

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
 6 ASSURANCE CORPORATION
 7
 8 Case No. 10-CV-1576
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 12 PRESIDING: HONORABLE WILLIAM D. JOHNSTON
 13
 14 PROCEEDINGS: Confirmation Hearing
 15
 16 DATE: November 17, 2010
 17
 18
 19 **A P P E A R A N C E S**
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 21 **MICHAEL B. VAN SICKLEN and MATTHEW R. LYNCH**, Attorneys at Law, FOLEY & LARDNER LLP, Madison, Wisconsin, appearing on behalf of Petitioner Sean Dilweg, Commissioner of Insurance of the State of Wisconsin, and the Department of Insurance of the State of Wisconsin.
 22
 23 **DANIEL W. STOLPER**, Attorney at Law, STAFFORD ROSENBAUM LLP, Madison, Wisconsin, and **HENRY J. RICARDO, RICHARD REINTHALER, PETER IVANICK, WILLIAM PRIMPS, and EMILY SAFFITZ**, Attorneys at Law, DEWEY & LeBOEUF LLP, New York, New York, appearing on behalf of Ambac Assurance Corporation.
 24
 25 **DAVID M. GREENWALD, PATRICK TROSTLE and ANDREW OLEJNIK**, Attorneys at Law, JENNER & BLOCK LLP, Chicago, Illinois, and **BRYAN NOWICKI**, Attorney at Law, REINHART BOERNER VAN DEUREN SC, Madison, Wisconsin, appearing on behalf of RMBS Policyholders.

1 **A P P E A R A N C E S (cont'd)**
 2
 3 **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, appearing on behalf of Depfa Bank plc.
 4
 5 **CHRISTOPHER J. STROEBEL**, Attorney at Law, VON BRIESEN & ROFER SC, Madison, Wisconsin, and **CRAIG S. BLOOMGARDEN**, Attorney at Law, MANATT PHELPS & PHILLIPS, Los Angeles, California, appearing on behalf of Federal Home Loan Mortgage Corporation.
 6
 7 **ANNE M. BENSKY**, Attorney at Law, GARVEY McNEIL & ASSOCIATES SC, Madison, Wisconsin, and **ANDREW DEVORE**, Attorney at Law, ROPES & GRAY, Boston, Massachusetts, appearing on behalf of One State Street.
 8
 9 **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, appearing on behalf of Wells Fargo Bank as Trustee for the LVM Bondholders.
 10
 11 **THOMAS PYPER**, Attorney at Law, WHYTE HIRSCHBOECK & DUDEK, Madison, Wisconsin, appearing on behalf of Countrywide Home Loans, Inc.
 12
 13 **LAWRENCE BENSKY**, Attorney at Law, LAW OFFICE OF LAWRENCE BENSKY LLC, Madison, Wisconsin, appearing on behalf of ALL Student Loan Corporation and Lloyds TSB Bank plc.
 14
 15 **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, appearing on behalf of the LVM Bondholders.
 16
 17 **THOMAS ROSS HOOPER**, Attorney at Law, SEWARD & KISSEL LLP, New York, New York, appearing telephonically on behalf of Bank of New York Mellon as Trustee.
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1 **A P P E A R A N C E S (cont'd)**
 2
 3 **MICHAEL E. JOHNSON**, Attorney at Law, ALSTON & BIRD LLP, New York, New York, appearing on behalf of Wells Fargo and Bank of America as Trustee.
 4
 5 **PAUL LUCEY**, Attorney at Law, MICHAEL BEST & FRIEDRICH, Milwaukee, Wisconsin, appearing on behalf of U.S. Bank Trust and Deutsche Bank Trust.
 6
 7 **JAMES C. OWEN**, Attorney at Law, McCARTHY LEONARD & KAEMMERER, Chesterfield, Missouri, appearing on behalf of ALL Student Loan Corporation and Lloyds TSB Bank plc.
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1 **P R O C E E D I N G S**
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 3 (The following proceedings
 4 reported by Reporter Poirior.)
 5
 6 (On the record at 9:02 a.m.)
 7
 8 THE COURT: The Circuit Court for Dane
 9 County is in session in the matter 10 CV 1576. This
 10 is In the Matter of the Segregated Account of Ambac Assurance Corporation. And because we were able to
 11 get our mic working this morning, we'll take
 12 appearances, but those of you that are behind the
 13 railing, if you'd just step up -- It should be on and
 14 working, Rich, is it? You push it on the top.
 15
 16 COURT OFFICER: Yes.
 17
 18 THE COURT: Okay. So we can use it this
 19 morning because we know there was great
 20 disappointment amongst many of you that you didn't
 21 get to use the handheld mic yesterday. So you can --
 22 Rich, just go over by the middle and they can step
 23 up. We'll take the appearances of the attorneys in
 24 the well starting with OCI.
 25
 MR. VAN SICKLEN: Good morning, your Honor. Again, Mike Van Sicklen and Foley & Lardner on behalf of the Rehabilitator and the Office of the Commissioner of the Insurance. Also present is Roger Peterson, the witness that will continue this

1 morning.
2 MR. STOLPER: Good morning, your Honor,
3 Dan W. Stolper appearing for -- of Stafford Rosenbaum
4 appearing for Ambac Assurance Corporation, and with
5 me is Richard Reintaler, William Primps, Peter
6 Ivanick, Henry Ricardo, and Emily Saffitz of Dewey &
7 LeBoeuf. And on behalf of Ambac is Cathleen Matanle,
8 Managing Director, and David Barranco, Managing
9 Director.

10 THE COURT: Mr. Greenwald.

11 MR. GREENWALD: Your Honor, David
12 Greenwald, Jenner & Block, on behalf of the group
13 that we've been referring to as the RMBS
14 Policyholders.

15 MR. BENTLEY: Good morning, your Honor,
16 Philip Bentley of Kramer, Levin for the LVM
17 Bondholders. As before, I'm here with my colleague,
18 Matthew Temkin, and our co-counsel, Noreen Parrett of
19 the Parrett & O'Connell firm.

20 THE COURT: It might be appropriate,
21 Rich, if you just go down the well and give them the
22 mic and they can announce their appearance there.

23 MR. BLOOMGARDEN: Good morning, your
24 Honor. Craig Bloomgarden, Manatt Phelps & Phillips,
25 on behalf of Freddie Mac, the Federal Home Loan

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1 Mortgage Corporation.

2 MR. OWEN: Jim Owen on behalf of Lloyds
3 and ALL student loan.

4 MR. WHITMER: Good morning, your Honor,
5 Steven Whitmer on behalf of Wells Fargo as trustee
6 for the LVM Bondholders here from Locke, Lord,
7 Bissell & Liddell, and I'm here with my colleague,
8 Kevin Wisniewski, also from Locke Lord, and our
9 co-counsel, Steve Morgan, from Murphy Desmond.

10 MR. DEVORE: Good morning, your Honor.
11 Andrew Devore of Ropes & Gray, and with me is Anne
12 Bensky of Garvey, McNeil & Associates, on behalf of
13 One State Street, LLC.

14 MR. WELSH: Good morning, your Honor.
15 Tom Welsh, Orrick, Herrington & Sutcliffe, and with
16 me is my co-counsel, Gregory Lyons of the O'Neil
17 Cannon firm, and we're representing Depfa.

18 MR. LUCEY: Your Honor, Paul Lucey of
19 Michael Best & Friedrich, representing Deutsche Bank
20 National Trust, Deutsche Bank Trust Company of
21 Americas, and U.S. Bank National Association, all in
22 their capacity as trustee of certain securitization
23 trusts.

24 MR. JOHNSON: Good morning, your Honor.
25 Michael Johnson from Alston & Bird. I am here today

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1 on behalf of Bank of America NA, wells Fargo Bank NA,
2 Wilmington Trust Company, Wilmington Trust FSB, all
3 in their capacities as trustee and in similar roles
4 for certain securitization trusts.

5 MR. PIEPER: Good morning, your Honor.
6 Tom Pieper, Whyte, Hirschboeck, Dudek, representing
7 Countrywide entities, both of them. And just so
8 everybody doesn't ask me, no, Cindy did not have her
9 baby. I was just sent in as a substitute.

10 THE COURT: All right. Anyone else want
11 to make an appearance in case your home office --

12 MR. ROSS HOOPER: Good morning, your
13 Honor. Thomas Ross Hooper of Seward & Kissell LLP on
14 behalf of the Bank of New York Mellon as trustee,
15 indenture trustee, or collateral agent, directly or
16 through its affiliate, for the benefit of holders and
17 secured parties of certain mortgage-backed
18 securities, other asset-backed securities,
19 collateralized loan obligations, and collateralized
20 debt obligations.

21 THE COURT: You cut me off in mid joke,
22 so could you state your name, please?

23 MR. ROSS HOOPER: I apologize, your
24 Honor. Thomas Ross Hooper of Seward & Kissel LLP.

25 THE COURT: All right. Anyone else on

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1 the phone?

2 (No response.)

3 All right. I started to say that if you
4 wanted to note your appearance so that those at your
5 home office would know that you're here, this is your
6 chance. All right. There are no other takers.

7 All right. We are in the process of the
8 direct examination of Roger Peterson for OCI.

9 Mr. Peterson, if you'd come back over to
10 the witness chair, we'll have you take the oath as
11 witness again for today's proceedings. Please raise
12 your hand before being seated.

13 (Witness sworn.)

14 All right. Be seated and state your
15 name for the reporter, please.

16 THE WITNESS: Roger Peterson.

17 THE COURT: All right. Proceed.

18 **ROGER A. PETERSON,**

19 called as a witness by the Plaintiff,
20 having been first duly sworn,
21 testified as follows:

22 **CONTINUED DIRECT EXAMINATION:**

23 BY MR. VAN SICKLEN:

24 Q Good morning, Mr. Peterson.

25 A Good morning.

8

1 Q I'm going to revisit the subject of claims paying
2 resources that we discussed briefly tomorrow to try
3 to clarify something that I think I inadvertently
4 muddled, and that is was there a change in the claims
5 paying resources between March and June 30th?
6 A **There was.**
7 Q And what was that change?
8 A **Well, primarily it would have related to the payment
9 on the Bank Settlement.**
10 Q Okay. And in front of you is Exhibit 27, the
11 October 8 Disclosure Statement. Would you turn to
12 page 52, please?
13 A **All right.**
14 Q And we had discussed this briefly yesterday. In the
15 middle of the page under the heading Roman Numeral
16 8A, there's a description of the amount that was
17 available as of June 30th, do you see that, of
18 6.8 billion?
19 A **Ido.**
20 Q And roughly, what was the amount available in claims
21 paying resources at the commencement of this
22 proceeding in March?
23 A **Approximately 8.2 billion.**
24 Q Okay. And we had discussed briefly, down on the
25 bottom chart in the right-hand column, the weighted

9

1 averages?
2 A **Mm-hm.**
3 Q And does that have anything to do with the claims
4 paying resource totals you just discussed?
5 A **No. As I tried to testify to yesterday, that has to
6 do with the number of years in the expected life of
7 those securities --**
8 Q Okay.
9 A **-- rather than a dollar amount.**
10 Q And are the present claims paying resources of the
11 company adequate to fund the requirements of the
12 claim?
13 A **OCI has determined that that's the case.**
14 Q In the present case, who is the court-appointed
15 Special Deputy Rehabilitator?
16 A **Kimberly Shaul.**
17 Q Have you ever served in that same role as a
18 court-appointed Special Deputy Rehabilitator in other
19 Wisconsin rehabilitation cases?
20 A **I have.**
21 Q More than one?
22 A **Yes.**
23 Q And do any of those involve the rehabilitation of an
24 insurer with a Segregated Account involved?
25 A **In one case.**

10

1 Q And what case was that?
2 A **The case of Northwestern National Insurance Company
3 of Milwaukee, Wisconsin.**
4 Q Okay. And that's the case we discussed briefly
5 yesterday?
6 A **That's correct.**
7 Q And do those other rehabilitation cases where you
8 were the Special Deputy involve plans of
9 rehabilitation?
10 A **They do.**
11 Q And in any of those situations, did those plans
12 involve a liquidation opt-out?
13 A **No, they did not.**
14 Q And in any of those other occasions for
15 rehabilitation plan, did the court require a
16 liquidation analysis?
17 A **No, none was required.**
18 Q And are you aware of any Wisconsin case ever
19 involving a rehabilitation that contained a
20 liquidation opt-out?
21 MR. DEVORE: Objection, your Honor;
22 relevance.
23 THE COURT: Overruled. That's a major
24 issue that you folks have raised in your pleadings.
25 MR. DEVORE: Yes, your Honor. My only

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1 objection is that what happened in other cases is not
2 applicable to what the constitutional standard is in
3 this case.
4 THE COURT: Well, if that's your
5 objection, still, the fact that that has been a
6 procedure or practice that's been done, this witness
7 is familiar with that practice and procedure, he's
8 apparently the architect of the -- one of the
9 architects of the plan, and is employing those past
10 experiences and procedures. I think it's relevant.
11 MR. VAN SICKLEN: Could the reporter
12 read the question back?
13 (Last question read back by
14 reporter.)
15 A **I'm not aware of any such case.**
16 BY MR. VAN SICKLEN:
17 Q And similarly, are you aware of any Wisconsin
18 rehabilitation case ever that required a liquidation
19 analysis or liquidation comparison?
20 MR. GREENWALD: Objection, your Honor.
21 I think the word "required" either calls for a legal
22 conclusion or is vague.
23 MR. VAN SICKLEN: I'll rephrase it.
24 BY MR. VAN SICKLEN:
25 Q Are you aware of any rehabilitation case ever where

12

1 the court that was presiding over the rehabilitation
2 required a liquidation analysis?
3 A **I'm not.**
4 Q Are you aware of any other state besides Wisconsin
5 that has statutory provisions for procedures for
6 placing a Segregated Account into rehabilitation?
7 A **No, I'm not aware of any.**
8 Q Okay. Back in March of this year you indicated that
9 had OCI not commenced this proceeding on March 24th,
10 that there would have been a significant set of
11 payments due the next day, on March 25th. Do you
12 recall that?
13 A **That's right, yes.**
14 Q Okay. Roughly, how many deals would have been
15 involved in that next set of payments?
16 A **As I understand it, it was 63.**
17 Q Okay. As compared to the total number of policies in
18 the company at that time?
19 A **Yeah.**
20 Q So --
21 A **14,000 to 15,000 policies.**
22 Q Of which 62 or 63 had a claim due in March?
23 A **That's correct.**
24 Q And had OCI filed a liquidation on March 24th instead
25 of the present rehabilitation, how, in your opinion,

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1 would those claims, those 63 claims, have been
2 treated in terms of their classification or priority?
3 A **Well, those claims due on March 25th would have been**
4 **Class 3 claims under Wisconsin law.**
5 Q And even as to that small group of 63 claims, in your
6 opinion, would they have gotten better or worse
7 treatment had you elected to proceed -- or file a
8 liquidation on March 24th?
9 A **Overall, I believe they would have been in a worse**
10 **position.**
11 Q And why is that?
12 A **Well, for the most part, the remaining part of their**
13 **claim, if -- Most of these deals had substantial**
14 **additional dollars due on the deal. As the deal**
15 **matured and the claim developed, those would have**
16 **been excluded after the termination of the policy.**
17 **For those deals that may have been in the rather late**
18 **stages of the claim development where the relative**
19 **amount that they would have received -- or not**
20 **received, I should say, in subsequent to liquidation**
21 **would have been small, those also would have been**
22 **cases where we -- The company paid a hundred cents on**
23 **the dollar for a number of months prior to the**
24 **liquidation, and under the liquidation, the**
25 **liquidator could have easily pursued preference**

14

1 **claims and sought reimbursement of those monies paid**
2 **prior to March of this year.**
3 Q And as to all of the other 15,000 policyholders
4 besides those 63, would they, in your opinion, have
5 been better or worse off in a liquidation?
6 A **As we -- As I testified to yesterday, the structure**
7 **that we've put together here with the company's**
8 **cooperation is avoid substantial additional loss to**
9 **the company, hence, all policyholders, in my opinion,**
10 **are better off for this plan.**
11 Q Okay. And if this Court were to reverse its prior
12 rulings and suddenly declare that the Segregated
13 Account or the Segregated Account Rehabilitation
14 proceeding was improper and dismissed this case,
15 would the company still be financially hazardous?
16 A **Yes, it would.**
17 Q And would OCI at that point have to exercise other
18 regulatory options?
19 A **We would feel that obligation, yes.**
20 Q And in what option would you select at that point?
21 A **It would be my expectation that we'd pursue a full**
22 **rehabilitation of the company.**
23 Q And would there -- What would the timeline be in
24 terms of the claims paying moratorium and getting to
25 a plan as compared to where we presently are?

15

1 A **Well, pursuing a full rehabilitation would create**
2 **substantial uncertainty as to contractual triggers**
3 **and so forth that we've described. It would create**
4 **months, perhaps years, of delay in making any initial**
5 **claim payment, and I would presume that overall claim**
6 **payments would be less given that we would expect a**
7 **higher level of overall losses.**
8 Q And therefore, would the present Segregated Account
9 Policyholders receive better or worse treatment in
10 such an alternative future full rehabilitation, in
11 your opinion?
12 A **Again I believe they would be worse off in a full**
13 **rehabilitation.**
14 Q And there was a question yesterday as to whether the
15 Segregated Account has a certificate of authority.
16 Does it?
17 A **It certainly does.**
18 Q And when was that issued?
19 A **March 24, 2010.**
20 MR. VAN SICKLEN: Thank you. That's all
21 I have.
22 THE COURT: Mr. Stolper or Mr. Ricardo,
23 did you wish to question?
24 MR. STOLPER: No. We have nothing, your
25 Honor. Thank you.

16

1 THE COURT: All right. Mr. Greenwald.
2 MR. GREENWALD: Thank you, your Honor.
3 **CROSS-EXAMINATION:**
4 BY MR. GREENWALD:
5 Q Good morning, Mr. Peterson.
6 A **Good morning.**
7 Q For the record, I'm David Greenwald from Jenner &
8 Block.
9 Mr. Peterson, you testified yesterday
10 and, I guess, this morning as well that in 2009, the
11 CDS book presented a serious threat to the viability
12 of AAC?
13 A **Yes.**
14 Q And when we refer to the CDS group of exposures,
15 we're talking about Credit Default Swap insured
16 contracts held by 14 banks?
17 A **Well, the CDS book is somewhat broader than that, but**
18 **in terms of those that were settled as part of the**
19 **bank deal, it involved those 14 banks, yes.**
20 Q Okay. So when I refer to the CDS book, we're talking
21 about the whole CDS exposure to the company?
22 A **Yes.**
23 Q And then the Bank Settlement deal related to a
24 specific group of CDS insured contracts held by 14
25 banks?

17

1 A **That's correct.**
2 Q Okay. And I just want to make sure we talk to each
3 other and not cross purposes.
4 A **Yeah.**
5 Q All right.
6 A **In different context, it can be -- the terminology or**
7 **what exactly is meant can be confusing.**
8 Q If you don't understand a question that I ask, please
9 let me know and I'll make sure to clarify it, because
10 this is complicated stuff.
11 The 14 banks involved in the Bank
12 Settlement deal included 13 foreign banks and one
13 U.S. bank; is that correct?
14 A **That's correct.**
15 Q There's been testimony in the case from Commissioner
16 Dilweg that the potential mark-to-market losses posed
17 by the CDS Bank Group ranged from \$12 billion to
18 \$16 billion. Do you recall that?
19 A **I recall the testimony, yes.**
20 Q OCI and the other parties retained BlackRock to
21 review the CDS Bank Group's CDS exposures; is that
22 correct?
23 A **BlackRock was retained, I believe, jointly by Ambac**
24 **and the Bank Group to evaluate those exposures.**
25 Q Okay. And OCI approved of BlackRock's retention?

18

1 A **We didn't object to it anyway. I don't recall the**
2 **specific approval.**
3 Q Well, you recall that you testified through affidavit
4 in May in this proceeding? Do you recall that?
5 A **I submitted an affidavit, yes.**
6 Q All right. And that affidavit we refer to as
7 Peterson Affidavit No. 1, I believe; is that correct?
8 A **Yes. It's referred to that way, yes.**
9 Q All right. And it was OCI's view that BlackRock was
10 considered a respected third-party consultant in this
11 area?
12 A **That was our view, yes.**
13 Q And your understanding is that BlackRock was retained
14 in late 2009?
15 A **No. To the best of my recollection, knowledge, it**
16 **would have been somewhere early fall of 2009. Well,**
17 **perhaps that would have been negotiations to seek a**
18 **third-party evaluator took place during the summer**
19 **and the early fall. Exactly when the contract for**
20 **those services was signed may have been later in the**
21 **year.**
22 Q And BlackRock's work was completed by early 2010?
23 A **Yes, that sounds correct.**
24 Q Why don't I -- Just so that you have this in front of
25 you, why don't I put in front of you Exhibit No. 9,

19

1 which is Peterson Affidavit No. 1.
2 Mr. Peterson, can you identify what
3 Exhibit No. 9 is?
4 A **It is that first affidavit of Roger A. Peterson.**
5 Q All right. Very good. And if I could draw your
6 attention to paragraph 21 on page 11 of Exhibit 9?
7 A **Paragraph 21 you said?**
8 Q 21, yes, on page 11.
9 A **All right.**
10 Q The first sentence states that "BlackRock finished
11 its independent appraisal assignment in early 2010"?
12 A **Yes, it does.**
13 Q Is that correct? And that's your statement in the
14 affidavit?
15 A **That's correct.**
16 Q Okay. Now, BlackRock, in conducting its analysis,
17 analyzed a base case, a stress case, and a market
18 value for the CDS Bank Group exposure; is that
19 correct?
20 A **That's correct.**
21 Q And if we turn to page 13 of your affidavit, Exhibit
22 9, can you tell us what that chart reflects?
23 A **It reflects a listing of 18 different deals**
24 **identified simply by deal numbers, an estimate of**
25 **base stress and market value loss estimates, and then**

20

1 all discounted at 5.1 percent, and then also includes
2 an average of the basic stress cases and an average
3 of all three cases.
4 Q All right. And if we look at BlackRock's analysis of
5 the base case, they estimated the base case exposure
6 a little more than \$7.6, almost \$7.7 billion; is that
7 correct?
8 A That's correct.
9 Q And BlackRock estimated a stress case of
10 \$9.186 billion; is that correct?
11 A That's the number, yes, sir.
12 Q And the market value calculation by BlackRock was
13 \$12.863 billion?
14 A That's correct.
15 Q Is that correct?
16 A Yeah.
17 Q And the market value is equivalent to a
18 mark-to-market calculation?
19 A It is.
20 Q And you recall again that Commissioner Dilweg had
21 identified a range of mark-to-market exposure \$12 to
22 \$16 million, correct?
23 A I do.
24 Q Here BlackRock's estimated mark-to-market exposure
25 was 12.863 billion?

21

1 A Mm-hm.
2 Q Correct?
3 A That's correct.
4 Q And BlackRock's estimate of mark-to-market exposure
5 was at the lower end of the \$12 to \$16 billion range,
6 correct?
7 A Yes. I believe the numbers that Commissioner Dilweg
8 was referring to were really the estimate of market
9 value loss across the broader CDS book rather than
10 exclusive to those in the bank deal.
11 Q Well, did the CDS Bank Group have an estimate of
12 mark-to-market damages that was higher than
13 BlackRock's figure of 12.863 billion?
14 A Not to my recollection.
15 Q Now, these exposures that BlackRock was reviewing
16 with regard to the CDS Bank Group arose from credit
17 default swap contracts that AAC's noninsurer
18 subsidiary, ACP, entered into with these 14 banks; is
19 that correct?
20 A That is correct.
21 Q In general, and without identifying any individual
22 deal, what types of credit defaults would trigger the
23 requirement to make payments to the CDS banks under
24 those ACP contracts?
25 A Could you repeat the question, please?

22

1 Q Right. I'm trying to get at what the underlying
2 security is that, if it failed, would trigger a
3 payment obligation on the part of ACP on the credit
4 default swap? Were these baskets of CDOs? Were
5 they --
6 A Yeah. They were primarily CDOs, CDO-Squareds.
7 Q Okay. So there was an underlying security that was
8 marked as the item that was being swapped. In other
9 words, the whether or not --
10 A Yeah, the credit protection of --
11 THE COURT: Wait. Wait until it's done.
12 Q Well maybe -- Why don't I just ask you to do this
13 because you did very well explaining very complicated
14 transactions yesterday. Can you explain to the Court
15 what a credit default swap is and what the underlying
16 triggering event is that would require a payment by
17 ACP to the CDS counterparties?
18 A Well, credit default swap provides credit protection
19 on a particular financial instrument. If that
20 financial instrument fails to pay, creates a default,
21 then there's a payment due on the credit default
22 swap.
23 Q Now in those ACP contracts, is there any requirement
24 that the CDS counterparties actually hold the
25 security that was marked to the contract?

23

1 MR. VAN SICKLEN: Your Honor, I guess I
2 object to this line of questioning unless
3 Mr. Greenwald can explain how it relates to the Plan
4 confirmation. This particular issue was brought to
5 your Honor's attention, you made a decision, and
6 Mr. Greenwald has it on appeal.
7 I think what he's doing is trying to
8 somehow boost his record for his appeal challenge in
9 the Bank Group Settlement, and absent the showing of
10 relevance to the Plan confirmation proceeding, I
11 think it's improper.
12 THE COURT: Mr. Greenwald, how does that
13 relate to the Plan, which is our object here?
14 MR. GREENWALD: In two or three ways,
15 your Honor. First, I'd note that OCI asked a large
16 number of questions about the CDS exposure to
17 Mr. Peterson, and I'm exploring just the underlying
18 nature of it. And I will quickly beyond this. I
19 have two or three more questions before I get into
20 other matters related to CDS, but not to the naked
21 CDS issue.
22 The second is it does go to priority,
23 and Mr. Peterson's testified about Class 3 versus
24 Class 5 and the effect on the Liquidation Analysis.
25 It goes directly to how these exposures are treated,

24

1 and I want to have an opportunity to ask Mr. Peterson
2 about that. These are predicate questions with
3 regard that.
4 And I would say third, I think given the
5 nature, you know, of the significance of the exposure
6 to Ambac, we should have just a little bit of factual
7 foundation to explain to the Court what these CDS
8 deals were. So I will move on to ACP after I get
9 this question answered if I could, your Honor.
10 THE COURT: All right. I'll let you do
11 that.
12 BY MR. GREENWALD:
13 Q All right. Mr. Peterson, if you could explain
14 whether or not the CDS counterparties were required
15 to actually hold the securities that, if they
16 defaulted, would trigger a payment obligation by ACP?
17 MR. VAN SICKLEN: And I have the same
18 continuing objection, your Honor. This has nothing
19 to do with the Plan. It's just boosting his appeal
20 record.
21 THE COURT: All right. We'll give him
22 that latitude. Go ahead and answer.
23 A **Well, in fact, I can't say with certainty that aspect**
24 **of the contractual requirements.**
25 Q And with the Court's discretion, if I could just -- I

25

1 understand you've testified you're not certain. Two
2 quick questions. Did you review any of the
3 underlying CDS contracts?
4 A **I relied on counsel and financial advisors largely to**
5 **do that.**
6 Q All right. As you're sitting here today, in general,
7 do you recall whether or not any of the contracts
8 required the CDS counterparties to hold the
9 underlying securities?
10 MR. VAN SICKLEN: Objection; foundation.
11 THE COURT: Go ahead and answer.
12 A **I don't feel comfortable -- I don't recall**
13 **specifically.**
14 MR. GREENWALD: All right. Thank you,
15 your Honor. I'm going to move on now.
16 BY MR. GREENWALD:
17 Q Now yesterday, Mr. Peterson, you testified that ACP
18 acted as a "transformer," correct?
19 A **That's right.**
20 Q And by that did you mean that ACP transformed
21 noninsurance risk into an insurance product?
22 A **The term transformer is an industry term. There was a**
23 **financial guaranty contract issued from AAC to ACP in**
24 **relation to each one of these credit default swaps,**
25 **so clearly there was an insurance contract associated**

26

1 **with those transactions that were entered into by**
2 **ACP.**
3 Q Well, let me just ask the question. When you used
4 the word "transformer" yesterday, that was the first
5 time it had been used in court, and I do reinsurance
6 for a living and I understand what a transformer is,
7 but no one I had ever talked to does. So can you
8 just explain what you mean by that as an industry
9 standard?
10 A **Well, I think it's your summary as -- To say that it**
11 **transforms a credit default swap obligation to an**
12 **insurance obligation is, in general, a reasonable way**
13 **to describe that in, perhaps, lay terms.**
14 Q Now, AAC issued policies that insured ACP's
15 performance on its CDS contract?
16 MR. VAN SICKLEN: Your Honor, this is
17 just more of the same. It has nothing to do with the
18 Plan confirmation.
19 THE COURT: I would agree with that. I
20 don't see how that's really relevant. Let's move on,
21 counsel.
22 MR. BENTLEY: Your Honor, I don't mean
23 to cut off Mr. Greenwald, but may I be heard on this
24 issue?
25 MR. VAN SICKLEN: I thought we were

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1 going one at a time.
2 THE COURT: Yes.
3 MR. BENTLEY: Well, your Honor, this is
4 an issue of great importance to my clients, and while
5 this issue may come up on my cross later today in the
6 event I cross Mr. Peterson, and so I don't want to be
7 precluded based on a ruling that your Honor makes
8 without my having the opportunity to address the
9 issue. We can address it again when I cross-examine
10 Dr. Peterson -- Mr. Peterson if your Honor prefers.
11 THE COURT: And would you help the
12 reporter by stating your name, please?
13 MR. BENTLEY: Yes. I'm sorry. Philip
14 Bentley of Kramer Levin for LVM Bondholders.
15 THE COURT: All right. Let's move on,
16 Mr. Greenwald.
17 MR. GREENWALD: Okay. Mr. Peterson --
18 And I wanted the Court to be aware, and I will move
19 very quickly, but I want to draw Mr. Peterson's
20 attention to page 29 of his affidavit which was
21 referred to yesterday by OCI, the affidavit as a
22 whole, just to ground this examination in this
23 particular aspect in the Exhibit 9 which is before
24 the Court. And it has to do with the *pari passu*
25 treatment, the equal treatment of the CDS

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1 counterparty.
2 THE COURT: Just a moment.
3 MR. GREENWALD: Let me get you there
4 first.
5 THE WITNESS: You were referred to
6 paragraph 29 you said?
7 THE COURT: Just a moment. One at a
8 time, please.
9 MR. GREENWALD: Sorry.
10 THE COURT: Go ahead.
11 THE WITNESS: Paragraph 29 you --
12 BY MR. GREENWALD:
13 Q Paragraph 29. I would direct your attention to the
14 bottom of the page, which is the question I wanted to
15 ask about, or the issue I wanted to ask about. The
16 word *pari passu* is not is there, but if you look at
17 the last sentence, Mr. Peterson, you stated in May,
18 "Similarly, the contention raised by the LVM
19 Bondholders that the ABS CDO policies should be
20 viewed as subordinate to their policies, which is
21 vigorously disputed by the Bank Group, was factored
22 into OCI's assessment that the Bank Group Settlement,
23 which is a compromise of many potential litigation
24 considerations and other factors, is fair and
25 equitable to all policyholders."

