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 appearing on behalf
 of ad hoc group of holders of
 surplus notes and beneficial
 interests and deferred amounts.

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(Whereupon, the following proceedings were duly had:)

THE CLERK: Sean Dilweg, et al. vs. Wells Fargo Bank Trustee of Bondholders, et al., 10 CV 1576.

Appearances, please.

MR. FINERTY: For the Wisconsin Office of the Commissioner of Insurance as Rehabilitator of the segregated account of Ambac Assurance Corporation, John Finerty and Justin Mertz of Michael, Best & Friedrich. Also present is the Special Deputy Commissioner of Insurance Daniel Schwartzer.

Good morning, Your Honor.

THE COURT: Good morning.

MS. NEIDER: Good morning, Your Honor.

On behalf of Ambac Assurance Corporation, I'm Barbara Neider. Next to me is Richard Slack. At the end here is Peter Ivanick also appearing on behalf of the company.

MR. KRAVIT: Good morning, Your Honor.

1 I'm Steve Kravit, Kravit Hovel Krawczyk. With me is
2 Benjamin Prinsen and Leila Sahar from my office.
3 We're representing the Military Housing Project.

4 THE COURT: Does anybody else wish to
5 have their -- all right. Whoever that might be.
6 Does anybody wish to have their appearances noted, or
7 are we going to somehow take --

8 Okay. Go ahead.

9 MR. FRIEDMAN: James Friedman of
10 Godfrey & Kahn with Brian Pfeiffer and John Ramirez
11 of White & Case on behalf of the ad hoc group.

12 MR. FINERTY: And that should be it,
13 Your Honor.

14 THE COURT: All right. Couple of
15 matters before we get to the meat of the day.

16 First of all, I want to apologize for
17 hijacking the proposed schedule by the Rehabilitator,
18 the updated schedule. We are in a situation now
19 where the courts are chronically underfunded and we
20 do not have the ability to do overtime. It requires
21 security staff. It requires bailiff staff. It
22 requires court staff. And so Branch 9 has adopted
23 the policy in all cases that we are done by 4:30 p.m.
24 so that we do not impose additional costs on the
25 system that is already lacking in funds.

1 Secondly, I want to thank the parties
2 for the excellent briefing. It's been very helpful
3 to me. I believe it has helped to focus me in on the
4 issues.

5 One thing I'm wondering is in light of
6 the fact the only issue currently pending that is
7 at -- that is being objected to is the issue of 6.13,
8 Article 6.13 of the second amended plan. You're
9 welcome to move around your evidence however you see
10 fit to deal with that particular issue, but it
11 doesn't appear that there's any dispute regarding any
12 other part of the plan --

13 I understand that you need to make a
14 record of what the Rehabilitator is proposing and why
15 he's proposing it so that it's clear to not only the
16 parties but to the entire world as to what's going on
17 here, so I'm not telling how to do things. But from
18 my perspective, the only real disputed issue appears
19 to be Article 6.13.

20 Is there anything anybody wishes to
21 place on the record before we proceed?

22 MR. FINERTY: Yes, Your Honor.
23 Obviously, the COFINA bondholders' objections have
24 been resolved. And if that keeps happening, I'll --

25 The trustee's objections, obviously, we

1 told the Court at the pretrial that those have been
2 resolved and they filed a formal withdrawal
3 yesterday.

4 So we will still have testimony,
5 however, on a couple of issues raised by the Court at
6 the pretrial, specifically as to the durability of
7 the company post-exit as it relates to Puerto Rico
8 exposure. And there will be some testimony, very
9 short amount of testimony, about the COFINA
10 settlement itself and the impact on the company. I
11 think that's important for the Court and the parties
12 to hear.

13 As a separate issue, we have previously
14 stipulated to the admission of the affidavits that
15 have been submitted in lieu of testimony. There will
16 be additional testimony, but that would include the
17 admission of the affidavit of David Barranco, the
18 affidavit of Daniel Schwartz, and the affidavit of
19 Steve Ksenak -- that's spelled K-S-E-N-A-K -- that
20 was filed on the 29th of December. So I would simply
21 just move the admission of those affidavits into
22 evidence.

23 THE COURT: Any objection?

24 Hearing none, received.

25 MR. FINERTY: In addition to that, we

1 will -- we are prepared to argue and answer any
2 additional questions of the Court on the question of
3 the appropriate standard of review and, of course,
4 the question of Article 6.13.

5 Our plan this morning was to have
6 testimony from the special deputy commissioner,
7 abbreviated testimony, I should say, from both
8 witnesses, and then Mr. McGettigan on the question of
9 the two elements of exit from rehabilitation.

10 And both of those, Mr. McGettigan in
11 particular, will have some testimony related to 6.13
12 with Mr. Kravit's opportunity to cross-examine. And
13 then we anticipate that that will not take much past
14 the lunch hour. And then after that, an opportunity
15 for oral argument and summations.

16 THE COURT: So you're still hoping to
17 get this done today, even with the Court's truncation
18 of the schedule?

19 MR. FINERTY: I think it's likely.

20 THE COURT: All right. Mr. Kravit, you
21 are only going to be cross-examining Mr. McGettigan;
22 is that correct?

23 MR. KRAVIT: Well, the agreement is we'd
24 have a chance to cross Mr. McGettigan. If there's
25 another witness that provides testimony that we would

1 like to challenge, I'll ask the Court if we can.

2 THE COURT: Limited to 6.13?

3 MR. KRAVIT: Yes, sir.

4 THE COURT: Okay. All right. If
5 there's nothing further --

6 Anything further, Mr. Kravit, before we
7 go with the evidence?

8 MR. KRAVIT: No, Your Honor.

9 THE COURT: Mr. Finerty, you may
10 proceed.

11 MR. FINERTY: Thank you, Your Honor.
12 The Rehabilitator calls Daniel Schwartz.

13 THE COURT: Mr. Schwartz, if you'd
14 come forward and be sworn, please, sir.

15 DAN SCHWARTZER,
16 was called as a witness in the above-entitled
17 matter, and after having been first duly
18 sworn, testified on oath as follows:

19

20 DIRECT EXAMINATION

21 BY MR. FINERTY:

22 Q Good morning, Mr. Schwartz.

23 MR. MERTZ: For the record, this is
24 Justin Mertz, M-E-R-T-Z.

25 Q Mr. Schwartz, would you please just take a moment

1 and introduce yourself to the Court, state your name
2 for the record, and why don't you just give us your
3 educational background, please.

4 A Sure. My name is Dan Schwartzer. I am the special
5 deputy commissioner appointed by this Court for the
6 segregated account of Ambac Assurance Corporation.

7 I have about 35 years in the insurance industry
8 in one way, shape, or form.

9 And my education is from a bachelor of business
10 administration as well as industry licenses both in
11 the financial services as well as the insurance
12 industry. Intermediary license in life, accident,
13 health, intermediary license in property and
14 casualty, as well as -- I don't hold them anymore,
15 but a Series 6 and Series 63 license in the financial
16 services industry.

17 Q When did you begin working with the Wisconsin Office
18 of the Commissioner of Insurance, also known as OCI?

19 A I went to OCI -- I was appointed in January of 2011.
20 January of 2011. January 4th.

21 Q What's the main function or functions of OCI?

22 A Office of Commissioner of Insurance has two primary
23 functions. It's the regulator for the entire
24 industry in the state. It has two primary functions:
25 Consumer protection and insurer solvency. And I

1 would argue that the insurance solvency is as much a
2 consumer protection as the other consumer protections
3 that the department does. Those are the two primary
4 functions.

5 Q You've stated that you're the special deputy
6 commissioner. Have you held any other positions at
7 OCI?

8 A Yes. I, again, was appointed as the deputy
9 commissioner in January of 2011 and served in that
10 role through May of 2016 -- May 23rd of 2016. When I
11 was at the department, I also served -- we had about
12 a year absence of the division administrator that is
13 in charge of both the market regulation and financial
14 examinations department. And I served in that -- I
15 also served as the division administrator for --
16 filled in that role as well as the deputy
17 commissioner role for about a period a little more
18 than a year because we had an absence. In addition
19 to the general supervisory role that I played over
20 the entire department, I also played a role in
21 basically running the division administration of
22 market reg. and financial examinations.

23 Q Now, let's focus on rehabilitation proceedings in
24 particular. What experience outside of this case do
25 you have with rehabilitation proceedings?

1 A So as the deputy, under my tenure there were roughly
2 a handful of other rehabilitations or liquidations
3 that occurred. One was similar in that it had a
4 segregated account. It was a property and casualty
5 company. It was in runoff since about the
6 mid-'80s.

7 In 2012, with an influx of cash, we were able to
8 get that out of rehabilitation and merge the
9 segregated account back into the general account.
10 There was some enhancement oversight of a mortgage
11 guarantee insurer which is similar in nature to the
12 business that Ambac was doing, and it got caught up
13 in the financial crisis of 2008 and 2009. That was
14 placed back out of enhanced supervision in the -- in
15 late 2016. And there were a couple of other ones as
16 well.

17 Q It sounded like the first one you mentioned also
18 involved what is known as a segregated account. Is
19 that correct?

20 I'll reask the question. It sounded like the
21 first case, the first rehabilitation proceeding that
22 you mentioned also involved a segregated account; is
23 that right?

24 A It did.

25 Q And can you just explain what the purpose of setting

1 up a segregated account is, what it entails.

2 A Well, it's part of the Wisconsin statutes
3 rehabilitation law, part of our Wisconsin
4 rehabilitation law. And it serves a couple of --
5 several purpose, really.

6 If there's a troubled company in a situation, as
7 Ambac is, that has policies that may come into
8 default because the company would be placed into
9 rehabilitation but it still needed -- the company
10 still needed to be rehabilitated, you would move
11 those assets or those policies, rather, into the
12 segregated account, allow the general account to
13 continue to operate and avoid some of the triggered
14 defaults.

15 Other reasons you might set up a segregated
16 account is that segregated accounts are set up to
17 move the bad risk to set up a separate company if its
18 own company split the company in two, and maybe even
19 allow the general account under supervision of the
20 OCI to write new business. The influx of new
21 business could be valuable in claims-paying resources
22 for the segregated account.

23 So there's a few different reasons why you might
24 set up a segregated account.

25 Q You mentioned the word "triggered defaults." Can you

1 explain what that means.

2 A In the instance of Ambac, there are policies that
3 have a trigger, where if the company was placed into
4 rehabilitation under supervision, it would trigger a
5 default in the policy and payments could be required
6 immediately and up front and potential loss of
7 control rights by the company on a number of other
8 instances.

9 Q And how would setting up a segregated account address
10 that issue?

11 A Setting up the segregated account under Wisconsin
12 statutes rehabilitation law creates a separate
13 identifiable entity so that if the segregated account
14 is set up to be in rehabilitation, then the general
15 account is not in rehabilitation. The segregated
16 account is in rehabilitation.

17 Q Let's turn to your focus on this case in particular,
18 this rehabilitation.

19 When you started with OCI, you were the deputy
20 commissioner as opposed to the special deputy
21 commissioner. Did you play a role in Ambac's -- or
22 the segregated account's rehabilitation proceeding as
23 deputy commissioner?

24 A Yeah. As deputy commissioner, my job was the
25 management and supervision of the regulatory, legal,

1 public information, and administrative functions of
2 the Department. I also served as the chief
3 prosecutor on all cases against either insurance
4 agents or insurance companies. And the regulatory
5 function is what I mentioned before, both market
6 regulation and financial examinations.

7 Under the financial examinations, that includes
8 the solvency of all carriers. We have 2,000
9 companies that are licensed to do business in this
10 state. 325 roughly domestics that call themselves --
11 Wisconsin home. We have to do the financial solvency
12 of all of those companies. And then that would
13 include if there was a company that was in trouble,
14 enhanced oversight and/or liquidation or
15 rehabilitation.

