

COURT OF APPEALS OF WISCONSIN
DISTRICT IV

In the Matter of the Rehabilitation of:

Segregated Account of
Ambac Assurance Corporation:

Appeal No. 2011AP561

TED NICKEL and the OFFICE OF
THE COMMISSIONER OF
INSURANCE,

Petitioners-Respondents,

AMBAC ASSURANCE,

Interested Party-Respondent,

v.

DEPFA BANK, PLC,

Interested Party-Appellant,

ACCESS TO LOANS FOR
LEARNING STUDENT LOAN
CORPORATION, AURELIS
CAPITAL MANAGEMENT LP,
BANK OF AMERICA, N.A.,
CUSTOMER ASSET
PROTECTION COMPANY
("CAPCO"), DEUTSCHE BANK
NATIONAL TRUST COMPANY,
DEUTSCHE BANK TRUST
COMPANY AMERICAS, EATON

VANCE, FEDERAL HOME LOAN
MORTGAGE CORPORATION
("FREDDIE MAC"), FEDERAL
NATIONAL MORTGAGE
ASSOCIATION ("FANNIE MAE"),
FIR TREE INC., KING STREET
CAPITAL MASTER FUND, LTD.,
KING STREET CAPITAL, L.P.,
LLOYDS TSB BANK
PLC, MONARCH ALTERNATIVE
CAPITAL LP, STONEHILL CAPITAL
MANAGEMENT LLC, U.S. BANK
NATIONAL ASSOCIATION, WELLS
FARGO BANK, N.A., WELLS FARGO
BANK, NATIONAL ASSOCIATION
AS TRUSTEE FOR THE LVM
BONDHOLDERS, WILMINGTON
TRUST COMPANY AND
WILMINGTON TRUST FSB,

Interested Parties-Co-Appellants,

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

**OPENING BRIEF OF WELLS FARGO BANK, N.A., IN
ITS CAPACITY AS TRUSTEE AND IN SIMILAR
CAPACITIES FOR CERTAIN RMBS TRUSTS AND AS
INDENTURE TRUSTEE ON CERTAIN STUDENT LOAN
BACKED SECURITIES TRANSACTIONS AND ON
BEHALF OF THE CERTIFICATEHOLDERS AND
NOTEHOLDERS FOR SUCH TRUSTS AND
TRANSACTIONS**

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N.A., in its Capacity as Trustee
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The undersigned Appellant, Wells Fargo Bank, N.A., in its capacity as trustee and in similar capacities for certain RMBS trusts and as indenture trustee on certain student loan backed securities transactions and on behalf of the certificateholders and noteholders for such trusts and transactions (“Wells Fargo Trustee”) submits this Opening Brief pursuant to Wis. Stat. § 809.19, and the Court’s Order dated May 3, 2011.

ISSUES PRESENTED FOR REVIEW

1. Did the Circuit Court err in granting OCI’s motion to confirm the Rehabilitator’s proposed Plan of Rehabilitation for the Segregated Account filed on October 8, 2010 (the “Plan”) and entering a Decision and Final Order Confirming the Rehabilitator’s Plan of Rehabilitation on January 24, 2011 (“Confirmation Order”) based on OCI’s proposed order?

The Circuit Court entered, without substantive revision, OCI’s proposed order approving the Plan.

2. Was it error for the Circuit Court to allow Ambac to satisfy policy claims through the delivery of Surplus Notes in lieu of cash?

The Circuit Court held the delivery of Surplus Notes in lieu of cash was lawful.

3. Was it error for the Circuit Court to allow Ambac to demand reimbursement of past paid claims in cash while Ambac is paying policy claims in part with Surplus Notes?

The Circuit Court approved the Plan despite the fact that it violates the “made whole” doctrine.

4. Was it error for the Circuit Court to allow Ambac an indefinite period of time to evaluate and pay claims in contravention of policy terms that require claims to be paid in a finite period of time?

The Circuit Court confirmed the Plan despite the fact that it contains provisions in violation of the contractual agreements of the Ambac policies.

5. Was it error for the Circuit Court to allow the subordination of the Surplus Note claims to current claims made on the Ambac policies?

The Circuit Court confirmed the Plan even though it impermissibly subordinates claims of policyholders holding Surplus Notes to current policyholder claims.

6. Was it error for the Circuit Court to enjoin trustees and similarly situated parties from enforcing policy and insurance agreement terms that would deny Ambac direction or control rights following a payment or similar default?

