COURT OF APPEALS OF WISCONSIN
DISTRICT IV

In the Matter of the Rehabilitation of:

Segregated Account of
Ambac Assurance Corporation,

Appeal No. 2011AP000561

TED NICKEL and OFFICE OF THE
COMMISSIONER OF INSURANCE,

Petitioners-Respondents,

AMBAC ASSURANCE,

Interested Party-Respondent,

DEPFA BANK, PLC,

Interested Party-Appellant,

ACCESS TO LOANS FOR LEARNING
STUDENT LOAN CORPORATION,
AURELIUS CAPITAL MANAGEMENT
LP, BANK OF AMERICA, N.A.,
CUSTOMER ASSET PROTECTION
COMPANY ("CAPCO"), DEUTSCHE
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DEUTSCHE BANK TRUST COMPANY
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FEDERAL HOME LOAN MORTGAGE
CORPORATION ("Freddie Mac"),
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PLC, MONARCH ALTERNATIVE
CAPITAL LP, STONEHILL CAPITAL
MANAGEMENT LLC, U.S. BANK
NATIONAL ASSOCIATION, WELLS
FARGO BANK, N.A. as Trustee for the
LVM Bondholders, WILMINGTON

TRUST COMPANY, WILMINGTON
TRUST FSB,

Interested Parties-Co-
Appellants,

ASSURED GUARANTY
CORPORATION, BANK OF NEW
YORK MELLON, COUNTRYWIDE
HOME LOANS SERVICING L.P.,
GOLDMAN SACHS & CO., INC.,
HSBC BANK USA, NATIONAL
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LLC, NUVEEN ASSET MANAGEMENT,
PNC BANK, RESTORATION CAPITAL
MANAGEMENT LLC, STONE LION
CAPITAL PARTNERS LP, and
TREASURER OF THE STATE OF OHIO,
UNITED STATES OF AMERICA,

Interested Parties.

**APPEAL FROM THE ORDER OF THE CIRCUIT COURT
OF DANE COUNTY CASE NO. 10 CV 1576
THE HONORABLE WILLIAM D. JOHNSTON PRESIDING**

APPELLANT U.S. BANK NATIONAL ASSOCIATION'S BRIEF

Paul E. Benson, SBN 1001457
Paul A. Lucey, SBN 1009833
Nathan L. Moenck, SBN 1066208
MICHAEL BEST & FRIEDRICH LLP
100 East Wisconsin Avenue, Suite 3300
Milwaukee, Wisconsin 53202-4108
Tel. 414.271.6560
Fax 414.277.0656

John M. Rosenthal, *Admitted Pro Hac Vice*
Kristine Bailey, *Admitted Pro Hac Vice*
MORGAN, LEWIS & BOCKIUS LLP
One Market, Spear Street Tower
San Francisco, California 94195
Tel. 415.442.1000
Fax 415.442.1001

Allyson N. Ho, *Admitted Pro Hac Vice*
MORGAN, LEWIS & BOCKIUS LLP
1000 Louisiana, Suite 4000
Houston, Texas 77002
Tel. 713.890.5000
Fax 713.890.5001

Attorneys for U.S. BANK NATIONAL
ASSOCIATION, solely in its capacity as
Trustee

Dated: July 1, 2011

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U.S. Bank National Association, acting solely in its capacity as trustee (the "Trustee") for certain residential mortgage-backed securities, other asset-backed securities, collateralized loan obligation, or collateralized debt obligation trusts (collectively the "Trusts"), respectfully submits its opening brief pursuant to this Court's briefing order and Wisconsin Statutes section 809.19.[1]

ISSUES PRESENTED

1. Did the Circuit Court err in denying the Trustee's motion to modify the Order for Temporary Injunctive Relief and for further relief relating to the lawfulness of the Plan?

The Circuit Court denied the Trustee's motion notwithstanding that the Plan is unlawful and the Injunction stripped the Trustee of its rights without sufficient compensation and protections.