16 So part of my job as special deputy commissioner
17 was oversight of that function and oversight
18 ultimately of rehabilitations and liquidations.

19 Q And, just to clarify, you just said special deputy
20 commissioner, but --

21 A I meant deputy. Sorry. Sorry.

22 Q Okay. In particular, with respect to Ambac, did you
23 have any involvement with Ambac's segregated account
24 rehabilitation?

25 A I did. When the commissioner and I first got to the

1 Department, we had briefings from the former
2 commissioner and the former deputy commissioner about
3 not only things that were occurring within the
4 Department, but several briefings on just Ambac
5 alone.

6 At that time, the special deputy commissioner --
7 the previous special deputy commissioner was the
8 deputy commissioner, Kim Shaul, and the commissioner
9 and I made a decision that we thought that this
10 really needed full-time attention. It should be
11 split -- the duty shouldn't be split between the
12 deputy with the role of the deputy and the role of
13 the special deputy.

14 So we brought on from within our department
15 Roger Peterson, who was in charge of Bureau of
16 Financial Examinations. And he had been on this case
17 since 2008 or even before. He had been the financial
18 regulator for OCI reviewing Ambac for many, many
19 years, and he knew much about the case. He was
20 interested in becoming special deputy commissioner.
21 And so we hired Roger, and he moved out to New York
22 and ran the day-to-day affairs, as I do today, of the
23 segregated account and the plan of rehabilitation.

24 My role as the deputy commissioner, along with
25 the commissioner, was to listen to the

1 recommendations from Roger and in some instances --
2 most instances take his recommendation and in some
3 instances just maybe make a different direction,
4 maybe make a different decision.

5 We met with Roger on a weekly basis. We met with
6 the advisers that the plan of rehabilitation allows
7 the special deputy to bring on as consultants and
8 advisers. We met with them. We met with the
9 insurance company. So it was, again, weekly meetings
10 with Roger, so it was fairly extensive.

11 Q So weekly meetings during what time period?

12 A From when Roger was put on as special deputy -- July
13 of, I believe '11. Somewhere in July of 2011, all
14 the way up until Roger left the special deputy in
15 January of '16.

16 Q Okay. And when Mr. Peterson left as special deputy
17 commissioner, what discussions occurred at OCI and
18 what happened?

19 A The rehabilitation was, we thought, going very well.
20 The purpose of the rehabilitation was working, which
21 was to stabilize the risk and the business that was
22 in the segregated account.

23 The general account, when it was first placed
24 into rehabilitation, was very stable. The claims
25 were known. And all of the adverse risk and the

1 unknown was in the segregated account. Over many
2 years, through Roger's efforts and the adviser's
3 efforts, that account was being stabilized.

4 THE COURT: Let me interrupt here. You
5 said the general account, when it was placed into
6 rehabilitation, was very stable. When you said "it,"
7 were you referring to the segregated account?

8 THE WITNESS: Segregated account, yes.
9 Thank you, Your Honor.

10 A My best guess is probably around the fall of '15, the
11 commissioner and I were looking at the change in the
12 segregated account as well as the change in the
13 general account. The general account began to become
14 more adversely risk. There was a lot of risks that
15 became more adversely classified, I should say.

16 The segregated account was becoming stable. And
17 there was this inequity between the segregated
18 account and general account, because on the
19 segregated account claims were only being paid 45
20 cents on the dollar, with 55 cents being deferred
21 payment option. And in the general account, they
22 were being paid 100 cents on the dollar. We began to
23 see somewhat of an inequity between the segregated
24 account and the general account.

25 Certainly one option might be to just increase

1 the payment percentage in the segregated account, but
2 we want -- that wouldn't necessary cure the inequity,
3 and we thought maybe this is the time to look at exit
4 strategies.

5 So in the fall of '15, we had that discussion.
6 And then in February of '17, I came on board as the
7 special deputy commissioner serving a dual role as
8 also the deputy commissioner.

9 Q So your role changed as special deputy commissioner.
10 I believe that was February of 2016; is that correct?

11 A Correct.

12 Q So since assuming your role as special deputy
13 commissioner, just give us a flavor of some of your
14 day-to-day duties with respect to the segregated
15 account's rehabilitation.

16 A The duties of the special deputy is the general
17 oversight and supervision of the segregated account.
18 So that would include the review and approval of all
19 the claims that would need to be paid out of the
20 segregated account. It would include the review and
21 approval of any commutation that exists in the
22 general and segregated account. It includes some
23 oversight from a regulatory perspective, obviously a
24 rehabilitation perspective on claims in the general
25 account even or transactions in the general account.

1 It would include the review and approval of the
2 reconciliation process. The reconciliation process
3 is the deferred payment that are owed to the
4 consumers -- the policyholders, rather, the 55 cents
5 that had accretion attached to it. And so making
6 sure that there was a reconciliation over twice a
7 year that the numbers were correct. I have to review
8 and approve that. Review and approve all of the rep
9 and warranty litigations. There was a lot of suits
10 that the segregated account took place in against the
11 banks relative to the issues of RMBS --

12 THE COURT: I'm going to address the
13 folks on the telephone again. Once again, please
14 mute your button so that we are not getting
15 interference in the hearing here today. It is very
16 distracting and makes it unable for us to continue.
17 Please mute your phones. Thank you.

18 Mr. Finerty.

19 Q Let me -- we'll just restart here.

20 Part of carrying out your role as special deputy
21 commissioner, did you rely on anyone else to assist
22 you?

23 A I did.

24 Q And who might that be?

25 A So the special deputy commissioner by authorization

1 of the plan of rehab that was approved by the Court
2 is allowed to bring on advisers to help with the
3 rehabilitation. We had Gordian Group, LLC, and
4 Dennis McGettigan as the main contact at Gordian as
5 one of the lead advisers. He was our financial
6 adviser for the rehabilitation.

7 We had Jefferies out of New York as an adviser.
8 And when I became special deputy, we expanded their
9 role to also include their expertise relative to
10 markets, relative to restructuring. They had quite a
11 bit of expertise relative to Puerto Rico.

12 And then we also had PricewaterhouseCoopers --
13 PwC -- was another adviser. They were our tax
14 adviser to deal with issues of tax consequences
15 relative to the plan of rehabilitation as well as
16 Michael Best from a tax perspective and also
17 Michael Best as our legal adviser.

18 Q A moment ago you referenced a conversation that you
19 had with Commissioner Nickel regarding a risk profile
20 change between the segregated account and the general
21 account. Could you explain that just a little bit
22 further.

23 A Sure.

24 Again, when the company was placed -- when the
25 segregated account was placed in the rehabilitation,

1 it was to take those risks that were troubled or
2 could cause issue in an overall rehabilitation and
3 put them in the segregated account and allow the
4 general account to continue to pay its claims
5 100 cents on the dollar. The general account was
6 healthy. The risk was good. There was a lot of
7 unknown in the segregated account.

8 So over the years, with the work done by the
9 previous SDC and his advisers, that book of business
10 in the segregated account began to be commuted and
11 began to stabilize. And the general account and the
12 policies in the general account began to be more
13 adversely classified. Those risks became more
14 adversely classified.

15 There was an inequity because of the IPP set at
16 45 cents in the segregated account compared to
17 100 cents in the general account, and we wanted to
18 try to fix the inequity. And when we had that
19 discussion, the commissioner also wanted to explore
20 maybe exits to rehabilitation to cure the inequity
21 once and for all.

22 Q When you say the IPP is 45 cents, just in layman's
23 terms, what does that mean?

24 A That means that any claim that's submitted by a
25 policyholder in the segregated account would receive

1 45 cents on the dollar for their claim. The other
2 55 cents would be put into a deferred amount that the
3 company would then have to pay at a future date when
4 it had the resources to pay it.

5 MR. MERTZ: I'd like to move to some
6 exhibits. Permission to approach, Your Honor?

7 THE COURT: Yes, go ahead.

8 Q Why don't you turn just to tab 1. Can you read the
9 title of this document, please.

10 A Yes. Listening Session Related to the Segregated
11 Account of Ambac Assurance Corporation Held by
12 Special Deputy Commissioner Dan Schwartzler,
13 July 12th, 2016, Prepared Remarks.

14 Q And could you just explain what this document is.

15 A This document was the prepared remarks that we
16 provided to interested parties. That would include
17 policyholders, stakeholders, creditors, anyone that
18 was interested in attending a listening session which
19 we held in July of 2016.

20 And when we invited folks to attend, our goal was
21 twofold. One was to try to get a sense from the
22 public at large and the affected stakeholders,
23 information from them on how the rehabilitation was
24 going, things they may be concerned about, questions
25 that they may have of us and of the Rehabilitator.

1 We instructed them that we would like their questions
2 in advance. We received all their questions in
3 advance and then did prepared remarks that we could
4 then disseminate to not just those that attended the
5 July 12th session but also post on the Court-required
6 communication Ambac policyholder website so that
7 everyone could see what the questions were and what
8 our answers were to those questions.

9 Q So this document was posted online, too?

10 A It was.

11 Q And you prepared the remarks that are in this?

12 A Myself and the entire advisory team looked through
13 the questions that were provided as well as the
14 answers that we were going to provide.

15 Q Why don't you turn to the last page of that exhibit.

16 A Yes.

17 Q And could you just read that out loud for the Court,
18 please.

19 A Yes. Concluding statement. Our team is responsible
20 for seeking an exit of the segregated account. Our
21 preferred goal is to achieve this through a plan that
22 is consensual among the company, policy
23 beneficiaries, and other stakeholders. However, we
24 are advising OCI to use all tools available to
25 accomplish a successful and durable exit that

1 enhances AAC's long-term claims-paying ability. We
2 look forward to working with all of you as we move
3 forward.

4 Q And this statement was read to the general public as
5 well at your listening session; is that right?

6 A It was.

7 Q What do you mean by stating that your goal is to
8 achieve a plan that is consensual?

9 A The commissioner and I, when we were discussing this
10 in the fall of '15, were looking at ways to cure the
11 inequity. By the time we got into February and into
12 May, when I was appointed full-time special deputy
13 commissioner and I resigned my role as deputy
14 commissioner, wanted to find exit strategies to get
15 the segregated account out of rehabilitation.

16 When we talked about what those strategies might
17 look like, there's certainly things that the
18 department can do and the Rehabilitator can do to try
19 to get the company out of rehab. But our preference
20 would be a consensual transaction where the company
21 and its creditors and policyholders could come to
22 some type of a commutation, some type of a
23 transaction that would emerge the segregated account
24 from rehabilitation. So we wanted to be consensual.
25 That was our preference. Consensual would mean that

1 at least the majority of those affected stakeholders
2 were in agreement with what that transaction looked
3 like.

4 Q After you made public your intent to move towards
5 this consensual transaction or exit the segregated
6 account from rehabilitation, did you have
7 conversations with the company, Ambac, about this
8 goal?

9 A We did. We met with Ambac even prior to the
10 July 12th listening sessions and instructed them that
11 it was now the focus of the rehabilitation, in
12 addition to all the other duties that the
13 Rehabilitator has of commuting claims, making sure
14 that policies are being paid correctly, making sure
15 reconciliations are done accurately, but that this
16 was a major focus of the Rehabilitator. And we
17 indicated that we would be having a listening session
18 to get feedback from affected stakeholders but to
19 also formally announce what our intentions were.

20 Q And what was Ambac's response to this discussion?

21 A Ambac was cooperative, and they wanted to have the
22 ability to try to work with their policyholders,
23 their affected stakeholders, to come up with a
24 consensual transaction. It wasn't the first time
25 that an effort was made necessarily to try to come up

1 with a transaction that gets it out of the
2 rehabilitation, but the previous effort didn't work
3 back in 2015, and they were enthusiastic about the
4 opportunity to try again.

