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In the Matter of the Rehabilitation of:

Case No. 10 CV 1576

Segregated Account of Ambac Assurance Corporation

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**Rehabilitator's Notice of Motion and Motion For Approval of the  
Process for Settling RMBS Remediation Claims**

**By the Commissioner of Insurance of the State of Wisconsin,  
as Rehabilitator of the Segregated Account of Ambac Assurance Corporation**

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**I. NOTICE OF MOTION**

TO: All Parties-in-Interest

PLEASE TAKE NOTICE that the Commissioner of Insurance of the State of Wisconsin, as Rehabilitator of the Segregated Account of Ambac Assurance Corporation, has moved the Court as set forth below to approve the Rehabilitator's proposed process for settling certain RMBS remediation claims. The motion is scheduled to be heard by the Court on Friday, October 5, 2012, commencing at 1:30 p.m. before the Honorable William D. Johnston at the Lafayette County Courthouse, 626 Main Street, Darlington, Wisconsin. Please take further notice that any objections to the relief requested by the Rehabilitator in this Motion should be in writing, with the basis for the objection explained with specificity, and filed and served by no later than noon (Central Time) on Monday, October 1, 2012.

PLEASE TAKE FURTHER NOTICE that any interested parties may appear at the hearing telephonically pursuant to the Court's standard tele-court procedure. Anyone interested in appearing telephonically should make the appropriate arrangements in advance of the hearing by calling 800-924-5680.

## II. REHABILITATOR'S MOTION

By this motion (the "Motion"), the Commissioner of Insurance of the State of Wisconsin, as the court-appointed rehabilitator (the "Rehabilitator") of the Segregated Account (the "Segregated Account") of Ambac Assurance Corporation ("Ambac"), requests that the Court approve the process the Rehabilitator proposes to utilize for evaluating and entering into settlements of the existing and potential lawsuits described below involving Segregated Account insurance policies issued in connection with residential mortgage-backed securities (the "RMBS Policies").

The Motion is supported by the accompanying Ninth Affidavit of Roger Peterson, the court-appointed Special Deputy Commissioner for the rehabilitation, and the Affidavit of Susan Lobel of Ambac.

In support of this Motion, the Rehabilitator states as follows:

1. Recoveries by the Segregated Account and Ambac from lawsuits and pre-litigation claims relating to RMBS Policies (collectively the "RMBS Remediation Claims" or "Claims") are a significant potential source of claim mitigation and claims-paying resources for the Segregated Account. In his October 8, 2011 Disclosure Statement Accompanying Plan of Rehabilitation ("Disclosure Statement"), the Rehabilitator estimated that the total present value of the RMBS Remediation Claims was approximately \$2.0 billion. (Oct. 8, 2011 Discl. Statement at 61.) More recently, in the Rehabilitator's May 24, 2012 Annual Report to the Court, the total present value of the Claims was projected to be approximately \$2.7 billion. (See May 24, 2012 Annual Report at 25.) In the most recent Form 10-Q filed by Ambac's parent corporation,

Ambac Financial Group, Inc. (“AFGI”), on behalf of itself and its subsidiaries (including Ambac and the Segregated Account), AFGI reported that with respect to those RMBS exposures for which it has established a reserve on its consolidated financial statements, it is estimating \$2.77 billion in subrogation value related to RMBS Remediation Claims.

2. The recovery estimates in the prior paragraph are aggregates covering all of the RMBS Remediation Claims for which the Rehabilitator and the Management Services Provider for the Segregated Account believe there presently is a reasonable basis for projecting potential recoveries. The Rehabilitator reassesses the aggregated amounts and their individual components as additional information becomes available including, but not limited to: (i) interim court decisions rendered in lawsuits filed by Ambac and/or the Segregated Account or in similar lawsuits filed by other financial guaranty insurers; (ii) pre-litigation review of documents relevant to the issuance of the RMBS Policies; (iii) ongoing review of mortgage loan files and reunderwriting of the mortgage loans underlying the insured securities; and (iv) information gathered in the discovery process in connection with the RMBS lawsuits, including documentary discovery, deposition testimony and expert work product.