The Circuit Court confirmed the Plan despite the fact that it unreasonably nullifies contractual terms in the Ambac-issued policies and related agreements.

7. Was it error for the Circuit Court to require trustees and similarly situated parties to undertake new responsibilities and incur additional out-of-pocket expenses without adequate remuneration or indemnification?

The Circuit Court confirmed the Plan despite the fact that it requires trustees and similarly situated parties to undertake new responsibilities and incur additional out-of-pocket expenses without adequate remuneration or indemnification.

STATEMENT ON ORAL ARGUMENT AND PUBLICATION

Appellant requests oral argument because of the complexity of the issues raised in the case.

The Court's opinion in this case will meet the criteria for publication in Wis. Stat. § 809.23. A published opinion will aid the lower courts and the parties in addressing the issues of substantial and continuing public interest that have arisen in this insurance company rehabilitation and may arise in future rehabilitations in this State and elsewhere.

STATEMENT OF THE CASE

I. Nature Of The Case.

This appeal arises from the insolvency of Ambac Assurance Corporation ("Ambac"), a financial guaranty

insurance company domiciled in Wisconsin. On March 24, 2010 the Office of Commissioner of Insurance (“OCI”) commenced the rehabilitation proceeding in Dane County Circuit Court (the “Rehabilitation”). That same day, OCI and Ambac created the “Segregated Account.” Ambac allocated to the Segregated Account numerous policies and other liabilities it considered to have “material projected impairments” (R.2:5),¹ including policies and contracts guaranteeing payment in respect of residential mortgage-backed securities, collateralized debt obligations and certain credit default swaps. Other policies and obligations, together with *all* of Ambac’s assets, were kept in Ambac’s “General Account.” The only sources of payment for

¹ “R.X:X” denotes a record cite, with the first number representing the document number and the second number(s) representing the cited pages. Because the Court indicated in its June 7, 2011 Order that it would use the records posted to OCI’s website and would permit parties to do the same, Wells Fargo Trustee’s cited the version of record documents posted on that site for the Court’s convenience. For all documents except for transcripts Wells Fargo Trustee’s cites the sequential page number(s) of the posted document rather than the page number(s) reflected in the document.

the Segregated Account's obligations were a non-marketable \$2 billion dollar note issued by Ambac's General Account, and a loss reinsurance agreement. (R.1:19-20.)

Also on March 24, 2010, OCI moved the Circuit Court to enter an Order for Injunctive Relief, which motion was granted on an *ex parte* basis (the "TRO"). Among other terms, the TRO, which is still in effect, precludes any person or entity from commencing proceedings against the Segregated Account, Ambac or OCI under penalty of forfeiture. (*See* R.9:13.)

A variety of interested parties filed motions challenging the Segregated Account, the terms of the TRO and the Rehabilitation proceeding. These challenges were rejected and are at least in part the subject of other pending appeals in Wisconsin and before the Seventh Circuit Court of Appeals.

On October 8, 2010, OCI filed its proposed Plan.² (*See* R.369.) The Wells Fargo Trustee, with other affected parties, objected to the Plan. (*See* R.458.) A hearing on the proposed Plan was held in November 2010. On January 24, 2011 the Circuit Court entered the Confirmation Order. (R.556.)

Pursuant to the Plan, holders of permitted policy claims will receive only 25% of their claim in cash, and the remaining 75% of their claim will purportedly be satisfied with “Surplus Notes.” (R.567:6 (§1.08), 14 (§1.62), 15 (§2.02).) Although the Plan provides for interest to be paid on the Surplus Notes and a 2020 date for repayment of principal, no payments can be made without OCI’s approval. (R.567:19 (§4.02(b)), 23 (§4.04(e)), 109.) Meanwhile, policyholders in the General Account will continue to have their claims paid in cash, in full, on a current basis. (*See* R.560:199-200; R.561:57.)

² The Plan as originally proposed by OCI is at R.371. For consistency, the Wells Fargo Trustee cites to the modified

II. Procedural History.

On March 24, 2010, OCI initiated the rehabilitation proceeding for the Segregated Account. (R.1.) On October 8, 2010, OCI filed the proposed Plan with the Circuit Court. (R.371.) The Circuit Court held a hearing on the proposed Plan and objections thereto on November 15-19 and 30, 2010 (R.560-64, R.613). On January 24, 2011 the Circuit Court entered the Confirmation Order, approving the modified Plan. (R.556.) This appeal ensued.