This issue presents questions of law that are reviewed de novo, including the interpretation of statutes, *Pheasant Run Condominium Homes Association v. City of Brookfield*, 2011 WI App 27, ¶ 5, 331 Wis. 2d 730, 795 N.W.2d 492 (Table); the application of a statute to a given set of facts, *Thorp v. Town of Lebanon*, 2000 WI 60, ¶ 18, 235 Wis. 2d 610, 612 N.W.2d 59; issues concerning OCI's statutory authority, *National Motorists Association v. Office of the Commissioner of Insurance*, 2002 WI App 308,

[1] The Trustee also joins in the brief submitted by Deutsche Bank National Trust Company and Deutsche Bank Trust Company Americas ("Deutsche Bank").

¶ 19, 259 Wis. 2d 240, 655 N.W.2d 179; and whether the government has effected a taking without just compensation, *E-L Enterprises, Inc. v. Milwaukee Metropolitan Sewage District*, 2010 WI 58, ¶ 20, 326 Wis. 2d 82, 785 N.W.2d 409.

2. Did the Circuit Court err in depriving the Trustees of discovery?

The Circuit Court held that the Trustees were not entitled to any discovery, notwithstanding Wisconsin statutes guaranteeing that right, and in contravention of the majority rule in other States, resulting in an Order without evidentiary basis.

The Circuit Court's failure to engage in a meaningful review of OCI's actions violates the Legislature's command that the Circuit Court review those actions (Wis. Stat. § 645.33(5)), and its decision should be reversed for that reason alone. Although findings of fact are generally reviewed for misuse of discretion, that standard does not apply here, where the Circuit Court refused to allow discovery and simply adopted OCI's own findings of facts. This Court may therefore conduct its own examination of the record to determine whether the trial court actually exercised its discretion. *Hedtcke v. Sentry Ins. Co.*, 109 Wis. 2d 461, 471-72, 326 N.W.2d 727 (1982). Failing to exercise discretion is itself an abuse of discretion that should be reversed. *Id.*

STATEMENT ON ORAL ARGUMENT AND PUBLICATION

The Trustee respectfully requests oral argument. Given the procedural complexity of this case and the importance of the issues involved, the Trustee respectfully suggests that oral argument would be helpful to the Court in resolving those issues.

The Court's opinion in this case will meet the criteria for publication in Wisconsin Statutes section 809.23 because it will decide an issue of substantial and continuing public interest.

SUMMARY OF ARGUMENT

Wisconsin law permits segregated accounts to insulate lines of insurance business, and policyholders who purchase coverage from segregated accounts understand that they will have only the assets in the segregated account to support their coverage. The law does not permit the forced transfer of existing general account policies to a segregated account for the purpose of bailing out a failing insurer at the sole expense of the transferred policyholders. But the Plan approved by the Circuit Court, if permitted to stand, would do just that.

As explained in Deutsche Bank's brief, the Segregated Account and the Plan are invalid. The Circuit Court's Injunction in furtherance of the Plan should therefore be reversed as well. Alternatively, it should be modified to allow the Trustees their set-off rights under New York law, to restore the Trust investors' contractual control rights, and to prevent the

Circuit Court from improperly expanding its own jurisdiction over these proceedings.

In addition, the Circuit Court reversibly erred in refusing to allow any discovery in these proceedings. Instead, the Circuit Court simply adopted OCI's proposed findings of facts and conclusions of law wholesale without any meaningful opportunity for adversary testing or even an evidentiary basis. Fundamental fairness requires more. The Circuit Court's Order approving the Plan (and entering the Injunction) should be reversed for that reason, too.

ARGUMENT

I. The Circuit Court's Injunction Should Be Dissolved Or Modified

In confirming the Plan, the Circuit Court approved a provision permitting the Injunction to remain in effect throughout the Plan's administration. J.A.622 (§ 10.02). The Injunction should be dissolved in its entirety because, as demonstrated in Deutsche Bank's brief, the creation of the Segregated Account and the transfer of the Trust Policies to that account violate Wisconsin law. Absent a valid Segregated Account, there can be no lawful rehabilitation—and hence no need to enjoin the Trustees from enforcing their rights under the Trust Policies.

