying claimants with 25 cents in cash starting

11:20:20 **19** perhaps in the coming months; right?

11:20:23 **20** **A.** If the order is confirmed, that is correct.

11:20:26 **21** **Q.** That 25-cent number is not uncertain in your mind.

11:20:33 **22** That's the starting point for this Plan as it's been

11:20:37 **23** framed; right?

11:20:37 **24** **A.** That is correct.

11:20:37 **25** **Q.** And yesterday you talked about all the things that

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11:20:42 **1** could happen. As the Court just mentioned, all sorts

11:20:44 **2** of things could happen in the future. No one knows

11:20:46 **3** what they might be.

11:20:48 **4** One of the things you talked about yesterday, for

11:20:50 **5** example, is there might be a double dip in the economy

11:20:54 **6** sometime down the road; right?

11:20:55 **7** **A.** That is correct.

11:20:56 **8** **Q.** And if there is a double dip in the economy, that

11:21:00 **9** could materially change the financial position of

11:21:03 **10** Ambac?

11:21:05 **11** **A.** That is correct.

11:21:06 **12** **Q.** And you'd agree -- well, that double dip could take

11:21:10 **13** place next year. It could take place in 2020. It

11:21:13 **14** could take place in 2030.

11:21:17 **15** MR. VAN SICKLEN: This just seems like argument,

11:21:19 **16** your Honor.

11:21:20 **17** THE COURT: Where are you going with this,

11:21:22 **18** counsel? We all understand the uncertainties of the

11:21:27 **19** economic world. But are you asking that there's --

11:21:31 **20** that whether this Plan is absolute guarantees that no

11:21:36 **21** matter what happens in the real world, it's --

11:21:40 **22** everything in it is guaranteed? That can't be -- you

11:21:44 **23** know, that's not realistic. But is that what you're

11:21:48 **24** seeking?

11:21:48 **25** MR. WHITMER: Your Honor, what we're seeking to

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11:21:49 **1** find out is whether the Plan has provided for making

11:21:52 **2** sure that at the end of the day, the claims-paying

11:21:56 **3** resources will be evenly distributed to all

11:21:59 **4** policyholders. And that's where we're going with this

11:22:01 **5** line of questioning.

11:22:01 **6** THE COURT: Well, I think that's already been

11:22:03 **7** answered.

11:22:05 **8** MR. WHITMER: We do have a line of questioning I

11:22:07 **9** think we can get to that.

11:22:09 **10** THE COURT: Why don't you do that? Because the

11:22:10 **11** end of the day is one thing. But the end of a decade

11:22:13 **12** or two decades is another.

11:22:17 **13** BY MR. WHITMER:

11:22:17 **14** **Q.** Mr. Commissioner, what assurances can you provide

11:22:23 **15** Wells Fargo as you sit here today that there will in

11:22:27 **16** fact be 25 cents on the dollar available for a claim

11:22:31 **17** that comes in after 2030?

11:22:35 **18** **A.** As I said in my earlier testimony, we'll examine the

11:22:40 **19** economic factors every June and look at what cash not

11:22:46 **20** split will go out the door. And to understand what

11:22:50 **21** may happen in 2030 at this point, you know, we feel

11:22:55 **22** comfortable on June 1st of, you know, that we can

11:22:59 **23** start 2011 with a cash note split of 25 cent/75 cent

11:23:06 **24** note. We'll review it in June of 2011, and then we'll

11:23:09 **25** review it in each subsequent year. That's what we

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11:23:12 **1** feel is a conservative approach. And it'll be

11:23:15 **2** reviewed each year and subsequent years.

11:23:18 **3** **Q.** As of 2030, at least some of the policyholders if this

11:23:23 **4** Plan is confirmed will have been paid out 25 cents on

11:23:26 **5** the dollar; right?

11:23:27 **6** **A.** They will have received the cash note split.

11:23:30 **7** **Q.** And what I'm asking for your input on is if we get to

11:23:36 **8** 2030, a big group of policyholders -- who knows how

11:23:40 **9** many -- have received 25 cents on the dollar. What

11:23:44 **10** assurances are there for my client, Wells Fargo, that

11:23:47 **11** there'll be sufficient resources in 2030 to make sure

11:23:50 **12** that they get treated at least the same as all the

11:23:53 **13** prior policyholders have been paid?

11:23:55 **14** **A.** I think, you know, we've taken the information that we

11:23:58 **15** know today. We've taken information from advisors

11:24:02 **16** that we've worked with over the last two and a half

11:24:05 **17** years who we feel have been more right than the

11:24:08 **18** company. And all we can do is take the best

11:24:12 **19** information we have on the projections of the economic

11:24:15 **20** future and start out the door at a 25/75-cent split.

11:24:21 **21** **Q.** Well, one of the things that OCI could do is they

11:24:25 **22** could put in place a reserve to ensure that when

11:24:29 **23** they're paying one policyholder in 2015 25 cents,

11:24:33 **24** there will also be money reserved for future claims at

11:24:37 **25** that same amount. Is that reserve, is that something

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11:24:41 **1** that you considered?

11:24:42 **2 A. We looked at a variety of options. We feel this**

11:24:45 **3 approach is the most fair and equitable.**

11:24:47 **4 Q.** And my question is, is the reserve one of those

11:24:51 **5 options that you looked at?**

11:24:53 **6 A. We looked at reserves. We looked at multiple**

11:24:58 **7 segregated accounts. There was a variety of issues**

11:25:00 **8 that we looked at.**

11:25:02 **9 Q.** What would be the downside of having a reserve in

11:25:07 **10 place to ensure that the LVM bondholders were to**

11:25:12 **11 receive at least the same amount as the other pre-2020**

11:25:20 **12 claimants, for example?**

11:25:21 **13 MR. VAN SICKLEN:** Objection. Speculation.

11:25:25 **14 THE COURT:** Do you have any ability to answer

11:25:27 **15 that?**

11:25:28 **16 A. I mean, Judge, you're getting into self-interested**

11:25:33 **17 policyholders. We're trying to balance it across all**

11:25:37 **18 the policyholders.**

11:25:38 **19 A reserve is an option. But we felt this**

11:25:41 **20 pay-as-you-go approach, um, was a better route. So, I**

11:25:45 **21 mean, that's kind of the high-level view that I had.**

11:25:49 **22 THE COURT:** All right. Proceed.

11:25:51 **23 Q.** Is there a provision contemplated by OCI by which

11:25:56 **24 there would be a clawback of some sort of the 25 cents**

11:25:59 **25 that were paid to the short-tail claimants if in fact**

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11:26:03 **1** we learn in 2030 that there are insufficient

11:26:07 **2 claims-paying resources to pay the LVM bondholders 25**

11:26:12 **3 cents?**

11:26:13 **4 A. I think the Plan is before you. Changes to the Plan**

11:26:17 **5 would need to go through the process we're going**

11:26:19 **6 through at this time.**

11:26:20 **7 Q.** And my question to you is, is there a provision or an

11:26:26 **8 approach which has been considered by OCI, any**

11:26:30 **9 approach at all, as to how clawback of that type might**

11:26:35 **10 take place?**

11:26:36 **11 A. I mean --**

11:26:37 **12 MR. VAN SICKLEN:** I object. It calls for

11:26:39 **13 speculation. It's privileged communications. And**

11:26:43 **14 there's no foundation this witness is the right person**

11:26:45 **15 to ask these things.**

11:26:46 **16 THE COURT:** I'll sustain that objection. I

11:26:49 **17 think he's answered your question, counsel. Let's**

11:26:52 **18 move on.**

11:26:53 **19 BY MR. WHITMER:**

11:26:53 **20 Q.** Mr. Commissioner, let's move on to a line of

11:26:57 **21 questioning that Mr. Owen presented to you.**

11:27:00 **22 A. Which one?**

11:27:00 **23 Q.** This has to do with the difference between the

11:27:07 **24 projections being accurate as opposed to the**

11:27:09 **25 projections being a reasonable approach.**

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11:27:12 **1** I believe it was your testimony yesterday, sir, on

11:27:16 **2** page 217 of the transcript, you said words to the

11:27:20 **3** effect of that this is purely what could happen. You

11:27:23 **4** talked yesterday a little bit about things that could

11:27:25 **5** happen; right?

11:27:27 **6 A. I believe I did. I don't have a transcript in front**

11:27:33 **7 of me.**

11:27:33 **8 Q.** Was there any effort made by OCI to evaluate the

11:27:39 **9** statistical certainty of the projections that are

11:27:43 **10** being presented to the Court today, for example,

11:27:46 **11** projections that contained standard deviations or

11:27:52 **12** economic confidence levels? Was there any efforts to

11:27:54 **13** do that?

11:27:56 **14 MR. VAN SICKLEN:** Object on foundation. I don't

11:27:58 **15** know if the witness knows.

11:28:01 **16 THE COURT:** Do you have any knowledge of what

11:28:03 **17** your advisors used as their statistical model to

11:28:07 **18** evaluate this?

11:28:09 **19 MR. DILWEG:** Yes.

11:28:09 **20 THE COURT:** All right. Go ahead.

11:28:10 **21 A. My understanding is we used some of the Moody's**

11:28:17 **22 estimates of the economy. You know, the issue becomes**

11:28:24 **23 -- what's your name?**

11:28:25 **24 Q.** I'm Steven Whitmer.

11:28:27 **25 A. Steven, the issue becomes, you know, what I've**

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11:28:31 **1 witnessed over the past two years, the variables that**

11:28:34 **2 are out there, to watch the stock market drop to 6,000**

11:28:40 **3 puts stresses on investments. It could have ruptured**

11:28:46 **4 Hartford Financial. These are all variables that we**

11:28:49 **5 have stressed and we feel comfortable putting forth**

11:28:52 **6 here. And the details of all of the modeling -- you**

11:28:57 **7 know, I know pieces and parts of it. I'm comfortable**

11:29:00 **8 with the approach. I know Roger Peterson could give**

11:29:03 **9 you more a detailed view of some of the models. But**

11:29:07 **10 this was something that we spent time on and we felt**

11:29:11 **11 very comfortable with.**

11:29:13 **12 Q.** So my question is with respect to the four sets of

11:29:15 **13** projections that are before this Court, is there any

11:29:20 **14** information you can provide us with respect to

11:29:22 **15** standard deviations, that these are accurate within

11:29:25 **16** plus or minus X percent? Anything along that line?

11:29:30 **17 MR. VAN SICKLEN:** Objection. That's four

11:29:33 **18** different sets of scenarios. It's the wrong witness.

11:29:38 **19 THE COURT:** I'll sustain that. Mr. Peterson

11:29:42 **20** apparently is the statistician and apparently would be

11:29:45 **21** better able to answer for you questions relating to

11:29:51 **22** what models they used, projections they ran, those

11:29:58 **23** kinds of things on which they based their

11:30:00 **24** recommendation to the Commissioner.

11:30:04 **25 Q.** Let's change directions, Mr. Commissioner.

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11:30:08 **1** I'd like to ask you a few follow-up questions to  
 11:30:10 **2** what Mr. Owen asked you about surplus notes. And just  
 11:30:14 **3** to cut to the chase, would it be correct to say that  
 11:30:20 **4** no one can know to any degree of mathematical  
 11:30:24 **5** certainty about what the value of those surplus notes  
 11:30:27 **6** will be in 2020?  
 11:30:28 **7 A. We have a view of what they will be now. And we feel**  
 11:30:35 **8 the General Account can support what we've put forth**  
 11:30:40 **9 with the information we have today.**  
 11:30:42 **10 Q.** And what is that view that you were just referring to?  
 11:30:47 **11 A. That the company has 6.8 billion in claims-paying**  
 11:30:51 **12 ability, and we feel that will cover the approach that**  
 11:30:54 **13 we've taken in this Plan of Rehabilitation.**  
 11:30:57 **14 Q.** You're not prepared to provide any kind of guarantee  
 11:31:06 **15** for us today, are you, that the surplus notes will be  
 11:31:09 **16** worth a hundred cents on the dollar as of 2020; right?  
 11:31:13 **17** MR. VAN SICKLEN: Argumentative; objection.  
 11:31:14 **18** THE COURT: Sustained.  
 11:31:21 **19 Q.** Sir, I want to ask you about whether a result is  
 11:31:30 **20** possible under this Plan -- no one knows what the  
 11:31:33 **21** future will hold, but I have a question specifically  
 11:31:35 **22** directed to my client concerning the LVM bondholders.  
 11:31:39 **23** Isn't it possible that under this Plan, 2030 will  
 11:31:42 **24** come, 2040 will come, and LVM policyholders will make  
 11:31:47 **25** a claim and there will not be enough money to pay them

11:33:16 **1** MR. WHITMER: I have no further questions.  
 11:33:17 **2** THE COURT: Next up?  
 11:33:33 **3** MR. DEVORE: Good morning, Commissioner. My  
 11:33:33 **4** name is Andrew Devore and I represent One State  
 11:33:33 **5** Street.  
 11:33:33 **6** **CROSS EXAMINATION**  
 11:34:04 **7** **BY MR. DEVORE:**  
 11:34:04 **8 Q.** Commissioner, are you familiar with the One State  
 11:34:09 **9** Street lease?  
 11:34:10 **10 A. I have some familiarity with it.**  
 11:34:13 **11 Q.** And what is your familiarity?  
 11:34:14 **12 A. It has been placed into a Segregated Account. It's**  
 11:34:18 **13 the current location of the corporate headquarters for**  
 11:34:24 **14 Ambac.**  
 11:34:24 **15 Q.** Are you aware of any other trade creditors that were  
 11:34:28 **16** placed into the Segregated Account?  
 11:34:32 **17 A. Ah, we have placed similar liabilities into the**  
 11:34:36 **18 Segregated Account on November 8th, I believe.**  
 11:34:39 **19 Q.** And what liabilities are those?  
 11:34:40 **20 A. The IRS and the shareholder liabilities.**  
 11:34:43 **21 Q.** Aside from the One State Street lease and the IRS  
 11:34:47 **22** liabilities, are there any other trade creditors  
 11:34:50 **23** placed into the Segregated Account?  
 11:34:51 **24 A. Could you explain what you mean by a trade creditor?**  
 11:34:54 **25 Q.** Non-policy claims.

11:31:52 **1** the equivalent of what the short-tail claimants  
 11:31:56 **2** received?  
 11:31:57 **3 A. As we discussed before, you know, the economic future**  
 11:32:03 **4 is uncertain in this country. So, I mean, there's a**  
 11:32:07 **5 number of variables. We feel that we've stressed**  
 11:32:10 **6 extreme stress situations, and we feel comfortable**  
 11:32:14 **7 with the Plan before you, your Honor, and we hope to**  
 11:32:17 **8 be done on our surplus notes in 2020. I mean, there's**  
 11:32:23 **9 all contingencies.**  
 11:32:27 **10 Q.** There are all sorts of contingencies. But just to be  
 11:32:30 **11** clear, the possibility that I just presented to you in  
 11:32:32 **12** the prior question, that is indeed a possibility of  
 11:32:36 **13** what might happen under the Plan as proposed to this  
 11:32:39 **14** Court?  
 11:32:41 **15 A. We have no goal to reach that. I mean, we have no**  
 11:32:45 **16 desire to reach the goal that you're outlining. So, I**  
 11:32:48 **17 mean, myself and subsequent commissioners will do**  
 11:32:51 **18 whatever is in their power to make sure that the**  
 11:32:55 **19 claims are paid fairly and equitably.**  
 11:32:59 **20 Q.** 'Cause as you told the Court -- and this is important  
 11:33:01 **21** to you -- that you're bound by statute to make sure  
 11:33:05 **22** that the interests of the policyholders are protected  
 11:33:11 **23** and the public and that all policyholders are treated  
 11:33:15 **24** fairly; right?  
 11:33:15 **25 A. That is correct.**

11:34:56 **1 A. None to my knowledge.**  
 11:34:58 **2 Q.** Do you know whether the One State Street lease is  
 11:35:04 **3** above market?  
 11:35:06 **4 A. I haven't looked at your square foot values.**  
 11:35:10 **5 Q.** Do you know why the State Street lease was allocated  
 11:35:14 **6** to the Segregated Account?  
 11:35:15 **7 A. No. There were a variety of policies recommended to**  
 11:35:19 **8 me by my staff, and State Street was one of them.**  
 11:35:23 **9 Q.** Do you have any understanding why this lease was  
 11:35:27 **10** allocated to the Segregated Account?  
 11:35:30 **11 A. It's something that I took as a recommendation from**  
 11:35:33 **12 staff.**  
 11:35:34 **13 Q.** But you don't have an understanding as to the reasons  
 11:35:37 **14** for it?  
 11:35:37 **15 A. No.**  
 11:35:37 **16 Q.** If you don't, that's fine.  
 11:35:38 **17 A. No.**  
 11:35:39 **18 Q.** I'll move on.  
 11:35:40 **19** Now, you testified yesterday that one of the  
 11:35:42 **20** purposes of allocating policies to the Segregated  
 11:35:47 **21** Account was to bring policyholders to the settlement  
 11:35:51 **22** table. Do you recall that?  
 11:35:52 **23 A. Ah, we talked about how policyholders were placed into**  
 11:35:59 **24 the Segregated Account. I think the issue is -- could**  
 11:36:06 **25 you repeat the statement?**

11:36:08 **1** Q. The question was you testified yesterday that one of  
 11:36:14 **2** the purposes of allocating policies to the Segregated  
 11:36:19 **3** Account was to bring the policyholders to the  
 11:36:22 **4** settlement table. Do you recall that?  
 11:36:23 **5** **A. To bring them to the table, correct.**  
 11:36:25 **6** Q. Do you know if the liability under the lease was  
 11:36:31 **7** allocated to the Segregated Account to bring the  
 11:36:33 **8** landlord to the settlement table?  
 11:36:36 **9** **A. Like I said, it was recommended by staff, and I don't**  
 11:36:40 **10** **know the reasoning behind it.**  
 11:36:41 **11** Q. Do you have any reason to doubt that one of the  
 11:36:43 **12** reasons of such an allocation was to bring the  
 11:36:46 **13** landlord to the settlement table?  
 11:36:48 **14** MR. VAN SICKLEN: I object. He just said he had  
 11:36:50 **15** no idea why it was allocated.  
 11:36:52 **16** THE COURT: Sustained.  
 11:36:59 **17** Q. Mr. Commissioner, when the Segregated Account was  
 11:37:02 **18** created on March 24th, OCI determined that the  
 11:37:06 **19** Segregated Account had adequate capital and surplus;  
 11:37:09 **20** is that correct?  
 11:37:10 **21** **A. As I've said before, the assets are in the General**  
 11:37:15 **22** **Account, so the assets flow from the General Account**  
 11:37:20 **23** **to the Segregated Account.**  
 11:37:21 **24** Q. Oh, I understand. My question is did OCI make a  
 11:37:25 **25** determination that there was adequate capital in the

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11:37:27 **1** surplus?  
 11:37:28 **2** **A. We feel there's adequate assets in the General Account**  
 11:37:31 **3** **to pay for Segregated Account liabilities based on the**  
 11:37:35 **4** **Plan of Rehabilitation.**  
 11:37:37 **5** Q. Could you clarify your answer? Do mean at the time  
 11:37:40 **6** the Segregated Account was created, or today?  
 11:37:43 **7** **A. Both. We have not changed our view of how we would**  
 11:37:48 **8** **pay out to claimants under the Plan of Rehabilitation.**  
 11:37:54 **9** Q. I'm sorry. I'm just a little confused.  
 11:37:56 **10** The question was at the time the Segregated  
 11:37:58 **11** Account was created, did OCI make a determination at  
 11:38:01 **12** that time, March 24th, that the Segregated Account  
 11:38:06 **13** was adequately capitalized?  
 11:38:08 **14** MR. VAN SICKLEN: I'd object. It calls for a  
 11:38:10 **15** legal conclusion.  
 11:38:10 **16** THE COURT: Sustained.  
 11:38:13 **17** MR. DEVORE: May I be heard, your Honor?  
 11:38:14 **18** THE COURT: Go ahead.  
 11:38:15 **19** MR. DEVORE: It has been the OCI's position all  
 11:38:18 **20** along that the account was adequately capitalized and  
 11:38:22 **21** that the OCI's determination should be afforded  
 11:38:25 **22** deference. I'm asking the question as to whether or  
 11:38:28 **23** not OCI in fact made that determination.  
 11:38:30 **24** THE COURT: If they what that determination?  
 11:38:35 **25** THE COURT REPORTER: Made that determination.

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11:38:35 **1** THE COURT: Oh. Okay.  
 11:38:36 **2** MR. VAN SICKLEN: I have the same objection.  
 11:38:38 **3** It's a statutory-defined term, and there's no  
 11:38:41 **4** foundation this witness is using the same sense of the  
 11:38:44 **5** word "adequate" that counsel is. It just calls for a  
 11:38:48 **6** legal conclusion. It's been briefed back and forth  
 11:38:51 **7** numerous times with this counsel.  
 11:38:53 **8** THE COURT: Sustained.  
 11:38:55 **9** MR. DEVORE: And this is the first time that the  
 11:38:56 **10** witness has been on the stand.  
 11:38:58 **11** THE COURT: Sustain the objection. Proceed.  
 11:38:58 **12** BY MR. DEVORE:  
 11:38:59 **13** Q. Commissioner, do you have any understanding of what  
 11:39:01 **14** the term "adequate capital and surplus" means?  
 11:39:03 **15** **A. I have some high-level understanding.**  
 11:39:05 **16** Q. And what is that understanding?  
 11:39:07 **17** **A. You have the ability to pay your claims.**  
 11:39:09 **18** Q. As they come due?  
 11:39:12 **19** MR. VAN SICKLEN: I object. Again, it's the  
 11:39:14 **20** same. We're asking legal conclusions of a fact  
 11:39:16 **21** witness.  
 11:39:19 **22** MR. DEVORE: I'm asking for what his  
 11:39:19 **23** understanding is.  
 11:39:20 **24** THE COURT: He's given you that. Sustain the  
 11:39:23 **25** objection. And move on, please.

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11:39:26 **1** BY MR. DEVORE:  
 11:39:26 **2** Q. Now, I'm sorry. Did you testify that OCI had not made  
 11:39:33 **3** a determination, or not? I don't recall.  
 11:39:36 **4** **A. The Plan of Rehabilitation, my understanding is**  
 11:39:39 **5** **there's enough capital to pay the claims in -- both**  
 11:39:44 **6** **the expected claims in the Segregated Account, the**  
 11:39:49 **7** **expected claims in the General Account.**  
 11:39:51 **8** Q. And that understanding is based on the Reinsurance  
 11:39:58 **9** Agreement that's served with a secured note that flow  
 11:40:05 **10** from the General Account to the Segregated Account.  
 11:40:10 **11** Is that right?  
 11:40:10 **12** **A. That's the structure of the Plan of Rehabilitation.**  
 11:40:13 **13** Q. Now, these liabilities of the Segregated Account that  
 11:40:17 **14** you mentioned that are covered by these agreements,  
 11:40:20 **15** does that include any liability under the One State  
 11:40:24 **16** Street lease?  
 11:40:24 **17** **A. My understanding, the One State Street lease is in the**  
 11:40:27 **18** **Segregated Account.**  
 11:40:28 **19** Q. So is it your understanding that that liability would  
 11:40:32 **20** be covered by those two agreements?  
 11:40:36 **21** MR. VAN SICKLEN: I guess I object what counsel  
 11:40:38 **22** means by "covered." And I really do think the next  
 11:40:41 **23** witness is a much better person to ask how these  
 11:40:44 **24** documents work.  
 11:40:45 **25** THE COURT: What do you mean by "covered,"

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11:40:46 **1** counsel?

11:40:47 **2** MR. DEVORE: Would those agreements be available

11:40:49 **3** to pay the liabilities under the One State Street

11:40:52 **4** lease?

11:40:55 **5** THE COURT: If you know.

11:40:56 **6 A. My understanding is these are the mechanisms that move**

11:41:00 **7 money to make payments in the Segregated Account.**

11:41:01 **8 Q.** Okay. Thank you.

11:41:02 **9** Now, do you recall that OCI considered at the time

11:41:09 **10** that the Segregated Account was created whether

11:41:11 **11** liability under that lease would be covered by those

11:41:15 **12** two agreements?

11:41:16 **13 A. It was a recommendation made to me by staff. I mean,**

11:41:20 **14 I did not spend time on One State Street.**

11:41:23 **15 Q.** Okay. Now, I'd like to talk about the process by

11:41:29 **16** which OCI assessed the assets and liabilities.

11:41:35 **17** Did OCI discount the projected liabilities of the

11:41:41 **18** Segregated Account to present value?

11:41:46 **19** MR. VAN SICKLEN: Objection; foundation. Wrong

11:41:48 **20** witness.

11:41:50 **21** MR. DEVORE: I believe, your Honor, he testified

11:41:53 **22** earlier that he was "trying to bring present value of

11:41:58 **23** liabilities into sync." So I'm asking the question

11:42:01 **24** whether those liabilities discounted to present value

11:42:05 **25** in creating the Segregated Account.

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11:42:08 **1** THE COURT: Do you know?

11:42:08 **2 A. I mean, we were trying to bring the numbers, you know,**

11:42:12 **3 true up the numbers, your Honor. And how the**

11:42:16 **4 present-value analysis was done and the details of**

11:42:17 **5 that is not something that I know intimately.**

11:42:20 **6 Q.** What do you mean by the term "true up?"

11:42:23 **7 A. To take 40 years of exposure and get a sense for what**

11:42:31 **8 the claims-paying resources are needed with what we**

11:42:35 **9 have to pay out over those 40 years.**

11:42:38 **10 Q.** Were you involved with any discussions regarding the

11:42:42 **11** lease liability allocation?

11:42:45 **12** MR. VAN SICKLEN: I object to the extent it

11:42:46 **13** calls for privileged information.

11:42:48 **14 Q.** Other than communications with counsel.

11:42:53 **15 A. As I've said before, your Honor, I had a**

11:42:57 **16 recommendation from staff to move it into the**

11:42:59 **17 Segregated Account. I have not spent time on the**

11:43:02 **18 intricacies of the policy.**

11:43:04 **19 Q.** Do you know if the, when you were discounting

11:43:07 **20** liabilities, if the lease was discounted based on its

11:43:11 **21** contingent nature, meaning that it was dependent upon

11:43:14 **22** an AFG bankruptcy proceeding?

11:43:17 **23 A. Like I said, I had recommendations from -- staff would**

11:43:21 **24 have spent time on this.**

11:43:22 **25 Q.** But you don't know about those questions?

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11:43:24 **1 A. Yeah. I mean it's nothing I spent time on.**

11:43:27 **2 Q.** Commissioner, do you know what comprised the

11:43:39 **3** claims-paying resources of the Segregated Account?

11:43:42 **4 A. I don't know the details of the 6.8 billion dollars.**

11:43:47 **5 It's obviously a combination of various investments**

11:43:51 **6 and cash. But I couldn't tell you what that current**

11:43:55 **7 position is.**

11:43:56 **8 Q.** It's your understanding that there's 6.8 billion

11:44:00 **9** dollars in claims-paying resources?

11:44:02 **10 A. That is correct.**

11:44:03 **11** MR. DEVORE: Can we get Exhibit 40 in front of

11:44:05 **12** the witness? I'm looking at page 8 of the document.

11:44:40 **13 Q.** Now, before yesterday -- yesterday I believe you

11:44:43 **14** testified that before yesterday you'd never seen this

11:44:47 **15** document before; is that correct?

11:44:47 **16 A. That is correct.**

11:44:48 **17 Q.** Did you review this document last night?

11:44:49 **18 A. No.**

11:44:51 **19 Q.** Now, on page 8 do you see where it references AAC's

11:44:58 **20** claims-paying resources as of March 31st?

11:45:07 **21 A. Is this under the Liquidation Analysis?**

11:45:12 **22 Q.** That's correct.

11:45:26 **23** (Pause)

11:45:28 **24 Q.** And do you see in the last sentence where it states

11:45:31 **25** that total claims-paying resources amount to

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11:45:35 **1** approximately 8.2 billion?

11:45:40 **2** MR. VAN SICKLEN: Your Honor, this is clearly

11:45:41 **3** the wrong witness. He's indicated he's never seen

11:45:44 **4** this document before. He has no idea. There's no

11:45:49 **5** foundation how that sentence works. And if counsel

11:45:52 **6** would be patient, I think he'd have a better witness.

11:45:55 **7** MR. DEVORE: I just had a simple follow-up

11:45:58 **8** question to understand what his knowledge is.

11:46:00 **9** THE COURT: All right. Do you understand the

11:46:01 **10** question?

11:46:03 **11** MR. DILWEG: Are you just wanting to read from

11:46:05 **12** the document?

11:46:06 **13 Q.** My question is: Do you know the basis for the

11:46:09 **14** difference between the \$8.2 million in that document

11:46:12 **15** and the \$6.8 billion in claims-paying resources that

11:46:16 **16** you've been assuming?

11:46:18 **17 A. No. I mean, this looks like it wraps up some of the**

11:46:21 **18 liabilities. But I'd have to understand that more**

11:46:24 **19 clearly.**

11:46:24 **20 Q.** Okay. But you don't, so we can move on.

11:46:27 **21** Now, can we get Tab 27, the Disclosure Statement,

11:46:40 **22** in front of the witness.

11:46:41 **23** Now, can you turn to the last page of the

11:46:55 **24** document, page 75.

11:46:58 **25** You testified -- can you identify your signature

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11:47:15 **1** appears there?

11:47:15 **2 A. That is correct.**

11:47:16 **3 Q.** Now, you testified yesterday that you had never read

11:47:20 **4** the Disclosure Statement before. Do you recall that?