III. Circuit Court Disposition.

The Circuit Court entered rulings that, among other things, confirmed the Plan. (R.556:56-60.)

version of the Plan that was approved by the Confirmation Order, at R.567.

IV. Statement Of Facts

The Wells Fargo Trustee incorporates by reference the Statement of Facts set out in the Appellants' Consolidated Opening Brief, (the "Consolidated Brief") at 15-33.

At the time of the hearing on OCI's proposed Plan, the Wells Fargo Trustee served as trustee for certain holders of securities in approximately 30 RMBS securitization transactions and 54 SLS transactions,³ which holders (the "Policyholders") are the ultimate beneficiaries of financial guaranty insurance policies (collectively, the "Policies") issued by and insurance agreements entered into by Ambac. (*See* R.459:2-3.) The Policies, which are held by the Wells Fargo Trustee for the

³ In addition, the Wells Fargo Trustee serves or served in an administrative capacity other than trustee for approximately 20 RMBS transactions where it performs certain duties in respect of Ambac-issued policies. The RMBS transactions for which it served as trustee or in such similar administrative capacity are referred to as, collectively, the "RMBS Transactions," and each individually, an "RMBS Transaction." The SLS transactions for which Wells Fargo served as Indenture Trustee are referred to as, collectively, the "SLS Transactions," and each individually, an "SLS Transaction." (R.459:2-3.)

benefit of the Policyholders, insure against certain losses incurred by, and/or allocated to, certificates and notes held by the Policyholders. (*Id.*) The Wells Fargo Trustee, on behalf of the Policyholders, has substantial current and projected future claims against the Segregated Account.

ARGUMENT

I. This Court Should Reverse The Circuit Court Because Its Confirmation of the Plan Does Not Reflect The Application Of Independent Judgment.

The Circuit Court erroneously adopted, virtually wholesale, the Plan and the Confirmation Order proposed by OCI. (*Compare* R.531 *with* R.556.) In adopting OCI's proposal verbatim, the Court provided no explanation for its decision to credit all of OCI's proposed findings of fact and conclusions of law while entirely rejecting all of the proposed findings of fact and conclusions of law submitted in opposition to the Plan. (*See* R.556.)

A trial court commits reversible error when it simply “accept[s one party’s] position on all of the issues of fact and law” and fails to articulate the factors it used in its analysis and decision. *Trieschmann v. Trieschmann*, 178 Wis. 2d 538, 541-44, 504 N.W.2d 433 (Wis. Ct. App. 1993); *see also Southeast Wisc. Prof. Baseball Park Dist.*, 304 Wis. 2d 637, 674, 738 N.W.2d 87 (Wis. Ct. App. 2007). The Circuit Court adopted OCI’s proposed order in support of the Plan even though parts were unsupported by, or contrary to, the evidentiary record, or were the subject of significant disputes of a factual or legal nature. (*See, e.g.*, R.556:24 (¶58), 28 (¶72), 35 (¶95), 35-36 (¶97), 38-39 (¶¶105-09), 40-41 (¶114), 50 (¶¶134-35), 51, (¶137), 51-52 (¶139-40), 54 (¶145), 55 (¶150), 56 (¶3), 57 (¶¶4-6), 58-59 (¶11), 59-60 (¶¶12-14).) The Circuit Court’s Confirmation Order should therefore be reversed.

II. It Was Error to Permit Ambac to Satisfy Policy Claims Through Surplus Notes in Lieu of Cash.

The Policies require that Ambac pay cash in respect of all valid claims submitted by the Wells Fargo Trustee. (*See, e.g.*, R.459:26-27.) The Plan, however, purports to allow Ambac to deliver Surplus Notes, instead of cash, in respect of 75 cents on every dollar of claim under the Policies. (*See* R.567:15 (§ 2.02).) The Circuit Court erred in holding that the satisfaction of the Policy claims through the issuance of these Surplus Notes was “fair and equitable to policyholders” (R. 556:57), because it did not find – and could not find – that the Policyholders would ever receive the full cash value of the Surplus Notes.

A party substituting a promise to pay (such as the Surplus Notes contemplated by the Plan) for the payment that is required under a contract, cannot “deem” that promise to be sufficient. *See Penterman v. Penterman*, 239 Wis. 17, 300 N.W. 765, 766 (1941) (holding “in the absence of evidence establishing an express agreement to this effect, delivery of a note by the debtor

to his creditor does not constitute an unconditional payment of the debt”). Yet that is precisely what the Plan purports to do in respect of the Surplus Notes, in contravention of this basic principle of Wisconsin law. (*See* R.567:15 (§2.02).)