5 Q And other than the listening session which was sort
6 of a general communication to interested parties, did
7 you have any one-on-one meetings with creditors to
8 discuss this exit?

9 A Yes. Post the listening session and actually during
10 the listening session, we invited people to contact
11 us if they wanted to ask more questions, if they
12 wanted to give us their feedback, if they wanted to
13 help come up with concepts and ideas on the
14 transaction. It wasn't our job to be involved in the
15 negotiations of a consensual transaction, but it was
16 our job to try to facilitate it if we could.

17 We met with policyholders in the segregated
18 account. I think it was in August, a month after the
19 listening session, we met with three of the major
20 policyholders in the segregated account, which was
21 NCUA, Fannie Mae, and Freddie Mac. And those
22 meetings were extremely useful and beneficial to us.

23 Q And after your conversation with Ambac, did they take
24 any steps to address your goals?

25 A Yes. Ambac began discussions with the affected

1 stakeholders both in the general account -- surplus
2 noteholders in the general account as well as
3 policyholders in the segregated account.

4 One of the things that we discovered in that
5 outreach with the policyholders was they fully
6 expected that any type of consensual transaction
7 would mean they would get their full principal back
8 of their claim. What we took away from those
9 meetings was that they were agreeable to talk about
10 potential discounts on the accretion. And that began
11 to kind of set the stage for us as to, from a
12 consumer protection perspective, from a fair and
13 equitable perspective, where a transaction might fall
14 in line.

15 Q Were there any guidelines given to Ambac as part of
16 this -- their discussions with creditors regarding
17 some type of consensual deal?

18 A Yeah. Yes.

19 The guidelines for Ambac and, quite frankly, for
20 all of the policyholders and stakeholders were
21 basically threefold. The transaction and the
22 ultimate exit from rehabilitation needed to be
23 durable, it needed to be fair and equitable to the
24 parties, and it needed to be in the best interest of
25 all policyholders. Not just in the segregated

1 account, but policyholders also in the general
2 account.

3 Q What do you mean by durable?

4 A Durable essentially meaning that the company can meet
5 its obligations, pay its claims, 100 cents on the
6 dollar on a go-forward basis, and that there is even
7 a cushion even beyond that in case some of the
8 estimates that we had within our own model which
9 shows the various scenarios from a base-case scenario
10 all the way down to stress-case scenarios, that
11 there's some margin of safety that's left even after
12 all claims are paid in case our estimates are off or
13 in case unforeseen events occurred.

14 Q And what's the margin of safety?

15 A The margin of safety, again, is really just a cushion
16 of capital and surplus that would be left within the
17 general account for the ability to pay claims if, in
18 fact, the scenario -- we use the worst-case scenario,
19 stress case four scenario to determine whether or not
20 the company could be durable on an exit in addition
21 to using the most pessimistic scenario having a
22 margin of safety --

23 THE COURT: All right. Let's hold up.
24 We're going to have to take a recess and see what we
25 can do about the phone system. We continue to have

1 interference from the phone system which goes
2 directly into the headphones of the court reporter,
3 and she's unable to take down the testimony here,
4 which is very important for us to do.

5 So we'll take a break, see if we can
6 resolve the issues. It may be phone-wide. It may be
7 the Internet wireless in the courthouse. Whatever
8 the problem is, if we can't fix it, we'll probably
9 just hang up.

10 We are in recess.

11 (Recess taken)

12 THE COURT: We're back on the record
13 with appearances previously noted.

14 Mr. Schwartzer is back in the witness
15 stand.

16 You may proceed with your questioning,
17 Mr. Mertz.

18 MR. MERTZ: Thank you, Your Honor.

19 BY MR. MERTZ:

20 Q Mr. Schwartzer, you mentioned that you sort of -- you
21 tasked Ambac with communicating with creditors
22 regarding a consensual plan.

23 As the special deputy commissioner and
24 Rehabilitator, what was your role in these
25 negotiations?

1 A More of the referee and a facilitator than involved
2 in any of the negotiations. We wanted to make sure
3 we set clear criteria for the rehabilitator to
4 approve any type of consensual transaction, and they
5 were the same three staples we talked about before,
6 being durable, best interest to policyholders, and
7 fair and equitable.

8 Q Did you continue to have conversations with these
9 creditor groups and Ambac throughout the course of
10 their discussions?

11 A We did.

12 Q And what did those involve?

13 A They would involve feedback from us as to potential
14 transaction mechanics. In other words, where the
15 company was looking to pay a certain amount out in
16 cash and secured note and a surplus note. The
17 creditors may have wanted more in cash, and we
18 indicated when we thought it would create a situation
19 where it would not be durable, where the company
20 maybe was looking for more of a discount from the
21 policyholders.

22 And we had concerns about too much of a discount
23 being not fair and equitable and not in the best
24 interest of the policyholders. It was those types of
25 conversations, updates from them, our feedback on

1 that, and whether or not such transaction mechanics
2 were in line to our thinking relative to an approval
3 of such transaction.

4 Q And at some point in time, was there an agreement
5 that was struck between Ambac and a group of
6 creditors?

7 A There was.

8 Q I'd like you to turn to tab 2. Are you familiar with
9 this document?

10 A I am.

11 Q Could you just read what it is, please.

12 A Exhibit C, Rehabilitation Exit Support Agreement and
13 First Amendment to the Rehabilitation Exit Support
14 Agreement.

15 Q And can you just generally explain to the Court what
16 this is.

17 A This is the agreement between the creditors and the
18 company on a commutation and a transaction that would
19 provide for an exit to rehabilitation, again, between
20 the creditors, the majority of the affected
21 policyholders and stakeholders, and the insurance
22 company, Ambac.

23 Q And after being presented with this, what's known as
24 the RESA, the Rehabilitation Exit Support Agreement,
25 what steps, if any, did you take as the

1 Rehabilitator?

2 A So this last version of the RESA was not the first
3 version we saw, obviously. We saw many versions. We
4 saw many iterations of the transaction mechanics that
5 are outlined within the agreement. And so when we
6 began to give our feedback and input, we obviously
7 wanted to see a completion of the agreement that
8 would meet our approval and move the Court to take
9 the company out of rehabilitation.

10 The first time we really saw this was in -- you
11 know, around February, March of 2017, of last year.
12 We were enthused about the progress, but we still
13 wanted to see a conclusion. We indicated to the
14 general public that we would give some type of
15 directional decisions on where we were going with the
16 rehabilitation by the end of the first quarter. We
17 got to the end of the first quarter, and they had not
18 reached an agreement yet at that point, and they
19 asked for an extension of time to continue their
20 discussions.

21 Having talked with both the company and the
22 affected parties, they both indicated good faith
23 effort to continue their discussions and their
24 negotiations, and we granted the 60-day extension.
25 By the time we got to that extension, they wanted an

1 additional ten days to the end of June to complete
2 the transaction. We granted those additional ten
3 days as well.

4 And then on July 1st, they had reached an
5 agreement, which is outlined -- which is this RESA
6 agreement. They had put their signatures in escrow
7 until the OCI could provide final approval of what
8 was being presented.

9 Q And what process was there to get final OCI approval
10 on the RESA?

11 A The advisory team and myself reviewed the final
12 transaction and made a decision to recommend to the
13 OCI that they approved the transaction and approved
14 our team moving forward with moving the Court to
15 remove the segregated account for rehabilitation. We
16 met with the OCI obviously well before the final
17 agreement on its -- on the various iterations we were
18 looking at to keep them up-to-date and to keep them
19 informed. Once this agreement was -- and the
20 signature pages were put in escrow on the 1st of
21 July, we set up another meeting with OCI to provide
22 our final recommendation.

23 The OCI reviewed our -- the transaction
24 mechanics. They reviewed the RESA. They reviewed
25 our recommendation and ultimately approved our

1 recommendation to move forward.

2 Q I sort of want to switch gears and go back to
3 something that you mentioned previously, and that is
4 the -- what you called rep and warranty litigation or
5 RMBS litigation.

6 A Yes.

7 Q Can you first just explain what RMBS means.

8 A Residential mortgage-backed securities.

9 Q And this RMBS litigation, what is that?

10 A That is the dispute between Ambac and many other
11 financial-guaranteed companies against the banks
12 relative to the mortgages that were underwritten by
13 those banks and the coverage that was provided by
14 financial-guaranteed companies on those mortgages.

15 Q And what significance does that have with respect to
16 the segregated account?

17 A The purpose of setting up the -- one of the other
18 purposes of setting up the segregated account was to
19 allow this dispute to mature and to determine whether
20 or not there would be any assets that the company
21 could recover from their disputes. And the rep and
22 warranty litigation is a large asset of the insurance
23 company and allows for claims-paying ability to the
24 segregated account, so it's extremely important.

25 Q Did you take any steps to value the RMBS litigation?

1 A Yes. The first time we reviewed the valuation, or
2 that I did, of the rep and warranty was when the
3 commissioner and I were first appointed. Obviously
4 those cases weren't very mature at that time and we
5 continued to get updated on all of the progress of
6 the various suits that were outstanding. As some of
7 those suits either were settled or concluded, we
8 received updates on what the value -- with the
9 continued value that the company was putting in their
10 financial statements relative to those suits.

11 We reviewed the expert reports that Ambac
12 obtained from financial experts on what the value was
13 when the suits first started. We reviewed primarily
14 the Bank of America/Countrywide experts and their
15 reports, which gave us some comfort, because even in
16 the expert reports of Bank of America/Countrywide,
17 they agree that there was damages. And then the
18 question was how much were the damages? That
19 certainly gave us some comfort in what the valuation
20 was of these suits.

21 We, coming on board as the special deputy
22 commissioner, met with Patterson Belknap. That's the
23 attorney firm that represents Ambac as well as the
24 segregated account, so they work for us as well on
25 the rep and warranty litigation. And we looked at --

1 spent a couple days in New York getting updated on
2 the specifics of the valuation of the rep and
3 warranty litigation for Ambac and also worked with
4 Michael Best. Michael Best had a different approach
5 to the valuation, but it ended up being really fairly
6 close to what Patterson Belknap came up with relative
7 to the value of that litigation.

8 Q In the expert reports you mentioned, are those the
9 ones that are attached to your affidavit filed in
10 this case?

11 A Yes.

12 Q I want to have you discuss another term that's within
13 the plan and the disclosure statement and the RESA,
14 and that's this issue of Tier 2 financing. Can you
15 explain to the Court what the concept of Tier 2
16 financing is.

17 A So Tier 2 financing is the infusion of additional
18 capital and surplus into the insurance company
19 through the RESA, through the transaction. It was
20 another component of the ultimate transaction that is
21 before us. And it is investors who have agreed to
22 invest into a transaction with the company for any
23 proceeds that would exceed \$1.6 billion in recoveries
24 from the rep and warranty litigation.

25 Q How does this relate to any analysis that you're

1 doing?

2 A Well, it was important for us for two reasons. The
3 first is that as we looked at the finances of the
4 company, an exit from rehabilitation was not possible
5 without additional capital and surplus from the
6 company. So this provided that much-needed
7 additional capital and surplus. It also was
8 important for the Rehabilitator, for the
9 commissioner, for all of us, in that it validated --
10 the market was basically validating what the rep and
11 warranty remediation was and provided a lot of
12 comfort to us that our valuation of the remediation
13 credits were reasonable.

14 Q And that was at approximately what value? What
15 about?

16 A In scenario -- for the company they had -- on their
17 remediation credit, they had roughly \$1.8 billion as
18 a remediation credit for all of the outstanding
19 litigation.

20 We used a much more pessimistic view of that in
21 our worst-case scenario, our stress-case scenario,
22 scenario 4. And so having the market validate that
23 there is an ability and a likely ability to receive
24 above \$1.6 billion provided us that comfort.