11:47:23 **5 A. No, I don't recall that.**

11:47:24 **6 Q.** If I read from the transcript at page 196:

11:47:30 **7** "Question: And did you review this document

11:47:32 **8** before it was filed on your behalf?"

11:47:34 **9** "Answer: I had a high-level summary of the

11:47:38 **10** document working with my advisors and my staff."

11:47:40 **11** Do you recall answering that?

11:47:41 **12 A. I did.**

11:47:42 **13 Q.** So the question is then did you read this document

11:47:45 **14** before you signed it?

11:47:45 **15 A. I didn't read all of it.**

11:47:47 **16 Q.** Okay. Now, I'd like to turn your attention to

11:47:51 **17** Exhibits D through G of the Disclosure Statement.

11:47:54 **18** Those are the recovery scenarios that we've been

11:47:57 **19** discussing.

11:47:57 **20 A. On what page?**

11:47:58 **21 Q.** They're Exhibits D through G.

11:48:04 **22 A. Oh. Okay.**

11:48:05 **23 Q.** Actually, can we put Exhibit 31 in front of the

11:48:08 **24** witness? These were the Amended Disclosure Statement

11:48:12 **25** scenarios. And I believe it was just for some of the

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11:48:14 **1** headings. I just want the record to be clear as to

11:48:18 **2** what we're referring to.

11:48:20 **3** Could you just explain what your familiarity is

11:48:40 **4** with those four scenarios that are set forth in

11:48:43 **5** Exhibits D through G generally?

11:48:45 **6 A. As I said before, I haven't spent much time on these**

11:48:49 **7** **scenarios, so --**

11:48:49 **8 Q.** That's fine. I just wanted what is your general

11:48:52 **9** understanding.

11:48:52 **10 A. Um, I mean, I, you know, throughout the process, we**

11:48:58 **11** **had stressed the company on four different stress**

11:49:02 **12** **cases. So I assume this reflects some of those stress**

11:49:05 **13** **cases moving forward.**

11:49:06 **14 Q.** Now, just for the record, do you have personal

11:49:09 **15** knowledge of the assumptions made in preparing those

11:49:12 **16** projections?

11:49:13 **17 A. No.**

11:49:14 **18 Q.** Okay. So you are not able to testify under oath as to

11:49:18 **19** the basis underlying these assumptions and

11:49:21 **20** projections?

11:49:22 **21 A. No.**

11:49:22 **22 Q.** Now, just for the record, do you know if Mr. Peterson

11:49:28 **23** has knowledge of the underlying assumptions of these

11:49:30 **24** projections?

11:49:30 **25 A. It's my understanding he does.**

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11:49:31 **1 Q.** Okay. Now, even though you don't have personal

11:49:37 **2** knowledge of the assumptions, I'd like to turn to a

11:49:40 **3** couple related topics that you addressed yesterday.

11:49:43 **4** If we could refer back to the Disclosure

11:49:48 **5** Statement, Exhibit 27.

11:49:50 **6** It might be prudent just to leave the Disclosure

11:49:57 **7** Statement in front of the witness for this line of

11:49:59 **8** questioning.

11:50:00 **9** I refer your attention to page 66 of the

11:50:09 **10** Disclosure Statement, specifically, the heading that

11:50:20 **11** begins B, Scenario 1. And then there are, you know,

11:50:26 **12** three subsequent scenarios underneath that. Do you

11:50:29 **13** see that?

11:50:29 **14 A. I do.**

11:50:30 **15 Q.** Now, do you see under each summary of the scenarios

11:50:37 **16** the references to R and W, remediation and recovery?

11:50:41 **17 A. I do.**

11:50:42 **18 Q.** Now, R and W remediation is based on claims Ambac

11:50:47 **19** alleges it has based on insuring pools of mortgages;

11:50:51 **20** is that correct?

11:50:51 **21 A. Roughly, yes.**

11:50:53 **22 Q.** And Ambac asserts that the mortgage originators, the

11:50:58 **23** banks that wrote these mortgages, made false

11:51:00 **24** representations and warranties regarding the ability

11:51:03 **25** of individual home buyers to pay the mortgages.

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11:51:06 **1** That's the concept that's embodied in this term; is

11:51:10 **2** that correct?

11:51:11 **3** MR. VAN SICKLEN: Foundation objection.

11:51:14 **4** MR. DEVORE: He testified to R and W yesterday.

11:51:16 **5** THE COURT: Do you know?

11:51:18 **6** MR. DILWEG: That's what my high-level

11:51:20 **7** understanding is, your Honor.

11:51:21 **8** THE COURT: Overruled.

11:51:23 **9 Q.** And then based on these representations and

11:51:25 **10** warranties, Ambac is seeking damages against the

11:51:29 **11** banks; is that your understanding?

11:51:31 **12 A. That is correct.**

11:51:34 **13 Q.** Now, the R and W remediation recoveries are estimated

11:51:38 **14** at approximately \$2 billion; is that correct?

11:51:42 **15** MR. VAN SICKLEN: Objection; foundation. Again,

11:51:44 **16** this is not the right witness.

11:51:46 **17** MR. DEVORE: Your Honor he testified to this

11:51:47 **18** yesterday. I'm just trying to follow up. I'll get to

11:51:50 **19** the point shortly.

11:51:51 **20** THE COURT: Is that stated in the document, the

11:51:53 **21** value is \$2 billion?

11:51:56 **22** MR. DILWEG: I had always thought it was \$1.8 or

11:51:58 **23** something like that, so --

11:52:07 **24** BY MR. DEVORE:

11:52:07 **25 Q.** I'm sorry. So what was your understanding of the

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11:52:09 **1** amount?  
11:52:09 **2 A. I mean, these are, as I think I said yesterday, I**  
11:52:12 **3 looked at these issues in the past at the time, and**  
11:52:16 **4 they had been \$1.8 billion.**  
11:52:18 **5 Q.** Okay. Now, do you have the Disclosure Statement in  
11:52:20 **6** front of you still? Could you turn to page 61? Under  
11:52:33 **7** C, Loss Reserves, could you review the first sentence?  
11:52:40 **8 A. Uh-huh (affirmative).**  
11:52:43 **9 Q.** Do you see the reference to \$2 billion of benefits  
11:52:48 **10** related to rejected R and W remediation recoveries?  
11:52:51 **11 A. Yes.**  
11:52:51 **12 Q.** So does this refresh your recollection as to the  
11:52:56 **13** actual amount of remediation recoveries that were  
11:52:59 **14** estimated?  
11:53:00 **15 A. These are estimates by the company, yes.**  
11:53:02 **16 Q.** By AAC.  
11:53:05 **17** Okay. Now, I'd like to turn back to page 66. And  
11:53:11 **18** we'll start with under Scenario 1. Do you see the  
11:53:17 **19** little 2i? It says, "Realization of R and W  
11:53:24 **20** remediation recoveries in accordance with AAC's  
11:53:27 **21** estimates."  
11:53:27 **22 A. Yes.**  
11:53:28 **23 Q.** So is it safe to assume that that means \$2 billion in  
11:53:31 **24** R and W remediation recoveries?  
11:53:34 **25** MR. VAN SICKLEN: Objection. Lack of

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11:53:35 **1** foundation. The witness has already indicated he  
11:53:37 **2** wasn't part of preparing these scenarios.  
11:53:41 **3** MR. DEVORE: He just testified that AAC's  
11:53:43 **4** estimates were \$2 billion.  
11:53:44 **5** THE COURT: I'll sustain the objection. Sustain  
11:53:47 **6** the objection.  
11:53:48 **7** MR. DEVORE: I'm sorry. I just want to make  
11:53:49 **8** clear, is Mr. Van Sicklen saying there's inconsistent  
11:53:52 **9** estimates?  
11:53:53 **10** MR. VAN SICKLEN: No. I'm saying that this is  
11:53:54 **11** not a witness with foundation to answer your question.  
11:53:57 **12** THE COURT: That objection is sustained. That's  
11:54:01 **13** been established.  
11:54:05 **14** BY MR. DEVORE:  
11:54:05 **15 Q.** You testified yesterday that OCI always had a  
11:54:14 **16** different opinion than the company regarding  
11:54:18 **17** remediation recoveries. Do you recall that?  
11:54:19 **18 A. That is correct.**  
11:54:20 **19 Q.** And what is that different understanding?  
11:54:24 **20 A. It's we've only seen \$60 million come in in R and W**  
11:54:30 **21 claims, so where we land between \$60 million and \$1.8**  
11:54:36 **22 or \$2 billion.**  
11:54:38 **23 Q.** And you would agree that that's a significant swing?  
11:54:40 **24 A. That is correct.**  
11:54:40 **25 Q.** Has OCI performed any independent analysis of the R

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11:54:47 **1** and W remediation estimates?  
11:54:49 **2 A. We've had independent analysis of these.**  
11:54:53 **3 Q.** And what were the results of those analyses?  
11:54:55 **4 A. It varied in our stress cases.**  
11:54:57 **5 Q.** Do you recall what the range was?  
11:55:00 **6 A. Not offhand.**  
11:55:01 **7 Q.** Does OCI consider \$2 billion in remediation recoveries  
11:55:11 **8** as a realistic estimate?  
11:55:17 **9** MR. VAN SICKLEN: I object, your Honor. This is  
11:55:20 **10** a witness without foundation. We're getting into  
11:55:24 **11** privileged communications in assessing these pending  
11:55:30 **12** lawsuits. I don't see where we're headed in terms of  
11:55:34 **13** probative evidence with this whole line of  
11:55:37 **14** questioning.  
11:55:38 **15** MR. DEVORE: Your Honor, this witness has  
11:55:40 **16** already laid the foundation.  
11:55:42 **17** THE COURT: Let him make his objection.  
11:55:43 **18** MR. VAN SICKLEN: Yeah. For this particular  
11:55:45 **19** witness, what he's communicated with -- about pending  
11:55:48 **20** lawsuits with counsel in trying to evaluate it is not  
11:55:51 **21** an appropriate area of inquiry.  
11:55:55 **22** MR. DEVORE: Your Honor, these form the entire  
11:55:56 **23** basis for the projections that are presented to this  
11:56:01 **24** Court and that Mr. Van Sicklen has moved into  
11:56:03 **25** evidence. I believe that One State Street is entitled

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11:56:06 **1** to examine the bases of these projections.  
11:56:11 **2** THE COURT: You still have to have a foundation  
11:56:14 **3** that he can answer the questions that you are asking.  
11:56:18 **4** Sustain the objection.  
11:56:19 **5 Q.** How would you characterize the \$2 billion estimate  
11:56:26 **6** that was provided by AAC?  
11:56:30 **7** MR. VAN SICKLEN: Asked and answered several  
11:56:31 **8** times.  
11:56:32 **9** MR. DEVORE: No, your Honor. I don't believe  
11:56:33 **10** this has been answered.  
11:56:34 **11 Q.** Would you characterize it as realistic?  
11:56:36 **12** THE COURT: Well, just a moment. Let me rule on  
11:56:38 **13** it.  
11:56:38 **14** Sustain the objection. It has been asked and  
11:56:41 **15** answered.  
11:56:43 **16 Q.** Are you aware that Scenario 1 is the only scenario out  
11:56:53 **17** of those four scenarios in which general claims are  
11:56:57 **18** projected to receive any recovery?  
11:57:03 **19 A. I'd have to review these more closely.**  
11:57:05 **20 Q.** We can take the time to do so. Can you look at  
11:57:08 **21** Exhibit D, Scenario 1, page 17.  
11:57:27 **22** (Pause)  
11:57:30 **23 Q.** Do you see the reference to recovery of junior surplus  
11:57:34 **24** note principal and interest?  
11:57:36 **25 A. Yes.**

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11:57:37 **1 Q.** And it indicates 100 percent?

11:57:40 **2 A.** **That is correct.**

11:57:43 **3 Q.** And are you aware that general claims such as One

11:57:46 **4** State Street are to be provided junior surplus notes?

11:57:51 **5 A.** **That's my understanding.**

11:57:53 **6 Q.** So it is your understanding that under Scenario 1 as

11:57:58 **7** presented to this Court that general claims would

11:58:00 **8** receive a hundred percent?

11:58:05 **9 A.** **It appears to be in Scenario 1.**

11:58:09 **10 Q.** And if we turn to page 17 of Exhibit E, do you see the

11:58:25 **11** reference to the recovery of junior surplus notes?

11:58:28 **12 A.** **What page are you on?**

11:58:29 **13 Q.** Page 17 of Exhibit E.

11:58:32 **14** MR. VAN SICKLEN: Your Honor, this document is

11:58:33 **15** in evidence. It's just wasting time.

11:58:36 **16** THE COURT: What's the point, counsel?

11:58:38 **17** MR. DEVORE: The point is that under Scenario 1

11:58:43 **18** only do general claims receive any recovery. And this

11:58:47 **19** witness has testified that OCI disagrees with the R

11:58:50 **20** and W remediation recoveries that form the basis for

11:58:55 **21** Scenario 1.

11:58:57 **22** THE COURT: That's argument. So what's the

11:58:59 **23** point of the question for the witness?

11:59:02 **24** MR. DEVORE: The witness testified that he

11:59:03 **25** wasn't familiar with them, and I was just walking him

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11:59:06 **1** through that.

11:59:06 **2** THE COURT: Let's move on then. If he isn't

11:59:08 **3** familiar, he isn't familiar. The documents are

11:59:11 **4** offered and received. They're in evidence. They are

11:59:13 **5** what they are. You're welcome to argue that later.

11:59:19 **6** BY MR. DEVORE:

11:59:19 **7 Q.** I'd like to turn your attention to the \$700 million

11:59:26 **8** tax allocation.

11:59:27 **9** THE COURT: That might be a good segue to turn

11:59:29 **10** your attention to the noon break.

11:59:32 **11** We will be in recess.

11:59:34 **12** Are you going to need a full hour for break?

11:59:37 **13** Yesterday we ran over maybe until 1:30. Can you do it

11:59:42 **14** in an hour?

11:59:44 **15** MR. VAN SICKLEN: Sure.

11:59:44 **16** THE COURT: We'll be back at one o'clock. You

11:59:47 **17** may step down. Court's in recess.

11:59:54 **18** (Recess taken at 12:00 p.m. until 1:59 p.m.)

11:59:54 **19** (End of Reporter Albert's Section.)

12:57:48 **20** (Beginning of Reporter Flakne's section.)

12:59:17 **21** THE COURT: All right. Be seated. Are the

13:00:25 **22** people on the telephone on? Are the people on the

13:00:28 **23** telephone ready? Hello? All right. Well, we'll

13:00:47 **24** assume they're connected. Is there anybody here?

13:00:52 **25** A VOICE: Yes, Your Honor.

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13:00:53 **1** THE COURT: Very good. Thank you. Let's call

13:00:55 **2** the Circuit Court for Dane County to session. Again

13:00:58 **3** our matter is 10-CV-1576. It is In the Matter of the

13:01:06 **4** Rehabilitation of the Segregated Account of Ambac

13:01:12 **5** Assurance Corporation. We had left with Mr. Delwig

13:01:15 **6** still on the stand, and, Mr. Devore, you're ready to

13:01:19 **7** proceed?

13:01:20 **8** MR. DEVORE: Yes, Your Honor.

13:01:22 **9** THE COURT: All right.

13:01:25 **10 Q.** Mr. Dilweg, before the break I mentioned that I'd next

13:01:30 **11** turn to the \$700 million tax liability allocation to

13:01:35 **12** the Segregated Account. Could you explain to the

13:01:36 **13** Court a basis for that potential tax liability?

13:01:44 **14 A.** **As far as the origin, the most recent -- It consists**

13:01:52 **15** **of a number of tax refund payments. I'm familiar with**

13:01:55 **16** **the most recent one of about 440 million, which came**

13:01:59 **17** **out of the president's stimulus package in the**

13:02:05 **18** **early -- in 2008 sometime, and it relates to how you**

13:02:11 **19** **look back at tax liabilities and change the look-back**

13:02:17 **20** **period thus resulting in the tax refund coming to the**

13:02:23 **21** **-- to the holding company down to the insurance**

13:02:28 **22** **company.**

13:02:28 **23 Q.** And that -- that flow from the holding company to the

13:02:32 **24** insurance company was under a tax-sharing agreement?

13:02:36 **25 A.** **We've had one in place since the early '90's.**

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13:02:40 **1 Q.** And the IRS has asserted that had may have the

13:02:45 **2** potential to bring enforcement action against that tax

13:02:48 **3** refund?

13:02:49 **4 A.** **That's my understanding.**

13:02:50 **5 Q.** Now creditors of AFG, the holding company, have

13:02:55 **6** asserted that they can pursue an avoidance action to

13:03:00 **7** recoup the transfer of this \$700 million; is that

13:03:04 **8** correct?

13:03:04 **9 A.** **They've asserted a number of things. I believe that's**

13:03:07 **10** **one of them.**

13:03:08 **11 Q.** And fraudulent transfer action was one?

13:03:10 **12 A.** **A number of assertions.**

13:03:13 **13 Q.** When did OCI first become aware of this potential tax

13:03:18 **14** liability?

13:03:18 **15** MR. VAN SICKLEN: Asked and answered yesterday

13:03:21 **16** several times.

13:03:22 **17** THE COURT: Sustained. You were supposed to be

13:03:24 **18** bound under the understanding to the answers and

13:03:28 **19** positions taken previously so there is no need to

13:03:31 **20** revisit plowed ground unless you're going to plant

13:03:31 **21** it.

13:03:45 **22 Q.** Who informed OCI of the potential tax liability?

13:03:49 **23 A.** **I believe it was attorney to attorney, but, you know,**

13:03:52 **24** **I would have to -- to -- I don't know offhand. I**

13:03:57 **25** **became aware of it as I said yesterday and right**

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13:04:01 **1** before the November 2nd week.

13:04:07 **2** Q. Now, has OCI performed its own analysis of the

13:04:12 **3** strength of the potential claim?

13:04:15 **4** THE COURT: Of the what?

13:04:17 **5** MR. DEVORE: The strength of the potential

13:04:19 **6** claim.

13:04:20 **7** MR. VAN SICKLEN: Which claim?

13:04:22 **8** MR. DEVORE: The \$700 million tax claim.

13:04:25 **9** MR. VAN SICKLEN: From the IRS or the avoidance

13:04:28 **10** action.

13:04:29 **11** Q. I'll restate the question. Has OCI performed an

13:04:32 **12** independent analysis of the strength of a \$700 million

13:04:37 **13** tax enforcement action?

13:04:39 **14** A. Your Honor, this is what our tax attorneys look at and

13:04:44 **15** they've begun to look at strength of the IRS's claim

13:04:48 **16** in conjunction with the company and potentially

13:04:50 **17** additional legal counsel, so it's an ongoing -- there

13:04:54 **18** is a concern.

13:04:55 **19** Q. Are you aware in the motion filed for supplemental

13:05:01 **20** injunctive relief that your counsel stated that the

13:05:07 **21** Rehabilitator has been advised by AFGI and its

13:05:10 **22** advisors that the tax refunds were proper and the IRS

13:05:14 **23** inquiry ultimately will not lead to any change AAC's

13:05:22 **24** entitlement to retain the refunds. Were you aware of

13:05:25 **25** that statement?

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13:05:27 **1** A. I was not aware of the exact statement.

13:05:28 **2** Q. Does it not lead to the conclusion that OCI did not

13:05:35 **3** perform it's own independent analysis?

13:05:35 **4** THE COURT: Can you avoid the double negative?

13:05:37 **5** MR. DEVORE: Does that statement indicate that

13:05:39 **6** OCI did not perform an analysis by itself?

13:05:41 **7** MR. VAN SICKLEN: I object. It mischaracterizes

13:05:43 **8** it, the witness said he's not familiar with the

13:05:47 **9** statement, and it doesn't seem probative of any fact

13:05:49 **10** that is useful to the trier of fact here.

13:05:51 **11** MR. DEVORE: I'm asking the witness to

13:05:53 **12** characterize it. I'm in the characterizing it.

13:05:55 **13** THE COURT: Sustain the objection.

13:05:56 **14** Q. You testified just a moment ago that you believe that

13:05:58 **15** the OCI was informed of this through a

13:06:03 **16** lawyer-to-lawyer communication?

13:06:06 **17** A. That is correct.

13:06:07 **18** Q. Do you know who the lawyers were that informed the

13:06:12 **19** lawyers for OCI?

13:05:41 **20** MR. VAN SICKLEN: Objection. What possible

13:06:15 **21** relevance does this have?

13:06:17 **22** THE COURT: What is the relevance?

13:06:22 **23** MR. DEVORE: Your Honor, sitting here today we

13:06:24 **24** have lawyers for Ambac and those were the same lawyers

13:06:26 **25** that acted -- that are prosecuting the bankruptcy

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13:06:30 **1** action. My question will be does he know in what

13:06:34 **2** capacity those lawyers were acting, for the

13:06:37 **3** shareholder or the insurance company?

13:06:41 **4** THE COURT: Well, let's take that question. If

13:06:44 **5** there were attorneys acting as the question has

13:06:49 **6** indicated, do you know on whose behalf they were

13:06:52 **7** acting?

13:06:53 **8** THE WITNESS: No, Your Honor. It came to my

13:06:56 **9** attention through our counsel Foley & Lardner, and we

13:07:02 **10** confer with my staff, my general counsel, we've had to

13:07:06 **11** deal with tax refunds in past rehabilitations, so it's

13:07:14 **12** always an issue, typically is an issue.

13:07:18 **13** Q. Thank you. Now I'd like to turn back to the full

13:07:23 **14** rehabilitation option that was rejected. In assessing

13:07:28 **15** OCI's option OCI did reject this full rehabilitation

13:07:33 **16** option; is that correct?

13:07:34 **17** A. Correct.

13:07:35 **18** Q. Now a principal reason was because of this collateral

13:07:38 **19** damage that we've been referring to?

13:07:40 **20** A. That's one reason.

13:07:42 **21** Q. Now, on direct examination you mentioned Dunkin''

13:07:48 **22** Brands?

13:07:48 **23** A. That is correct.

13:07:49 **24** Q. Can you explain what type of collateral damage OCI was

13:07:53 **25** concerned about with respect to Dunkin'' brands?

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13:07:57 **1** A. My understanding is he would be asking entities like

13:08:01 **2** Dunkin'' to go back out into the credit market and

13:08:04 **3** secure financing. They had I believe been acquired by

13:08:11 **4** the Carlyle Group awhile back and had a -- quite an

13:08:18 **5** intricate financing position, and so to ask them to go

13:08:23 **6** back out into the market could have thrown them into

13:08:27 **7** some operational chaos.

13:08:29 **8** Q. And by operational chaos, what do you mean?

13:08:32 **9** A. We wouldn't get any more coffee or doughnuts.

13:08:36 **10** Q. Now was OCI also concerned with the -- So you were

13:08:39 **11** concerned with business interruption?

13:08:41 **12** A. That is correct.

13:08:42 **13** Q. Job losses? Job losses of the employees of Dunkin''?

13:08:47 **14** A. I mean, you know, it's a franchise relationship. I

13:08:50 **15** think Dunkin'' only has about a thousand corporate

13:08:54 **16** employees but you know has thousands of franchise

13:08:57 **17** stores.

13:08:57 **18** Q. Now, with respect to Dunkin'' Brands you testified

13:09:00 **19** that avoiding this collateral damage was, quote, I'm

13:09:04 **20** sorry, was one of the, quote, most important policy

13:09:15 **21** goals" in the Segregated Account. Do you recall that

13:09:17 **22** testimony?

13:09:17 **23** A. That is correct. Durable coverage is the result

13:09:22 **24** there.

13:09:22 **25** Q. In determining -- In choosing the Segregated Account

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13:09:29 **1** approach did OCI consider whether these affects could  
13:09:33 **2** be mitigated or avoided by these companies taking  
13:09:36 **3** advantages of insolvency laws like AAC is doing here  
13:09:40 **4** and AFG has in its Chapter 11 proceeding to avoid  
13:09:44 **5** those collateral damages?  
13:09:49 **6** MR. VAN SICKLEN: Your Honor, I object to the  
13:09:52 **7** relevance of speculating what other things these  
13:09:54 **8** policyholders might have done. I just don't see the  
13:09:57 **9** relevance to our proceeding and we only have so much  
13:10:01 **10** time this week.  
13:10:03 **11** MR. DEVORE: And this is the first time I've  
13:10:04 **12** been afforded the opportunity to examine Commissioner  
13:10:08 **13** Dilweg and I'll get to the point in two questions.  
13:10:13 **14** THE COURT: I'll sustain the objection. I don't  
13:10:15 **15** see how it's relevant what others would have done.  
13:10:18 **16** MR. DEVORE: No. I didn't ask -- I asked what  
13:10:20 **17** they considered, if they considered it?  
13:10:22 **18** THE COURT: If other people considered it?  
13:10:24 **19** **Q.** No. If OCI considered whether these other companies  
13:10:27 **20** could avoid this collateral damage?  
13:10:31 **21** **A.** **As I believe I stated earlier today to a prior**  
13:10:35 **22** **questioner, Your Honor, you know, we looked at a**  
13:10:38 **23** **variety of options, we felt that a full rehabilitation**  
13:10:43 **24** **would trigger a number of covenants, whether it would**  
13:10:48 **25** **be an entity like Dunkin" Donuts or whether it would**

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13:10:51 **1** **be a municipality like Watertown, Wisconsin.**  
13:10:54 **2** **Q.** Since filing the Segregated Account for rehabilitation  
13:10:58 **3** on March 24th has OCI assessed whether these  
13:11:02 **4** collateral damage issues would still exist?  
13:11:04 **5** **A.** **My understanding -- Yes. My understanding is we see**  
13:11:09 **6** **our concerns between one to three billion dollars**  
13:11:12 **7** **worth of collateral damage.**  
13:11:15 **8** **Q.** Now, do you know how much of that would be a located  
13:11:18 **9** to Dunkin" Brands?  
13:11:19 **10** **A.** **My understanding is Dunkin" Brands is now no longer**  
13:11:24 **11** **in effect a policyholder.**  
13:11:30 **12** **Q.** Okay. And that is because of their refinancing of the  
13:11:32 **13** debt?  
13:11:32 **14** **A.** **I believe that's what they did.**  
13:11:34 **15** **Q.** Are you aware whether Sonic or Hertz has tried to  
13:11:38 **16** refinance their debt?  
13:11:44 **17** **A.** **In asking and tracking this my understanding is both**  
13:11:47 **18** **Hertz is soon -- their policy is soon to expire so**  
13:11:50 **19** **they will look elsewhere for credit. The other two I**  
13:11:53 **20** **am not aware of any refinancing at this time.**  
13:11:56 **21** **Q.** I'd like to ask some follow-up questions on the  
13:12:01 **22** liquidation analysis that's been the subject of  
13:12:04 **23** substantial examination and I won't belabor the point.  
13:12:07 **24** But what is your understanding of the term liquidation  
13:12:11 **25** analysis?

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13:12:11 **1** **A.** **It's a full -- I mean a liquidation is a full**  
13:12:15 **2** **liquidation of the company and all of its assets.**  
13:12:18 **3** **Q.** Are you aware if there is any liquidation analysis in  
13:12:22 **4** the Disclosure Statement that was filed on  
13:12:24 **5** October 8th?  
13:12:25 **6** **A.** **Like -- Like I said yesterday, Your Honor, I've not**  
13:12:29 **7** **spent much time in our liquidation analysis. I**  
13:12:32 **8** **realize there has been amendments to our Plan but my**  
13:12:37 **9** **driving issues here was the collateral damage issues,**  
13:12:43 **10** **if we would have had the bank -- if we would have not**  
13:12:46 **11** **had the bank settlement, so my time being spent on**  
13:12:50 **12** **liquidation analysis was not time that I spent.**  
13:12:53 **13** **Q.** And I believe you testified yesterday that the  
13:12:54 **14** liquidation analysis filed this past Friday you had  
13:12:58 **15** not seen before; is that correct?  
13:13:00 **16** **A.** **That is correct.**  
13:13:01 **17** **Q.** Now, even though you don't have personal knowledge of  
13:13:03 **18** the liquidation analysis I just have a couple of  
13:13:07 **19** questions to address items that are listed there and  
13:13:09 **20** if we could get tab -- Exhibit 40 in front of the  
13:13:15 **21** witness, please?  
13:05:41 **22** MR. VAN SICKLEN: Your Honor, we went through  
13:13:17 **23** this yesterday. The witness has clearly established  
13:13:19 **24** his lack of foundation on this and -- and we're going  
13:13:23 **25** to have Mr. Peterson. These people can ask him these

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13:13:29 **1** questions. This is a waste of time and cumulative.  
13:13:32 **2** MR. DEVORE: I'll ask a questions without the  
13:13:33 **3** liquidation analysis. It's not dependent on the  
13:13:37 **4** liquidation analysis.  
13:13:39 **5** THE COURT: You have a pattern of speech where  
13:13:41 **6** you tend to drop your voice.  
13:13:44 **7** MR. DEVORE: I'm sorry.  
13:13:44 **8** THE COURT: And you talk very fast. Can you  
13:13:46 **9** just kind of slow down and enunciate more clearly so  
13:13:50 **10** that we can hear you. Now, what did you say?  
13:13:51 **11** MR. DEVORE: I can ask the questions without the  
13:13:52 **12** liquidation analysis, and if we need to we can go back  
13:13:56 **13** to it.  
13:13:57 **14** THE COURT: All right. Well, ask your question  
13:13:59 **15** and see where you're going.  
13:14:03 **16** **Q.** In deciding not to pursue a liquidation of the  
13:14:08 **17** company, one of the factors that OCI considered was  
13:14:10 **18** that it would have to terminate the policies within  
13:14:14 **19** 15 days of liquidation; is that correct?  
13:14:15 **20** **A.** **That is correct.**  
13:14:19 **21** **Q.** Are you aware that the statute permits alternatives to  
13:14:23 **22** automatic termination of the policies?  
13:14:25 **23** **A.** **No, I'm not.**  
13:14:27 **24** **Q.** So you're not aware that OCI could sell the policy  
13:14:31 **25** also?