Alternatively, the Injunction (and corresponding provisions of the Plan) should be modified in at least three respects to protect the Trustee's

bargained-for rights. First, the Trustee's rights to set-off should be preserved. Second, the Trustee's control rights should be reinstated. And third, the limits of the Circuit Court's jurisdiction should be enforced.

A. The Trustee's Set-Off Rights Should Be Preserved

The Trust Policies are expressly governed by New York law, which grants policyholders both a statutory and common-law right of set-off that permits their premium and other payment obligations to be reduced by the amount of payments owed by the insurer. That set-off right allows entities—such as the Trusts and Ambac—"that owe each other money to apply their mutual debts against each other, thereby avoiding the absurdity of making A pay B when B owes A." *Citizens Bank of Md. v. Strumpf,* 516 U.S. 16, 18 (1995) (internal citation and quotation marks omitted); *Pink v. Isle Theatrical Corp.*, 3 N.E.2d 521, 521 (N.Y. 1936).[2]

"The general rule, recognized by courts and commentators alike, holds that mutual debts and credits between parties may be set off . . . even in cases involving insolvent insurance companies." *In re Midland Ins. Co.*, 590 N.E.2d 1186, 1190 n.2. (N.Y. 1992). The Injunction and Plan, however, compel the Trusts to remit unearned premiums and "other payments"—including recoveries, reimbursements, interests, deferred

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[2] Even if, as OCI argued in the Circuit Court, Wisconsin law applies rather than New York law, Wisconsin law would, at most, only prohibit set-off of *premiums* and not "other amounts." Wis. Stat. § 645.56(2)(d). At a minimum, then, the Plan and Injunction are too broad in that respect.

interest and default interest—owed to the Segregated or General Account *in full*, without any set-off for amounts owed by Ambac to the Trusts. J.A.179 (¶ 7), J.A.617-18 (§ 8.01(iv)).

The Injunction goes so far as to condition future payment of claims on the Trustees' compliance with these provisions. J.A.179 (¶ 7). Contrary to governing law, once the Trustees remit premiums and other payments as specified by the Plan, they will no longer have *any* viable set-off right to exercise. Stripping the Trustees of that right without any compensation was error.

B. The Trust Investors' Contractual Control Rights Should Be Restored

The Injunction prevents the transfer to Trust investors of the investors' contractual "control rights"—including the rights to consent to, or withhold consent to, any amendments, modifications, or waivers of the terms of the transactions or actions under the transaction documents; rights to declare or waive events of default, termination events, rapid amortization events, or similar events; and rights to direct the exercise of remedies following an event of default—with respect to the Trustees. *See* J.A.178-79 (¶ 6), J.A.182-85 (¶¶ 9.B, 9.C). Instead, Ambac and OCI (as Rehabilitator) are permitted to retain such rights even though the conditions triggering such a transfer have already occurred. *See* J.A.178-79 (¶ 6), J.A.182-85 (¶¶ 9.B, 9.C).

In March 2010, Ambac stopped performing its duties and consequently lost its control rights under the Trust-governing agreements. As a matter of contract, that event expressly entitled the Trust investors to reacquire from Ambac their contractual rights to provide certain instructions and directions to the Trustees. The Injunction, however, permits Ambac—a defaulted, non-performing party—to continue exercising those direction and control rights nonetheless. The Injunction thus provides a benefit to Ambac that was not secured at the time it issued the Trust Policies, while stripping away the Trust investors' own bargained-for rights.