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1 Do you see that?
2 A **Yes, I do.**
3 Q Okay. My question is did OCI independently have a
4 view about whether the CDS contracts were insurable
5 interests?
6 A **Well, we believed -- we acknowledged that an
7 insurance contract existed between AAC and ACP.
8 Whether that would result in a mark-to-market
9 obligation or a pay-as-you-go obligation was
10 undefined at this point, but we recognized there were
11 significant arguments that could be made in either
12 side of that. But at a minimum, there was an amount
13 relative to the economic loss, the pay-as-you-go
14 loss.**
15 Q Did OCI take an independent view of whether or not
16 the CDS Bank Group's claim should be treated *pari*
17 *passu* with policyholders or, instead, as a general
18 unsecured claim?
19 MR. VAN SICKLEN: I have the same
20 objection, your Honor. This is retreading an issue
21 that counsel lost at when we approved the bank deal
22 and he has on appeal.
23 THE COURT: Sustained. Let's move on,
24 counsel.
25 MR. GREENWALD: All right.

30

1 BY MR. GREENWALD:
2 Q Mr. Peterson, let me talk about the effect of the
3 overall exposure of the CDS bank deal and going now
4 to the merits of how to treat those in terms of
5 priority.
6 It's true, isn't it, that the CDS bank
7 exposure mark-to-market risk -- Strike that.
8 It's true, isn't it, that the CDS Bank
9 Group mark-to-market exposure threatened the
10 viability of AAC?
11 A **That's true.**
12 Q And you testified about that yesterday?
13 A **Yes.**
14 Q Okay. And the CDS Bank Group mark-to-market exposure
15 also threatened the viability of AFG, the parent of
16 AAC, correct?
17 A **Yes.**
18 Q And in fact, AFG, as early as 2009, had disclosed in
19 its public filings that it may need to seek
20 bankruptcy protection as early as 2011. Do you
21 recall that?
22 A **It did, yes. Yes.**
23 Q And you were aware of that?
24 A **I was aware of that.**
25 Q This is a serious problem?

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1 A **Yes.**
2 Q And it wasn't the only problem that AAC had. We're
3 going to talk about the others later, but the CDS
4 Bank Group was a significant potential exposure to
5 the company?
6 A **It was. I would add, though, that the disclosure
7 that the holding company may need to seek bankruptcy
8 also related to the fact that they had been made
9 clear that OCI was very unlikely to approve any
10 additional dividends and they had bond obligations
11 and a certain amount of cash left that put them in a
12 position that they made the disclosures as to the
13 future likelihood of bankruptcy.**
14 Q Okay. So it wasn't just the CDS exposure that
15 threatened the viability of AFG is what you're
16 saying?
17 A **That's correct.**
18 Q In your first affidavit, and let me draw your
19 attention to page -- I believe it's page five of your
20 affidavit, down at the last paragraph.
21 A **All right.**
22 Q Do you see there that in May, in your affidavit you
23 stated that OCI had taken into account comments it
24 received from certain economic leaders regarding
25 systemic risk posed by the exposure to Ambac?

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1 A Yes.
2 Q Did the comments received from national leaders
3 include any specific comments with regard to the CDS
4 exposure?
5 MR. VAN SICKLEN: CES?
6 MR. GREENWALD: CDS. I'm sorry.
7 A I don't recall specifically whether there was a
8 reference to the CDS exposure. In broad terms, the
9 discussions that we had with the New York Fed and
10 others affirmed our perception that systemic risks
11 related to Ambac could exist and that they were worth
12 considering in our overall planned development.
13 Q And who at the New York Fed did OCI speak to?
14 A I don't believe I'm at liberty to disclose that. We
15 are under a confidentiality agreement with the New
16 York Fed.
17 MR. GREENWALD: I'm gonna ask for the
18 Court's ruling on something. Commissioner Dilweg
19 testified this week that he spoke to a New York Fed.
20 It's stated without identifying the New York Fed in
21 Mr. Peterson's affidavit. I believe that, not the
22 substance of the communication, which I'm going to
23 ask about now, but I'd like at least to ask the
24 identity of the person at the New York Fed who spoke
25 to OCI? And I believe that that information is not

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1 confidential, and if it was, it's been waived.
2 MR. VAN SICKLEN: Well, I guess I would
3 respond and object. The witness has indicated it is
4 confidential, and I don't understand how the identity
5 is relevant. They're not attributing particular
6 statements to an individual. They're just talking
7 about the discussions they've had, both witnesses.
8 MR. GREENWALD: And if I could have one
9 more comment, your Honor. OCI, Commissioner Dilweg,
10 and Mr. Peterson, in his affidavit, has used this
11 information to support the decision by OCI. I
12 believe I should be allowed a little leeway here to
13 at least get the identification of who they spoke to
14 at the New York Fed.
15 THE COURT: Was the confidentiality a
16 written confidentiality agreement?
17 THE WITNESS: It is.
18 THE COURT: Have you had access to that?
19 MR. VAN SICKLEN: I have not, your
20 Honor. I'm aware it's a fairly standard form that
21 they have with state regulators and the like. And I
22 again reiterate that I don't see the relevance of the
23 identity. Counsel's not going to be calling this
24 person as a witness. We're not offering particular
25 statements from anyone. It's just a background of

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1 the OCI vetting with another agency. That's
2 relevant.
3 THE COURT: Did you sign this agreement
4 on behalf of OCI? Or did the Commissioner?
5 THE WITNESS: It's been in place for
6 some time. We have confidentiality agreements with
7 the Federal Reserve, with the officer -- or the
8 Office of Comptroller of the Currency, the OTC,
9 other -- FDIC. And they've been in place for a short
10 time subsequent to the adoption of the Gramm-Leach --
11 GBL (sic) Law, federal law that required
12 communication between state and federal regulators.
13 MR. VAN SICKLEN: And I would note one
14 other point, your Honor, is that the protection is --
15 belongs to the Fed. Not us. It's not something that
16 OCI can waive.
17 THE COURT: Well, I don't know. I
18 haven't seen the agreement. I can accept the
19 argument it would be with the Fed. If it's their
20 privilege, their confidentiality, they would have to
21 waive it. I'll sustain the objection.
22 MR. GREENWALD: All right. Let me move
23 on then.
24 BY MR. GREENWALD:
25 Q Mr. Peterson, you testified yesterday that between

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1 December, 2009 and March 22, 2010, there was
2 essentially a tri-party negotiation between the
3 company, the bank CDS counterparties, and OCI. Do
4 you recall that?
5 A Yes.
6 Q And you also testified that you -- that OCI was
7 trying to referee these negotiations?
8 A That was part of my testimony as well, yes.
9 Q Who did you work with at AAC regarding the CDS bank
10 negotiations?
11 A Members of their -- Their general counsel, Kevin
12 Doyle, was present. Executive officers were present
13 at various times. The CFO at the time was present.
14 There was a number of people. You know, we -- to say
15 worked with is perhaps not the most accurate
16 description because it was kind of a tri-party
17 negotiation. Again, we worked on AAC's side, so the
18 implication that that's the case with the term
19 "worked with" may not be accurate.
20 Q I'll use negotiate. I was using a softer word.
21 So OCI was negotiating with the CDS bank
22 counterparties and with Ambac to resolve the CDS bank
23 exposure, correct?
24 A That's fair to say, yes.
25 Q Okay. And OCI was negotiating with, among other

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1 people, Kevin Doyle, AAC's executive officers
2 including the former CFO of AAC?

3 A **Yeah. I believe -- I believe Sean Leonard was**
4 **present there, David Wallis, the CEO, was present at**
5 **various times, the current CFO, David Trick, was**
6 **present at various times, as well as other officers**
7 **of key personnel of Ambac and their counsel, Dewey &**
8 **LeBoeuf.**

9 Q So counsel, Dewey & LeBoeuf, was negotiating AAC in
10 these negotiations for AAC?

11 A **That's correct.**

12 Q And was AFG participating in these negotiations as
13 well?

14 MR. VAN SICKLEN: Your Honor, we're
15 getting back into this whole issue of revisiting an
16 agreement that been vetted and approved by the Court
17 and they have on appeal, and it's not relevant to the
18 confirmation.

19 THE COURT: I'll sustain that. Can we
20 get to something more substantive, or can you make an
21 offer of proof and show how this relates to the Plan
22 and the approval of the Plan? I realize you're doing
23 a lot of discovery, or attempting a lot of discovery,
24 but that's really not productive at this point.

25 MR. GREENWALD: Well, I guess I'd have

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1 two comments, your Honor. One is that this is
2 exactly the kind of stuff, questions we would ask in
3 discovery that probably then wouldn't come to court.
4 We haven't had an opportunity to do any discovery,
5 and in some ways I'm forced to ask Mr. Peterson
6 questions for the first time here today. And I
7 apologize if it does feel a little rough in court
8 when we have to do that as opposed to --

9 THE COURT: Well, how is it relevant?

10 MR. GREENWALD: Let me get to that, your
11 Honor. I'm sorry. It's relevant because
12 Commissioner Dilweg testified yesterday that he
13 acknowledged that there was a conflict between the
14 AFG Board and the AAC Board, and I'd like to at least
15 identify very quickly whether AFG was involved in the
16 negotiations over a truly massive amount of the
17 claims paying resources of the company being paid out
18 of AAC to the CDS Bank Settlement Group.

19 THE COURT: Well, ask the question then.

20 MR. GREENWALD: I will then.

21 BY MR. GREENWALD:

22 Q Did AFG participate in these negotiations?

23 A **There was no separate identified position for AFG to**
24 **my knowledge.**

25 Q The same people at AFG and AAC were in positions of

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1 senior officers, for example?

2 A **What roles they took in their individual negotiations**
3 **or consultations with counsel I'm not aware of.**

4 Q All right. I'll move on now. Thank you.

5 Now, regarding the tri-party
6 negotiations themselves, did you enter into
7 confidentiality agreements with the CDS
8 counterparties?

9 MR. VAN SICKLEN: Objection, your Honor.
10 This has nothing to do with the confirmation, and
11 we're going to be here for another month if counsel
12 keeps this up.

13 THE COURT: All right. And let's get --
14 try to get back on focus. This isn't a discovery.
15 It is -- It relates to the Plan and the role that was
16 in the Plan, not all of the -- necessarily all of the
17 negotiations, unless you can show me how they're
18 relevant. It might be relevant to your sense of need
19 for discovery, but we have a Plan, and the question
20 -- you know, the question that the statutes and case
21 law put down is, basically, is it fair, is it a
22 proper exercise of the discretion.

23 MR. GREENWALD: And let me get to that
24 point, your Honor. Then I will ask these questions
25 which are at the sort of end of this series of sort

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1 of predicate questions.

2 BY MR. GREENWALD:

3 Q Did OCI reach out to any policyholders other than the
4 CDS Bank Group to form some sort of policyholder
5 committee to try and resolve the overall problems of
6 the short-tail exposures to AAC?

7 A **Well, throughout this process there's been efforts to**
8 **identify particular policyholders in classes of**
9 **business and, to some extent, overall. AAC doesn't**
10 **have direct information as to who all of the parties**
11 **-- policyholders are. They can identify trustees and**
12 **-- But to attempt to identify all the policyholders**
13 **was practically impossible, as I understand it.**

14 Q And let me ask just one more question with the
15 Court's patience. Did OCI ever attempt to reach out
16 to the major RMBS Policyholders to have confidential
17 discussions about a restructuring of AAC that would
18 resolve the major short-tail exposure of the company?

19 A **Prior to March 24th?**

20 Q Correct.

21 A **No.**

22 Q Let me move on then to the Plan and its creation or
23 design. You testified that you've spent two and a
24 half years of your life essentially devoted to the
25 Ambac situation, correct?

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1 A **A good portion of that time, yes.**
2 Q All right. An enormous amount of effort involved,
3 both you and others at OCI?
4 A **That's correct.**
5 Q Now, in the course of structuring -- And you've also
6 testified that you've acted as a rehabilitator in
7 other cases?
8 A **That's correct as well.**
9 Q And one of those cases, the Northwestern National
10 case, involves the Segregated Account?
11 A **It does.**
12 Q Is that correct? In that -- In the Northwestern
13 National case, assets were actually transferred into
14 the Segregated Account; is that correct?
15 A **That's correct.**
16 Q And you considered the capital that was transferred
17 into the Northwestern National Segregated Account to
18 be adequate for the operation of that Segregated
19 Account?
20 A **We did.**
21 Q Currently, with respect to Northwestern National
22 Segregated Account, the Segregated Account is
23 solvent, is it not?
24 A **It is.**
25 Q It's making claim payments today?

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1 A **Yes, it is.**
2 Q Now, you testified yesterday that prior to
3 March 24th, when the Segregated Account was created,
4 that AAC was resistant to putting AAC into
5 rehabilitation, correct?
6 A **That's correct.**
7 Q And AFG was also resistant to putting AAC into
8 rehabilitation?
9 A **Well the decision rests with the Board of AAC.**
10 Q And what -- When did you first propose the option of
11 a Segregated Account to AAC?
12 A **I don't recall specifically.**
13 Q Was it in 2009 or 2010, do you believe?
14 A **The idea was developed in 2009 initially. Exactly**
15 **when we communicated it to AAC, I don't recall.**
16 Q Now, the purposes -- And Commissioner Dilweg
17 testified to the reasons that OCI chose to adopt the
18 Segregated Account and propose this Plan, and you
19 also testified about that and I'd like to ask you a
20 few questions about that.
21 Among other reasons, one of the purposes
22 of creating the Segregated Account was to stabilize
23 the municipal bond business in the General Account,
24 correct?
25 A **It had that benefit.**

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1 Q It also had the benefit of avoiding what you've
2 termed collateral damage, correct?
3 A **Yes.**
4 Q And it also had the possibility of enabling one of
5 Ambac's affiliates someday to write new business in
6 the future; is that correct?
7 A **Well, that is not precluded by the Plan, but it is**
8 **not a direct goal of the Plan either.**
9 Q And just to tie up this point, if I could take you to
10 your affidavit at page six?
11 A **Mm-hm.**
12 Q I'm gonna draw your attention to the first paragraph.
13 If we go to the second sentence, and let me read this
14 into the record so we'll have the whole thing.
15 "Part of Ambac's publicly disclosed
16 long-term strategy for restructuring involves the
17 potential to resume writing new, safe, public finance
18 business through Everspan, the benefits of which
19 would inure to Ambac policyholders as a whole due to
20 the vertical corporate ownership relationship between
21 Ambac and Everspan."
22 MR. VAN SICKLEN: And I would ask, for
23 completeness, that counsel also read the last
24 sentence.
25 MR. GREENWALD: I'm going to continue to

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1 read.
2 BY MR. GREENWALD:
3 Q "Everspan's direct involvement in a rehabilitation
4 proceeding, however, would impair its ability to
5 attain credit ratings sufficient to write new
6 business. Insuring public finance bonds had been the
7 cornerstone of Ambac's business throughout its
8 existence. OCI concluded that it made sense to
9 pursue a restructuring plan which allowed for the
10 possibility of the company returning someday to its
11 roots in municipal bond insurance."
12 Did I read that correctly?
13 A **It appears that you did, yes.**
14 MR. GREENWALD: And Mike, was that
15 complete for you?
16 MR. VAN SICKLEN: Yes.
17 MR. GREENWALD: Okay.
18 BY MR. GREENWALD:
19 Q First, can you explain to the Court what Everspan is?
20 A **Everspan is a subsidiary financial guaranty insurer**
21 **that Ambac acquired, if I recall correctly, in the**
22 **late 90's. It was previously named Connie Lee**
23 **Insurance Company, and its roots were in insuring**
24 **college loans; hence, Connie Lee. It insured bond**
25 **issues related to college buildings and, you know,**

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1 medical facilities related to university medical,
2 things like that.
3 Q And does it currently write business?
4 A No. It hadn't written any new business since,
5 perhaps, the early 90's. It was in runoff when Ambac
6 acquired it.
7 Q Okay. Can you explain what you meant here by the
8 long-term restructuring plans of Ambac included
9 someday hoping to write new business under Everspan?
10 A Well, as the company was going through these
11 financial difficulties, there were points in time
12 where they were considering -- they were developing
13 plans to provide funding to Connie Lee as a vehicle
14 to continue writing business, business -- it's core
15 business of municipal bond business that they
16 expected to be profitable. You know, conditions
17 deteriorated in a way that didn't allow that
18 capitalization of that -- of Connie Lee -- or
19 Everspan, I should say, and that plan was never
20 activated. But through March of this year, there
21 were still long-term goals to get capitalization
22 available for Everspan and pursue that line of
23 business.
24 Q And one of the reasons that OCI approved -- Strike
25 that.

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1 One of the reasons OCI chose not to
2 pursue rehabilitation of the entire AAC was so that
3 Everspan would not be impaired from doing that,
4 potentially, in the future?
5 A That's one of a number of reasons.
6 Q Now, do you know whether or not AAC continues to have
7 that as a long-term plan if it becomes possible?
8 A Well, the viability of that I think is increasingly
9 unlikely. Whether they consider that a long-term
10 plan or not, I can't say.
11 Q Well, you testified yesterday, and this is regarding
12 the upstreaming of dividends to AFG by AAC. I
13 believe your testimony, in sum and substance, was
14 dividends are not going to be upstreamed in any
15 short-term period, and that if they were to be
16 upstreamed, they would -- Strike that. OCI would
17 allow them to be upstreamed to AFG if new capital
18 were being introduced and it would be of benefit to
19 all policyholders.
20 In general, do you recall that
21 testimony? I can draw your attention directly to it.
22 A Actually, I don't recall the portion about new
23 capital.
24 Q Okay. Well, let me -- And I was paraphrasing. Let
25 me take you to page 226 of the transcript from

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1 yesterday, if you could.
2 A All right.
3 Q Let me take you to page 226. And the specific
4 testimony, if we look beginning at line 13, do you
5 see that?
6 A Yes.
7 Q Is your type big enough? I have a Min-U-Script, so
8 my eyes are challenged here. But I believe it says,
9 "In line with Commissioner Dilweg's testimony, we
10 wouldn't believe dividends are appropriate until, you
11 know, the notes are paid with some possibility that
12 it could be structured in a way that creates
13 additional value for policyholders of the insurers,
14 you know, as opposed to just dividends that go out to
15 stockholders, bondholders of the holding company."
16 Do you see that?
17 A Yes.
18 Q Well let me ask you just the open-ended question
19 then. Under what circumstances as you've described
20 here on page 226 of yesterday's testimony would OCI
21 approve of dividends being upstreamed to AFG?
22 A There may be business relationships, negotiations
23 where the ultimate value to policyholders is enhanced
24 by resolving a business situation with regard to say
25 the NOLs or if, in other cases, some business

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1 venture. But, you know, we would be quite prudent in
2 evaluating those kind of prospects.
3 Q Well, and let me ask the question that ties it back
4 to Everspan. Has is anyone proposed to you a
5 structure that would enable value to be upstreamed to
6 AFG to recapitalize AFG, in part, with NOLs and then
7 to enable Everspan to write business going forward?
8 A Not -- Not including all of those elements, no.
9 Q All right. Well, let me draw your attention to the
10 NOL testimony yesterday. Do you recall that you
11 testified about a transaction term sheet that
12 Commissioner Dilweg had introduced -- Strike that --
13 that Commissioner Dilweg had testified about on
14 Monday?
15 A There was a nonbinding term sheet existing with the
16 AFG bondholders.
17 Q Okay. As we're sitting here today, is it your
18 understanding that overall, AFG has about \$7 billion
19 in net operating losses?
20 A That's correct range, yes.
21 Q And that the vast majority of those net operating
22 losses, or NOLs, are attributable to losses at the
23 Ambac Assurance Group level?
24 A That's correct as well.
25 Q I want to show you, are you familiar -- Let me ask

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1 the first question. Are you familiar with the June,
2 2010 amendment to the AAC/AFG tax-sharing agreement?
3 A **Not in detail.**
4 Q Are you aware that it required that AFG compensate
5 AAC to the extent that AFG utilized NOLs attributable
6 to AAC's losses?
7 A **I believe that's correct, yes. I think OCI would
8 have argued that that was the case prior to that
9 amendment too, that that event was a clarification of
10 the prior agreement.**
11 Q Okay. Can you explain what OCI's view was that you
12 just referred to about AFG paying AAC for use of the
13 NOLs?
14 A **Well, in general, without specific knowledge of the
15 tax-sharing agreements in dispute, it's our belief
16 that tax sharing agreements should be devised so that
17 entities that are -- that generate tax expense or
18 benefits take part in the overall group filing with
19 -- in relationship to their direct tax position.**
20 Q Okay. That was -- I apologize for not completely
21 understanding. Is it your testimony that OCI's
22 position is that if an NOL was generated by the
23 insurer, that the insurer should receive compensation
24 given the noninsurer parent takes advantage of the
25 NOLs?

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1 A **In general, we would attempt to achieve that
2 position. That is a fair treatment of the insurer.**
3 Q Okay. Do you recall, when you looked at the
4 preliminary term sheet that was filed in the
5 bankruptcy proceeding last week in New York, that
6 there was a provision there that might require AAC to
7 actually pay AFG for use of NOLs? Do you recall
8 that?
9 A **I recall that.**
10 Q Does OCI have a view on that?
11 A **That is a provision that is being considered, being
12 negotiated.**
13 Q But based on OCI's general principles, that doesn't
14 seem fair to policyholders?
15 A **You have to put it in context of the overall
16 transaction in order to judge whether it's fair or
17 not to policyholders.**
18 Q Let me ask you, is there any provision in the term
19 sheet that might require AFG to pay AAC for use of
20 the NOLs?
21 A **No, I don't believe there is.**
22 Q Okay. Now, in working on the rehabilitation that
23 involves the creation of a Segregated Account that
24 you've previously been involved with -- And that was
25 Northwestern National, correct?

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1 A **That's right.**
2 Q And you've also been incredibly involved in creating
3 the Segregated Account structure here, correct?
4 A **Pretty heavily involved, yes.**
5 Q Right. Now, in doing that, did you review the
6 Segregated Account statute in the Insurance Code of
7 Wisconsin?
8 A **I reviewed them with counsel.**
9 Q And that would have been Section 611.24 of the
10 Wisconsin Statutes; is that correct?
11 A **That is the correct cite.**
12 Q Okay. Now, your first contact with Ambac was back in
13 the early 1990's; is that correct?
14 A **Yes.**
15 Q You were a financial examiner with OCI at that time?
16 A **That's correct.**
17 Q You were assigned analysis responsibilities for Ambac
18 for a number of years in the 1990's; is that correct?
19 A **That's right.**
20 Q And as part of those responsibilities, you reviewed
21 the quarterly and year-end financial statements and
22 audit reports regarding Ambac?
23 A **I did.**
24 Q When you became a financial examiner supervisor, you
25 had specific responsibility for monitoring Ambac?

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1 A **That's right.**
2 Q And is it true that Ambac began writing mortgage
3 guaranty insurance in the mid 1990's?
4 A **Mortgage guaranty insurance?**
5 Q Yeah.
6 A **No, I don't believe that's correct use of the term.**
7 Q Okay. What -- What is -- What is it that they began
8 writing that was new to Ambac in the 1990's with
9 respect to mortgage insurance?
10 A **In the late 1990's, they began writing financial
11 guaranty insurance through ACP which backed the swaps
12 that insured security transactions, some of which
13 were mortgage securities.**
14 Q And the book of business that Ambac began writing in
15 the late 1990's related in one way or another to
16 residential mortgage-backed securities?
17 A **A portion of it did.**
18 Q Okay. I now want to direct your attention to the
19 Plan and also the current situation that's sort of
20 pending the review of the approval of the Plan. In
21 March -- This was on March 24, 2010. At the request
22 of the Commissioner, the Court entered an order of
23 injunctive relief with regard to this proceeding,
24 correct?
25 A **Yes.**

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1 Q And pursuant to that injunctive relief, the
2 Segregated Account Policyholders are prohibited from
3 making any claims while the -- prior to ruling on the
4 approval of the Plan; is that correct?
5 A **Yes, that's correct.**
6 Q But the injunctive relief also requires that the
7 policyholders in the Segregated Account continue to
8 make premium payments on their policy to the extent
9 the insurance policies required that, correct?
10 A **That's correct, as well.**
11 Q Those premium payments are paid into Ambac's General
12 Account, correct?
13 A **They are.**
14 Q And to the extent that the underlying Segregated
15 Account policies have terms that would allow a
16 trustee to offset claims against unpaid claims
17 against premiums -- Strike that so it's clean.
18 To the extent that the Segregated
19 Account policies have provisions that would allow a
20 trustee to offset unpaid claims against premium that
21 comes due, they're now prohibited under the
22 injunctive proceeding from doing that?
23 A **That's correct as well.**
24 Q I want to turn your attention to remediation claims.
25 Under the Plan -- Now I want to focus on the Plan

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1 that's been proposed to the Court. Under the Plan --
2 Well, let me first ask the question just so that it's
3 all clear. When you use the term "remediation," what
4 do you mean?
5 A **The term could be used in a number of different
6 contexts, so outside of putting it in the context,
7 it's difficult to say. Remediation can involve those
8 reps and warranties claims, it can involve
9 enforcement of control rights under the contracts, a
10 number of things. Sometimes it refers to pursuits of
11 the reps and warranty claims, but isn't exclusive to
12 that process.**
13 Q Okay. Because my review of the Plan was that the
14 remediation and recovery section covered a number of
15 things, and why don't I try and tease out specific
16 words that we can use so that we're agreeing on what
17 we're talking about.
18 Let's talk about reps and warranties
19 remediation claims.
20 A **All right.**
21 Q Okay. With regard to the reps and warranty
22 remediation claims, any recoveries from those are
23 assigned to the General Account; is that correct?
24 A **I believe so, yes.**
25 Q The reps and warranties remediation claims all relate

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1 to the RMBS policies in the Segregated Account; is
2 that correct?
3 A **I believe so, although I can't be certain that it's
4 absolutely exclusive to that. There may be other
5 litigation that AAC is pursuing under a reps and
6 warranties cause of action.**
7 Q These -- The reps and warranties claims deals
8 primarily with the mortgage-backed trusts?
9 A **That's correct.**
10 Q And the putbacks that you talked about yesterday were
11 individual mortgages, correct?
12 A **That's correct.**
13 Q And also the possibility of cash settlement payments
14 to Ambac involving those claims?
15 A **That's correct, too, yes.**
16 Q Okay.
17 MR. GREENWALD: Kaija, if you could give
18 Mr. Peterson Exhibit, I believe, 27, the Disclosure
19 Statement.
20 MR. VAN SICKLEN: I think it's in --
21 BY MR. GREENWALD:
22 Q Okay. I wanted to draw your attention first to page
23 61 of the Disclosure Statement.
24 A **All right.**
25 Q And this is a question that's on -- I think I asked

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1 of Commissioner Dilweg and then Mr. Van Sicklen asked
2 a follow-up question that I may not have understood
3 where a number came from, so I'm going to ask you.
4 If you look at the paragraph under c, Loss Reserves?
5 A **Mm-hm.**
6 Q The first -- And then you gave some testimony in
7 general about this yesterday and I want to just
8 clarify. The first sentence states, "As of June 30,
9 2010, total statutory loss reserves associated with
10 defaulted Segregated Account policies were
11 approximately \$1.7 billion net of \$2 billion of
12 benefits related to projected R&W remediation
13 Recoveries relating to ongoing representation and
14 warranty breaches in certain RMBS transactions
15 implying total Policy Claims associated with such
16 Policies of \$3.8 billion."
17 Did I read that correctly?
18 A **Yes, you did.**
19 Q Okay. Now the \$2 billion figure relating to reps and
20 warranties remediation, is that a figure that comes
21 from AAC?
22 A **It does.**
23 Q And has OCI taken an independent view of what the
24 likely recoveries are on the reps and warranties for
25 remediation claims?

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1 A **We have -- We are continuing to evaluate that**
2 **potential. Our position as to that is part of our**
3 **confidential analysis of the company.**
4 Q So if I were to ask you to disclose what OCI's
5 independent view of the R&W remediation claims is, is
6 it your position that's confidential?
7 A **It is.**
8 Q And you would not be willing to disclose that in
9 court today?
10 A **That's correct.**
11 Q And you sure hope that AAC collects \$2 billion?
12 A **I think that would be good for the policyholders.**
13 Q I want to draw your attention to the bottom of page
14 61, in d, Prospective Losses.
15 A **Mm-hm.**
16 Q And can you describe just, in general, what this
17 paragraph addresses?
18 A **Well, it addresses the potential losses in the**
19 **General Account.**
20 Q And --
21 A **And Segregated Account, I guess, yes.**
22 Q And the Segregated Account? Or the General Account?
23 A **It's talking about potential losses in the Segregated**
24 **Account.**
25 Q Okay. And toward the middle it says, "Both the

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1 Segregated Account Base Case Loss Estimates and the
2 Segregated Account Stress Case Loss Estimates exclude
3 R&W Remediation recoveries, which are addressed
4 separately."
5 Do you see that?
6 A **Yes.**
7 Q Okay. And then the next sentence states, "Where
8 statistical loss estimates were provided, the
9 Rehabilitator developed nominal cash flows estimates
10 that are believed to be consistent with such
11 statistically-based loss estimates."
12 Do you see that?
13 A **Yes.**
14 Q The next sentence is the one that I want to ask you
15 about. All in caps it states, "THESE SEGREGATED
16 ACCOUNT BASE CASE LOSS ESTIMATES AND SEGREGATED
17 ACCOUNT STRESS CASE LOSS ESTIMATES DO NOT REFLECT THE
18 VIEWS OF AAC OR ITS MANAGEMENT."
19 Do you see that?
20 A **That's right.**
21 Q Why did you include that in the Disclosure Statement?
22 A **It was necessary to make it clear that those**
23 **estimates of loss are OCI's estimates with consult --**
24 **or with the input of our financial advisors and legal**
25 **staff.**

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1 Q And how do AAC's estimates for the base and stress
2 case differ from OCI's that are reflected in the
3 Disclosure Statement?
4 A **OCI's estimate of ultimate loss is somewhat higher**
5 **than the company's reported losses.**
6 Q And have AAC's views about the base and stress case
7 estimates been disclosed in this proceeding?
8 A **Well, they are reported in their statutory financial**
9 **statements and in their GAAP filings.**
10 Q So to figure that out, we'd have to take a -- that
11 document and compare it to OCI's figures reflected
12 here?
13 A **I presume that's the case, yes.**
14 Q Okay. And there are a number of times in this
15 Disclosure Statement where a similar, you know,
16 all-capitalized statement about AAC and management
17 not agreeing with OCI reflected in this document?
18 A **I believe there are others, yes. It is OCI's**
19 **Disclosure Statement related to the Plan.**
20 Q Now, I want ask a question with regard to these R&W
21 remediation claims. When this Plan -- if this Plan
22 were to be effective -- Strike that. Let me come
23 back a little way and lay a foundation here.
24 If there are two policyholders, one in
25 the General Account with a hundred dollar claim and

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1 one in the Segregated Account with a hundred dollar
2 claim, and let's assume that the Plan is effective.
3 It's true, isn't it, that if the General Account
4 Policyholder comes and makes a claim, he'll get a
5 hundred dollars in cash from Ambac?
6 A **That's correct.**
7 Q And the Segregated Account Policyholder with a
8 hundred dollar claim will get \$25 in cash and a \$75
9 note that may be paid in the future; is that correct?
10 A **That's correct as well.**
11 Q In order for the two policyholders to come out even
12 at the end of the day, the note has to be worth \$75
13 to the Segregated Account Policyholder, doesn't it?
14 A **Yes, that's the case.**
15 Q And the Bank Group, pursuant to the CDS Settlement,
16 has already received surplus notes from the General
17 Account; is that correct?
18 A **Yes. \$2 billion worth of notes.**
19 Q And would it surprise you to know that the bank
20 surplus notes are trading for only 10 to 20 cents on
21 the dollar?
22 MR. VAN SICKLEN: I object to the form
23 of the question. There's no foundation. Surprise
24 him? What do you mean?
25 MR. GREENWALD: I'll withdraw it.