3. The RMBS Remediation Claims typically arise from counterparties’ alleged breaches of representations and warranties regarding underwriting and the qualities of the mortgage loans underlying the securities being insured. Certain of the RMBS Remediation Claims also involve fraud claims. The types of potential recoveries can vary depending upon the facts of the case, and include: damages for claims paid or projected to be paid on the RMBS Policies by Ambac or the Segregated Account; cash recoveries attributable to fraud and contract claim damages; and various forms of “put

back” remedies, whereby the RMBS Remediation Claim counterparty is compelled to repurchase those mortgage loans that do not conform to the counterparty’s contractual representations and warranties, or otherwise assume the exposures attributable to those loans

4. Ambac and/or the Segregated Account are currently parties to the following lawsuits involving RMBS Remediation Claims:

- *Ambac Assurance Corporation v. EMC Mortgage LLC, et al.*, (Supreme Court of the State of New York, County of New York, originally filed in federal court on Nov. 5, 2008).
  - This case is the continuation of a case that was originally filed on November 5, 2008 in the U.S. District Court for the Southern District of New York. The case was refiled in state court on February 17, 2011, after the federal court ruled that the complaint be amended in a manner that had the effect of eliminating federal jurisdiction. On July 18, 2011, Ambac filed a First Amended Complaint asserting claims for breach of contract, indemnification and reimbursement against EMC, as well as claims of fraudulent conduct by EMC and J. P. Morgan Securities Inc. In its First Amended Complaint, Ambac asserts an additional claim for breach of contract against EMC and a claim for successor liability against a new defendant, JP Morgan Chase Bank, N.A. The Defendants filed their answer to the First Amended Complaint on August 30, 2011, and the parties are currently engaged in discovery.
- *Ambac Assurance Corporation and the Segregated Account of Ambac Assurance Corporation v. DLJ Mortgage Capital, Inc. and Credit Suisse Securities (USA) LLC*, (Supreme Court of the State of New York, County of New York, filed on January 12, 2010).
  - Ambac and the Segregated Account allege breach of contract, fraudulent inducement, breach of implied duty of good faith and fair dealing, indemnification, reimbursement, and have requested the repurchase of loans that breach representations and warranties as required under the contracts, as well as damages. On July 8, 2010, the defendants moved to dismiss the complaint. Ambac and the Segregated Account opposed the motion. In decisions dated April 7, 2011 and October 7, 2011, the Court granted the defendants’ motion in part, striking only the claim for consequential damages and jury demand. The Court otherwise

denied the defendants' motion. Discovery is ongoing. No trial date has been set.

- *Ambac Assurance Corporation and The Segregated Account of Ambac Assurance Corporation v. Countrywide Securities Corp., et al.*, (Supreme Court of the State of New York, County of New York, filed on September 8, 2010).
  - Ambac and the Segregated Account filed an Amended Complaint on September 8, 2011, alleging breach of contract, fraudulent inducement, indemnification and reimbursement, breach of representations and warranties, and requested the repurchase of loans that breach representations and warranties as required under the contracts, as well as damages, and asserted a successor liability claim against Bank of America. The defendants answered the Amended Complaint on November 3, 2011. Discovery is ongoing. No trial date has been set.
- *Ambac Assurance Corporation and The Segregated Account of Ambac Assurance Corporation v. EMC Mortgage LLC, et al.*, Supreme Court of the State of New York, County of New York, originally filed on March 30, 2012).
  - Ambac and the Segregated Account allege claims of fraudulent inducement and breach of contract against EMC and J.P. Morgan Securities LLC, as well as claims against JPMorgan Chase Bank, N.A. as EMC's successor in interest, arising from the defendants' misrepresentations and breaches of contractual warranties regarding certain transactions that are not the subject of the previously filed lawsuit against the same defendants (described above). On August 14, 2012, Ambac filed a First Amended Complaint asserting an additional claim for breach of the repurchase protocol. Defendants have not yet responded to the First Amended Complaint.
- *Ambac Assurance Corporation and The Segregated Account of Ambac Assurance Corporation v. First Franklin Financial Corporation, et al.*, (Supreme Court of the State of New York, County of New York, filed April 16, 2012).
  - Ambac and the Segregated Account allege breach of contract, fraudulent inducement, indemnification, reimbursement and request the repurchase of loans that breach representations and warranties as required under the contracts, as well as damages. Defendants filed a motion to dismiss on July 13, 2012. Ambac and the Segregated Account intend to oppose the motion.

5. Although all of these cases seek recoveries relating to RMBS Policies, these suits differ from each other in terms of the legal claims pursued, the defenses that might apply, the details of the underlying transaction documents, the amount of damages suffered, and the procedural posture of the litigation.

6. The Rehabilitator expects Ambac and the Segregated Account to file additional lawsuits pertaining to RMBS Remediation Claims, and the work necessary to do so is continuing. While Ambac and the Segregated Account intend to pursue these suits vigorously, the Rehabilitator and Ambac are also involved periodically in negotiations with various existing and potential defendants to attempt to settle certain of the RMBS Remediation Claims so as to avoid the costs and uncertainties to both sides of litigation.