The Injunction should be modified to permit the Trust investors to exercise their contractual control rights to direct the Trustee—and to permit the Trustee to accept such directions and refuse any directions delivered by Ambac or OCI in its capacity as Rehabilitator of the Segregated Account—where the relevant underlying transaction documents provide that direction or control rights have reverted from Ambac to the Trust investors.[3]

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[3] The Injunction also prevents the Trustee from exercising its right to take any action, including, "effect[ing] a transfer, assignment, termination, foreclosure, or liquidation . . . without regard to the occurrence of the Events or the financial condition of the Segregated Account, the Allocated Subsidiaries, or the Ambac General Account." J.A.182-85 (¶¶ 9.B, 9.C). That prohibition is overbroad. There is no legitimate reason the Trustee should not be permitted to exercise its rights under the underlying transaction documents to the extent that such rights do not arise out of the Events (as that term is defined in Paragraph 4 of the Injunction Order (J.A.177)) or from the financial condition of the Segregated Account, the Allocated Subsidiaries, or the Ambac General Account. Prohibiting the Trustee from taking actions that in no way impact the Plan or the Segregated Account is overbroad and thus reversible error.

C. The Limits Of The Circuit Court's Jurisdiction Should Be Enforced

Under the Injunction, the Trustee is prohibited from "prosecuting any actions . . . in *any* state, federal, or foreign court, administrative body, or other tribunal against" OCI, Ambac, the Segregated Account, or the General Account. J.A.176 (emphasis added). The governing injunction statute, however, only contemplates the enforcement of injunctions in "*this* state" (i.e., Wisconsin). Wis. Stat. § 645.05(1). To enforce an injunction in *another* state, OCI must apply to the court in that jurisdiction for the same relief. *Id.* §§ 645.05(2), 645.34(1).

The Circuit Court has no authority to make an end-run around the statute—much less to extend its own jurisdiction beyond that conferred by the statute. *See*, *e.g.*, *Kohler Co. v. Wixon*, 204 Wis. 2d 327, 336, 555 N.W.2d 640 (Ct. App. 1996). It was error for the Court to expand the Court's jurisdiction by approving these provisions, and the Injunction should be modified to exclude them.

II. The Circuit Court's Denial Of All Discovery Resulted In The Approval Of A Plan With No Evidentiary Basis

Wisconsin law expressly authorizes parties to engage in discovery regarding any issue relevant to the subject matter involved in the pending action. Wis. Stat. § 804.01(2)(a). Other jurisdictions have recognized this right in the specific context of rehabilitation proceedings. *See Tex. Commerce Bank v. Garamendi*, 14 Cal. Rptr. 2d 854, 870-71 (Ct. App.

1992); *Grode v. Mut. Fire, Marine & Inland Ins. Co.*, 572 A.2d 798, 801-02 (Pa. Commw. Ct. 1990). Contrary to Wisconsin law and the majority rule, the Circuit Court denied all discovery in this case. That not only impaired the Trustees' efforts to meaningfully evaluate and properly challenge the Plan, but also resulted in the lack of any evidentiary foundation for its approval of the Plan.

OCI released little to no back-up documentation on the most crucial portions of the Plan—and produced *none* of the supporting documents underlying the Disclosure Statement on which the Circuit Court heavily relied. J.A.111 (¶ 20). As a result, neither the Court nor the Trustees had any way to verify OCI's statements or calculations in the Disclosure Statement—the "accuracy or completeness" of which OCI expressly disclaimed. J.A.345. The Circuit Court's approval of the Plan nonetheless was reversible error for that reason, too.

CONCLUSION

For the foregoing reasons, the Circuit Court's Order should be reversed.

Dated this 1st day of July, 2011.

Respectfully submitted,

U.S. BANK NATIONAL ASSOCIATION, solely in its capacity as Trustee,
By Its Attorneys,

/s/ Nathan L. Moenck________________
Paul E. Benson, SBN 1001457
Paul A. Lucey, SBN 1009833
Nathan L. Moenck, SBN 1066208
MICHAEL BEST & FRIEDRICH LLP
100 East Wisconsin Avenue, Suite 3300
Milwaukee, Wisconsin 53202-4108
Tel. 414.271.6560
Fax 414.277.0656

John M. Rosenthal, *Admitted Pro Hac Vice*
Kristine Bailey, *Admitted Pro Hac Vice*
MORGAN, LEWIS & BOCKIUS LLP
One Market, Spear Street Tower
San Francisco, California 94195
Tel. 415.442.1000
Fax 415.442.1001

Allyson N. Ho, *Admitted Pro Hac Vice*
MORGAN, LEWIS & BOCKIUS LLP
1000 Louisiana, Suite 4000
Houston, Texas 77002
Tel. 713.890.5000
Fax 713.890.5001

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FORM AND LENGTH CERTIFICATION

I hereby certify that this brief conforms to the rules contained in § 809.19(8)(b) and (c) of the Wisconsin Statutes for a brief produced with a proportional serif font. The length of this brief is 2,005 words.