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1 BY MR. GREENWALD:
2 Q Mr. Peterson, do you know how the surplus notes that
3 were given to the Bank Settlement Group by the
4 General Account are trading?
5 A I haven't monitored that directly. Occasionally
6 there's been discussion of that, of the value that
7 those are trading at.
8 Q But is it your understanding that they're trading for
9 cents on the dollar?
10 A Yes, I think that's generally true.
11 Q Let me go to a question regarding subrogation. The
12 broad term "remediation" as used in the Plan includes
13 the concept of subrogation; is that correct?
14 A I believe so.
15 Q Okay. And can you describe what subrogation means in
16 general in the insurance industry as you understand
17 it?
18 A Well, subrogation develops when an insured loss is
19 paid and there are recoveries available related to
20 that insured loss; the salvage of a car, the rights
21 to proceed against other responsible parties with
22 regard to a liability claim, that type of thing.
23 Q So if I'm in a car accident and someone wrongfully
24 hits me and I suffer a hundred dollars of loss and I
25 collect a hundred dollars from my insurance company,

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1 the insurance company can go after the guy who hit me
2 to try and get the hundred dollars back, right?
3 A If -- Yes.
4 Q Now under the Plan, the Plan assigns a hundred
5 percent of the subrogation rights of a claim to the
6 General Account, correct?
7 A I believe that's correct, yes.
8 Q And it does that even though the policyholders in the
9 Segregated Account only get paid \$25 of their hundred
10 dollar claim in cash, correct?
11 A It does so because those rights existed in AAC at the
12 beginning of -- or prior to the existence of the
13 Segregated Account, and to transfer those assets to
14 the Segregated Account was viewed as a transfer of
15 assets that had the potential of triggering defaults
16 in the way that I described yesterday.
17 Q Well, let's go back to the car wreck. I'm now in the
18 Segregated Account, a Segregated Account Driver, and
19 I have a crash and I suffer a hundred dollars of loss
20 and I come to you and I make a claim, and I get \$25
21 in cash and a note for \$75 that might be paid in the
22 future. Isn't it true under that circumstance that
23 the General Account can go collect a hundred dollars
24 from the guy who hit me?
25 A I think your analogy is correct, yes.

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1 Q And there's no requirement for the General Account to
2 pay me the \$75 in cash when it collects on that
3 hundred dollar subrogation claim; is that correct?
4 A Those obligations haven't been directly linked.
5 Q So when the General Account collects a subrogation
6 claim, it goes into the general pool of General
7 Account funds and assets, correct?
8 A I believe that's the case.
9 Q And those subrogation claims would be available to
10 pay all the claims that would be made against the
11 General Account assets, correct?
12 A That's correct as well.
13 Q Some of those might be claims made under the secured
14 note to benefit the Segregated Account Policyholders,
15 correct?
16 A Well, let me interject. As to this analogy and how
17 it applies to the reps and warranty claims, how those
18 receipts of funds on reps and warranty claims are
19 effectively received or transferred to a particular
20 deal is -- It doesn't always -- There's no cash --
21 always work that there's a cash payment to the
22 General Account. There are putbacks or funds that
23 may be put into the trust that then result in less
24 losses to that particular deal, so that it isn't as
25 simple as a claim of a hundred dollars going to the

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1 General Account in every case.
2 Q And I don't want to talk about every case. I want to
3 talk just about those cases where the General Account
4 actually recovers a cash recovery. In the event that
5 Ambac, the General Account, makes a cash recovery on
6 a subrogation claim, there's no obligation that it
7 immediately pay it to the Segregated Account
8 Policyholders, correct?
9 A That's correct.
10 Q Mr. Peterson, I now want to draw your attention to
11 Exhibits D through G of the Disclosure Statement that
12 you discussed yesterday. And I think we have it
13 marked as a separate Exhibit 28 just for ease of use.
14 Exhibit 28 or it would be Exhibit 27, Exhibits D
15 through G. They're identical.
16 A I found it.
17 Q And I just have a few questions about these
18 scenarios.
19 I believe your testimony yesterday was
20 that Exhibits D through G are four scenarios that
21 were prepared by OCI; is that correct?
22 THE COURT: Mr. Greenwald, this may be
23 an appropriate time to take the morning recess --
24 MR. GREENWALD: Yes. Thank you, your
25 Honor.

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1 THE COURT: -- since you've moved into a
2 new area. We'll be in recess for 15 minutes. You
3 may step down, Mr. Peterson.
4 THE WITNESS: Thank you, your Honor.
5 (Recess had at 10:28 a.m.)
6 (End of Reporter Poirior's
7 segment.)
8 (Following proceedings reported
9 by Reporter Weisling.)
10 THE COURT: All right. Let's call the
11 court back into session in the matter of the
12 Rehabilitation of the Segregated Account of Ambac
13 Assurance Corporation. And, Mr. Greenwald, you were
14 in cross on Mr. Peterson. You may continue.
15 MR. GREENWALD: Thank you, Your Honor.
16 **CONTINUED CROSS-EXAMINATION**
17 BY MR. GREENWALD:
18 Q Mr. Peterson, just before the break I put in front of
19 you Objectors' Exhibit 28 for identification. Do you
20 recognize these as Exhibits D through G of the OCI's
21 disclosure statement?
22 A **They are.**
23 Q And you testified about these documents yesterday?
24 A **I did.**
25 Q You were directly involved in working on the creation

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1 of these documents; is that correct?
2 A **Well, the development of the models initially, yes.**
3 **And was consulted periodically, as you know, as they**
4 **evolved over time and so forth.**
5 Q Well, Mr. Van Sicklen asked you a series of questions
6 as you went through the various sections. Do you
7 have a working knowledge of these documents?
8 A **I do.**
9 Q All right. Now Exhibits D through G, I'm going to
10 ask you an open-ended question. How would you
11 describe what those are? You used a couple of
12 different phrases yesterday.
13 A **Well, these are scenarios that represent certain**
14 **possibilities as to how the value of surplus notes**
15 **may accrue over time, given assumptions about claim**
16 **development and recoveries on the reps and warranties**
17 **litigation.**
18 Q I think yesterday you used the word illustrative; is
19 that right?
20 A **I may have, yes.**
21 Q So the illustrations in Scenarios D through G do not
22 provide any projected cash flow for the payment of
23 principle or interest on the surplus notes; is that
24 correct?
25 A **That's correct.**

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1 Q How would these -- Strike that. Did OCI or its
2 consultants model possible cash flow payouts of
3 principle and interest on the surplus notes?
4 A **Not to my knowledge, no.**
5 Q Did OCI ever ask its consultants to do a cash flow
6 projection of payments of principle and interest?
7 A **No. Not directly.**
8 Q Scenarios D through G show -- and let me draw your
9 attention to it, I think it will probably be
10 easier -- so if we go to, for example, Scenario 1,
11 Exhibit D, if you could look at that.
12 A **Um-hum.**
13 Q And if you look at the first pages 1 through 4, the
14 very first major line: Invested assets?
15 A **Okay.**
16 Q And does it track this model's invested assets
17 cumulatively beginning in 2001 and going to page 2050
18 on page 4?
19 A **2011 through 50 do you mean?**
20 Q Yes, 2011 through 2050.
21 A **Yes. There's an accumulation of invested assets**
22 **across those pages.**
23 Q And at the end of the 40-year period in the year 2050
24 this would model approximately \$53 billion in
25 invested assets; is that correct?

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1 A **Yes.**
2 Q That assumes for this model's purposes that no
3 payments have been made for principle and interest on
4 the surplus notes; is that correct?
5 A **That's correct.**
6 Q Because the principle and interest would have been
7 paid out of invested assets; is that correct?
8 A **That's correct as well.**
9 Q Have you ever modeled -- Strike that. Have you ever
10 attempted to determine what invested assets might
11 exist at the end of this four-year period if some or
12 all of the principle and interest were paid out as
13 called for by the surplus notes?
14 A **I don't believe that we've put any particular**
15 **assumptions in as to payments on the surplus notes**
16 **into this model. We have through other means tested**
17 **the viability of cash payments on the surplus notes**
18 **as part of our diligence to know that the 25-cent**
19 **cash note split is reasonably prudently sustainable.**
20 Q Is that diligence and analysis regarding testing the
21 payment of principle and interest reflected in this
22 disclosure statement?
23 A **Not directly, no.**
24 Q Now, you testified that -- Strike that. Both you and
25 Commissioner Dilweg have testified that payment of

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1 principle and interest on the surplus notes will be
2 subject to the discretion of and approval of OCI,
3 correct?
4 A **That's correct.**
5 Q And it's your intention to review the claims-paying
6 assets on an annual basis to determine the cash-note
7 split going forward, correct?
8 A **Yes.**
9 Q And also to determine whether or not to pay interest
10 as called for by the notes, correct?
11 A **That's correct as well.**
12 Q And whether to pay the notes as they mature in the
13 year 2020, correct?
14 A **Yes.**
15 Q And OCI has reserved to itself the right to decide
16 not to pay in the year 2020 if it determines that it
17 would not be prudent to do so, correct?
18 A **We have.**
19 Q And it's possible, in fact, that the notes might be
20 extended all the way out to the year 2050 if OCI
21 decided in its discretion if that were appropriate?
22 A **Extended, having notes reissued, yes, something like**
23 **that. Full payment may extend past June 7th of 2020.**
24 Q Okay. I think we're done with Scenarios 1 through 4,
25 although it may be the same notebook that I ask you

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1 to return.
2 I want to draw you, Mr. Peterson, to the
3 Plan, which is Exhibit 26, and specifically I'd like
4 to draw your attention to Section 801 -- 8.01 of the
5 Plan.
6 A **All right.**
7 Q Now, I will acknowledge that this has been modified
8 in certain respects by an amended disclosure
9 statement, and my questions which be at a general
10 level that I believe -- and you can correct me if I'm
11 wrong -- will be applicable to both the original and
12 the amended statement.
13 MR. VAN SICKLEN: Do we have the amended
14 statement?
15 MR. GREENWALD: Sure. What did we mark
16 it as? Do you remember? Is that Amendment 2 to the
17 disclosure statement Exhibit 40?
18 MR. VAN SICKLEN: It's the modified
19 order.
20 MR. GREENWALD: The modified order. Do
21 you remember what number that is? Oh, I'm not going
22 to ask questions about that.
23 THE COURT: Just off the record while
24 they're discussing this.
25 (Discussion held off the record.)

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1 MR. GREENWALD: All right. If we could
2 go back on the record. And I apologize, Your Honor.
3 Q (By Mr. Greenwald) Mr. Peterson, I'm going to end up
4 asking you open-ended questions. There was a
5 modification to 8.01 that came in late Friday, and
6 it's possible that I have a misunderstanding about
7 its current scope.
8 Is it your understanding that the
9 current version in Section 8.01 of the proposed Plan
10 would release and discharge certain potential causes
11 of actions against AAC shareholders and officers and
12 directors?
13 MR. VAN SICKLEN: Objection.
14 Foundation.
15 THE COURT: Do you have that in front of
16 you? The one he's referring to?
17 THE WITNESS: The amended document? No.
18 MR. GREENWALD: Let me ask if we have
19 it. Your Honor, if I could approach and have this
20 marked as an exhibit, please.
21 THE COURT: All right.
22 MR. GREENWALD: Your Honor, can I
23 approach the witness?
24 THE COURT: Yes.
25 THE WITNESS: Thank you.

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1 BY MR. GREENWALD:
2 Q All right, Mr. Peterson, I've placed in front of you
3 what I've marked as Objectors' Exhibit 65 for
4 identification -- and I thank counsel for providing
5 it to me -- so my question, if you could review it
6 first, and then I'll have some questions for you.
7 Okay. Mr. Peterson, I'm going to try to
8 lay a foundation here, just find out if this is a
9 document that I should ask you questions about or if
10 this is for someone else.
11 Is this a document that you have a
12 working knowledge of?
13 A **With regard to releases, I've relied on counsel to**
14 **develop those, that language.**
15 Q Okay. And fact this is an amended version of it that
16 was filed last week, I think while you were out of
17 town?
18 A **That's correct.**
19 Q And have you seen this version of the release?
20 A **Well, I have. But I hadn't studied this portion of**
21 **the document in any detail.**
22 Q Okay. Then I will withdraw the document. I
23 appreciate that. I can tell by your reading it that
24 it was probably not refreshing your memory about its
25 terms.

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1 A **It's rather dense.**
2 Q All right. Thank you.
3 THE COURT: Not your memory, the
4 document.
5 THE WITNESS: At either time, who knows.
6 BY MR. GREENWALD:
7 Q All right. Well, now I'm going to place in front of
8 you what has previously been marked for
9 identification as Objectors' Exhibit 40, a document
10 you testified about yesterday that includes the
11 Liquidation Analysis.
12 A **I have it.**
13 Q Okay. Do you recall that Exhibit 40 is Amendment 2
14 to the disclosure statement; is that correct?
15 A **Yes.**
16 Q And is it a document that you testified to yesterday
17 during the direct examination?
18 A **I did.**
19 Q And if we turn to page 6 of Exhibit 40, is that the
20 beginning of the Liquidation Analysis?
21 A **It is.**
22 Q And if we turn to page 8 of Exhibit 40, is that the
23 chart that you testified to about two scenarios of
24 liquidation?
25 A **It is.**

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1 Q When was this particular Liquidation Analysis first
2 done by OCI?
3 MR. VAN SICKLEN: When you say "this" do
4 you mean other chart or --
5 MR. GREENWALD: Well, yeah, let me ask
6 about the chart first, I suppose.
7 BY MR. GREENWALD:
8 Q Mr. Peterson, when was this chart prepared, do you
9 know?
10 A **Within the last couple of weeks.**
11 Q And do you know -- Strike that. When was the overall
12 analysis regarding the liquidation that's contained
13 in this Exhibit 40 first prepared by OCI?
14 A **I don't know when it was first prepared in written
15 form. The knowledge as to the consequences of
16 liquidation were discussed early on as we thought
17 about potential receivership actions again AAC.**
18 Q Well, let me ask the question. Well, first, who
19 conducted this Liquidation Analysis that is reflected
20 in general in Exhibit 40 beginning at page 6?
21 MR. VAN SICKLEN: Objection as to form.
22 Conducted or --
23 MR. GREENWALD: Strike that.
24 Q Who prepared the Liquidation Analysis that's
25 reflected beginning at page 6 of Exhibit 40?

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1 A **I don't know specifically. I believe it was a
2 compilation of work from our financial advisors and
3 legal staff.**
4 Q And did you work on preparing this document?
5 A **I didn't work on it directly, no.**
6 Q Did you work with OCI's consultants to prepare the
7 substance of this Liquidation Analysis?
8 A **I had worked with OCI's advisors over a two-year
9 period in which we discussed the elements of this
10 Liquidation Analysis, the fundamental understandings
11 of the criteria here, the form of the, you know, the
12 factors that would come into play in a liquidation
13 scenario.**
14 Q And was there ever a report or a written analysis of
15 what the liquidation value would be in the event that
16 the Plan was proposed?
17 A **Prior to this one, I don't recall.**
18 Q If we turn to page 8, which is the chart, just about
19 above the chart it says that based on the foregoing
20 in a hypothetical liquidation of AAC as of March 24,
21 2010, the recovery analysis is as follows. Do you
22 see that?
23 A **I do.**
24 Q Who selected the valuation date of March 24, 2010?
25 A **I don't know. It was a relevant date to use in that**

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1 **it was the date the company was placed into
2 rehabilitation.**
3 Q Has OCI conducted any -- Strike that. Has OCI
4 conducted any Liquidation Analysis as of a later
5 valuation date?
6 A **We haven't compiled that analysis into a written
7 document that I know of.**
8 Q And you have not provided it to the policyholders in
9 the Segregated Account, correct?
10 A **No, we have not.**
11 Q So this document does not reflect, for example, a
12 valuation liquidation -- Strike that. This report,
13 for example, does not reflect a Liquidation Analysis
14 as of June 30, 2010?
15 A **No, it does not.**
16 Q And it doesn't represent a Liquidation Analysis as of
17 October 8, 2010 when the Plan the was filed, does it?
18 A **It does not.**
19 Q And it does not reflect a Liquidation Analysis as of
20 the Plan effective date, does it?
21 A **No. Not that either.**
22 Q I want to direct your attention to the chart again
23 and actually the page before, which then we'll take
24 time with. Turn to page 7, the first full paragraph
25 that has the 4 in parens.

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1 A I'm sorry, could you describe that again.
2 Q Yes. I'm sorry. It's the first full paragraph that
3 starts on CDS counterparties on page 7 of Exhibit 40.
4 A All right. I have it.
5 Q The first sentence says CDS counterparties would have
6 submitted approximately \$16.3 billion as of March 31,
7 2010 in mark-to-market termination claims arising
8 from CDS contracts and likely would have argued that
9 since such mark-to-market claims arose while their
10 respective policies were still in force, that is
11 before April 8, 2010, such claims should be treated
12 as Class 3 claims. Do you see that?
13 A I do.
14 Q Does that \$16.3 billion relate to the CDS exposure
15 that was resolved in the CDS Bank Settlement
16 Agreement?
17 A I believe it relates to a broader group of CDS, as we
18 discussed earlier today.
19 Q What portion of the \$16.3 billion relates to the CDS
20 bank settlement specifically?
21 A The valuation -- I'm not confident that the valuation
22 date here of March 24th also relates to the same
23 valuation date that was used in the BlackRock
24 analysis. BlackRock's analysis had a mark-to-market
25 value of approximately 12.8 billion. But I don't

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1 know that that used -- I suspect it couldn't have
2 used a March 24th, 2010 date in that it was -- that
3 report was generated prior to that date. So they're
4 not directly comparable, but in scale they are.
5 Q Well, I guess my question just is is the
6 \$16.3 billion almost entirely related to the bank
7 settlement group or does it relate to a whole 'nother
8 set of CDS exposures?
9 A There are a significant additional group of CDS
10 exposures, including Watson Baksome (phonetic), Seal
11 All The Deals, and so forth, that it's my
12 understanding have -- continue to have somewhere in
13 the neighborhood of \$3 billion worth of
14 mark-to-market exposure on.
15 Q And where are those contracts currently residing, the
16 General Account or the Segregated Account?
17 A Those are in the General Account and are protected
18 by -- or as to certain contractual triggers are --
19 forbearances exist on those triggers.
20 Q And just to be clear, there's approximately \$3
21 billion mark-to-market exposure with regard to
22 policies that remain in the General Account; that's
23 true?
24 A That's generally correct, yes.
25 Q And I want to ask you about the forbearances. And

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1 with respect to what portion of the \$3 billion have
2 counterparties entered into forbearance agreements,
3 if you can tell me?
4 A I believe large, if not a hundred percent of that
5 amount.
6 Q And are those permanent forbearance agreements or
7 temporary?
8 A My recollection is that they are permanent
9 forbearance agreements, but they don't forbear
10 against all default triggers if possible under the
11 relevant agreements.
12 Q Can you describe what default triggers are not -- you
13 know, the forbearance agreement doesn't agree --
14 doesn't apply to?
15 A I can't recall exactly, but it's my understanding
16 that if an additional, a full rehabilitation, a
17 rehabilitation of the General Account is a trigger
18 that has not been forebared in those agreements.
19 Q But those CLO contracts that have those triggers have
20 been left at the General Account level?
21 A Currently, yes.
22 Q Now in the -- back in March when you came to the
23 Court to get the -- this proceeding started, I
24 believe one of the explanations for putting the RMBS
25 book into the Segregated Account was that those

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1 policies also had triggers that could lead to
2 acceleration of exposure; is that correct?
3 A Could you repeat the question, please.
4 Q Sure. Don't the RMBS, residential mortgage-backed
5 securities policies, also have triggers embedded
6 within the trusts that they insure?
7 A I believe, yes, they have some triggers. I think
8 they're different in nature, if I understand
9 correctly.
10 Q But one of the reasons that they presented particular
11 risk was that the losses could increase if all of
12 Ambac were put into a rehabilitation; is that
13 correct?
14 A That's one of the reasons, yes.
15 Q Okay. And was there any attempt by OCI to get
16 forbearance agreements from the RMBS book?
17 A As was testified to earlier that it was practically
18 impossible to identify all the holders of the RMBS
19 book.
20 Q And did you reach out to any of the large trustees to
21 attempt to get forbearance agreements?
22 A We were in a situation where confidentiality leading
23 up to our movement, request for rehabilitation, was
24 paramount in importance that disclosure of
25 potential -- a potential rehabilitation or a likely

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1 rehabilitation could have triggered loss -- lots of
2 additional actions that would have precipitated loss.
3 So it was very -- it would have been very risky to
4 reach out to additional counterparties, particularly
5 on a kind of a unilateral basis.
6 Q But you were confidentially speaking with the CDS
7 Bank Group to resolves its claims?
8 A With the CDS Bank Group had approached AAC or vice
9 versa for -- and had established confidentiality
10 between those parties months in advance of our -- of
11 OCIs involvement in those relationships.
12 Q So they came to the company early and attempted to
13 sell; is that what you're saying?
14 A They got organized, they took action, and they
15 represented a very significant risk, kind of the most
16 significant risk at the time that Ambac was
17 interested in addressing. So yes, they got -- they
18 worked together or they proceeded to negotiate.
19 Q If I could turn your attention back to the chart on
20 page 8 of Exhibit 40, just to tie this one loose end
21 up. This chart does not reflect the economics of the
22 CDS Bank Settlement Agreement, correct?
23 A No. It's prior to the cash payments related to that
24 issuance of notes.
25 MR. GREENWALD: Your Honor, if I could

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1 have one moment to confer with one of my counsel.
2 And I think I'm done, but I want to make sure that I
3 am, in fact, done.
4 THE COURT: All right.
5 MR. GREENWALD: One moment. Thank you.
6 Your Honor, as I promised, we decided that less is
7 more, and we have no further questions at this time.
8 I would have one motion that I'd like to raise.
9 THE COURT: All right.
10 MR. GREENWALD: Which is based on OCI's
11 objections and the Court's rulings with regard to my
12 questions about the terms of the underlying CDS
13 contracts. And in light of Mr. Peterson's testimony,
14 extensive testimony yesterday about how important
15 those triggers were with respect to the reasons for
16 OCI deciding not to go with the full rehabilitation,
17 I would move to strike those sections of Mr. Peterson
18 yesterday relating to the SEC contracts and bank
19 settlement.
20 MR. VAN SICKLEN: We would oppose that,
21 Your Honor. The testimony yesterday was responsive
22 to the questions. It came in without objection, as I
23 recall. The questions that counsel was posing this
24 morning earlier did not go to the same subject matter
25 as the testimony yesterday and dealt not with the

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1 issue of the mark-to-market triggers but very a
2 different matter about claim classification issues
3 which he's presently appealing. So we would ask that
4 the testimony not be struck.
5 THE COURT: Testimony will not be
6 struck. The motion will be denied. I agree with Mr.
7 Van Sicklen that was the way the ruling was and that
8 was the way the testimony was. All right. Next up?
9 Start by stating your name, please. We have a
10 different reporter now.
11 MR. BENTLEY: Yes. Your Honor, if you
12 would give me a moment to get organized. We're
13 switching seats here.
14 THE COURT: State your name.
15 MR. BENTLEY: Philip Bentley of Kramer
16 Levin for the LVM Bondholder.
17 THE COURT: Let me remind you again that
18 the agreement that was stated to the Court as to the
19 objectors, each would be bound by the questions asked
20 by the predecessor and by the answers given so that
21 we don't have unnecessary repetition. So with
22 that --
23 MR. BENTLEY: Your Honor, if I may, I
24 believe the agreement was slightly different than
25 that. The agreement was that any objection raised by

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1 any policyholder is deemed made by all other
2 policyholders. It didn't go to questions that
3 policyholders asked but merely to objections.
4 MR. VAN SICKLEN: I guess I do disagree.
5 The agreement was that we wouldn't have the same
6 questions and testimony come in eight different times
7 from eight different objecting parties. It would be
8 cumulative. And so I have a different recollection
9 of the agreement and the Court's ruling.
10 MR. BENTLEY: Well, Your Honor, I
11 certainly don't intend to go over plowed ground.
12 THE COURT: Well, that's good. We in
13 this community appreciate plowed ground, so we don't
14 wanting to over it again. All right. Proceed.
15 **CROSS-EXAMINATION**
16 BY MR. BENTLEY:
17 Q Good morning, Mr. Peterson?
18 A Good morning.
19 Q I'm going to start by asking you some questions
20 relating to the treatment of CDS claims under the
21 plan of rehabilitation. And let me start by asking:
22 You have a good deal of familiarity, I take it, with
23 the CDS claims against Ambac, correct?
24 A Reasonably so.
25 Q I recall your testimony from yesterday that you spent

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1 a great deal of time between December of last year
2 and the end of March this year working on that issue,
3 correct?

4 A **That's correct. These are complex instruments.**

5 **People make careers out of trying to understand these**
6 **duties.**

7 THE COURT: I think we're seeing that
8 today. Right, Mr. Greenwald?

9 MR. GREENWALD: Yes, sir.

10 BY MR. BENTLEY:

11 Q Would you say you have as much sophistication on
12 those CDS issues as anybody at OCI?

13 A **That's probably true.**

14 Q And in connection with the negotiation and OCI's
15 evaluation of the CDS settlement that was reached in
16 March, can you describe the role you played -- these
17 are the others at OCI.

18 MR. VAN SICKLEN: I guess I renew my
19 objection to this whole line. We've had a long
20 hearing with, you know, extensive briefing and
21 affidavits and rules about the bank settlement. What
22 role he played relative to others in connection with
23 that settlement that was made by the General Account
24 not the Segregated Account and was ruled on by Your
25 Honor and Mr. Bentley has on appeal, I don't think is

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1 directly relevant to the Plan.

2 MR. BENTLEY: Your Honor, if I may.

3 THE COURT: I would agree, Mr. Bentley.

4 Again, who has most expertise or familiarity or
5 involvement is probably not the issue unless you're
6 seeking to affect the credibility of this witness
7 that he simply had so little involvement as to not be
8 knowledgeable. If that's where you're going, then
9 get to it.

10 MR. BENTLEY: No, that's not where I'm
11 going, Your Honor. Let me withdraw the question and
12 move on. I think where I'm going on the relevance of
13 that question will become much clearer, and I may
14 return to that once it's clearer.

15 Q (By Mr. Bentley) Mr. Peterson, you are aware that
16 the Plan of Rehabilitation has provisions relating to
17 the CDS claims that were not part of the March
18 settlement, correct?

19 A **I believe that's the case.**

20 Q Okay. And are you generally familiar with what that
21 treatment is under the Plan?

22 A **Actually I don't specifically recall, no.**

23 Q Would it refresh your recollection if I tell you that
24 the Plan provides that any claims arising either
25 under an insurance policy or under any sort of

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1 financial guaranty agreement, including financial
2 guaranties given in connection with CDS, are all
3 treated in the same class?

4 MR. VAN SICKLEN: I guess I would
5 object. I think it mischaracterizes what the Plan
6 says. If you have a provision, show it to the
7 witness.

8 THE COURT: Is it in an exhibit?

9 MR. BENTLEY: We can certainly walk
10 through the Plan if that's helpful.

11 Q Have you reviewed the Plan's provisions on this
12 issue, Mr. Peterson?

13 A **I reviewed the Plan in general. This particular**
14 **issue is not one that I recall specifically though.**

15 Q But are you aware that the Plan treats the nonsettling
16 CDS claims on par with policyholder claims?

17 MR. VAN SICKLEN: Object. They're both
18 policy claims. That's mischaracterizing.

19 MR. BENTLEY: Well, I'm happy to say on
20 par with other policyholder claims, if that's how Mr.
21 Van Sicklen wants to characterize them.

22 THE WITNESS: Well, consistent with my
23 testimony previously, we acknowledge that there are
24 financial guaranty policies that exist between AAC
25 and ACP that were related to coverage on certain

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1 credit default swaps. I would expect that the Plan
2 continues to acknowledge the existence of those
3 financial guaranty policies.

4 BY MR. BENTLEY:

5 Q And if I represent to you that the Plan treats
6 claimants under those policies on par with claims of
7 the LVM Bondholders and other policyholders, you
8 don't have any reason to believe that that's not
9 true, do you?

10 A **Well, no, I have no reason to believe that's not**
11 **true. But I think there's an important distinction**
12 **that that doesn't represent that any mark-to-market**
13 **claims have been acknowledged as opposed to the**
14 **economic claims that, you know, may exist under those**
15 **policies.**

16 Q Understood. The Plan provides a mechanism for
17 determining the allowed amount of any given claim,
18 correct?

19 A **I believe it does, yes.**

20 Q And so claimants that have claims under these sorts
21 of policies, CDS policies, would assert a claim, the
22 claim would either be consented to by OCI or it would
23 be resolved by an order of court, and that would give
24 the claimant allowed amount, correct?

25 A **That sounds correct.**

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1 Q Okay. And under the Plan that allowed amount would
2 receive the same 25 cents in cash and 75 cents in
3 surplus notes that policyholders are getting under
4 the Plan?
5 A **Yes. But those deals are not expected to generate**
6 **loss.**
7 Q I understand the disclosure statement projects a
8 range of loss for these claims, these nonsettled CDS
9 claims with a high end of approximately \$20 million,
10 correct?
11 A **I don't recall that number specifically. But --**
12 Q Okay.
13 A **--20 million we would view as an immaterial amount**
14 **of claim relative to the overall amounts at issue**
15 **here.**
16 Q Understood, it's a lot smaller than some other
17 claims, but would you agree with me that \$20 million
18 is real money?
19 A **Well, if it was in any checking account yes, it would**
20 **be.**
21 THE COURT: Like Everett Dirksen said, a
22 billion here, a billion there, pretty soon you're
23 talking real money.
24 THE WITNESS: After working in insurance
25 regulation for 20 some years I recognize that the

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1 numbers I'm often looking at are not in my checking
2 account and are subject to materiality evaluation
3 beyond what my personal views of money might be.
4 BY MR. BENTLEY:
5 Q Now, we've just been talking about the CDS claims
6 that are not part of the CDS settlement, but you're
7 aware, aren't you, that the CDS settlement is
8 presently on appeal, correct?
9 A **Yes. I understand that there's a number of appeals**
10 **pending.**
11 Q And if that appeal prevails the CDS would be vacated
12 and the settling CDS banks would be returned to the
13 status they were in prior to the settlement?
14 A **Well --**
15 MR. VAN SICKLEN: I object. There is a
16 whole host of legal issues there. They've already --
17 the deal's been consummated, so they wouldn't have
18 claims, in our opinion. So it's not that simple, and
19 this witness isn't qualified to answer the
20 speculative question of "what if" from the Court of
21 Appeals.
22 MR. BENTLEY: Your Honor, I'll rephrase.
23 THE COURT: That would be good. Let's
24 move on.
25 BY MR. BENTLEY:

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1 Q Can you speak -- Strike that. Mr. Peterson, you're
2 not a lawyer, correct?
3 A **That's correct.**
4 Q And while you have a certain business understanding
5 of how the Plan works in some respects, you can't
6 speak to issues that might be legally disputed as to
7 how it works, correct?
8 A **That's generally correct.**
9 Q And same thing goes for what would happen to the CDS
10 settlement if it were invalidated on appeal; fair?
11 A **Yes, I wouldn't -- I would have to seek advice from**
12 **counsel about the contingencies there.**
13 Q Okay. Well, are you aware that under the Plan the
14 possibility exists that if the CDS settlement were to
15 be invalidated on appeal, the CDS banks who had
16 settled would then assert claims under the Plan and
17 assert that those claims are entitled to the same
18 priority that the LVM Bondholders and other
19 policyholders are receiving, that is, the same 25
20 cents in cash on 75 percent -- 75 cents in surplus
21 notes. Are you aware that that's a possibility?
22 MR. VAN SICKLEN: Objection. Counsel
23 just laid the foundation that this witness was
24 incompetent to answer that question.
25 THE COURT: Sustained.