25 Q And when you say remediation credit, is that

1 essentially the value of the asset they're reporting?

2 A That's the valuation of the asset. Correct.

3 Q Okay. So you just mentioned that after receiving the
4 RESA, you went and made -- eventually made a proposal
5 to OCI recommending approval of the RESA; is that
6 right?

7 A I did.

8 Q And can you turn to tab 3, please. And are you
9 familiar with this document?

10 A I am.

11 Q And can you state for the Court what it is, please.

12 A This is the written final authorization from the
13 Rehabilitator from the commissioner to accept our
14 recommendation to approve the transaction and to move
15 the Court to remove the segregated account from
16 rehabilitation.

17 Q And this is dated July 19, 2017; is that correct?

18 A Yes.

19 Q So after receiving this letter, what steps did you
20 take -- let's just say with respect to Ambac?

21 A Well, the first step was to provide a copy and to
22 contact both the company and the ad hoc group, the
23 creditors that were parties to the RESA, that the OCI
24 had formally approved the transaction. That allowed
25 then the company and the creditors to exchange the

1 signature pages that were held in escrow. And then
2 it began our process as the advisers to move forward
3 with the necessary work to not only approve the
4 transaction but to move the Court to take the company
5 out of rehab.

6 We also wanted to make sure that it was known to
7 the stakeholders and the public. So in addition to
8 posting on the Ambac policyholder website, we also
9 held a listening session to talk about the
10 transaction, to try to get feedback on the
11 transaction from all interested parties and
12 stakeholders, and to try to answer any questions that
13 we might be able to.

14 Q Previously, you stated that some of the guidelines
15 for the consensual transaction included durability
16 and that the plan is fair and equitable. Did your
17 state take any steps to analyze those two factors
18 with respect to the final consensual transaction that
19 was submitted to you?

20 A Yes. We reviewed the transaction that was submitted
21 on July 1st. Our team, Dennis McGettigan and
22 Gordian Group, did their analysis. Our team
23 reviewed the transaction and determined that it was
24 durable, that it was fair and equitable, and that it
25 was in the best interest of all policyholders.

1 Q If you could turn to the next tab, please, tab 4.

2 A Yes.

3 Q Are you familiar with this document?

4 A I am.

5 Q And what is it?

6 A This is the expert report of Dennis McGettigan from
7 Gordian.

8 Q Is that what you were just referring to in conducting
9 your analysis?

10 A I was.

11 Q And just, generally speaking, what's the purpose of
12 Mr. McGettigan's expert report?

13 A The purpose of the expert report is to give in great
14 detail the financial solvency of the company
15 post-rehabilitation to discuss both its loss
16 projections and its assets and to ultimately make a
17 determination as our expert adviser as to whether or
18 not the transaction was durable.

19 Q And have you reviewed this full report?

20 A I have.

21 Q And relied upon it?

22 A I did.

23 Q And what's your -- as the special deputy
24 commissioner, what's your impression of what the
25 conclusion of this report means?

1 A The ultimate conclusion by Mr. McGettigan is that the
2 plan is durable, that there was a recognition of
3 Puerto Rico and a recognition of the hurricanes that
4 just hit Puerto Rico; but that even if his loss
5 projections would change on Puerto Rico, that his
6 expert opinion was that this was durable moving
7 forward.

8 Q Puerto Rico and the latest hurricane that hit
9 Puerto Rico didn't occur until sometime well after
10 September 22nd; is that right?

11 A No. The hurricane hit just prior to September 22nd
12 when the report was done. There wasn't a lot of
13 visibility for Dennis on what the effects might be on
14 the fiscal effect of the island, but that even not
15 having enough visibility at this point, his loss
16 projections would change, which he left the
17 possibility that it could, it would still be a
18 durable plan.

19 Q And let's turn to the next -- actually, I'm going to
20 skip the next tab. Let's turn to tab 6, which should
21 be the second amended plan; is that right?

22 A Yes.

23 Q Are you familiar with the second amended plan of
24 rehabilitation?

25 A I am.

1 Q Have you reviewed it?

2 A I have.

3 Q What role did you play in this document?

4 A This is the document that was created and required
5 once the commissioner gave us approval to move
6 forward with approving the transaction and to move
7 the company out of the -- the segregated account out
8 of rehabilitation that was crafted by our legal
9 advisers Michael Best with input from all of our
10 advisers.

11 Q And from your perspective, on a very high level, what
12 are the major points that the plan addresses?

13 A The second amended plan addresses, really, the
14 conclusion of the rehabilitation. It merges the
15 segregated account back into the general account. It
16 provides for a consideration package to those who --
17 those policyholders in the segregated account as well
18 as general account surplus noteholders. And it
19 provides for the conclusion of the rehabilitation.
20 It also has a process to make sure claims in the
21 interim are paid according to the transaction as well
22 as what happens post-transaction.

23 Q Does it incorporate the terms of the Rehabilitation
24 Exit Support Agreement?

25 A It does.

1 Q In particular, have you reviewed Article 6.13 of the
2 plan?

3 A I have.

4 Q What's your understanding of the purpose behind that
5 provision?

6 A The purpose of 6.13 is to ensure that there are no
7 defaults moving forward. It's an essential part of
8 Wisconsin's rehabilitation plan.

9 Q What's the policy behind 6.13 of the plan from OCI's
10 perspective?

11 A Well, the policy piece of it is essentially that it
12 is the exclusive jurisdiction of Wisconsin's
13 rehabilitation law and exclusive jurisdiction of this
14 Court on any rehabilitation or liquidation that
15 occurs in the state of Wisconsin, and that's
16 important to protect policyholders. Our job is to
17 protect policyholders.

18 And so from a policy perspective, it's to ensure
19 there's not an interference with how we run
20 rehabilitations in the state and how we have for
21 many, many years.

22 Q What's the reason or what's the rationale for
23 including Article 6.13 in the plan of the segregated
24 account in this particular plan?

25 A Again, to ensure that there are no defaults that

1 aren't cured by the ultimate conclusion of the
2 rehabilitation. So, as an example, if there -- when
3 the rehabilitation occurred, if there were any
4 companies that were troubled, they were put into the
5 segregated account. If there were policies that had
6 defaults in them, that would not be fixed by creating
7 the segregated account. You know, we would put those
8 in there as well. That was the -- the purpose was to
9 ensure that upon merger, the general account merged
10 with the segregated account could move forward and to
11 protect claims-paying resources.

12 Q Does a merger in particular have anything to do with
13 6.13?

14 A It has everything to do with 6.13, yes.

15 Q And with a plan, you also submitted a disclosure
16 statement; is that right?

17 THE COURT: Before we move on, let me
18 ask you some questions about 6.13.

19 If I understand it, your position is
20 that there have been no defaults?

21 THE WITNESS: That's correct.

22 THE COURT: So why are we phrasing it in
23 terms of curing faults then existing? Isn't your
24 purpose served by simply a declaration by this Court
25 that there have been no defaults and that there's an

1 injunction against anyone from contending there have
2 been defaults as a result of the establishment of the
3 segregated account and the funding for it?

4 THE WITNESS: It is our contention that
5 there are no defaults. That the original plan of
6 rehabilitation served its purpose that any policies
7 that existed that might have default trigger language
8 in their policies would not be in default by the
9 creation of the segregated account and that emergence
10 from rehabilitation in the segregated account and the
11 general account can move forward.

12 THE COURT: Maybe this is a question for
13 the lawyers. Why do I need to cure something that
14 hasn't happened?

15 THE WITNESS: It might be a question for
16 the lawyers. I'm giving you from my -- and I'm not a
17 lawyer. I'm giving you from my perspective the
18 rationale that the Rehabilitator, the commissioner,
19 myself wanted to make sure that there was an
20 inclusion of some language to ensure that upon
21 emergence from rehabilitation, there would be no
22 additional defaults and we could protect the
23 claims-paying resources of the company for the
24 benefit of the policyholders.

25 THE COURT: All right. I'll leave it

1 for the lawyers to discuss that with me later.

2 Go ahead.

3 BY MR. MERTZ:

4 Q You just stated that it's your position that no
5 defaults have actually occurred, but to your
6 knowledge, are defaults alleged?

7 A There are alleged defaults. Correct.

8 Q Is that inside the segregated account?

9 A No. It's within the general account.

10 Q So 6.13 would affect those alleged claims of
11 defaults; is that right?

12 A It would affect those or any other potential.

13 Q You just stated that you have an interest in
14 protecting claims-paying resources through 6.13.
15 What exactly do you mean by protecting claims-paying
16 resources?

17 A Well, any default could mean additional capital
18 surplus going to the suit, to the default, to the
19 issue. When we look at a rehabilitation, our goal
20 was to make sure we're protecting claims-paying
21 resources for the benefit of insurance companies. We
22 felt that this language was important to accomplish
23 that goal.

24 Q And claims-paying resources, do you mean the assets
25 of Ambac?

1 A The assets of the insurance company post-emergence.

2 Q And what happens to the segregated account at the
3 conclusion of the consensual transaction?

4 A The segregated account is done. It's over. There's
5 no more segregated account once it's merged back into
6 the general account.

7 Q So it becomes one in the same?

8 A It becomes one in the same again. Yes.

9 Q I had previously just asked a quick question about
10 the disclosure statement that was prepared and filed.
11 Did you review that document as well?

12 A I did.

13 Q And just generally speaking, what was the purpose of
14 submitting a disclosure statement together with the
15 plan?

16 A So I understand from our legal counsel that it wasn't
17 a requirement, but it was certainly a goal of the
18 Rehabilitator to be as transparent about this entire
19 process as we possibly could. The disclosure
20 statement is an opportunity for everyone to
21 understand the transaction in great detail. And that
22 was the main reason, transparency, was to have a
23 disclosure statement.

24 Q So in September, around the 25th, you filed your
25 motion to further amend the plan. You filed a plan,

1 the disclosure statement, and after a period of time,
2 there's some objections that are filed.

3 Are you -- did you review those objections and
4 are you aware of them?

5 A I am.

6 Q Let's talk in particular about an objection that was
7 filed by the COFINA bondholders. Are you familiar
8 with that objection?

9 A Yes.

10 Q Are you familiar with their request for an
11 adjournment?

12 A Yes.

13 Q From your perspective, why were they asking for an
14 adjournment?

15 A When the COFINA bondholders filed their objection,
16 obviously that was not the first time that we had
17 communicated with the COFINA bondholders. We've been
18 in communication either large meetings, attorneys
19 talking to each other, conference calls with the
20 COFINA bondholders several times over the last two
21 years. The COFINA bondholders are the holders of the
22 COFINA bonds. At the time we began discussions with
23 them, there may have been six or seven bondholders.
24 They had always given their input about the
25 rehabilitation. They've always given their input

1 about concerns about durability. And we took those
2 questions very serious and those concerns very
3 seriously. We always made sure that the work that
4 Dennis was doing was on the models were, in fact,
5 durable.

6 Prior to sending in the second amended plan on
7 September 25th, there was some commutations that took
8 place between the company and several of those COFINA
9 bondholders as the commutation. It was accretive.
10 It provided an increase in the margin of safety. And
11 yet, there were three that did not commute their
12 claims.

13 When we got to filing the second amended plan, we
14 had several conversations again with COFINA
15 bondholders and their representatives, and they
16 indicated concerns about durability and concerns
17 about Puerto Rico. Each time there was a discussion,
18 each time there was a concern, we took those concerns
19 seriously. We continued to review and double and
20 triple check our durability analysis, continued to
21 check loss projections on Puerto Rico.

22 And so we spent a lot of time trying to address
23 their concerns, listening to what their concerns
24 were. And each time we heard their concerns and
25 reviewed our model, we continued -- we had the same

1 conclusion, that our model was durable.

2 And so when they filed the objection and
3 reviewing the objection going to review loss
4 projections on Puerto Rico, we went so far as to even
5 make a visit to the island to determine whether or
6 not the projections that Dennis had in loss
7 projections were accurate.