Dated this 1st day of July, 2011.

Respectfully submitted,

U.S. BANK NATIONAL ASSOCIATION, solely in its capacity as Trustee,
By Its Attorneys,

/s/ Nathan L. Moenck________________
Paul E. Benson, SBN 1001457
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MICHAEL BEST & FRIEDRICH LLP
100 East Wisconsin Avenue, Suite 3300
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CERTIFICATION OF COMPLIANCE WITH RULE 809.19(12)

I hereby certify that:

I have submitted an electronic copy of this brief, excluding appendix, if any, which complies with the requirements of s 809.19(12). I further certify that:

This electronic brief is identical in content and format to printed form of the brief filed as of this date. A copy of this certificate has been

served with the paper copies of this brief filed with the court and served on all opposing parties.

Dated this 1st day of July, 2011.

Respectfully submitted,

U.S. BANK NATIONAL ASSOCIATION, solely in its capacity as Trustee,
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__/s/ Nathan L. Moenck___________

Paul E. Benson, SBN 1001457
Paul A. Lucey, SBN 1009833
Nathan L. Moenck, SBN 1066208
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100 East Wisconsin Avenue, Suite 3300
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Interested Parties.

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CERTIFICATE OF SERVICE

I hereby certify that on July 1, 2011, I served by first class mail, postage prepaid and/or electronic mail, this brief upon counsel listed below.

Ted Nickel and Office of the Commissioner of Insurance, State of Wisconsin
c/o Michael B. Van Sicklen
David G. Walsh
Matthew R. Lynch
Foley & Lardner LLP
150 East Gilman Street

Served three (3) copies pursuant to Wis. Stat. § 809.19(8) by first class mail.

P.O. Box 1497
Madison, WI 53701-1497
Email: mvansicklen@foley.com
Email: dwalsh@foley.com
Email: mlynch@foley.com

c/o Kevin G. Fitzgerald
Andrew A. Oberdeck
Foley & Lardner LLP
777 E. Wisconsin Ave.
Milwaukee, WI 53202
Email: kfitzgerald@foley.com
Email: aoberdeck@foley.com

Ambac Assurance
c/o Daniel W. Stolper
Barbara A. Neider
Stafford Rosenbaum LLP
222 W. Washington Ave., Ste. 900
P.O. Box 1784
Madison, WI 53701-1784
Email: dstolper@staffordlaw.com

Served three (3) copies pursuant to Wis. Stat. § 809.19(8) by first class mail.

Peter A. Ivanick
William G. Primps
Lynn Roberts
Emily L. Saffitz
Dewey & LeBoeuf LLP
1301 Avenue of the Americas
New York, NY 10019-6092
Email: wprimps@dl.com
Email: esaffitz@dl.com
Email: pivanick@dl.com
Email: lwroberts@dl.com

Todd L. Padnos
Dewey & LeBoeuf LLP
1950 University Avenue
Suite 500
East Palo Alto, CA 94303-2225
Email: tpadnos@dl.com

Wells Fargo Bank
c/o Stephen L. Morgan
Brittany S. Ogden
Jennifer M. Krueger

Served three (3) copies pursuant to Wis. Stat. § 809.19(8) by first class mail.

