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In the Matter of the Rehabilitation of:

Segregated Account of  
Ambac Assurance Corporation

Case No. 10 CV 1576

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**OBJECTION TO MOTION TO AUTHORIZE  
PAYMENTS TO AAC'S SHAREHOLDER**

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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 (the "RMBS Holders"), in their capacity as owners of or managers of funds that own residential mortgage-backed securities insured by Ambac Assurance Corporation ("AAC"),<sup>1</sup> by their attorneys, hereby object to the Rehabilitator's Motion to Authorize the Rehabilitator and the Segregated Account to Proceed with Specified Agreements with Ambac Assurance Corporation and Ambac Financial Group, Inc. and Its Official Committee of Unsecured Creditors (the "Motion"). For the reasons set forth below, the Court should deny the Motion.

**OBJECTION**

Repeatedly, the RMBS Holders have objected to steps taken by the Rehabilitator that violate Wisconsin law. Specifically, the RMBS Holders have objected that this rehabilitation permits AAC's shareholder, Ambac Financial Group, Inc. ("AFG"), to benefit at the expense of AAC's policyholders. Now, the Rehabilitator asks this Court to approve agreements whereby AAC will pay its shareholder possibly hundreds of millions of dollars. Neither OCI nor AAC should be suggesting any payments to AFG while AAC policyholders who were allocated to the Segregated Account (1) have not received any payments in over 19 months, (2) have no

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<sup>1</sup> The RMBS Holders are not fiduciaries for any other creditors or equity holders of AAC or its affiliates nor are they insiders of AAC or its affiliates for any purpose.

timetable for receiving payments given the Rehabilitator's determination to hold up the effectiveness of the Plan of Rehabilitation, and (3) see their premiums and recoveries on account of their policies directly benefit AAC's *General Account*.

**I. Wisconsin Law Requires Payment of Policyholder Claims in Full Before Any Distributions to Shareholders.**

When an insurer fails, the Wisconsin Legislature has defined what it means to treat claimants fairly and equitably. When an insurance company's financial condition will result in loss to claimants or shareholders, Wisconsin's regulatory scheme provides for the "equitable apportionment of [that] unavoidable loss." Wis. Stat. §645.01(4)(d). That equitable apportionment is accomplished through Wisconsin's statutorily-mandated priority scheme in Wis. Stat. §645.68. That law requires that claims of one class must be paid in full before members of a lower-priority class receive any payment. Wis. Stat. §645.68. Policyholder loss claims (Class 3) come ahead of general creditor claims (Class 5), contribution (or surplus) notes (Class 10), and shareholder claims (Class 11), among others. *Id.* Thus, policyholder claims must be paid in full before an insurer's shareholders receive anything. *Id.*

If the Court were to approve the agreements, it would authorize the Rehabilitator and AAC to violate the law. Pursuant to the agreements, AFG would be paid:

- A \$30 million "Cash Grant";
- Up to \$25 million of operating expenses over five years (and possibly more thereafter);
- \$350 million of Junior Surplus Notes directly from the Segregated Account;
- Possibly hundreds of millions of dollars of "tolling payments" for AAC's use of net operating losses, which AAC itself generated; and
- Other expense/cost amounts.

The agreements also provide for the following additional benefits to AFG:

- AAC commits to transfer to AFG “a more than insignificant amount of an active trade or business”;
- AAC’s contractual payment obligations to AFG under the agreements would be treated as priority, administrative claims in any full rehabilitation of AAC and thus paid in full before any policyholder claims; and
- AFG and its current and former members, shareholders, affiliates, officers, directors, employees and agents will receive releases.

On the first day of these proceedings, this Court gave AAC and the Segregated Account protection from policyholder claims – a breathing spell because OCI asserted AAC’s resources were insufficient to pay policyholders in full. This Court should not now approve millions of dollars of payments to, and other benefits for, AAC’s shareholder. That violates the law – Wis. Stat. §645.68.

## **II. The Rehabilitator Has Made No Showing to Justify the Proposed Transactions.**

Even if the Court were to consider approving some amount of payments to AFG, the Rehabilitator has failed to satisfy its evidentiary burden that (1) the proposed transactions are reasonable and fair, and (2) AAC’s and the Segregated Account’s surplus is reasonable in relation to their outstanding liabilities and is adequate to their financial needs. Section 617.21(1) of the Wisconsin Statutes prohibits an insurer from “entering into a transaction between the insurer and affiliate unless ... (a) The transaction at the time it is entered into is reasonable and fair to the interests of the insurer ... [and] (c) The insurer’s surplus following any dividends or distributions to shareholders or a person having control of the insurer is reasonable in relation to the insurer’s outstanding liabilities and adequate to its financial needs.”

In the Motion, the Rehabilitator has not: (1) quantified the benefit of preserving the net operating losses for AAC; (2) quantified or otherwise provided an assessment of the litigation risks that would otherwise face AAC and the Segregated Account absent these agreements; or

(3) quantified the “resource drain” that these agreements might avoid and permit the Rehabilitator to stay focused on these proceedings and implement a rehabilitation plan for the benefit of policyholders. The Rehabilitator is asking the Court to approve the payment of millions of dollars to AAC’s shareholder – millions of dollars that will not otherwise be available to pay policyholders’ claims. At the very least, the Court should be apprised of the value of the purported benefits that the agreements provide.

Regarding the reasonableness and fairness of the transactions, there is nothing fair, reasonable, or equitable about the insurer paying its shareholder to use tax assets (net operating losses), which the *insurer* generated. The net operating losses came from AAC. AAC proposes to pay AFG for these assets only because AFG is making the inequitable and inappropriate threat that it would destroy those net operating losses if AAC does not accede to AFG’s demands. It is not fair, reasonable, or equitable. Nothing prohibits AFG from maintaining skeletal operations to preserve these assets for its consolidated tax group. Instead, AFG and its creditors are attempting to extract money from AAC to which they are not entitled. The Court should block this effort and protect AAC’s policyholders.

Regarding AAC’s and the Segregated Account’s surplus, again the Rehabilitator has not provided any information or analysis that would permit the Court to conclude that the transactions satisfy the legal requirement that the insurer maintain reasonable surplus for its outstanding liabilities and financial needs. In fact, the evidence points to the contrary – for over 19 months, neither AAC nor the Segregated Account have been paying policyholders allocated to the Segregated Account; and they do not have sufficient resources to pay policyholders in full in cash.

Thus, once again, the Rehabilitator requests that the Court approve transactions that violate the law.

**CONCLUSION**

For all of these reasons, the Motion should be denied.

Dated this 7th day of November, 2011.

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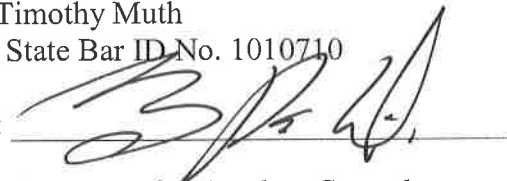
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