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

OBJECTORS' REPLY IN FURTHER SUPPORT OF THEIR OBJECTION TO THE APPLICATION FOR APPROVAL OF ENGAGEMENT OF ROGER A. PETERSON AS FULL-TIME SPECIAL DEPUTY COMMISSIONER OF THE SEGREGATED ACCOUNT

It is inappropriate for OCI to transition Mr. Peterson from a deputy administrator at OCI to a consultant position in which he would apparently perform the same tasks, but at a 650% salary increase paid out of the limited assets available to satisfy claims under policies allocated to the Segregated Account. In its response, OCI asserted, once again, that the Objectors lack standing to object and that Mr. Peterson by reason of his experience and knowledge of AAC's affairs is uniquely qualified to receive this compensation. As shown in this reply, OCI's response provides further reason why the Court should deny OCI's Application for Approval of Engagement of Roger A. Peterson, As Full-Time Special Deputy Commissioner of the Segregated Account (the "Application"). The Court should refuse to permit Mr. Peterson to parlay his government position into a lucrative job in the private sector at the expense and over the objection of those with interests in the Segregated Account.

I. THE OBJECTORS HAVE STANDING TO OPPOSE MR. PETERSON'S ENGAGEMENT.

As it has throughout this proceeding, OCI claims the Objectors lack standing, this time to object to the Application. But OCI concedes that this Court has already concluded the Objectors "may be heard." (OCI Resp., at 2.)

OCI's response asserts that the Objectors may not make statements on behalf of "policyholders." OCI's focus on whether the Objectors qualify as "policyholders" is a red herring. Throughout these proceedings, OCI has opposed the participation of any third parties, whether "policyholders" or not. (*See, e.g.*, Oct. 14, 2010 Hrg. Tr., at 75-81.) Nonetheless, Objectors satisfy the definition of "Holders" under the Plan of Rehabilitation. (Plan of Rehabilitation, at §1.29.) In that capacity, they have standing to object to OCI's attempt to dissipate assets that may be used to pay valid claims. The Objectors seek to protect their real economic interests, which OCI's actions continue to harm.

OCI's claim that it does not know what the Objectors' interests are in these proceedings reflects an apparent desire *not* to know. Throughout this proceeding, including twice during the hearing in November 2010, the Objectors have offered to identify the RMBS trusts in which they hold notes and their aggregate holdings for *in camera* review. (*See, e.g.,* Nov. 15, 2010 Hrg. Tr., at 117; Nov. 19, 2010 Hrg. Tr. at 45-46.) OCI has never accepted this offer, instead preferring to repeat its now time-worn argument that the Objectors have no standing. Enough is enough: the Objectors have every right to be heard in this proceeding and the Court should no longer be burdened by OCI's repeated, groundless, attack.

II. OCI FAILED TO JUSTIFY MR. PETERSON'S PROPOSED COMPENSATION.

OCI's response revealed three flaws with its Application: (a) OCI concealed the nature of the proposal; (b) there are serious questions about whether Mr. Peterson should be retained; and (c) if Mr. Peterson should be retained, the proposed compensation is too high.

A. OCI Concealed Details About The Application.

In the Application, OCI described Mr. Peterson's compensation: base salary ($600,000), a "stay bonus" if Mr. Peterson remained for 40 months ($375,000); three months' living expenses to ease his transition to the new job ($22,500); and other capped expenses ($20,000).

(*See* Application, at 7.) OCI did not produce the employment contract, even though it was negotiated and signed before the Application was filed, until after OCI filed its Application. Even then, the Objectors had to press OCI to provide this information.

The belatedly-produced contract reveals that OCI failed to disclose a significant aspect of Mr. Peterson's compensation. In addition to what OCI disclosed, the contract provides that Mr. Peterson will receive an additional $975,000 payment should OCI determine his services are no longer needed at any time over the next 28 months. (OCI Resp., at Ex. A, § 3.3.) After that 28 month period, the amount of the payment will decrease by $50,000 per month until the 40th month, when Mr. Peterson would receive the $375,000 stay bonus. (*Id.*) For example, if in the next twenty-eight months OCI converts the rehabilitation to a liquidation and decides that Mr. Peterson's services will not be needed, Mr. Peterson will be entitled to receive $975,000. If OCI decides it wants someone else in the job, even if Mr. Peterson's conduct does not provide any cause for replacing him, Mr. Peterson will receive $975,000. Despite describing less significant aspects of his compensation, OCI did not disclose this huge liability.