Murphy Desmond S.C.
33 East Main Street, Suite 500
P.O. Box 2038
Madison, WI 53701-2038
Email: smorgan@murphydesmond.com
Email: bogden@murphydesmond.com
Email: jkrueger@murphydesmond.com

Steven T. Whitmer
Kevin Wisnieski
Locke Lord Bissell & Liddell LLP
111 S. Wacker Dr.
Chicago, IL 60606
Email: swhitmer@lockelord.com
Email: kwisniewski@locklelord.com

Wells Fargo Bank/Trustee for RMBS Certificate Holders c/o Jane C. Schlicht Cook & Franke S.C. 660 E. Mason Street Milwaukee, WI 53202 Email: schlicht@cf-law.com Michael E. Johnson William B. Macurda Cele Ogawa Alston & Bird LLP 90 Park Avenue New York, NY 10016 Email: michael.johnson@alston.com Email: bill.macurda@alston.com Email: cele.ogawa@alston.com	Served three (3) copies pursuant to Wis. Stat. § 809.19(8) by first class mail.
The Bank of NewYork Mellon c/o Laura E. Callan Thomas Solheim Solheim Billing & Grimmer, S.C. One S. Pinckney Street, Suite 301 P.O. Box 1644 Madison, WI 53701-1644 Email: lcallan@sbglaw.com Email: tsolheim@sbglaw.com Dale C. Christensen, Jr.	Served three (3) copies pursuant to Wis. Stat. § 809.19(8) by first class mail.

Thomas Ross Hooper
Seward & Kissel LLP
One Battery Park Plaza
New York, NY 10004
Email: christensen@sewkis.com
Email: hooper@sewkis.com

Federal Home Loan Mortgage Corporation (Freddie Mac)
c/o David I. Cisar
Susan E. Lovern
Owen Thomas Armstrong, Jr.
von Briesen & Roper, s.c.
411 East Wisconsin Avenue, Suite 700
P.O. Box 3262
Milwaukee, WI, 53201-3262

Email: dcisar@vonbriesen.com
Email: slovern@vonbriesen.com
Email: oarmstrong@vonbriesen.com

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Christopher J. Stroebel
von Briesen & Roper, s.c.
Three S. Pinckney Street, Ste. 1000
Madison, WI 53703
Email: cstroebel@vonbriesen.com

Craig S. Bloomgarden
Manatt, Phelps & Phillips, LLP
11355 West Olympic Boulevard
Los Angeles, CA 90064
Email: cbloomgarden@manatt.com

Marcia D. Alazraki
Manatt, Phelps & Phillips, LLP
7 Times Square
New York, NY 10036
Email: malazraki@manatt.com

Federal National Mortgage Association (“Freddie Mae”)
c/o Rodney W. Carter
Davis & Kuelthau, S.C.
300 North Corporate Drive, Ste. 150
Brookfield, WI 53045-5804
Email: rcarter@dkattorneys.com

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c/o David M. Schlecker
Reed Smith LLP
599 Lexington Avenue
New York, NY 10022
Email: dschlecker@reedsmith.com

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
RMBS Policy Holders
c/o Bryan K. Nowicki
R. Timothy R. Muth
Jessica Hutson Polakowski
Reinhart Boerner Van Deuren s.c.
22 E. Mifflin Street, Suite 600
Madison, WI 53703
Email: bnowicki@reinhartlaw.com
Email: tmuth@reinhartlaw.com
Email: jpolakowski@reinhartlaw.com

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John B. Simon
David M. Greenwald
Michael T. Brody
Andrew J. Olejnik
Jenner & Block LLP
353 N. Clark Street
Chicago, IL 60654
Email: dgreenwald@jenner.com
Email: jsimon@jenner.com
Email: mbrody@jenner.com
Email : aolejnik@jenner.com

Patrick J. Trostle
Mark Lightner
Jenner & Block LLP
919 Third Avenue, 37th Floor
New York, NY 10022
Email: ptrostle@jenner.com
Email: mlightner@jenner.com

Eaton Vance Management,
Gregory T. Everts
Quarles & Brady

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P.O. Box 2113
Madison, WI 53701-2113
Email: greg.everts@quarles.com

