STATE OF WISCONSIN CIRCUIT COURT DANE COUNTY

In the Matter of the Rehabilitation of:

Segregated Account of
Ambac Assurance Corporation

Case No. 10 CV 1576

OBJECTION TO APPLICATION FOR APPROVAL OF ENGAGEMENT OF ROGER A. PETERSON AS FULL-TIME SPECIAL DEPUTY COMMISSIONER OF THE SEGREGATED ACCOUNT

Aurelius Capital Management, LP, Fir Tree, Inc., King Street Capital, L.P., King Street Capital Master Fund, Ltd., Monarch Alternative Capital LP, and Stonehill Capital Management LLC, in their capacity as owners of or managers of funds that own residential mortgage-backed securities insured by Ambac Assurance Corporation ("AAC"), by their attorneys, hereby object to the engagement of Roger A. Peterson as full-time Special Deputy Commissioner of the Segregated Account of AAC (the "Segregated Account"). Mr. Peterson's engagement – at an exorbitant salary that directly diminishes assets available to satisfy claims of policyholders allocated to the Segregated Account – is inappropriate and inequitable in light of his likely contribution to AAC's financial decline, his failure to protect policyholders after the initiation of these rehabilitation proceedings, and the continued requirement that Segregated Account policyholders pay premiums, excess interest spreads, and reimbursement amounts to AAC's General Account without any right to recover for claims under those policies.

BACKGROUND

Mr. Peterson has worked for the Wisconsin Office of the Commissioner of Insurance ("OCI") in a variety of capacities since June 1988 and is currently the Director of OCI's Bureau of Financial Analysis and Examinations. (Nov. 16, 2011 Hrg. Tr. at 129-30.) His primary

responsibility at OCI is "monitoring the solvency of insurance companies," particularly those domiciled in Wisconsin. (*Id.* at 130.) During the 1990s, he was tasked with monitoring AAC's health and solvency. (*Id.* at 133.) Prior to Mr. Peterson's involvement, AAC primarily wrote policies for municipal bonds. (Disclosure Statement Accompanying Plan of Rehabilitation, at 3.) However, on Mr. Peterson's watch, AAC began to write insurance policies for structured finance products, such as credit default swaps and mortgage-backed securities. (Nov. 16, 2010 Hrg. Tr. at 133-34.) Mr. Peterson conceded at the confirmation hearings for the Rehabilitator's Plan of Rehabilitation (the "Plan") that these products were "more complex" than the instruments it had historically insured. (*Id.* at 133.) However, he testified that it was not until December 2007 that OCI "began to understand the potential risks [associated with the structured finance policies] more clearly." (*Id.* at 135-36.) Around that time, AAC's ratings agencies downgraded its credit ratings, and AAC stopped writing new policies altogether. (*Id.* at 136-37.)

Unable to turn AAC's business around, OCI and AAC walled off a portion of AAC's policies, allocated them to the Segregated Account, and petitioned this Court for the rehabilitation of that account on March 24, 2010. Mr. Peterson was involved in the planning for that "restructuring" for at least two years prior to that date, and he was heavily involved in the selection of policies for allocation to the Segregated Account. (First Affidavit of Roger A. Peterson, at 1; Nov. 16, 2010 Hrg. Tr. at 177-79.) He is also currently serving as Special Deputy Commissioner of the Segregated Account as part of his regular activities for OCI. (*See* Application for Approval of Engagement of Roger A. Peterson, as Full-Time Special Deputy Commissioner of the Segregated Account ("Application"), at 2.)

On June 8, 2011, however, OCI filed the Application to engage Mr. Peterson as a full-time employee of the Segregated Account. (*See id.* at 3.) Under the terms of the proposed

engagement, Mr. Peterson would be paid at least $600,000 per year with the potential for a bonus of $375,000. (*Id.* at 7.) OCI claims to have engaged a consultant to determine the appropriate compensation package for an individual in this position. (*Id.* at 5.) OCI also claims that it conducted these negotiations with Mr. Peterson – a senior OCI official who has been with the department for over twenty years – at arm's length. (*Id.*) As has been the case throughout these proceedings, however, all of the arrangements regarding Mr. Peterson's proposed engagement were made behind closed doors and without any disclosures or consultation of policyholders.