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13:14:31 **1** MR. VAN SICKLEN: Objection. Calls for legal  
13:14:33 **2** conclusions.  
13:14:35 **3** THE COURT: Sustained.  
13:14:39 **4** **Q.** Now, the General Account consists of approximately  
13:14:43 **5** 14,000 policies; is that correct?  
13:14:45 **6** **A. I think it was 13.**  
13:14:48 **7** **Q.** Okay.  
13:14:48 **8** **A. Roughly. I mean, I believe it's 13,000. You may have**  
13:14:53 **9** **been more policies back in March.**  
13:14:54 **10** **Q.** Now those same policies form the value -- form the  
13:14:57 **11** basis of the value of the 2 billion dollar secured  
13:15:01 **12** note; is that correct?  
13:15:02 **13** MR. VAN SICKLEN: Objection. Mischaracterizes  
13:15:05 **14** the evidence in the record. The policies form the  
13:15:07 **15** basis?  
13:15:09 **16** **Q.** The assets in the general account -- I can rephrase.  
13:15:13 **17** The assets in the General Account form the basis for  
13:15:17 **18** paying the liabilities in the Segregated Account; is  
13:15:20 **19** that correct?  
13:15:21 **20** **A. The assets of the General Account are the basis --**  
13:15:25 **21** **Yeah. That is correct. Right.**  
13:15:27 **22** **Q.** And one of the principal assets are the policies?  
13:15:33 **23** **A. Correct.**  
13:15:34 **24** **Q.** Is it your view that the Plan provides full recovery  
13:16:01 **25** on all claims including Class 5 claims before

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13:17:27 **1** THE COURT: Sustained.  
13:17:28 **2** MR. DEVORE: I'm asking him --  
13:17:29 **3** THE COURT: You're bound by the prior testimony  
13:17:33 **4** in that regard.  
13:17:41 **5** **Q.** Are you aware that AAC is still in the space that is  
13:17:44 **6** leased under the One State Street lease?  
13:17:46 **7** **A. That's my understanding.**  
13:17:47 **8** **Q.** Now, are you aware that neither AAC or AFG made a rent  
13:17:53 **9** payment in November?  
13:17:54 **10** **A. No, I am not.**  
13:17:56 **11** **Q.** Is it OCI's intent that releasing the Plan would  
13:18:01 **12** provide AAC or AFG with an option not to pay the rent?  
13:18:05 **13** MR. VAN SICKLEN: Objection. Calls for a legal  
13:18:07 **14** conclusion, no foundation.  
13:18:08 **15** Mr. DEVORE: I'm asking if it's the intent of  
13:18:10 **16** the OCI. The language in the release I will submit is  
13:18:12 **17** unclear, and when we were back in the situation where  
13:18:15 **18** we submitted an objection to the injunction, the  
13:18:20 **19** response from OCI was that the secured note and  
13:18:24 **20** Reinsurance Agreement covered the One State Street  
13:18:27 **21** lease liability. The terms were not clear. On the  
13:18:30 **22** record OCI clarified that it was intended to cover the  
13:18:34 **23** lease liability. I would like to do the same thing  
13:18:36 **24** here to clarify what is the intent of the ambiguous  
13:18:40 **25** language?

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13:16:05 **1** shareholders are provided a recovery?  
13:16:07 **2** **A. I'm sorry. Could you repeat the question?**  
13:16:08 **3** **Q.** Is it OCI's view that the Plan provides full recovery  
13:16:13 **4** on all claims, including general claims, such as One  
13:16:17 **5** State Street's lease, before shareholders receive any  
13:16:20 **6** value?  
13:16:24 **7** **A. It's my understanding that the preferential treatment**  
13:16:27 **8** **of the policyholder over the shareholder is clear and**  
13:16:30 **9** **that objective is met. How One State Street fits into**  
13:16:36 **10** **that priority scheme, like I said before, I haven't**  
13:16:40 **11** **spent time on One State Street.**  
13:16:43 **12** **Q.** But in general is it OCI's position that AFG, AAC's  
13:16:50 **13** sole shareholder is not receiving any value under the  
13:16:52 **14** Plan?  
13:16:52 **15** **A. Yeah. We have not provided a value to the**  
13:16:55 **16** **shareholders for 18 months.**  
13:16:59 **17** **Q.** Now, are you aware that under the terms of revised  
13:17:02 **18** Section 8.01 of the Plan all holders of claims release  
13:17:07 **19** AFG from any quote "claims, obligations, rights,  
13:17:11 **20** causes of action or liabilities based upon any act,  
13:17:14 **21** omission, transaction or other activity of any kind or  
13:17:19 **22** nature made in connection with, arising out of, among  
13:17:22 **23** other things, AAC?  
13:17:24 **24** MR. VAN SICKLEN: Objection, cumulative and  
13:17:26 **25** calls for legal conclusions.

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13:05:41 **1** MR. VAN SICKLEN: I object.  
13:18:41 **2** THE COURT: Well, if this is ambiguous this  
13:18:44 **3** wouldn't be the witness to clarify that. If you're  
13:18:47 **4** asking for a legal conclusion.  
13:18:50 **5** MR. DEVORE: No. I'm asking what the intent of  
13:18:52 **6** OCI is with respect to our liabilities.  
13:18:54 **7** MR. VAN SICKLEN: That's a different question  
13:18:55 **8** than what was asked.  
13:18:56 **9** THE COURT: Can you answer that question?  
13:18:58 **10** THE WITNESS: Could you repeat which question  
13:19:01 **11** are you asking here?  
13:19:02 **12** **Q.** Is it the intent of OCI to release Ambac or the  
13:19:09 **13** Segregated Account or AFG from the liabilities under  
13:19:12 **14** the lease?  
13:19:13 **15** **A. No. That's not our intent. You know, the intent**  
13:19:18 **16** **is -- is with the full rehabilitation plan is to take**  
13:19:21 **17** **a time out to reorder the liabilities and then start**  
13:19:26 **18** **performing payments. Where One Street fits into that**  
13:19:32 **19** **priority structure, like I said, I haven't spent time.**  
13:19:35 **20** **Q.** But with respect to the AFG, the parent company, it  
13:19:38 **21** was never the intent of OCI to release AFG, the parent  
13:19:42 **22** company from liability under the lease?  
13:19:43 **23** MR. VAN SICKLEN: I object. This is calling for  
13:19:45 **24** legal argument by a witness that's not qualified to  
13:19:49 **25** answer it. Counsel is looking at not even the most

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13:19:53 **1** current form of the order which contains the lease --

13:19:55 **2** I'm sorry --

13:19:56 **3** MR. DEVORE: Yes, I am actually.

13:19:57 **4** MR. VAN SICKLEN: -- the discharge language of

13:19:59 **5** Section 8.01. And if he wants to make his legal

13:20:02 **6** argument later, fine. But this isn't a fact question

13:20:05 **7** for nonlawyer witness.

13:20:06 **8** MR. DEVORE: Your Honor, I'm asking what the

13:20:07 **9** intent of OCI is with respect to the liability. It's

13:20:10 **10** not asking for a legal conclusion as to what this

13:20:12 **11** language says?

13:20:13 **12** THE COURT: Sustain the objection. Let's move

13:20:16 **13** on counsel.

13:20:21 **14** MR. DEVORE: I have no further questions at this

13:20:23 **15** time.

13:20:23 **16** THE COURT: All right. Who's up next? No one

13:20:30 **17** else. Is there anyone on the phone that wants to ask

13:20:32 **18** a question?

13:20:37 **19** All right. Hearing none, Mr. Van Sicklen, any

13:20:43 **20** redirect.

13:20:44 **21** MR. VAN SICKLEN: I just have one question on

13:20:46 **22** redirect, Your Honor.

13:20:46 **23** **REDIRECT EXAMINATION**

13:20:46 **24** **BY MR. VAN SICKLEN:**

13:20:48 **25** **Q.** Commissioner, you were asked yesterday a couple

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13:20:52 **1** questions by Mr. Greenwald about the Plan providing

13:20:56 **2** OCI with optionality or leverage regarding settlements

13:21:01 **3** and communications. Could you explain to the Court

13:21:03 **4** what you meant in that regard?

13:21:07 **5** **A.** This is in regards to yesterday?

13:21:11 **6** **Q.** Yes.

13:21:11 **7** **A.** I think the issue on leverage, Your Honor, one thing

13:21:14 **8** we have found in working with the company is really

13:21:18 **9** the -- at times the policyholders don't have the

13:21:23 **10** ability to get the company to the table to discuss

13:21:28 **11** proper settlement, and my role here, as I talked about

13:21:32 **12** before, when we set the field we're the referees, we

13:21:37 **13** bring policyholders to the company and bring the

13:21:40 **14** companies -- we're able to leverage the company to the

13:21:43 **15** policyholders so that if they want to settle, it's an

13:21:46 **16** option in the Plan, they can settle. If they want to

13:21:49 **17** remain at the cash amount split that we've settled on

13:21:56 **18** for that year, they can do so.

13:21:58 **19** So I think it's important to understand that in my

13:22:01 **20** view representing the policyholders, bringing the

13:22:05 **21** company to the table, leveraging the company to the

13:22:08 **22** table is an important aspect of this Plan, and I want

13:22:12 **23** to make sure that we clarified that.

13:22:15 **24** **Q.** And just so I'm concern, the leverage that you just

13:22:19 **25** mentioned is in regard to the company or in regard to

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13:22:21 **1** the policyholders?

13:22:22 **2** **A.** It's in regard to the company so that the

13:22:27 **3** policyholders have the ability to finalize a

13:22:30 **4** settlement and bring at times as we saw with the

13:22:36 **5** Weinstein deal, Your Honor, we brought the settlement

13:22:38 **6** to you, it was about \$50 million, so that gives them a

13:22:42 **7** clear process that we referee for lack of a better

13:22:46 **8** term.

13:05:41 **9** MR. VAN SICKLEN: Okay. Thank you. No more.

13:22:49 **10** THE COURT: All right. I assume you moved up.

13:22:53 **11** MR. GREENWALD: Your Honor, if I could -- And I

13:22:53 **12** have not further questions for Commissioner Dilweg,

13:22:56 **13** but I would before Commissioner leaves the stand like

13:22:58 **14** to offer just one exhibit into evidence that we used

13:23:00 **15** during the testimony.

13:23:01 **16** THE COURT: All right. What is your exhibit?

13:23:04 **17** MR. GREENWALD: It is exhibit we marked for

13:23:07 **18** identification 38. And I would move into evidence

13:23:10 **19** just Exhibit B. Commissioner Dilweg testified

13:23:15 **20** regarding this November 7, 2010, letter and attached

13:23:20 **21** terms of transaction. He identified his signature and

13:23:24 **22** that the document was his, so I'd move that into

13:23:27 **23** evidence. And for the convenience of the Court I

13:23:29 **24** would remark the exhibit as 38B so it's clear that it

13:23:34 **25** wasn't the entire exhibit.

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13:23:35 **1** THE COURT: All right. Do you have that ready

13:23:37 **2** to offer?

13:23:38 **3** Mr. GREENWALD: The B I do not, I can have it --

13:23:41 **4** We have it in the notebook and can pluck out Exhibit B

13:23:45 **5** if you'd like right now.

13:23:47 **6** THE COURT: Any objection to that?

13:23:49 **7** MR. VAN SICKLEN: Not from OCI, Your Honor.

13:23:52 **8** MR. RICARDO: Not from Ambac, either.

13:23:59 **9** THE COURT: All right. Why don't you do your

13:24:03 **10** plucking.

13:24:03 **11** MR. GREENWALD: Thank you, Your Honor.

13:24:06 **12** THE COURT: 38 Exhibit B.

13:24:09 **13** MR. GREENWALD: B as boy, yes.

13:25:56 **14** THE COURT: All right. Now is that -- is that

13:25:58 **15** the one that is going to come into evidence?

13:26:03 **16** MS. KIAJA: Yes. Mm-hmm (Yes).

13:26:04 **17** THE COURT: If it's coming into evidence we

13:26:07 **18** should keep it for the record. All right.

13:26:11 **19** Exhibit 38B will be received.

13:26:13 **20** MR. GREENWALD: Thank you, Your Honor, and you

13:26:16 **21** moved up.

13:26:21 **22** THE COURT: That completes the questioning of

13:26:23 **23** this witness?

13:26:25 **24** MR. VAN SICKLEN: Yes, Your Honor.

13:26:25 **25** THE COURT: All right. You may step down.

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13:26:27 **1** THE WITNESS: Thank you.

13:26:46 **2** THE COURT: Call your next witness.

13:26:48 **3** MR. VAN SICKLEN: Thank you. The much awaited

13:26:51 **4** testimony of Mr. Peterson.

13:26:52 **5** THE COURT: Mr. Peterson, please come to the

13:26:54 **6** witness chair and before being seated, raise your hand

13:26:57 **7** to receive the witness oath.

13:26:57 **8** **ROGER A. PETERSON**

13:26:57 **9** was duly sworn by the Clerk and was examined and

13:27:09 **10** testified as follows:

13:27:09 **11** THE COURT: All right. Be seated. All right.

13:27:10 **12** State your name, please?

13:27:10 **13** THE WITNESS: Roger Allen Peterson.

13:27:10 **14** THE COURT: Proceed.

13:27:10 **15** **DIRECT EXAMINATION**

13:27:10 **16** **BY MR. VAN SICKLEN:**

13:27:19 **17** **Q.** Good afternoon, Mr. Peterson. I'm going to ask you a

13:27:24 **18** few background questions. What is your educational

13:27:27 **19** background?

13:27:28 **20** **A.** **I have an undergraduate degree from University of**

13:27:31 **21** **Wisconsin Platteville in business and economics, and a**

13:27:35 **22** **masters in business administration, emphasize in**

13:27:39 **23** **finance from University of Wisconsin Whitewater.**

13:27:43 **24** **Q.** Okay. And when did you join OCI?

13:27:48 **25** **A.** **June 1988.**

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13:29:31 **1** Can you give the Court a sense of a number of the

13:29:35 **2** types of matters that you're overseeing in your role?

13:29:39 **3** **A.** **In my position as director we have 330 approximately**

13:29:50 **4** **domiciled insurance companies in Wisconsin. By**

13:29:56 **5** **different measures Wisconsin is about the sixth**

13:29:58 **6** **largest insurance domicile in -- in the country. We**

13:30:06 **7** **-- Those companies range from small mutual insurers**

13:30:12 **8** **like Darlington Mutual Insurance Company down the**

13:30:15 **9** **street to Northwestern Mutual Life, Sentry Insurance**

13:30:21 **10** **and numbers of companies in Progressive Group and**

13:30:27 **11** **others.**

13:30:27 **12** **Q.** And how long have you held your present position?

13:30:30 **13** **A.** **I've been the director since 2004.**

13:30:34 **14** **Q.** And perhaps you can just kind of walk-through from

13:30:40 **15** your start at OCI up until 2004 time your duties and

13:30:45 **16** responsibilities.

13:30:47 **17** **A.** **Certainly. I started out as a financial examiner**

13:30:52 **18** **conducting those field audits and conducting analysis**

13:30:56 **19** **within other companies. Over time I was promoted**

13:31:03 **20** **through those ranks to become first a senior examiner**

13:31:07 **21** **where I was in charge of the largest and most complex**

13:31:12 **22** **examinations. Sometime after that I took what was at**

13:31:18 **23** **the time a new position as an advance examiner in**

13:31:24 **24** **charge of reserve analysis. And in approximately 1988**

13:31:32 **25** **I took a position as the -- one of the examiner's**

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13:27:52 **1** **Q.** And prior to that did you have any kind of other

13:27:55 **2** relevant insurance experience?

13:27:56 **3** **A.** **Not prior to joining OCI, no.**

13:27:59 **4** **Q.** And what is your present position at OCI?

13:28:01 **5** **A.** **I'm the Director of Bureau of Financial Analysis and**

13:28:05 **6** **Examinations.**

13:28:05 **7** **Q.** Okay. And what does that entail?

13:28:09 **8** **A.** **Well, my position is responsible for monitoring the**

13:28:12 **9** **solvency of insurance companies operating in Wisconsin**

13:28:18 **10** **and has a particular responsibility for those**

13:28:24 **11** **companies that are domiciled under Wisconsin law.**

13:28:26 **12** **Q.** And do you have subordinate staff that you could just

13:28:31 **13** give an overview of for the Court?

13:28:33 **14** **A.** **There are approximately 40 people that work in my**

13:28:36 **15** **bureau, 29 I believe positions are field examiner**

13:28:44 **16** **analyst positions, people that go out and conduct**

13:28:48 **17** **audits of the insurance companies and also review the**

13:28:52 **18** **quarterly and year-end financial statements of the**

13:28:56 **19** **insurers. Other staff include advanced examiner**

13:29:02 **20** **positions that have specialized roles in evaluating**

13:29:06 **21** **mergers and acquisitions, doing quality control**

13:29:10 **22** **evaluations on our -- on our work products, reserve**

13:29:16 **23** **analysis positions, IT evaluations, things like that.**

13:29:23 **24** **Q.** Okay. And the Commissioner had mentioned yesterday

13:29:28 **25** that Wisconsin is the sixth largest insurer state.

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13:31:39 **1** **supervisors within the bureau, meaning that I had**

13:31:43 **2** **approximately seven or eight examiner staff working**

13:31:48 **3** **for me at that point in time and had direct**

13:31:53 **4** **responsibility for the analysis solvency monitoring of**

13:31:59 **5** **a particular group of companies and then as I said in**

13:32:03 **6** **June 2004 I became the bureau director.**

13:32:07 **7** **Q.** Okay. And during this more recent period of, you

13:32:10 **8** know, when you became the director, what sorts of

13:32:13 **9** regular communications did you have with your fellow

13:32:16 **10** regulators in other states?

13:32:18 **11** **A.** **Well, we -- we have a duty to communicate with --**

13:32:25 **12** **with other states and, you know, as transactions come**

13:32:31 **13** **up potential mergers, acquisitions, troubled companies**

13:32:36 **14** **and so forth, we have communications on those -- on**

13:32:42 **15** **those issues.**

13:32:44 **16** **In addition to my responsibilities as bureau**

13:32:47 **17** **director, I'm also the chair of the Financial Analysis**

13:32:52 **18** **Working Group at the National Association of Insurance**

13:32:57 **19** **Commissioners and in that role I have significant**

13:33:02 **20** **contact with most all of the other 50 state regulators**

13:33:08 **21** **-- financial regulators.**

13:33:10 **22** **Q.** Okay. And when did you first become -- have contact

13:33:14 **23** with Ambac as part of your job at OCI?

13:33:19 **24** **A.** **During the time when I was a financial examiner back**

13:33:26 **25** **-- would have been early '90's I believe I was**

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13:33:29 **1** involved on an examination and audit of -- of Ambac,  
 13:33:36 **2** so that would have been the first time when I was --  
 13:33:42 **3** and in fact I was assigned the analysis  
 13:33:48 **4** responsibilities for Ambac for a number of years. At  
 13:33:54 **5** the time that I became an insurance financial examiner  
 13:34:01 **6** supervisor, to use the correct title, Ambac was one of  
 13:34:05 **7** those companies that I had specific responsibility for  
 13:34:09 **8** monitoring.  
 13:34:11 **9** Q. And I think you mentioned you got assigned to sort of  
 13:34:15 **10** the largest, most complex and challenging assignments.  
 13:34:18 **11** Was Ambac one of those?  
 13:34:19 **12** A. Well, for a lot of years it wasn't complex in terms of  
 13:34:23 **13** its financial risk or we didn't perceive it to be, but  
 13:34:28 **14** in terms of the kind of products that it wrote and so  
 13:34:32 **15** forth, it became more complex over time, particularly  
 13:34:37 **16** beginning in the very late '90's and through the  
 13:34:41 **17** current decade.  
 13:34:43 **18** Q. You indicated that you first began having contact with  
 13:34:46 **19** Ambac back at the start of the 1990's. Did you have  
 13:34:50 **20** regular -- Just walk the Court through your continuing  
 13:34:52 **21** work with Ambac from that point to the present and  
 13:34:55 **22** we'll get into more depth about the last year or two.  
 13:35:00 **23** A. Well, beginning there in the early '90's I -- as I  
 13:35:04 **24** said I was an examiner on the particular audit. At  
 13:35:11 **25** one time I was in charge of that exam, I don't recall

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13:35:19 **1** the exact year, somewhere in the mid '90's, so, you  
 13:35:24 **2** know, during that period of time I assisted on an exam  
 13:35:27 **3** and then subsequently if my recollection serves, it  
 13:35:32 **4** was in charge of conducting an audit of Ambac.  
 13:35:35 **5** During that time I also was involved in analyzing  
 13:35:39 **6** the quarterly and year-end financial statements, CP  
 13:35:44 **7** audit reports and such that are filed with regard to  
 13:35:47 **8** Ambac.  
 13:35:49 **9** After I became the -- took the supervisor's  
 13:35:55 **10** position. I would have met with the company. The  
 13:36:01 **11** company had a practice of meeting with us once or  
 13:36:04 **12** twice a year, would have done that, been, you know,  
 13:36:09 **13** involved in that -- those meetings and would have  
 13:36:11 **14** continued that analysis role. There would have been  
 13:36:18 **15** one of my staff would have done the initial analysis  
 13:36:21 **16** but then I would have reviewed their work.  
 13:36:24 **17** Q. Okay. And I think you indicated sometime in the late  
 13:36:27 **18** 1990's that Ambac became more complex in terms of the  
 13:36:30 **19** exposures that it was providing. Could you describe  
 13:36:33 **20** that?  
 13:36:34 **21** A. Well, in that time frame is when they began to write  
 13:36:40 **22** insurance policies on the CDS contracts that were  
 13:36:48 **23** issued by its affiliate Ambac Credit Products.  
 13:36:52 **24** Q. And in the roughly 20-year period from the early '90's  
 13:36:58 **25** to the present do you have periodic but continuous

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13:37:02 **1** contact with Ambac as one of the entities that you had  
 13:37:05 **2** responsibilities in regard to?  
 13:37:07 **3** A. That's a fair summary.  
 13:37:08 **4** Q. Okay. Now, in this case you've authored four  
 13:37:19 **5** affidavits; is that correct?  
 13:37:19 **6** A. That's correct.  
 13:37:20 **7** Q. One's in regard to the bank transaction, one was in  
 13:37:23 **8** regard to the consummation of that transaction, one  
 13:37:26 **9** was in regard to Weinstein settlement and then one  
 13:37:28 **10** more recently in regard to the injunction issues' is  
 13:37:31 **11** that correct?  
 13:37:31 **12** A. That is correct.  
 13:37:32 **13** Q. And to the best of your knowledge do your statements  
 13:37:36 **14** in those affidavits remain true and accurate?  
 13:37:38 **15** A. They do.  
 13:37:39 **16** Q. I want to turn --focus on more recent periods starting  
 13:37:45 **17** in 2008. Would you kind of give the Court a sense of  
 13:37:52 **18** your responsibilities and OCI's sort of stepped up  
 13:37:58 **19** involvement in regard to Ambac, sir, starting in early  
 13:38:01 **20** 2008 and maybe walk up until the fall of 2009?  
 13:38:06 **21** A. All right. Actually probably December of 2007 we  
 13:38:17 **22** began to understand the potential risks more clearly  
 13:38:26 **23** in the -- in the mortgage market and the exposures  
 13:38:30 **24** that Ambac had in that regard, it's during the time  
 13:38:36 **25** that press and -- and other financial -- you know,

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13:38:42 **1** financial media were beginning to take note of  
 13:38:47 **2** those -- those risks. We had some contact with a  
 13:38:51 **3** company early on then and fairly soon recognized that  
 13:38:58 **4** the exposures were significant and complex and that we  
 13:39:05 **5** would be best positioned to seek out financial  
 13:39:09 **6** advisors and legal advisors to help us understand the  
 13:39:15 **7** complex and risky environment that we're in.  
 13:39:20 **8** We've since the time that those advisors have been  
 13:39:24 **9** engaged I've worked very closely with both financial  
 13:39:30 **10** and legal advisors to help structure the analysis and  
 13:39:45 **11** evaluation that we were going to do and understand the  
 13:39:53 **12** evaluations that were made. We on regular intervals,  
 13:40:00 **13** quarterly intervals we were developing our own  
 13:40:05 **14** independent evaluation of loss potential for Ambac and  
 13:40:12 **15** over time during the course of 2008 and into early  
 13:40:19 **16** 2009 we saw continued deterioration both in their  
 13:40:28 **17** reported results and in our own estimates of what loss  
 13:40:33 **18** potential may have been.  
 13:40:35 **19** Q. Explain to the Court what was happening with the  
 13:40:39 **20** ratings for the Ambac product by Moody's and the like  
 13:40:43 **21** and what effect those downgrades had on business?  
 13:40:47 **22** A. Right. For a long time Ambac was -- its business  
 13:40:55 **23** model is based on its financial ratings and the credit  
 13:41:01 **24** protection that it -- it sold. An ability to market  
 13:41:05 **25** that credit protection was based on those financial

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13:41:09 **1 ratings. And in early 2008 those ratings became under**  
13:41:18 **2 question by the rating agencies. Ambac, in order to**  
13:41:24 **3 try to address some of those concerns, went out and**  
13:41:28 **4 conducted a capital raise, \$1.5 billion if my memory**  
13:41:37 **5 serves, and that for time moderated the -- the rating**  
13:41:44 **6 agencies' concerns but only for a short time.**  
13:41:48 **7 Later in the year the company was downgraded and**  
13:41:53 **8 in a series of downgrades was effectively taken out of**  
13:41:59 **9 -- its ability to writing new business really ceased**  
13:42:02 **10 by the end of 2008.**  
13:42:04 **11 Q.** Okay. Did there come a point where Ambac in fact  
13:42:08 **12** stopped writing new business?  
13:42:10 **13 A. Yes. Near the end of 2008 I believe, but it hasn't**  
13:42:17 **14 written any new business for quite some time now.**  
13:42:19 **15 Q.** Okay. Some of the questioning the last few days have  
13:42:23 **16** mentioned or described Ambac as a monoline, is that a  
13:42:30 **17** term you're familiar with?  
13:42:30 **18 A. Yes.**  
13:42:30 **19 Q.** Explain.  
13:42:30 **20 A. Monoline refers to either -- It's used in the context**  
13:42:37 **21 of either financial guarantee insurers or mortgage**  
13:42:41 **22 guarantee insurers.**  
13:42:43 **23 Q.** Okay. Was Ambac considered a monoline?  
13:42:46 **24 A. Ambac is a financial guarantee insurer and was**  
13:42:51 **25 considered a monoline, yes.**

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13:42:52 **1 Q.** At that point in time, you know, during 2008, 2009,  
13:42:56 **2** who were Ambac's competitors, fellow monolines?  
13:43:01 **3 A. MBIA, a company Financial Guarantee Insurance**  
13:43:07 **4 Corporation, otherwise FGIC, Assured Guarantee, Radian**  
13:43:14 **5 had a small company in the market, PMI had a company**  
13:43:22 **6 in the market that I think has now changed its name to**  
13:43:27 **7 Syncora. There was about five or six major**  
13:43:29 **8 competitors.**  
13:43:30 **9 Q.** Okay. And were those competitor fellow monolines sort  
13:43:34 **10** of following the same fate and situations as Ambac?  
13:43:41 **11** MR. GREENWALD: Your Honor, I'm going to object.  
13:43:42 **12** Your Honor, objection just in terms of time, if we  
13:43:45 **13** could just ground this into a specific period.  
13:43:48 **14** MR. VAN SICKLEN: Okay. I was still referring  
13:43:50 **15** to this kind of, you know, latter part of 2008, into  
13:43:53 **16** 2009.  
13:43:55 **17** THE COURT: Well --  
13:43:58 **18 Q.** Let me just restate it. Was this a company specific  
13:44:00 **19** problem or was it a problem for that particular type  
13:44:03 **20** of insurer during that period?  
13:44:06 **21 A. All of the financial guarantee companies that had**  
13:44:09 **22 written significant mortgage exposures or other**  
13:44:16 **23 asset-backed exposures related to mortgages or -- or**  
13:44:21 **24 multi-structured securities came under a lot of stress**  
13:44:27 **25 and have failed or nearly failed.**

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13:44:31 **1 Q.** Okay. And is it fair to say that Ambac's problems,  
13:44:36 **2** financial challenges increased over time during this  
13:44:39 **3** 2008, 2009 period?  
13:44:41 **4 A. Absolutely.**  
13:44:42 **5 Q.** And did your time and effort and that of OCI also  
13:44:47 **6** increase during that period?  
13:44:48 **7 A. Yes. Very much so. Quite dramatically actually.**  
13:44:53 **8 Q.** Okay. And give a sense of like the rough percentages  
13:44:56 **9** of your time was spent increasingly dealing with  
13:44:59 **10** Ambac?  
13:45:00 **11 A. Well, early on there was a significant commitment in**  
13:45:08 **12 time to get to understand the situation at Ambac and**  
13:45:12 **13 to work with the financial advisors and so forth to**  
13:45:17 **14 kind of put our monitoring structure in place.**  
13:45:21 **15 Perhaps during 2008 there was some moderation in the**  
13:45:27 **16 work needed, but during 2009 as the company's**  
13:45:34 **17 financial results continued to worsen, the amount of**  
13:45:39 **18 involvement with our advisors and with the company**  
13:45:43 **19 increased steadily until December of last year when we**  
13:45:51 **20 were in a position Ambac had been trying to work on a**  
13:45:58 **21 global settlement with the CDS bank counterparties, it**  
13:46:05 **22 became clear that their ability to close that global**  
13:46:12 **23 settlement was limited and that OCI needed to be**  
13:46:16 **24 involved to help facilitate that -- that deal or --**  
13:46:22 **25 or de-risk the company by pursuing that deal. And at**

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13:46:26 **1 that point I had to a lot of involvement, I was in New**  
13:46:32 **2 York weeks on end and 70 hours a week and whatever,**  
13:46:38 **3 since that time it's been probably 30 to 50 or more**  
13:46:44 **4 hours a week.**  
13:46:49 **5 Q.** You mentioned putting OCI monitoring structure in  
13:46:53 **6** place at Ambac. Could you describe that process and  
13:46:58 **7** what you meant by that?  
13:46:59 **8 A. As I said we wanted to be in a position where we had**  
13:47:02 **9 an independent evaluation of the potential losses that**  
13:47:06 **10 Ambac was exposed to, so our financial advisors worked**  
13:47:14 **11 directly with the company to get baseline information**  
13:47:21 **12 about the exposures, how reserves were developed and**  
13:47:25 **13 get data at the deal level in order to really recreate**  
13:47:35 **14 and independently develop estimates of loss for Ambac.**  
13:47:41 **15 Q.** And as the regulator for the company, what's sort of  
13:47:45 **16** actual statutory advantages did you enjoy in terms of  
13:47:50 **17** access to information and people at Ambac?  
13:47:56 **18 A. Well, we had full access to the information the**  
13:48:01 **19 company had. I wouldn't say that there weren't times**  
13:48:05 **20 where communications -- we had communication**  
13:48:10 **21 difficulties, but ultimately we received all the**  
13:48:14 **22 information that we needed and -- and so we had full**  
13:48:18 **23 access to the data underlying their estimates and**  
13:48:24 **24 their calculations of -- of loss estimates and also**  
13:48:30 **25 had information to put us into -- into a position to**

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13:48:33 **1** evaluate their investment portfolio to evaluate

13:48:42 **2** contract -- contracts that they had with affiliates

13:48:46 **3** and the types of businesses that their -- those

13:48:49 **4** affiliates were involved in and the guarantees that

13:48:53 **5** existed between Ambac, Ambac Assurance and those

13:48:59 **6** affiliates, so we had full access to those -- that

13:49:03 **7** information.