Although the Circuit Court relied on the four scenarios in the Disclosure Statement (*see* R.556:35-37 (¶¶97-101)) in approving the Surplus Notes, the Circuit Court itself stated in the Confirmation Order that the scenarios “have *no direct relevance* as to whether or when payments will be made.” (R.556:37 (¶102) (emphasis added).) The Circuit Court also did not address the Wells Fargo Trustee’s objections regarding the market value of the Surplus Notes. (*See e.g.*, R.458:5-8.) As the Wells Fargo Trustee (and others) pointed out, the market value of the Surplus Notes is unknown and it is likely that they will trade at less than face value.⁴ The Circuit Court erred by

⁴ The fact that OCI can cause Ambac to refrain from making scheduled payments of interest and principal, standing alone, virtually assures that the Surplus Notes will trade at a

entering a Confirmation Order that permits Ambac to substitute one form of consideration for the consideration bargained for under the Policies.

III. The Plan Contains Several Objectionable Terms and Omits Terms Required to Protect the Interests of the Policyholders.

The Court erred in approving the Plan because it contains terms that will have a prejudicial impact on the Policyholders' interests, including a provision, described *infra*, which violates Wisconsin's "made whole" doctrine and which essentially allows Ambac to use the securitization Trusts as a supplemental credit facility, and because the Plan does not include terms necessary to protect the Policyholders' interests.

substantial discount. (*See* R.567:23 (§ 4.04(e)).) The Circuit Court decision did not address this point, but did acknowledge the wide discretion given to OCI in respect of the Surplus Notes, stating that "[i]f OCI does not approve the payment of interest on the Surplus Notes, such interest will accrue and compound annually until paid or *otherwise*." (*See* R.556:53 (¶144).) (emphasis added).

A. The Plan Unreasonably Allows Ambac to Demand Reimbursement in Cash Where It Has “Paid” Underlying Claims in Surplus Notes

Under the terms of most Policies and related Operative Documents,⁵ Ambac enjoys certain rights of subrogation and reimbursement rights for claims previously paid. In a typical RMBS Transaction, Ambac enjoys, on the date scheduled for distributions for a given period (the “Distribution Date”), a priority right of reimbursement for policy claims previously paid to the extent it was required to pay such claims on earlier Distribution Dates. Pursuant to the Plan, Ambac will effectively be able to invoke such reimbursement rights to drain the Trusts of cash despite not paying claims with 100% cash. Although the Plan permits Ambac to pay 25% of the value of each approved

⁵ The Operative Documents can include a pooling and servicing agreement, servicing agreements, a sale and servicing agreement, a trust agreement and/or an indenture and other related documents. (*See* R.459:3) RMBS and SLS transactions usually also incorporate an insurance agreement, which further delineates the rights and responsibilities of the parties to the transaction vis-à-vis the insurance policy

claim in cash and deliver Surplus Notes in respect of the remaining 75%, it would allow Ambac to recoup 100% of the value of such claims in cash. Section 4.04(g) of the Plan provides in relevant part that, notwithstanding “the satisfaction of Permitted Policy Claims with Surplus Notes in lieu of Cash, AAC shall be entitled to recover *the full amount* of all recoveries, reimbursements and other payments . . . under the applicable Policy.” (R.567:23-24.)

The Circuit Court erroneously dismissed objections to this language, stating that the objecting parties “assume[] that RMBS securities will recover to the point where there will be actual cash flows from which to obtain recoveries, which is not the case now to any material degree.” (R.556:44-45 (¶126).) Even if there were not *now* any reimbursements (a fact OCI did not prove), it is clear from the provision of Section 4.04(g) that

(together with the Operative Documents, the “Governing Documents”). (*Id.*)

OCI anticipates that there may be such cash flow in the future.⁶
(See R.567:23-24.)

Section 4.04(g) of the Plan thus permits Ambac to plunder the Trusts by delivering Surplus Notes of questionable value in respect of policy claims but then forcing the Trusts to pay cash amounts back to Ambac by way of reimbursements.⁷

⁶ That OCI expects Ambac to receive cash, and not some other form of consideration, from the transactions is confirmed by the Disclosure Statement, which provides that “*Ambac’s right to recover the full Cash amount of all recoveries reimbursements and other payments . . . entitles AAC to recover from the primary obligor on the relevant Ambac-insured instrument or contract 100% of the cash amount such obligor was contractually obligated to pay but failed to pay, even if the Holder of a Permitted Policy Claim receives less than . . . 100% in Cash on account of such Permitted Policy Claim under the Plan.*” (R.372:44 (emphasis in original).)