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1 MR. BENTLEY: Let me put it another way.
2 Q Sitting here as a nonlawyer, you can't tell me that's
3 not a possibility, can you?
4 MR. VAN SICKLEN: Same objection.
5 THE COURT: Sustained.
6 MR. BENTLEY: Okay.
7 Q Let me ask you a question or two about what the
8 consequence would be, your understanding, if that
9 were to happen. Given that my friend Mr. Van Sicklen
10 and I don't agree as to what would happen, and given
11 that you can't speak to what would happen, I want you
12 to indulge me for a moment and assume that what would
13 happen is what I think might happen. And I want to
14 ask you some questions about how that would play out.
15 Okay?
16 MR. VAN SICKLEN: Your Honor, I object
17 to the relevance or probative value of this line of
18 questioning. If counsel wants to save it for his
19 oral argument, he can. That's the appropriate place
20 for it.
21 MR. BENTLEY: May I respond, Your Honor?
22 THE COURT: Yes.
23 MR. BENTLEY: This is extremely
24 important, Your Honor. We're concerned, and I think
25 pretty much everybody on this side of the courtroom

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1 is concerned, that these provisions in the Plan don't
2 nearly have the relatively small impact that the
3 witness mentioned, namely an impact of up to \$20
4 million, which I agree is relatively small in the
5 context of this case. It may have a vastly bigger
6 impact. If the CDS settlement is reversed on appeal,
7 the Court of Appeals has already held that the appeal
8 is not moot, that the settlement can be unwound, the
9 payments recaptured from the banks, and if that were
10 to happen the bank CDS claims would spring back to
11 life, they would be in exactly the same position as
12 the relatively few nonsettling CDS claims are under
13 the Plan.

14 The Plan does not provide in that
15 circumstance they would be treated any differently
16 than the few nonsettling CDS claimants are treated.
17 And the consequence of that, Your Honor, is huge.
18 You've heard testimony that banks would have claims
19 that could be as high as \$12 to \$16 billion if you
20 use a mark-to-market measure, would still be many
21 millions of dollars even if you don't use a
22 mark-to-market measure. And if they got this
23 treatment under the Plan, they'd be getting 25 cents
24 in cash of that multibillion dollar number. That's
25 an amount that OCI -- sorry -- Ambac can't possibly

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1 pay. It would blow up the Plan. If Mr. Van Sicklen
2 wants to correct or clarify how the Plan would treat
3 these claims and say no, they will not get the pari
4 passu treatment with the policyholders in that
5 circumstance, that's great, we would love to have
6 that clarification, and I can move on.

7 But if he won't give that clarification,
8 we're talking about being a multibillion dollar
9 issue, Your Honor, that has the potential blow up
10 this Plan.

11 THE COURT: Mr. Van Sicklen.

12 MR. VAN SICKLEN: I think that was a
13 great closing argument, and he can save it, and I'd
14 be happy to deal with it then.

15 I think he's mischaracterizing the Court
16 of Appeals' preliminary decision about a permissive
17 appeal. It hasn't ruled on the merits, it hasn't
18 held that the bank -- consummated bank settlement can
19 be unwound. There's so many variations there. The
20 answer is if there is a sudden unexpected
21 development, OCI will deal with it at that time. And
22 beyond that it's so speculative it's just not
23 helpful.

24 MR. BENTLEY: Your Honor, what we did
25 not hear from Mr. Van Sicklen was a commitment that

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1 the scenario that I laid out will not happen.

2 THE COURT: Well, here's the thing. We
3 can sit here and I could go through every one of
4 these intelligent folks sitting out here, and every
5 one of them could spin a scenario and we could spend
6 from now until this time next we're working out those
7 scenarios. The thing is, we have a Plan. If
8 scenarios or situations happen they will be dealt
9 with as they would happen, as they do happen. The
10 Plan if, the Plan does not address a particular
11 scenario, it doesn't address it. Is that fatal to
12 the Plan? That's what we'll discuss. I don't see
13 how it is.

14 MR. BENTLEY: My point, Your Honor, is
15 given that this is a possibility that counsel is not
16 prepared to foreclose, it is vital that we be allowed
17 to create a record so that the issue can be explored
18 and so that a reckless plan that could create
19 billions of dollars of exposure in the state isn't
20 approved without a full examination.

21 I simply want to ask the witness whether
22 he or others at OCI have looked into certain factual
23 issues bearing on the appropriateness or
24 inappropriateness of this plan provision. This is a
25 provision of the plan that Your Honor is being asked

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1 to approve.

2 THE COURT: It is or isn't? You said
3 before that I thought you said it wasn't.

4 MR. BENTLEY: The provision in the Plan
5 that Your Honor is being asked to approve is the
6 provision that says holders of CDS claims receive the
7 same 25-cent cash and 75 cents in notes that other --
8 that policyholders receive.

9 THE COURT: And the problem is?

10 MR. BENTLEY: And the problem is OCI has
11 given up, OCI has capitulated on how it treats the
12 CDS claimants. There's a huge dispute, Your Honor,
13 there's a huge issue as to whether CDS claims should
14 be treated on par with real policyholders or whether
15 they should come behind policyholders.

16 THE COURT: And is that something to
17 take up later?

18 MR. BENTLEY: It's something that the
19 Plan is going to approve, and so we want to explore
20 as a factual matter whether this is a proper and a
21 lawful provision of this provision of this Plan.

22 THE COURT: Anything further, Mr. Van
23 Sicklen.

24 MR. VAN SICKLEN: Just very briefly.
25 This is the same argument Mr. Bentley gave back in

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1 May. The Court's ruled on it, Mr. Bentley lost.
2 It's just not appropriate to reargue the same decided
3 issue here. And if he wants to use it in his oral
4 argument about the Plan, that's fine. I don't think
5 asking this witness the vaguest is of speculative
6 hypotheticals adds anything to the Court's base of
7 knowledge to make a decision.
8 THE COURT: I agree. I'll sustain the
9 objection. Let's move on. I think we've addressed
10 it. And, as I said, we can all come up with
11 scenarios and say well, your plan doesn't necessarily
12 address this. The Plan is what we have. I'm going
13 to hear argument in the end, and we'll deal with it
14 from there. Let's move on.
15 MR. BENTLEY: Let's move on.
16 Q Who, if anyone, at OCI was involved in reviewing
17 these plan provisions and evaluating whether -- the
18 Plan provisions we've been talking about, the one
19 that gives policyholder priority to the CDS claims,
20 determining whether those are proper and should be
21 included in the Plan?
22 A I was involved, general counsel was involved.
23 Q Can you describe the nature of your involvement?
24 A In the production of the disclosure statement,
25 correct?

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1 Q No. I think maybe my question wasn't clear. What I
2 mean to be asking about is the formulation of this
3 provision of the plan and the decision of whether to
4 include this provision in the Plan or not. Was that
5 something that you or anyone else ad OCI gave any
6 consideration to?
7 MR. VAN SICKLEN: Objection. Vague. I
8 have no idea what provision he's --
9 MR. BENTLEY: I thought it's clear, Your
10 Honor. We're talking about the provision that gives
11 policyholder priority to CDS claims.
12 MR. VAN SICKLEN: Could you point to the
13 provision that says that, counsel?
14 MR. BENTLEY: It's laid out in our
15 brief, Mr. Van Sicklen. You know exactly what I'm
16 speaking about.
17 Your Honor, I can walk you through the
18 provisions in the Plan, if you like.
19 THE COURT: Well, go to the Plan, and
20 that might help the witness understand where you're
21 going.
22 MR. BENTLEY: Okay. Give me one moment,
23 Your Honor.
24 Q Mr. Peterson, do you have Exhibit 26?
25 A I do.

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1 Q Okay. Could you please turn to Section 1.48?
2 A Page number?
3 MR. VAN SICKLEN: Page 8.
4 BY MR. BENTLEY:
5 Q Can you read out loud the definition of policy
6 contained in section 1.48?
7 A Certainly. Any financial guaranty insurance policy,
8 surety bond, or other similar guaranty allocated to
9 the Segregated Account pursuant to the Plan of
10 operation.
11 Q Okay. Now, you've testified that the financial
12 guaranties that ACP gave in connection with CDS were
13 financial guaranty insurance policies, correct?
14 A I have.
15 Q And so they would be included in the definition of
16 policy in Section 1.48, correct?
17 A I think that's reasonable, yes.
18 Q Okay. Please read out loud Section 1.49.
19 A 1.49 policy claim. A claim under a policy or
20 policies.
21 Q So would you agree that a policy claim includes a
22 claim under a CDS policy?
23 A Well, again, the amount or the character of that
24 claim isn't defined under that section.
25 Q Understood. But whatever the claim turns out to be,

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1 whatever its allowed claim amount is, it would
2 institute a policy claim, correct?
3 A Presumably, yes.
4 Q Now please turn to Section 2.02. And do you agree
5 that holders of CDS claims would be the -- entitled
6 to the treatment provided in Section 2.02?
7 A The application of 2.02 involves the operation of the
8 agreement as a whole. I don't know that I am in a
9 position to testify about the operation of that
10 section without reviewing the broader agreement.
11 Q Okay. I'll drop this in a moment but because the
12 judge asked -- let me just try to help you out with
13 one follow-up question.
14 If you turn to the third, starting on
15 the third line of the section, you see it says each
16 holder of a permitted policy claim shall receive.
17 And then it goes to describe what they receive?
18 A Um-hum.
19 Q And we just agreed that a policy claim would include
20 a CDS claim, correct?
21 A We did.
22 Q And if their claim is allowed or permitted it would
23 be a permitted policy claim, correct?
24 A Yes. Subject to that qualification.
25 Q So you agree that's it says that is the treatment

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1 that claim would get --
2 A **Yes.**
3 Q -- under the plan?
4 A **If permitted and --**
5 THE COURT: I want one talking at a
6 time. So go ahead.
7 MR. BENTLEY: Sure.
8 THE WITNESS: Yes. If permitted and
9 subject to the other provisions.
10 BY MR. BENTLEY:
11 Q And this is the treatment that the LVM Bondholders
12 and other policyholders will get under the plan as
13 well, correct?
14 A **Yes.**
15 Q So CDS claimants will get the same 25 cents in cash
16 and 75 cents in surplus notes for any permitted claim
17 they may have?
18 A **Yes.**
19 Q So are we speaking the same language if I say in
20 other words they will be treated on par with other
21 policyholders?
22 A **Again, to the extent that claims are permitted and**
23 **are not excluded under the other operations of the**
24 **Plan. Or other legal rights that the Rehabilitator**
25 **may assert in defense of the claims.**

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1 Q Now, you're aware, aren't you, that my client and a
2 number of other policyholders have objected to the
3 Plan on the ground, among others, that it's wrong,
4 it's unlawful to give pari passu treatment as between
5 CDS claimants and other policyholders; you're aware
6 of that?
7 A **Not specifically I didn't recall that.**
8 Q Well, I represent to you that we and many other
9 policyholders have objected to the Plan on the
10 ground, among others, that CDS claims should be
11 subordinate to the treatment of -- should be
12 subordinated to policyholder claims.
13 MR. VAN SICKLEN: I'll just object to
14 the characterization "many others." Mr. Bentley can
15 speak for himself. We'll agree he's got this issue
16 on appeal.
17 MR. BENTLEY: I've not talking about
18 appeal; I'm talking about objections to the Plan.
19 And you'll hear for others who have asserted the same
20 objection to the Plan, so I won't speak them.
21 Q Now, this isn't an issue that's new to you, is it,
22 Mr. Peterson? The dispute over whether CDS claims to
23 be subordinated to policyholders claims?
24 A **Well, not in general. The issue in general has been**
25 **discussed, yes.**

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1 Q Well, in fact, when you were working night and day on
2 the CDS issues at the end of '09 and early part of
3 this year part of your job was to evaluate the merits
4 of the settlement that was being negotiated, wasn't
5 it?
6 A **Yes. With regard to some aspects. You know, OCI had**
7 **a team of people evaluating the reasonableness of the**
8 **proposal.**
9 Q Is it fair to say you were the lead member of that
10 team, or was someone else the lead?
11 A **With regard to some of the financial aspects I could**
12 **have been considered the lead; with regard to legal**
13 **aspects, I would suggest our general counsel was --**
14 **took the lead.**
15 Q As to evaluation of factual issues, not legal issues,
16 relating to the fairness of the proposed settlement,
17 is it fair to say that you were the lead person at
18 OCI?
19 A **I'm not sure how you make that distinction between**
20 **which are factual issues and which are legal issues.**
21 Q Well, I mean, you had a pretty good understanding,
22 didn't you, of some of the issues that were in
23 dispute and that were being negotiated between
24 Ambac -- or among Ambac, OCI, and the CDS banks,
25 correct?

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1 A **Yes.**
2 Q I mean, you were working around the clock some weeks
3 on that negotiation, correct?
4 A **Pretty nearly, yes.**
5 Q Okay. And do you recall Commissioner Dilweg's
6 testimony on Monday that a personal goal of his is to
7 develop all the facts as fully as he can before he
8 takes action; do you remember that testimony?
9 A **Um-hum. I do.**
10 Q And you would share that goal, wouldn't you, in
11 connection with the work you do at OCI?
12 A **Generally speaking, yes.**
13 Q And you were trying to accomplish that goal in the
14 work you did in connection with the CDS settlement,
15 correct?
16 A **To the extent reasonably possible, yes, we attempted**
17 **to develop and understand all the relevant facts.**
18 Q And so in order to undertake that task effectively,
19 you began by acquainting yourself with what the
20 issues were, correct? You spoke with the lawyers and
21 got a sense of what factual issues mattered, right?
22 A **Yes.**
23 Q What were the principle factual issues that mattered,
24 to your recollection?
25 A **With regard to the CDS claims?**

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1 Q Correct.

2 A **There were substantial claims pending, and arguments**

3 **existed as to the amount of those claims. But in any**

4 **case, those CDS claims were very significant to the**

5 **claims-paying resources of AAC. We had some**

6 **parameters around those -- the amounts of those**

7 **claims as was developed by our own evaluation of CDS**

8 **claims and through the BlackRock estimations, and**

9 **those claims under base, stress and market value**

10 **claims were -- or bases were evaluated and weighted**

11 **in our determination of the reasonableness of the**

12 **bank settlement.**

13 Q So it's fair to say one of the principal factual

14 issues in your view was what would the size of the

15 bank's claim be if litigated rather than settled, how

16 will big they would be?

17 MR. VAN SICKLEN: Your Honor, I am going

18 to interject. I've given a lot of leeway. This was

19 the same issue we argued in front of you back in May.

20 Counsel's had a lot of chance to try to make a

21 showing of relevance here, and I don't see it. He's

22 just rearguing a motion he lost.

23 MR. BENTLEY: Your Honor, if I may, what

24 I directly addressed last time Mr. Van Sicklen and I

25 addressed Your Honor a few minutes ago was the Plan

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1 contains provisions, what Mr. Peterson walked through

2 for the Court's benefit was the Plan contains

3 provisions that treat the CDS claims on par with

4 policyholder claim, with real policyholder claims.

5 There are big issues in dispute as to whether they

6 should be treated on par. Some of these issues are

7 legal, some are factual. Mr. Peterson, was one of

8 the --

9 THE COURT: What are the factual issues?

10 MR. BENTLEY: That's exactly what I'm

11 asking Mr. Peterson. He just told me one, and I'm

12 going to ask him --

13 THE COURT: Well, tell me. You tell me

14 what you see the factual issues to be, so we can see

15 whether this witness, you know, can enlighten us on

16 that.

17 MR. BENTLEY: Fair enough. Shall I

18 inform the Court first, or shall I just go ahead with

19 a question?

20 THE COURT: No. You tell me. Make an

21 offer.

22 MR. BENTLEY: Sure. Sure. There are

23 several key factual issues that go to the central

24 legal issue. And just to put it in context for Your

25 Honor, the central legal issue is whether the CDS

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1 claims should be subordinated or not. And that issue

2 hinges on a number of factual issues. One of them is

3 the financial condition of ACP, the so-called

4 Transformer Ambac Credit Products, the Ambac

5 subsidiary that issued these credit default swaps,

6 what was its condition prior to the rehabilitation.

7 So that's one thing Mr. Peterson may know about and

8 I'm going to ask him about.

9 There are other factual issues as well.

10 One of them is did the CDS banks suffer any actual

11 losses in connection with the matters that are

12 covered by the CDS. If they didn't, Your Honor, then

13 the statute, Wisconsin statute is very clear. It

14 says to be entitled to policyholders priority you

15 have to have suffered, quote, losses under policies.

16 So it has to be an insurance policy, and you have to

17 have suffered losses. So one key factual question is

18 were any losses suffered, and I'd like to hear what

19 Dr. Peterson knows on that subject.

20 THE COURT: All right. Take your first

21 question and ask him then. You've got two questions

22 now that you're seeking facts on.

23 MR. BENTLEY: Certainly, Your Honor.

24 Q In connection with --

25 MR. VAN SICKLEN: Excuse me, Your Honor.

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1 Again, it's that questions that are relevant to his

2 objection to the settlement that you approved.

3 MR. BENTLEY: I'm not arguing about the

4 settlement, Your Honor. I'm arguing about the Plan.

5 MR. VAN SICKLEN: That the Bank Group

6 put in an amicus brief here in which they spent 37

7 pages discussing their response to Mr. Bentley's

8 argument.

9 MR. BENTLEY: So Mr. Van Sicklen is

10 establishing that there are --

11 THE COURT: One at a time, please. Mr.

12 Bentley, you've got to curb your enthusiasm.

13 MR. BENTLEY: I apologize, Your Honor.

14 MR. VAN SICKLEN: The legal issue he

15 raised has been tried and decided by Your Honor, and

16 it's the law of the case at present that OCI crafted

17 its Plan to comply with. And Mr. Bentley has it on

18 appeal. But to start to try to litigate fact issues

19 that relate to the legal issue that he just described

20 has nothing to do with the Plan.

21 THE COURT: I think that's right, Mr.

22 Bentley.

23 MR. BENTLEY: Your Honor, may I respond?

24 THE COURT: I think I've heard enough

25 response. But I'm getting it again and again and

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1 again in variation after variation. Let's just move
2 on. I think this issues's been addressed, and let's
3 just move on. You'll get a chance to make your legal
4 arguments in the closing.

5 MR. BENTLEY: Your Honor, I'd like to
6 establish facts. I have no interest in making legal
7 arguments unless Your Honor wishes. I simply want to
8 ask the witness a couple of facts that, as Mr. Van
9 Sicklen knows very well, have never been explored
10 before Your Honor because we weren't given discovery
11 in connection with the settlement. They're not
12 relevant in connection with the Plan. And in
13 connection with the settlement your Honor never ruled
14 on the legal or factual issues, just on the fairness
15 of the settlement. We now don't have a settlement.
16 We're talking about treatment of --

17 THE COURT: Mr. Bentley, I admire your
18 skill. You're very skillful. I keep coming back to
19 the same thing that I ruled on. And I don't need
20 that argument again and again and again. If you have
21 a fact question --

22 MR. BENTLEY: Okay.

23 THE COURT: -- ask the fact question so
24 we can evaluate whether that applies to the Plan.

25 MR. BENTLEY: Okay.

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1 THE COURT: -- and I'll take your
2 arguments on the 29th and 30th.

3 MR. BENTLEY: Okay. Let me turn to a
4 factual question.

5 Q And let me start with, Mr. Peterson, some of the
6 testimony you gave yesterday about these factual
7 issues. Do you have a transcript of your testimony
8 of yesterday's hearing?

9 A I do.

10 Q Excellent. Could you turn to page 151.

11 A I have it.

12 Q Just one moment. I'm sorry. And I'm going to ask
13 you about the testimony you gave at the bottom of 151
14 and top of 152. Why don't you take a moment and read
15 that to yourself, and then I'll ask you a question or
16 two. Tell me when you're ready.

17 A I've read the question and answer at the bottom of
18 page 151 and top of page 152, if that's the subject
19 matter you intend to ask about.

20 Q It is. You've referred to Ambac Credit Products, or
21 ACP for short, as a transformer?

22 A I have.

23 Q And what you mean by that is Ambac created ACP in
24 order to meet the demands for credit default swaps
25 from banks and others, correct?

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1 A That's essentially it, yes.

2 Q And instead of putting capital directly into ACP,
3 Ambac, that is, AAC, provided a financial guaranty?

4 A That's correct.

5 Q And ACP didn't have any significant capital, putting
6 aside that financial guaranty, correct?

7 THE COURT: All right. That may be the
8 appropriate signal to break for noon.

9 MR. BENTLEY: Your Honor, could I ask
10 that we just finish this short line of questioning?

11 THE COURT: No. We've got it down and
12 we can have it read back. And we'll resume here at
13 1:00.

14 MR. BENTLEY: Could I make one other
15 request, Your Honor? Could the witness not speak
16 with his counsel about the subject of this testimony
17 during the lunch break?

18 THE COURT: Well, that is very unusual,
19 a witness not talk to his attorney.

20 MR. BENTLEY: About a question that's
21 pending, Your Honor.

22 MR. VAN SICKLEN: Well, I'm okay if he
23 wants to answer the one pending question, and maybe
24 that will simplify life here.

25 THE COURT: And lunch. All right.

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1 MR. BENTLEY: Could you read the
2 question back, please.

3 (Question read.)

4 THE WITNESS: I don't recall the
5 specific amount of capital in ACP. But relative to
6 its exposures it had a nominal amount of capital.

7 MR. BENTLEY: We can break for lunch
8 now, Your Honor. Thank you.

9 THE COURT: Thank you now, Mr. Bentley.
10 And you can now talk to your attorney during lunch.
11 Let's get here about 10 after 1 to resume
12 proceedings.

13 (End Reporter Weisling Section B.)

14 (On the record at 1:08 p.m.)

15 (Following reported by Jennifer
16 Poirior.)

17 THE COURT: Mr. Peterson, will you come
18 back to the bench, please, to the witness chair?
19 You're still under oath.

20 MR. GREENWALD: Your Honor, I believe
21 Mr. Bentley will be here in just one moment.

22 MR. VAN SICKLEN: He's taking a ride on
23 the Monorail. He's lost.

24 THE COURT: While we're waiting for
25 Mr. Bentley, let's call the Circuit Court for Dane

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1 County into session. Again this is In the Matter of
2 Case No. 10 CV 1576, The Rehabilitation of the
3 Segregated Account of Ambac Assurance Corporation.
4 Mr. Peterson is on the witness stand.
5 He's still under oath, and you were cross-examining,
6 Mr. Bentley. Did you wish read-back of your last
7 question?
8 MR. BENTLEY: No. That's all right,
9 your Honor. I'm prepared to move on to a new topic.
10 THE COURT: All right.
11 **CONTINUED CROSS-EXAMINATION:**
12 BY MR. BENTLEY:
13 Q Good afternoon, Mr. Peterson.
14 A **Good afternoon.**
15 Q I'd like to change the subject now and ask you a
16 number of questions about the financial projections
17 that you've been involved in preparing and that
18 support the Plan of Rehabilitation.
19 A **Mm-hm.**
20 Q Let me start with a little bit of background with
21 respect to your involvement in the development of
22 those projections. Fair to say that you've been
23 working for quite some time now to understand Ambac's
24 potential loss exposures and the value of its assets?
25 A **That's correct.**

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1 Q When did you begin to be involved in that process?
2 A **Very early in 2008.**
3 Q And you worked with financial advisors in that
4 effort?
5 A **That's correct.**
6 Q Jefferies and the Gordian Group?
7 A **That's correct.**
8 Q And you and your financial advisors worked directly
9 with the company to get baseline information with
10 respect to these issues?
11 A **Yes.**
12 Q Because you believed it was important that you be
13 able to develop your own independent loss estimates
14 rather than simply relying on Ambac's judgment in
15 that regard, correct?
16 A **That's correct.**
17 Q And your view is these estimates, whether it's loss
18 exposures of future investment returns or returns on
19 other assets, involve, among other things, the
20 exercise of judgment?
21 A **They do.**
22 Q And on some of these matters, your judgment and OCI's
23 judgment differs substantially from Ambac's judgment?
24 A **It differs. Whether substantially is the appropriate**
25 **description or not, I don't know.**

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1 Q Sometimes less, sometimes more?
2 A **Yes.**
3 Q And in order to be in a position to form your own
4 judgment, you believed it was important to have full
5 access to all of the information that the company had
6 underlying these estimates, correct?
7 A **Yes.**
8 Q You needed to get data at the deal level, for
9 example?
10 A **Yes.**
11 Q And if you hadn't been able to get access to data at
12 the deal level and all of the other data that you did
13 have access to, would it have impaired your ability
14 to form a judgment on these matters?
15 A **Perhaps. Likely.**
16 Q You believe it's important to collect all the
17 information so that you can make a fully informed
18 judgment?
19 A **Yes.**
20 Q So, for example, tell me some of the information you
21 considered it necessary to review in order to form
22 your own judgment as to Ambac's potential RMBS loss
23 exposures.
24 A **There were cash flow estimates for each deal. There**
25 **are -- Well, it depended on kind of the structure of**

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1 **the deals. There were some greater information**
2 **available on first lien deals than there are on**
3 **second lien deals and so forth, but, you know, there**
4 **was a body of information available on those. There**
5 **was information about the deal structure where the**
6 **waterfalls in the deals were and so forth.**
7 Q And this included historical information about cash
8 flows under the deal -- each deal?
9 A **Yes.**
10 Q And whose projections did it include with respect to
11 future cash flows?
12 A **Well, we received information from the company as to**
13 **their projections of future cash flows. We evaluated**
14 **the reasonableness of those and in some cases made**
15 **adjustments.**
16 Q And if you could summarize for the Court some of the
17 key information that you felt you needed to review in
18 order to form your own judgment as to Ambac's
19 potential muni loss exposure, Ambac's potential loss
20 exposure on its muni book.
21 A **We evaluated the credit risk management processes**
22 **that exist at Ambac, and looked at, you know, the**
23 **potential for loss, the estimates of loss for those**
24 **policies that were viewed to have a risk of default.**
25 **I think there was an overall evaluation of the credit**

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1 risk process to have some assurance that all the
2 policies that -- you know, were being reviewed at an
3 aggregate level so that those potentially problematic
4 exposures could be reasonably identified.

5 Q Did you review, among other things, internally
6 developed default information?

7 MR. VAN SICKLEN: Internal at Ambac or
8 at OCI?

9 Q Well, the responses to questions that OCI filed last
10 week, I believe, refers to -- refers to internally
11 developed information concerning internally developed
12 loss severities, for example. Is that a term you're
13 familiar with?

14 A Well, our advisors received information about Ambac's
15 development of losses and has evaluated those
16 estimates and in some cases made adjustments to that
17 or added cushions to that as we deemed appropriate in
18 order to be prudent in this matter.

19 Q And you received information of this sort as to each
20 one of the municipal policies, or something less than
21 that?

22 THE COURT: Mr. Bentley, can you help us
23 out here? You're talking away from your mic. Could
24 you move it over between your two -- Looks like
25 you've got two transcripts or something in front of

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1 you there. Could you move it between you because
2 you're moving away and then we're having trouble
3 hearing you.

4 MR. BENTLEY: Is that better, your
5 Honor?

6 THE COURT: Yes. Much. Thank you.

7 MR. BENTLEY: Thank you for pointing
8 that out. I'm sorry. I don't remember if there was
9 a question pending.

10 THE COURT: Read back.

11 (Last question read back by
12 reporter.)

13 BY MR. BENTLEY:

14 Q Or something less than that?

15 A Well, as I said, we reviewed the company's processes
16 as they applied to its surveillance, loss
17 surveillance, credit surveillance process, and to
18 assure that there was a reasonable process in
19 existence that could identify potentially --
20 potential loss or credit problems. We didn't go
21 through 14,000 policies to make an independent
22 assessment of loss potential in each of those
23 policies.

24 Q You looked at the policies where you thought there
25 was a potential -- significant potential for loss?

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1 A And looked at the company's system to identify those.

2 Q Now, did you develop a statistical expected loss
3 approach with respect to potential municipal policy
4 loss exposures?

5 A No. I don't think it's fair to say that there was a
6 statistical approach.

7 Q Sorry. You did not develop a statistical approach?

8 A That's correct.

9 Q Did you review a statistical approach that anyone
10 else had developed?

11 A No.

12 THE COURT: Were you given any notice
13 that such a statistical approach had been generated?

14 THE WITNESS: No.

15 BY MR. BENTLEY:

16 Q Now, is it fair to say that had you not received this
17 various information from Ambac with respect to RMBS
18 losses, with respect to municipal losses, you would
19 not have felt you were in a position to form your own
20 judgment as to Ambac's potential loss exposures in
21 these areas?

22 A That's correct.

23 Q And if somewhere -- If someone else were to come in,
24 some other party were to come in and try to evaluate
25 Ambac's potential loss exposures, would you agree

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1 that they would need access to similar data in order
2 to form their own judgment on that matter?

3 A Yes, they would.

4 THE WITNESS: Your Honor, if I may
5 enhance the record as to that statistical question?

6 THE COURT: All right. Go ahead.

7 THE WITNESS: It's my view that the
8 evaluation of the municipal bond book, really a
9 statistical evaluation isn't really relevant in this
10 case. There are so few losses historically in the
11 municipal bond book that to say that some statistical
12 evaluation is -- would draw you to some different
13 conclusion than we have, the main drivers of
14 potential loss in the municipal bond book are
15 economic factors that are really unpredictable and,
16 you know, in the current environment are essentially
17 unprecedented.