13:49:03 **8** Q. And what sort of confidentiality concerns and issues

13:49:08 **9** does a company like Ambac have in regards to letting

13:49:12 **10** either the regulator or someone else see these types

13:49:16 **11** of information?

13:49:17 **12** A. Well, these are complex and very sensitive financing

13:49:25 **13** arrangements that Ambac insures and so that the

13:49:30 **14** counterparties to that -- to those transactions

13:49:35 **15** are -- have a clear interest in keeping that

13:49:37 **16** information confidential and, you know, it has trading

13:49:45 **17** value that would be improper to disclose to other

13:49:53 **18** parties. As the regulator our examination authority,

13:50:00 **19** and that extends to conducting in-depth analysis,

13:50:06 **20** allows us to receive that information and to keep it

13:50:12 **21** confidential, the statutory references 601.465 of the

13:50:19 **22** Wisconsin Statutes.

13:50:21 **23** Q. And you had mentioned that it's a unique position of

13:50:27 **24** independence that OCI had in its due diligence issue.

13:50:32 **25** Could you elaborate on that?

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13:50:35 **1** MR. GREENWALD: Objection, Your Honor. I don't

13:50:37 **2** think that's what Mr. Peterson said. I guess I would

13:50:39 **3** just object in general. I think Mr. Van Sicklen can

13:50:42 **4** do this without leading quite so much.

13:50:45 **5** Q. I'll rephrase the question. You used the terms

13:50:50 **6** independence of OCI. What did you mean?

13:50:52 **7** A. This evaluating the risks that Ambac is exposed to is

13:50:57 **8** quite complex and is subject to substantial judgment,

13:51:02 **9** and we wanted to be in a position where we could use

13:51:10 **10** our own judgment or understand the potential variables

13:51:18 **11** that are incorporated in that judgment and thereby be

13:51:22 **12** in a position to have an independent view of the

13:51:25 **13** company's loss potentials rather than relying

13:51:28 **14** exclusively on what the company reported.

13:51:32 **15** Q. And how would the nature of the types of exposures

13:51:35 **16** that Ambac was insuring as opposed to other types of

13:51:39 **17** insurance businesses increase or affect the concern

13:51:43 **18** about confidentiality?

13:51:46 **19** A. Well, again these securities, they're insuring

13:51:51 **20** securities that are traded in the market. They have

13:51:55 **21** specific information about the -- and make

13:52:01 **22** evaluations of the likelihood of default on these

13:52:06 **23** securities. That information is quite sensitive and

13:52:11 **24** is something that people could trade on.

13:52:15 **25** Q. And as the regulator did you have access to people at

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13:52:20 **1** Ambac to answer questions when you had them?

13:52:23 **2** A. Absolutely.

13:52:23 **3** Q. And how was that important to your admission?

13:52:29 **4** A. Well again developing understanding of the business,

13:52:34 **5** understanding the company's data, how they evaluated

13:52:42 **6** their business, how they assess the risks, and how we

13:52:45 **7** might replicate, enhance from an independent

13:52:52 **8** perspective that was all -- it all required

13:52:57 **9** significant communication with the -- with the

13:53:02 **10** company personnel to really gain that body of

13:53:05 **11** knowledge and perspective.

13:53:07 **12** Q. What would be the challenges for individual interested

13:53:12 **13** policyholders to replicate the types of information

13:53:15 **14** that you gained?

13:53:17 **15** A. I think it is essentially impractical or impossible.

13:53:24 **16** The confidentiality concerns that any one policyholder

13:53:32 **17** would have, you know, certainly they'd be willing to

13:53:37 **18** look at other people's data but I'm quite sure that

13:53:41 **19** the expectations for potential loss or default on

13:53:46 **20** their own securities would be something of -- that

13:53:50 **21** they would be concerned about as well as, you know,

13:53:54 **22** there is a broad -- there is many different books of

13:53:58 **23** business, there is broad perspective on what

13:54:03 **24** expectations there might be for individual -- you

13:54:09 **25** know, financial developments in particular sectors or

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13:54:13 **1** in the economy as a whole that, you know, any group of

13:54:21 **2** people that could obviously have disparate views about

13:54:24 **3** what those likelihoods are.

13:54:26 **4** Q. Describe sort of the range or complexity of the

13:54:30 **5** different books of business, you know, the types of --

13:54:33 **6** of different policies or risks being insured by Ambac?

13:54:45 **7** A. For a number of years Ambac's principal business was

13:54:49 **8** insuring municipal bonds. And those, you know were

13:54:56 **9** its core business through the early '90's. Those

13:55:04 **10** became more complex, as well. Commissioner Dilweg

13:55:09 **11** referred to the fact that Wisconsin acquired the first

13:55:13 **12** municipal GIC, that there was a Guaranteed Investment

13:55:19 **13** Contract associated with a financial guaranteed

13:55:22 **14** policy, but in general the municipal book is -- is

13:55:27 **15** perhaps more straightforward and particularly in the

13:55:32 **16** sense when it insures just general obligation bonds of

13:55:37 **17** a municipality. But then there is other types of

13:55:43 **18** deals that they became involved with, including

13:55:47 **19** student loan deals. There are international finance

13:55:53 **20** deals, there were asset-backed securities of different

13:56:02 **21** types, partially made up of mortgages but maybe other

13:56:06 **22** auto loans and credit card receivables and things like

13:56:09 **23** that that they insured. There were the whole --

13:56:16 **24** whole business securitization like the Dunkin' Donuts

13:56:21 **25** and Hertz, and there were Credit Default Swaps that

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13:56:30 **1** were issued by its affiliate ACP, and insurance was  
 13:56:36 **2** provided to ACP to support the potential obligation on  
 13:56:41 **3** those Credit Default Swaps that insured that backed  
 13:56:45 **4** the default risk on other securities and sometimes  
 13:56:52 **5** what are called CDS squares that are securities within  
 13:56:57 **6** the security that are then wrapped together. It's --  
 13:57:00 **7** you know, the range of complexity and types of  
 13:57:05 **8** businesses is significant.  
 13:57:09 **9** Q. Okay. Turning to late 2009 I think you got up to the  
 13:57:18 **10** cusp of that a minute ago. What was at that point in  
 13:57:19 **11** time or that period was Ambac and OCI looking at the  
 13:57:24 **12** same mind about their financial position?  
 13:57:27 **13** A. No, they were not. We were not.  
 13:57:29 **14** Q. Why don't you describe what the differences were  
 13:57:36 **15** and --  
 13:57:36 **16** A. Well, in the course of 2009 and perhaps somewhat  
 13:57:40 **17** before Ambac had the -- the market had -- it loss  
 13:57:46 **18** its ratings, the market had began to perceive the risk  
 13:57:51 **19** of -- that Ambac might not meet all of its  
 13:57:54 **20** obligations, and Ambac had done a number of what we  
 13:57:59 **21** call one-off commutations, commutations on individual  
 13:58:05 **22** or small groups of securities and which we -- our  
 13:58:09 **23** office reviewed as being fair to the interest of the  
 13:58:16 **24** policyholders, but as we got towards the end of 2009  
 13:58:20 **25** it became apparent that these one-off commutations

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13:58:26 **1** were not going to be sufficient to really address the  
 13:58:29 **2** financial risks of the company. We had our  
 13:58:34 **3** independent assessment of potential loss that did  
 13:58:39 **4** differ from -- from that of the company's but it was  
 13:58:44 **5** clear that the CDS book with the bank card  
 13:58:53 **6** counterparties was the most problematic and highest  
 13:58:57 **7** risk book of business that the company had and that it  
 13:59:04 **8** was essential to try to deal with that risk in any  
 13:59:11 **9** kind of plan that -- that dealt with the exposures of  
 13:59:17 **10** this company.  
 13:59:18 **11** Q. Give the Court a sense of the amount of time and  
 13:59:21 **12** effort that you personally and OCI generally expended  
 13:59:24 **13** in discussions regarding any kind of bank settlement?  
 13:59:29 **14** A. We -- During the course of December, January,  
 13:59:36 **15** February, March, it's hard to remember exactly but in  
 13:59:40 **16** the course of those months from December, 2009,  
 13:59:46 **17** through March 22nd or so of this year we were involved  
 13:59:56 **18** in what was essentially a tri-party negotiation  
 14:00:01 **19** between the company, the bank CDS counterparties and  
 14:00:08 **20** our office in playing, as Commissioner Dilweg said,  
 14:00:20 **21** essentially trying to be a referee in those  
 14:00:23 **22** negotiations, trying to pull the parties closer to a  
 14:00:25 **23** center. In fact, to a certain extent suggesting what  
 14:00:33 **24** our view of the center might be to help those --  
 14:00:37 **25** those parties come together and negotiate what was

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14:00:42 **1** ultimately the bank deal as it's described.  
 14:00:47 **2** Q. And what was the company's position in those months,  
 14:00:51 **3** you know, December to February regarding regulatory  
 14:00:57 **4** options like full rehabilitation?  
 14:01:01 **5** A. They were very much resistant to that.  
 14:01:04 **6** Q. And could you elaborate on what their position was in  
 14:01:07 **7** that regard and why?  
 14:01:08 **8** A. Well, they -- they acknowledged that the bank  
 14:01:16 **9** exposures were a significant risk and that it was  
 14:01:24 **10** necessary to try to -- try to deal with that risk.  
 14:01:28 **11** But there was a significant differential in our  
 14:01:33 **12** valuation of the RMBS, the Residential Mortgage Bank  
 14:01:38 **13** Security book of business as well as in the student  
 14:01:41 **14** loan books and so forth such that near the end of 2009  
 14:01:48 **15** as we conducted our independent analysis and we used  
 14:01:54 **16** multiple scenarios or kind of a base case/bid case/  
 14:02:01 **17** stressed case evaluation we started to see that in --  
 14:02:07 **18** in the mid case of expected losses, that the company  
 14:02:14 **19** wouldn't have sufficient claim paying resources to  
 14:02:18 **20** meet all of its obligations in that mid case and, you  
 14:02:25 **21** know, the settlement with the banks impacted that but  
 14:02:30 **22** didn't change the underlying fact that there were  
 14:02:35 **23** significant risks with the company.  
 14:02:37 **24** Q. Was -- Give the Court -- I'm sorry. Strike that.  
 14:02:42 **25** What was sort of the monthly claims that were being

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14:02:45 **1** paid during that period?  
 14:02:46 **2** A. As Commissioner Dilweg said the -- during those early  
 14:02:52 **3** months of this year we -- Ambac was paying 130 to  
 14:03:00 **4** \$150 million a month on the RMBS book.  
 14:03:04 **5** Q. Okay. And there were some questions this morning  
 14:03:06 **6** about short-tail, long-term -- long-tail claims.  
 14:03:10 **7** Could you explain your perspective on those terms?  
 14:03:14 **8** A. Well, the terms don't have specific definitions, but,  
 14:03:18 **9** you know, as insurance regulators or financial  
 14:03:23 **10** analysts involved with insurance short-tail probably  
 14:03:29 **11** means a claim that's likely to develop in three to  
 14:03:32 **12** five years; long-tail, you know, claim develops in ten  
 14:03:38 **13** or more, and, you know, I guess there is some area in  
 14:03:42 **14** between that is unclear, whether it's short or  
 14:03:47 **15** long-tailed.  
 14:03:47 **16** Q. Okay. In the monthly payments that were going out at  
 14:03:49 **17** the time door to Ambac during that period, what types  
 14:03:52 **18** of claims were those playing?  
 14:03:54 **19** A. Well, those were paying -- They were in a current pay  
 14:03:57 **20** mode. Each -- Each month there was a number of RMBS  
 14:04:01 **21** securities that couldn't fully meet the cash expenses  
 14:04:08 **22** of the deal, and Ambac was required to make up those  
 14:04:11 **23** cash payments from the -- from the deal to the tune  
 14:04:18 **24** of the 130, 150 million a month. Those would be  
 14:04:23 **25** short-tail liabilities, and they're in current pay and

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14:04:28 **1** they expect to continue to pay monthly as well as

14:04:32 **2** there were other RMBS securities that were near that

14:04:37 **3** point where they were near default and would -- Ambac

14:04:41 **4** would have to begin paying on those in the near term.

14:04:44 **5** **Q.** What effect was that process having on the company's

14:04:47 **6** claim paying resources?

14:04:49 **7** **A.** It was having a significant draw on the overall claim

14:04:54 **8** pay resources that such combined with our increased

14:05:01 **9** expectation about ultimate loss put us in that

14:05:05 **10** position where we believed that the company even in

14:05:12 **11** kind of a moderate case may not be able to meet all of

14:05:15 **12** its obligations under the policies over the long-term,

14:05:19 **13** understanding that some of the policies have -- may

14:05:25 **14** not have claims payable for 30 or 40 years.

14:05:29 **15** **Q.** And moving to look at the Disclosure Statement in a

14:05:33 **16** minute, but give the Court a sense of the different

14:05:36 **17** types of liquidity of the claims paying resources of

14:05:40 **18** the company?

14:05:40 **19** **A.** Well, over time, you know, you went back to 2007 or

14:05:47 **20** before, the company had a pristine investment

14:05:51 **21** portfolio, large number of treasuries, large number of

14:06:00 **22** municipal bonds and so forth. In the course of 2008

14:06:07 **23** there -- the character of its investment portfolio

14:06:13 **24** changed, primarily because of some other business

14:06:19 **25** operations that the Ambac Group had.

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14:06:23 **1** Another affiliate within the group, Ambac Credit

14:06:29 **2** Financing, I believe, issued those Guaranteed

14:06:32 **3** Investment Contracts, GICs, and other -- There were

14:06:39 **4** other swap -- interest rate currency swaps, all of

14:06:43 **5** which had collateral provisions associated with those

14:06:47 **6** contracts, and when Ambac's rating fell from AAA to AA

14:06:54 **7** and down the scale, there were more and more

14:06:59 **8** collateral requirements under those -- under those

14:07:03 **9** agreements, and because if -- There was -- And there

14:07:11 **10** was inner company agreements guarantees such that if

14:07:15 **11** those affiliates didn't meet those collateral

14:07:18 **12** requirements and post those for the benefits of --

14:07:21 **13** benefit of the GIC holders and so forth, that that

14:07:25 **14** event of default would have created a financial

14:07:28 **15** guarantee claim on -- on Ambac and more over one

14:07:34 **16** default on a particular transaction would have caused

14:07:40 **17** other cross defaults and there would have been even

14:07:45 **18** kind of a larger draw on Ambac's assets. So that's --

14:07:51 **19** To put that in context, we -- we allowed the

14:07:55 **20** transfer of certain investments from Ambac Assurance

14:08:02 **21** to these affiliates to collateralize some of these GIC

14:08:08 **22** and swap transactions that in exchange for those

14:08:13 **23** assets that went to the affiliates, those affiliates

14:08:17 **24** were invested more heavily in mortgage -- mortgage

14:08:23 **25** pools, RMBS pools, and other relatively riskier

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14:08:28 **1** securities that Ambac Assurance got in exchange for

14:08:35 **2** the more secure investments that were required under

14:08:38 **3** the collateralization requirements.

14:08:40 **4** **Q.** And if OCI had not taken those steps at that point and

14:08:44 **5** instead there had been a rapid liquidation of some of

14:08:47 **6** those longer term types of assets, what effect would

14:08:50 **7** that have on the ultimate value of those claim paying

14:08:54 **8** sources?

14:08:55 **9** **A.** Well, there would have been immediate loss. These

14:09:01 **10** swap and GIC transactions for the most part are

14:09:05 **11** expected to earn out and actually make money over

14:09:12 **12** time, but there was a commitment of collateral that

14:09:16 **13** was required to maintain those deals, and that if --

14:09:21 **14** if that hadn't been met there would have been an

14:09:26 **15** immediate default and an immediate cash payout based

14:09:30 **16** on those terminations that wouldn't have been readily

14:09:36 **17** recoverable. It was -- You would have had a loss as

14:09:39 **18** opposed to in effect making a -- an investment in

14:09:43 **19** those affiliates to protect their positions.

14:09:46 **20** **Q.** Okay. Again going back to this transition period late

14:09:50 **21** 2009 up until this particular proceeding was commenced

14:09:55 **22** in March of this year, you indicated the company was

14:09:58 **23** -- didn't agree with OCI's perspective in regard to a

14:10:02 **24** voluntary or full rehabilitation. What did you see as

14:10:06 **25** the advantages of a voluntary or cooperative

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14:10:09 **1** rehabilitation?

14:10:10 **2** **A.** Well, as we -- we looked at the exposures that the

14:10:15 **3** company had, we became aware of the default triggers

14:10:21 **4** that are resident in quite a number of its contracts,

14:10:27 **5** what has now become known as collateral damage, but

14:10:32 **6** there are any variety of default triggers that -- that

14:10:38 **7** exist in the contracts and putting a general or a full

14:10:46 **8** rehabilitation of Ambac would have triggered those

14:10:52 **9** default across a large number of contracts and

14:10:56 **10** resulted in the crystallization of substantial loss

14:11:03 **11** from kind of a variety of different contractual

14:11:06 **12** obligations.

14:11:08 **13** **Q.** Now, I think the Court's heard some testimony about

14:11:11 **14** CDS contracts. What -- Let's walk through the

14:11:15 **15** different types of contracts that have these triggers.

14:11:18 **16** What does that mean, CDS contract?

14:11:20 **17** **A.** Well, CD is a Credit Default Swap. A swap was issued

14:11:26 **18** by -- as was testified to earlier I believe, but

14:11:31 **19** there is an -- there was an affiliate or is an

14:11:34 **20** affiliate within the Ambac family called Ambac Credit

14:11:40 **21** Products that was in the -- in the terms used in the

14:11:44 **22** industry was the transformer. Banks and other parties

14:11:52 **23** that wanted to buy credit protection had a -- had a

14:11:58 **24** greater demand for, got more favorable accounting and

14:12:03 **25** regulatory capital treatment if they acquired a Credit

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14:12:09 **1** **Default Swap as opposed to financial guarantee**  
 14:12:12 **2** **insurance, so in order to meet that demand Ambac and**  
 14:12:17 **3** **other companies in the industry created these**  
 14:12:20 **4** **transformers, Ambac Credit Products that issued these**  
 14:12:25 **5** **Credit Default Swaps and then in order to provide --**  
 14:12:33 **6** **instead of putting capital directly into those**  
 14:12:36 **7** **affiliates, Ambac provided a -- a financial**  
 14:12:40 **8** **guarantee, in fact, each Credit Default Swap has an**  
 14:12:45 **9** **associated financial guaranteed policy that guarantees**  
 14:12:50 **10** **ACP's performance with regard to those swaps.**  
 14:12:55 **11** **Q.** And are those later type of financial guarantee  
 14:12:58 **12** policies similar in forms to Ambac's other financial  
 14:13:02 **13** guarantee policies?  
 14:13:02 **14** **A.** **I believe they are.**  
 14:13:04 **15** **Q.** Now, were all of the company's CDS contracts resolved  
 14:13:09 **16** through the bank settlement or did there remain others  
 14:13:12 **17** that did not settle?  
 14:13:13 **18** **A.** **No. They're not all settled. There are other credit**  
 14:13:20 **19** **enhancement vehicles on -- on collateralized loan**  
 14:13:29 **20** **obligation deals and so forth. It did resolve the**  
 14:13:31 **21** **contracts related to those -- There was primarily**  
 14:13:40 **22** **resolved the contracts relates to the 14 banks that**  
 14:13:44 **23** **were involved, but there are other swap obligations**  
 14:13:50 **24** **that are -- that still exist.**  
 14:13:53 **25** **Q.** Okay. I think you mentioned collateralized loan

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14:13:57 **1** obligations that is that sometimes called a CLO?  
 14:14:00 **2** **A.** **It is, yes.**  
 14:14:00 **3** **Q.** Would those instruments also contain these types of  
 14:14:04 **4** triggers?  
 14:14:04 **5** **A.** **They do.**  
 14:14:05 **6** **Q.** Okay. And are there still those types of exposures in  
 14:14:10 **7** either the General or Segregated Account?  
 14:14:13 **8** **A.** **Those exposures continue to exist. For the most part**  
 14:14:17 **9** **those are in the General Account, but we have obtained**  
 14:14:21 **10** **the -- the companies contained forbearance agreements**  
 14:14:26 **11** **that restrict the -- the counterparties' ability to**  
 14:14:32 **12** **act on certain of the contractual triggers within --**  
 14:14:38 **13** **within those agreements.**  
 14:14:40 **14** **Q.** I think yesterday we also heard the term commercial  
 14:14:43 **15** ABS contracts. What are those?  
 14:14:46 **16** **A.** **Commercial ABS is kind of a number of subcategories,**  
 14:14:53 **17** **but they include things like Dunkin'' Donuts, Hertz,**  
 14:14:59 **18** **and so forth where there are revenues from particular**  
 14:15:04 **19** **business are secured ties, there are other deals where**  
 14:15:15 **20** **there is groups of different kind of commercial**  
 14:15:19 **21** **revenue streams that are packaged into -- into a**  
 14:15:25 **22** **group of securities and asset-backed security class.**  
 14:15:29 **23** **It's difficult to recall all the different structures,**  
 14:15:34 **24** **but --**  
 14:15:35 **25** **Q.** Do each of those different structures have their own

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14:15:38 **1** individual types of triggers and --  
 14:15:39 **2** **A.** **Yes. I mean, to a large extent the contractual forms**  
 14:15:46 **3** **are really negotiated for each deal and -- and are**  
 14:15:51 **4** **quite unique deal to deal.**  
 14:15:53 **5** **Q.** Okay. There has been a lot of discussion about the  
 14:15:56 **6** three particular ABS commercial policies for which  
 14:16:00 **7** affidavits were submitted, but is it -- are those  
 14:16:03 **8** just part of the larger book?  
 14:16:05 **9** **A.** **Those are just part of a larger book, yeah.**  
 14:16:08 **10** **Q.** I don't know if you know off the top of the head but  
 14:16:10 **11** what type of total exposure is in that book of these  
 14:16:14 **12** commercial ABS in terms of net par outstanding?  
 14:16:20 **13** **A.** **Well, I don't recall exactly what the net par**  
 14:16:23 **14** **outstanding is. There is still a significant**  
 14:16:28 **15** **mark-to-market risk with regard to the CLO's and the**  
 14:16:33 **16** **commercial ABS books even today.**  
 14:16:37 **17** **Q.** Another category that's been mentioned in some of the  
 14:16:42 **18** materials filed is swap sureties. Is that a term  
 14:16:45 **19** you're familiar with?  
 14:16:46 **20** **A.** **I'm familiar with that as well, yes.**  
 14:16:48 **21** **Q.** Okay. Why don't you describe for the Court what that  
 14:16:50 **22** type of a product is?  
 14:16:52 **23** **A.** **There are -- Let's see. They're a little complex,**  
 14:17:01 **24** **too, and I need to -- Despite working with this stuff**  
 14:17:05 **25** **for two years it sometimes -- I have to think a**

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14:17:08 **1** **minute to put these things in context. But**  
 14:17:11 **2** **effectively there are -- there may be a municipal**  
 14:17:18 **3** **bond transaction or a -- an underlying agreement that**  
 14:17:24 **4** **may be done in a fixed interest rate form or in a**  
 14:17:29 **5** **variable interest rate form, but there is an advantage**  
 14:17:33 **6** **to -- to try to convert that form from fixed to**  
 14:17:40 **7** **floating or floating to fixed, and that's what these**  
 14:17:44 **8** **interest rate swaps are designed to convert those**  
 14:17:52 **9** **securities from one financial perspective to another**  
 14:17:59 **10** **and then there is the surety element comes in when**  
 14:18:04 **11** **Ambac agrees to take the financial risk of -- that**  
 14:18:09 **12** **that -- that that swap would fail.**  
 14:18:13 **13** **Q.** Okay. And does that swap surety type of product also  
 14:18:16 **14** contain collateral damage triggers?  
 14:18:20 **15** **A.** **They often did, yes.**  
 14:18:22 **16** **Q.** And then do these and other products at Ambac also  
 14:18:27 **17** contain any provisions or restrictions regarding  
 14:18:31 **18** transfers of assets?  
 14:18:33 **19** **A.** **They do.**  
 14:18:33 **20** **Q.** And explain how those work?  
 14:18:36 **21** **A.** **These transaction as well as I believe a majority of**  
 14:18:42 **22** **the municipal bond book has provisions where Ambac**  
 14:18:48 **23** **Assurance can't transfer its assets away -- to**  
 14:18:53 **24** **another affiliate or so forth, some of the languages**  
 14:18:58 **25** **involves things like all or substantially all but in**

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14:19:01 **1** other ones the threshold for breach of those  
14:19:04 **2** contractual terms is even lower. And that impacted  
14:19:10 **3** the way we designed or developed the Segregated  
14:19:17 **4** Account in that we weren't able to move large numbers  
14:19:21 **5** of assets out of Ambac Assurance into the Segregated  
14:19:26 **6** Account because it would have created a large number  
14:19:30 **7** of contractual default on -- or violated those  
14:19:35 **8** triggers.  
14:19:35 **9** Q. And if, in fact, a large number of those defaults or  
14:19:39 **10** triggers have been pulled what effect would that have  
14:19:43 **11** had on the claim amounts that the company was facing?  
14:19:48 **12** A. Would have -- Well, created a mass of litigation that  
14:19:53 **13** none of us really wanted to imagine as well as  
14:19:56 **14** substantial loss in addition.  
14:20:00 **15** Q. And has OCI worked with other insurers in regard to  
14:20:05 **16** Segregated Accounts during your 20 plus years with the  
14:20:09 **17** agency?  
14:20:10 **18** A. We have.  
14:20:11 **19** Q. Can you give the Court a sense of that process and --  
14:20:14 **20** and regularity?  
14:20:15 **21** A. Well, it's occurred a few times over our history.  
14:20:22 **22** We're currently involved with a rehabilitation of a  
14:20:27 **23** company Northwestern National Insurance Company of  
14:20:30 **24** Milwaukee that -- in which there was a Segregated  
14:20:36 **25** Account created and that company had a book of

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14:20:43 **1** commercial multi-peril risks, largely small commercial  
14:20:49 **2** kind of mom and pop commercial risk, but it also got  
14:20:53 **3** heavily involved in assuming reinsurance from other  
14:20:57 **4** insurers and was exposed to mass tort obligations  
14:21:02 **5** across the country through that I assumed reinsurance.  
14:21:08 **6** So as those assumed reinsurance liabilities became  
14:21:12 **7** more and more problematic for the company, we -- and  
14:21:16 **8** the company looked at ways to attempt to resolve that  
14:21:20 **9** and a plan was developed where the Segregated Account  
14:21:25 **10** was created, the direct liabilities of NNIC were  
14:21:30 **11** transferred to -- to the Segregated Account along  
14:21:34 **12** with what was believed to be adequate assets along  
14:21:42 **13** with it, and then the company proceeded under OCI's  
14:21:48 **14** supervision, we placed the General Account in that  
14:21:52 **15** case into rehabilitation and a global commutation of  
14:22:02 **16** those reinsurance-assumed risk was pursued and at this  
14:22:06 **17** point has been effectively completed and Judge  
14:22:11 **18** Johnston has been aware of that case as well.  
14:22:15 **19** Q. And that's because the case is venued in Dane County  
14:22:18 **20** and being presided over here?  
14:22:19 **21** A. It has.  
14:22:21 **22** Q. And that case involved as you indicated use of a  
14:22:25 **23** Segregated Account albeit in a somewhat different  
14:22:28 **24** fashion in here?  
14:22:30 **25** A. Yes, a different -- different structure and so forth.