7. Nothing in Chapter 645, Wis. Stats., or the Plan of Rehabilitation confirmed by this Court requires the Rehabilitator to obtain this Court's approval to settle RMBS Remediation Claims. To the contrary, Wis. Stat. § 645.33 gives the Rehabilitator broad powers and authority to manage the rehabilitation effort as he deems necessary and expedient. However, consistent with the Rehabilitator's continuing efforts to make the rehabilitation process as transparent and open as practical and given the potential importance of these Claims to the rehabilitation, the Rehabilitator believes it is appropriate to inform the Court about how the Rehabilitator is administering these Claims and seek the Court's approval of the general process the Rehabilitator intends to use for evaluating and approving settlements of RMBS Remediation Claims.

8. The Rehabilitator's counsel actively monitors and, in some instances, formally appears in, the lawsuits brought on the RMBS Remediation Claims. The

Segregated Account and Ambac are generally represented by the law firm of Patterson Belknap Webb & Tyler LLP in the RMBS Remediation Claims lawsuits. Foley & Lardner LLP represents the interests of the Segregated Account in certain of the cases as co-counsel. Attorney Michael Freed at Jefferies & Company also actively monitors certain of the RMBS Remediation Claims for the Rehabilitator (all of the above counsel are collectively the “RMBS Remediation Claims Counsel”).

9. The RMBS Remediation Claims Counsel provide regular reports to the Rehabilitator’s Special Deputy Commissioner regarding the status of work on the RMBS Remediation Claims, significant developments regarding any of the Claims, and settlement opportunities and negotiations. In addition, Special Deputy Commissioner Peterson, the Rehabilitator’s counsel, Ambac’s in-house attorneys who are dedicated to RMBS Litigations, the senior management of Ambac’s RMBS and Reinsurance Group (collectively the “RMBS Litigation Team”), have a meeting or phone conference every other week devoted specifically to reviewing the status of filed and potential RMBS Remediation Claims lawsuits. In the past, those same individuals met on an as-needed basis to review the actual and projected claims under the relevant insurance policies, and the actual and projected litigation or pre-litigation expenditures associated with the RMBS Remediation Claims. Since being on-site, the Special Deputy Commission recently instituted a more formal policy of holding those meetings on a scheduled quarterly basis. The Special Deputy Commissioner updates the Commissioner and OCI on significant developments respecting the RMBS Remediation Claims as part of weekly conference calls addressing various issues in the rehabilitation. All such communications

regarding the RMBS Remediation Claims are extremely sensitive and are conducted subject to the attorney-client privilege and work-product privilege.

10. To further familiarize himself with the information necessary to make strategic decisions relating to the RMBS Remediation Claims, Special Deputy Commissioner Peterson has frequent communications with Ambac staff and with the Rehabilitator's counsel and other advisors regarding the RMBS Remediation Claims. Mr. Peterson reviews the court filings respecting the RMBS Remediation Claims, as well as selected pleadings, briefing and decisions in related cases involving other monoline insurers or RMBS counterparties. He also reviews various key business records relating to such Claims. As detailed in Mr. Peterson's supporting Ninth Affidavit, the above combination of oversight, assessment, communication and review provides him with a well-informed foundation for understanding the strengths, weaknesses and other attributes of the Claims necessary to evaluate and structure potential settlements. Procedurally, he discusses and approves the framework and economic parameters of potential settlements with the RMBS Litigation Team before any settlement offers are made to a counterparty.

11. For each RMBS Remediation Claim that is already, or may become, the subject of a lawsuit, Ambac develops estimates of the Claim's likely potential value and reviews the estimate with the Rehabilitator's team. In most instances, those estimates are components of the \$2.7 billion estimated aggregate recovery value stated in the Rehabilitator's May 24, 2012 Annual Report.

12. All settlement proposals received or to be made by Ambac and the Segregated Account are reviewed by Special Deputy Commissioner Peterson and the



RMBS Litigation Team. Given the highly individual nature of each RMBS Remediation Claim, there is no set formula for determining the acceptability of a particular settlement proposal. Similarly, there is no set rule or preconceived notion about the best way to structure any particular settlement, other than the guiding principle that the Rehabilitator will strive to pursue the optimum outcome for Segregated Account policyholders and creditors available under the particular circumstances. The Rehabilitator believes that it would be imprudent and contrary to the best interests of the Segregated Account and its policyholders to have preconceived formulas or structures for such settlements. The RMBS Remediation Claims arise from a wide range of transactional structures, each with their own unique set of material facts and considerations. Additionally, the counterparties to such Claims often have their own individualized needs and expectations regarding the optimum way of structuring settlements. To reiterate, however, the Rehabilitator will consistently strive to pursue the structure and terms for any settlement that advances the best interests of the Segregated Account rehabilitation, and will do so guided by the principles of fairness and best interests of policyholders underlying Wis. Stat. Chapter 645.