8 We talked to many people on the island --
9 government officials, business owners, folks from the
10 oversight board -- and we came to the conclusion that
11 at least from the federal oversight board's review of
12 this, there wasn't going to be resolution to what was
13 going on in Puerto Rico for many, many, many months.
14 I think they even thought their fiscal plan wasn't
15 coming out until late April or early April of this
16 year.

17 So the request to try to postpone the hearing
18 until there was better clarity just didn't make sense
19 to us knowing that there was not going to be clarity
20 for many, many months on the island. And knowing
21 that our model was durable, I personally just reached
22 the conclusion that they were more concerned about
23 their trading prices of their bonds, and I totally
24 understand that, but that's just not something that
25 the Rehabilitator can be concerned about. We have to

1 be concerned about policyholders.

2 Q In fact, did you ask Mr. McGettigan to update his
3 report?

4 A Because of the objection but also because of
5 additional clarity on the island, yes, we asked
6 Mr. McGettigan to update his report and update his
7 loss projections and also to update us on any
8 additional commutations that had taken place since we
9 filed the second amended plan. There are -- the
10 company is very active in commutations. And there
11 were several that were accomplished since
12 December 25th, so we included those additional
13 commutations, which again increased the margin of
14 safety.

15 Q Could you turn back to tab 5 for a moment, please.

16 A Yes.

17 Q Can you identify this document, please.

18 A This is the update to Dennis' expert report.

19 Q This is, in fact, the updated report you asked him to
20 prepare; is that right?

21 A Yes.

22 Q Did you review this update?

23 A I did.

24 Q And upon review of the update, what were your
25 conclusions regarding Mr. McGettigan's analysis on

1 durability?

2 A That with the updated loss projections, that the
3 plan -- second amended plan was durable and was --
4 continued to be fair and equitable and in the best
5 interest of policyholders.

6 Q And I believe it was last week that the COFINA
7 bondholders withdrew their objection. Are you aware
8 of that?

9 A I am.

10 Q Can you just briefly explain the circumstances of
11 that withdrawal.

12 A Yes. Any commutation, obviously, I have to authorize
13 and approve. And certain transactions that take
14 place in the general account over certain dollar
15 threshold, I also have to review and approve. And
16 post the pretrial conference that was in
17 mid-December, discussions began again between the
18 company and the remaining three COFINA bondholders,
19 and they reached a commutation, very similar to the
20 commutation that existed with the first set of COFINA
21 bondholders. That commutation was positive for the
22 company insofar as it increased the margin of safety
23 for the exit.

24 Q Does that mean that it positively impacted your
25 durability analysis?

1 A Yes, it positively impacted the analysis. It was
2 accretive as one of our requirements on all
3 commutations. And that the accretiveness of the
4 commutation then added more durability to the plan.

5 Q So as you sit here today and after everything you've
6 reviewed and analyzed and been involved with during
7 this case, what's your final conclusion with respect
8 to the second amended plan as we sit here today?

9 A The final conclusion is that this second amended plan
10 is in the best interest of all the policyholders,
11 both the segregated and general account holders; that
12 it is fair and equitable; and that it is, in fact,
13 durable. And the emerged company will have the
14 wherewithal to pay claims 100 cents on the dollar
15 moving forward.

16 Q And provided that the consensual transaction subsumed
17 in the second amended plan actually closes. After it
18 closes, do you believe that any of the reasons that
19 would warrant a continued rehabilitation would still
20 remain in place?

21 A No. The purpose of the segregated account would have
22 been met. And similar to the company in 2012 that we
23 allowed the emergence of the segregated account back
24 in the general account, it would be the same scenario
25 with Ambac. Purpose has been met and the companies

1 need to be merged back together.

2 MR. MERTZ: No further questions, Your
3 Honor. Thank you.

4 THE COURT: Cross, Mr. Kravit?

5 MR. KRAVIT: Yes, Your Honor.

6

7 CROSS-EXAMINATION

8 BY MR. KRAVIT:

9 Q Mr. Schwartzer, you were involved essentially in an
10 oversight role since -- basically full-time since
11 when? 2015 or so?

12 A Full-time, February -- well, May of 2016.

13 Q Okay. Prior to May of 2016, what was your role?

14 A I was -- from February of '16 through May, special
15 deputy commissioner and deputy commissioner of
16 insurance. My role was oversight of the
17 rehabilitation.

18 And then from January '11 to February of '16 was
19 the deputy commissioner and had oversight of the
20 rehabilitation.

21 Q In 2015, in or about September of 2015, were you
22 asked to approve a transaction whereby Ambac would
23 make an investment in certain D bonds related to
24 Military Housing Project?

25 A In '15, that would have been to Roger Peterson. To

1 be honest, I don't recall that particular
2 recommendation.

3 Q Okay. Are you aware that in or about September 2015,
4 while this rehabilitation was pending -- although the
5 MHPI policies are not in the rehabilitation. You
6 agree with that, don't you?

7 A Yes.

8 Q They're not in the segregated account?

9 A The MHPI are not in the segregated account.

10 Q Are you aware that Ambac made a transaction
11 purchasing for \$72 million Class D tranche bonds in
12 the Military Housing Project?

13 A I have no recollection of that specific transaction.
14 Again, that would have been in '15 where
15 Roger Peterson was the special deputy commissioner.

16 Q Now, the part of Ambac that did that was not under
17 rehabilitation. Do you agree?

18 A If it was an MHPI policy bond, that would not be part
19 of the rehabilitation.

20 Q Assume with me that Ambac as an investment purchased
21 \$72 million of Class D bonds in the Military Housing
22 Project in September of 2015. Are you with me?

23 A Uh-huh.

24 Q The investment that an insurance company makes is
25 part of the way an insurance company has capital and

1 earns profit in order to be durable, correct, to be
2 able to pay claims?

3 A It's -- that's part of it. It's also a commutation
4 that needs to be accretive.

5 Q You're a deputy insurance commissioner, and you're
6 very experienced.

7 Is it usual that an insurance company would buy a
8 risky class of bonds that are discounted from
9 \$122 million to \$70 million as an investment? Usual
10 or unusual?

11 A In the Ambac case, since its inception in 2010, I
12 would say -- I'm not going to say it is common, but
13 it wasn't uncommon. The goal in any of the
14 commutations or any of the purchases that are made by
15 Ambac, again, transactions need to be reviewed by the
16 SDC. And if the SDC through its financial advisers
17 determines that the transaction ends up being
18 accretive and providing more claims-paying resources,
19 we would be foolish not to approve that direction.

20 Q Were you aware that this investment was unusual
21 enough that it had to be approved by the commissioner
22 of insurance?

23 A It had to be approved by the Rehabilitator through
24 the authority granted to the SDC. I have no doubt
25 that there was probably a discussion that took place

1 with me, with the commissioner, as to, you know, I'm
2 going to approve this transaction. We had many of
3 those discussions. But to remember a specific one,
4 the numbers of claims, the number of commutations
5 over the last seven years have been numerous. So I
6 don't remember a specific one.

7 But, yes, it would need through the plan of
8 rehabilitation, the authority granted by the plan
9 through the SDC into the Rehabilitator, a process by
10 which there would be approval that would be needed.

11 Q If the unencumbered, the nonrehabilitative Ambac for
12 its portfolio, there'd be no need for the insurance
13 commissioner to have to approve that, correct?

14 A Can you repeat that? I'm sorry.

15 Q If the nonrehabilitative portion of Ambac were as a
16 routine investment to buy treasury bonds, there'd be
17 no reason why the insurance commissioner would have
18 to approve that, correct?

19 A There is an investment policy that is approved by the
20 department as there is all insurance companies, and
21 particularly one that's under enhanced supervision,
22 as the general account would have been. And the
23 approval of that investment policy gives them some
24 deference for certain investments and others need
25 approval.

1 Q All right. Going to this ownership by Ambac, the
2 nonrehabilitative part of bonds in the MHPI, are you
3 aware Ambac decided to exercise its rights under
4 those bonds?

5 A Again, I don't have a direct memory of that specific
6 event.

7 Q All right. Did you know that Ambac in 2015, the
8 unencumbered part filed lawsuits in several different
9 states over several different states, not Wisconsin,
10 on the issue of whether the Military Housing Project
11 had defaulted in the sense that they -- that Ambac
12 was going to exercise rights to require some
13 payments?

14 A Yes, I'm aware of that.

15 Q You've studied that, right?

16 A I have.

17 Q In fact, you approved Ambac's filing of those
18 lawsuits, did you not?

19 A The department, the Rehabilitator -- and those
20 occurred, again, before I was special deputy
21 commissioner, were approved by the Rehabilitator.

22 Q Yep. Ambac couldn't just go out and file a lawsuit
23 somewhere without -- while it's under -- even though
24 only part of it's under rehabilitation without the
25 commissioner approving, correct?

1 A Remember that the general account is not in rehab, so
2 their ability to file suits, transact business in the
3 general account doesn't necessarily need our
4 authority or approval to do that. There are
5 transactions that take place within the general
6 account where specifically through the cooperation
7 agreement it requires the approval of the SDC. But
8 their cooperation with us informing us of certain
9 suits, certain things that they were going to do
10 within the general account, they certainly wanted our
11 blessing on some of those. And the things that they
12 needed approval on, they needed our approval.

13 Q And, in particular, the suits against MHPI were
14 approved; am I right?

15 A There was not an objection by the Rehabilitator for
16 those suits to move forward.

17 MR. KRAVIT: Your Honor, may I approach
18 with a document?

19 THE COURT: Sure.

20 Q Sir, I've handed you a document that the title is
21 MHPI Pending Litigation January of 2018. Do you see
22 that?

23 A I do.

24 Q I want you to look at this list. And I'll ask you if
25 you recognize at least the title and name of these

1 seven litigations that are listed here.

2 A I recognize some of them. Yes.

3 Q All right. Would you agree that these -- well,
4 accept my representation that these are pending
5 lawsuits today or have been disposed of by dismissal.
6 Would you agree with that?

7 A Yes.

8 Q Would you agree that two of them have been disposed
9 by dismissal because they were Ambac plaintiff claims
10 but they were outside the statute of limitations?
11 Have you been told that?

12 A I'm aware of that.

13 Q And are you aware that three of them, and that would
14 be the Texas, Maryland, and Kansas cases, have
15 presently motions for summary judgment on the exact
16 issue that 6.13 addresses? That is, whether or not
17 Ambac had defaulted under a Bespoke Insurance policy
18 or provision. That each side has filed motions for
19 summary judgment and they are set for decision in
20 cases in Texas, Maryland, and Kansas. Are you aware
21 of that?

22 A Yes.

23 Q So it would be accurate on the right side of this
24 chart, which summarizes that status, what's said
25 there as far as you know is accurate, correct?

1 A Without reading it in detail, as far as I know, yes,
2 it's accurate.

3 Q Are you aware that in Virginia and Kansas these cases
4 are pending, again, both brought by Ambac, but there
5 is no -- nothing really to talk about yet, correct?

6 A I believe that's correct.

7 Q All right. In 2015, do you know why it is that Ambac
8 decided to go to out-of-state courts to assert rights
9 under the MHPI process?

10 A From my recollection, the issue at hand was the
11 dispute by MHPI policyholders that the mere creation
12 of the segregated account didn't mean that these
13 policies were -- my recollection was that the
14 arguments that were being raised in these cases was
15 that Ambac was -- general account was somehow in
16 default, and that by being considered in default,
17 they would lose some of their control rights.

18 And so as a protection for those control rights
19 and certainly from the Rehabilitator's perspective
20 and the Department's perspective, in our view there
21 was no default because the general account wasn't in
22 rehabilitation and they wanted to defend their
23 control rights, and I believe that's ultimately why
24 there was a blessing given to move forward.