Other questions remain unanswered after OCI's response: Who else did OCI consider? Did it offer the position to someone else? What were the negotiations with Mr. Peterson over salary? What was OCI's first offer? Given that the salary is to be paid by the Segregated Account, what did OCI do, if anything, to learn the views of parties with insurance claims to be paid by the Segregated Account? How much would it cost simply to hire another person at OCI to take over the duties Mr. Peterson is no longer able to fulfill? Can an existing OCI employee be tasked with those jobs? OCI's response raises many more questions than it answers.

B. OCI Has Failed To Prove Mr. Peterson Is The Right Person For The Job.

In arguing Mr. Peterson is the right person for the job, OCI finds itself with a dilemma. On the one hand, OCI paints Mr. Peterson as the ultimate insider – he knows AAC inside and

out. On the other hand, OCI seeks to distance him from all of AAC's problems: despite his "unparalleled" knowledge of AAC's affairs, and despite his "two decades of experience examining" AAC's affairs, OCI denies that he had any role to play in AAC's demise.

The shortcomings of Mr. Peterson's regulatory oversight of AAC have become evident in these proceedings. During the Plan confirmation hearings only last November, Mr. Peterson testified that OCI did not intend to impose a "lengthy delay" between the confirmation of the Plan and the commencement of claims payments. (Nov. 16, 2010 Hrg. Tr., at 215.) Yet OCI has done just that. Though the Plan was confirmed in January 2011, OCI has repeatedly delayed its implementation and stated as recently as June 1, 2011 that OCI is not satisfied that conditions precedent to the Plan's effectiveness have been satisfied. At the present time, OCI is considering amendments to the Plan or even a full rehabilitation of AAC. (Report on the Rehabilitation of the Segregated Account of Ambac Assurance Corporation ("Report"), at 6.) This rehabilitation formally began in March 2010 after months of planning. Now, as we approach one and one-half years of rehabilitation, not a single dime has been paid on policies in the Segregated Account, and it is unclear if and when they will ever be paid.

Not only does OCI fail to explain why Mr. Peterson is right for the tasks that lie ahead, but OCI provides no meaningful explanation of what those tasks will be. OCI's response does not set forth what Mr. Peterson will be doing in the next month, year, and beyond. The responsibilities listed in the employment agreement are general to the point of meaninglessness. (OCI Resp., at Ex. A, Schedule 1.) Because OCI has not disclosed what Mr. Peterson will do, there is no showing that Mr. Peterson is skilled to do it. OCI asks permission to commit the Segregated Account to paying Mr. Peterson millions of dollars over the next 40 months, or longer, but does not disclose why he is the right person for the job, whatever that may be.

Finally, OCI's explanation that Mr. Peterson is ethically permitted to provide to the Segregated Account the services outlined in the employment contract ignores Wisconsin law. (*See* OCI Resp., at 7-8.) Mr. Peterson currently serves as Deputy Administrator – Division of Regulation and Enforcement. (OCI Resp., at 3.) As such, Mr. Peterson qualifies as a "state public official" under Wis. Stat. § 19.42. (*See* Wis. Stat. § 19.42(14) (defining "state public official" as "any individual holding a state public office") and § 19.42(13)(j) (defining "state public office" to include a "division administrator" of OCI (an independent agency created under Wis. Stat. § 15.73).) Wisconsin Statutes § 19.45(8) prohibits state public officials, including Mr. Peterson, from certain post-government-employment activity, including (a) for 12 months after his departure, having compensated dealings with anyone in his former department; (b) for 12 months after his departure, addressing issues that fell within the scope of his responsibility while a state public official; and (c) on a permanent basis, accepting compensation for addressing matters on which he personally and substantively worked while a state public official. It is apparent that he will do all three.

C. OCI Fails To Justify Mr. Peterson's Compensation.

OCI submits a consultant's report prepared before OCI signed its contract with Mr. Peterson to support Mr. Peterson's exorbitant salary increase and compensation package. (*See* OCI Resp., at Ex. B.) The report does not address the total package Mr. Peterson will receive – with its bonuses and termination rights. (*See id.*) The report was prepared before the compensation package was disclosed. Even focusing on the base pay, the report undermines, rather than supports what OCI proposes to do.