13. Ambac's parent corporation, AFGI, is not a party to any of the Claims and shall receive no consideration or compensation as part of settling any of the Claims.

14. The RMBS Litigation Team evaluates each settlement proposal in light of, among other things, the strengths and weaknesses of the case, interim court rulings, assessments of depositions and experts, the expected future costs of litigation, the perceived settlement range acceptable to the other side and their collectability, and the estimate of the likely recovery if the Claim proceeds to trial. The RMBS Litigation Team

also considers the documents relevant to the issuance of the RMBS Policies, the ongoing review of mortgage loan files and reunderwriting of the mortgage loans underlying the insured securities, information gathered in the discovery process in connection with the RMBS lawsuits, including documentary discovery, deposition testimony and expert work product and interim court rulings in lawsuits filed by Ambac and/or the Segregated Account or in similar lawsuits filed by other financial guaranty insurers. These assessments are made with the RMBS Remediation Claims Counsel and are based on complicated, highly sensitive and legally privileged analysis of the information described above. By having daily access to all this detailed information about and privileged analysis of the RMBS Remediation Claims, the Special Deputy Commissioner is in a unique position to make decisions that are in the best interest of policyholders.

15. In order to maximize the amounts of recoveries received in settlements, the Rehabilitator proposes to not publicly disclose the specific dollar amounts or other key terms of settlement agreements. He also proposes not to identify the counterparties to such agreements, or to submit such agreements to the Court for approval on an individual basis. Instead, the Rehabilitator proposes to provide periodic notices to the Court and parties-in-interest in this proceeding stating the fact of any material settlements, any information the counterparties will themselves need to disclose publicly pursuant to their own corporate or regulatory disclosure obligations, and any other information the counterparties agree to disclose. Such notices to this Court and parties-in-interest will be made as part of the Rehabilitator's annual reports to the Court, or sooner where appropriate. Upon request by the Court, the Rehabilitator will inform the

Court *in camera* of the details of any settlement agreements and the negotiations and assessments leading up to them.

16. Requiring public disclosure of settlement amounts or Court approval of individual settlement agreements would be contrary to the best interests of the Segregated Account's policyholders and creditors. Requiring such disclosure would make it more difficult to reach settlements and, as a result, lead to increased litigation costs and lower settlement amounts. Most, if not all, of the current or potential defendants in RMBS Remediation Claims are defendants in other similar lawsuits. Certain of those parties have expressed concern that publicly disclosing a settlement favorable to the Segregated Account would adversely affect their efforts to negotiate settlements in other cases. Conversely, depending on the circumstances, requiring the Rehabilitator to publicly disclose a settlement might adversely affect the Rehabilitator's bargaining position in other settlement negotiations. Certain actual or potential defendants have also expressed the view that they would be materially less interested in settling these Claims with the Segregated Account and Ambac if settlements will require individualized approvals by this Court with public disclosure of terms, because such a process might escalate into a contentious, litigious process involving third parties, with potential demands for discovery, stays, lengthy appeals, and no certain date for a final resolution.

17. In the Rehabilitator's view, there is no realistic scenario in which public disclosure of settlement terms or mandated individual court approvals would lead to settlements more beneficial to the Segregated Account. The approval process proposed by the Rehabilitator, with limited disclosures, is the best way to protect the interests of policyholders. The Rehabilitator submits that no constructive purpose would be served

by pursuing specific approvals for individual settlements of RMBS Remediation Claims because there would be no meaningful way for either parties-in-interest, or the Court, to evaluate the wisdom of the Rehabilitator's positions regarding such settlements without jeopardizing the sensitive and valuable attorney-client and work product privileges which protect the information which the Rehabilitator and his team have considered in the settlement process. Requiring a process that permits second-guessing of the Rehabilitator's exercise of discretion regarding the inherently subjective process of negotiating settlements also is undesirable because it would supplant and ignore the broad authority underlying the Rehabilitator's statutory right to make such discretionary decisions. This is not a situation like the commutation of policy claims, where the payments to be made under the Plan of Rehabilitation serve as a point of reference for evaluating the reasonableness of the amounts paid to commute a policy.