⁷ In the SLS Transactions, Ambac's right to reimbursement for payments on claims for principal generally does not require that it be reimbursed in cash, but rather that it receive the insured note, or an interest in a portion thereof in an amount equal to the reimbursement amount. (See R.459:8-9.) Because the SLS Notes will have matured by the point in time at which a claim for full payment of principal has been made, the SLS Noteholders are giving up their right to enforce (or direct the trustee to enforce on their behalf) the SLS Note obligation against the issuer of the SLS Note (the “SLS Issuer”) in exchange for Ambac’s payment under the Policy for the full amount of principal on the SLS Note. Ambac then maintains the right (as owner of the transferred SLS Note) to

The Circuit Court erred in failing to analyze the needless inequity of this provision. It is one thing to allow Ambac to “underperform” its contractual obligations through the Surplus Notes, but it is quite another to allow Ambac to enjoy all its reimbursement rights as if it had performed its obligations in full by paying 100% in cash. *Cf. Mutual Life Ins. Co. v. Delta Airlines, Inc.*, 608 F.3d 109, 149 (2d Cir. 2010) (holding that bankruptcy discharge could not be treated as satisfaction in full of underlying contract claim).

Ambac's reimbursement scheme also violates the basic principles of equity underlying the “made whole” doctrine, which provides that a party claiming subrogation rights may not recover until the insured is fully compensated for his or her

pursue remedies against the SLS Issuer for the full principal amount of the SLS Note. Under Section 4.04(g) of the Plan, SLS Noteholders would be forced to exchange one note for another, and instead of seeking repayment of the principal amount of the SLS Note from an entity with the creditworthiness of the SLS Issuer, the SLS Noteholders will be forced to accept the Segregated Account's Surplus Notes.

losses. As the Wisconsin Supreme Court has held, “[t]he burden of loss should rest on the party paid to assume the risk, and not on an inadequately compensated insured.” *Ruckel v. Gassner*, 2002 WI 67, ¶ 17, 253 Wis. 2d 280, 646 N.W.2d 11 (quoting *Couch on Insurance*, §§ 223:133, 223:136 (3d ed. 2000)). It has further held that the “made whole” doctrine may not be overridden by contract. *Ruckel*, 2002 WI 67, ¶ 43, 253 Wis.2d 280, 646 N.W.2d 11.

Ambac never bargained for the right to deliver Surplus Notes (or anything other than cash) in respect of policy claims, much less the right to receive 100% cash reimbursements in respect of claims “paid” 75% in Surplus Notes. There is thus no justification for allowing OCI to divert from the Trusts cash that could be used to make Policyholders whole (by redeeming previously delivered Surplus Notes) to “reimburse” Ambac in respect of claims that were “satisfied” through the prior delivery of the Surplus Notes.

The Court did not meaningfully address the Wells Fargo Trustee's objections to the Plan's reimbursement provisions and erred in entering the Confirmation Order approving the Plan.

B. The Plan Allows Ambac an Indefinite Period of Time to Evaluate and Pay Claims, in Contravention of the Policies' Terms

The Circuit Court erred in failing to address the Wells Fargo Trustee's objection to the Plan's terms permitting Ambac an indefinite period of time to pay claims, without regard to Policy terms requiring that claims be promptly paid. (R.567:21 (§ 4.04(b)).) The Governing Documents require that Ambac pay all timely submitted claims within a finite period of time. This requirement ensures that the party charged with responsibility for making distributions to Policyholders is able to pay, on the Distribution Date, all amounts owed to Policyholders, including amounts that are the responsibility of Ambac under the terms of the Policies. (*See* R.459:4.) Yet under the Plan, Ambac has an

indefinite period of time in which to evaluate each Policy claim.

(*See* 567:21 (§ 4.04(b)).)

The deferral of payments on claims will present the Wells Fargo Trustee with difficult operational issues, and

Policyholders could be prejudiced. (*See* R.459:4-5.)