18 So, you know, parties have differing
19 views about how those things may roll out in the next
20 few years or decade, but to say that that is a
21 statistical evaluation, if that's what we're getting
22 at here, I think that is where I disagree, that there
23 was a -- you know, that we -- statistical evaluation
24 wasn't conducted because it really isn't relevant to
25 the underlying risk that the municipal bond book is

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1 exposed to.
2 BY MR. BENTLEY:
3 Q So what are the principal things you looked to in
4 order to form a judgment as to Ambac's potential
5 municipal loss exposures?
6 A **We judgmentally set stress losses for the municipal**
7 **book at a billion dollars in the scenarios such that**
8 **the claims or the success of the Plan was still**
9 **viable in that scenario. That, again, is not to**
10 **suggest that the plan would ultimately be exposed to**
11 **that or that OCI might not exercise regulatory**
12 **actions before that point, but in terms of being**
13 **prudent and having a cushion for potential losses of**
14 **the municipal bond book, we judgmentally put in that**
15 **estimate into the calculations.**
16 Q And you would agree -- Strike that. You were here
17 while Commissioner Dilweg testified on Monday and
18 Tuesday?
19 A **I was.**
20 Q And do you recall his testimony that all projections
21 have inherent uncertainty? And he also said, "If I
22 knew the future economics of our country, I wouldn't
23 be sitting here today."
24 Do you recall that?
25 A **I do, yes.**

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1 Q I mean, fair to say nobody has a crystal ball? You
2 don't? I certainly don't?
3 A **That is fair to say.**
4 Q And some future events are more uncertain than
5 others, true?
6 A **That's true.**
7 Q Would you agree that, as you said a moment ago, the
8 situation with respect to municipal -- future
9 municipal losses is particularly uncertain given that
10 we're now at a somewhat unprecedented moment with
11 respect to municipal exposures?
12 A **I wouldn't necessarily characterize it as**
13 **particularly uncertain. I don't know that there's**
14 **any greater risk of variation there than there is in**
15 **other potential losses. In fact, it could be**
16 **substantially less.**
17 Q So is it fair to say that in building your stress
18 case where you projected a billion dollars in
19 municipal losses, you did not assume any greater
20 uncertainty in the municipal area than in other
21 areas?
22 A **There was no direct linkage as to the relative amount**
23 **of uncertainty in the municipal bond book as opposed**
24 **to any other book.**
25 Q Let's talk for a moment about the municipal

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1 situation. You'd agree with me, wouldn't you, that a
2 number of municipalities are under fiscal stress at
3 the moment?
4 A **Yes. There are several, yes.**
5 Q In the past, the states have sometimes bailed out
6 municipalities when the municipalities were under
7 stress, correct?
8 A **Yes.**
9 Q Right now the states are under a great amount of
10 fiscal stress of their own, aren't they?
11 A **That is the case, yes.**
12 Q And so they may have less ability going forward to
13 bail out municipalities than they had in the past?
14 A **That's essentially true, yes.**
15 Q At any time since the Great Depression, really?
16 A **I-- Yeah, I haven't studied the whole economic**
17 **history of municipal bonds since the '30's, but that**
18 **sounds like a reasonable conclusion to draw.**
19 Q Now, do you think that the results of the recent
20 congressional elections warrant any reconsideration
21 of your projections of municipal losses?
22 A **I wouldn't feel qualified to answer that question.**
23 **Socioeconomic patterns, I think, are beyond my area**
24 **of expertise.**
25 Q Well, would you agree with me that there's, at a

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1 minimum, a very big question whether a
2 republican-controlled House of Representatives is
3 going to be prepared to bail out states or
4 municipalities?
5 MR. VAN SICKLEN: Your Honor, I think
6 we're getting to the point of wasting the Court's and
7 everyone else's time.
8 THE COURT: I do believe that's true. I
9 don't see any relevance to that. We can speculate on
10 that all day or take a break and go down and get a
11 cup of coffee and talk politics, but that seems to
12 have no relevance here.
13 MR. BENTLEY: I can explain the
14 relevance, but I'm happy to move on, your Honor.
15 THE COURT: Well, please do.
16 BY MR. BENTLEY:
17 Q In developing loss estimates with respect to the
18 General Account, did your stress case rest on certain
19 economic assumptions?
20 A **They weren't tied to -- For the General Account they**
21 **weren't tied directly to certain economic**
22 **assumptions to the best of my knowledge.**
23 Q They weren't tied on different potential levels of
24 unemployment, for example?
25 A **Not directly.**

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1 Q Would you agree with me that if unemployment hits
2 double digits, that could increase the risk of
3 municipal bond defaults?
4 A **I believe unemployment is currently at double digits.**
5 Q Well, it's actually at 9. something?
6 A **Well in many locales, it is in double digits.**
7 Q Let me try it slightly differently. Do you recall
8 the Commissioner's testimony yesterday that there
9 might be a double dip in the economy sometime down
10 the road?
11 A **I do.**
12 Q And do you recall his testimony that if there were
13 such a double dip, the General Account would be
14 stressed well beyond its means?
15 A **I don't recall that specific testimony, no.**
16 Q Okay. Do you have a transcript of the Monday
17 hearing?
18 A **I don't believe so.**
19 MR. BENTLEY: Your Honor, if you'll give
20 me a moment, we need to come up with a transcript we
21 can give to the witness.
22 THE WITNESS: Thank you, your Honor.
23 MR. BENTLEY: Thank you, your Honor.
24 BY MR. BENTLEY:
25 Q Mr. Peterson, could you look at page 207 of the

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1 November 15 transcript.
2 A **All right.**
3 Q Just a moment. You're faster than I am. I'm sorry.
4 It's at the very top of page 208.
5 A **Just a moment, please. I see it now, yes.**
6 Q Do you see the Commissioner testified, "And we
7 recognize that if, for example, there's a double dip
8 in the economy, the General Account could be stressed
9 well beyond its means."
10 Do you see that?
11 A **I do see it.**
12 Q Do you agree with that?
13 A **Well, there are circumstances where that could be the**
14 **case. You know, what constitutes a double dip**
15 **recession and the outcomes of that and how they**
16 **pertain to the resources of the General Account is --**
17 **involves quite a number of assumptions that I'm not**
18 **prepared to testify about.**
19 Q But sitting here today, you don't disagree with the
20 Commissioner's testimony, do you?
21 MR. VAN SICKLEN: Object. It
22 mischaracterized what the witness just answered.
23 THE COURT: I believe so. Sustain the
24 objection.
25

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1 BY MR. BENTLEY:
2 Q Okay. Do you recall the witness -- Sorry. The
3 Commissioner also testified that if there were to be
4 a double dip in the economy, "we would be back in
5 here with you looking at options for the General
6 Account rehabilitation."
7 That's at page 246 of Monday's
8 transcript.
9 A **Mm-hm. Just a moment. What line number?**
10 Q Lines 12 to 15.
11 A **All right. Yes, I see it.**
12 Q Okay. Do you agree that, as the Commissioner
13 testified, if there were a double dip in the economy,
14 the General Account might very well need to file for
15 rehabilitation?
16 A **I agree that OCI has retained its regulatory**
17 **authority as to the General Account, and if it were**
18 **experiencing losses that put that account in danger**
19 **or affected this Plan in a way that we deemed as**
20 **unfair to the policyholders, that we wouldn't be**
21 **precluded from taking additional regulatory action,**
22 **including placing the General Account into**
23 **rehabilitation.**
24 Q Do you -- With respect to -- I don't think you
25 answered my question, which is do you agree with the

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1 Commissioner's testimony that if there were a double
2 dip, OCI would be back here in this court putting the
3 General Account into rehabilitation?
4 MR. VAN SICKLEN: Objection. He
5 answered it not once, but I think at least two or
6 three times now.
7 MR. BENTLEY: No, he didn't.
8 THE COURT: All right. End -- You know,
9 this is interesting. I always find it fascinating
10 when you're asking somebody to comment on another
11 witness' testimony. There are rules in evidence that
12 rely to that. This witness is a fact witness as to
13 the Plan, construction of the Plan. I think we're
14 starting to drift far afield here.
15 The Commissioner's testimony is the
16 Commissioner's testimony as to his opinions. To ask
17 for comments on other person's testimony continuously
18 again and again and again is repetitive and is
19 starting to be a waste of the Court's time, time of
20 all these good folks here. So I will sustain the
21 objection and ask that you move on.
22 MR. BENTLEY: I'll move on, your Honor.
23 BY MR. BENTLEY:
24 Q Have you given any consideration to what impact, if
25 any, there would be on the losses in the General

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1 Account if the General Account were to commence
2 rehabilitation proceedings?
3 A Can you restate the question, please?
4 THE COURT: Just read it back.
5 (Last question read back by
6 reporter.)
7 A Well, we have talked about some of the risks that --
8 of default triggers and so forth that are -- remain
9 on policies that are in the General Account that
10 would be -- that among the losses that you're
11 alluding to developing in the General Account would
12 be factors that would be considered as we thought
13 about whatever regulatory actions -- you know, as
14 we'd move towards regulatory actions or considered
15 them.
16 Q So, for example, you testified earlier today that
17 there are CLO policies in the General Account. Do
18 you recall that?
19 A Yes.
20 Q And that Ambac's mark-to-market exposure with respect
21 to those policies is in the vicinity of \$3 billion?
22 A I testified to that, yes.
23 Q Okay. Would those mark-to-market -- Do you have an
24 understanding whether those mark-to-market damages
25 would be triggered if the General Account were to

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1 commence rehabilitation proceedings?
2 A In the most recent -- The information I recall with
3 regard to those CLO policies is that while they have
4 significant mark-to-market exposures, the economic
5 losses projected on that CLO book are rather nominal,
6 are quite a bit less -- I don't remember the exact
7 numbers, but don't equate to 3 billion -- such that
8 there is a big differential between what claims might
9 be argued for on a mark-to-market basis as opposed to
10 an economic loss basis.
11 Q Do you have an understanding one way or the other as
12 to whether, if the General Account went into
13 rehabilitation, those mark-to-market damages would be
14 triggered with respect to the CLO policies?
15 A That involves the legal analysis that we were
16 discussing prior to lunch. I'm not in a position to
17 argue -- to make comment or give testimony about the
18 outcome of litigation on the mark-to-market claim
19 issue.
20 Q Is it fair to say that the stress case filed in
21 support of the Plan with respect to loss estimates in
22 the General Account does not include any losses that
23 might be suffered as a result of the General Account
24 commencing rehabilitation proceedings?
25 A That stress was not specifically -- That stress

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1 amount was not specifically designed to incorporate
2 the rehabilitation factor or the additional loss that
3 might be related to a rehabilitation filing.
4 Q So those losses are not included in the \$1 billion
5 estimate, correct?
6 A No, they're not.
7 THE COURT: If there were losses?
8 THE WITNESS: If there were losses,
9 they're not included.
10 MR. BENTLEY: Those potential losses,
11 yes, your Honor.
12 BY MR. BENTLEY:
13 Q Does your \$1 billion stress case estimate with
14 respect to General Account losses rest on a discount
15 factor?
16 A Not that I recall. My recollection is that that was
17 very much a judgmental stress case number that we
18 used given the fact that the statistical base to try
19 to project municipal losses or other losses in the
20 General Account was largely nonexistent so that a
21 judgmental figure was the most reasonable to utilize,
22 and that's where it came from. It was judgmental in
23 nature, and to say exactly what elements it included
24 in that judgment, I don't recall. I don't know that
25 we spent hours debating what should be included in

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1 that judgmental analysis.
2 Q When you say that \$1 billion figure was picked based
3 on a judgmental analysis, do you mean that there was
4 no formula backing up the \$1 billion figure?
5 A That's correct.
6 Q It's just a figure you came up with based on your
7 general judgment?
8 A Yes.
9 Q Can you be more -- any more specific as to the
10 elements that went into the \$1 billion figure?
11 A No, I don't think I can.
12 Q Could anybody else at OCI, or are you the one with
13 most knowledge of this?
14 A At OCI, I would be -- I would be the one with most
15 knowledge.
16 Q Okay. Let's turn now to the loss estimates with
17 respect to the Segregated Account that were filed in
18 support of the Plan. And there you have both a base
19 case and a stress case, correct?
20 A Yes.
21 Q What unemployment presumptions, if any, went into the
22 stress case?
23 A The stress case utilizes a number of economic factors
24 from Moody's economy.com, and it's my recollection
25 that they -- it utilizes an S3 scenario from Moody's.

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1 Q The S3?
2 A I believe so.
3 Q Can you help us all out and tell us what that is?
4 A Well, that's -- It's a -- That's an area that
5 involves a number of parameters on things like house
6 price index, unemployment rates, interest rate
7 scenarios, and so forth. You know, I can't remember
8 specifically all the factors that are resident in
9 that economic projection, and some of those elements
10 may have come from other sources who I can't recall
11 with a hundred percent certainty, but we utilized
12 factors, you know, from sources like that, like
13 Moodys.com -- or economy.com, rather.
14 Q Can you tell me what unemployment assumptions the S3
15 scenario incorporates?
16 A Well, the scenarios are updated on a regular basis by
17 economy.com, and so for any particular period the
18 exact, you know, data related to unemployment or
19 house prices for a particular metropolitan region
20 vary from data point, you know, one time period to
21 another, so no, I can't tell you specifically what
22 unemployment numbers were associated with a
23 particular estimation.
24 Q You mentioned that the numbers change over time. As
25 of what date did you use the Moody's S3 scenario?

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1 A For which evaluation?
2 Q For the Segregated Account stress case.
3 A It was -- That was presented in the Disclosure
4 Statement?
5 Q And can you describe the --
6 THE COURT: Just a moment. Just a
7 moment. Did you answer that? I thought you asked
8 him a question.
9 THE WITNESS: I did, your Honor.
10 THE COURT: All right. I think he's
11 trying to get some clarification.
12 MR. BENTLEY: Oh, I didn't realize that
13 was a question. I don't believe the date is given.
14 THE COURT: Let's go back and see what
15 we have here.
16 "Q You mentioned that the numbers change
17 over time. As of what date did you
18 use the Moody's S3 scenario?"
19 "A For which evaluation?"
20 "Q For the Segregated Account stress
21 case."
22 "A It was -- That was presented in the
23 Disclosure Statement?"
24 "Q Can you describe the" --
25 That's where I interrupted.

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1 BY MR. BENTLEY:
2 Q So can you tell me what the date was of the S3
3 scenario that you used?
4 A Well, the estimate of loss included in the disclosure
5 was as of June 30th. We had been receiving regularly
6 updated information from economy.com. We would have,
7 to the best of my knowledge, used the most recent
8 data available at the time. I wouldn't know exactly
9 when that -- what release of economy.com's
10 information was included in our analysis.
11 Q Can you characterize the S3 scenario; that is, how it
12 compares to other -- how it falls on the spectrum of
13 Moody's scenarios?
14 A It's my understanding that the S3 scenario is
15 described as being such that 90 percent of the
16 possible outcomes would be more favorable than that
17 scenario and 10 percent of the possible outcomes
18 would be worse than the scenario described.
19 Q Okay. Okay. Thank you. Let me turn to another
20 topic, which is your projections with respect to
21 Ambac's claims paying resources. Is it correct that
22 in all four of the scenarios that are annexed to the
23 disclosure, the same projections are used with
24 respect to claims paying resources?
25 A I believe that's correct.

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1 Q So there's no base case or stress case for the claims
2 paying resources?
3 A That's true, but adjustments were made to add
4 conservatism to those estimates.
5 Q Did OCI internally develop a base case, a stress
6 case, or very -- or alternative cases with respect to
7 the claims paying resources projections?
8 A Again, there were adjustments made to add
9 conservatism to those estimates of claims paying
10 resources. They weren't -- Those adjustments weren't
11 structured in a base and stress case, but one
12 conservative or reasonably conservative case was
13 developed.
14 Q Now, the reinvestment rates that are used in your
15 projections are set forth in Exhibit C to the
16 Disclosure. Why don't we take a look at that. It's
17 Exhibit C to Exhibit 27.
18 A I have it.
19 Q Please turn to not the cover page of the exhibit, but
20 the first page with text.
21 A Mm-hm.
22 Q And look, please, at the second paragraph under the
23 heading Statement of Operations. Do you see that?
24 A Yep.
25 Q And does this paragraph set forth the different

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1 reinvestment rates that are used in OCI's
2 projections?
3 A **It does.**
4 Q And again, those same rates were used with respect to
5 all four scenarios?
6 A **That's correct.**
7 Q Now, did you internally prepare different
8 reinvestment rates for different types of
9 investments? So, for example, one rate for municipal
10 bond investments, another for RMBS investments.
11 A **This is a blended reinvestment rate that was utilized
12 based on the makeup of the company's portfolio.**
13 Q And so to get to this blended rate, did you start by
14 doing separate rates for each of the different books
15 -- sorry -- each of the different types of
16 investments in Ambac's portfolio?
17 A **I don't recall the details of how that blended rate
18 was developed.**
19 Q Presumably, you had a different rate for RMBS and for
20 municipal bond?
21 A **Well, there's exhibits that talk about the various
22 holdings of -- and we had cash flow projections on
23 the -- and principal and interest projections on the
24 investments within the portfolio. So yes, we had
25 information about potential returns by classification**

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1 **of investment assets.**
2 Q And then you took those and blended them together
3 into these unitary rates?
4 A **Yeah, to some -- Yes.**
5 Q Now, did you stress -- did you stress these
6 projections to take into account the possibility of a
7 double dip in the economy?
8 A **There was some -- It's my recollection that there was
9 some modeling that -- done that looked at the effect
10 on the Plan and the Segregated Account assets under
11 various investment returns. Given the range, it
12 wasn't determined to be one of the key elements, at
13 least as compared to loss development and remediation
14 recoveries.**
15 Q Well, would you agree with me that if unemployment
16 hit double digits or if there were to be a double dip
17 in the economy, that could have a substantial impact
18 on the return earned on Ambac's RMBS investments?
19 MR. VAN SICKLEN: Objection; cumulative.
20 The witness has indicated a lot of different
21 potential understandings what a double dip, you know,
22 would mean, et cetera. This is cumulative.
23 THE COURT: And counsel, your form of
24 your question is intriguing, would you agree with me.
25 That means that you're inviting him to be on the same

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1 mental status that you are when you form the
2 question. It's really an improper form of question
3 because it calls for speculation. Just ask the
4 question.
5 MR. BENTLEY: Okay.
6 THE COURT: If you want to state what
7 you believe, fine, you've done that, I think, in your
8 briefs and that. But when you ask him if he would
9 agree with you, it kind of clouds up the whole thing
10 because we're not really sure what you believe,
11 unless you're gonna tell us that you believe -- start
12 your question with this is what I believe, now do you
13 agree with that?
14 MR. BENTLEY: I'm happy to reframe it,
15 your Honor.
16 THE COURT: All right.
17 MR. BENTLEY: And, in fact, I'm getting
18 close to the end here. Let me see if I can sum up.
19 THE COURT: Don't hold out carrots.
20 MR. BENTLEY: That was a big one, your
21 Honor.
22 BY MR. BENTLEY:
23 Q As we discussed before and as the Commissioner
24 testified, there may be a double dip in the economy
25 sometime down the road. Agreed?

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1 A **It is a possibility, yes.**
2 Q Is it fair to say that if there were a double dip in
3 the economy, that would likely increase the magnitude
4 of the losses in Ambac's RMBS book?
5 A **Well, as opposed to -- Yes, it would in terms of
6 creating a higher probability of loss, moving it from
7 50 to something more than 50 percent of increase,
8 sure. But what is double -- What does double dip
9 mean? That we had one quarter where we had a
10 reduction in gross domestic product? You know, that
11 is -- would be another recession if you had a
12 reduction in gross domestic product.**
13 Q I think you --
14 A **You know, to try to project what any particular
15 recession or double dip of a recession might have in
16 terms of mortgage defaults or the severity of
17 mortgage defaults is, you know, something that I'm
18 not in a position to testify about.**
19 Q I think the one thing that we can all agree on, if
20 the Judge will let me put it that way, is none of us
21 have a crystal ball, right?
22 A **Mm-hm.**
23 Q What the economy will do in the future is highly
24 uncertain, correct?
25 MR. VAN SICKLEN: I object. This is

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1 cumulative --
2 THE COURT: Sustained.
3 MR. VAN SICKLEN: -- and argument.
4 THE COURT: Sustained.
5 BY MR. BENTLEY:
6 Q Well, if the economy were to turn down substantially,
7 that could affect your projections in a number of
8 ways, couldn't it?
9 MR. VAN SICKLEN: Same objection.
10 THE COURT: Sustained. Same is true if
11 it goes up. That's just a given.
12 MR. BENTLEY: Okay. Well here's the
13 point, your Honor.
14 BY MR. BENTLEY:
15 Q Would you agree with the following, which I believe:
16 That it's possible that the economy may turn down
17 sharply enough that the value of the RMBS investments
18 will go down, the value of the municipal bond
19 investments would go down, the claims, the loss
20 exposures in the muni book and RMBS book would go up,
21 and the collective consequence of all of these
22 developments could be that at some point down the
23 road, whether it's in 2020 or 2030, Ambac might not
24 have sufficient claims paying resources to pay claims
25 that arise then 25 cents on the dollar? Do you agree

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1 with that?
2 MR. VAN SICKLEN: Objection; form,
3 compound, speculative.
4 THE COURT: It is many things. Do you
5 have an understanding of that? Can you enter into
6 that speculation?
7 THE WITNESS: Well, I do have a
8 response, your Honor. As to the speculation of what
9 impact it would have, there are cases where, yes, it
10 would have a significant impact. I would also note
11 that OCI has been closely monitoring the financial
12 position of Ambac, both General Account and
13 Segregated Account, and has taken action quite
14 promptly when those loss contingencies developed, and
15 we're going to continue to monitor the financial
16 position of those accounts going forward, and that
17 it's not -- these kind of losses don't develop
18 overnight. This company doesn't pay catastrophe
19 losses. They are losses that develop over time and
20 are paid over a long period of time so that if, in
21 fact, an adverse scenario did develop in terms of
22 cash payments, there would be a relative small amount
23 of cash payments made before you -- this Regulator
24 could identify larger potential losses for the most
25 part, particularly with regard to the municipal bond

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1 business or other books of business that are clearly
2 a pay-as-you-go type of loss.
3 BY MR. BENTLEY:
4 Q I take it your testimony is that if there were to be
5 a very adverse scenario where the claims paying
6 resources of Ambac are limited, OCI would take prompt
7 steps to minimize the amount of cash that goes out
8 the door from that point on?
9 A **That's essentially my testimony, yes.**
10 Q But it's also true, isn't it, that under this Plan,
11 if it's confirmed and goes effective, 25 cents in
12 cash will go out to all current claims, correct?
13 A **That's correct.**
14 Q And --
15 A **There's a number of parties that have argued that 25**
16 **cents is insufficient. And we have studied the**
17 **potential losses of Ambac to a great deal. We've**
18 **added conservatism to those estimates, and we've**
19 **developed a Plan that we believe is prudent in**
20 **allowing a degree, 25 percent of cash payments, and**
21 **that in most scenarios, that will -- the predominance**
22 **of scenarios, that Plan is viable. And the only --**
23 **If you're suggesting the alternative is to pay**
24 **nothing until we know what the economic outcomes will**
25 **be over the next number -- X number of years, well, I**

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1 **suppose that is a possibility, that is a Plan that**
2 **could have been submitted. We don't believe that**
3 **that's fair to the interests of the policyholders.**
4 Q And I'm not suggesting any alternative. I'm just
5 asking questions to get your understanding.
6 A **Mm-hm.**
7 Q I understand you're balancing a lot of
8 considerations. I appreciate that.
9 A **Well, that's -- In fact, that's what I wanted to**
10 **elicit in my response, that we are balancing a number**
11 **of factors.**
12 Q And I appreciate that that's difficult, so I don't
13 mean to take away from that. All I'm trying to find
14 out is do you agree with me that it's possible down
15 the road, if an adverse scenario develops, Ambac
16 might find itself unable to pay 25 cents in cash to
17 claims that arise at that point?
18 MR. VAN SICKLEN: Objection; form.
19 THE COURT: Sustained. And it's also
20 repetitive.
21 MR. BENTLEY: Your Honor, with respect
22 to -- He has not answered the question, and I think
23 he can and I think he's willing to.
24 THE WITNESS: I'm quite sure I said it
25 was possible.

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1 THE COURT: Just a moment. What part of
2 sustained don't you understand?
3 MR. BENTLEY: I'm sorry, your Honor. I
4 was trying to reargue the point.
5 THE COURT: You certainly were.
6 Sustained. Proceed.
7 MR. BENTLEY: Okay.
8 BY MR. BENTLEY:
9 Q You're hopeful that Ambac will have the ability to
10 pay claimants 25 cents or more in most scenarios
11 going forward, correct?
12 A **Correct.**
13 Q There may be some scenarios where Ambac cannot do
14 that, correct?
15 MR. VAN SICKLEN: Same objection;
16 cumulative.
17 THE COURT: Sustained.
18 BY MR. BENTLEY:
19 Q Okay. Let me move on.
20 A **Thank you.**
21 Q I'm going to turn back briefly to one final topic,
22 namely, the CDS topic, and I'm going to elicit a few
23 more factual responses to some factual questions.
24 As part of OCI's evaluation of the
25 Plan's treatment of CDS claims or at any earlier time

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1 have you ever given any consideration to whether any
2 of the CDS banks have suffered losses, actual losses,
3 in connection with their CDS contracts?
4 A **The company paid losses on CDS contracts in the past.**
5 Q The company paid claims on CDS contracts?
6 A **Yes, claims.**
7 Q And what I'm asking is whether the payment of those
8 claims was a reimbursement of a loss the bank had
9 suffered as distinct from, essentially, paying the
10 bank on its winning wager?
11 MR. VAN SICKLEN: I object. Now we're
12 into argument and cumulative about an issue that we
13 exhausted --
14 MR. BENTLEY: It's not cumulative.
15 THE COURT: Mr. Bentley, you've got to
16 give the opportunity to be heard.
17 MR. BENTLEY: My apologies, your Honor.
18 THE COURT: Go ahead, Mr. Van Sicklen.
19 MR. VAN SICKLEN: Thank you. I object
20 to this line of questioning. We more than were
21 lenient this morning in allowing latitude. It's been
22 decided and he's just arguing.
23 THE COURT: I'll sustain that objection.
24 I think this is again repetitive.
25

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1 BY MR. BENTLEY:
2 Q Well, let me ask a new question that I've not asked.
3 As part of OCI's assessment of the Plan's treatment
4 of CDS, or at any prior time, have you given any
5 consideration to whether any of the CDS banks hold
6 the underlying security to which their CDS contract
7 relates?
8 MR. VAN SICKLEN: Same objection; no
9 relevance.
10 MR. BENTLEY: I can describe the
11 relevance if your Honor wishes.
12 MR. VAN SICKLEN: I think this is what
13 you argued in May.
14 MR. BENTLEY: No, it's not. Your Honor,
15 in May --
16 THE COURT: All right. Make your case
17 and then I'll rule.
18 MR. BENTLEY: Okay. In May, your Honor
19 approved a settlement. Now the Plan is proposing to
20 make payments to CDS claims on par with policyholder
21 claims, and if that's going to be done, your Honor,
22 we submit there needs to be a factual showing that
23 these CDS claims aren't entitled to be paid on par.
24 And as a legal matter, your Honor, if the banks don't
25 hold the underlying securities, then it's crystal

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1 clear they have no entitlement to be paid. So that's
2 why I'm asking the factual question, have you looked
3 at whether they hold the underlying securities?
4 THE COURT: Have you looked at that?
5 THE WITNESS: On a limited basis.
6 There's been evidence that they do hold those
7 securities. I don't -- I'm not personally
8 knowledgeable about the breadth of that.
9 BY MR. BENTLEY:
10 Q On a limited basis they hold the underlying --
11 A **Well, there's evidence that they do hold those -- the**
12 **underlying securities.**
13 Q What evidence are you referring to?
14 A **In the process of the negotiations with the Bank**
15 **Group, there were discussions about the positions**
16 **they held. I think there are witnesses with the**
17 **company that would have better knowledge of these**
18 **facts.**
19 Q Who would that be?
20 A **Either Mr. Barranco or Ms. Matanle.**
21 Q I'm sorry. Who was the second person that you
22 mentioned?
23 MR. VAN SICKLEN: They're the two people
24 who are identified in our witness list.
25

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1 BY MR. BENTLEY:
2 Q Cathleen Matanle?
3 A Yes.
4 Q Okay. So we will then follow up with them on that
5 question.
6 Is it fair to say that you don't have
7 personal knowledge as to the answer to this question?
8 MR. VAN SICKLEN: Objection. The
9 witness just answered it.
10 MR. BENTLEY: No, your Honor. I'm
11 entitled to explore whether it's hearsay or double
12 hearsay or triple hearsay.
13 THE COURT: Sustain the objection. It
14 has been answered.
15 BY MR. BENTLEY:
16 Q What's your basis for the testimony you just gave,
17 the answer you just gave?
18 MR. VAN SICKLEN: This is not
19 understanding the word sustained again. I object.
20 THE COURT: I agree. Sustained again,
21 Mr. Bentley.
22 BY MR. BENTLEY:
23 Q You said some banks hold underlying securities. How
24 many?
25 MR. VAN SICKLEN: Objection; relevance.

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1 THE COURT: Sustain that. I don't know
2 that it is relevant. Apparently there are other
3 people who can fill that information in that might
4 have talked with them. Let's move on, Mr. Bentley.
5 BY MR. BENTLEY:
6 Q Can you tell me whether the underlying security is
7 held in more than one instance?
8 MR. VAN SICKLEN: Same objection.
9 THE COURT: Sustained.
10 MR. BENTLEY: Okay. I have nothing
11 further, your Honor.
12 THE COURT: All right. Do you want to
13 switch chairs with whoever is the next objector?
14 State your name, please, for the
15 reporter.
16 MR. OWEN: Jim Owen for ALL and Lloyds
17 Bank. Give me one moment to get organized here,
18 please.
19 **CROSS-EXAMINATION:**
20 BY MR. OWEN:
21 Q Good afternoon, Mr. Peterson.
22 A Good afternoon, Mr. Owen.
23 Q I'll ask you some questions about your affidavits
24 first if that's okay.
25 A That will be fine.

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1 Q Exhibit 41 of ours is your first affidavit. Exhibit
2 41?
3 MR. VAN SICKLEN: Exhibit 41?
4 MR. OWEN: I'm sorry. Sorry about that.
5 That's the supplemental brief that I'll be asking you
6 for.
7 MR. VAN SICKLEN: 9, perhaps?
8 MR. OWEN: I need one moment to get
9 organized here, please.
10 BY MR. OWEN:
11 Q In your first affidavit, sir, you mentioned the
12 factors that would go into a claim or a policy going
13 into the General Account and the factors going into
14 the Segregated Account. I'd like to go over those
15 with you. The factors that go into, on page eight,
16 paragraph 12, you said the, "Policies that were (a)
17 without material projected losses, (b) for which
18 collateral damage of rehabilitation could outweigh
19 the, benefits and/or (c) for which policyholders
20 signed a binding agreement to forbear from the
21 exercise of contractual triggers and to commute
22 certain impaired exposures at a substantial discount
23 to likely loss levels were left in the General
24 Account."
25 Is that correct?

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1 A That is what it says, yes.
2 Q And which policies were then put into the Segregated
3 Account? Were they just the policies with material
4 projected losses?
5 A No. There were classes of business put into the
6 Segregated Account, such as all RMBS policies were
7 moved there rather than a policy-by-policy treatment
8 for RMBS.
9 Q But all of the policies that were put into the
10 Segregated Account were policies that had material
11 projected losses, correct?
12 A No. There are individual RMBS policies that don't
13 have material projected losses.
14 Q Okay. Well let's go through those factors then. A,
15 you said the policies that were left in the General
16 Account were without material projected losses,
17 correct?
18 A That's correct.
19 Q And then B, there was going to be collateral damage
20 of rehabilitation that would outweigh the benefits,
21 but the policies that went into the Segregated
22 Account had -- were subject to rehabilitation, so
23 they might have collateral damage, correct?
24 MR. VAN SICKLEN: Objection to the form
25 of the question. It was vague.