The consultant's report advised OCI in the abstract what it may expect to pay to hire a special deputy commissioner. (*Id.* at 4-9.) It describes a number of "comparables" for that compensation – hiring a consultant, hiring an insurance executive, and so on. (*Id.*) One of the

options it describes is hiring a former regulator, which is what OCI has decided to do. The report calculates the compensation OCI would expect to pay to a former regulator to work as a deputy rehabilitator. The report assumes a base salary of $125,000, applies an adjustment for cost of living in New York, and a 170% increase to reflect the loss of state employment tenure. (*Id.* at 7-8.) Even after those healthy adjustments, OCI's consultant calculates that the resulting expected total income for a regulator taking the job is $360,000.[1] (*Id.*) Inexplicably, OCI offered Mr. Peterson $600,000, plus bonuses, and other elements of compensation. The document OCI has belatedly disclosed refutes, rather than supports, its action.

OCI several times in its response defends the pay Mr. Peterson will receive with the excuse that none of it will be paid by the government. (OCI Resp., at 1, 8.) Yet OCI's duty is not just to safeguard its own budget. It is also charged with fairly regulating insurers domiciled in Wisconsin. It is no answer to the objection to claim that Mr. Peterson's salary is of no concern because someone else is paying it. That "someone else" includes the parties OCI is duty-bound by Wisconsin law to protect. From the beginning of this matter, the Objectors have complained that OCI's actions have undermined Wisconsin-domiciled insurers and materially impaired Wisconsin's reputation as a state in which to invest and do business. This is another example of that conduct. OCI's regulatory actions will cause insurance purchasers to look elsewhere, harming insurance businesses throughout the State. If OCI forces Mr. Peterson's salary upon the Segregated Account, further reducing the limited funds available to pay legitimate claims, companies interested in buying insurance will steer away from Wisconsin

[1] Not knowing what approach OCI would take, the consultant developed an expected annual pay range of $400,000 - $800,000 for the position. (OCI Resp., at Ex. B, at 9.) That annual average, however, reflects a balance of all of the possible options. Significantly for the Court's current purposes, the consultant's report established the expected price for the option OCI selected as $360,000. (*Id.* at 7-8.)

insurers. Doing business with a Wisconsin insurer runs the risk of being forced to pay excessive charges designed to transition one of OCI's employees to a lucrative job in New York.[2]

III. OCI'S CLAIM THAT THE OBJECTION IS "TACTICAL" IS GROUNDLESS.

OCI's final argument is that the Objectors have pursued a litigation strategy "to throw sand in the gears of the rehabilitation proceeding at every opportunity and to capitalize on any resulting uncertainty." (OCI Resp., at 10.) OCI suggests the purpose of the Objectors' litigation position is "to profit from their own speculation on the market." (*Id.*) OCI's reckless charge is a blatant effort to divert attention from the issue before this Court.

To support its reckless charge, OCI parades before the Court a series of press clippings about various of the Objectors – clippings that have no relevance to the Application, which are advanced without foundation and which are hearsay on their face. (*Id.* at 11-12.) OCI used these clippings to suggest the Objectors are acting irresponsibly because of how they acquired their interests and because they are attempting to make a profit on their investment. (*Id.*) Even if, despite fatal evidentiary defects, the clippings were to be given any weight at all, which they should not, they do not support OCI's charge. OCI describes as an improper tactic the strategy of acquiring securities at a low price and taking action to protect the rights associated with the securities. In our free market system, there is nothing wrong with a party attempting to buy low with the goal of earning a greater return. The notion of "security of transfer," that is, that subsequent security purchasers assume all rights to profit or loss in transactions, dates back at least to Alexander Hamilton's decision to support the U.S. Government's redemption in full of

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[2] OCI also compares Mr. Peterson's compensation package to pay earned by certain fund managers, who have been entrusted by their clients with investing billions of dollars. (OCI Resp., at 8-9.) The comparison is irrelevant – policyholders in the Segregated Account did not select Mr. Peterson to manage billions of dollars of their personal capital at an expense they are willing to bear, and Mr. Peterson has not taken on the risk that those fund managers face on a daily basis. It is no more useful to compare Mr. Peterson's salary to that of the New York Yankees' starting third baseman. (Alex Rodriguez by the way, earns $32 million per year.)

revolutionary war bonds that soldiers had sold to investors. Hamilton reasoned that punishing speculators would be "ruinous to public credit" and supporting the bonds would increase their value. ALEXANDER HAMILTON, FIRST REPORT ON PUBLIC CREDIT (1790). For the State of Wisconsin, through its Commissioner of Insurance, to suggest otherwise reinforces a concern the Objectors have repeatedly expressed with respect to the actions taken by OCI in these proceedings – Wisconsin is acting as a state that is hostile to investment and business.