Policyholders who bargained for the right to prompt payment of claims in respect of Ambac-insured securities could be required to wait an indefinite period of time to receive payment even of the 25% of each claim that the Plan contemplates will be paid in cash. The Plan includes no mechanism for compensating investors for the loss of use of cash during the deferral period.⁸

If Ambac does not pay a claim until after the Distribution Date, the Wells Fargo Trustee will have to decide on which “record date” Policyholders should be paid. Although the Wells Fargo Trustee currently intends to deliver any late-paid Ambac Policy claim amounts to Policyholders of record as of the date

when Ambac decides to deliver the claim consideration, to the extent the insured securities have changed hands, any prior record date Policyholders might argue that they have been prejudiced because, under the Governing Documents, the claims should have been paid on the earlier Distribution Date when the claim was made to Ambac. (*See* R.459:5.)

If Ambac chooses to delay delivery of claim consideration, the timing delay will also create administrative difficulties and economic expense for the Wells Fargo Trustee. These extra expenses and administrative duties are unexpected, unplanned for, and were not contracted for when the Wells Fargo Trustee assumed its role. (*See* R.459:5-6.) The Circuit Court did not address these difficulties at all, simply asserting in conclusory fashion that “OCI has taken care to work with trustees to avoid unreasonable burdens upon them, and has assured the Court that it will continue to do so as administrative

⁸ This is by no means a *de minimis* burden. Some investors have

challenges arise.” (R.556:40-41 (¶114).) No Record evidence supports the Circuit Court’s statement.

C. The Plan Unfairly Subordinates Surplus Note Claims

Under the Plan, claims on the Surplus Notes will, in the event of a liquidation, be subordinated to the claims of various other Ambac creditors, including policyholders with current claims on Ambac policies. The Disclosure Statement provides in relevant part that “[t]he payment of principal of and interest on the Surplus Notes will be expressly subordinate in right of payment to the prior payment in full of all . . . Policy Claims.” (R.372:52-53.)⁹ The Disclosure Statement further provides that “upon any distribution to creditors of claims in any rehabilitation . . . or similar proceeding relating to the Segregated Account . . . the Holders of Policy Claims . . . will first be entitled to receive payment in full of all amounts due . . . before the holders of the

now been waiting for payment of claims since March 2010.

Surplus Notes will be entitled to receive any payment.” (*Id.* at 53.)

The subordination of Surplus Note claims to current policy claims will improperly prioritize current policy claims over stale policy claims that still have not been satisfied 100% in cash. The delivery of Surplus Notes does not satisfy Ambac’s payment obligation of cash but rather simply defers that obligation until at least 2020, the earliest date when Ambac could be required to pay the Surplus Notes’ principal balance. There is simply no rational basis for treating current policy claims differently from old policy claims that still have not been fully satisfied in cash. Particularly given that OCI has acknowledged that the Surplus Notes are simply a mechanism by which Ambac’s cash claims payment obligations would be “slowed” (*see* R. 372:19), it was reversible error for the Circuit

⁹ “Policy Claims” are defined as “all existing or future claims of policyowners, beneficiaries and insureds arising from . . . any and all existing or future policies.” (R. 372:53.)

Court to approve the Plan without analyzing the Wells Fargo Trustee's objection.

D. The Plan Converts Objectionable Terms of the Order for Temporary Injunctive Relief Into Permanent Restraints

Without analysis, the Circuit Court adopted the Plan's terms converting all provisions of the TRO into a permanent injunction. (*See* R.567:36 (§ 10.02).) One of those provisions restrains securitization trustees from enforcing terms of the Policies that permit them to, in the case of a payment or similar insurer default, deny Ambac direction or control rights.¹⁰ (*See* R.9:4, 6 (¶¶ 6, 9).)

¹⁰The Governing Documents generally allocate to Ambac broad consent and direction rights, such as consent to the employment of subcontractors, consent to or direction of the sale or transfer of any of the trust estate, direction of the Wells Fargo Trustee (on behalf of the trust) to institute legal proceedings after an event of default, direction of the termination of the trust after an event of default, direction of the Wells Fargo Trustee (on behalf of the trust) to waive certain past defaults, and appointment of successor parties (servicers, administrators and trustees) to perform services on behalf of the trust. (*See* R.192:2-3.) Ambac generally loses these rights upon the occurrence of certain defaults (an "Insurer Default"). An Insurer Default generally occurs

As the securitization parties bargained for, Ambac's right to wield direction and control rights was dependent on it fulfilling its duties as the certificate insurer. Since the commencement of the Rehabilitation, Ambac has ceased performing those duties, even as the Wells Fargo Trustee has continued to pay premiums and other amounts. (*See* R.192:1-2.) Under the Governing Documents, Ambac should no longer have the power to direct or control the Wells Fargo Trustee. (*See* R:192:3.) The Plan, however, nullifies these provisions of the Policies.