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1 BY MR. OWEN:
2 Q Well, if the policies that were in the General
3 Account --
4 THE COURT: Just a moment. Just a
5 moment. Do you understand?
6 MR. OWEN: I'm sorry. Can you answer
7 the question?
8 THE COURT: Just a moment. Do you
9 understand the question?
10 THE WITNESS: Well, I thought it was
11 appropriate to rule on the objection first.
12 THE COURT: All right. Thank you. The
13 objection went to the vagueness of it. I wondered if
14 it was to you. Was it a vague question? Let me read
15 it back to you.
16 THE WITNESS: Thank you, your Honor.
17 MR. OWEN: I can restate it.
18 BY MR. OWEN:
19 Q It's your affidavit. It says that the policies that
20 were left in the General Account were those that were
21 gonna suffer collateral damage because of the
22 rehabilitation that would outweigh the benefits.
23 Now, if the other --
24 A **Yes, that's what it says.**
25 Q But the policies that went into the Segregated

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1 Account were gonna be subject to rehabilitation, so
2 they were definitely going to be subject to
3 rehabilitation. So those wouldn't be -- That factor
4 wouldn't apply to those policies in the Segregated
5 Account, would it?
6 MR. VAN SICKLEN: Objection as to form.
7 It's just -- It's argumentative.
8 THE COURT: It is argumentative, but
9 again, I thought maybe the witness had been able to
10 move through the various connective clauses of the
11 question. Do you have it?
12 THE WITNESS: Well, the response is that
13 some of those collateral damages that were possible
14 in the policies that were moved to the Segregated
15 Account were enjoined by this Court.
16 BY MR. OWEN:
17 Q But if they -- So you believe that all the collateral
18 damages that could occur to the policies in the
19 Segregated Account have been enjoined; there's no
20 possible collateral damages that are occurring to
21 those policyholders in the Segregated Account?
22 That's your testimony?
23 MR. VAN SICKLEN: Objection; compound.
24 THE COURT: It is compound.
25

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1 BY MR. OWEN:
2 Q I'll make it very simple. Is your testimony that the
3 policyholders in the Segregated Account are not
4 suffering any collateral damages right now?
5 A **No, that's not -- I couldn't answer a question as
6 broad as that.**
7 Q Okay. And then C, were any of the policyholders in
8 the Segregated Account given the option to sign that
9 binding agreement to forbear from the exercise of the
10 contractual triggers?
11 A **Consistent with my testimony this morning, it was
12 impractical to -- or impossible to contact
13 policyholders across the various policies without
14 precipitating the kind of losses that we were trying
15 to protect against.**
16 Q So C doesn't apply to the policyholders in the
17 Segregated Account, does it?
18 A **No. These relate to the -- The paragraph relates to
19 the policies that were retained in the General
20 Account.**
21 Q So basically, those policies in the Segregated
22 Account are the policies with material projected
23 losses, and even though we may suffer collateral
24 damages, it's your belief that the injunction is
25 going to stop some of them, but you're not sure all

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1 of them. Is that your summary of your testimony?
2 MR. VAN SICKLEN: Objection as to form.
3 It's vague.
4 THE COURT: Do you understand that
5 question?
6 THE WITNESS: Yes, I understand the
7 question.
8 THE COURT: Can you answer it?
9 THE WITNESS: In summary, not being
10 inclusive of all possible outcomes, yes, that is a
11 reasonable summary.
12 BY MR. OWEN:
13 Q Have you reviewed any of the briefs that have been
14 filed in this matter with respect to the ALL/Lloyds
15 policies?
16 A **No, not generally speaking. I haven't -- I've
17 focused on development of the plan, the Disclosure
18 Statements, and so forth. I haven't been
19 particularly involved in opposing -- reviewing
20 opposing briefs or appeals.**
21 Q If I ask you -- Let me read for you this one
22 statement that says the ALL policies at issue and
23 indeed any student loan policies subject to the
24 assessment process that would be allocated to the
25 Segregated Account present exactly the type of, and I

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1 quote, "material projected impairments" that the
2 Segregated Account was designed to include. Do you
3 agree with that statement?

4 A Yes.

5 Q So the primary factor that was -- that was designed
6 to put policies into the Segregated Account was
7 material projected impairments, was it not?

8 MR. VAN SICKLEN: Objection;
9 mischaracterizes the witness' statement several
10 times.

11 THE COURT: Sustained.

12 BY MR. OWEN:

13 Q What factors, other than material projected
14 impairments of the policies, went into the OCI's
15 decision to put policies into the Segregated Account?

16 A It's detailed in the affidavit.

17 Q You're on the stand now. I'd like to hear your
18 testimony.

19 A We evaluated potential losses from classes of
20 business including the student loan class. We
21 evaluated losses related to contractual triggers. We
22 -- And as I described previously, we did -- we looked
23 at that in terms of classes of business and
24 subclasses of business and, at times, at individual
25 policy levels.

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1 Q Well, that was still potential losses, losses with
2 contractual triggers in classes, subclasses, in
3 individual policies. That's all gets down to
4 potential losses, correct?

5 MR. VAN SICKLEN: Objection as to form.

6 I don't know what he means by losses with potential
7 triggers.

8 MR. OWEN: I repeated his testimony.

9 MR. VAN SICKLEN: I don't think so,
10 but --

11 BY MR. OWEN:

12 Q You can correct me if I misstated your testimony.

13 A We didn't put policies in the Segregated Account for
14 the fun of it. There was risks associated with those
15 policies or groups of policies that we felt it was
16 necessary to protect the overall structure for
17 rehabilitation that we were developing, you know,
18 when it appeared necessary to protect that structure
19 from these risks, certain policies or groups of
20 policies were moved to the Segregated Account.

21 Q And what do you mean by risks?

22 A Risks of loss, risks of payments on contractual
23 triggers, risk of claims related to accelerations of
24 loss, risks related to increased interest rates on
25 the underlying deals such that the assets supporting

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1 that deal were diminished more quickly and, thus,
2 would ultimately create a bigger loss.

3 Q But every policy has a risk, and you mentioned
4 yesterday the difference between net par outstanding,
5 the potential ultimate liability under a policy
6 versus the actual impairment, whether it be a paid
7 loss or reserve for the loss. Upon which basis were
8 you basing this decision to put them in the
9 Segregated Account, the net par outstanding under the
10 policy or the actual paid or reserve?

11 THE COURT: Are you asking for your
12 policies, the ALL policies?

13 BY MR. OWEN:

14 Q I'm asking for -- I will stick with our policies,
15 which is the ALL/Lloyds policy. The student loan
16 policy.

17 A Of the items I recall you mentioning, the answer is
18 none of those. We didn't --

19 Q Which one was it? What was the basis for the ALL
20 student -- the ALL/Lloyds Bank Student Loan policy?

21 A As I responded in the previous question, there were
22 losses related to the credit quality of some of the
23 student loan deals, that the underlying loans,
24 private loans, that are not backed by federal
25 guaranties were experiencing significant defaults and

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1 were impairing the credit quality of those deals.

2 In addition to that, there were factors

3 related to the financing of the deal where there were
4 auction rates or variable rate structures that had
5 effectively failed, and penalty rights of interest
6 were being charged against the deal and thereby
7 diminishing the assets in the deal.

8 Q Were there actual losses under the ALL/Lloyds
9 policies at any time?

10 A These are estimates of future loss, as I described
11 previously, sir.

12 Q So there were no actual losses?

13 A I don't recall specifically. To the best of my
14 knowledge, that is the case, that there hadn't been
15 actual losses paid yet.

16 Q And did you do any specific analysis of the exact
17 amount of the projected future losses?

18 A Yes. We evaluated the projected losses.

19 Q And are those anywhere in the record in this court
20 proceeding?

21 A No. We haven't provided policy-by-policy loss
22 estimates for the reasons that --

23 Q And if we -- I'm sorry.

24 A For the reasons that were described earlier in my
25 testimony.

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1 Q And if we waive that confidentiality, you would
2 provide that information?
3 MR. VAN SICKLEN: I object. It calls
4 for speculation.
5 THE COURT: That would have to be worked
6 through counsel.
7 THE WITNESS: Yeah, I can't -- I can't
8 respond to that. It involves issues that I can't
9 determine right off the top of my head.
10 MR. OWEN: Your Honor, if the decision
11 of this Court is to put our policies in the
12 Segregated Account based on the material projected
13 impairment and the losses, and we're willing to waive
14 what they're saying is the only reason they won't put
15 it in the record is confidentiality, and you're going
16 to put our policies into the account based on a
17 statement that he's making, and right now it's just
18 -- it's just speculation, and your Honor has been
19 refusing to put any -- allow any testimony in the
20 record based on speculation, then we're willing to
21 waive that and allow him to put it in the record.
22 THE COURT: But your question and what
23 you're posing at this point under these
24 circumstances, the next question will be all right,
25 start naming those policies. The position is that

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1 this is something that would be a legal decision that
2 would have to be worked out with counsel. This
3 witness isn't in a position, apparently, to make that
4 legal statement on behalf of the Commissioner.
5 MR. OWEN: Okay.
6 THE COURT: So sustain the objection.
7 MR. VAN SICKLEN: It's attached to the
8 affidavit you were just looking at, counsel.
9 MR. OWEN: Okay. Making sure.
10 MR. VAN SICKLEN: Just in somewhat
11 fairness to respond to counsel's last question about
12 information, the affidavit of Mr. Peterson is, as
13 Mr. Owens knows, that dealt with the Lloyds is
14 Affidavit No. 4, has specific information about the
15 loss exposures on his client's policy.
16 MR. OWEN: No. It only has specific
17 information about the present shortfall with no
18 specific information about the material projected
19 impairments. As you well know, the maturity date is
20 June of 2013. Not a word in any of the affidavits
21 filed by the Commissioner as to the material
22 projected impairments as of the date of loss under
23 the policy. Not one word in the record.
24 THE COURT: All right. Proceed.
25

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1 BY MR. OWEN:
2 Q I show you what's been marked the March 24, 2010
3 letter signed by you, a two-page letter. Are you
4 familiar with this document?
5 A Yes, sir.
6 Q Can you explain its purpose?
7 A It was a request to establish the Segregated Account.
8 Q And did the document actually approve the Segregated
9 Account?
10 A I believe there was a subsequent document that
11 actually approved the Segregated Account.
12 Q So in paragraph five where it says OCI -- on the
13 second page, says "OCI finds that the creation of the
14 Segregated Account and the Allocation do not
15 constitute fraudulent conveyances." And so for those
16 -- That was just a finding, but not a final order
17 approving it; is that correct?
18 MR. VAN SICKLEN: Final order by who?
19 MR. OWEN: I was just -- Final order by
20 the Commissioner's Office.
21 A The document stands for itself. We made that
22 determination at the time that this request was made,
23 the actual approval of the Segregated Account, as I
24 said, I believe, was done in a separate subsequent
25 document.

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1 Q On the same day?
2 A On the same day.
3 Q And on the same day this secured note was signed and
4 executed?
5 A I believe that's the case too, yes.
6 Q And the Reinsurance Agreement was executed?
7 A I believe all of those documents were executed on
8 March 24th.
9 Q And the Certificate of Authority was issued by the
10 Commissioner's Office?
11 A That's correct as well.
12 Q And is there a copy of the Certificate of Authority
13 on the website?
14 A I don't believe it's on the website, to my
15 recollection.
16 Q I'm sorry?
17 A Not to my recollection. But I believe it's
18 referenced in the record.
19 Q That's what my next question was. Do you know if
20 it's in the record of these proceedings?
21 MR. VAN SICKLEN: It's -- Well, one, I'm
22 happy to provide a copy. It's publicly available.
23 And two in the questions and answers, I think it's
24 page eight, the very top, that we filed last week OCI
25 responded to that question.

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1 MR. OWEN: Yeah. We did ask the
2 question. I saw your response that there was one,
3 but as far as publicly available, we did make a
4 request to the OCI and have not received it yet, so
5 I'm asking whether it's in the record because so far
6 we have not been able to receive a copy or the
7 application. So is one going to be in the record?
8 MR. VAN SICKLEN: I'm happy to share it
9 with you, counsel. I can dig it up and find it for
10 you.
11 MR. OWEN: Okay.
12 BY MR. OWEN:
13 Q Do you know if an application was filed requesting a
14 Certificate of Authority?
15 A Yes. A document responding to this request from
16 Ambac was submitted to OCI indicating their -- the
17 Board's approval of the Segregated Account and the
18 need or the request to issue a Certificate of
19 Authority.
20 Q And do you know the date that application was filed
21 under Section 611.20 requesting a Certificate of
22 Authority?
23 A Well, the citation that you gave I don't recall from
24 my -- from memory, but the request for the
25 Certificate of Authority would have also been

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1 March 24th of this year.
2 Q And do you know the purpose of the process of an
3 application for a Certificate of Authority?
4 A Yes.
5 Q What is that?
6 A Companies file applications to become licensed, to
7 have a Certificate of Authority as a Wisconsin
8 insurer. They file those with the Commissioner's
9 Office. There is information that's provided with
10 regard to that -- those entities, and we review that
11 information, and if the information is deemed
12 sufficient and is not in violation of law, then a
13 Certificate of Authority is issued.
14 Q Is that a process that also allows the public to give
15 their input on the application, give them time to
16 review the application, give public input on the
17 application? Notice to the public that there's been
18 application of Certificate being requested?
19 A No.
20 Q No?
21 A No. The process doesn't involve public notice.
22 Q The application is not a public document?
23 MR. VAN SICKLEN: Public in the -- I
24 think the witness is struggling. Public in what
25 sense? I mean, open records request to OCI?

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1 MR. OWEN: I don't know if the witness
2 is having any trouble, Mr. Van Sicklen.
3 BY MR. OWEN:
4 Q Do you know -- Are you having any trouble with my
5 question whether it's a public document or not?
6 A Well, we have taken the position that transactions in
7 the process of being evaluated are considered
8 confidential. Upon completion of an evaluation,
9 there is -- and the record is complete, then it
10 becomes a public record in our -- it's been our
11 position.
12 Q And do you know if that position applies to
13 application for a Certificate of Authority?
14 A I don't know that that question has been presented to
15 me directly until this time.
16 Q And do you know if, prior to the application for a
17 Certificate of Authority, that there should be an
18 organizational permit?
19 A That is part of the process, yes.
20 Q And was there an --
21 A For a -- For a new corporation, that's correct.
22 Q And was -- Is the Segregated Account not a separate
23 insurer and a new corporation in this instance?
24 A I think there's a nuance here that it is perhaps what
25 could be referred to as a corporation within a

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1 corporation.
2 Q So it's not a separate insurer under the statute in
3 your determination?
4 A It is a separate insurer. The question as to whether
5 a separate application and the other document that
6 you referred to -- It's escaping me right now.
7 Q Organizational permit.
8 A Organizational permit is necessary is not clear to
9 me.
10 Q So your testimony is that in this instance, because
11 there was a hurry to get this process done and no one
12 wanted to let the public know that this process was
13 going on because of what you've already instigated
14 was that people in the Segregated Account might get
15 upset and find out about it and trigger instances,
16 that the organizational permit process was
17 disregarded?
18 MR. VAN SICKLEN: Objection.
19 THE WITNESS: That is not at all my
20 testimony.
21 MR. VAN SICKLEN: Yeah. One, it's not
22 his testimony. Two, this isn't some kind of jury
23 trial in Ohio, wherever Mr. Owens conducts business
24 generally. It's grossly improper.
25 MR. OWEN: Missouri, by the way, the

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1 Show-Me State. We like to see things done properly.
2 THE COURT: All right. It is about -- I
3 guess if there's black letter for an argument
4 question, that would be it. Sustain the objection.
5 Improper. Improper question.
6 MR. OWEN: Okay.
7 BY MR. OWEN:
8 Q Was an organizational permit disregarded in this
9 instance?
10 A I don't recall.
11 MR. VAN SICKLEN: Wait. Wait. I
12 object. Disregarded? It's more of the same.
13 MR. OWEN: He just answered, your Honor.
14 THE COURT: I'll sustain the objection.
15 BY MR. OWEN:
16 Q Do you know whether, pursuant to statute, an
17 application shall include a statement by the
18 principal officer of any material changes that are --
19 have already taken place or likely to take place in
20 the facts on which the issuance of the organizational
21 permit was based?
22 MR. VAN SICKLEN: Objection; calls for a
23 legal conclusion.
24 THE COURT: Sustained.
25 MR. OWEN: I can't ask him whether he

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1 knows whether the statute requires that, your Honor,
2 even if he knows?
3 THE COURT: I sustained the objection,
4 counsel.
5 MR. OWEN: Okay.
6 Q Was there a fear that if an organizational permit or
7 an application was made public, that individuals in
8 the Segregated Account would be aware of that and
9 trigger some of the -- and take advantage of some of
10 the triggers that were in their policies?
11 MR. VAN SICKLEN: Objection as to form.
12 THE COURT: What's the form objection?
13 MR. VAN SICKLEN: It's just
14 argumentative, and the witness -- and lack of
15 foundation. He's indicated he's not sure that one's
16 even required, so to argue that it's, you know, it
17 was not submitted for some alternative purpose when
18 the witness indicated a complete lack of foundation
19 as to whether one was even required calls for
20 speculation.
21 MR. OWEN: Your Honor, the witness has
22 testified several times that they were -- that the
23 OCI had a fear that if these information came out to
24 the Segregated Account policyholders that
25 rehabilitation was in the offering, that they would

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1 trigger provisions in their policies and that's why
2 they were not given notice. I'm trying to find out
3 whether that had anything to do with the fact that
4 they did not follow procedures on the application
5 process.
6 THE COURT: I'll sustain the objection.
7 You're basing it on the conclusion not shown, which
8 is that they didn't follow procedures. That's the
9 conclusion you've apparently reached or are basing
10 your questions on, which is not shown here. Proceed.
11 BY MR. OWEN:
12 Q In paragraph one of your letter you state -- Can you
13 look at the first sentence of your paragraph one,
14 starting with the Allocation, ending with the
15 Segregated Account? You talked about the Allocation
16 being fairly balanced. Are you following me?
17 A Oh, yes. In paragraph one, yes.
18 Q Yes. Was that your way of saying that there was
19 adequate capital and surplus in the Segregated
20 Account?
21 THE COURT: I think the question is when
22 you talk about Allocation being fairly balanced, was
23 that saying there's adequate capital and surplus in
24 the Segregated Account.
25 THE WITNESS: Well, it references -- The

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1 paragraph references the sources of funding to the
2 Segregated Account and, in connection with the other
3 points in the letter, supports the contention that
4 the creation is fair and within provisions of
5 Wisconsin law.
6 BY MR. OWEN:
7 Q Tell me this. How did the Commissioner's Office
8 satisfy itself that the Segregated Account would have
9 and maintain adequate amounts of capital and surplus
10 in the Segregated Account?
11 A **Through -- As was testified to earlier, through the**
12 **fact that the secured note and the excess of loss**
13 **reinsurance provided a mechanism to fund the**
14 **Segregated Account and gave it the necessary funds to**
15 **pursue the plan that was anticipated, and that those**
16 **demands available to the Segregated Account**
17 **constituted substantially all of the funds available**
18 **from the General Account.**
19 Q When you say fund the Segregated Account, do you mean
20 fund the liabilities of the Segregated Account?
21 A Yes.
22 Q And yesterday you testified that the Segregated Note
23 and Reinsurance Agreement were a permanent mechanism
24 for affecting cash payments under the Plan. What is
25 -- What did you mean by permanent mechanism?

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1 A They're expected to exist throughout the life of the
2 Segregated Account and be there to provide those --
3 the funding necessary to make cash payments and so
4 forth under the Segregated Account's Plan.
5 Q So both of those -- both the Secured Note and the
6 Reinsurance Agreement, in your opinion, have no
7 expiration dates by permanent?
8 A That's my recollection, yes.
9 Q Okay. On page 197 of the transcript, Mr. Van Sicklen
10 asked you to assume --
11 THE COURT: Just a moment. Which day?
12 MR. OWEN: Yesterday. I'm sorry.
13 THE WITNESS: The page number again,
14 sir?
15 BY MR. OWEN:
16 Q Page 197.
17 A All right.
18 Q Starting at line six through line 11, if you want to
19 read over it real quickly.
20 And then there were some objections,
21 sir. If you want to keep reading, your answer was on
22 page 198, lines six through 11. And I'll read it.
23 His question was:
24 "Q And assuming that the future events
25 under the four scenarios that you

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1 have modeled, you know, reality is
2 somewhere within those scenarios, is
3 there adequate, ah, capital through
4 these vehicles of the note and the
5 Reinsurance Agreement to fund the
6 requirements of the Plan as you've
7 modeled it here?"
8 Your answer was:
9 "A Well, the funding of the Segregated
10 Account was determined to be adequate
11 in that the cash flow needs of the
12 Plan are met and substantially all of
13 the assets of the General Account
14 have been made available to the
15 Segregated Account through the
16 structure of the Plan as well."
17 Is your answer again based on the fact
18 that the Security Note and the Reinsurance Agreement
19 will meet the potential of the reality, as Mr. Van
20 Sicklen said, of the four scenarios?
21 A If you're suggesting that there are cases within the
22 scenarios where the surplus notes may not be paid in
23 full, these scenarios clearly document that.
24 Q But under the four -- any of those four scenarios,
25 your testimony is the Reinsurance Agreement and the

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1 Secured Note will cover those liabilities?
2 A Substantially all the assets that would be available
3 otherwise are, in fact, available through the Demand
4 Note and the Excess of Loss Agreement to fund those
5 liabilities.
6 Q Okay. Can you look at Exhibit 5, the Secured Note
7 executed on March 24th?
8 A Mm-hm.
9 Q The maker is Ambac, is it not, AAC?
10 A It is.
11 Q And payee is the Segregated Account?
12 A It is.
13 Q And on the final page of that document, it is signed
14 off on by Kevin Doyle on behalf of Ambac and by Kevin
15 Doyle on behalf of the Segregated Account. And what
16 was Kevin Doyle's position?
17 A He was General Counsel for Ambac Assurance
18 Corporation.
19 Q And what was his position with the Segregated
20 Account?
21 A I believe he has a similar position with the
22 Segregated Account.
23 Q And which brings my question. What -- Is there a
24 Board of Directors for the Segregated Account?
25 A There's not a separate Board of Directors for the

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1 Segregated Account.
2 Q In fact, the Rehabilitator is the governing person
3 for the Segregated Account, is he not?
4 A Effectively, yes.
5 Q And he's, by a Management Service Agreement and a
6 Cooperation Agreement, he's allowed to designate the
7 representatives of Ambac to act for him, is he not?
8 A That's correct.
9 Q So on that same day he apparently designated
10 Mr. Doyle to act for him as a rehabilitator of the
11 Segregated Account in signing this document. Is that
12 your understanding? Or do you have one?
13 A I believe that is the case, yes.
14 Q Have you seen many documents where the same person
15 signs as the maker and the payee in acting in your 20
16 plus years?
17 A I think there are a number of affiliated documents
18 where officers hold similar positions in different
19 affiliates and sign on behalf of both of those
20 affiliates.
21 Q Okay. And in this instance it mentions on page one
22 the covered policies. And what were the covered
23 policies? Page one.
24 A I believe it's all the policies that are allocated to
25 the Segregated Account.

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1 Q And those were formerly the policies in -- covered by
2 AAC, correct?
3 A Yes.
4 Q But now they're policies of the Segregated Account,
5 correct?
6 A They were transferred, yes.
7 Q And the -- Paragraph A allows the -- says that these
8 -- The maker has established the payee in accordance
9 with the Plan of Operation as amended from time to
10 time. Is that correct? Last sentence in Paragraph
11 A?
12 A Yes.
13 Q Is that your understanding, that the Plan of
14 Operation can be amended from time to time?
15 A Yes.
16 Q And the Plan of Operation is Exhibit 2. Can you look
17 at that? The Plan of Operation is a document that's
18 entered into between Ambac and the Segregated Account
19 as well, correct?
20 A It is.
21 Q So those two --
22 A It's also subject to oversight by this Court.
23 Q And where is that contained in the document, that it
24 can be -- that it's subject to any modification
25 provision in the Plan. I know the Plan of

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1 Rehabilitation is, but is there a provision in the
2 Plan of Operation?
3 A The Plan of Operation was submitted to this Court.
4 Q Okay. It was submitted for approval. Does the Plan
5 of Operation contain any provision for modification?
6 A That would be my understanding. Or operationally,
7 that would certainly be the Rehabilitator's intent as
8 to seek this Court's approval of any modification of
9 the Plan. To find that exact provision, I can't
10 point to it directly.
11 Q Arguably, Mr. Doyle can sign off and amend the Plan
12 on behalf of both the Segregated Account and Ambac at
13 any time?
14 MR. VAN SICKLEN: I'm sorry. Which
15 Plan?
16 BY MR. OWEN:
17 Q The Plan of Operation. He can sign off on behalf of
18 Ambac and he can sign off on behalf of the Segregated
19 Account? He's empowered.
20 A I would suggest that that would be a gross violation
21 of his responsibilities under the Management Services
22 Agreement.
23 Q So a lawsuit could ensue?
24 A I don't know that any--
25 MR. VAN SICKLEN: I object.

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1 THE COURT: Just a moment. Just a
2 moment. This is argument. Let's move on.
3 BY MR. OWEN:
4 Q To your understanding, was Mr. Doyle authorized to
5 sign the Secured Note?
6 A My understanding is he had sufficient authority to do
7 so.
8 Q Look at the Payments Section of the Secured Note on
9 page two.
10 A That's Exhibit 9 again? 5?
11 Q Exhibit 5.
12 A All right. Thank you. Payment section, page two.
13 Yes.
14 MR. VAN SICKLEN: I'm sorry. Which
15 paragraph, counsel?
16 MR. OWEN: Paragraph 1(a) on page two,
17 Payments. 1(a) is Principal.
18 MR. VAN SICKLEN: Thank you.
19 BY MR. OWEN:
20 Q And it provides for a maturity date of March 24, 2050
21 where the Note should be available in full. Is that
22 your understanding?
23 A Yes, that is what it says.
24 Q Subject to mandatory prepayments. And if you'll look
25 down, it calls for various payments of, under the

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1 covered policies commutations, cash interest and
2 payments, and then it has, "provided" -- right in the
3 middle of the paragraph -- "in each case such amounts
4 due and payable are in accordance with the Plan of
5 Rehabilitation and not otherwise disapproved by the
6 Rehabilitator. Is that your understanding, that the
7 Rehabilitator has the option at any time of
8 disapproving a payment under this paragraph?
9 A It appears to give that authority. In what context
10 that would be utilized I'm not going to speculate.
11 Q Neither can I.
12 Also makes the payments subject to the
13 Plan of Rehabilitation. It's your understanding the
14 Plan of Rehabilitation can be amended from time to
15 time subject to the approval of the Court, correct?
16 A It can.
17 Q Let's look at the Reinsurance Agreement, Exhibit 6.
18 And the attachment point of this Reinsurance
19 Agreement, as you understand, is the \$2 billion
20 Secured Note, and I think you testified yesterday --
21 I'm sorry. First, yes?
22 A That's correct, yes.
23 Q And the \$2 billion you selected was because you
24 assumed there might be \$8 billion in losses and
25 2 billion was the 25 percent cash point?

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1 A Well, that wasn't exclusively the reason, but that
2 essentially was it, yes. I mean, we -- There were
3 some judgment involved, but it established payments
4 or sufficient demand note capacity for expected
5 losses on cash payments.
6 Q Again, it wasn't exclusively the reason. What other
7 reasons were there for choosing that amount?
8 A I can't recall right now.
9 THE COURT: Has that been asked?
10 MR. VAN SICKLEN: Yes, it has, your
11 Honor.
12 THE COURT: All right. You're bound by
13 the answers given to those questions previously to
14 avoid repetition, so that would mean, under that
15 rule, I'll sustain the objection to that question.
16 Let's move on.
17 BY MR. OWEN:
18 Q If you look at page two, is it your understanding
19 that the Section 1.02, the Finite Aggregate Coverage,
20 is a provision that is governing when the Reinsurer
21 shall provide payment to the Ceding Company along
22 with the Follow the Fortunes clause?
23 A Yes.
24 Q And if you'll look down again in the middle of that
25 paragraph, there is another -- it talks about amounts

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1 due and payable?
2 A In accordance with the Plan.
3 Q I'm sorry?
4 A In accordance with the Plan of Rehabilitation?
5 Q Yes, sir. It talks about cash payment, claim
6 payments, loss settlements, commutation payments.
7 But then it says, "provided that in each case, such
8 amounts due and payable are in accordance with the
9 Plan of Rehabilitation and not otherwise disapproved
10 by the Rehabilitator"?.
11 A Language similar to that in the Note?
12 Q Yes.
13 A Yes, it does say that.
14 Q And do you know, again -- So at any time the
15 Rehabilitator could disapprove of a reinsurance
16 payment?
17 A It gives that authority.
18 Q Or the Plan of Rehabilitation could be amended at any
19 time?
20 A As was -- Yes. As was the case in the previous
21 question.
22 Q And it says at the very bottom that, "For greater
23 certainty" in the last paragraph, and it goes on to
24 say that (quoted as read) "the Reinsurer shall not be
25 required to pay or reimburse the Ceding Company

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1 unless and until (and to the extent that) a cash
2 interest payment or cash principal payment under the
3 Surplus Note is authorized for payment by the
4 Rehabilitator in accordance by the Plan of
5 Rehabilitation."
6 Are you plan familiar with that
7 provision?
8 MR. VAN SICKLEN: Your Honor, these
9 documents speak for themselves. I'm not sure --
10 MR. OWEN: I'll ask him a follow-up
11 question, your Honor.
12 THE WITNESS: Actually, I'm having -- I
13 don't readily see the line that you're referring to.
14 BY MR. OWEN:
15 Q The final section of Section 1.02. If you'll take
16 your time and read that, starting with "greater
17 certainty."
18 A I see it now. Thank you. I've read it. Your
19 question?
20 Q Is it your understanding that the Reinsurer in this
21 case, Ambac, AAC, does not need to make any payment
22 unless the Surplus Note has been approved for payment
23 by the Rehabilitator?
24 A Yes, until there's a cash payment on the Surplus
25 Notes.

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1 Q That's what I mean.
2 A That's correct.
3 Q And those are the cash payments that you were
4 referring to earlier as the potential projected
5 payment amounts? It could be -- It could end up
6 being 20 cents on the dollar, 40 cents on the dollar,
7 60 cents on the dollar, whatever the final amount on
8 that 75 percent --
9 A Yeah.
10 Q -- Surplus Note?
11 A As demonstrated in the scenarios, there are different
12 ultimate payouts available. As was previously
13 discussed, payments may occur sooner than that
14 ultimate 2050 date and so forth, but they're not
15 illustrated.
16 Q And there may be no payments at all, correct, on the
17 Surplus Notes?
18 A It is a possibility, as is being hit by a meteor.
19 Q Agreed. Is there a Follow the Settlements clause in
20 this contract as distinguished from a Follow the
21 Fortunes clause?
22 A Yes, I believe there is.
23 Q Where is that?
24 A My quick paging through the document, I haven't
25 located it.

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1 Q Do you understand a Follow the Settlement clause to
2 be one that says you are bound by all settlements,
3 unconditionally bound by all settlements made by the
4 Cedant?
5 A **Well, that's consistent with the Follow the Fortunes,
6 follow the settlements provisions of a Reinsurance
7 Contract.**
8 Q Understood. But in this case there is a Follow the
9 Fortunes clause on page four, Section 4.01, but there
10 is not a Follow the Settlement clause, unless you can
11 point me to one.
12 A **Well, when you asked about the Follow the
13 Settlements, in fact, I presumed you were referring
14 to Follow the Fortunes, so I need to correct my
15 testimony that a Follow the Settlements provision
16 exists in the contract.**
17 Q Okay. And let's look at the Follow the Fortunes
18 clause. In the Follow the Fortunes clause, the --
19 you mentioned in your previous testimony that you
20 thought there was a modification, but I was unclear
21 on your testimony. You said the modification
22 referred to the -- Well, let me ask you about it.
23 What is your opinion as to the
24 modification of the Follow the Fortunes clause in
25 this contract?