This is regulatory capture in its purest form. After acceding to AAC's demands in the context of the rehabilitation process over the objection of every third party policyholder and affected party who appeared in this Court, and after ignoring input from policyholders and other affected parties to construct the plan, Mr. Peterson is now being rewarded with a vast multiple of his current compensation. This unjustified payment is inappropriate and should not be sanctioned by the Court.

ARGUMENT

Mr. Peterson's proposed retention is inequitable, ill-advised, and unconscionable and should be rejected for a number of reasons.

First, Mr. Peterson should not be permitted to parlay his work as a government official into a lucrative private position at the expense of the policyholders of a troubled insurer. It is for precisely this reason that other jurisdictions prohibit rehabilitators and their employees from accepting positions with the insurers they are charged with rehabilitating, at least for a certain period. *See, e.g.*, Cal. Ins. Code § 1043 (a copy of which is attached hereto as Exhibit 1). Mr. Peterson should not be permitted to engage in that type of self-dealing here, particularly because his work as AAC's regulator arguably contributed to its financial downfall.

Mr. Peterson was specifically tasked with monitoring AAC in the 1990s when it began to insure the very products that OCI claims caused it to become financially hazardous beginning in 2007. There is no indication that Mr. Peterson took or required AAC to take any sort of precautionary measures at that time, and he candidly admitted that it was not until approximately 2007 that he began to comprehend the risks associated with AAC's new business. Pursuant to Wis. Stat. § 611.24(1)(a), OCI could have required AAC to create a segregated account for its structured finance insurance back when it began writing those policies. Having failed to do so then, OCI (with substantial assistance from Mr. Peterson) is now attempting to fix its mistake retroactively by allocating certain policies to the inadequately capitalized Segregated Account simply because the risks against which those policies insure have come to pass. Mr. Peterson should not be given *more* authority over the Segregated Account given that his actions (or inaction) contributed to its necessity in the first place.

Second, though Mr. Peterson has been heavily involved in the rehabilitation of the Segregated Account since it was formally initiated in March 2010, policyholders are no closer to a resolution than they were at that time. Nearly fifteen months after the Segregated Account was created, pursuant to the TRO and the injunctive provisions of the Plan, policyholders in the Segregated Account have paid the General Account more than $100 million in premiums and are required to continue to pay premiums, excess interest spreads, and reimbursement amounts to the General Account. In addition, rights to eventual trust obtained put-back recoveries, and subsequent recoveries (on account of value realized on properties sold), and any recoveries on account of claims against mortgage insurers, originators, sponsors and other parties have been stripped from policyholders and transferred to AAC's General Account. Yet, policyholders have no idea if or when they will receive any payment at all, let alone full payment, of their claims.

Though OCI cited this claims-payment moratorium as a reason for expediting the Plan confirmation hearings, OCI admitted as recently as June 1, 2011 that the conditions to the Plan's effectiveness have not occurred and it is considering amending the Plan or even commencing a full rehabilitation of AAC. In sum, whatever Mr. Peterson and OCI are doing is not working. There is no indication that Mr. Peterson will be able to turn things around simply because he moves to New York to dedicate more time to the Segregated Account.

Third, under no circumstances should Segregated Account policyholders fund Mr. Peterson's exorbitant salary increase. While working on the Segregated Account rehabilitation as an employee of OCI, Mr. Peterson was paid by the State of Wisconsin. However, if engaged as a full-time employee of the Segregated Account, his $600,000 yearly salary would be paid as an administrative expense of the Segregated Account. (Application, at 1, 7.) In other words, Mr. Peterson would be making four times the salary of Wisconsin's Governor and Chief Justice of the Supreme Court,[1] but that money would be paid directly from the Segregated Account. As an administrative expense, it would also be paid first, timely, and in full. This is inequitable and unconscionable when Segregated Account policyholders have already waited nearly fifteen months for payment of their claims and in all likelihood will recover only a fraction of what they are due if the Segregated Account ever does begin to pay them.