25 Q Okay. The general account was not in rehabilitation

1 and the MHPI policies were in the general account,
2 right?

3 A They were.

4 Q The issue is under a Bespoke Insurance provision of
5 these seven, and actually 13, MHPI entities, Ambac
6 was a wraparound insurer, but it was required to have
7 a certain credit rating, correct?

8 A Correct.

9 Q And through no fault of MHPI in 2008, Ambac no longer
10 had that rating. Do you agree?

11 A Correct.

12 Q Okay. So under the terms of the policy, which I
13 think is C(ii), clause C(ii), that meant that if MHPI
14 was correct, Ambac would lose its so-called control
15 rights; am I correct?

16 A Correct.

17 Q Okay. So the issue was, could Ambac exercise control
18 rights under the policy to basically as a lender
19 decide how much and when the Military Housing
20 Projects could spend money? Correct?

21 A Correct.

22 Q Now, you understand the Military Housing Projects are
23 50-year projects, correct?

24 A Yes.

25 Q I mean, this is not a financing for Mar-a-Lago,

1 right?

2 A No. They're military housing bases.

3 Q The U.S. Army is a partner. It's expected to take a
4 50-year course. And during that time period under
5 the contracts MHPI has with the Army, there is to be
6 upgrades, there is to be teardowns, there's to be
7 rebuilding all to make those projects equal to
8 private residential development. Do you understand
9 that?

10 A That's my basic understanding.

11 Q So in order to do that, the cash flow from the
12 properties, according to MHPI anyway, was to be
13 dedicated to this upgrade as well as obviously paying
14 investors, one of whom who was the Army, correct?

15 A Correct.

16 Q Asserting control rights by Ambac meant that Ambac
17 could determine as a lender whether or not the money
18 MHPI was to spend could be spent in the way they
19 choose to spend it. Do you agree?

20 A I would agree.

21 Q Okay. And that's before Ambac decided to buy Class D
22 tranche bonds in these projects. Do you agree with
23 that?

24 A I do.

25 Q The control rights existed before that.

1 A I'm assuming so. It was a contract --

2 Q And you also agree that the trigger point for being
3 unable to exercise those control rights was the
4 fallaway of Ambac from a AA rating or some kind of
5 rating to whatever it felt, right?

6 A Yes.

7 Q So Ambac in 2015 and, actually, way before that as of
8 2008 when it went into this problem, lost its
9 ratings, could -- if the MHPI was correct, could not
10 exercise control rights subsequent to the time they
11 lost the ratings. Do you agree that?

12 A I believe that's accurate.

13 Q All right. So now, in 2015, at some point, Ambac
14 decides not just to assert its control rights and say
15 there's been no default. As a company for an
16 investment, it bought \$70 million of D tranche bonds
17 at that time, right?

18 A Again, I'm not familiar specifically with that
19 transaction.

20 Q Were you told that a strategy of Ambac, the
21 nonrehabilitative part of Ambac, at that time was to
22 buttress their ability to control the dollars that
23 the MHPI spent?

24 A It was our understanding that there was a concern
25 that the loss of control rights on that policy would

1 mean additional claims-paying resources that would be
2 depleted from the general account. The general
3 account provides a reinsurance agreement to the
4 segregated account, and so the claims-paying
5 resources of the general account are extremely
6 important to the overall plan of rehabilitation.

7 Q And it was never suggested to you that there was any
8 default in payment on these policies, was there?

9 A That the policies were in default?

10 Q Right. Did the MHPI pay the policies' premiums when
11 due?

12 A My understanding is yes.

13 Q Have they ever been in default?

14 A I do not believe so.

15 Q And all the analysis that your experts did, has
16 anybody indicated that there's any extra risk of
17 default from MHPI from the time these matters were
18 put into place around 2000 to the present?

19 A Yes. There are loss projections for military housing
20 generally within our financial expert's report, but
21 within the model that has been used by our expert
22 for -- since 2009.

23 Q Okay. So we'll get into that. But, sir, isn't it
24 the case that when Ambac underwrote this insurance to
25 sell it back when it was solvent, that the

1 underwriters took into account in the premium the
2 possibility that the Army could, you know, excise the
3 barracks or close a base or something like that?
4 That's part of the underwriting, isn't it?

5 MR. MERTZ: Objection. Calls for
6 speculation.

7 THE COURT: Do you know?

8 A What I do know from what I've been told and been
9 updated on military housing since I've been at the
10 department and as special deputy commissioner is
11 there were two contracts. One was for this upfront
12 dollar to be paid, a surety bond. The other was for
13 the wrap. And the -- those insurance contracts were
14 exercised between two parties, and Ambac was
15 attempting to enforce one of the terms of those
16 contracts. And from our perspective, it made sense
17 from the perspective that it was protecting
18 claims-paying resources.

19 Q That's a little off point what I asked, so I want to
20 ask it again.

21 A Okay.

22 Q The Military Housing Projects have been paying their
23 premiums since the inception, correct?

24 A Yes.

25 Q The premiums were set by Ambac, right?

1 A I believe so.

2 Q And when an insurance company sets premiums, it
3 considers the risks, it underwrites the risks, right?

4 A Yes.

5 Q One of those risks is that the housing will be
6 abandoned because it's the Army and Congress can do
7 whatever it wants, right?

8 A Sure. Yes.

9 Q Has that risk changed for the better or worse since
10 2000 when these policies were initiated?

11 A No. Those risks haven't changed. But what did
12 change was the potential of loss of control rights.
13 And particularly -- not so much the loss of control
14 rights, but the surety bond. I'm assuming, as any
15 insurance company, they would be considering the
16 surety bond being in effect either by themselves or
17 by some other entity if it needed to be or through a
18 cash deposit by MHPI. And I would assume that that
19 was one of the factors that went into the premium
20 calculation by Ambac in their wrap. So while there
21 was no default from a barrack closing or anything
22 related to that, there was a concern relative to the
23 surety bond.

24 Q A concern relative to surety bond. And did that
25 translate to dollars? Did any of your experts say

1 how much more or less that exposure was than the
2 premium being charged for -- them being paid on the
3 Ambac policies?

4 A Not that I recall.

5 Q So let's get to what we're here for, sir.

6 In your tab -- well, the tab -- in your
7 affidavit. Okay? I don't know that it was specially
8 submitted, but I'm looking at the affidavit of
9 Daniel Schwartzer in support of confirmation of the
10 second amended plan of rehabilitation. You're
11 familiar with that?

12 A I'm familiar with that, yes.

13 Q At the conclusions on page 8, you conclude that the
14 consummation of the consensual transaction meets the
15 following material objectives. It says, A, Ambac's
16 immediate financial stability upon closing the
17 transaction. It will be stable on closing this
18 transaction, right? That's your opinion?

19 A Correct.

20 Q That the consensual transaction establishes a margin
21 of safety as required by the Rehabilitator which
22 accounts for anticipated and unanticipated risks and
23 potential estimation errors related to the ongoing
24 operations of AAC, right?

25 A Yes.

1 Q That's your opinion, correct?

2 A Yes.

3 Q Anticipated risks would include the risk of
4 litigation that Ambac initiated in seven states; am I
5 correct?

6 A It would include all things, so yes.

7 Q But it would specifically include that, would it not?

8 A It would include all things, so that would be
9 included.

10 Q And then, C, you've concluded that a durable exit of
11 the segregated account from rehabilitation -- it
12 meets this objective, a durable exit of the
13 segregated account from rehabilitation and allows the
14 Court to close these rehabilitation proceedings,
15 correct?

16 A That's correct.

17 Q And, finally, you conclude -- sorry. You've also
18 concluded that the fair and equitable treatment
19 procedurally and substantively to policyholders and
20 others exists, right?

21 A Correct.

22 Q Now, you agree that MHPI is a policyholder, right?

23 A Correct.

24 Q So when you say fair and equitable treatment, you're
25 saying policyholders generally, not MHPI in

1 particular; am I right?

2 A Policyholders in the segregated account and the
3 general account.

4 Q Okay. Do you think that 6.13 is fair to MHPI as a
5 policyholder in particular?

6 A I do.

7 Q Why?

8 A Because our intent from the beginning was that
9 there -- once the companies were merged into --
10 segregated account was merged into the general
11 account, that there would be no defaults. The policy
12 by MHPI was an insurance policy that was negotiated
13 between two parties, sophisticated parties. And from
14 our view, it's being treated as such. It's being
15 treated as it was intended.

16 Q So -- but all you are -- all Ambac, the nonsegregated
17 account, is achieving by 6.13 is taking away the
18 supposed right of MHPI to declare Ambac in default
19 because its credit rating dropped, which is a policy
20 provision. You agree that what -- your 6.13 takes
21 that away from MHPI, right?

22 A I agree that 6.13 cures all defaults which would
23 include anything that MHPI might move forward on.

24 Q You do understand that the other side of the bargain,
25 that is MHPI made a bargain in this insurance policy,

1 part of which was that if Ambac kept its AA rating,
2 it could have control rights; and the other part was
3 a penalty that if the party with control rights felt
4 insecure, they could cause the MHPI to deposit money.
5 Am I right?

6 A That's my understanding. Yes.

7 Q So you are taking away the defense that Ambac failed
8 by 6.13 unilaterally without any litigation in those
9 seven courts; am I right? Your plan takes that away;
10 yes?

11 A That would be the end result from the Rehabilitator
12 wanting 6.13 to make sure that the merged account --
13 the segregated account merged back in the general
14 account is free of -- cured of any defaults and
15 retains its claims-paying ability for all claimants,
16 including MHPI.

17 MR. KRAVIT: Judge, may I approach one
18 more document?

19 THE COURT: Yes.

20 Q Sir, I've given you a blowup of 6.13, and it has the
21 emphasis added, so it's not the official document.

22 6.13 eliminates any default or event of default
23 regarding the segregated account or the nonsegregated
24 account that exists or alleges to exist and it says
25 they will be deemed cured -- being deemed to be cured

1 and not to have occurred or existed now or in the
2 past or in the future.

3 That's the language we've been focusing on, and
4 that's the language you say will prevent MHPI from
5 saying that the drop in credit rating of Ambac is
6 some kind of default, right?

7 A That is the language that is preferred by the
8 Rehabilitator to cure defaults.

9 Q Just in case that wasn't clear enough, take a look at
10 XII at the bottom of this, which also indicates that
11 that deemed to be cured will occur -- in each case is
12 applicable based on what is defined as the preceding
13 circumstances.

14 What I want to point out to the Court is the
15 second page, which is the definition of preceding
16 circumstances. And you will look at -- buried in
17 this definition somewhere in this large document that
18 you want the Court to approve is the preceding
19 circumstances as defined sub Roman numeral IV, any
20 ratings downgrade of the Ambac parties.

21 Do you see that, sir?

22 A I do.

23 Q Is there any other policy that you know of,
24 segregated or not segregated, where there is an issue
25 as to whether Ambac is downgraded -- been downgraded

1 and, therefore, something -- there's controversy
2 about it?

3 A Not to my knowledge. That's one of the reasons why
4 we wanted to have the language in. But not to my
5 knowledge.

6 Q So this language, any ratings downgrade of the Ambac
7 parties, was inserted specifically to address the
8 MHPI policies; am I right?

9 A It was addressed to potentially prevent a default
10 that had we known might have existed in 2010, we
11 might have moved the company into the segregated
12 account. Not knowing that that was an issue in 2010,
13 that policy remained in the general account.

14 Q Okay, sir. That is definitely after the fact
15 justifying. Because in 2010 it was known that Ambac
16 had a downgrade. It was known.

17 So are you saying that all these supervisors of
18 Ambac and the OSC and so on never figured out between
19 2008 and 2015, seven years later when Ambac filed
20 these lawsuits, that this ratings downgrade would
21 affect some insurance policies?