18. Confirming the Rehabilitator's authority to enter into settlements as proposed in this motion is consistent with the broad discretionary authority contemplated by the authors of Chapter 645. The Rehabilitator is not a private party with a self-interested perspective relative to the Claims; he is a highly qualified public servant charged with carrying out the duties specified in Chapter 645, Wis. Stats.

19. Section § 645.33(4) grants the Rehabilitator broad discretion with regard to the conduct of litigation necessary for the rehabilitation of the insurer, providing: "If the rehabilitator finds that there has been criminal or tortious conduct or breach of any contractual or fiduciary obligation detrimental to the insurer by any person, the rehabilitator may pursue all appropriate legal remedies on behalf of the insurer." Similarly, section 645.33(2) grants the Rehabilitator "all the powers of the officers and

managers [of the insurer].” The officers and managers of the insurer would typically have the power to negotiate and enter into – without the need for public disclosure – settlements such as those described by the Rehabilitator here. The official comments to Chapter 645 confirm the Legislature’s intent to grant the Rehabilitator broad discretion in matters such as this, explaining that

[Chapter 645] is designed to make rehabilitation a very flexible procedure. It is essential that it be regarded as *a management rather than as a legal task*. Though it is called a formal proceeding because it begins with a formal petition to a court and a hearing, thereafter it should be essentially informal in operation. The order is formulated to emphasize flexibility and informality, and *the rehabilitator is given broad powers*. He must act under the supervision of the court, of course, but *the court’s control should be liberal, not strict, and should be provided without cumbersome procedures*.

WIS. STAT. ANN. § 645.32 cmt. (1967) (emphasis added).

20. As this Court has repeatedly noted in its prior rulings (consistent with settled Wisconsin law and the legislative history underlining Wis. Stat. Chapter 645), rehabilitation proceedings like this should be administrative in nature and avoid unnecessary litigious court proceedings and requirements, and the Rehabilitator and his Special Deputy Commissioner should be accorded broad discretion to carry out the rehabilitation as they deem necessary and appropriate. As noted in another portion of the legislative history, the Rehabilitator and his Special Deputy Commissioner for the rehabilitation:

should have great freedom of operation . . . court supervision must be liberal and general, not strict or detailed . . . . The Rehabilitator may take such action as he deems necessary or expedient. . . . He shall have all the powers of the officers and managers. . . . He shall have full power to direct and manage. . . . and to deal with the property and business of the insurer . . . . Broad and flexible powers are needed. The Rehabilitator can obtain early instruction

by the court respecting the range of action he may take without specific approval. . . . Court control of the rehabilitation process should be very liberal. Success may depend on the court's understanding of the imperative need for the Rehabilitator to have broad discretion and freedom to act quickly. The Rehabilitator, not the court, must make the day-to-day decisions.

*See* L. 1967, c. 89, § 17, eff. Aug. 5, 1967.

21. Consistent with the above-quoted legislative history about rehabilitation, this Court previously explained that:

A rehabilitation proceeding is not an adversarial litigation designed to adjudicate the diverse and divergent interests of each policyholder. It is a formal remedial measure to “rehabilitate the business of a domestic insurer.” Wis. Stat. §645.32(1). Accordingly, rehabilitation is “a very flexible procedure” that is “regarded as a management rather than a legal task. . . . [The rehabilitator] must act under the supervision of the court, of course, but the court’s control should be liberal, not strict, and should be provided without cumbersome procedures.” Wis. Stat. Ann. §645.32 cmt.

(July 16, 2010 Order; R.258).

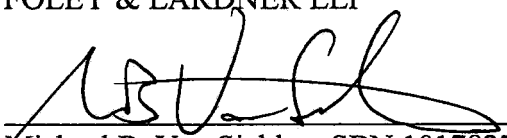
22. The Rehabilitator’s proposed process for negotiating, vetting, and entering into settlements of RMBS Remediation Claims is in the best interests of the policyholders and creditors of the Segregated Account, as well as the public generally. The Rehabilitator has assigned an appropriate team of individuals to assist him with his decision making, and has established a thorough evaluation process designed to maximize the likelihood that the Segregated Account and Ambac enter into settlements on the most favorable terms to the Segregated Account achievable in light of the specific facts of each case. Everything about the Rehabilitator’s proposed process is focused on the primary goal of this rehabilitation – maximizing and distributing the claims-paying resources available to the Segregated Account.

For the reasons stated above, the Rehabilitator respectfully requests that the Court grant this motion and approve the Rehabilitator's proposed process for approving litigation settlements as described herein.

Dated this 17th day of August, 2012.

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