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1 A **It is modified to acknowledge that draw of payment on
2 a cash basis as cash payments are made rather than on
3 the full value of a loss settlement being the cash
4 and note.**
5 Q And where do you find that language?
6 A **"Except as modified by the Plan of Rehabilitation."**
7 Q Okay. Now, you look down further in that same
8 paragraph --
9 THE COURT: This may be an appropriate
10 time to take the afternoon recess. We'll be in
11 recess for 15 minutes. And Mr. Peterson, you may
12 step down.
13 THE WITNESS: Thank you, your Honor.
14 (Recess had at 2:56 p.m.)
15 (End of Reporter Poirior's
16 segment.)
17 (Begin Reporter Weisling Section D.)
18 THE COURT: All right. Be seated.
19 Court is again in session. Mr. Peterson is on cross.
20 And, Mr. Owen, you're ready to proceed?
21 **CROSS-EXAMINATION**
22 BY MR. OWEN:
23 Q Mr. Peterson, you mentioned that there was one
24 modification to the Follow the Fortunes, and that was
25 the "except as modified by the plan of

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1 rehabilitation." And I ask you to look farther down
2 in this paragraph where it says, "provided, however,
3 that this article shall not be construed to expand
4 the liability of the Reinsurer beyond what is
5 specifically assumed under this agreement." Do you
6 understand the meaning of that provision?
7 A **This agreement is intended to require payments from
8 the General Account to the Segregated Account for
9 policies and claims on those policies that are
10 approved in accordance with the Plan and by the
11 Rehabilitator and that the article shouldn't be
12 construed to expand that liability.**
13 Q And the words "provided, however" are italics,
14 correct?
15 A **They are.**
16 Q And would this not refer back to the Section 1.02 and
17 what is actually the claims that are assumed under
18 the agreement? It's what they have to pay under the
19 agreement; does it not refer to that?
20 A **I don't want to get into the legal interpretation.**
21 THE COURT: Just a minute, just a
22 minute, just a minute. You've got a negative. Let
23 me follow this. Would it not? What do you mean when
24 you -- Would it not? You mean no, it doesn't or yes,
25 it does or what are you looking for when you use that

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1 double negative in your question, would it not?
2 MR. OWEN: Would it not is a double
3 negative? My question says does that provision refer
4 back to Section 1.02 of the agreement.
5 THE COURT: Well, that isn't what you
6 said before because it's clear. Go ahead.
7 THE WITNESS: It doesn't specifically
8 refer back to it that I can see. And how that should
9 be interpreted legally, I don't think I'm the best
10 qualified person to testify on.
11 BY MR. OWEN:
12 Q Okay. The provision also has a section on the assets
13 and collateral, Section 5.07. Do you know how that
14 provision has been interpreted?
15 A **Interpreted by who?**
16 Q If it's been interpreted so far. By the OCI.
17 THE COURT: The question is has it been
18 interpreted and by whom?
19 BY MR. OWEN:
20 Q Has it been interpreted so far by the OCI?
21 A **OCI believes that this agreement requires the payment
22 from the General Account to the Segregated Account
23 based on cash claim payments made consistent with the
24 Plan of Rehabilitation and not otherwise disapproved
25 by the Rehabilitator. And that to the extent those**

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1 **claims are made and approved and are consistent with**
2 **the Plan, we believe that this is an absolute**
3 **requirement that payments be made from the General**
4 **Account to the Segregated Account.**

5 Q And one of the provisions says that the note -- the
6 last sentence of Section 5.07 says, "No part of the
7 Collateral is subject to any Lien or any adverse
8 claim of any kind whatsoever, except those in favor
9 of the Ceding Company," which is the Segregated
10 Account. What's your interpretation of that?

11 MR. VAN SICKLEN: I object for this
12 witness.

13 THE COURT: Just a moment. Let me hear
14 the objection.

15 MR. VAN SICKLEN: Calls for a legal
16 conclusion.

17 THE COURT: Counsel?

18 MR. OWEN: He's the person
19 administrating this account, Your Honor. You said we
20 had to wait until we got the person who is the
21 administrator of this account, and he's the one who's
22 testified that this agreement provides protection for
23 all the liabilities in the account. And now I'm not
24 able to ask this person how it provides for
25 protection for all the liabilities in the account.

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1 THE COURT: Well, I think that's been
2 probably asked and answered by your predecessors two
3 or three times.

4 MR. OWEN: No one's asked the question
5 under this -- one question about the Reinsurance
6 Agreement, Your Honor, and especially about the
7 collateral provision.

8 THE COURT: Well, then let's do this.
9 Do you have the question in mind? Can you answer it?

10 THE WITNESS: I do. And I believe it is
11 a legal question. I don't feel I'm qualified to
12 interpret how that works.

13 MR. OWEN: Thank you.

14 A **I don't act alone as administrator of this Plan. In**
15 **fact, I'm not appointed as the administrator of this**
16 **Plan.**

17 THE COURT: You're not the
18 Rehabilitator.

19 THE WITNESS: I'm not the Rehabilitator.

20 BY MR. OWEN:

21 Q Who would be the person to have an answer to that
22 question?

23 A **Currently Commissioner Dilweg is the Rehabilitator of**
24 **the -- of Ambac Assurance. Kimberly Shaul is the**
25 **Special Deputy Rehabilitator. Those parties along**

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1 **with myself act with advice of counsel and with the**
2 **advice of financial advisors to make determinations**
3 **about or interpretation of contracts.**

4 Q On page 10 of the agreement, there's Section 8.01 on
5 insolvency. Mr. Van Sicklen asked you a question
6 about this. Are you familiar with the fact that
7 these provisions are required in order for the other
8 ceding company to take credit on its financial
9 statements for its reserves?

10 A **I'm familiar with that requirement, yes.**

11 Q Is that provision -- is there any necessity for the
12 ceding company in this case to take credit for its
13 reserves if the General Account is carrying the
14 reserves? Do you understand in this case it's a
15 General Account?

16 A **The accounting treatment is a reinsurance and**
17 **retrocession reinsurance.**

18 Q Explain that for the Court.

19 A **There is, as it is accounted for in the statutory**
20 **accounting statements of the General Account and the**
21 **Segregated Account, there is both a reinsurance**
22 **cession and a retrocession, meaning that reinsurance**
23 **is -- in the way it's accounted for, I think reserves**
24 **are transferred. Because claims were established or**
25 **policies were moved to the Segregated Account, there**

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1 **is, this is accounted for as a Reinsurance Agreement,**
2 **and then this document where there is reinsurance**
3 **that provides protection to the Segregated Account is**
4 **accounted for as a retrocession agreement.**

5 Q As if there was a retrocession agreement, because
6 there is no retrocession agreement, is there?

7 A **Yes. That's the accounting treatment that's**
8 **presently being used, as I describe. But there is no**
9 **retrocession agreement in place.**

10 Q In fact, if you look at Sections 10.01 and 10.02 on
11 pages 10 and 11, again, 10.01 would treat this under
12 Chapter 40 of Wisconsin law and Section 906 of New
13 York insurance law as if the first section, 10.01,
14 treats it again as if the ceding company was keeping
15 the reserves, but section 10.02 says that the
16 reinsurer shall maintain the reserves required to be
17 established and maintained by the ceding company. Is
18 that your understanding?

19 MR. VAN SICKLEN: Objection. Relevance.
20 Calls for a bunch of legal conclusions. And it's
21 compound.

22 MR. OWEN: Your Honor, it's relevant and
23 I'll get to that.

24 THE COURT: I'll sustain the objection.
25

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1 BY MR. OWEN:
2 Q Is it your understand, sir, in the Disclosure
3 Statement that's been filed and approved by you that
4 that the General Account is carrying all the reserves
5 of the ceding company?
6 A **I believe that's correct.**
7 Q Do you know if the ceding company, in other words,
8 the Segregated Account, is carrying any reserves
9 right now?
10 A **Again, there's a reinsurance session to the**
11 **Segregated Account, and it's accounted for as a**
12 **retrocession back to the General Account.**
13 Q And what is the purpose for that? Is there -- In
14 other words, there's no liabilities for anything
15 except for paid claims right now in the Segregated
16 Account; is that your testimony?
17 A **Because the secured note and this Reinsurance**
18 **Agreement fully fund those liabilities.**
19 Q But isn't the purpose for the oversight by a
20 regulator when a ceding company is ceding reserves to
21 a reinsurer for the -- so that the regulator can come
22 in and review that statement and see whether, in
23 fact, the reinsurer is capable and that the reinsurer
24 is actually assuming those reserves properly?
25 MR. VAN SICKLEN: Objection.

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1 Argumentative and calls for a whole bunch of legal
2 conclusions.
3 THE COURT: Have you got any opinion on
4 this or can you answer that question? I guess he's
5 asking you for an opinion.
6 THE WITNESS: Well, we, the
7 Commissioner's Office, is clearly involved in
8 understanding the financial position of both of these
9 entities.
10 BY MR. OWEN:
11 Q So, in other words, you're skipping that step of
12 oversight where the ceding company would normally
13 post a reserve on its financial statement, and then
14 the regulator would come in and oversee this and make
15 sure that the reinsurers actually assuming those
16 reserves, that has been skipped in this transaction,
17 has it not?
18 A **I don't believe that's an accurate portrayal, no.**
19 Q The agreement just says that the General Account is
20 maintaining the reserves for the Segregated Account,
21 does it not?
22 MR. VAN SICKLEN: Objection. This is
23 cumulative and just getting argumentative.
24 THE COURT: Sustained.
25

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1 BY MR. OWEN:
2 Q What act of active oversight is there currently in
3 making sure that the reinsurer in this case is
4 properly accounting for the reserves of the
5 Segregated Account, the reinsurer, Ambac?
6 A **Those statements are prepared by Ambac staff under**
7 **the Management Services Agreement. They are**
8 **submitted and are available for review by OCI staff**
9 **and are subject to audit of the independent CPAs as**
10 **well as our office at any time that we choose to do**
11 **so.**
12 Q It's the same general oversight that the
13 Commissioner's Office has over any company, is it
14 not?
15 A **Well, in addition to that, we are in daily -- daily**
16 **involved with the oversight of both the General and**
17 **Segregated Account.**
18 Q Including the posted reserves of the Segregated
19 Account?
20 A **We're not -- OCI is not involved directly in**
21 **establishing -- we're not directing how those**
22 **reserves should be established.**
23 Q Thank you. Who is in charge of the claims handling
24 for the Segregated Account?
25 MR. VAN SICKLEN: Now or pursuant to the

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1 Plan?
2 MR. OWEN: Pursuant to the Plan.
3 Q Actually pursuant to the Plan Rehabilitation as
4 amended from time to time, because it's not approved
5 yet.
6 A **Well, the Plan, to my knowledge, has not been**
7 **amended. So --**
8 Q I'm just getting amended all the time?
9 A **Not as to the -- The operations of claims are handled**
10 **by Ambac staff under the management services**
11 **agreement and are subject to review and approval by**
12 **the Rehabilitator prior to payment.**
13 Q And what staff does the Rehabilitator have to oversee
14 the claims handling of these types of claims?
15 A **I have conducted that type of role -- there haven't**
16 **been any claims made from the Segregated Account --**
17 **as well as Deputy Commissioner Shaul have both acted**
18 **in that capacity. We've utilized our financial**
19 **advisors as commutation agreements and so forth have**
20 **been presented.**
21 Q I'm talking about when an actual policy claim comes
22 in under the Segregated Account. Do you have claims
23 handlers, claims adjustors that handle these types of
24 claims on your staff that work at your office?
25 A **Those claims administration procedures are -- have**

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1 **been delegated to AAC with the oversight of the**
2 **Rehabilitator.**
3 Q And I'm trying to understand the oversight. I don't
4 know many departments of insurance that have claims
5 adjustors that are experienced in handling financial
6 guaranty claims, and I'm asking do you have such
7 staff that are experienced in the claims adjusting
8 for these time of complex types of financial guaranty
9 policies?
10 A **We have financial advisors and legal advisors that I**
11 **believe are capable of assisting us to the extent**
12 **necessary to evaluate these claims.**
13 Q And do you know whether or not it's customary to have
14 the reinsurer handling the claims for the Cedant
15 under a reinsurance agreement.
16 A **Customary in this context or just generally outside**
17 **of a rehabilitation?**
18 Q Customary in the industry under a reinsurance
19 agreement.
20 THE COURT: It does happen.
21 MR. OWEN:
22 Q In what context? Is it normal and usual to have the
23 person who's responsible for paying the claim under
24 the Reinsurance Agreement to be handling the claim
25 for the Cedant?

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1 A **When the reinsurer controls those assets and is**
2 **substantially liable, I think it is common that the**
3 **reinsurer administers the claims as well.**
4 Q Under what types of agreements, reinsurance
5 assumption agreements, or how often is that done?
6 I'm trying to find out if you believe that this
7 arrangement to have the reinsurer doing the claims
8 handling for the Cedant is normal and usual in the
9 industry.
10 A **AAC has responsibilities under that Management**
11 **Services Agreement that it is required to execute --**
12 **well, in a fair and reasonable way and -- So that the**
13 **allegation that there is some kind of different**
14 **interest or some problem that isn't subject to the**
15 **oversight of the Rehabilitator is I think incorrect.**
16 Q No, I'm not making an allegation that the
17 Rehabilitator is in any way improper. I'm trying to
18 say that -- Do you understand that the scenario with
19 the policyholder, the insurer, and the reinsurer is
20 one in the insurance industry where there is
21 generally no privity of contract between the
22 policyholder and the reinsurer. Do you understand
23 that?
24 A **I understand that, as I testified, there are cases**
25 **where when the reinsurer is substantially the entity**

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1 **that's going to make payments on the claims that it**
2 **is not unusual that that reinsurer would have --**
3 **would administer those claims.**
4 Q But is there not inherent conflict and is that not
5 why the Rehabilitator has maintained some discretion
6 and control over this process, an inherent conflict
7 meaning that the reinsurer who's going to be paying
8 the claims for the insurer for the Cedant's -- for
9 the policyholders' policies has a financial interest
10 in paying that and therefore there's an inherent
11 conflict in letting them handle the very claims
12 coming in from the policyholder?
13 MR. VAN SICKLEN: Objection.
14 Argumentative and cumulative.
15 THE COURT: It is. But it's intriguing.
16 Do you have the question in mind?
17 THE WITNESS: I can't say that I do, no.
18 THE COURT: All right.
19 MR. OWEN: Your Honor, there's
20 reinsurance bad faith claims throughout the nation
21 because the reinsurer's handling the claims or is
22 getting involved. And they stay completely out of
23 the claims-handling process. The cases are legion
24 where reinsurers are sued for this. I think Your
25 Honor -- the witness just shook his head.

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1 Q You're aware of the fact that there is reinsurance
2 bad faith claims handling because a reinsurer gets
3 involved in the claims handling by the Cedant,
4 correct?
5 A **Well, yes, there are reinsurance disputes that exist.**
6 Q I make a living off it for 21 of my 30 years. So the
7 key is if there is an inherent conflict in letting
8 them handle it, the Rehabilitator seems to have put
9 in a provision to allow for oversight of that, has he
10 or has he not?
11 A **I already testified that I believe that the**
12 **Rehabilitator through the -- our financial and legal**
13 **advisors has the ability to oversee the claims being**
14 **presented to the Segregated Account and paid by the**
15 **General Account.**
16 Q I'm trying to say with all of these scenarios in this
17 Reinsurance Agreement, where the reserves are being
18 kept-- held by the General Account and not by the
19 ceding company, where the reinsurer is handling the
20 claims, and where there is a provision that allows
21 the ceding company to disapprove claims that are
22 being -- under the payment clause, do you believe
23 that this is a normal and usual reinsurance agreement
24 in the industry?
25 MR. VAN SICKLEN: This is cumulative.

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1 THE COURT: Sustained.
2 BY MR. OWEN:
3 Q Let me just ask you without the complicated question.
4 Do you believe after -- being in the industry for
5 20-plus years that this is a normal and usual
6 Reinsurance Agreement?
7 THE COURT: Rehabilitations usually
8 aren't normal and usual in the industry. Some sort
9 of events have occurred to trigger it.
10 MR. OWEN: It's still, Your Honor --
11 Q In the industry, is my question.
12 A **The form of the Reinsurance Agreement is**
13 **substantially similar to forms that exist in other --**
14 **the fact that the reinsurer holds the assets is a**
15 **particular element of this structure that serves**
16 **purposes of the overall rehabilitation, and as I**
17 **testified to a -- several times I believe that the**
18 **Rehabilitator has adequate facility to oversee the**
19 **administration of this Reinsurance Agreement.**
20 Q In your March 24th letter you state that the -- in
21 paragraph 4 that OCI finds the creation of the
22 Segregated Account and the allocation was not done
23 with the intent to hinder delay or defraud present or
24 future creditors of AAC but rather to preserve
25 claims-paying resources for the benefit of all

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1 policyholders. I'm asking you, hasn't there been a
2 hindrance and a delay of the payments to the
3 Segregated Account creditors?
4 MR. VAN SICKLEN: This is just arguing
5 legal issues.
6 THE COURT: Sustained.
7 BY MR. OWEN:
8 Q Is it your belief that the policies allocated to the
9 Segregated Account have been effectively subordinated
10 to policies remaining in the General Account?
11 A **I wouldn't use that language, no.**
12 Q I'll show you what's been published by Moody's in the
13 May 10th --
14 MR. OWEN: May I approach the witness,
15 Your Honor?
16 THE COURT: Sure.
17 BY MR. OWEN:
18 Q In Moody's May 10th publication they said, "In our
19 view the policies allocated to the Segregated Account
20 have been effectively subordinated to the policies
21 remaining in the General Account." Do you disagree
22 with that statement?
23 A **Ido.**
24 Q Okay. When you referred to the triggers that cause
25 the Dunkin' brands and the Sonics and the Hertz,

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1 those triggers of coverage, is it your opinion based
2 on your prior experience as a rehabilitator, I think
3 you said as special deputy, that there was no
4 potential injunctive relief that you could have
5 sought in a full rehabilitation to stop the exercise
6 of those triggers?
7 A **I don't believe that was my testimony.**
8 Q No. I'm asking you. Could you have sought an
9 injunctive relief to stop the exercise of those
10 triggers in a full rehabilitation?
11 MR. VAN SICKLEN: The witness has
12 answered this several times. I mean, it's
13 cumulative.
14 THE COURT: Sustained. You're bound by
15 those previous askings and answers.
16 BY MR. OWEN:
17 Q Is it your belief that the collateral damage that was
18 going to be caused to Dunkin' brands and hertz and
19 Sonic was definite or it was just possible?
20 A **The likelihood that holders of some of those**
21 **securities would have acted in their self-interest to**
22 **accelerate payments on obligations is not certain but**
23 **seemed quite likely.**
24 Q And on what is that decision based? Did you review
25 the policies or the documents?

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1 A **Members of our team did.**
2 Q And did they report the basis of their findings to
3 you?
4 A **They did.**
5 Q Did you read the affidavits of the representatives of
6 Dunkin' and Sonic?
7 A **I did some time ago.**
8 Q Do you know if they made those statements that the
9 damage was definite or whether it was just something
10 that if certain events occurred that damage could
11 occur?
12 A **I don't recall specifically what their affidavit**
13 **said.**
14 Q Did you base your decisions in part on their
15 affidavits?
16 MR. VAN SICKLEN: I'm sorry, I don't
17 know what period of time we're talking about. The
18 affidavits came in long after the rehabilitation
19 started.
20 BY MR. OWEN:
21 Q Did you rely in any fashion on the affidavits of the
22 representatives of Dunkin' and Sonics and Hertz?
23 THE COURT: For what purpose?
24 BY MR. OWEN:
25 Q In making your decision not to do a full

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1 rehabilitation?

2 THE COURT: Before March 24th?

3 MR. OWEN: At any time. This proceeding
4 has been open ever since, Your Honor.

5 THE WITNESS: Again the affidavits were
6 received subsequent to the rehabilitation. The
7 perspective that collateral damage possibilities
8 existed was an element of our decision to create this
9 rehabilitation structure. The -- That risk continues
10 and those affidavits, without reviewing their
11 specific content, I believe continue to support the
12 fact this that risk exists.

13 BY MR. OWEN:

14 Q And do you know if the concern of Dunkin' was based
15 on a termination of the insurance policy or a
16 rehabilitation?

17 A I don't recall at this time.

18 Q Do you know if the affidavit of Hertz was based again
19 on a termination of the policy or just a
20 rehabilitation?

21 A I don't recall at this time.

22 Q Do you know if your concerns for those -- well,
23 strike that. Do you know if Dunkin' is still a
24 policyholder?

25 MR. VAN SICKLEN: It's cumulative. This

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1 witness has already gone through this.

2 THE COURT: It's been gone through, and
3 it's been answered. You're bound by those previous
4 answers.

5 MR. OWEN: I just looked at the
6 transcript, Your Honor, and I believe that was a
7 different witness and I think he wasn't sure.

8 THE COURT: Well, I will thought that --

9 MR. OWEN: It was Mr. Dilweg, and I
10 believe I looked at his testimony on page 117 and he
11 says he believes they refinanced their debt, he was
12 not sure. And I think this witness might be able to
13 shed more light.

14 THE WITNESS: I can answer if you like.

15 THE COURT: All right, go ahead.

16 THE WITNESS: To the best of my
17 knowledge Dunkin' is in the process of refinancing
18 its debt. To the best of my knowledge that
19 transaction is not closed at this point.

20 BY MR. OWEN:

21 Q Do you know if they're still a policyholder?

22 A I presume that up until the refinancing closes that
23 they would be a policyholder. But, again, it is my
24 understanding that that refinancing is in progress.

25 Q Do you know about Sonic?

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1 MR. VAN SICKLEN: Know what about Sonic?

2 BY MR. OWEN:

3 Q Do you know whether they're still a policyholder?

4 A I don't specifically know.

5 Q Do you know if they have made any attempts to
6 refinance their debts?

7 A I don't recall. I don't know.

8 Q The \$989 million in paid claims that -- is that the
9 current status of the paid claims in the Segregated
10 Account?

11 MR. VAN SICKLEN: Objection. You don't
12 mean paid.

13 MR. OWEN: I'm sorry. I have refer to
14 that in the terminology of the industry. The
15 \$900 million in -- \$989 million or in that general
16 ballpark of claims that are pending in the Segregated
17 Account, are those being carried -- is that your
18 understanding of the amount? I'm taking that from
19 the transcript of Mr. Dilweg.

20 A I don't specifically recall the amount. It is -- My
21 recollection is that it's in excess of 800 million,
22 but the amount you quoted, I don't specifically
23 recall.

24 Q I'll look at the disclosure statement, Exhibit 41,
25 page 21, it did list an answer on 12-A from

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1 March 24th through September 30th was approximately
2 856 million?

3 A I have it.

4 Q And that's the --

5 A What page are you looking at?

6 Q Page 21, Mr. Peterson.

7 A Page 21. I'm not actually finding it.

8 Q On 12-A the answer says --

9 A You're referring to Exhibit 27?

10 Q I'm sorry. 41. If you look at 27 it would be page
11 62, I believe. But I don't think there's a total in
12 Exhibit 27, as far as I could find. Page 62 of
13 Exhibit 28, the Disclosure Statement, I was reading
14 from the supplemental Disclosure Statement on page
15 21. Page 62 of the disclosure statement I do believe
16 gives some figures. Are you on page 62 of the
17 disclosure?

18 A I am.

19 Q Now, that seems to give some figures of what I assume
20 are unpaid claims of the first lien RMBS policies of
21 251 million, the second lien RMBS policies of
22 405 million. Are those current unpaid claims in the
23 Segregated Account? Or am I am misreading it?

24 A I believe that's correct.

25 Q And then if you look all the Exhibit 4, page 21, the

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1 supplemental disclosure.

2 A I have it.

3 Q That gives a figure of \$856 million. Is that an

4 updated figure on those unpaid claims?

5 A It's a figure through September 30th.

6 Q Would that include those same numbers we just read

7 from page 62 of the Disclosure Statement?

8 A I believe it would.

9 Q Do you know if those are just increases in the

10 figures for the first and second lien RMBS policies

11 or they include other types of policies?

12 A To the best of my knowledge it's primarily increases

13 to the RMBS policies.

14 Q And are those liabilities being carried -- I'm

15 sorry -- are those unpaid claims being carried as

16 liabilities in the Segregated Account?

17 A They are retroceded back to the General Account, I

18 believe, as I testified to, in the operations of

19 those statements.

20 Q I understand that they can be ceded and then

21 retroceded in your fashion, but I'm saying are they

22 being carried as the unpaid claims right now, are

23 they being carried as liabilities of the Segregated

24 Account? I can understand that reserves can be --

25 A They're not presented as direct liabilities of the

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1 Segregated Account. They are presented as reserves

2 that are ceded to the Segregated Account by virtue of

3 the transfer of the policies to the Segregated

4 Account and then retroceded back to the General

5 Account by virtue of the Reinsurance Agreements and

6 demand note that are resident in our Plan.

7 Q Once a claim is a permitted claim, is it still a

8 reserve, sir?

9 A These aren't permitted claims at this point.

10 Q I'm going to ask you, once a claim is a permitted

11 claim, is it still a reserve?

12 MR. VAN SICKLEN: Objection. Relevance.

13 MR. OWEN: Your Honor, it's very

14 relevant. These are questions have how they carry

15 the liabilities on the books of the Segregated

16 Account.

17 THE COURT: Well, are we at that point

18 of carrying liabilities on the books of the

19 Segregated Account?

20 THE WITNESS: Well, there are no

21 permitted claims within the Segregated Account at

22 this point.

23 MR. OWEN: But, Your Honor, the question

24 comes to how -- as to adequate capital and surplus

25 how they're going to carry they're liabilities and

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1 how they're going to carry their reserves. We're

2 entitled to find out how that financial practice is.

3 THE COURT: Do you know how that's going

4 to work under the Plan?

5 THE WITNESS: There will be -- No, I

6 don't know exactly what accounting presentation will

7 be used. But to the extent that there are permitted

8 claims and there are payments pending on those

9 permitted claims, there will be a draw on the secured

10 note or on the Reinsurance Agreement that is there to

11 offset any liability related to that because the

12 money is going to be drawn from the Segregated

13 Account -- or from the General Account to the

14 Segregated Account.

15 BY MR. OWEN:

16 Q I understand. But under the Plan -- under the

17 Plan -- and I'll point to the provision -- under the

18 Plan, once a claim is permitted under -- If can if

19 you look at Exhibit 26, page 7, 1.42, it's determined

20 to be -- by the rehabilitator or management service

21 provider to be a matured, noncontingent, due and

22 payable obligation according to the provisions of the

23 policy.

24 A That's part of the definition of permitted claim,

25 yes.

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1 Q So if the claim is permitted, is it not at that time

2 entitled to a 25 percent cash and then a 75 percent

3 at least right to be paid that amount of money? May

4 not be getting that 75 percent, but it's entitled to

5 the right to get a 75 percent surplus note at that

6 time?

7 A Yes.

8 Q So won't you carry it as a liability once it becomes

9 a permitted claim?

10 A Surplus notes when issued become recorded as equity.

11 Q Okay. So on your books you're going to carry

12 25 percent as a cash payment due from the reinsurer

13 until it gets paid and 75 percent you're going to

14 carry as equity?

15 A Again, I can't foresee exactly the statutory

16 accounting presentations that will be utilized. I

17 haven't spent time looking at that element of this.

18 Members of my staff have been involved with statutory

19 accounting treatment and guidance related to this

20 Plan.

21 Q Okay. So we don't know sitting here today how you're

22 going to determine the adequate capital and the

23 surplus in the account?

24 A I said I can't testify to that.

25 Q Okay. Thank you.

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1 MR. OWEN: Nothing further, Your Honor?

2 THE COURT: All right. Who's up next?

3 MR. WELSH: Thank you, Your Honor.

4 **CROSS-EXAMINATION**

5 BY MR. WELSH:

6 Q Good afternoon, Mr. Peterson. My name's Tom Welsh.
7 I represent Depfa, one often the objectors.

8 A **Good afternoon.**

9 Q I'm pretty sure that there's a little sliver of dirt
10 on the far side of the back forty that hasn't been
11 plowed, and I'm going to try to just stick to that as
12 best I can. I may ask a couple of follow-up
13 questions, but I'll try my best to keep it short.

14 Where I wanted to start is with Ambac
15 UK. You know, as I understand it, Ambac UK is a
16 wholly unsubsidiary of Ambac Assurance, correct?

17 A **That's correct.**

18 Q And it was formed in and is domiciled in the United
19 Kingdom; is that correct?

20 A **That's correct.**

21 Q So its regulator is the Financial Services
22 Administration; is that right?

23 A **Financial Services Authority, I believe is the title.**

24 Q Correct. Right. So they are your counterpart over
25 in the U.K. with respect to regulating Ambac UK?

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1 A **That's correct.**

2 Q Ambac UK wrote policies on various types of municipal
3 projects over in Europe; is that correct?

4 A **Yes. That's my understanding.**

5 Q I believe that my client owns -- well, not I
6 believe -- my client owns some infrastructure finance
7 units, which I believe would be the equivalent of
8 U.S.-based muni bonds. Is that roughly your
9 understanding of the type of business that Ambac UK
10 would have written?

11 A **I don't have a detailed understanding on some of the
12 international books of business.**

13 Q Okay. But they basically give the European
14 equivalent of financial guaranty?

15 A **Yes. I mean, Ambac UK provided credit enhancements
16 to certain securities issued in Europe.**

17 Q Okay. And there was also a 1997 Reinsurance
18 Agreement between Ambac UK and Ambac Assurance; are
19 you aware of that?

20 A **Yes.**

21 Q And pursuant to that agreement, the risks that are
22 written by Ambac UK were ceded to -- substantially
23 ceded to Ambac Assurance here in the U.S.?

24 A **That's correct. I believe it was a 90 percent
25 cession.**

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1 Q Meaning 90 percent of the liability or loss that
2 would be incurred under those policies written by
3 Ambac UK was ceded to Ambac Assurance?

4 A **Yes. There were other contractual arrangements
5 between the affiliates as well. But yes, that's my
6 recollection.**

7 Q And what I want to hone in on is the structure and
8 the accounting terms of that agreement so that I can
9 understand a section of the disclosure statement that
10 discusses the commutation of that agreement. But let
11 me ask just a couple more foundation questions real
12 quickly.

13 So that Reinsurance Agreement, as I
14 understand it, was allocated to the Segregated
15 Account as part of this process, correct?

16 A **Yes. As were other -- any Reinsurance Agreement was.**

17 Q Okay. And the liabilities under that Reinsurance
18 Agreement had it not been commuted would have fallen
19 into Class 5 or general creditor class treatment
20 under this Plan, correct?

21 A **Yes. I believe that's correct.**

22 Q And at some point in time in the -- relatively
23 recently, I don't have the date in front of me have
24 but that policy was commuted, correct?

25 A **It has been, yes.**

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1 Q All right. Can you just describe for us what the
2 material terms of the commutation arrangements were?

3 A **Well, the policy was commuted at a level of loss that
4 was below the attachment point of the Reinsurance
5 Agreement such that there was no payments due from
6 AAC to AUK related to the Reinsurance Agreement.**

7 Q Do you know how the premiums -- Well, let me back up
8 a little bit. So when Ambac UK would transfer 90
9 percent of the liabilities this agreement to Ambac
10 Assurance, it would pay a reinsurance premium to --
11 let me strike that. I think I misspoke.

12 When Ambac UK would cede 90 percent of
13 its liability to Ambac Assurance, it would also pay a
14 reinsurance premium in exchange for Ambac Assurance
15 accepting that liability, correct?

16 A **That's correct.**

17 Q Do you know how the cession was accounted for? And
18 let me ask real specifically. Occasionally there
19 will be different mechanisms to fund that transfer of
20 reinsurance premium and also to protect the
21 reinsured's right to payment in the event losses
22 occur?