Jeffrey W. Spear
Joel M. Walker
Kenneth M. Argentieri
Duane Morrris LLP
600 Grant Street, Suite 5010
Pittsburgh, PA 15219
Email: jmwalker@duanemorris.com
Email: jwspear@duanemorris.com
Email: kmargentieri@duanemorris.com

Nuveen Asset Management, Restoration Capital Management LLC, Stone Lion Capital Partner LP, LVM Bondholders
c/o Noreen Joy Parrett
Connie L. O'Connell
Parrett & O'Connell
10 East Doty Street, Suite 621
Madison, WI 53703
Email: nparrett@parrettoconnell.com
Email: coconnell@parrettoconnell.com

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Philip Bentley
Amy Caton
Susan Jacquemot
Kramer Levin Naftalis & Frankel LLP
1177 Avenue of the Americas
New York, NY 10036
Email: pbentley@kramerlevin.com
Email: acaton@kramerlevin.com
Email: siacquemot@kramerlevin.com

Depfa Bank plc
c/o Grant C. Killoran
Seth E. Dizard
Gregory W. Lyons
O'Neil, Cannon, Hollman, DeJong & Laing S.C.
111 E. Wisconsin Avenue, Ste. 1400
Milwaukee, WI 53202
Email: grant.killoran@wilaw.com
Email: seth.dizard@wilaw.com
Email: greg.lyons@wilaw.com

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c/o Michael C. Weed
Thomas J. Welsh
Andrew K. Davidson
Orrick, Herrington & Sutcliffe LLC
400 Capitol Mall, Suite 3000
Sacramento, CA 95814-4497
Email: mweed@orrick.com
Email: tomwelsh@orrick.com
Email: adavidson@orrick.com

One State Street, LLC c/o Anne M. Bensky Kathleen G. McNeil Garvey McNeil & Associates, S.C. One Odana Court Madison, WI 53719 Email: mcneil@gmmattorneys.com Email: bensky@gmmattorneys.com	Served three (3) copies pursuant to Wis. Stat. § 809.19(8) by first class mail.

c/o Mark I. Bane
Ropes & Gray LLP
1211 Avenue of the Americas
New York, NY 10036
Email: mark.bane@ropesgray.com

c/o D. Ross Martin
Andrew G. Devore
Ropes & Gray
Prudential Tower
800 Boylston Street
Boston, MA 02199-3600
Email: ross.martin@ropesgray.com
Email: andrew.devore@ropesgray.com

Access to Loans for Learning Student Loan Corporation AND Lloyds TSB Bank plc c/o Lawrence Bensky Law Office of Lawrence Bensky, LLC 10 E. Doty Street, Ste. 800 Madison, WI 53703 Email: lbensky@benskylaw.com	Served three (3) copies pursuant to Wis. Stat. § 809.19(8) by first class mail.

c/o James C. Owen
McCarthy, Leonard & Kaemmerer

400 S. Woods Mill Road
Chesterfield, MO 63017
Email: jowen@mlklaw.com

Wilmington Trust Co./Wilmington Trust FSB c/o Jane C. Schlicht Cook & Franke S.C. 660 E. Mason Street Milwaukee, WI 53202 Email: schlicht@cf-law.com c/o Michael E. Johnson William B. Macurda Cele Ogawa Alston & Bird LLP 90 Park Avenue New York, NY 10016 Email: michael.johnson@alston.com Email: bill.macurda@alston.com Email: cele.ogawa@alston.com	Served three (3) copies pursuant to Wis. Stat. § 809.19(8) by first class mail.
Bank of America c/o Jane C. Schlicht Cook & Franke S.C. 660 East Mason Street Milwaukee, WI 53202-3877 Email: schlicht@cf-law.com Michael E. Johnson William B. Macurda Cele Ogawa Brian Cox Alston & Bird LLP 90 Park Avenue New York, NY 10016 Email: michael.johnson@alston.com Email: bill.macurda@alston.com Email: cele.ogawa@alston.com Email: brian.cox@alston.com	Served three (3) copies pursuant to Wis. Stat. § 809.19(8) by first class mail.
Assured Guaranty Corp. & Goldman Sachs & Co., Inc. James E. Bartzen Earl H. Munson Boardman Suhr Curry & Field LLP	Served three (3) copies pursuant to Wis. Stat. § 809.19(8) by first class mail.