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14:22:34 **1** Based on some different circumstances, but used a  
14:22:40 **2** Segregated Account in a rehabilitation of an overall  
14:22:45 **3** company situation.  
14:22:45 **4** Q. Okay. And what if any effect did the existence of all  
14:22:50 **5** these contractual triggers that you described at Ambac  
14:22:53 **6** in regard to prohibiting transfers of assets have on  
14:22:57 **7** your choice of -- of how you handle the Segregated  
14:23:01 **8** Account in this proceeding as opposed to the North  
14:23:04 **9** western?  
14:23:04 **10** A. Right. With regard to Northwestern National those  
14:23:08 **11** kind of contractual triggers about assets transfers  
14:23:12 **12** wouldn't have existed in your average commercial and  
14:23:16 **13** multiple-peril policy, but in these -- in these  
14:23:20 **14** financial guarantee policies those kind of provisions  
14:23:25 **15** do exist and in the case of Ambac the existence of  
14:23:30 **16** those contractual triggers restricted our ability to  
14:23:37 **17** transfer assets to the Segregated Account without  
14:23:41 **18** substantial additional risk of loss.  
14:23:45 **19** Q. And in the weeks and days immediately leading up to  
14:23:51 **20** March 24th commencement of this proceeding was there  
14:23:54 **21** agreement at that point with Ambac as to whether this  
14:23:57 **22** would be a voluntary or contested proceeding?  
14:24:01 **23** A. No. There was no agreement right up until kind of the  
14:24:07 **24** last minute, although I would say, you know, the  
14:24:10 **25** company was operating on -- on somewhat of a dual

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14:24:15 **1** track. They were working with OCI and our advisors to  
14:24:23 **2** analyze the risks of those contractual triggers and  
14:24:27 **3** things like that providing us information that we  
14:24:30 **4** utilized but certainly at the management level there  
14:24:36 **5** was no agreement as to accepting a -- any form of  
14:24:43 **6** rehabilitation really up until the last minute.  
14:24:46 **7** Q. Okay. And in fact when was the board meeting as you  
14:24:49 **8** recall relative that allowed this proceeding to be  
14:24:53 **9** voluntary relative to the start of this proceeding?  
14:24:56 **10** A. I wasn't physically present, but I understand that it  
14:25:00 **11** was the morning of March 24th, and the filing -- the  
14:25:06 **12** creation of the Segregated Account occurred, you know,  
14:25:12 **13** the board voted for it, OCI issued its approval, and  
14:25:19 **14** the actions that placed the company into -- or put  
14:25:22 **15** the Segregated Account into Rehabilitation commenced  
14:25:26 **16** in a -- you know, in very tight sequence.  
14:25:30 **17** Q. And had the board not approved it that morning was OCI  
14:25:33 **18** prepared to proceed with a different regulatory  
14:25:36 **19** option?  
14:25:36 **20** A. We were. We were.  
14:25:37 **21** Q. What was that?  
14:25:38 **22** A. We felt like it was our duty to take regulatory  
14:25:43 **23** reaction and that without -- you know, the  
14:25:49 **24** possibility or the willingness of the board to create  
14:25:55 **25** the Segregated Account and so forth, we would have

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14:25:57 **1** **been forced to implement a full rehab of the company.**  
 14:26:02 **2** **Q.** And at that point in time did you and OCI believe that  
 14:26:06 **3** there were advantages to one type of proceeding versus  
 14:26:10 **4** the other?  
 14:26:11 **5** **A.** Absolutely.  
 14:26:12 **6** **Q.** And what -- Why was that?  
 14:26:14 **7** **A.** Again, the collateral damage issues, the default  
 14:26:19 **8** triggers in terms of either additional mark-to-market  
 14:26:25 **9** losses on the CLO book and other commercial ABS books  
 14:26:30 **10** or general contractual defaults that could have  
 14:26:39 **11** occurred and they would have significantly increased  
 14:26:43 **12** the loss to Ambac as well as the broader public policy  
 14:26:55 **13** implications of putting the whole company into  
 14:26:58 **14** rehabilitation, the loss of durable coverage, the  
 14:27:00 **15** adverse effect on businesses that had relied on -- on  
 14:27:06 **16** their financing vehicles that would have blown up  
 14:27:10 **17** because of a full rehab. I could explain a particular  
 14:27:16 **18** example if that's helpful.  
 14:27:17 **19** **Q.** Sure. Please. Please do explain.  
 14:27:19 **20** **A.** In -- Like in the case of -- of Hertz or Dunkin"  
 14:27:26 **21** Donuts and so forth, the placing that particular --  
 14:27:33 **22** all of Ambac or that particular policy into a  
 14:27:38 **23** rehabilitation proceeding would have given the holders  
 14:27:42 **24** of those securities the right to essentially call that  
 14:27:48 **25** security immediately, and Dunkin" Donuts, Hertz,

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14:27:54 **1** **would have had to come up with hundreds of millions of**  
 14:27:58 **2** **dollars essentially overnight to replace that**  
 14:28:02 **3** **financing which effectively during March of this year**  
 14:28:05 **4** **would have been effectively impossible and then, you**  
 14:28:11 **5** **know, could have led to bankruptcy of those companies**  
 14:28:14 **6** **if they were unable to make payment on those and**  
 14:28:19 **7** **refinance those obligations.**  
 14:28:22 **8** **Q.** And is there anything unique about those particular  
 14:28:25 **9** three examples you used relatively to the ABS  
 14:28:30 **10** commercial corps or was it a similar problem?  
 14:28:32 **11** **A.** Yeah. It was similar problems. I mean, there would  
 14:28:35 **12** have been -- The default would have cost -- would  
 14:28:38 **13** have created loss for Ambac directly as well as then,  
 14:28:44 **14** you know, there is a compounding effect if -- if the  
 14:28:48 **15** particular business entity then was unable to  
 14:28:52 **16** refinance and -- you know, created bankruptcy or  
 14:28:55 **17** losses of -- but, you know, in general that same kind  
 14:29:00 **18** of fact scenario existed in other policies.  
 14:29:06 **19** **Q.** Okay. And at that point in March when we were  
 14:29:14 **20** proceeding to make this choice between a full rehab  
 14:29:17 **21** and a Segregated Account rehab, had OCI also  
 14:29:25 **22** considered the alternative of liquidation?  
 14:29:29 **23** **A.** We had. The liquidation scenario was given thought  
 14:29:43 **24** in -- but we saw it as one that had extreme  
 14:29:49 **25** litigation risk. It -- It really -- The act or

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14:30:00 **1** **liquidation typically requires the cancellation of the**  
 14:30:08 **2** **insurance contracts with 15 days notice. What it**  
 14:30:12 **3** **meant to try to cancel a financial guarantee contract**  
 14:30:16 **4** **that is established sometimes for a 40-year term, to**  
 14:30:21 **5** **try to cancel that with a 15-day notice was really**  
 14:30:25 **6** **unclear what that meant and what legal remedies the**  
 14:30:31 **7** **holders of that contracts might pursue as well as that**  
 14:30:39 **8** **full liquidation certainly would have also caused**  
 14:30:43 **9** **default and the mark-to-market claims on the CDS book**  
 14:30:49 **10** **and CLO book and these others that had those types of**  
 14:30:54 **11** **-- done on CDS form.**

MR. VAN SICKLEN: And we'll back to that and go through the liquidation analysis. Your Honor, I can go into that section now or you want to break? It will be a fairly detailed discussion?

THE COURT: All right. It may be an appropriate time to take the afternoon recess. You may step down, Mr. Peterson. We'll be in recess for 15 minutes.

(Recess taken at 2:32 p.m. until 2:45 p.m.)

(End of Reporter Flakne's section.)

(Start of Reporter Albert's section.)

THE COURT: Mr. Peterson, will you come back to the chair?

The Circuit Court for Dane County again will be in session. This is 10 CV 1576, The Matter of the

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14:48:23 **1** Rehabilitation of the Segregated Account of Ambac  
 14:48:26 **2** Assurance Corporation. And Mr. Peterson is testifying  
 14:48:33 **3** on direct. You may continue.  
 14:48:35 **4** MR. VAN SICKLEN: Thank you, your Honor. Do we  
 14:48:37 **5** need to wait for the clerk?  
 14:48:38 **6** THE COURT: We're told she is on her way. I  
 14:48:44 **7** think we can get started.  
 14:48:45 **8** MR. VAN SICKLEN: Okay. I'd be happy to.  
 14:48:45 **9** **CONTINUED DIRECT EXAMINATION**  
 14:48:45 **10** **BY MR. VAN SICKLEN:**  
 14:48:48 **11** **Q.** Mr. Peterson, calling you back to this time period of  
 14:48:54 **12** March 24th when OCI was making its decision to start  
 14:48:58 **13** this proceeding, what, if any, concerns were there  
 14:49:00 **14** about the timing relative to the next month of  
 14:49:04 **15** payments?  
 14:49:04 **16** **A.** Well, there were regular payments required under the  
 14:49:13 **17** RMBS securities. March 20 -- or the 25th of the month  
 14:49:17 **18** was a large payment date, other than ones staggered  
 14:49:22 **19** through the month. But the 25th was the biggest  
 14:49:25 **20** payment date of the month, and we were approaching  
 14:49:27 **21** that, March 20th the day before. If I recall  
 14:49:32 **22** correctly, there was another \$120 million or something  
 14:49:36 **23** due to be paid out on the 25th.  
 14:49:39 **24** **Q.** Okay. And certain of the policyholders have  
 14:49:43 **25** criticized OCI for not giving notice to all of the

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14:49:48 **1** policyholders in advance about the fact that you were  
14:49:52 **2** gonna take this regulatory action. Why didn't you  
14:49:54 **3** give notice to all 15,000 policyholders?  
14:50:01 **4** **A. Well, providing that notice of our intent to put some**  
14:50:07 **5** **policies into rehabilitation would have given them the**  
14:50:12 **6** **right to act on their triggers. There were not only**  
14:50:18 **7** **the kind of the default triggers, but there were other**  
14:50:21 **8** **ones based on ratings and so forth that any number of**  
14:50:26 **9** **policyholders could have accelerated their claims by**  
14:50:32 **10** **acting promptly upon that notice before we put the**  
14:50:36 **11** **company into rehabilitation or the Segregated Account**  
14:50:38 **12** **into rehabilitation.**  
14:50:40 **13** **Q.** Based on your years of work with Ambac as a  
14:50:46 **14** publicly-traded company, what requirements and  
14:50:49 **15** obligations did you understand the company had once it  
14:50:52 **16** made a corporate decision to file for rehabilitation  
14:50:56 **17** in terms of public disclosures to the market?  
14:51:02 **18** MR. GREENWALD: Objection, your Honor. Lack of  
14:51:04 **19** foundation. If we could just take it step by step and  
14:51:08 **20** establish Mr. Peterson's knowledge of SEC regulations  
14:51:11 **21** or others, it would be helpful, given the testimony  
14:51:14 **22** earlier today about knowledge or lack of knowledge of  
14:51:17 **23** statutory provisions just to establish a foundation  
14:51:20 **24** here.  
14:51:20 **25** MR. VAN SICKLEN: I think the question was

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14:51:22 **1** prefaced -- maybe we could have it read back.  
14:51:41 **2** (Question read back.)  
14:51:41 **3** THE COURT: Overruled. Foundation is laid.  
14:51:44 **4** **A. I don't, you know, understand SEC regulations in great**  
14:51:52 **5** **detail, but I do understand the requirement to**  
14:51:54 **6** **promptly report a significant decision affecting the**  
14:51:59 **7** **corporation like the creation of a Segregated Account**  
14:52:03 **8** **or the agreement to allow the rehabilitation of the**  
14:52:10 **9** **Segregated Account.**  
14:52:11 **10** **Q.** Okay. I've put in front of you, Mr. Peterson, a copy  
14:52:15 **11** of the Disclosure Statement dated October 8th that the  
14:52:22 **12** objecting parties have marked as Exhibit 27, which is  
14:52:26 **13** in evidence. Do you have that in front of you?  
14:52:27 **14** **A. I do.**  
14:52:28 **15** **Q.** Is that a document that you're familiar with and  
14:52:31 **16** played a role in preparing?  
14:52:32 **17** **A. I was involved in its preparation, yes.**  
14:52:35 **18** **Q.** I'm gonna try to walk you through some provisions of  
14:52:40 **19** it. And we'll jump around a bit, but --  
14:52:43 **20** **A. Certainly.**  
14:52:44 **21** **Q.** If you could start on page 7.  
14:52:50 **22** **A. All right.**  
14:52:50 **23** **Q.** There's a discussion in the middle of the page about  
14:53:00 **24** the reasons for rehabilitating just the Segregated  
14:53:04 **25** Account. Do you see that?

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14:53:05 **1** **A. I do.**  
14:53:06 **2** **Q.** Yeah. And walking through those bullet points, does  
14:53:09 **3** that fairly represent, ah, and describe the reasons  
14:53:13 **4** that you and OCI had for taking the Segregated Account  
14:53:17 **5** approach?  
14:53:18 **6** **A. Ah, yes. We outlined our reasons in this section. I**  
14:53:24 **7** **could summarize them if there's value to doing that.**  
14:53:28 **8** **Q.** Sure. Just briefly would be helpful.  
14:53:30 **9** **A. You know, as stated here in the document, the**  
14:53:35 **10** **rehabilitation, the claims moratorium provided us a**  
14:53:41 **11** **vehicle to retain assets of the combined General and**  
14:53:51 **12** **Segregated Accounts so that claims could be paid**  
14:53:56 **13** **equitably across the accounts. It -- let's see --**  
14:54:11 **14** **provided durable coverage to numbers of policyholders,**  
14:54:21 **15** **certain members of the bank group, and it's -- there's**  
14:54:28 **16** **four points here, but I won't read them to you.**  
14:54:30 **17** **Q.** Okay. And continue on to the top of the next page,  
14:54:33 **18** page 8. Are those the reasons again marshalled there?  
14:54:38 **19** **A. Are you referring to the bullet points --**  
14:54:47 **20** **Q.** Yes.  
14:54:48 **21** **A. -- on page 8? Yes. Reasons why we rejected the full**  
14:55:01 **22** **Rehabilitation had to do with the failure to preserve**  
14:55:01 **23** **durable coverage, loss of control rights, ah, undue**  
14:55:08 **24** **financial hardship on certain AAC policyholders; other**  
14:55:18 **25** **-- the ability to use -- you know, we had the**

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14:55:23 **1** **possibility of using some injunctions, but there were**  
14:55:28 **2** **legal risks there. And finally, it talks about the**  
14:55:32 **3** **full rehab would have been a trigger on the**  
14:55:37 **4** **mark-to-market losses that were resident in the bank**  
14:55:41 **5** **group.**  
14:55:42 **6** **Q.** And based on your experience since March to the  
14:55:46 **7** present, what is your belief as to whether OCI made a  
14:55:52 **8** wise choice in rejecting the rehabilitation of the  
14:55:56 **9** whole company as an option?  
14:55:58 **10** **A. I clearly believe that both the policyholders in the**  
14:56:05 **11** **General Account and Segregated Account are better off**  
14:56:09 **12** **for the use of the Segregated Account and its**  
14:56:13 **13** **rehabilitation than we would have been utilizing a**  
14:56:16 **14** **full rehab or liquidation.**  
14:56:18 **15** **Q.** And based on what you've learned and seen through  
14:56:22 **16** various objections and the like during the course of  
14:56:24 **17** this proceeding, has your belief in any of these  
14:56:27 **18** bulleted reasons for rejecting the full rehabilitation  
14:56:30 **19** option changed?  
14:56:31 **20** **A. Haven't changed in direction. Our knowledge of the**  
14:56:37 **21** **potential risks has evolved over time. But the facts**  
14:56:43 **22** **in terms of what is outlined here has not changed.**  
14:56:47 **23** **Q.** Okay. And dropping down to the lower part of page 8,  
14:56:51 **24** there's a discussion about why OCI objected to  
14:56:55 **25** liquidation options. Do you see that?

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14:56:57 **1 A. Yes.**  
 14:56:57 **2 Q.** And you're familiar with the thinking that went into  
 14:57:03 **3** the Disclosure Statement discussion on page 8 and 9  
 14:57:06 **4** about that liquidation option?  
 14:57:08 **5 A. I am.**  
 14:57:09 **6 Q.** Okay. And just turning over to the top of page 9, I'd  
 14:57:12 **7** like to walk through some of the main points. Do you  
 14:57:17 **8** see where the first line talks about the first reason,  
 14:57:21 **9** that it would resolve the termination of the policy.  
 14:57:25 **10** Would you explain to the Judge why that was a very  
 14:57:27 **11** important consideration for OCI?  
 14:57:30 **12 A. Well, as I alluded to before, termination of the**  
 14:57:35 **13 policies would have created some substantial legal**  
 14:57:43 **14 issues as to whether what claims were payable on up to**  
 14:57:51 **15 that point of termination for claims that were -- that**  
 14:57:57 **16 hadn't fully developed to that point. It was unclear**  
 14:58:01 **17 what, if any, claim those policies might have. But**  
 14:58:07 **18 certainly, they -- there were substantial exposures as**  
 14:58:12 **19 of March of this year that parties would have been**  
 14:58:19 **20 compelled to litigate on the points of whether, you**  
 14:58:25 **21 know, what contractual damages they may have had for**  
 14:58:29 **22 cancellation of the policies.**  
 14:58:31 **23 Q.** And in regard to litigating, if there was litigation  
 14:58:35 **24** about those, you know, contractual damages, would  
 14:58:40 **25** there be certainty in your mind at OCI as to the

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14:58:44 **1** priority of those types of breaches of contract  
 14:58:47 **2** damages?  
 14:58:51 **3** MR. DEVORE: Objection. Calls for a legal  
 14:58:53 **4** conclusion.  
 14:58:54 **5** THE COURT: Mr. Devore, why don't you come up  
 14:58:56 **6** and have a seat up here, if you want. Or maybe you're  
 14:59:02 **7** comfortable back here.  
 14:59:03 **8** MR. DEVORE: I'm fine here.  
 14:59:04 **9** THE COURT: You're fine there. All right. I  
 14:59:06 **10** was going to give you the younger seat. The seat  
 14:59:10 **11** you're in is about 100 years old. The one up here  
 14:59:13 **12** might be 75.  
 14:59:14 **13** All right. What was the objection?  
 14:59:19 **14** MR. DEVORE: The objection was it calls for a  
 14:59:21 **15** legal conclusion.  
 14:59:22 **16** THE COURT: All right. Mr. Van Sicklen.  
 14:59:23 **17** MR. VAN SICKLEN: I'll just rephrase it.  
 14:59:27 **18 Q.** On the fourth line there at the top of the page,  
 14:59:30 **19** there's a discussion about the effect on resulting  
 14:59:32 **20** priority of the claims. Did you have an understanding  
 14:59:34 **21** of what you were trying to get at in the Disclosure  
 14:59:40 **22** Statement there?  
 14:59:41 **23** MR. DEVORE: Same objection.  
 14:59:42 **24** THE COURT: Overruled. This is the man who's  
 14:59:46 **25** creating it. And whether or not his opinion is a

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14:59:51 **1** legal conclusion or not I don't know until I hear what  
 14:59:55 **2** his basis of thinking was. Proceed.  
 15:00:00 **3 A. Well, with the advice of our general counsel and**  
 15:00:05 **4 others, we -- those claims that were in existence**  
 15:00:12 **5 prior to the termination of the policy within that 15**  
 15:00:16 **6 days would have been Class 3 claims that would have**  
 15:00:23 **7 been payable. The treatment of any claims after that**  
 15:00:27 **8 point in time was -- could have been a matter of**  
 15:00:34 **9 litigation. We would have presumed that they would**  
 15:00:39 **10 be, even if established, would have been Class 5**  
 15:00:45 **11 claims, kind of general creditor type claims.**  
 15:00:50 **12 Q.** A few lines lower than that, Mr. Peterson, there's  
 15:00:53 **13** reference to, "In the event of liquidation, AAC will  
 15:00:58 **14** be required to return under the premium." Do you  
 15:01:02 **15** recall taking that into account in your liquidation  
 15:01:04 **16** analysis?  
 15:01:04 **17 A. Yes. When you cancel a policy in liquidation, there**  
 15:01:11 **18 is an amount due back for the unearned premium that**  
 15:01:18 **19 would have created additional liabilities for Ambac**  
 15:01:21 **20 that didn't otherwise exist.**  
 15:01:23 **21 In addition, there's -- our estimates were that**  
 15:01:26 **22 there is somewhat over a billion dollars worth of**  
 15:01:31 **23 future premium resident in the Ambac book that would**  
 15:01:37 **24 have been lost by terminating these policies.**  
 15:01:39 **25 Q.** A few lines below where I just referenced, there's a

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15:01:45 **1** discussion there of \$1.9 billion dollars. Is that  
 15:01:48 **2** what you were referencing?  
 15:01:50 **3 A. Yes, yes. It's -- the number has diminished since**  
 15:02:02 **4 then, but -- or perhaps I don't recall --**  
 15:02:02 **5 Q.** Okay.  
 15:02:03 **6 A. -- accurately.**  
 15:02:04 **7 Q.** And again, this may be obvious to the Court, but why  
 15:02:08 **8** would the company lose the future unearned -- I'm  
 15:02:10 **9** sorry -- the future premium stream in a termination?  
 15:02:14 **10** MR. DEVORE: Objection. No foundation. He's  
 15:02:16 **11** asking how the company treated him.  
 15:02:18 **12** THE COURT: Overruled.  
 15:02:20 **13 A. I think policyholders are unlikely to pay a premium on**  
 15:02:26 **14 policies that have been terminated.**  
 15:02:27 **15 Q.** And then a little bit lower down there's a discussion  
 15:02:35 **16** about an additional disadvantage of liquidation. Do  
 15:02:38 **17** you see that?  
 15:02:39 **18 A. Yes.**  
 15:02:39 **19 Q.** Okay. And what is your understanding of that  
 15:02:42 **20** provision? What were you trying to take into account  
 15:02:45 **21** there?  
 15:02:45 **22 A. Well, yes, it would have. Assuming that the**  
 15:02:52 **23 Segregated Account structure existed, you can't place**  
 15:02:57 **24 the Segregated Account into liquidation without also**  
 15:03:00 **25 putting the General Account into rehabilitation and**

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15:03:05 **1** **thereby triggering those other defaults and collateral**  
15:03:11 **2** **damage that we were concerned about.**  
15:03:13 **3** **Q.** And are you aware that last week the Rehabilitator  
15:03:21 **4** filed an Amendment Number 2 to the Disclosure  
15:03:25 **5** Statement that contained some additional information  
15:03:27 **6** about liquidation?  
15:03:28 **7** **A. Ah, yes. The Liquidation Analysis?**  
15:03:32 **8** **Q.** Yes.  
15:03:33 **9** **A. Yes, yes.**  
15:03:36 **10** MR. VAN SICKLEN: May I give a copy of the  
15:03:37 **11** Exhibit 40 to the witness?  
15:03:39 **12** THE COURT: The court officer will pick it up.  
15:03:42 **13** And did you want that marked, or is that already on  
15:03:47 **14** your stipulated documents?  
15:03:48 **15** MR. VAN SICKLEN: Well, here. This might be a  
15:03:50 **16** cleaner copy.  
15:03:53 **17** MR. GREENWALD: It's already 40. Do you want it  
15:03:56 **18** marked as a different number?  
15:03:57 **19** MR. VAN SICKLEN: No. I had indicated it's with  
15:04:02 **20** the objectors' Exhibit 40, and it's already been  
15:04:06 **21** admitted into evidence.  
15:04:07 **22** THE COURT: All right. Proceed.  
15:04:09 **23** BY MR. VAN SICKLEN:  
15:04:09 **24** **Q.** Would you flip to the back several pages of that  
15:04:18 **25** analysis, Mr. Peterson.

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15:04:19 **1** **A. Yes.**  
15:04:20 **2** **Q.** Okay. And you're familiar with that analysis and had  
15:04:22 **3** a chance to -- you've seen it before?  
15:04:24 **4** **A. I've looked at it in recent days, yes.**  
15:04:27 **5** **Q.** Okay. And describe this relationship to the  
15:04:33 **6** Liquidation Analysis that we just walked through in  
15:04:38 **7** the original October 8th Disclosure Statement. How do  
15:04:44 **8** they differ?  
15:04:44 **9** **A. Well, perhaps this is more detailed in terms of**  
15:04:50 **10** **numbers and particular estimates, but in terms of from**  
15:04:55 **11** **a qualitative perspective, they are very similar. The**  
15:05:00 **12** **same types of risks are identified in this analysis as**  
15:05:06 **13** **was done in the previous filing and was part of our**  
15:05:11 **14** **consideration for months prior to filing the**  
15:05:18 **15** **rehabilitation.**  
15:05:18 **16** **Q.** And was the choice of not pursuing a full liquidation  
15:05:24 **17** as opposed to the Segregated Account rehabilitation a  
15:05:28 **18** difficult one for you and OCI?  
15:05:30 **19** **A. No. It's rather clear that losing assets such as the**  
15:05:36 **20** **future value of premium and increasing liabilities in**  
15:05:43 **21** **terms of under premium or other liabilities related to**  
15:05:49 **22** **the defaults, that didn't seem to be a very good**  
15:05:51 **23** **option.**  
15:05:53 **24** **Q.** Did you feel back in March that it required further  
15:05:56 **25** analysis and study than you had already given at that

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15:06:00 **1** time?  
15:06:00 **2** **A. I think we concluded rather quickly that that was a**  
15:06:06 **3** **suboptimal choice and didn't waste a lot of time**  
15:06:12 **4** **figuring out how much -- by how much it was**  
15:06:16 **5** **suboptimal.**  
15:06:17 **6** **Q.** Okay. And then looking at Exhibit 40, there's a  
15:06:21 **7** chart, the second page of the Liquidation Analysis?  
15:06:24 **8** **A. Uh-huh (affirmative).**  
15:06:25 **9** **Q.** Do you have that in front of you?  
15:06:28 **10** **A. Yes. I have it in front of me.**  
15:06:31 **11** **Q.** Could you help the Court understand what that chart's  
15:06:34 **12** trying to portray?  
15:06:36 **13** **A. Certainly.**  
15:06:37 **14** **Q.** Maybe let the --  
15:06:39 **15** **A. Let the Judge catch up?**  
15:06:46 **16** **Q.** Go ahead, Mr. Peterson?  
15:06:49 **17** **A. The chart describes two possible scenarios with regard**  
15:06:58 **18** **to the treatment of mark-to-market termination**  
15:07:01 **19** **payments, and then details other loss and other**  
15:07:10 **20** **premium claims that would be -- that would be related**  
15:07:15 **21** **to a Liquidation Class 1 administrative expenses is**  
15:07:22 **22** **consistent under both scenarios. Loss claims under**  
15:07:30 **23** **Scenario 1 where the mark-to-market terminations are**  
15:07:34 **24** **considered to be Class 5 claims, that is just limited**  
15:07:37 **25** **to \$130 million of loss claims which really relates to**

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15:07:42 **1** **that March 25th claim payments on RMBS and some others**  
15:07:52 **2** **that would have occurred in that 15 days subsequent to**  
15:07:54 **3** **March 24th.**  
15:07:55 **4** **Under Scenario 2 it has \$16.4 billion of estimated**  
15:08:02 **5** **loss if in fact the mark-to-market terminations were**  
15:08:08 **6** **treated as Class 3 claims, which would have fully**  
15:08:12 **7** **exhausted the \$7.9 billion of claims-paying resources**  
15:08:19 **8** **that were -- would have been available under that**  
15:08:21 **9** **scenario, which incorporates the loss of future**  
15:08:25 **10** **premium income and so forth. So that, you know, in**  
15:08:32 **11** **the other scenarios, it -- back to Scenario 1, then if**  
15:08:38 **12** **those mark-to-markets were treated as Class 5, there**  
15:08:43 **13** **would have been availability to pay the other premium**  
15:08:49 **14** **claims, \$2.3 billion. And then it shows what the**  
15:08:57 **15** **present value of those claims -- additional claims may**  
15:09:02 **16** **have been under both a base case and stress case**  
15:09:06 **17** **scenarios, \$22.3 and \$25.6 billion, and compared to**  
15:09:11 **18** **the remaining assets after the higher-priority claims**  
15:09:17 **19** **were made -- were paid, leaving \$5.5 billion, and then**  
15:09:23 **20** **in each of those cases representing 25 percent**  
15:09:28 **21** **recovery and a 22 percent recovery on all those other**  
15:09:33 **22** **claims given those base and stress cases.**  
15:09:38 **23** **Q.** Then looking right below, there's some text right  
15:09:42 **24** below the chart. Does that remain your conclusion,  
15:09:46 **25** that of OCI's, based on all the information that

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15:09:49 **1** you've gathered since March?

15:09:50 **2 A. Yes. It's -- it serves to document a little more**

15:10:00 **3 accurately, but it remains our conclusion that there**

15:10:04 **4 were severe drawbacks to liquidation of AAC.**

15:10:08 **5 Q.** I'm gonna just continue on down the Disclosure

15:10:18 **6** Statement on page 9, and then going into the next two

15:10:23 **7** pages, 10 and 11, there's a discussion of the process

15:10:27 **8** of forming the Segregated Account. Do you see that?