In the October 25, 2010 decision, the Circuit Court held that the Rehabilitator's ability to carry out his statutory duties would be damaged if such "control-shifting" provisions were not enjoined. (*See* R.397:10-11.) The Circuit Court erred in so

(among other instances) if there is a failure by Ambac to make a payment when due and/or the commencement of a rehabilitation proceeding. If an Insurer Default occurs and Ambac loses the control and direction rights, the Governing Documents often redirect these rights to certain of the investors of the applicable transaction. (*Id.*)

holding because the restoration of the bargained-for rights need not have any impact on the financial condition of Ambac or the Segregated Account. Any exercise of direction or control rights by the Wells Fargo Trustee would still be subject to the other restraints imposed by the Plan. Thus, for example, no Policyholder could direct the Wells Fargo Trustee to sue Ambac or the Segregated Account for failing to pay amounts due under the Policy. They likewise could not direct the Wells Fargo Trustee to cease paying premiums or other amounts. The Circuit Court thus erred in simply accepting the proposition that prejudice to Ambac would result if the control-shifting terms in the Policies were not enjoined, and the Confirmation Order should be reversed to the extent it continues the TRO's restraint on control-shifting provisions.

E. The Plan Would Prejudice the Wells Fargo Trustee

1. The Surplus Note Scheme Will Force the Wells Fargo Trustee to Undertake New Responsibilities and Incur Additional Out-

of-Pocket Expense Without Remuneration or Reimbursement

The delivery of Surplus Notes to the Wells Fargo Trustee will present it with difficult operational issues. When it agreed to serve as trustee the Wells Fargo Trustee (and other participants in the transactions) understood that the only consideration that would ever be delivered to investors was cash. (*See* R.459:6.) The Wells Fargo Trustee's procedures and protocols have thus been designed to handle distribution of cash consideration. Under the Plan, trustees could be required to facilitate the issuance of book-entry Surplus Notes through The Depository Trust Company ("DTC") to participant holders of record at DTC. (*See* R.567:23-23 (§ 4.04(d)).) The Wells Fargo Trustee will have to build a new operational process to handle the Surplus Notes, which will be time-consuming and will impose additional burden. To deliver the Surplus Notes, the Wells Fargo Trustee will be required to purchase a securities position report from DTC and then contact individual investors

to plan for the electronic delivery of the Surplus Notes. In addition, new reporting, reconciliation, oversight, quality control, staffing, documentation, compliance and audit procedures will have to be developed, tested, implemented and managed. (*See* R.459:6-7.) These operational and procedural challenges will be exacerbated by the fact that the Surplus Note delivery process will entail significant manual effort on the part of individual employees, thereby increasing the chance for human error. (*Id.*)

While it is difficult to quantify the expense associated with the devotion of additional human and information technology resources to the trust administration process for affected Trusts, the burden will be significant and will necessitate the reallocation of valuable institutional resources. (*See* R.459:7.) The Wells Fargo Trustee also anticipates incurring a number of hard, out-of-pocket expenses, including

professional services fees (attorneys, accountants and consultants) and costs imposed by DTC. (*Id.*)

The Circuit Court did not meaningfully analyze the additional duties, burdens and expenses that the Plan will impose on the Wells Fargo Trustee, and instead dismissed the objections in reliance on OCI's assurance that it will work with trustees "to avoid imposing unreasonable burdens" and finding that the additional burdens were "*de minimis.*" (R.556:40-41 (¶114).)

The imposition of additional duties, burden and expense on the Wells Fargo Trustee runs afoul of the terms of the Operative Documents and well-settled law. The Operative Documents generally provide that the trustee's duties are limited to those expressly set forth therein. (*See, e.g.*, R.459:22-23.) It is also well-settled under New York law, the law generally applicable to the Operative Documents, that prior to the occurrence of a transaction event of default (as defined in the

Operative Documents), a trustee's responsibilities are strictly limited to those set forth in such documents.¹¹ *See, e.g., Elliott Assocs. v. J. Henry Schroder Bank & Trust Co.*, 838 F.2d 66 (2d Cir. 1988). Simply stated, nothing in the Wisconsin Statutes or otherwise under Wisconsin law gives, nor could give, OCI the right to impose duties and costs upon an entity not subject to its regulatory mandate, and the Confirmation Order did not state any reasons that it could.