One S. Pinckney Street, Ste. 400
P.O. Box 927
Madison, WI 53701-0927
Email: emunson@boardmanlawfirm.com
Email: jbartzen@boardmanlawfirm.com

CN Franklin Reddick III
Akin Gump Strauss Haver & Feld
2029 Century Park East, Ste. 2400
Los Angeles, CA 90067
Email: freddick@akingump.com

KnowledgeWorks Foundation, As The Administrator of the Ohio Centric Student Loan Program AND
Treasuer of the State of Ohio
c/o Melissa A. Kern
Frost Brown Todd LLC
1103 Boundary Road
Middleton, WI 53562
Email: mkern@fbtlaw.com

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c/o Greg E. Mitchell
Frost Brown Todd LLC
2800 Lexington Financial Center
250 W. Main Street
Lexington, KY 40507
Email: gmitchell@fbtlaw.com

c/o Jeffrey A. Lipps
Joel E. Sechler
Carpenter Lipps & Leland LLP
280 Plaza Suite 1300
280 N. High Street
Columbus, OH 43215
Email: lipps@carpenterlipps.com
Email: sechler@carpenterlipps.com

PNC Corporation AND Customer Asset Protection Company ("CAPCO")
c/o John Franke
Gass Weber Mullins LLC
309 N. Water Street, Ste. 700
Milwaukee, WI 53202
Email: franke@gasswebermullins.com

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c/o Peter D. Laun
Jones Day
500 Grant Street, Ste. 4500
Pittsburgh, PA 15219
Email: pdlaun@jonesday.com

Attorneys for U.S.A.
c/o Robert J. Kovacev
Hilarie Snyder
Tax Division, U.S. Dept. of Justice
P.O. Box 7238
Washington, DC 20044
Email: Robert.j.kovacev@usdoj.gov
Email: hilarie.e.snyder@usdog.gov

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Countrywide Home Loans Servicing L.P.
c/o Bruce G. Arnold
Whyte Hirschboeck Dudek S.C.
555 E. Wells Street, Suite 1900
Milwaukee, WI 53202-3819
Email: barnold@whdlaw.com

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c/o Thomas M. Pyper
Cynthia L. Buchko
Whyte Hirschboeck Dudek S.C.
333 E. Main Street, Suite 300
Madison, WI 53703
Email: tpyper@whdlaw.com
Email: cbuchko@whdlaw.com

HSBC Bank U.S.A. N.A.
c/o Randall D. Crocker
Susan E. Lovern
von Briesen & Roper, s.c.
411 E. Wisconsin Ave., Suite 700
P.O. Box 3262
Milwaukee, WI, 53201-3262
Email: rcrocker@vonbriesen.com
Email: slovern@vonbriesen.com

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Christopher J. Stroebel
von Briesen & Roper, s.c.
Three S. Pinckney Street, Ste. 1000
Madison, WI 53703
Email: cstroebel@vonbriesen.com

Pieter Van Tol
Hogan Lovells US LLP
875 Third Avenue
New York, NY 10022
Email: pieter.vantol@hoganlovells.com

The Bank Insureds
c/o James A. Friedman
Brady Williamson
Anthony G. Gaughan
Godfrey & Kahn, S.C.
P.O. Box 2719
Madison, WI 53701-2719
Email: jfriedman@gklaw.com
Email: bwilliamson@gklaw.com
Email: agaughan@gklaw.com

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Michael P. Carroll
Donald S. Bernstein
Avi Gesser
Davis Polk & Wardwell LLP
450 Lexington Avenue
New York, NY 10017
Email: donald.bernstein@davispolk.com
Email: michael.carroll@davispolk.com
Email: avi.gesser@davispolk.com

/s/ Nathan L. Moenck
Nathan L. Moenck