15:10:31 **9 A. Yes.**

15:10:31 **10 Q.** And on page 10 and onto 11 there's bullet points

15:10:38 **11** describing the types of criteria that were used in

15:10:44 **12** making those allocation decisions back in March; is

15:10:48 **13** that correct?

15:10:48 **14 A. Yes. It outlines some of those criteria that were**

15:10:53 **15 used.**

15:10:53 **16 Q.** Okay. Let's come back to that then.

15:10:57 **17** What was your role in regard to that process back

15:11:00 **18** in earlier this year?

15:11:01 **19 A. I was in the room every day, ah, trying to, ah, break**

15:11:09 **20 out the different books of business into appropriate**

15:11:15 **21 categories, understanding the types of risks and**

15:11:20 **22 triggers and so forth that might be associated with**

15:11:24 **23 particular books of business or sub books, and in**

15:11:28 **24 order to, as accurately as we could, allocate those**

15:11:35 **25 policies into the Segregated Account or retain them in**

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15:11:39 **1 the General Account, making sure that we understood**

15:11:45 **2 the risks that were resident in each of those groups**

15:11:51 **3 of policies or, in some cases, down to the individual**

15:11:55 **4 policy level.**

15:11:56 **5 Q.** Approximately how long did you participate in that

15:12:00 **6** process of evaluation?

15:12:02 **7 A. I think we worked at it for about six weeks.**

15:12:05 **8 Q.** Essentially continuously through that period?

15:12:08 **9 A. Pretty much so, yes.**

15:12:09 **10 Q.** And did you have the assistance of advisors and other

15:12:13 **11** OCI support in that process?

15:12:17 **12 A. We had both financial advisors assisting in the**

15:12:22 **13 process as well as company personnel that were**

15:12:26 **14 providing relevant information about the contractual**

15:12:30 **15 forms and so forth.**

15:12:32 **16 Q.** And did you feel that you did as much due diligence

15:12:37 **17** this that process as you possibly could given the time

15:12:41 **18** constraints?

15:12:42 **19 A. Absolutely. We -- we took great pains to make sure**

15:12:47 **20 that we understood the risks of those policies and**

15:12:55 **21 groups of policies so that we -- you know, we didn't**

15:12:59 **22 want to find out after the fact that there were**

15:13:01 **23 triggers in policies that we had overlooked and that**

15:13:05 **24 caused significant loss. So we exercised substantial**

15:13:12 **25 diligence, I would say, in trying to make that**

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15:13:15 **1 allocation.**

15:13:16 **2 Q.** And what was the approach that you and the OCI team

15:13:20 **3** used in making that evaluation in terms of was it

15:13:23 **4** policy-by-policy or segments? Help the Court

15:13:27 **5** understand how you went about it.

15:13:29 **6 A. For the most part, our approach was -- was to look at**

15:13:34 **7 business segments that had risk or that had**

15:13:39 **8 contractual triggers that were potentially**

15:13:43 **9 problematic. And we really approach a problem**

15:13:48 **10 initially with that mindset.**

15:13:50 **11 As we drilled down into the books of business and**

15:13:54 **12 sub classifications, you know, we recognized that**

15:13:58 **13 there were some variability in the contract forms even**

15:14:03 **14 within groups. So we created sub groups or we, you**

15:14:08 **15 know, we kept -- generally, we wanted to look at,**

15:14:12 **16 rather than looking at, ah, the potential risk only**

15:14:21 **17 from an economic perspective where that could have**

15:14:27 **18 been perceived as unfair that we're just allocating**

15:14:32 **19 the bad policies to, we wanted to try to do that in as**

15:14:39 **20 fair and objective way as possible. So we tried to**

15:14:45 **21 look at books of business and so forth.**

15:14:46 **22 And then over time, there was some specifics that**

15:14:49 **23 we just had to act on as well.**

15:14:52 **24 Q.** And when you say some specifics, meaning in regard to

15:14:55 **25** particular policies or --

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15:14:57 **1 A. Yes.**

15:14:58 **2 Q.** Such as?

15:14:59 **3 A. Well, like in the student loans, there were a handful**

15:15:07 **4 of student loan policies that were clearly problematic**

15:15:16 **5 because of the types of collateral that were resident**

15:15:20 **6 in the deal -- the financing structure of the deal,**

15:15:25 **7 the interest rates, the penalty interest rates that**

15:15:29 **8 were being paid and so forth, while some of the other**

15:15:32 **9 student loans were more difficult to evaluate the**

15:15:38 **10 risk, and in that case we created the assessment**

15:15:43 **11 process to give a more thorough review of those**

15:15:49 **12 policies.**

15:15:50 **13 Q.** Okay. And did that assessment process come to a

15:15:55 **14** conclusion and result in decisions subsequent to

15:15:58 **15** March?

15:15:58 **16 A. It did. We, throughout the course of the summer --**

15:16:03 **17 well, in fact, another consultant, SCLS -- I don't**

15:16:12 **18 know the exact meaning of the acronym -- but they were**

15:16:17 **19 specialists in evaluating student loan deals. And**

15:16:22 **20 that firm provided some additional insight into the**

15:16:29 **21 risks. And with, again, with our financial advisors**

15:16:35 **22 and legal advisors, we completed that assessment**

15:16:40 **23 process and submitted a group of additional student**

15:16:44 **24 loan deals to be placed in the Segregated Account.**

15:16:48 **25 Q.** Is that process now complete?

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15:16:51 **1 A. It is.**  
15:16:51 **2 Q.** Okay. Going back to the period leading up to March  
15:16:54 **3** 24th, what, if any, part of your allocation efforts  
15:17:01 **4** related to de-risking exposures in the General  
15:17:06 **5** Account?  
15:17:06 **6 A. Well, again, there were contractual triggers that**  
15:17:13 **7** **existed that perhaps the deal itself had a relatively**  
15:17:23 **8** **low risk of default. Some of the CLO deals could be**  
15:17:30 **9** **described that way where, you know, the performance of**  
15:17:35 **10** **the deal itself was relatively strong. But there were**  
15:17:40 **11** **default triggers related to those types of deals. And**  
15:17:45 **12** **the market for some of those deals was weaker such**  
15:17:49 **13** **that there were mark-to-market negative, you know,**  
15:17:54 **14** **gaps between carry value and the market value. And,**  
15:18:02 **15** **you know, in those cases, we sought forbearances from**  
15:18:07 **16** **those policyholders in order to -- they had an**  
15:18:15 **17** **interest in retaining durable coverage to keep the**  
15:18:20 **18** **guaranty in place on the deal and would continue to**  
15:18:25 **19** **pay premium and so forth. But there was this risk of**  
15:18:30 **20** **triggering a mark-to-market loss. We achieved some**  
15:18:36 **21** **forbearances on those policies. And with those**  
15:18:39 **22** **forbearances in place, it was appropriate to retain**  
15:18:44 **23** **those policies in the General Account.**  
15:18:50 **24 Q.** And try to describe the efforts that you and OCI made  
15:18:56 **25** in terms of pulling together these disclosure

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15:18:59 **1** materials, both Exhibit 27 and the other materials .  
15:19:05 **2 A. Ah, there was substantial work done to all -- you**  
15:19:13 **3** **know, throughout our involvement with this, with the**  
15:19:16 **4** **company to first, as I was describing earlier, get an**  
15:19:20 **5** **independent view of the risks and ultimately to convey**  
15:19:30 **6** **as appropriate portions of that view in the Disclosure**  
15:19:35 **7** **Statements. And, you know, those models and things**  
15:19:39 **8** **that we used to evaluate our decisions we have**  
15:19:46 **9** **condensed into the Disclosure Statement.**  
15:19:48 **10 Q.** And did -- was OCI is it fair to say trying to make  
15:19:53 **11** this as full and complete as possible under the  
15:19:57 **12** circumstances?  
15:19:57 **13** MR. GREENWALD: Objection, your Honor. Leading.  
15:19:59 **14** I mean, I think Mr. Peterson is doing a good job  
15:20:02 **15** without leading.  
15:20:03 **16** THE COURT: Well, I don't think it's leading  
15:20:04 **17** because I don't think it contains in the question the  
15:20:09 **18** form of the answer. It can go several ways on it. So  
15:20:13 **19** it's not directed to an answer.  
15:20:15 **20** MR. GREENWALD: Okay. Thank you, your Honor.  
15:20:16 **21** THE COURT: All right. Proceed.  
15:20:18 **22 A. Ah, yes. We -- our goal was to provide as much**  
15:20:23 **23** **information as possible given the requirements of**  
15:20:30 **24** **confidentiality and our ability to really have**  
15:20:38 **25** **flexibility in the plan and so forth. But with some**

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15:20:41 **1** **general constraints like that, we sought to give as**  
15:20:46 **2** **much information as possible about how the plan would**  
15:20:50 **3** **work.**  
15:20:51 **4 Q.** What would be involved in some third-party  
15:20:55 **5** non-regulator trying to replicate this same kind of  
15:21:00 **6** body of information in the time available?  
15:21:02 **7 A. Ah --**  
15:21:04 **8** MR. DEVORE: Objection, your Honor. It's vague.  
15:21:06 **9** I don't understand what the "time available" term  
15:21:08 **10** refers to.  
15:21:08 **11** MR. VAN SICKLEN: From March to the present.  
15:21:11 **12 A. It's hard to imagine -- was there a ruling on the**  
15:21:17 **13** **question?**  
15:21:17 **14** THE COURT: Well, the objection was addressed,  
15:21:20 **15** so you can answer.  
15:21:22 **16 A. Thank you.**  
15:21:22 **17** **It's hard to imagine that a group of policyholders**  
15:21:31 **18** **first having the requisite information available to**  
15:21:37 **19** **make this kind of analysis would have been, as we**  
15:21:41 **20** **discussed earlier, impractical or impossible. And**  
15:21:45 **21** **beyond that, the idea that thousands of policyholders**  
15:21:52 **22** **with individual interests could come to an agreement**  
15:21:58 **23** **on one plan that has, you know, all the different**  
15:22:04 **24** **elements that this plan has seems, again, practically**  
15:22:09 **25** **impossible.**

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15:22:10 **1 Q.** And Mr. Peterson, perhaps we could jump ahead in the  
15:22:17 **2** Disclosure Statement, Exhibit 27, to page 40.  
15:22:19 **3** Toward the bottom of the page under the heading  
15:22:32 **4** Subordination, there's a discussion of the surplus  
15:22:35 **5** notes. Do you see that?  
15:22:36 **6 A. Yes.**  
15:22:37 **7 Q.** And could you amplify what you're trying to convey in  
15:22:42 **8** the disclosure there?  
15:22:45 **9 A. Let me just take a moment to review it.**  
15:22:51 **10** **Well, I think there's two main concepts that**  
15:23:18 **11** **surplus notes are, of their nature, subordinate claims**  
15:23:24 **12** **within the structure of obligations of the insurance**  
15:23:29 **13** **company. But perhaps of more concern is that we were**  
15:23:34 **14** **trying to make it clear that all surplus notes issued**  
15:23:39 **15** **by either the General Account or the Segregated**  
15:23:43 **16** **Account will be treated equally pari passu.**  
15:23:54 **17 Q.** Are there presently notes issued outstanding by the  
15:24:01 **18** General Account?  
15:24:01 **19 A. There are related to the bank deal.**  
15:24:01 **20 Q.** And what was the -- was there a template used to  
15:24:05 **21** create those or --  
15:24:07 **22 A. OCI approves -- or insurance companies on a fairly**  
15:24:15 **23** **regular basis issue surplus notes. OCI has a form of**  
15:24:20 **24** **a surplus note, essentially, a template that we**  
15:24:26 **25** **provide to the companies which provides a structure**

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15:24:31 **1** that is acceptable to the office.

15:24:34 **2 Q.** And was that template followed in regard to the notes

15:24:37 **3** issued by the General Account?

15:24:39 **4 A.** It was.

15:24:40 **5 Q.** And how are those notes -- well, strike that.

15:24:46 **6** What are the other features of a surplus note

15:24:52 **7** under that standard template?

15:24:53 **8 A.** Well, probably the key feature is that all payment of

15:24:59 **9** principal and interest under surplus note is subject

15:25:03 **10** to approval by the Commissioner.

15:25:06 **11 Q.** And are you familiar with the form of surplus notes

15:25:10 **12** proposed to be issued under the plan?

15:25:12 **13 A.** I am in general.

15:25:14 **14 Q.** Yeah. And how, if at all, do they differ in material

15:25:20 **15** ways from the General Account notes?

15:25:22 **16 A.** There's no material difference between the General and

15:25:28 **17** Segregated Account notes.

15:25:29 **18 Q.** Do they have the same maturity date?

15:25:33 **19 A.** Same maturity date, same interest rate, same --

15:25:40 **20** subject to the same provisions about payment of

15:25:45 **21** surplus or of principal and interest being subject to

15:25:49 **22** OCI's approval.

15:25:51 **23 Q.** And are the Plan surplus notes also, you know, do they

15:25:58 **24** also track the OCI template?

15:26:01 **25 A.** Absolutely.

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15:26:03 **1 Q.** And is there -- are those notes, both the General

15:26:10 **2** Account form of surplus notes and the Segregated

15:26:12 **3** Account Plan notes standard in their form in that

15:26:16 **4** regard?

15:26:17 **5 A.** Yes. We're rather sticklers about surplus notes being

15:26:25 **6** maintained very closely to that -- to that template.

15:26:30 **7 Q.** Does that form attempt to make those notes standard

15:26:34 **8** and fair in terms of their use in different contexts,

15:26:39 **9** different insurers?

15:26:40 **10 A.** Yes.

15:26:43 **11 Q.** Let's come back to the basic structure of the plan,

15:26:52 **12** the cash note split.

15:26:53 **13** How did you arrive at, or you and OCI, at the

15:26:57 **14** present percentage splits?

15:26:59 **15 A.** We developed models on both to estimate the expected

15:27:11 **16** loss under different scenarios as well as cash flow

15:27:16 **17** models that were used to prove out whether -- at what

15:27:25 **18** cash outflow could be sustained. Those cash flow

15:27:34 **19** models are the basis for the four scenarios that are

15:27:39 **20** presented in the Disclosure Statement.

15:27:41 **21 Q.** And before we get to those, as part of the modeling

15:27:45 **22** exercise, did OCI and you look at the General Account

15:27:50 **23** and Segregated Account assets and liabilities?

15:27:53 **24 A.** We modeled both General Account and Segregated

15:27:59 **25** Accounts. And, you know, all of the cash flows and

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15:28:03 **1** expenses and so forth related to both accounts.

15:28:07 **2 Q.** Okay. And let's maybe turn ahead to page 52 of the

15:28:12 **3** Disclosure Statement.

15:28:24 **4 A.** All right.

15:28:24 **5 Q.** What was OCI trying to explicate there for the benefit

15:28:29 **6** of interested parties?

15:28:31 **7 A.** Well, we are trying to document our recovery analysis

15:28:46 **8** and describe assumptions that underlie those -- that

15:28:52 **9** analysis.

15:28:54 **10 Q.** Down below there's a chart there. What is that trying

15:28:57 **11** to capture and explain?

15:29:00 **12 A.** Well, near the bottom of page 52, it explains or

15:29:07 **13** documents the different types of securities held in

15:29:11 **14** the AAC investment portfolio and shows information

15:29:18 **15** about carrying value versus fair value versus par

15:29:24 **16** value, those -- the yield to maturity and the weighted

15:29:31 **17** average life of those different classes of securities.

15:29:35 **18 Q.** Okay. And then the far right column, the WAL, is that

15:29:41 **19** the Weighted Average Life reference?

15:29:45 **20 A.** Yes, Weighted Average Life.

15:29:46 **21 Q.** And why is that number -- how does that relate that

15:29:50 **22** 8.8 to the number up above under the heading of 6.8

15:29:55 **23** billion?

15:29:56 **24 A.** Um, well, the -- they don't particularly relate. Um,

15:30:05 **25** the Weighted Average Life has to do with the expected

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15:30:10 **1** repayment profile of the securities. The \$6.8

15:30:18 **2** billion, you know, is a dollar figure, where 8.8 is

15:30:23 **3** years.

15:30:24 **4 Q.** Okay. There was some confusion earlier in the

15:30:27 **5** testimony about that.

15:30:28 **6 A.** Oh. I'm sorry.

15:30:29 **7 Q.** I was just trying to clear that up.

15:30:31 **8 A.** Okay.

15:30:32 **9 Q.** And then a few pages on, page 54, also an analysis of

15:30:38 **10** the investment portfolio, the liquidity to that.

15:30:43 **11 A.** Uh-huh (affirmative).

15:30:44 **12 Q.** Could you explain to the Court what OCI was trying to

15:30:48 **13** capture there in the disclosure?

15:30:50 **14 A.** Top of page 53?

15:30:52 **15 Q.** 54.

15:30:54 **16 A.** Oh, yes. Um, as we were conducting our analysis, we

15:31:03 **17** recognized that there were certain investments of AAC

15:31:10 **18** that were highly liquid and others that were illiquid.

15:31:17 **19** On one end of the spectrum, U.S. Treasuries highly

15:31:22 **20** liquid. On the other end of spectrum, some

15:31:26 **21** intercompany loans and some others that there's really

15:31:28 **22** no direct market value for, or no market for, I should

15:31:36 **23** say. Not market value.

15:31:36 **24** And in order to model the cash flows

15:31:39 **25** appropriately, we needed to be able to bucket those

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15:31:44 **1** different types of securities into these liquidity  
 15:31:48 **2** buckets such that we could make assumptions about what  
 15:31:52 **3** securities would be used to pay -- make certain  
 15:31:56 **4** payments and what ones would have to be retained over  
 15:32:01 **5** time.  
 15:32:01 **6** Q. And back before the rehab started, was there a concern  
 15:32:05 **7** at OCI about a mismatch in terms of the liquidity of  
 15:32:09 **8** assets and demand for claims?  
 15:32:11 **9** A. Yes. We particularly, you know, when we were  
 15:32:18 **10** experiencing or the company was experiencing \$150  
 15:32:26 **11** million a month in RMBS payments, there was a  
 15:32:29 **12** significant draw on those liquid assets, putting us in  
 15:32:32 **13** a position where some of the -- those liquid assets  
 15:32:41 **14** could be fully exhausted and some of the less liquid  
 15:32:45 **15** assets that are currently trading below their par  
 15:32:52 **16** value, but reasonably expected to recover at least to  
 15:32:57 **17** some degree over time, we didn't -- you know, there  
 15:33:01 **18** was a concern that the bleed, you know, the cash  
 15:33:05 **19** outflow and the loss of liquid assets would then  
 15:33:08 **20** result in the need to sell less liquid assets on  
 15:33:13 **21** discount in order to continue to fund the cash needs  
 15:33:18 **22** of the company.  
 15:33:18 **23** Q. And how, if at all, does the Plan address those  
 15:33:23 **24** concerns?  
 15:33:23 **25** A. Again, that works into our overall evaluation of what

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15:33:33 **1** level of cash in the cash note split can be sustained  
 15:33:42 **2** comfortably.  
 15:33:43 **3** Q. And just flipping ahead a few pages, before we get to  
 15:33:46 **4** the scenarios on page 57, we start with the liability  
 15:33:49 **5** side of the picture.  
 15:33:57 **6** Are you with me?  
 15:33:58 **7** A. Ah, just a second.  
 15:34:03 **8** All right.  
 15:34:04 **9** Q. And --  
 15:34:05 **10** A. At B?  
 15:34:06 **11** Q. Yes, under B. And then carrying on to the next page,  
 15:34:09 **12** the General Account.  
 15:34:10 **13** A. Uh-huh (affirmative).  
 15:34:11 **14** Q. Do you see that?  
 15:34:12 **15** A. I do.  
 15:34:13 **16** Q. There was some questioning yesterday of the  
 15:34:32 **17** Commissioner regarding certain of the exposures here  
 15:34:36 **18** in the General Account in terms of net par outstanding  
 15:34:43 **19** versus exposure. Do you recall that?  
 15:34:45 **20** A. I do in general.  
 15:34:46 **21** Q. Could you help clear that issue up?  
 15:34:49 **22** A. Certainly. If I -- under the Credit Profile section  
 15:34:58 **23** here, there's -- on page 58 there's a description of  
 15:35:01 **24** different classes of policies that are in the General  
 15:35:08 **25** Account, U.S. Public Finance, other structured finance

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15:35:13 **1** CLOs, CDOs, and International. And then within each  
 15:35:20 **2** one of those, there's a description of the degree of  
 15:35:28 **3** -- or its status in terms of the company's credit  
 15:35:32 **4** classification system.  
 15:35:34 **5** The total net par outstanding across all four of  
 15:35:39 **6** those classes was \$5.2 billion, and it shows in the  
 15:35:47 **7** table that \$2.3 and \$2.1 billion respectively are  
 15:35:57 **8** classified in the 1A and 2 credit classification  
 15:36:05 **9** buckets, and a relatively smaller amount are in the  
 15:36:12 **10** Class 3 and 4 classifications.  
 15:36:15 **11** Q. Okay. So the first column where it says NPO -- that's  
 15:36:20 **12** Net Par Outstanding?  
 15:36:21 **13** A. It is.  
 15:36:21 **14** Q. Is that the exposure that the company's expecting on a  
 15:36:25 **15** claim, or something else?  
 15:36:27 **16** A. Well, it's the full exposure. It's not the estimated  
 15:36:32 **17** loss by any means.  
 15:36:33 **18** Q. Okay.  
 15:36:34 **19** A. It's the full value of the policy totalled for each of  
 15:36:39 **20** those types of policies.  
 15:36:42 **21** Q. Okay. And then we look at Tab B of the Disclosure  
 15:36:46 **22** Statement. There's a description of each of the risk  
 15:36:51 **23** classifications.  
 15:36:55 **24** A. Yes.  
 15:36:55 **25** Q. Okay. Could you explain the difference between, you

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15:36:59 **1** know, the growing severity from Class 1 down to Class  
 15:37:06 **2** 4, how that works and how it ties back into the chart?  
 15:37:09 **3** A. Uh-huh (affirmative). Well, as you can see, Class 1  
 15:37:13 **4** are the fully performing classifications with only a  
 15:37:24 **5** remote probability of claim. There is a, what is a  
 15:37:30 **6** called a survey list classification where there may be  
 15:37:35 **7** specific reasons to -- for additional analysis, but  
 15:37:41 **8** there's no clear kind of need for adverse  
 15:37:50 **9** classification yet.  
 15:37:51 **10** Class 1A, potential problems with risks that are  
 15:38:03 **11** really 2B-dimensional, and Class 2 as our sub -- or  
 15:38:13 **12** described in general as substandard requiring  
 15:38:16 **13** intervention. And these are classifications that the  
 15:38:23 **14** company uses to monitor the policies that it has, the  
 15:38:31 **15** risks that it has on those policies. But they also,  
 15:38:37 **16** um, you know, just help identify the potential for  
 15:38:42 **17** default. And each of these classifications are ones  
 15:38:49 **18** where the potential for default is -- well, I don't  
 15:38:54 **19** see the exact -- any exact numbers, but it was, you  
 15:38:58 **20** know, still, ah, relatively low possibility of  
 15:39:03 **21** default. And to go beyond that, then, you know, even  
 15:39:08 **22** if there is a default in -- it's very rare that the  
 15:39:16 **23** full amount of the policy value is ever paid on an  
 15:39:21 **24** individual default.  
 15:39:22 **25** So in the previous testimony, there was

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15:39:26 **1** **implication that there were \$5.2 billion worth of**  
15:39:32 **2** **exposure that could result in loss to the General**  
15:39:38 **3** **Account. Well, that needs to be qualified by the fact**  
15:39:41 **4** **of that of that \$5.2 of Net Par Outstanding, most of**  
15:39:47 **5** **it is in classifications where the risk of default is**  
15:39:51 **6** **relatively low, and that even if a default occurs, the**  
15:39:57 **7** **loss on that particular policy is likely to be**  
15:40:01 **8** **substantially less than the full policy value.**  
15:40:04 **9** **Q.** Okay. And then if we just flip ahead from page 58 to  
15:40:09 **10** page 60, is that the kind of corresponding  
15:40:13 **11** classification of the Segregated Account exposures?  
15:40:15 **12** **A.** Yes, it is.  
15:40:24 **13** **Q.** Okay. And give a sense to the Court of your view on  
15:40:30 **14** the success or lack of success in the de-risking  
15:40:35 **15** exercise and the allocation process that you spent six  
15:40:39 **16** weeks with?  
15:40:39 **17** **A.** Well, as you can see from this chart, the predominance  
15:40:47 **18** of the classifications in the Segregated Account are  
15:40:51 **19** in those Class 3 and Class 4 categories representing  
15:41:01 **20** the fact that those are the policies that had much  
15:41:05 **21** higher risks of default.  
15:41:07 **22** **Q.** And in terms of the actual experience from March to  
15:41:17 **23** the present, between the two accounts in terms of loss  
15:41:21 **24** claims, how have they compared?  
15:41:24 **25** **A.** Ah, well, there are pending claims in the Segregated

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15:41:30 **1** **Account that are in the \$850 to \$900 million ranges,**  
15:41:39 **2** **if I recall correctly, as opposed to paid claims in**  
15:41:45 **3** **the General Account of \$13 million or so.**  
15:41:50 **4** **Q.** Okay. And I would like to call your attention to  
15:41:55 **5** Exhibit 41 in the binders.  
15:41:59 **6** I have an extra copy I'd be happy to hand the  
15:42:03 **7** witness. It's the Rehabilitator's Supplement.  
15:42:13 **8** **A.** Thank you.  
15:42:14 **9** **Q.** It's also marked as Exhibit 41. Do you have it in  
15:42:18 **10** front of you, Mr. Peterson? And I'm just going to  
15:42:21 **11** call your attention to the very last two pages, the  
15:42:24 **12** charts that were provided as part of the questions and  
15:42:27 **13** answers that --  
15:42:28 **14** **A.** Uh-huh (affirmative).  
15:42:29 **15** **Q.** -- were filed with the Court. And explain what those  
15:42:36 **16** present value charts are showing as between the two  
15:42:38 **17** accounts?  
15:42:39 **18** **A.** Yeah. I'm looking at the page titled Segregated  
15:42:48 **19** Account - Top 20 Policies by Present Value of Expected  
15:42:51 **20** Loss. And it gives a general description of the top  
15:42:58 **21** 20 exposures and the expected loss as of June 30th  
15:43:05 **22** under base and stress case scenarios with those losses  
15:43:11 **23** discounted at 5.1 percent.  
15:43:16 **24** **If you look down at the list for the Segregated**  
15:43:21 **25** **Account, on a base case, those top three exposures are**

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15:43:30 **1** **\$493 million, \$199 million, and \$155 million.**  
15:43:37 **2** **By comparison, if you look at the top exposures in**  
15:43:48 **3** **the General Account, and in fact, there's really only**  
15:43:54 **4** **five listed as opposed to the top 20, and the expected**  
15:44:02 **5** **losses within those policies are \$26, \$17, and just**  
15:44:11 **6** **short of \$14 million with a total in the range of**  
15:44:18 **7** **\$80-some million.**  
15:44:19 **8** **Q.** Flipping ahead to page 62 of the Disclosure Statement.  
15:44:27 **9** **A.** The Disclosure rather than the Supplement?  
15:44:30 **10** **Q.** Yes, the full Disclosure Statement, Exhibit 27.  
15:44:35 **11** **A.** 62?  
15:44:37 **12** **Q.** Correct. And up at the end of the top paragraph,  
15:44:51 **13** there's a discussion. It says the Segregated Account  
15:44:54 **14** Base Case Loss Estimates. Do you see that?  
15:44:57 **15** **A.** Uh-huh (affirmative).  
15:44:58 **16** **Q.** Let's talk about the -- how does the Plan propose to  
15:45:05 **17** deal with those loss estimates? What's the structure  
15:45:09 **18** for going forward if the Plan is approved?  
15:45:12 **19** **A.** Well, losses on the Segregated Account will be paid 25  
15:45:21 **20** cents in cash, 75 percent in surplus notes.  
15:45:28 **21** **Q.** Okay. And explain the overview of the vehicle for  
15:45:35 **22** accomplishing that, the secured note and the  
15:45:38 **23** Reinsurance Agreement. How do those work in this  
15:45:41 **24** process under the Plan?  
15:45:42 **25** **A.** Well, the capital fund and funding necessary to make

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15:45:47 **1** **payments from the Segregated Account comes through two**  
15:45:52 **2** **sources -- the secured note, \$2 billion secured note,**  
15:46:00 **3** **and an Excess of Loss Reinsurance Agreement covering**  
15:46:04 **4** **those exposures in the Segregated Account and provided**  
15:46:07 **5** **by the General Account.**  
15:46:09 **6** **Q.** And are these a permanent mechanism for effecting the  
15:46:14 **7** cash payments that arise under the plan?  
15:46:15 **8** **A.** They are.  
15:46:19 **9** **Q.** And why did OCI choose the figure of a \$2 billion  
15:46:23 **10** secured note instead of some other figure?  
15:46:26 **11** **A.** Well, our estimates of loss from within the Segregated  
15:46:34 **12** Account were in the range of \$8 billion such that the  
15:46:39 **13** 25 cent cash payment on those obligations would result  
15:46:46 **14** in \$2 billion of cash instead. That and other factors  
15:46:56 **15** caused us to set it at \$2 billion.  
15:47:00 **16** **Q.** And if hypothetically at some point the \$2 billion  
15:47:03 **17** secured note was fully drawn, what happens in regard  
15:47:06 **18** to the Reinsurance Agreement?  
15:47:07 **19** **A.** The Segregated Account has the same rights to draw  
15:47:14 **20** cash from the General Account through the Excess of  
15:47:18 **21** Loss Reinsurance Agreement.  
15:47:21 **22** **Q.** And what is the effect on the company's surplus of  
15:47:25 **23** issuing surplus notes?  
15:47:27 **24** **A.** It's a rather odd treatment, I guess, for those  
15:47:32 **25** unfamiliar with statutory accounting, but statutory --