22 MR. MERTZ: Objection. Argumentative.

23 THE COURT: It is argumentative.

24 Sustained.

25 Q What did you do to look for other policies that would

1 have a rating downgrade, you or Ambac, to your
2 knowledge?

3 A So, to my knowledge, while I wasn't there, the then
4 special deputy commissioner Roger Peterson was the
5 bureau director at the OCI. OCI and their team of
6 advisers went through some painstaking efforts to
7 determine which policies had triggers, which ones
8 didn't, and those policies that might have a
9 trigger -- that could have a default, I should say,
10 were moved to the segregated account.

11 Policies that were at risk were moved to the
12 segregated account and there was very long process
13 trying to understand what was in the policies and
14 what might cause an avalanche of claims to occur such
15 that there would be a liquidation of the company
16 rather than a rehabilitation of the company. And
17 then all claimants would have been paid pennies on
18 the dollar for their claims. There would be no
19 rehabilitation, no chance to try to rehabilitate the
20 company and get claims paid in full. And so there
21 was efforts made then to try to understand what those
22 policies were.

23 I did not know about this until they filed and
24 made the argument that the company was in
25 rehabilitation. That was the argument that was being

1 made by MHPI, that the company was in rehabilitation.
2 And in those other jurisdictions was arguing that the
3 creation of the segregated account didn't fix that.
4 And that goes to the protection of our exclusive
5 jurisdiction and the protection of our rehabilitation
6 statutes.

7 Q One second. When, if ever, did you learn that Ambac
8 could use its own default as both a sword and a
9 shield and seek \$200 million from my clients of
10 actual money to be put into these projects in the
11 sense to ameliorate based on Ambac's control rights?

12 MR. MERTZ: Objection. Argumentative.
13 No foundation.

14 THE COURT: Sustained.

15 Q When did you learn that there was a potential
16 \$200 million payment that could be required from
17 MHPI?

18 MR. MERTZ: Objection. Speculation.

19 THE COURT: Overruled.

20 A I don't know the exact time. I do know that it was
21 probably when I was the deputy commissioner and not
22 the special deputy commissioner. So that would have
23 been probably pre-February of 2017. I was aware of
24 this surety bond issue.

25 Q Okay. Are you aware that the policy provided that it

1 was a default by Ambac if there was an authorization
2 or taking possession by a receiver of Ambac or taking
3 possession of any material portion of Ambac's
4 property? Are you aware that that was a default?

5 A I was aware that that's an argument that was being
6 made by the MHPI parties.

7 Q It became the policy of Ambac to exercise control
8 rights to demand that MHPI put up \$200 million; is
9 that correct?

10 MR. MERTZ: Objection. Foundation.

11 THE COURT: Well, do you know?

12 A Can you repeat the question.

13 Q All right. It became the policy of Ambac once it
14 became known that what it wished to do was to ask the
15 Military Housing Projects to put up \$200 million into
16 an account by exercising its control rights to do so?

17 A So my recollection was that when this came up, there
18 were many discussions -- and this is all information
19 I received post the conversations -- that Ambac had
20 several conversations with the military housing folks
21 about this issue to try to determine how they could
22 mutually handle this.

23 And when those discussions broke down and there
24 was apparently no way to mutually handle it is when
25 they moved forward with trying to protect their

1 control rights, one of them being -- having the
2 military housing folks find another surety bond. And
3 from our perspective, that meant that we were
4 protecting the claim-paying resources from the
5 general account.

6 Q When you say they move forward, in fact, it's Ambac
7 that moved forward by filing these cases?

8 A Ambac moved forward -- from my understanding, my
9 recollection, they moved forward filing the cases
10 once negotiations or discussions with MHPI broke down
11 and there was no more discussions to be had.

12 Q Ambac made a demand before it filed suit that
13 \$200 million be placed in escrow by the MHPI?

14 A That's my understanding of the suit.

15 Q And then when they didn't do that, meaning the MHPI
16 didn't do that, Ambac filed suit eventually in seven
17 states to force it, right?

18 A I don't recall who filed which suits in which states,
19 but I know there's many suits -- I don't recall, I
20 should say, which suits in which states; but there
21 were obviously many suits that were filed, yes,
22 regarding MHPI and this particular issue.

23 Q And it was Ambac who chose the forums, correct?

24 A Chose the forums?

25 Q Well, chose Monterey, California; Pennsylvania;

1 Texas; Maryland; Kansas; Virginia?

2 A I would assume it would be Ambac. It wasn't the
3 Department.

4 Q So nobody while you were Rehabilitator thought, well,
5 maybe we should bring some claim regarding this to
6 this Court?

7 THE COURT: Let me ask you this. Five
8 of the ones were Ambac's choice. Two of them appear
9 to be the choice of the Military Housing, at least on
10 your exhibit.

11 MR. KRAVIT: Your Honor, actually, six
12 were. But what happened was Ambac sued in federal
13 court in -- I believe it was Maryland, and then my
14 clients filed a holding action because federal court
15 was inappropriate and it was, sure enough, dismissed
16 in federal court. So that one really is an Ambac
17 case. The only one here that was directly filed as a
18 declaratory judgment by my client is the one in
19 California.

20 THE COURT: All right.

21 MR. KRAVIT: And that one has been --
22 dismissal's been granted on statute of limitations
23 grounds and is on appeal.

24 BY MR. KRAVIT:

25 Q Speaking of that, sir, are you aware of any claims

1 arising out of the California dismissal?

2 A You'd have to ask more specifically.

3 Q Did you know that attorneys' fees were assessed
4 against Ambac in the California dismissal?

5 A I don't recall specifically that. No.

6 Q Is that factored into any of your research or reason
7 for this plan, the fact that Ambac has an exposure
8 for attorneys' fees because it improvidently -- well,
9 because its case got dismissed in California?

10 A The model and ultimately the report by
11 Dennis McGettigan from Gordian attempts to reflect
12 all exposures, all assets. You'd have to ask
13 Mr. McGettigan, but I'm assuming it included the
14 potential losses of military housing in one way,
15 shape, or form.

16 Q Is there any money damage to Ambac if MHPI wins its
17 cases? What's the damage?

18 MR. MERTZ: Objection. Calls for a
19 legal conclusion.

20 Q If you know.

21 THE COURT: Yeah, I'm not taking it as a
22 legal conclusion. I'd be interested in his opinion.

23 A We've had several discussions. My understanding from
24 both the company and from our own experts is that
25 it's difficult to quantify.

1 Q Well, is it one dollar? A hundred dollars? A
2 million dollars?

3 A Again, just to be very frank and honest, the
4 discussions I've had with our financial advisers, the
5 discussions I've had with Ambac is it is very
6 difficult to quantify the loss of control rights from
7 a monetary perspective. There's a lot of factors
8 that need to be taken into consideration. So, no, I
9 was never given a specific number or a specific range
10 of what might be a loss of claims-paying resources.

11 Q All right. 6.13 is in here as a significant
12 prohibitive injunction by this Court which you
13 understand and which you wish to take the legs out of
14 any argument that Ambac has defaulted in the seven
15 cases Ambac brought, correct?

16 A It is intended -- as I've said numerous times, it is
17 intended to cure all defaults so that when the
18 company is merged back into the general account, we
19 are protecting claims-paying resources for all
20 policyholders, including MHPI.

21 Q And what claims-paying resources are you protecting?
22 How much?

23 A Again, we don't -- I was never given a definitive
24 amount of what that might be, but it's a policy and a
25 philosophical decision of the Department that for

1 rehabilitations today and future rehabilitations,
2 that we're protecting the exclusive jurisdiction of
3 this Court and our Wisconsin rehabilitation law.

4 Q That sounded like you're a lawyer, but we'll accept
5 that.

6 So the answer is that Ambac's -- what Ambac is
7 protecting in a matter of dollars is speculative.
8 You don't know. Right?

9 A I do not know.

10 Q And all the reports we've read that have been filed
11 here, including the old affidavits, none of them put
12 a dollar amount on what is to be protected by the
13 6.13. Do you agree?

14 A I would agree.

15 Q All right. On the other side of the ledger, you
16 agree, do you not, that MHPI risks having to take
17 \$200 million and put it into an account for 50 years.
18 You agree with that?

19 A I believe that's one option. I believe the other
20 option is the purchase of another surety bond which
21 then they wouldn't have to put up \$200 million.

22 Q You agree, do you not, that Ambac has exercised
23 control rights not just to seek \$200 million, but to
24 stop cash flows in smaller amounts as a lender in the
25 projects?

1 A My understanding is that is one of the things that
2 they would consider with their control rights to
3 ensure that there wasn't a default by the policy that
4 they're insuring.

5 Q They're insuring against a default and policies that
6 have never -- that are still being paid to the tune
7 of a million or more dollars a year; am I right?

8 A I do not know of any defaults.

9 Q All right. And there's no money out of pocket that
10 Ambac is in this -- in these lawsuits other than its
11 own attorneys' fees, which it brought on by filing
12 the cases, right?

13 A There have been attorneys' fees in these cases.
14 Correct.

15 Q Are the attorneys' fees estimated or any part of your
16 determination in the speculative power that you think
17 might happen if you don't get 6.13?

18 A Yes.

19 Q How much?

20 A My understanding is that there is roughly
21 \$15 million that has been reserved by the company for
22 future MHPI litigation.

23 Q Okay. So \$15 million, let's put some perspective on
24 that. The value of this agreement that's been made
25 that you want to have approved is what?

1 A The value of the entire transaction?

2 Q Yes.

3 A It's a \$3, \$4 billion transaction for emergence from
4 the segregated account.

5 Q Okay. So let's get this straight. To protect
6 against \$15 million in projected attorneys' fees,
7 which you now say you have reserved for all this
8 litigation in the context of an almost multi-billion
9 dollar settlement, you need 6.13 which has the result
10 of applying to one policyholder and causing them as
11 Ambac has demanded to put \$200 million in an account
12 to do nothing, right?

13 A The way that I would answer that is that it's the
14 same reason we went to this rehabilitation court to
15 define what the rehabilitation meant when we created
16 a segregated account. And that's to preserve our
17 rehabilitation laws, and not just for this
18 rehabilitation, but the need to preserve our laws for
19 future rehabilitations and retain exclusive
20 jurisdiction of our rehabilitation statutes. That's
21 important -- that's an important policy decision.

22 And whether or not there is known risks to
23 claim-paying resources with this case, we know that
24 the language is better in than out. And we know from
25 a policy decision it's going to protect future

1 rehabilitations, which is intended to protect
2 consumers at the end of the day.

3 Q Is the plan you're proposing durable without 6.13?

4 A My understanding is it is.

5 Q Thank you.

6 Now, I want you and the Court to look at what you
7 have filed as Exhibit C. I don't know if that was
8 tab 2. I'm not sure what that was. Rehabilitation
9 Exit Support Agreement.

10 MR. KRAVIT: Do you have that, Judge?

11 THE COURT: I do somewhere. Yep.

12 Q Do you have that, sir?

13 A Is that tab 2? RESA? Yeah, tab 2.

14 Q I want you to turn to page 8.

15 A Yes.

16 Q And I want you to note that this is Section 5,
17 representations and warranties. And I'm going to
18 read the start of this. "Each of the parties
19 severally and not jointly represents and warrants to
20 each of the other parties that the following
21 statements are true and correct as of the date
22 hereof."

23 And then I'm going to No. 6, proceedings. "No
24 litigation or proceeding before any court,
25 arbitrator, or administrative or government body is

1 pending against it that would adversely affect its
2 ability to enter into this agreement or perform its
3 obligations under this agreement and the term
4 sheets."