OCI charges that some of the Objectors have in other cases used litigation in an attempt to improve their return. OCI states certain of the Objectors have filed lawsuits to vindicate their rights. (OCI Resp., at 11-12.) In our system, the civil courts are open to hearing precisely these types of claims. Any party, even an investor, is permitted in our democracy to assert its legal rights. The Objectors in this case have done just that. The doors of this courthouse are open to all parties, such as the Objectors, to seek redress for legal wrongs. For OCI to suggest the Objectors have behaved improperly by seeking to hold OCI to the obligations of Wisconsin law, suggests that OCI views itself as above the law. OCI has no right to criticize private parties who, at their own expense, seek to hold OCI to the obligations of Wisconsin law.

Finally, the suggestion that the Objectors have objected to Mr. Peterson's salary in order to create uncertainty in the market so that they can exploit that uncertainty through trading is ridiculous on its face. If uncertainty creates trading opportunities, the uncertainty in this case results from the inconsistent actions of OCI. In October 2010, counsel for OCI advised this Court that OCI needed to rush to a confirmation hearing so that it could begin paying claims:

> [W]e have a very onerous payment moratorium in place as part of the first day injunction order in this case. OCI takes very seriously the power it wielded in coming to you in March of this year to request that payment moratorium. . . .
>
> [T]hat claims-payment moratorium has placed a heavy burden, heavy toll on many [claimants]. . . .

> [T]here's a very strong desire on OCI's part to get to the confirmation process as expeditiously as possible so that these folks can get going on receiving the types of distributions under our plan that are called for. . . .
>
> And we'll undoubtedly hear shortly from lots of the lawyers here that are interested in, you know, delaying and dragging this process out, but what they don't hear about and what you don't hear about is what we in OCI hear about is the folks who are posting questions on our website, calling that are counting literally the days until payments start under a plan. We take that as a very serious reason to have a prompt process.

(Oct. 14, 2010 Hrg. Tr., at 22-24.) In his testimony, Mr. Peterson confirmed that OCI intended to implement the Plan quickly if it was confirmed: OCI did not plan a "lengthy delay" between Plan confirmation and implementation, and anticipated that OCI would begin accepting claims on the Segregated Account in January 2011 and making payments on those claims in February 2011. (Nov. 16, 2010 Hrg. Tr., at 215.)

Yet nine months later, OCI continues to hem and haw about whether it will ever implement the Plan. Upon confirmation, OCI announced that its effective date would be delayed until May 2011. That date did not hold either, as OCI announced on April 22, 2011 that the Plan would not be consummated in May after all because the Rehabilitator was "not satisfied that the conditions necessary for the Plan to become effective have all been satisfied." (*See* Notice from the Rehabilitator Regarding Implementation of the Plan of Rehabilitation (Apr. 22, 2011), *available at* http://ambacpolicyholders.com/press-releases/.) On May 10, 2011, OCI updated the policyholders' website to indicate that it "is continuing to evaluate the implications of current information regarding claims development and potential tax consequences for the implementation of the Plan of Rehabilitation." (*See* Notice from the Rehabilitator (May 10, 2011), *available at* http://ambacpolicyholders.com/press-releases/.)

Most recently, in the report it issued on June 1, OCI reported that as of that date, OCI was not satisfied that conditions precedent to its effectiveness had been satisfied. (Report, at 4.) OCI conceded that it "ha[d] not designated an effective date for the Plan." (*Id.*) OCI further indicated that it was considering whether to amend the Plan or initiate rehabilitation proceedings for AAC based on tax considerations arising from the rehabilitation and the "continued deterioration of AAC's financial strength." (*Id.* at 6.)

OCI has generated more than enough uncertainty all on its own. Even if Objectors desired uncertainty, Objectors could not possibly have generated the uncertainty that OCI's haphazard and opaque approach to the rehabilitation has caused.

CONCLUSION

There are too many unanswered questions, and the few answers OCI has given raise even more questions. The Application should be denied.

Dated this 7th day of July, 2011.

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