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15:47:37 **1** surplus notes are treated as equity, given the fact  
 15:47:43 **2** that they are subject to -- any payment on those notes  
 15:47:48 **3** is subject to approval of the Commissioner and their  
 15:47:52 **4** subordinated nature. So as equity, when surplus notes  
 15:47:57 **5** are issued, it actually increases the surplus,  
 15:48:01 **6** statutory surplus.  
 15:48:04 **7** Q. And explain to the Court how through the plan the  
 15:48:08 **8** Reinsurance Agreement keeps the company's surplus  
 15:48:13 **9** above the \$100 million threshold?  
 15:48:15 **10** A. Well, sessions or, you know, transfers of risk under  
 15:48:21 **11** the Reinsurance Agreement are limited such that the  
 15:48:27 **12** surplus of the General Account must be maintained at  
 15:48:30 **13** \$100 million.  
 15:48:32 **14** Q. And if the Plan is approved and the process of paying  
 15:48:36 **15** claims through cash and notes proceeds, explain how  
 15:48:40 **16** the Reinsurance Agreement interplays with the secured  
 15:48:44 **17** note in the early years to keep the surplus above \$100  
 15:48:48 **18** million.  
 15:48:48 **19** A. Well, in one of the more adverse scenarios, Scenario  
 15:48:56 **20** 4, there is some loss of surplus in the General  
 15:49:04 **21** Account that caused the condition where that  
 15:49:08 **22** limitation under the Reinsurance Agreement becomes  
 15:49:12 **23** effective. But that really only -- that limits the  
 15:49:19 **24** risk that is ceded in a particular accounting period  
 15:49:23 **25** under the Reinsurance Agreement and helps maintain or

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15:49:30 **1** causes the General Account to maintain surplus of at  
 15:49:35 **2** least \$100 million.  
 15:49:39 **3** There's really no expectation that that would  
 15:49:42 **4** limit the cash requirements flowing to the Segregated  
 15:49:48 **5** Account.  
 15:49:48 **6** Q. And assuming that the future events under the four  
 15:49:54 **7** scenarios that you've modeled, you know, reality is  
 15:49:59 **8** somewhere within those scenarios, is there adequate,  
 15:50:04 **9** ah, capital through these vehicles of the note and the  
 15:50:08 **10** Reinsurance Agreement to fund the requirements of the  
 15:50:11 **11** Plan as you've modeled it out here?  
 15:50:14 **12** MR. GREENWALD: Objection, your Honor. I'm  
 15:50:16 **13** sorry. Can I have the question back? My objection is  
 15:50:18 **14** I think it put in the middle of it an assertion that  
 15:50:21 **15** isn't in the record. But there could have been in  
 15:50:23 **16** there that I didn't hear.  
 15:50:24 **17** THE COURT: Read it back for Mr. Greenwald,  
 15:50:27 **18** please.  
 15:50:47 **19** (Question read back.)  
 15:50:48 **20** MR. GREENWALD: I guess I'd object to the  
 15:50:50 **21** reality is somewhere in those numbers.  
 15:50:53 **22** MR. OWEN: I'll join in the objection as  
 15:50:56 **23** speculation, your Honor.  
 15:50:58 **24** MR. DEVORE: One State Street joins as compound.  
 15:51:01 **25** THE COURT: All of those will be overruled. I

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15:51:03 **1** think there's a proper framework there. And that was  
 15:51:07 **2** the assumption, and this man is qualified as an expert  
 15:51:10 **3** in his area, and he's asked to make that assumption.  
 15:51:15 **4** I think that's an appropriate question. You may  
 15:51:17 **5** answer it.  
 15:51:18 **6** A. Well, the funding of the Segregated Account was  
 15:51:22 **7** determined to be adequate in that the cash flow needs  
 15:51:28 **8** of the Plan are met and substantially all of the  
 15:51:35 **9** assets of the General Account have been made available  
 15:51:39 **10** to the Segregated Account through the structure of the  
 15:51:42 **11** Plan as well.  
 15:51:43 **12** Q. What is the significance or how did you go about  
 15:51:47 **13** setting this \$100 million floor or requirement?  
 15:51:52 **14** A. The \$100 million relates to minimum surplus  
 15:51:58 **15** requirements established by state regulators.  
 15:52:01 **16** Q. And are there any other assets of the General Account  
 15:52:06 **17** above or beyond that threshold requirement, statutory  
 15:52:11 **18** requirements that are not subject to the ability of  
 15:52:15 **19** the Segregated Account claimants through the note and  
 15:52:17 **20** the Reinsurance Agreement to get payments?  
 15:52:20 **21** A. No. All of the -- subject to just that limitation,  
 15:52:25 **22** all of the assets of the General Account are available  
 15:52:27 **23** to the Segregated Account.  
 15:52:28 **24** Q. And is the support through the secured note and the  
 15:52:46 **25** Reinsurance Agreement in your opinion and that of

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15:52:49 **1** OCI's adequate capital for the purposes of the  
 15:52:54 **2** Segregated Account and its Plan?  
 15:52:56 **3** A. We have made that determination.  
 15:52:57 **4** Q. Okay. Let's talk a little bit about the Reinsurance  
 15:53:07 **5** Agreement.  
 15:53:07 **6** Is there an insolvency provision in that  
 15:53:11 **7** agreement?  
 15:53:12 **8** A. There is.  
 15:53:13 **9** Q. And is it standard, to the best of your knowledge?  
 15:53:18 **10** A. I don't recall looking at that particular provision.  
 15:53:22 **11** I presume it is.  
 15:53:23 **12** Q. Okay. And does the Reinsurance Agreement have what  
 15:53:27 **13** some people refer to as a -- well, strike that.  
 15:53:30 **14** Do you know what a "follow the fortunes" provision  
 15:53:36 **15** is?  
 15:53:36 **16** A. I'm familiar with the "follow the fortunes" concept,  
 15:53:41 **17** yes.  
 15:53:41 **18** Q. Okay. And what is it, briefly?  
 15:53:42 **19** A. That the reinsurer will follow the fortune of the  
 15:53:51 **20** ceding company in that, to the extent that there's a  
 15:53:55 **21** loss at the ceding company, that reinsurer bears loss  
 15:53:58 **22** on the same, you know, in the same way.  
 15:54:02 **23** Q. And the ceding company here would be the Segregated  
 15:54:05 **24** Account?  
 15:54:05 **25** A. The ceding company is the Segregated Account, yes.

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15:54:09 **1 Q.** And does this particular Reinsurance Agreement being  
15:54:12 **2** used under the Plan have such a provision?  
15:54:14 **3 A.** **It does. I believe there's a modification to the**  
15:54:26 **4 follow -- to the "follow the fortunes" type provision**  
15:54:31 **5 that has been a subject of question. And that**  
15:54:34 **6 modification really has only to do with the fact that**  
15:54:40 **7 the Segregated Account will be making payment on a**  
15:54:47 **8 cash note split rather than on a full cash basis.**  
15:54:52 **9 Q.** That the payments will be in accordance with the Plan  
15:54:55 **10** as opposed to some other way?  
15:54:56 **11 A.** **That's correct.**  
15:54:57 **12 Q.** There's been a lot of talk about these four scenarios  
15:55:07 **13** that are described starting at page 66 of the  
15:55:10 **14** Disclosure Statement. And they have some attachments  
15:55:14 **15** that follow.  
15:55:15 **16 A.** **Uh-huh (affirmative).**  
15:55:16 **17 Q.** Were you part of developing these scenarios and basing  
15:55:21 **18** decisions on 'em?  
15:55:23 **19 A.** **Yes. I was involved in, um, developing, consulting**  
15:55:30 **20 with our financial advisors on the models that**  
15:55:35 **21 underlie these scenarios as well as the assumptions**  
15:55:39 **22 that are built into these particular scenarios.**  
15:55:43 **23 Q.** And what were you trying to accomplish through these  
15:55:48 **24** alternative scenarios and explain here in this  
15:55:54 **25** Disclosure Statement to interested parties?

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15:55:55 **1 A.** **Well, we wanted to put some scope on the potential**  
15:56:01 **2 outcomes for payment on the surplus notes. And the**  
15:56:09 **3 two biggest risk factors in that relate to the**  
15:56:17 **4 severity of the losses and how they develop as well as**  
15:56:22 **5 what ultimately is collected on the Reps and**  
15:56:27 **6 Warranties litigations.**  
15:56:29 **7 Q.** And there's been some mention of put-back claims.  
15:56:37 **8** Could you explain to the Court what that is?  
15:56:39 **9 A.** **Well, Ambac is pursuing litigation against the**  
15:56:46 **10 originators of these mortgages underlying the RMBS**  
15:56:57 **11 securities, and the form in which recoveries on that**  
15:57:03 **12 litigation or even through negotiation, um, payments**  
15:57:08 **13 are made or adjustments are made to the pool can be**  
15:57:15 **14 through a process called put-backs.**  
15:57:19 **15** **An individual loan that is put into a security,**  
15:57:26 **16 um, and, you know, its performance then and cash flows**  
15:57:31 **17 then build up in the securities. As a resolution to**  
15:57:37 **18 the originator not following the representations and**  
15:57:42 **19 warranties contained in the deal documents, they may**  
15:57:48 **20 agree to take back that loan -- that particular loan**  
15:57:54 **21 into their own ownership and substitute a conforming**  
15:58:00 **22 loan into the securitization. So that's where the**  
15:58:05 **23 term "put-back" comes in. It's a put-back of that**  
15:58:09 **24 particular loan back to the originator.**  
15:58:11 **25 Q.** Okay. And are there also cash claims as part of the

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15:58:17 **1** warranty litigation?  
15:58:18 **2 A.** **Yeah. You know, other settlement methods for those**  
15:58:23 **3 breach of Reps and Warranties might be a cash payment**  
15:58:26 **4 by the originator rather than buying back loans.**  
15:58:31 **5 Q.** And was there consideration to whether to transfer or  
15:58:36 **6** allocate to the Segregated Account the cash recoveries  
15:58:39 **7** in regard to the Rep and Warranty litigation?  
15:58:44 **8 A.** **Ah, certainly.**  
15:58:46 **9 Q.** And why wasn't that done here?  
15:58:48 **10 A.** **We -- again, that had to do with those contractual**  
15:58:53 **11 triggers about -- that limited Ambac's ability to**  
15:58:58 **12 transfer assets away from AAC.**  
15:59:01 **13 Q.** Okay. And I think I may have jumped past it, but in  
15:59:04 **14** your Disclosure Statement, Exhibit 27, if you look at  
15:59:08 **15** page 62 to 63, is that the area where you tried to  
15:59:18 **16** disclose and explain the subject matter you just  
15:59:24 **17** testified about?  
15:59:31 **18** This is a portion of the Disclosure Statement  
15:59:33 **19** dealing with the Rep and Warranty claims?  
15:59:35 **20 A.** **It appears to be, yes.**  
15:59:36 **21 Q.** Let's go back to the four scenarios.  
15:59:41 **22** What are the difference between the four?  
15:59:46 **23 A.** **Four scenarios? Under Scenario 1, it assumes a base**  
15:59:53 **24 case of losses and recovery of the remediation claims**  
16:00:02 **25 at the level estimated by Ambac.**

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16:00:08 **1** **Under Scenario 2, that Reps and Warranties**  
16:00:16 **2 recovery is eliminated.**  
16:00:18 **3** **Under 3, we have -- you have a stress case loss**  
16:00:23 **4 scenario, but do have recovery under Reps and**  
16:00:28 **5 Warranties at the company's estimate.**  
16:00:31 **6** **And Scenario 4 is stress losses with no Reps and**  
16:00:39 **7 Warranties recovery.**  
16:00:40 **8 Q.** And perhaps you can help walk us through this very  
16:00:43 **9** briefly, the actual tab of exhibits that sort of  
16:00:48 **10** portray in chart form these scenarios.  
16:00:52 **11 A.** **I could.**  
16:00:55 **12 Q.** Let's just start with Scenario 1. Are they all in  
16:00:59 **13** sort of the same --  
16:01:00 **14 A.** **Exhibit D then?**  
16:01:01 **15 Q.** Yes, please.  
16:01:07 **16** Yes. Why don't you just explain how these pages  
16:01:10 **17** work and what's trying to be depicted here?  
16:01:12 **18 A.** **All right. Well, beginning from page 1, there are --**  
16:01:22 **19 there's a balance sheet for the Segregated Account**  
16:01:29 **20 that runs out over the years out till 2050 that covers**  
16:01:38 **21 pages 1 through 4.**  
16:01:42 **22** **Income statement again from the current time**  
16:01:50 **23 period out through the year 2050 takes you through**  
16:01:58 **24 pages 5 through 8.**  
16:02:00 **25** **Cash flow statement similarly with some, you know,**

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16:02:05 **1** initial adjustments just like on the other pages, and  
 16:02:09 **2** then running out through 2050.  
 16:02:14 **3** And beginning at page 13, um, we have the memo  
 16:02:24 **4** items disclosed that kind of shows the buildup of  
 16:02:33 **5** amounts due on notes and things like lost payments.  
 16:02:41 **6** It provides more detail as to changes in cash payments  
 16:02:49 **7** or buildup of the surplus notes and so forth.  
 16:02:53 **8** And then page 17 summarizes the outcome showing  
 16:03:01 **9** the value of the investment book and the total accrued  
 16:03:09 **10** value of Segregated Account surplus notes as well as  
 16:03:15 **11** the bank settlement surplus notes and shows a recovery  
 16:03:20 **12** percentage for those notes and then outlines the  
 16:03:27 **13** excess claim-paying resources, compares those to  
 16:03:31 **14** potential number of or value of surplus junior surplus  
 16:03:38 **15** notes that could be issued, as well as showing a  
 16:03:42 **16** recovery percentage for the junior surplus notes.  
 16:03:45 **17** Q. Okay. And each of the four scenarios of charts here  
 16:03:51 **18** in D, E, F, G follow the same methodology?  
 16:03:55 **19** A. They all follow the same structure, yes.  
 16:03:57 **20** Q. Okay. And do these scenarios show payments being made  
 16:04:01 **21** in principal or interest on the surplus notes being  
 16:04:04 **22** issued under the Plan?  
 16:04:05 **23** A. They do not.  
 16:04:06 **24** Q. And why is that?  
 16:04:07 **25** A. Well, these scenarios were developed for illustrative

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16:04:12 **1** purposes to show the ultimate recovery that may be  
 16:04:15 **2** possible on the surplus notes rather than to make any  
 16:04:20 **3** particular assumptions about when payments on surplus  
 16:04:25 **4** notes might be made.  
 16:04:28 **5** Q. There's been some angst among certain policyholders  
 16:04:32 **6** about the fact that the scenarios don't show the  
 16:04:35 **7** payments going out in the surplus notes.  
 16:04:38 **8** Is that -- is there any significance that they  
 16:04:42 **9** should attach to the way you've tried to illustrate  
 16:04:44 **10** the issue here in terms of the likelihood of making  
 16:04:47 **11** payments?  
 16:04:47 **12** A. The presentation here has no relevance as to when OCI  
 16:04:56 **13** expects or will make payments or authorize payments on  
 16:05:01 **14** the surplus notes.  
 16:05:02 **15** Q. And what are your expectations in regard to trying to  
 16:05:06 **16** make payments on the surplus notes? What's going to  
 16:05:09 **17** guide OCI going forward if the Plan is confirmed?  
 16:05:15 **18** A. Well, we have established the process to evaluate the  
 16:05:19 **19** potential for payments on the surplus notes or  
 16:05:24 **20** adjustment of the cash note split on an annual basis.  
 16:05:31 **21** We're required to report to this Court by June 1st of  
 16:05:34 **22** each year with our analysis as to the financial  
 16:05:39 **23** position of the Segregated Account and its ability as  
 16:05:44 **24** part of that analysis, its ability to make payment on  
 16:05:49 **25** the surplus notes.

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16:05:51 **1** Q. And is there any sort of objective by OCI in terms of  
 16:05:55 **2** trying to maximize payments on the notes as opposed to  
 16:06:00 **3** save money for some future rainy day?  
 16:06:02 **4** A. Our plan is really designed to provide as much value  
 16:06:08 **5** to policyholders as we can as soon as we can. But we  
 16:06:14 **6** need to be prudent and not expose the Segregated  
 16:06:24 **7** Account to the possibility or at least make that the  
 16:06:29 **8** possibility that we would pay 25 cents now and not be  
 16:06:34 **9** able to save that. We need to make that possibility  
 16:06:38 **10** remote. We believe we have.  
 16:06:41 **11** But short of that, we -- our intent is to make  
 16:06:44 **12** payments and transfer as much value to policyholders  
 16:06:47 **13** as soon as we can under the plan.  
 16:06:51 **14** Q. And does the plan also provide for a reporting vehicle  
 16:06:55 **15** each year when you make that assessment?  
 16:06:57 **16** A. I just described that, I believe.  
 16:07:00 **17** Q. Okay. But what kind of information do you believe  
 16:07:04 **18** you'll be providing to the policyholders as you make  
 16:07:07 **19** these annual updates?  
 16:07:09 **20** A. I don't know that that's been completely documented at  
 16:07:15 **21** this point. But the expectation is that the report  
 16:07:18 **22** would be along the lines similar to this Disclosure  
 16:07:24 **23** Statement, at least in terms of evaluating possible  
 16:07:28 **24** scenarios and making a description of the general  
 16:07:34 **25** financial condition of the Segregated Account.

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16:07:36 **1** Q. Now, you were present earlier this afternoon when  
 16:07:41 **2** Wells Fargo's counsel asked the Commissioner some  
 16:07:45 **3** questions about whether OCI would consider setting up  
 16:07:48 **4** reserves or holding back payments going out to  
 16:07:52 **5** claimants on this process. Do you recall that?  
 16:07:55 **6** A. I do.  
 16:07:55 **7** Q. Okay. What is your view on the -- why haven't you  
 16:08:00 **8** incorporated that in the Plan?  
 16:08:01 **9** A. Well, we've incorporated a degree of conservatism in  
 16:08:08 **10** our Plan, you know, developed through the models and  
 16:08:16 **11** then judgmentally applied a cushion on top of that in  
 16:08:21 **12** determining the 25 percent cash, 75 percent cash note  
 16:08:29 **13** split.  
 16:08:29 **14** To establish a particular reserve related to an  
 16:08:34 **15** individual policy has no particular value beyond the,  
 16:08:43 **16** in my view, beyond the generally conservative analysis  
 16:08:49 **17** that we've taken. We've analyzed the expected cash  
 16:08:56 **18** flows under all claims under different scenarios, and  
 16:08:59 **19** that really functions to establish a cushion, a  
 16:09:07 **20** reserve already. It'll be essentially kind of  
 16:09:11 **21** duplicative of the process that we're already doing.  
 16:09:15 **22** Q. In regard to the concept you just mentioned of a  
 16:09:18 **23** cushion, there was some concern earlier this afternoon  
 16:09:21 **24** about the future is uncertain and there could be  
 16:09:23 **25** changes in the financial condition of the company or

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16:09:27 **1** the economy.

16:09:27 **2** What sort of cushion is built into your Plan to

16:09:34 **3** deal with changes of financial condition going

16:09:34 **4** forward?

16:09:34 **5** **A. Well, if you look at Scenario 4, the adverse case,**

16:09:42 **6** **you'll note that there's still an expectation of in**

16:09:48 **7** **the long run to still be able to pay 45 cents on the**

16:09:52 **8** **dollar on the surplus notes that are issued, including**

16:09:58 **9** **accrued interest and so forth of the -- that suggests**

16:10:03 **10** **that there's a substantial cushion above the 25**

16:10:09 **11** **percent cash payments that we're intending to make.**

16:10:13 **12** **Q. And why do the surplus notes have a maturity date that**

16:10:17 **13** **they have presently? Why did you set that date?**

16:10:20 **14** **A. Well, through negotiations with the bank**

16:10:28 **15** **counterparties, um, it was just a desire on the part**

16:10:36 **16** **of the counterparties to have a specific date. I**

16:10:41 **17** **think it was -- for the market acceptance, a maturity**

16:10:47 **18** **was necessary, and so we selected a ten-year term.**

16:10:54 **19** **And there -- the bank notes were issued June 7th of**

16:11:00 **20** **this year and are due June 7th of 2020.**

16:11:05 **21** **In order to make other notes all pari passu with**

16:11:12 **22** **those -- with the bank notes, we also set a maturity**

16:11:19 **23** **date for the separate Segregated Account surplus notes**

16:11:23 **24** **at June 7, 2020.**

16:11:25 **25** **Q. And what happens when we get to June, 2020 in terms of**

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16:11:30 **1** later claims that may be presented through the

16:11:33 **2** Segregated Account? How will those be handled?

16:11:35 **3** **A. Well, presuming that the Rehabilitation hasn't been**

16:11:43 **4** **fully resolved by that point in time, which perhaps it**

16:11:48 **5** **will be, but assuming that it hasn't and there are**

16:11:52 **6** **outstanding surplus notes from the current Plan as**

16:12:00 **7** **well as unpaid claims in the Segregated Account, then**

16:12:05 **8** **some revision to the Plan would be necessary as we**

16:12:09 **9** **report -- approach that June, 2020 date to allow**

16:12:14 **10** **continuation or reissue of notes beyond 2020 and**

16:12:22 **11** **payment of claims beyond that point.**

16:12:25 **12** **Q. And that would occur pursuant to the Rehabilitation**

16:12:29 **13** **proceeding or court supervision?**

16:12:31 **14** **A. It would. We would be back in front of this or some**

16:12:34 **15** **other court in 2020. Perhaps -- perhaps I won't be**

16:12:39 **16** **here nor Judge Johnston. But the Office would be**

16:12:45 **17** **required to present those changes to the Court.**

16:12:51 **18** **Q. Okay. Mr. Peterson, certain policyholders have**

16:12:54 **19** **expressed concerns that despite all your best efforts**

16:12:57 **20** **on projections and modeling that everything might go**

16:13:03 **21** **bad in the future, that it's worse than you've, you**

16:13:06 **22** **know, provided for here and that the note would be**

16:13:12 **23** **fully drawn and the Reinsurance Agreement would no**

16:13:15 **24** **longer have assets to draw against and the General**

16:13:19 **25** **Account would get close to the \$100 million.**

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16:13:21 **1** What assurance can you give claimants about what

16:13:25 **2** OCI would do at that point?

16:13:29 **3** **A. Well, first off, I would say that we have developed**

16:13:36 **4** **what I believe is a prudent plan in selecting the 25**

16:13:42 **5** **percent cash level. But if it were the case that**

16:13:47 **6** **losses in either the Segregated or General Account**

16:13:56 **7** **developed adversely to the point where the Plan was**

16:14:02 **8** **endangered or the relative fairness of the Plan was**

16:14:05 **9** **endangered, the Office still has the regulatory tools**

16:14:11 **10** **available to take action to modify the Plan with the**

16:14:18 **11** **approval of the Court or perhaps seek a rehabilitation**

16:14:24 **12** **of the General Account or whatever is necessary to try**

16:14:28 **13** **to, in the long run, protect the interests and treat**

16:14:32 **14** **the policyholders fairly and equitably.**

16:14:35 **15** **Q. One of the provisions of the Plan is something called**

16:14:38 **16** **the Alternative Resolutions Provision. Are you**

16:14:42 **17** **familiar with that?**

16:14:43 **18** **A. I am.**

16:14:43 **19** **Q. Okay. What is the purpose of that provision?**

16:14:46 **20** **A. Um, we recognized early on that some policyholders may**

16:14:55 **21** **not want to hold the surplus notes to maturity or for**

16:15:00 **22** **any particular point in time, and we recognize that**

16:15:07 **23** **providing optionality to policyholders through other**

16:15:15 **24** **resolutions is a real benefit to some policyholders.**

16:15:21 **25** **And so we've, you know, we have built that into the**

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16:15:27 **1** **Plan so that we can consider alternative resolutions.**

16:15:32 **2** **Q. And is that something new, or has that kind of process**

16:15:35 **3** **been on going for some time?**

16:15:39 **4** **A. We've been dealing with policyholders that, you know,**

16:15:45 **5** **are facing Ambac and have wanted to create a**

16:15:54 **6** **commutation sort of consistently prior to the**

16:16:00 **7** **Rehabilitation and through this Rehabilitation.**

16:16:03 **8** **Q. And who has in those cases initiated those**

16:16:06 **9** **discussions?**

16:16:07 **10** **A. Ah, in virtually every case, it's the policyholder**

16:16:12 **11** **that's initiated those discussions.**

16:16:17 **12** **The only exception that I would -- that I could**

16:16:22 **13** **think of when I say "virtually all" is that kind of in**

16:16:27 **14** **the normal course of business, there was a need to**

16:16:31 **15** **restructure certain student loan deals that Ambac**

16:16:37 **16** **would have pursued in any case, whether in**

16:16:43 **17** **rehabilitation or not, where it's my understanding**

16:16:46 **18** **that Ambac may have made the initial contacts in those**

16:16:51 **19** **particular cases, but in others, it's been the**

16:16:55 **20** **policyholders.**

16:16:56 **21** **Q. Okay. And in those types of alternative resolutions,**

16:17:03 **22** **are they always commutations, or are there other types**

16:17:04 **23** **of resolutions and amendments? Give the Court a sense**

16:17:08 **24** **of the variety of changes that are made.**

16:17:10 **25** **A. Well, you know, the most significant resolutions to**

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16:17:14 **1** date have been commutations. But there have been just  
16:17:19 **2** some policy tear-ups. You know, there were -- in  
16:17:25 **3** order to refinance some deals, there's sometimes a  
16:17:33 **4** termination payment related to the deal structure.  
16:17:39 **5** Um, provisions of the Ambac policy sometimes  
16:17:46 **6** require a termination payment to Ambac for early  
16:17:51 **7** release from the policy because there's future  
16:17:53 **8** premiums that were expected under the policy. So  
16:17:57 **9** there's been tear-ups of policies, some release of or  
16:18:02 **10** some negotiated settlement on termination payments  
16:18:05 **11** and, you know, a variety of things that fall along  
16:18:11 **12** those general descriptions.  
16:18:13 **13** Q. Would the J.P. Morgan agreement that was brought to  
16:18:16 **14** this court be one of the examples of that?  
16:18:18 **15** A. Yes. That would be kind of a different aspect there.  
16:18:21 **16** But in that case, J.P. Morgan waived some future  
16:18:30 **17** claim, contractual claim to rights that it had in  
16:18:36 **18** order to, um, modify its policy and move into the  
16:18:42 **19** General Account, if my memory serves.  
16:18:45 **20** Q. And did that require any payment to J.P. Morgan to  
16:18:49 **21** secure that?  
16:18:50 **22** A. It did not.  
16:18:50 **23** Q. And did it essentially shield the Segregated Account  
16:18:52 **24** from claims from J.P. Morgan?  
16:18:54 **25** A. It did.