Fourth, OCI's Application contains inadequate disclosure regarding its decision to retain Mr. Peterson and increase his salary significantly. OCI concedes that Mr. Peterson was its only candidate when it decided to engage a full-time Special Deputy Commissioner. (Application, at 4.) OCI purportedly retained a consultant to consider what Mr. Peterson's compensation should

[1] Mr. Peterson's proposed salary would exceed the collective salaries paid to the Governor, Lieutenant Governor, Secretary of State, Attorney General and Treasurer of Wisconsin.

be in that position but provided no details regarding that consultant's analysis. (*See id.* at 6-7.) Though the consultant recommended a salary of between $400,000 and $800,000, OCI fails to explain why it rejected a salary at the lower end of the spectrum. (*See id.*) In short, OCI has failed entirely to demonstrate that it engaged in a thorough, reasonable evaluation of Mr. Peterson's engagement or that it adequately considered the interests of policyholders in that process.

CONCLUSION

For all of these reasons, OCI's Application should be denied.

Dated this 20th day of June, 2011.

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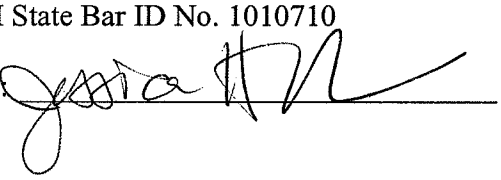
By: 

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EXHIBIT 1

Effective: July 1, 2011

West's Annotated California Codes Currentness
Insurance Code (Refs & Annos)
Division 1. General Rules Governing Insurance (Refs & Annos)
Part 2. The Business of Insurance (Refs & Annos)
Chapter 1. General Regulations
Article 14. Proceedings in Cases of Insolvency and Delinquency (Refs & Annos)

➡ § 1043. Power to mutualize, reinsure, or rehabilitate insurer; employment of commissioner or deputies

<Section as amended by Stats.2011, c. 15 (A.B.109), eff. April 4, 2011, operative no earlier than July 1, 2011, and only upon the creation and funding of a community corrections grant program. See, also, section prior to amendment by Stats.2011, c. 15 (A.B.109), eff. April 4, 2011, operative no earlier than July 1, 2011, and only upon the creation and funding of a community corrections grant program.>

In any proceeding under this article, the commissioner, as conservator or as liquidator, may, subject to the approval of said court, and subject to such liens as may be necessary mutualize or reinsure the business of such person, or enter into rehabilitation agreements. No commissioner who acts as conservator of such person or who mutualizes, merges or reinsures the business of such person or who enters into rehabilitation agreements affecting such person, and no deputy commissioner who has participated in the administration of the affairs of such person for the commissioner as conservator shall for a period of two years from and after the effective date of such mutualization, reinsurance or rehabilitation become an officer or director of, or serve as an officer or director of, or serve in any position of gain or profit in, any company formed in whole or in part of the assets or funds, or any part of the assets or funds of such mutualized, merged, reinsured or rehabilitated person.

Every person violating this provision is guilty of a public offense and shall be punished by imprisonment pursuant to subdivision (h) of Section 1170 of the Penal Code, or in a county jail not exceeding one year, or by a fine not exceeding ten thousand dollars ($10,000), or by both that fine and imprisonment.

Such rehabilitation or reinsurance agreements shall provide that, subsequent to the date thereof and for such period of time as the commissioner may determine, no investment or reinvestment of the assets of the person rehabilitated or reinsured shall be made without first obtaining the written approval of the commissioner.

Every party to such agreement, and every director, officer, agent and employee of such person, and every other person who knowingly in violation thereof directs or aids or assists in causing to be made an investment or reinvestment of any of said assets without first having obtained the written approval of the commissioner, or who makes such investment or reinvestment in nonconformity with the written approval of the commissioner then in effect authorizing such investment or reinvestment, is guilty of a public offense and shall be punished by imprisonment pursuant to subdivision (h) of Section 1170 of the Penal Code, or in a county jail or by a fine not exceeding ten thousand dollars ($10,000), or by both that fine and imprisonment.

CREDIT(S)

(Stats.1935, c. 145. Amended by Stats.1935, c. 291, p. 1008; Stats.1943, c. 831, p. 2627, § 1; Stats.1976, c. 1139, p. 5086, § 89, operative July 1, 1977; Stats.1983, c. 1092, § 182, eff. Sept. 27, 1983, operative Jan. 1, 1984; Stats.2011, c. 15 (A.B.109), § 208, eff. April 4, 2011, operative contingent.)

Current with urgency legislation through Ch. 25 of 2011 Reg.Sess. and Ch. 2 of 2011-2012 1st Ex.Sess.

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