23 A **Such as funds held and so forth.**

24 Q Funds held, trust accounts.

25 A **I don't recall what the provisions in regard to**

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1 payments or payments -- you know, funds being held or
2 so forth, I don't recall the terms of the contract.
3 Q So your understanding is as a result of the
4 commutation, no cash traded hands?
5 A That's my understanding, yes.
6 Q Did you have direct communications with FSA about
7 that commutation?
8 A In the months proceeding that commutation I did, not
9 in the days just before the commutation.
10 Q Was FSA concerned that their domiciliary company in
11 Ambac UK was in a hazardous -- operating in a
12 hazardous financial condition; did they communicate
13 to you?
14 A Well, they were concerned about Ambac Assurance's
15 ability to perform under the Reinsurance Agreement,
16 and that concern was heightened when the liabilities
17 under that Reinsurance Agreement were moved to the
18 Segregated Account and were in a position where
19 they'd be treated as a junior claim.
20 Q So they were concerned about the fact that by virtue
21 of that agreement, the Reinsurance Agreement, being
22 moved down into the Segregated Account that their
23 domiciliary company Ambac UK was being disadvantaged
24 by that?
25 A Yes. And in response to that they ordered Ambac UK

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1 to stop making reinsurance payments to Ambac
2 Assurance?
3 Q Which side of the relationship actually initiated the
4 commutation negotiations?
5 A I don't know who made the first volley.
6 Q All right. How active was your participation in the
7 commutation issues?
8 A Members of the AC staff in New York negotiated the
9 commutation with independent members of Ambac UK in
10 London. I received, as well as our financial and
11 legal advisors received, updates with regard to
12 that -- those negotiations. And we provided some
13 input or guidelines indicating that we wouldn't allow
14 any payment out of AAC to AUK with regard to the
15 commutation given the intention of it being at a
16 junior status.
17 Q Would it have received junior surplus notes had it
18 remaintained a reinsured of Ambac Assurance?
19 A Well, if the underlying claims exposures and so forth
20 underneath that pertaining to that reinsurance
21 agreement continued to develop adversely, that
22 potential existed.
23 Q At this point I seem to recall the Disclosure
24 Statement states that you're not attributing any
25 value to Ambac Assurance's ownership of that foreign

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1 subsidiary; is that correct?
2 A That's correct.
3 Q Do you think there is any equity value in that?
4 A I think there's a likelihood that there will a value
5 at some point. But, you know, we don't necessarily
6 believe that that could be realized in the near term
7 and hence we, for purposes of this Plan we didn't
8 include any value.
9 Q Okay. Let me move to another topic, which is the net
10 operating loss carry-forwards that are generated by
11 Ambac Assurance. Some of this ground has been
12 plowed, so I'll just ask you a couple of limited
13 questions about it.
14 A Does that mean you're going to disc it now?
15 Q No. They missed a patch or two. What I'd like to do
16 is the OCI's positions with respect to its Ambac
17 Assurance's ownership rights off its own operating
18 loss carry-forwards now that the parent company is in
19 bankruptcy. And very specifically did the OCI ever
20 think about utilizing this court as a proceeding that
21 would allow you to reorganize under Internal Revenue
22 Code Section 382(l)5 such that you could sever from
23 the parent company and retain complete control over
24 Ambac's NOLs for the benefit of its policyholders?
25 A I recall some discussion about tax provisions along

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1 those lines. There were potential for changes of
2 control or the bankruptcy may, in fact, sever that
3 consolidated relationship. Whether -- to what extent
4 we analyzed taking actions to precipitate that
5 earlier, I don't specifically recall.
6 Q Is it OCI's position though that the losses that are
7 generated from the operating of the insurance company
8 should be treated as assets of the insurance company?
9 A That's OCI's position, although there are certain
10 parties that disagree with that position and are
11 prepared to litigate that, namely the bondholders of
12 AFG.
13 Q Do you believe that the injunctions, the supplemental
14 injunctions that were entered on Monday, the 8th of
15 November, protect the insurance company from the
16 parent company taking a worthless stock deduction and
17 thus effectively destroying the value of the
18 insurance company and all carry-forwards?
19 MR. VAN SICKLEN: Objection. Calls for
20 a legal conclusion.
21 THE COURT: Sustained.
22 BY MR. OWEN:
23 Q The reason I'm asking these question is they pick up
24 on part of the dialogue we had with the Insurance
25 Commissioner yesterday. You were in court yesterday

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1 when we were examining Commissioner Dilweg?
2 A **Yes.**
3 Q And I was asking him about the two hats that he
4 wears. Do you recall that aspect of his testimony?
5 A **In general, yes.**
6 Q So with respect to OCI's relationship with an
7 insurance company that is not yet in rehabilitation,
8 he's wearing a hat of a regulator, correct?
9 A **Correct.**
10 Q Once the company is actually put into a formal
11 rehabilitation proceeding, then he puts on another
12 hat and he becomes the Rehabilitator, or let's say
13 the receiver, of that company and its assets,
14 correct?
15 A **That's correct.**
16 Q And during that dialogue we were talking about this
17 particular proceeding and how it gives rise to
18 certain operational challenges, and I'd like to ask
19 you about those, since it seems like you get the
20 lucky task of being more deeply involved in the
21 operations of Ambac.
22 My specific question is when you are at
23 Ambac's offices along with Deputy Commissioner Shaul,
24 do you understand what capacity -- or what capacity
25 the Commissioner has in dealing with Ambac in its

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1 offices? Are you there as a representative of the
2 Rehabilitator or as a representative of the
3 regulator?
4 A **We conduct activities that oversee both the
5 Segregated Account and the General Account, so we are
6 performing both functions. We trade hats. A number
7 of times during other day, I presume. Although I
8 don't physically have hats to wear.**
9 Q Back in 1989 --
10 A **Perhaps I should get them, just to make it clear.**
11 Q Back 1989 when the A's were playing the Giants in the
12 World Series I got a hat that had both hats.
13 A **There's an idea.**
14 Q Maybe that's an idea you could pursue.
15 The reason I ask -- and let me go back
16 and ask a foundational question. You, being a
17 special deputy receiver, correct? Or special deputy
18 rehabilitator.
19 A **Yes.**
20 Q So you've been in that capacity where you walk into a
21 company's offices and you are effectively
22 representing the owner or the receiver of the
23 company, correct?
24 A **Yes. I don't think the word owner is necessarily
25 accurate. But yes, we represent the policyholders**

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1 **and -- as receiver of the entity.**
2 Q But when Judge Johnston gives you a rehabilitation
3 order, it gives you the authority, for example, to
4 change locks on the doors, correct?
5 A **Yes.**
6 Q To --
7 A **I've never physically changed the locks or ordered
8 them to be changed, although it has occurred in other
9 cases.**
10 Q Right. And you also get the right to take control of
11 all the cash and all the bank accounts, correct?
12 A **Yes.**
13 Q And you get to hire and fire employees of the
14 company, to make sure that you're right-sized to
15 conduct the operations of company in rehabilitation,
16 correct?
17 A **To the extent that that entity has employees. In the
18 case here we -- services are being provided by AAC
19 that is not in rehabilitation.**
20 Q Correct. And you can also, for example, if you are,
21 again, the Rehabilitator of the entire company, you
22 can decide what lawyers to hire and how many lawyers
23 they should bring to hearing and things like that,
24 that's part of your right and power, correct?
25 A **That's right.**

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1 Q So what I'm really trying to get here is an
2 understanding of how this bifurcated proceeding is
3 potentially presenting -- or whether it will present
4 challenges to you as you implement this Plan for the
5 benefit of the Segregated Account policyholders. And
6 my question is you testified yesterday that when you
7 first started going to Ambac, some of the senior
8 officers weren't necessarily entirely on board with
9 your presence there and your role?
10 A **I testified to that, yes.**
11 Q And right now if this Plan is confirmed when you're
12 representing the Segregated Account as representative
13 of the Rehabilitator, you don't have the ability to
14 actually make payments under the note, correct?
15 A **Segregated Account is charged with making, you know,
16 receiving claims and demanding payment from the
17 General Account to pay those claims, so the authority
18 to get that -- to get the money necessary to do so I
19 think is clear in the demand note.**
20 Q But it's a contractual relationship as opposed to,
21 say, the type of power you would be able to exercise
22 were you the Rehabilitator of all of Ambac and you
23 were exercising the power that Judge Johnston would
24 give you to control the cash, control the employees,
25 control their lawyers, correct?

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1 A Well, the Segregated Account has separate bank
2 accounts. If it became necessary I believe the
3 Rehabilitator could pursue a Plan -- or pursue the
4 objective of moving assets to the Segregated Account
5 to have more complete control over the distribution.
6 But that, as we've testified to, previously, that
7 transfer of assets had risks in terms of potential
8 contractual triggers.

9 Q The Segregated Account has bank accounts?
10 A It does.
11 Q Are they funded?
12 A Money moves through those bank accounts.
13 Q So at any given time are they just disbursement
14 accounts, like zero balance checking accounts?
15 A I think that's a fair characterization of the
16 accounts, yes. Money is received from the General
17 Account, and payments are paid from the Segregated
18 Account books -- and from those bank accounts.
19 Q But it doesn't have its own independent investment
20 portfolio?
21 A That's correct.
22 Q There was one other part of my discussion with
23 Commissioner Dilweg that I'd like you to react to. I
24 went through a line of questioning just to establish
25 that outside of this context a surplus note is a form

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1 of loan that is made to an insurance company on terms
2 that allow the insurance company to carry it as a
3 surplus enhancement or enhancement to surplus and
4 capital, correct?
5 A That's correct.
6 Q But basically it's just a loan?
7 A Well, it's a subordinated loan because of that and
8 because of the payment approval requirements is
9 treated as equity.
10 Q Right. And at the end of that line of questioning I
11 asked the Commissioner whether it was fair to just
12 characterize the surplus notes that my client is
13 going to get as essentially just a forced loan to one
14 of the policyholders, and he told me that was a
15 mischaracterization of the Plan. Can you help me
16 understand why it's a mischaracterization for my
17 client to feel like they're being forced to make a
18 loan of 75 percent of the amount of the claim that
19 they're getting to Ambac Assurance? Why is that a
20 mischaracterization?
21 A Well, I can't explain why your client feels a
22 particular way.
23 Q No. I was talking about the mischaracterization
24 piece of it. We're getting surplus notes, surplus
25 notes are a form of loan. So we're, as policyholders

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1 of the Segregated Account, we're being asked to make
2 a loan to Ambac Assurance.
3 A You're being given a note that subject to approval of
4 Commissioner will make additional payments on your
5 claims over time.
6 Q Sounds like a loan?
7 MR. VAN SICKLEN: I object. This is
8 just argumentative.
9 THE COURT: It is at this point. I
10 think we've had this asked and answered. I think
11 it's answered again. Let's move on.
12 MR. WELSH: Okay.
13 THE COURT: Sustain the objection.
14 BY MR. WELSH:
15 Q Just one more quick question. Earlier there was a
16 lot of hullabaloo and a lot of questioning about the
17 bank settlement and what happens if it gets
18 overturned. But isn't it correct that if it does get
19 overturned there's nothing in this Plan that would
20 prevent the Commissioner from simply creating, say, a
21 new Segregated Account to deal with that at that
22 time, is there?
23 A Yeah, perhaps that's the case. Yeah. We're not
24 precluded or the company wouldn't be precluded from
25 creating another Segregated Account.

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1 MR. WELSH: That's all I have. Thank
2 you very much.
3 THE COURT: Thank you, Mr. Welsh. Next?
4 **CROSS-EXAMINATION**
5 BY MR. JOHNSON:
6 Q Good afternoon, Mr. Peterson. I'm Michael Johnson.
7 I represent Bank of America, Wells Fargo, and
8 Wilmington Trust, all in their capacity as trustees
9 and in similar roles in respect to certain
10 securitization trusts.
11 I wanted to start by asking you some
12 questions about policy reimbursements. The Plan and
13 the Disclosure Statement refer in a couple of places
14 to reimbursements. What is OCI referring to when it
15 refers to reimbursements?
16 A I would have to see that in the context.
17 Q We could look -- Why don't we look at Exhibit 40,
18 which is Amendment Number 2 to the Disclosure
19 Statement. If you would, please, in that exhibit
20 turn to page 4.
21 A All right.
22 Q And do you see the heading there, it refers to
23 recoveries and reimbursement on policy claims?
24 A I do.
25 Q To what is being referred here when the amendment to

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1 disclosure statement refers to reimbursements?
2 A I believe that refers to recoveries on reps and
3 warranty litigation or other reimbursement of claims
4 that were previously paid by Ambac.
5 Q Isn't it correct that under many RMBS policies that
6 were issued by Ambac, Ambac has a right or has
7 certain rights of reimbursement in respect of claims
8 that were paid in the past?
9 A They contend they do. Yes.
10 Q And it's also the case, is it not, that under the
11 terms of certain transaction documents Ambac has
12 rights to recoup by way of reimbursement amounts that
13 were previously paid out in respect of policy claims,
14 correct?
15 A Yes. I believe that's the case.
16 Q Now, under the terms of the Plan, the Segregated
17 Account is going to be delivering to RMBS trustees,
18 paying agents and the like, 25 cents in cash and 75
19 cents in surplus notes in respect to the claims that
20 are deemed permitted claims, correct?
21 A That's correct.
22 Q And it's also the case, is it not, that to the extent
23 that Ambac enjoys a right of reimbursement under
24 those RMBS policies or the related transaction
25 documents, the reimbursement is going to be paid back

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1 a hundred cents in cash under the terms of the Plan;
2 is that correct? Is that your understanding?
3 A I guess that's the hope that, they'll receive cash,
4 or the expectation.
5 Q And so even though Ambac or the Segregated Account
6 will be delivering 25 cents in cash and 75 cents in
7 surplus notes when it's paying out on claims, to the
8 extent that it's going get a reimbursement back, it's
9 going to take out a hundred cents in cash; is that
10 correct?
11 A When you say take out, I'm not sure in what context
12 that means.
13 Q To the extent that there are reimbursement rights
14 under the RMBS policies or the related transaction
15 documents, under the terms of the Plan the Segregated
16 Account is entitled to insist that it get paid a
17 hundred cents in cash, correct?
18 A Yes. The source of that cash is a little unclear to
19 me.
20 Q I'm referring now to the proceeds that are being
21 generated by the RMBS transactions themselves. Let's
22 just take a step back. Maybe that will help.
23 I mean, the way the typical RMBS
24 transaction works in respect to the policy is that if
25 there is a shortfall in the amounts that the insured

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1 certificate holders are to receive in a given payment
2 period, there will be a claim made against the Ambac
3 policy to pick up the shortfall, correct?
4 A Yes.
5 Q So the insured certificate holder, at least prior to
6 the implementation of the Plan, if everything was
7 working right, if there was a shortfall in the deal,
8 Ambac was making up the shortfall such that the
9 insured certificate holder was getting everything
10 that they were expecting, correct?
11 A That's correct.
12 Q And when the Plan goes effective, what's going to
13 happen is that shortfall amount that Ambac is
14 covering is going to be paid at 25 cents in cash and
15 75 cents in surplus notes?
16 A That's correct as well.
17 Q Now, under some of the transaction documents and the
18 policy documents Ambac has a right of reimbursement
19 such that if the deal's cash flows permit it, Ambac
20 can pick up by way of reimbursement and take out of
21 the deal certain proceeds that will, in essence, make
22 it whole for a prior policy claim that had to be paid
23 made, correct?
24 A Well, yes. If there were excess cash flows I don't
25 dispute that there are provisions that allow Ambac to

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1 receive reimbursement of their prior payments when
2 those excess cash flows exist.
3 Q And my question to you is it's correct, is it not,
4 that notwithstanding the fact that claims are going
5 to be paid out by the Segregated Account on the 25/75
6 split such that only 25 percent of a given claim is
7 going to get paid in cash by the Segregated Account,
8 the Segregated Account when it gets reimbursement
9 from these deals pursuant to its contractual
10 reimbursement rights is going to --
11 A If it gets reimbursed.
12 Q -- is going to be receiving a hundred percent in cash
13 back, correct?
14 A If it gets reimbursement, yes.
15 Q In essence, the insured certificate holders will be
16 left holding surplus notes, but Ambac or the
17 Segregated Account will be receiving cash from these
18 transactions, correct?
19 A I believe that assumes that the particular RMBS
20 security recovers such that it actually starts having
21 excess cash flows.
22 Q And it's acknowledged, is it not, in Amendment Number
23 2 to the Disclosure Statement that this presents what
24 I think is characterized in here as a complication,
25 correct? I'm looking just to direct you to where I'm

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1 looking. It's the paragraph that starts on the lower
2 half of page 4 of Exhibit 40.

3 A **Um-hum. Beginning with, "However, in a minority of
4 the transactions?"**

5 Q Yes. And then in the middle of that paragraph on
6 that page, I'll just read the text. It says, "The
7 payment of claims in part with surplus notes in
8 nonnetting deals presents a complication as AAC
9 benefits from receiving a hundred percent of the
10 excess cash flow in cash while the Segregated Account
11 is paying 25 percent of claims in cash." Did I read
12 that correctly?

13 A **Yes, you did.**

14 Q On the following page, if you turn to page 5 of
15 Exhibit 40, you'll see that it says the Rehabilitator
16 considered a number of alternatives to this issue,
17 including limiting the excess cash flows payable to
18 AAC to the cash percentage -- and I'm paraphrasing
19 now -- under the Plan and using the remainder of the
20 excess cash to redeem in whole or in part surplus
21 notes received by the holders. Did you participate
22 in the consideration of those alternatives?

23 A **I relied on legal counsel in this area.**

24 Q Is there anyone besides you at OCI who participated
25 in the discussion or consideration of those

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1 alternatives?

2 A **I believe our general counsel might have been
3 involved. I don't specifically know.**

4 Q Is it fair to say that ultimately OCI decided not to
5 pursue any of those alternatives in essence because
6 it would have been too complicated to work out a
7 solution to the issue?

8 A **Well, those alternatives are not being pursued. The
9 exact rationale as to why they're not, I'm not
10 familiar with. But the complexity of doing so
11 apparently was a factor.**

12 Q Well, it's true, is it not, that one of the problems
13 that OCI faced was that there was no mechanism to
14 trace surplus notes to a particular transaction?

15 A **Yes. I mean, surplus notes are going to be issued on
16 a monthly basis based on claims submitted during that
17 month. And those surplus notes could be traded in
18 the market and so forth.**

19 Q Did OCI consider an alternative that would have
20 permitted insured certificate holders who ultimately
21 received beneficial interests in certificate notes to
22 basically self identify and come to OCI or to Ambac
23 and say we have surplus notes that were issued to us
24 in respect of policy claims and we would like to get
25 cash for those to the extent that Ambac has received

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1 cash by way of reimbursements?

2 A **I wasn't directly involved in evaluating those
3 possibilities.**

4 Q Do you know whether OCI considered the possibility of
5 establishing some sort of short-term escrow
6 arrangement pursuant to which claims would have been
7 paid but any reimbursement amounts would have been in
8 essence held in escrow to permit a period during
9 which those reimbursement amounts could have been
10 traced back to specific surplus note holders?

11 A **Again, those involved details that I had limited
12 involvement with and don't recall those particular --
13 limited or no involvement and don't recall those
14 particular aspects.**

15 Q Do you believe that it's fair and equitable to insure
16 certificate holders that Ambac will benefit by
17 receiving a hundred percent of excess cash flows in
18 cash while Segregated Account -- while the Segregated
19 Account is paying to insured certificate holders only
20 25 percent of claims in cash?

21 A **In the context of the broader Plan, I believe it's
22 fair and equitable.**

23 Q Do you agree that there is a risk that RMBS
24 transactions will end up in essence financing Ambac's
25 operations by virtue of the fact that the Segregated

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1 Account will be delivering to these transactions
2 surplus notes but Ambac will be receiving by way of
3 reimbursements cash?

4 A **As noted in the disclosure, there are a minority of
5 the deals where that may be a possibility. And I
6 believe they also require the result where the RMBS
7 security and the cash flows recover to an extent that
8 there are, in fact, excess cash flows, you know, as
9 opposed to continuing to generate loss. That may not
10 happen in a number of transactions as well.**

11 **So to a limited extent there may be some**

12 **of the situations that you described, and, as I said**

13 **before, in the context of the broader Plan, I believe**

14 **it's fair and reasonable.**

15 Q Mr. Peterson, the issue that we're discussing is not
16 limited just to situations in which there's excess
17 cash flow, is it?

18 A **Again, this is an area of -- the technical operation
19 of the securities that I've relied on other members
20 of our team to work through these as best as
21 possible. I don't profess to understand all the
22 detailed workings of these securities.**

23 Q If I heard correctly, Mr. Peterson, you testified
24 on -- I believe it was on your direct or perhaps it
25 was during one of the earlier cross-examinations that

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1 as part of your work over the past year or more
2 you've had the opportunity to review the waterfall
3 provisions in a number of trust indentures and
4 pooling agreements; is that correct?
5 A I think you're mischaracterizing my testimony. Other
6 than the waterfall provisions, as in the legal
7 description, I came to understand the effects of the
8 waterfalls in terms of how it affected the loss
9 exposure and loss potential.
10 Q And in developing the Plan and Disclosure Statement
11 did you personally review any specific pooling
12 agreements or trust indentures for RMBS transactions?
13 A No.
14 Q Do you know if there was anybody on your staff who
15 was charged with the responsibility for reviewing
16 pooling agreements and trust indentures?
17 A Members of our team reviewed documents like that, I
18 believe.
19 Q And did you discuss the issue with them of the
20 possibility of Ambac receiving by way of
21 reimbursements a hundred percent in cash where the
22 Segregated Account had paid out by way of claims
23 under policies only 25 cents?
24 A In general we -- there were discussions about some of
25 these situations, and we made efforts to treat

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1 policyholders as fairly as possible, given the
2 circumstances. And there were directions given in
3 that regard.
4 Q But the specific issue I just identified you did not
5 discuss with any of your staff members?
6 A I don't recall. Other than that direction that was
7 given to try to work for a fair and equitable
8 solution to the extent possible.
9 Q Under the terms of the Plan, RMBS trustees and those
10 serving in roles through RMBS trustees are going to
11 have the responsibility for delivering surplus notes
12 to insured certificate holders in those transactions,
13 correct?
14 A That's correct.
15 Q And it's fair to say, is it not, that for trustees to
16 perform that task is going to impose certain burden
17 on them, is it not?
18 A I presume so. Yes, I think that's reasonable.
19 Q It's fair to say that most of these RMBS
20 transactions, if not all of them, were never
21 structured such that certificate holders would
22 receive anything more than cash, correct?
23 A That's correct.
24 Q And it is also fair to say that it is not to the
25 extent the trustees now have to deliver out surplus

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1 notes to these insured certificate holders, they're
2 going to have to establish new sets of policies and
3 procedures to effect that?
4 A That's correct as well. And that's why members of
5 our team and the company have reached out to the
6 trustees to create a dialogue to help understand what
7 issues might exist with that treatment and to the
8 extent possible facilitate the distribution in the --
9 in an efficient manner.
10 Q Trustees will also incur certain out-of-pocket
11 expenses in connection with distributing surplus
12 notes, correct?
13 A I believe that's the case. Some CUSIP runs, is that
14 what you're referring to?
15 Q Well, yes. For example, trustees are going to be
16 required, are they, not to secure certain reports
17 from the depository trust company and the --
18 THE COURT: Mr. Johnson, to be fair and
19 equitable, I admonished earlier counsel about, "it
20 would be fair, would it not," that kind of a preface
21 to a question leaves the person being asked wondering
22 is it fair, would it not, then the next part of it.
23 So if you could just drop that. I don't want others
24 who were so admonished to feel that I'm somehow
25 giving you other than fair and equitable treatment.

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1 MR. JOHNSON: I should have been
2 admonished by the gentlemen sitting to my left, I
3 guess. I will try to improve my question style.
4 THE COURT: Just ask the question
5 straight.
6 BY MR. JOHNSON:
7 Q DTC will be charging, will it not, for certain
8 reports that the trustees will be required to procure
9 in order to effect the delivery of these surplus
10 notes to insured certificate holders?
11 A Yeah. That's my general understanding, yes.
12 Q Under the terms of the Plan has any provision been
13 made for trustees to be compensated for out-of-pocket
14 expenses that they will incur for additional work
15 that they will have to perform in connection with the
16 delivery of surplus notes to insured certificate
17 holders?
18 A My recollection of advice from our team was that
19 amounts recoverable related to those expenses were
20 really a matter of the contract that the trustee has
21 with regard to the administration of the deal.
22 Q Certain. Those deals, however, include not just
23 insured certificate holders but also certificate
24 holders who have no financial guaranty insurance,
25 correct?

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1 A **You'll have to -- could you restate or repeat that**
2 **question? I'm not sure I understand.**
3 Q Sure. Under some RMBS transactions all of the
4 certificates that are issued by the issuer have the
5 benefit of an Ambac financial guaranty policy,
6 correct?
7 A **At different tranches, yes. Some are insurance**
8 **tranches some are not.**
9 Q Some tranches are not insured, correct?
10 A **That's correct.**
11 Q And to the extent that the trustee is incurring
12 out-of-pocket expenses, it would not be fair to pass
13 on those expenses to the entirety of the deal,
14 correct?
15 A **Perhaps.**
16 Q To the extent that trustees can document
17 out-of-pocket expenses that are associated with
18 delivering surplus notes to certificate holders, will
19 OCI permit the trustees to be reimbursed from the
20 Segregated Account by way of administrative claim for
21 those expenses?
22 A **I don't have the authority to modify our Plan through**
23 **my testimony.**
24 Q Is it your understanding that OCI will allow trustees
25 to recoup out-of-pocket expenses if they can document

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1 as an administrative claim against the Segregated
2 Account?
3 A **I know that subject has been discussed. The exact**
4 **resolution of that I don't recall.**
5 Q And to the extent that trustees can document the
6 expense that's associated with the extra work and
7 burden that they will -- you know, that they will
8 suffer as a result of having to deliver surplus notes
9 to insured certificate holders, have there been any
10 discussions about permitting the trustees to seek
11 reimbursement by way of an administrative claim
12 against the Segregated Account?
13 A **I believe that element has been discussed. Again, I**
14 **don't recall the position that's been taken or what**
15 **aspects of that were critical to the discussion.**
16 Q Mr. Peterson, have you had any discussions with any
17 representatives of DTC in respect of the procedures
18 associated with delivering surplus notes to the
19 ultimate beneficiaries?
20 A **I've been present in certain of those meetings, yes.**
21 Q In any of the meetings that you participated in was
22 there any discussion of having DTC handle the surplus
23 notes and the deliver of the surplus notes to the
24 ultimate, you know, beneficial holder of the RMBS
25 certificate?

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1 A **There might have been. You know, this involves**
2 **business practices with the distribution of**
3 **securities that are really beyond my expertise. I**
4 **was present at certain meetings, but to say that I**
5 **understand the details of how securities are**
6 **distributed through the process, I don't. And so**
7 **exactly how that process works and what options might**
8 **be available to distribute those securities in a**
9 **different way, I can't testify to what other options**
10 **might be available.**
11 Q Do you know whether DTC was willing to perform the
12 function of taking the surplus notes and delivering
13 them to the beneficial holders of the RMBS
14 certificates?
15 A **I don't recall specifically.**
16 Q Ambac's RMBS policies generally require that it make
17 payments on claims within a certain period of time,
18 correct?
19 A **Yes.**
20 Q Under the Plan, however, the Segregated Account is
21 not obligated to abide by those deadlines, correct?
22 A **Those deadlines have effectively been extended by the**
23 **Plan. I think we've outlined the process that we**
24 **intend to use in terms of receiving claims and**
25 **evaluating those claims and then making payment by, I**

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1 **believe, the 20th of the following month.**
2 Q In fact the Plan actually sets no deadline for the
3 Segregated Account to make a determination that a
4 claim is a permitted claim, does it?
5 A **No. Not in that respect. To the extent that they**
6 **are deemed to be permitted we -- and we expect to**
7 **have a prompt evaluation of claims. But to the**
8 **extent that a claim can't be readily identified as**
9 **being permitted or not or falls under some dispute,**
10 **no deadline for a resolution was established. I**
11 **think that's correct.**
12 Q How promptly does OCI expect that the claims
13 determination process will proceed?
14 A **As I said, in the normal course to the extent that**
15 **there aren't significant or readily reconcilable**
16 **issues with a claim that we expect to receive the**
17 **claims one month -- in one month, there's a number of**
18 **claims that are due on the 25th or payment would have**
19 **had been made -- payment would have been made by the**
20 **25th, we expect to review process and make claims**
21 **payments on those by the 20th of the following month.**
22 Q In the months leading up to March of this year did
23 your analysis of Ambac's business identify as one
24 of -- one area of concern the speed with which Ambac
25 was paying claims?

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1 A I don't.
2 MR. VAN SICKLEN: The speed or the
3 amount? I'm confused.
4 BY MR. JOHNSON:
5 Q The speed.
6 A You mean to say the interval between when a claim was
7 submitted and when the claim was paid?
8 Q That's a better way to put it. Yes.
9 A That wasn't a primary focus of our analysis or not
10 one that I specifically recall.
11 Q Does then extending out that period between the
12 submission of the claim and the determination of
13 claim as a permitted claim somehow facilitate the
14 rehabilitation of Ambac?
15 A Well, the Rehabilitator has a responsibility to
16 evaluate the claims that are being submitted and in
17 order give the protections that other parties were
18 concerned about, we have designed a time period into
19 the Plan where the Rehabilitator can effectively
20 evaluate claims and submit them for the payment.
21 Q But under the terms of the Management Services
22 Agreement, OCI is going to be relying in the first
23 instance on Ambac to make that determination,
24 correct?
25 A In the first instance. But we are -- the

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1 Rehabilitator has been and will continue to provide
2 significant oversight on these processes,
3 particularly in the early months as we are making
4 sure they're functioning properly.
5 Q Does OCI intend to review each claim, each
6 determination that a claim should be a permitted
7 claim?
8 A We haven't devised a specific plan for that. But I
9 would presume that in the early month we would review
10 a significant portion of those claims to understand
11 the process of -- and feel comfortable that claims
12 are being determined as permitted correctly, and so I
13 expect to exercise significant oversight over the
14 process, particularly in the early months.
15 Q The extending out of the period between the
16 submission of the claim and the determination that
17 the claim is a permitted claim is going to result in
18 a disconnect, is it not?
19 A Yes.
20 Q Do you understand what I mean by disconnect?
21 A Yes. I think I understand that, you know, the claim
22 payments for a particular month's claim and the --
23 associated with the deal transaction, you know, it's
24 been typical that claims were submitted and paid
25 within the same month, that the documentation about

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1 the amounts due for a particular month were all
2 contained within that month. That's no longer going
3 to be the case. Yes, I understand that.
4 Q And there might be problems, for example, if
5 certificate holders decide to sell their certificate
6 in that one-month period such that when a claim is
7 paid it's no longer held by the certificate holder
8 who held the certificate at the time the claim was
9 actually filed, correct?
10 A Yes, I understand that. And we disclosed that fact,
11 those contingencies, in our Disclosure Statement.
12 Q OCI does not expect that trustees will go back and
13 try to identify the actual holders of the
14 certificates at the time the claim was made, does it?
15 A I don't recall the provisions in that regard.
16 Q Is it your understanding that it will be an
17 acceptable practice for trustees to simply pay -- at
18 the time a claim is deemed a permitted claim and the
19 Segregated Account delivers the cash and surplus
20 notes it will be an acceptable practice for the
21 trustees to simply push out that cash and surplus
22 note to the existing certificate holders?
23 THE COURT: Or would they to the
24 claimant?
25 THE WITNESS: I believe those are

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1 elements that are contained in the Plan that we are
2 seeking confirmation of, to the best of my
3 understanding and recollection.
4 MR. JOHNSON: Thank you, Mr. Peterson.
5 I have nothing further.
6 THE COURT: All right. It's time to
7 recess for other day. How many more Objectors have
8 questions? One? Two. Possibly? All right. We'll
9 let you sleep on that then. All right. I guess
10 we'll see you tomorrow morning then at 9:00.
11 (Proceedings adjourned at 4:58 p.m.)
12 (End Weisling Reporter Section D.)
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1 STATE OF WISCONSIN)

2) SS

3 COUNTY OF DANE)

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5 We, JENNIFER L. POIRIOR and ELLEN W.

6 WEISLING, Official Court Reporters for Dane County

7 Circuit Court, do hereby certify that we took in

8 shorthand the above-entitled proceedings held on the

9 17th day of November, 2010; we reduced the same to a

10 written transcript and that it is a true and correct

11 transcript of my notes and the whole thereof.

12 Dated at Madison, Wisconsin this 17th day

13 of November, 2010.

14

15

16

17 _____
18 Ellen w. Weisling, RMR
19 Official Court Reporter

20

21

22 _____
23 Jennifer L. Poirior, RMR, CRR
24 Official Court Reporter

25

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