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16:18:55 **1** Q. One of the requirements of the Plan to become  
16:19:03 **2** effective was obtaining the SEC No-Action Letter. Do  
16:19:06 **3** you remember that?  
16:19:08 **4** A. In general, yes.  
16:19:09 **5** Q. Okay. And what is -- why did the Rehabilitator wish  
16:19:14 **6** to obtain that type of exemption? What value did it  
16:19:20 **7** add or protection?  
16:19:21 **8** A. Well, again, you know, as part of our goal of creating  
16:19:25 **9** as much value as possible for the policyholders, we  
16:19:28 **10** recognize that if the surplus notes were tradeable,  
16:19:32 **11** ah, they were provided more effective value for the  
16:19:36 **12** policyholders. They could choose to dispose of those  
16:19:42 **13** -- those notes, you know, given market conditions when  
16:19:46 **14** they -- when they wanted to. And so we've taken some  
16:19:53 **15** significant pains to try to set up a process where  
16:19:57 **16** those -- where the surplus notes would be -- would be  
16:20:03 **17** tradeable. And the No-Action Letter relates to that  
16:20:07 **18** objective.  
16:20:08 **19** Q. One of the other documents attached through the  
16:20:15 **20** Disclosure Statement is a Fiscal Agency Agreement with  
16:20:17 **21** Bank of New York Mellon?  
16:20:18 **22** A. Uh-huh (affirmative).  
16:20:19 **23** Q. And why was that necessary?  
16:20:22 **24** A. Well, it involves technical aspects about how  
16:20:30 **25** securities are placed into the market. But Bank of

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16:20:36 **1** New York Mellon, you know, through that Physical  
16:20:40 **2** Agency Agreement has agreed to facilitate that  
16:20:46 **3** distribution of the notes.  
16:20:48 **4** Q. There's been some questions about once the Plan,  
16:21:01 **5** assuming it is confirmed, how rapidly OCI would start  
16:21:05 **6** to effectuate payments in cash and notes. What is  
16:21:10 **7** your expectation in that regard?  
16:21:11 **8** A. Um, there's some variability, some contingencies  
16:21:23 **9** involved with that. But as I understand it, kind of  
16:21:27 **10** the best-case scenario is that we would be in a  
16:21:31 **11** position to accept claims on the Segregated Account in  
16:21:36 **12** January next -- of 2011 and begin actual payments in  
16:21:43 **13** February.  
16:21:44 **14** Q. So the contemplation is not a lengthy delay following  
16:21:48 **15** confirmation?  
16:21:49 **16** A. It's not expected, no.  
16:21:51 **17** Q. Okay. Let's turn to a different subject, and that's  
16:21:56 **18** the Ambac Management Services relationship we have  
16:22:01 **19** under the Rehabilitation.  
16:22:03 **20** Give a sense of the, in your review of the  
16:22:09 **21** benefits to Segregated Account and OCI, of having that  
16:22:15 **22** Management Services relationship?  
16:22:16 **23** A. It's a tremendous benefit to the Segregated Account.  
16:22:25 **24** Um, the complexity of these -- of these deals is such  
16:22:31 **25** that it is essential, virtually essential to retain

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16:22:41 **1** qualified staff and particular staff that was involved  
16:22:45 **2** with these particular deals, has contacts and  
16:22:50 **3** relationships with the counterparties to these deals,  
16:22:56 **4** to have them in place so that we can effectively, um,  
16:23:02 **5** work on potential commutations, exercise control  
16:23:07 **6** rights under the contracts, to mitigate loss, to  
16:23:12 **7** manage the book of business, to assess the risk of the  
16:23:16 **8** business through the risk classification process and  
16:23:22 **9** so forth.  
16:23:23 **10** You know, to try to replicate that with a  
16:23:30 **11** substantially new group of persons would be a  
16:23:36 **12** significant setback to the administration of the  
16:23:41 **13** Segregated Account.  
16:23:41 **14** Q. And have you and Ms. Shawl spent time on a regular  
16:23:46 **15** basis in New York overseeing that process since the  
16:23:52 **16** Rehabilitation started?  
16:23:53 **17** A. We have. Virtually every week at least one of us has  
16:23:59 **18** been in New York working with the company, overseeing  
16:24:04 **19** the company's actions under the Management Services  
16:24:07 **20** Agreement.  
16:24:11 **21** Q. Are you receiving good cooperation and assistance from  
16:24:15 **22** the folks under the Management Services Agreement?  
16:24:19 **23** A. For the most part. The relationship has developed  
16:24:25 **24** over the months since the initial rehab.  
16:24:30 **25** I would have to say that initially there was a

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16:24:33 **1** degree of tension, particularly with the senior  
 16:24:38 **2** management of the company. But over time we have  
 16:24:41 **3** worked through some of those issues and, for the most  
 16:24:43 **4** part, the staff has been quite helpful, cooperative,  
 16:24:56 **5** throughout the process.  
 16:24:57 **6** Q. And are you satisfied that there are adequate checks  
 16:25:00 **7** and balances in place in terms of supervising  
 16:25:03 **8** decisions that the Management Services Provider would  
 16:25:08 **9** make to date and going forward?  
 16:25:11 **10** A. We've been -- Commissioner Shawl, or Deputy  
 16:25:17 **11** Commissioner Shawl and I have been involved in the  
 16:25:22 **12** day-to-day operations of the company since March 24th.  
 16:25:30 **13** There are processes in place where our review and  
 16:25:35 **14** acknowledgment of potential transactions are required  
 16:25:39 **15** as well as at somewhat higher thresholds actual  
 16:25:46 **16** approvals are required for transactions in both the  
 16:25:49 **17** General and Segregated Accounts.  
 16:25:52 **18** Q. And is it -- does the Plan provide for a continuation  
 16:25:55 **19** of those types of controls going forward under the  
 16:25:58 **20** Plan?  
 16:25:59 **21** A. It does. That kind of oversight is required under  
 16:26:08 **22** both the Cooperation Agreement primarily and as well  
 16:26:15 **23** as in general through the Management Services  
 16:26:17 **24** Agreement.  
 16:26:17 **25** Q. And have you and OCI had prior experience in other

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16:26:21 **1** proceedings regarding the priority handling of types  
 16:26:25 **2** of claims in these delinquency proceedings?  
 16:26:29 **3** A. I personally have acted as Rehabilitator or Liquidator  
 16:26:36 **4** of several companies. I'd have to think.  
 16:26:40 **5** Q. Has there been a consistent practice at OCI in these  
 16:26:44 **6** delinquency proceedings in terms of the prioritization  
 16:26:47 **7** of the different types of claims, policy claims,  
 16:26:51 **8** contract claims, reinsurance claims and the like?  
 16:26:55 **9** MR. DEVORE: Objection; relevance. Past  
 16:26:58 **10** practices don't affect what's legal under the statute.  
 16:26:58 **11** THE COURT: Could you read back the question?  
 16:27:14 **12** (Question read back.)  
 16:27:16 **13** THE COURT: Your response to the objection?  
 16:27:19 **14** MR. VAN SICKLEN: I think past practice is  
 16:27:21 **15** relevant in terms of showing OCI's consistent  
 16:27:24 **16** practices in terms of the discretion its decisions  
 16:27:28 **17** should be accorded.  
 16:27:29 **18** THE COURT: Agreed. Overrule the objection.  
 16:27:32 **19** You may answer the question.  
 16:27:34 **20** Do you remember it?  
 16:27:35 **21** A. OCI staff is quite cognizant of the priority scheme  
 16:27:42 **22** established in the law and I believe very respectful  
 16:27:46 **23** of that, and past practice has always been consistent  
 16:27:51 **24** with that.  
 16:27:52 **25** Q. And is this Plan in regard to the prioritization of

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16:27:56 **1** types of claims consistent with that uniform past  
 16:27:58 **2** practice?  
 16:27:58 **3** A. I believe it is.  
 16:28:05 **4** MR. VAN SICKLEN: Your Honor, I still have a  
 16:28:07 **5** ways to go probably. I wonder if I should get to a  
 16:28:10 **6** certain target to close Mr. Peterson? I won't finish,  
 16:28:15 **7** I don't think.  
 16:28:16 **8** THE COURT: Ah, we were looking at about -- we  
 16:28:20 **9** did five o'clock yesterday. Is that workable for  
 16:28:23 **10** everybody? Why don't you keep going then.  
 16:28:27 **11** Mr. Peterson, do you have any problem with that?  
 16:28:29 **12** MR. PETERSON: No. That's fine, your Honor.  
 16:28:30 **13** Thank you.  
 16:28:30 **14** MR. VAN SICKLEN: And I'll do my best to try to  
 16:28:33 **15** meet the deadline.  
 16:28:34 **16** THE COURT: If you don't, we'll stop at 5:00.  
 16:28:37 **17** MR. PETERSON: Perhaps a little water would be  
 16:28:39 **18** advisable.  
 16:28:49 **19** BY MR. VAN SICKLEN:  
 16:28:49 **20** Q. Mr. Peterson, are you familiar with a --  
 16:28:54 **21** A. Thank you very much.  
 16:28:55 **22** Q. I'm sorry -- an insurer in Illinois named Triad?  
 16:28:59 **23** A. I am.  
 16:28:59 **24** Q. And how has the Illinois Department handled that  
 16:29:09 **25** company's financial challenges?

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16:29:12 **1** A. Well, Triad is a mortgage guaranty insurer domiciled  
 16:29:18 **2** in Illinois that became troubled early on in this  
 16:29:22 **3** mortgage crisis and was less well capitalized than its  
 16:29:30 **4** other counterparties in the industry. The Illinois  
 16:29:35 **5** regulators recognized its potential capital  
 16:29:45 **6** deficiencies, and there was communication with other  
 16:29:49 **7** regulators on that subject. And the Department took  
 16:29:55 **8** action to slow claim payments of Triad through a cash  
 16:30:03 **9** note split, you know, that is similar to what's  
 16:30:09 **10** proposed here.  
 16:30:10 **11** Q. And did the Illinois Department do that through a  
 16:30:13 **12** public proceeding?  
 16:30:15 **13** A. No. It was done through an order of the Commissioner  
 16:30:18 **14** in Illinois.  
 16:30:19 **15** Q. And to the best of your knowledge, was that order  
 16:30:22 **16** posted or made public or any of the reasoning behind  
 16:30:26 **17** it to members of the public?  
 16:30:29 **18** A. Well, not prior to its issuance, to the best of my  
 16:30:33 **19** knowledge.  
 16:30:33 **20** Q. And was, to the best of your knowledge, the type of  
 16:30:37 **21** disclosures that are being made here in regard to the  
 16:30:41 **22** Ambac Plan made to policyholders in the Triad  
 16:30:44 **23** situation?  
 16:30:44 **24** A. To my knowledge, there was no similar disclosures made  
 16:30:50 **25** public.

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16:30:50 **1** Q. You indicated at the start when I was going through  
16:30:57 **2** your background about some of the communications you  
16:30:59 **3** have with other regulators. I'd like to just touch on  
16:31:05 **4** that again.  
16:31:07 **5** **A. Certainly.**  
16:31:07 **6** Q. How often do you have these other contacts with  
16:31:11 **7** regulators?  
16:31:12 **8** **A. Well, as chair of the Financial Analysis Working**  
16:31:20 **9** **Group, we have -- the working group consists of 16**  
16:31:28 **10** **member states that work with staff at the National**  
16:31:36 **11** **Association of Insurance Commissioners, at the NAIC,**  
16:31:40 **12** **to analyze potential troubled insurers across the**  
16:31:45 **13** **nation. And we regularly meet to evaluate those**  
16:31:56 **14** **potentially troubled companies, receive information**  
16:32:00 **15** **from the NAIC staff. This working group is really**  
16:32:05 **16** **made up of the some of the most qualified regulator --**  
16:32:11 **17** **financial regulators in the industry. And we, through**  
16:32:19 **18** **this process, identify those potentially troubled**  
16:32:24 **19** **companies and communicate with the domestic regulators**  
16:32:29 **20** **of those companies as to what we see as potential**  
16:32:32 **21** **risks for that company, ask those regulators what they**  
16:32:40 **22** **might be doing to control those risks, to deal with,**  
16:32:50 **23** **you know, restrict the company's business, whatever,**  
16:32:53 **24** **what kind of -- what kind of workout plans may be**  
16:32:57 **25** **underway, to suggest things like that in some cases.**

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16:33:02 **1** **So, you know, there's -- there's formal or there's**  
16:33:08 **2** **scheduled communications on that at each NAIC meeting.**  
16:33:16 **3** **Those were typically conducted quarterly. But**  
16:33:22 **4** **recently, NAIC has gone to three meetings a year**  
16:33:26 **5** **rather than four.**  
16:33:27 **6** **But in addition to that, we, the working group,**  
16:33:32 **7** **has an annual meeting. It has regular calls that**  
16:33:37 **8** **follow up on each of the quarterly reviews that we**  
16:33:41 **9** **conduct.**  
16:33:43 **10** **In addition to that surveillance process and that**  
16:33:48 **11** **peer-review process that's conducted by the working**  
16:33:51 **12** **group, we are often called on to look at specialized**  
16:33:59 **13** **specific problems in the insurance industry. I can't**  
16:34:03 **14** **discuss the nature of those. Those are often highly**  
16:34:09 **15** **confidential. But, you know, we look at specific**  
16:34:12 **16** **problems the industry is facing and communicate with**  
16:34:18 **17** **other, you know, other state regulators on those**  
16:34:22 **18** **issues. And as chair of that working group, I often**  
16:34:26 **19** **communicate with federal regulators and occasionally**  
16:34:30 **20** **international regulators with regard to insurance**  
16:34:36 **21** **industry risks.**  
16:34:37 **22** Q. Okay. And Ambac had, in particular, some British  
16:34:43 **23** exposures and the like. Did you have occasion to talk  
16:34:46 **24** with the UK regulator in regard to Ambac?  
16:34:50 **25** MR. GREENWALD: Objection, your Honor. I think

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16:34:53 **1** that was a compound question.  
16:34:54 **2** The confusion here, I think, is in the question.  
16:34:59 **3** I'm not sure if he's speaking to being the UK  
16:35:02 **4** regulator regarding Ambac or through FAWG --  
16:35:04 **5** THE COURT: Can you grab your mic and pull it  
16:35:06 **6** up?  
16:35:06 **7** MR. GREENWALD: I'm sorry, your Honor.  
16:35:07 **8** My objection is that it's a compound question.  
16:35:09 **9** Based on the question, I don't know if the question  
16:35:11 **10** asks for contact with the UK regulator, the FSA with  
16:35:14 **11** regard to Ambac, or with regard to matters generally  
16:35:18 **12** through his position in FAWG.  
16:35:20 **13** THE COURT: Read the question back, please.  
16:35:20 **14** (Question read back.)  
16:35:34 **15** MR. GREENWALD: I withdraw my question. It was  
16:35:37 **16** clear. It's getting late. I apologize.  
16:35:39 **17** **A. Yes. Ambac has an affiliate, Ambac UK, that wrote**  
16:35:49 **18** **financial guarantee policies in the European market,**  
16:35:53 **19** **and those policies were heavily reinsured by Ambac**  
16:35:59 **20** **Assurance, the New York company, or our company.**  
16:36:03 **21** **And as Ambac Assurance became financially**  
16:36:10 **22** **troubled, the FSA was concerned about Ambac**  
16:36:16 **23** **Assurance's ability to perform on that reinsurance**  
16:36:20 **24** **that supported the Ambac UK entity. So there were**  
16:36:26 **25** **communications with the British regulators, the FSA,**

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16:36:32 **1** **at several points in time to discuss our evaluation of**  
16:36:39 **2** **Ambac's financial position and ultimately to discuss**  
16:36:45 **3** **arrangements for the commutation of that reinsurance**  
16:36:48 **4** **arrangement between Ambac UK and AAC.**  
16:36:55 **5** Q. And in regard to the state -- the contacts you had  
16:36:58 **6** with your fellow state regulators, did you also have  
16:37:00 **7** occasion to discuss the Ambac challenges with them?  
16:37:04 **8** **A. I have reported to the Financial Analysis Working**  
16:37:10 **9** **Group, and at every meeting that we've had since this**  
16:37:18 **10** **situation broke. Those meetings are not restricted**  
16:37:25 **11** **only to the -- as I said, at each of the NAIC's**  
16:37:31 **12** **regular meetings, we have a meeting of the FAWG group,**  
16:37:42 **13** **and other state regulators beyond the membership of**  
16:37:45 **14** **the Working Group itself are invited and regularly**  
16:37:48 **15** **attend those Working Group meetings, and I've**  
16:37:52 **16** **regularly reported on the situation with Ambac at**  
16:37:57 **17** **those meetings.**  
16:37:58 **18** Q. And were those communications useful to you in helping  
16:38:01 **19** to inform OCI's discretion about the steps to take  
16:38:06 **20** and --  
16:38:06 **21** **A. Ah, yes, very much so, particularly as we were leading**  
16:38:12 **22** **up to and implemented the -- or the Segregated Account**  
16:38:18 **23** **was created and put into rehabilitation. I know some**  
16:38:28 **24** **of my fellow regulators had questions about the**  
16:38:30 **25** **structure, and I was able to, ah, convey information**

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16:38:35 **1** about what we were expecting to do.

16:38:37 **2** Q. Okay. There was some questioning of the Commissioner

16:38:42 **3** about another model line MBIA. Do you recall that?

16:38:46 **4** A. I do.

16:38:46 **5** Q. How is the restructuring there similar or dissimilar

16:38:51 **6** to what's being pursued here?

16:38:53 **7** A. Well, in our -- this case, the assets, the

16:39:02 **8** claims-paying resources of Ambac Assurance, are all

16:39:07 **9** being retained for the benefit of the Segregated

16:39:19 **10** Account policyholders, and there's no leakage outside

16:39:27 **11** of that. There are certain limitations with regard to

16:39:30 **12** the surplus position of the General Account, but there

16:39:34 **13** are -- it's significantly different than the MBIA

16:39:38 **14** transaction in that in MBIA's case, there was an, I

16:39:44 **15** believe, 500 or \$5 billion dividend paid to the

16:39:54 **16** holding company, which then was contributed to another

16:39:57 **17** affiliate, and the municipal insurance block of

16:40:02 **18** business was transferred to that -- to that affiliate,

16:40:08 **19** such that the interrelationship between or the support

16:40:14 **20** between the municipal business and that \$5 billion in

16:40:21 **21** assets that was available to support that and the

16:40:25 **22** other books of business that are considered to be

16:40:30 **23** substantially more risky was really completely

16:40:33 **24** severed, where in our case that is not the case.

16:40:38 **25** There's continuing availability of resources to

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16:40:43 **1** support claims in the Segregated Account.

16:40:47 **2** Q. Okay. Since you brought up the point about dividends

16:40:52 **3** and MBIA, let's turn to the dividend question here.

16:40:56 **4** Has OCI permitted dividends to go up to AFG

16:41:00 **5** holding company in recent months?

16:41:03 **6** A. In recent months, no.

16:41:04 **7** Q. Is there any present expectation that dividends will

16:41:09 **8** be permitted to go up to the holding company?

16:41:11 **9** A. Absolutely no expectation of dividends in the near

16:41:16 **10** term.

16:41:16 **11** Q. And why is that? And what is the relationship between

16:41:19 **12** that decision about allowing dividends and the Plan?

16:41:22 **13** A. Um, in line with Commissioner Dilweg's testimony, we

16:41:29 **14** wouldn't believe dividends are appropriate until, you

16:41:35 **15** know, the notes are, ah, are paid with some

16:41:44 **16** possibility that it could be structured in a way that

16:41:48 **17** creates additional value for policyholders of the

16:41:53 **18** insurers, you know, as opposed to just dividends that

16:41:58 **19** go out to stockholders, bondholders of the holding

16:42:03 **20** company.

16:42:03 **21** Q. There was a question about the fact that as part of

16:42:07 **22** the bank settlement, there was some kind of statement

16:42:12 **23** in there about that AAC could make dividends up to \$52

16:42:21 **24** million in any given year. Do you recall that?

16:42:23 **25** A. I do.

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16:42:23 **1** Q. And explain the background of that and what it really

16:42:30 **2** -- what it's providing.

16:42:32 **3** A. Well, I think the bank group recognized that there may

16:42:35 **4** be some advantage to allowing dividends to the holding

16:42:40 **5** company that would help avoid a change of control at

16:42:47 **6** the holding company which then could have resulted in

16:42:50 **7** the loss of its tax advantage through the net

16:42:54 **8** operating losses. And so while that authority or

16:43:02 **9** contractual provision in the bank settlement allowed

16:43:08 **10** dividends of up to \$52 million a year to go up to the

16:43:12 **11** holding company, OCI was never compelled to approve

16:43:17 **12** that, and our judgment as to the appropriateness of

16:43:22 **13** any dividends remains in place.

16:43:26 **14** Q. Was that \$52 million number a cap or an authorization?

16:43:31 **15** A. It was a cap of the amounts that -- to be compliant

16:43:36 **16** with the bank settlement, AAC was bound to stay within

16:43:42 **17** that \$52 million a year. But it certainly didn't

16:43:47 **18** provide any authorization from OCI to make a dividend

16:43:51 **19** payment.

16:43:52 **20** Q. And can AAC make dividend payments without OCI's

16:43:57 **21** approval?

16:43:57 **22** A. Currently they are, because of the losses experienced

16:44:03 **23** in the company, any dividend payment would be

16:44:07 **24** considered an extraordinary dividend under the law and

16:44:11 **25** would require our written approval.

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16:44:14 **1** Q. And since this \$52 million cap was put in place

16:44:18 **2** through the bank settlement, has any -- have any

16:44:22 **3** amount of dividends been paid?

16:44:23 **4** A. None since the bank deal was put in place.

16:44:27 **5** Q. Okay. Could you turn to -- I guess I can get the

16:44:38 **6** binder -- Exhibit 38B, the one that was just moved in.

16:45:23 **7** THE COURT: 28B?

16:45:24 **8** MR. VAN SICKLEN: I think you may have pulled

16:45:29 **9** that one out.

16:45:32 **10** MR. PETERSON: I have it, courtesy of your Honor

16:45:38 **11** and the clerk.

16:45:40 **12** THE COURT: Back on the record then if we

16:45:42 **13** weren't already. I guess we were.

16:45:45 **14** BY MR. VAN SICKLEN:

16:45:45 **15** Q. Mr. Peterson, you now have what was marked earlier

16:45:49 **16** this afternoon as Exhibit 38B in front of you.

16:45:53 **17** A. Uh-huh (affirmative).

16:45:53 **18** Q. It's a letter from the Commissioner with an attached

16:45:56 **19** nonbinding term sheet?

16:45:58 **20** A. Yes.

16:45:59 **21** Q. I have some questions on several of the terms in the

16:46:05 **22** nonbinding term sheet.

16:46:07 **23** There were some questions yesterday of the

16:46:12 **24** Commissioner about Number 1, that AFG would retain

16:46:14 **25** ownership of AAC. Do you see that?

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16:46:17 **1 A. Uh-huh (affirmative).**  
 16:46:17 **2 Q.** What is your understanding of what, if any, rights OCI  
 16:46:24 **3** would have to alter that?  
 16:46:25 **4 A. I can't imagine, ah, what rights OCI would have to**  
 16:46:32 **5 effect the sale or transfer the ownership of AAC. We**  
 16:46:40 **6 can't sell the company to anybody.**  
 16:46:43 **7 Q.** And this discussion a little further down about the  
 16:46:52 **8** net operating losses, are you familiar with that issue  
 16:46:57 **9** generally?  
 16:46:57 **10 A. Generally, yes.**  
 16:46:58 **11 Q.** What -- give the Court a sense of what OCI was trying  
 16:47:01 **12** to accomplish here in regard to the Net Operating  
 16:47:07 **13** Losses?  
 16:47:07 **14 A. All right. Well, you know, the Net Operating Losses**  
 16:47:11 **15 represent a significant tax advantage that AAC and the**  
 16:47:19 **16 Segregated Account have going forward. But they are**  
 16:47:26 **17 by no means locked in stone. The maintenance or the**  
 16:47:32 **18 availability of those Net Operating Losses are subject**  
 16:47:37 **19 to a number of contingencies. I referenced before the**  
 16:47:43 **20 fact that a change of control in the holding company**  
 16:47:46 **21 can disallow the Net Operating Losses going forward.**  
 16:47:52 **22 The holding company can take actions to, ah, take**  
 16:47:59 **23 what I understand is a worthless stock deduction in**  
 16:48:04 **24 its tax filings that would illuminate the benefit of**  
 16:48:11 **25 the Net Operating Losses, so that there are, um,**

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16:48:16 **1 factors that are outside of the insurance company's**  
 16:48:21 **2 for OCI's control that might reduce or eliminate the**  
 16:48:27 **3 value of the NOLs that have accumulated to date.**  
 16:48:36 **4 Q.** And then on the second page of the term sheet under  
 16:48:39 **5** paragraph 7A --  
 16:48:43 **6 A. Uh-huh (affirmative).**  
 16:48:43 **7 Q.** -- what -- explain whether the effort by OCI here is  
 16:48:50 **8** to avoid destruction or loss of the NOL or to transfer  
 16:48:55 **9** it somehow?  
 16:48:56 **10 A. Well, the goal is to maintain those NOLs for the value**  
 16:49:09 **11 of the General and Segregated Accounts, to the extent**  
 16:49:14 **12 possible. Given the contingencies that are -- or at**  
 16:49:21 **13 at least some of which are in control of the holding**  
 16:49:24 **14 company, there was a need to try to structure an**  
 16:49:29 **15 agreement that would protect those NOLs for the**  
 16:49:37 **16 benefit of the insurance companies.**  
 16:49:39 **17 The offer, you know, to exchange up to 3.5 or I**  
 16:49:52 **18 think the converse 3.8 million of NOLs had to do with**  
 16:50:00 **19 the fact that also the insurance company's ability to**  
 16:50:06 **20 utilize those NOLs is limited. It only -- the Net**  
 16:50:12 **21 Operating Losses only have value to the extent that**  
 16:50:15 **22 you have future income, and that future income isn't**  
 16:50:21 **23 boundless.**  
 16:50:23 **24 So the ability to utilize future NOLs was -- is**  
 16:50:29 **25 limited within the insurance companies such that, you**

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16:50:36 **1 know, giving or negotiating to exchange a portion of**  
 16:50:40 **2 those NOLs for greater certainty in the utilization of**  
 16:50:46 **3 the ones that are retained is something that we are**  
 16:50:52 **4 looking into.**  
 16:50:53 **5 THE COURT:** Is there an IRS limit on the NOL?  
 16:51:00 **6** In other words, can you carry it forward five years or  
 16:51:05 **7** something like that?  
 16:51:05 **8 MR. PETERSON:** There are limitations. I'm not a  
 16:51:10 **9** tax expert. From my education years ago, I believe  
 16:51:16 **10** the loss carried forward limitation was 15 years. But  
 16:51:20 **11** that may have changed in the 20-some years it's been  
 16:51:24 **12** since I took tax class in college. Or 30 years, to be  
 16:51:32 **13** accurate.  
 16:51:32 **14 BY MR. VAN SICKLEN:**  
 16:51:34 **15 Q.** Mr. Peterson, under the scenarios and projections that  
 16:51:37 **16** underlie the Plan, is there any expectation of these  
 16:51:37 **17** in carrying out the Plan on the.  
 16:51:37 **18 THE COURT REPORTER:** I'm sorry. Expectation of  
 16:51:37 **19** what?  
 16:51:37 **20 MR. VAN SICKLEN:** You can strike that. I think  
 16:51:50 **21** we're all getting tired here. I will try to at least  
 16:51:51 **22** finish the subject.  
 16:51:53 **23 Q.** Does the Plan contemplate or depend on using any  
 16:51:58 **24** amount of NOLs going forward?  
 16:52:00 **25 A. The scenarios that we have modeled do not include any**

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16:52:09 **1 amount of NOLs at the inception of the Plan. There**  
 16:52:13 **2 are certain loss expectations in the first few years**  
 16:52:17 **3 of this Plan that will generate some NOLs that are**  
 16:52:20 **4 incorporated into the model. But the NOLs that exist**  
 16:52:27 **5 at the beginning of the Plan are not incorporated in**  
 16:52:31 **6 our analysis and are not part of the viability of the**  
 16:52:39 **7 Plan.**  
 16:52:39 **8 Q.** And under the modeling going forward, is the rate of  
 16:52:45 **9** accumulating or future NOLs, is that gonna occur at a  
 16:52:51 **10** pace more rapid than the actual need to use them?  
 16:52:54 **11 A. Well, um, it varies by scenario. In the most**  
 16:53:01 **12 favorable scenarios, we might not generate enough NOLs**  
 16:53:10 **13 to offset taxable gains from things like the Reps and**  
 16:53:24 **14 Warranty litigation and so forth.**  
 16:53:27 **15 Q.** There's a reference in the term sheet at paragraph 3.8  
 16:53:32 **16** about "carve out for future discussion or even suit of  
 16:53:40 **17** \$38 million." Do you see that?  
 16:53:42 **18 A. Um --**  
 16:53:43 **19 Q.** Or do you recall what that's about?  
 16:53:46 **20 A. Well, yes. I recall in general.**  
 16:53:47 **21 Q.** Why don't you explain that to the Court?  
 16:53:49 **22 A. There's -- tax recoveries that have occurred over the**  
 16:53:57 **23 last couple years have been allocated to the**  
 16:54:01 **24 affiliates within the group. According to the tax**  
 16:54:04 **25 allocation representatives of the holding company,**

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16:54:13 **1** bondholders believe that there has been some error in  
 16:54:19 **2** the allocation of those tax refunds to the tune of \$38  
 16:54:23 **3** million that came to AAC rather than being retained at  
 16:54:32 **4** the holding company or in entities where the holding  
 16:54:37 **5** company would have been -- would have had access to  
 16:54:40 **6** the money.  
 16:54:40 **7** Q. And throughout this whole discussion of the nonbinding  
 16:54:44 **8** term sheet, was there -- what was the goal and effort  
 16:54:49 **9** of OCI?  
 16:54:50 **10** A. Well, ah, it again is consistent with our kind of base  
 16:54:58 **11** goal of reducing the potential for loss to the  
 16:55:05 **12** insurance companies and, you know, providing as much  
 16:55:12 **13** value to the policyholders as possible.  
 16:55:14 **14** Q. Was there any effort or intention to somehow cede  
 16:55:19 **15** assets or value belonging to the General Account or  
 16:55:21 **16** the Segregated Account up to the parent company  
 16:55:24 **17** through this process?  
 16:55:25 **18** A. Absolutely not.  
 16:55:27 **19** MR. VAN SICKLEN: Your Honor, I'm very close to  
 16:55:28 **20** I think being done. But if we could maybe break, I'd  
 16:55:32 **21** probably have just a couple minutes to get organized.  
 16:55:35 **22** THE COURT: Well, why don't we take -- it's  
 16:55:37 **23** almost five o'clock. Let's take a recess for the  
 16:55:39 **24** evening, and then we can continue at this point  
 16:55:41 **25** tomorrow.

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STATE OF WISCONSIN )  
 ) SS  
 COUNTY OF DANE )

We, LINDA M. FLAKNE and ANN ALBERT,  
 Official Court Reporters for Dane County Circuit  
 Court, do hereby certify that we took in shorthand the  
 above-entitled proceedings held on the 16th day of  
 November, 2010; we reduced the same to a written  
 transcript and that it is a true and correct  
 transcript of our notes and the whole thereof.

Dated this 16th of November, 2010.

LINDA M. FLAKNE, RMR  
 Official Court Reporter

ANN ALBERT, RMR, CRR  
 Official Court Reporter

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 the certifying reporters.

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16:55:42 **1** MR. VAN SICKLEN: I don't think I'll take much  
 16:55:44 **2** further, but it would be more organize if I spend a  
 16:55:47 **3** minute to go through my notes.  
 16:55:48 **4** THE COURT: All right. We'll be in recess then.  
 16:55:50 **5** You can leave your items here, and the place will be  
 16:55:52 **6** locked.  
 16:55:52 **7** You can step down.

(Proceedings adjourned at 5:00 p.m.)

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