Furthermore, although the Plan was revised to provide certain indemnification for trustees, pursuant to their objections (*see* R.556:59-60 (¶14)), this indemnification is inadequate. The indemnification provided under the Plan pertains only to lawsuits by third parties (*see* R.567:32-34 (§8.02)) and will not compensate the Wells Fargo Trustee for out of pocket losses and

¹¹ Events of default that trigger heightened trustee duties under the Operative Documents generally do not include a payment or other insurer default. Accordingly, the fact that Ambac has defaulted on its payment and other obligations under the policies does not constitute an event of default implicating heightened trustee duties.

other expenses that will be incurred in implementing the Plan. The Circuit Court conclusorily stated that the additional administrative burdens and expenses would be “*de minimis*,” without adequately analyzing the burdens that would be imposed. (R.556:40-41 (¶114).) The Plan was therefore confirmed in error.

2. The Plan Imposes Duties on Some RMBS and SLS Trustees that Were Delegated to Other Entities Under the Operative Documents

The Circuit Court ignored the objections regarding the imposition of certain duties on “trustees” that, in some Trusts, are not the responsibility of trustees under the relevant Operative Documents. For example, Section 4.04 requires that “to the extent received by a Holder acting in its capacity as *trustee*, [Surplus Notes] shall be transferred by such Holder to the beneficial holders for whom it is acting as *trustee*.” (R.567:22 (§ 4.04(d)) (emphasis added).) It goes on to provide that “any such Holder or beneficiary acting as a *trustee* may allocate,

distribute or disburse Surplus Notes issued in accordance with the Plan by allocating, distributing or disbursing such Surplus Notes . . . to the beneficial holders.” (*Id.*:23 (emphasis added).)

In certain transactions, however, the trustees are not responsible for making distributions. Section 4.04(d) will, nevertheless, inappropriately require the “trustee” to deliver Surplus Notes when another agent has the contractual responsibility for making distributions.

Because the Plan improperly imposes duties on trustees that run afoul of the Operative Documents’ allocations of responsibilities and because the Confirmation Order did not analyze this improper delegation, the Circuit Court erred in approving the Plan.

CONCLUSION

The Wells Fargo Trustee respectfully requests that the Court reverse the Circuit Court’s Confirmation Order approving the Plan.

Dated this 30th day of June, 2011.

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COURT OF APPEALS OF WISCONSIN
DISTRICT IV

In the Matter of the Rehabilitation of:

Segregated Account of
Ambac Assurance Corporation:

Appeal No. 2011AP561

TED NICKEL and the OFFICE OF
THE COMMISSIONER OF
INSURANCE,

Petitioners-Respondents,

AMBAC ASSURANCE,

Interested Party-Respondent,

v.

DEPFA BANK, PLC,

Interested Party-Appellant,

ACCESS TO LOANS FOR
LEARNING STUDENT LOAN
CORPORATION, AURELIS
CAPITAL MANAGEMENT LP,
BANK OF AMERICA, N.A.,
CUSTOMER ASSET
PROTECTION COMPANY
("CAPCO"), DEUTSCHE BANK
NATIONAL TRUST COMPANY,
DEUTSCHE BANK TRUST
COMPANY AMERICAS, EATON

VANCE, FEDERAL HOME LOAN
MORTGAGE CORPORATION
("FREDDIE MAC"), FEDERAL
NATIONAL MORTGAGE
ASSOCIATION ("FANNIE MAE"),
FIR TREE INC., KING STREET
CAPITAL MASTER FUND, LTD.,
KING STREET CAPITAL, L.P.,
LLOYDS TSB BANK
PLC, MONARCH ALTERNATIVE
CAPITAL LP, STONEHILL CAPITAL
MANAGEMENT LLC, U.S. BANK
NATIONAL ASSOCIATION, WELLS
FARGO BANK, N.A., WELLS FARGO
BANK, NATIONAL ASSOCIATION
AS TRUSTEE FOR THE LVM
BONDHOLDERS, WILMINGTON
TRUST COMPANY AND
WILMINGTON TRUST FSB,

Interested Parties-Co-Appellants,

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

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 5,343 words.

Dated this 30th day of June, 2011.

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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.

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