5 Did I read that correctly?

6 A Yes.

7 Q So Ambac signed this agreement, right?

8 A They were one of the signatures. Yes.

9 Q So did all the people who were providing the money to
10 fund the rehab plan, correct?

11 A Correct.

12 Q They have sworn that no -- this is as of September of
13 2017, correct?

14 A Yes.

15 Q By September 2017, all these seven cases, all the
16 litigation between MHPI and Ambac is known.

17 A I'm sorry.

18 Q Correct?

19 A I'm sorry. I think you answered. You said
20 September. It's since July.

21 Q Fine. As of July 2017, all the litigation we're
22 talking about, all of the seven litigations that are
23 on the chart I provided earlier, those were all known
24 to Ambac for sure, correct?

25 A Yes.

1 Q And Ambac has represented as a matter of contract
2 that no litigation, including that litigation, will
3 adversely affect its ability to enter into the
4 agreement, right?

5 A Yes.

6 Q And then this RESA was adopted into your rehab plan I
7 think you testified earlier today, correct?

8 A Correct.

9 Q Here's what we've learned. Without 6.13, the plan is
10 durable. Every party was aware of all of these
11 litigations and warranted that it would not affect
12 the plan, right?

13 A I would assume so. Yes.

14 MR. KRAVIT: No more questions.

15 THE COURT: Redirect?

16 MR. MERTZ: Thank you, Your Honor.

17

18 REDIRECT EXAMINATION

19 By Mr. Mertz:

20 Q I'd just like to clear up sort of a logistical issue
21 regarding MHPI projects. And I just would like you
22 to write down and discuss who's who with respect to
23 MHPI projects.

24 When we say MHPI projects, are we referring to
25 developers?

1 A Developers that, from my understanding, were in a
2 public/private partnership with duty to develop these
3 housing units, and Ambac obviously provided two types
4 of coverage for that transaction.

5 Q And do you know how those projects, the military
6 housing projects, are funded?

7 A They are funded -- I don't have direct knowledge, and
8 I couldn't answer specifically how they're funded.
9 But my understanding is the federal government backs
10 up those projects from a funding perspective and the
11 rest of the dollars are raised through the generation
12 of the bonds.

13 Q So with the generation of bonds, Ambac actually
14 insures those bonds, is that right?

15 A They insure the bonds and would pay the principal and
16 interest if there was a default.

17 Q With that analysis, are MHPI projects actually
18 policyholders?

19 A No. The -- they would not be necessarily a
20 policyholder.

21 Q They're the project developers?

22 A They're the project developer. Right.

23 Q So the developers are not policyholders from the
24 Rehabilitator's perspective, correct?

25 A They would not -- the developers --

1 MR. KRAVIT: I'm going to object to
2 leading, and there's no foundation, and he's not a
3 lawyer.

4 THE COURT: Overruled.

5 A My understanding is the developers themselves are not
6 policyholders.

7 MR. MERTZ: No further questions, Your
8 Honor.

9 THE COURT: Mr. Kravit's clients are
10 project developers?

11 MR. KRAVIT: Say what? Sorry?

12 THE COURT: Your clients are project
13 developers; is that right?

14 MR. KRAVIT: My clients are the project
15 developers and they are the policyholders. Yes, sir.

16 THE COURT: There's a dispute as to
17 whether they're the policyholders? Ambac takes the
18 position that you don't have any standing here or it
19 sounds like in the seven lawsuits to raise the
20 contract default language that you're asserting.
21 That's what I understand Ambac's position to be.

22 MR. KRAVIT: Well, maybe, but that is
23 pending on summary judgment in three courts already,
24 Your Honor. What they seek to do is have you decide
25 that without any evidence beyond this gentleman.

1 THE COURT: I understand that. You say
2 the policy does cover you, your clients?

3 MR. KRAVIT: My clients pay the
4 premiums, and they bought -- and the bond is for
5 their benefit. Yes.

6 THE COURT: I thought there was language
7 quoted by Ambac that you're not third-party
8 beneficiaries to any of this.

9 MR. KRAVIT: I'm not going to argue
10 about third-party beneficiary. We are the
11 policyholders as defined.

12 THE COURT: You are named insured under
13 the policy? Is there a rider --

14 MR. KRAVIT: I have to look into that.
15 I don't have that in front of me.

16 THE COURT: Is there a rider that makes
17 you an additional insured under the policy?

18 MR. KRAVIT: I don't know the answer.
19 I'll find out.

20 THE COURT: You know -- you don't think
21 that's important here?

22 MR. KRAVIT: No.

23 THE COURT: Okay.

24

25

EXAMINATION

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By the Court:

Q Mr. Schwartzer, is it a deal-breaker if I don't approve 6.13 but approve everything else? I mean, is there a contract among the consensual parties that if the judge approves everything but this, we're going to renegotiate the entire deal?

A No. That's not the case on the parties. My interest, as I said, is strictly not just this rehabilitation but future rehabilitations. Yes.

Q So what you're trying to do is protect Wisconsin rehabilitation laws' turf for all potential rehabilitations and ultimately liquidations if necessary?

A Exactly, yes.

Q Is there a way to do that in a manner that accommodates the interests of the Military Housing Projects since it doesn't appear that losing this litigation, if you were to lose it -- I don't think there really is a default here. But if you were to lose it, it doesn't appear that it's going to adversely affect the durability of this exit?

A Not of this exit. That's absolutely correct, sir.

Q Is there a way to -- maybe this is, again, a question for the lawyers -- a way to phrase 6.13 that allows

1 the litigation to go forward but make it clear that
2 it is only by permission of this Court and that this
3 Court retains jurisdiction, or could I simply issue
4 an order that removes all issues regarding defaults
5 to this Court?

6 A Not being an attorney, it would be hard for me to
7 answer that. But if there was a way to -- you know,
8 there'd have to be a settlement between the two
9 parties. There may or may not be a discussion
10 between the two parties. It would be great if they
11 could. We want to make sure there's nothing in the
12 final order that would set a precedent that would
13 allow someone else, because someone else was able to
14 intervene in our rehabilitation law and in our
15 jurisdiction, that it wouldn't happen in the future.
16 That would be my -- that's my concern.

17 Q Is there any danger of other defaults other than the
18 Military Housing Project, Inc., claim?

19 A Not to my knowledge.

20 Q And once this is merged back in, there wouldn't be
21 any grounds, right? Alleged grounds?

22 A That's the hope and the reason for 6.13, is there
23 wouldn't be grounds. There wouldn't be alleged
24 defaults. They would all be cured and our
25 rehabilitation statute would be protected.

1 Q And is -- I don't know whether this is something that
2 I should get into with you or get into at all, but is
3 there contemplated litigation by Ambac against other
4 bondholders, policyholders, anybody that is
5 potentially going to trigger a defense that there is
6 a default and, therefore, there's no control rights?

7 A Not to my knowledge.

8 Q So this is, in particular for this particular exit,
9 it's limited to the Military Housing Project
10 interest, and there doesn't appear to be anything on
11 the horizon with respect to any other interested
12 party in terms of a threat to the control rights of
13 Ambac?

14 A That's my understanding, that there are no additional
15 ones. That there's this one and we're trying to
16 protect against it.

17 Q You're trying to protect against this, but your major
18 goal really is to protect the jurisdiction of this
19 Court and the ability of the Wisconsin OCI and
20 rehabilitation courts to go forward in future
21 circumstances?

22 A It really is. If you look at the history in the last
23 50 years, this is kind of unique for a state
24 regulation. We've only had ten insolvencies. We
25 have very good consumer protection laws. And of

1 those ten insolvencies, liquidations,
2 rehabilitations, there's only been two instances in
3 the last 50 years that policyholders haven't been
4 paid 100 cents on the dollar. That's a good record
5 to have, and that's what we're trying to protect and
6 preserve. And it really is for consumer protection.

7 MR. KRAVIT: Your Honor, one comment.

8 We have offered to not oppose 6.13 so long as MHPI is
9 exempted.

10 THE COURT: Well, all right. I don't --

11 I want to get back to --

12 Q I think one of the concerns would be if Mr. Kravit is
13 correct, maybe comity would be stretched beyond what
14 is -- and maybe this isn't a question for you as
15 opposed to a lawyer. But are we stretching comity if
16 we -- when we have these pending actions that were
17 initiated by Ambac which raised affirmative defenses
18 of loss of control rights due to default, I all of a
19 sudden bring those back here where they may very well
20 and probably do belong, are we stretching the bonds
21 of comity or boundaries of comity that these other
22 courts may say, well, you know, we've reached a point
23 where, you know, Wisconsin as a sister state is due
24 comity but this has deprived Mr. Kravit's clients of
25 a forum that was chosen by Ambac to resolve the

1 dispute.

2 A So I couldn't answer the legal piece of that.

3 Q I'm not even sure a lawyer could do that.

4 A Right. I guess the only point I would make or my
5 response to you, Your Honor, would be that even when
6 the IRS was involved in attempting to seize assets by
7 the company, there was an effort and ultimately
8 upheld, I know there was some type of a settlement
9 that ultimately did it, that provided that kind of
10 injunctive relief.

11 But even when the IRS was trying to do it, there
12 was a protection of the rehabilitation process in
13 this state to not have defaults or assets seized when
14 you're trying to rehabilitate a company and sole goal
15 is to make sure there's claims-paying resources to
16 pay the claims now and in the future. And I know
17 that that's --

18 Q The IRS honored that?

19 A The IRS ultimately did by signing and -- I can't say
20 that's why they did. I know there was an agreement.
21 There was an argument in the federal court where they
22 were trying to get around the -- not get around, but
23 move it to a different jurisdiction, and the federal
24 court sent it back to the rehabilitation court.

25 At least there was recognition that there is a

1 process in place for rehabilitations in this state
2 and we're just simply trying to preserve that
3 process.

4 THE COURT: Any further questions or can
5 we let this gentleman go, or should we take a break
6 at this point?

7 MR. KRAVIT: I'd like to ask one
8 question I forgot to ask him, if you don't mind.

9 THE COURT: Go ahead.

10

11 RECROSS-EXAMINATION

12 BY MR. KRAVIT:

13 Q Back to the purchase by Ambac of the D bonds of MHPI
14 of \$72 million, do you agree or disagree that if MHPI
15 had to post \$200 million as the first resource based
16 on Ambac's claims, that the value of the D bonds
17 would go up?

18 A To be honest, I would ask my expert adviser,
19 financial adviser, whether he thought that was the
20 case. I wouldn't be comfortable answering that.

21 Q So you don't know whether Ambac as a strategy bought
22 the D bonds and then tried to force the
23 \$200 million in in order to get a profit, a raise in
24 the value of the D bonds?

25 MR. MERTZ: Objection. Calls for

1 speculation.

2 THE COURT: Well, I think he already
3 answered the question --

4 MR. KRAVIT: The question was does he
5 know.

6 THE COURT: -- and you don't know.

7 A I don't know. Again, I only know that if the
8 department weighed in on the \$70 million, it had to
9 be accretive and provided claims-paying resources to
10 the company.

11 MR. KRAVIT: Thank you. That's it.

12 THE COURT: Anything further, Mr. Mertz?

13 MR. MERTZ: Just one or two quick
14 questions, Your Honor.

15

16 REDIRECT EXAMINATION

17 BY MR. MERTZ:

18 Q Mr. Schwartzer, you testified earlier the plan
19 incorporates the RESA. That's the Rehabilitation
20 Exit Support Agreement; is that right?

21 A Yes.

22 Q And is it your understanding that certain parties to
23 the RESA that signed the RESA and agreed to that
24 could terminate if the plan as filed is not
25 confirmed?

1 A Yes.

2 Q Can you take a look at tab 2 quickly, which is the
3 RESA itself.

4 A Yes.

5 Q And if you go to -- actually, it might be easier to
6 flip from the back. But from the back of that
7 package, three pages in is page 6. It's actually
8 Exhibit A to the RESA. So we're actually in an
9 exhibit to the Rehabilitation Exit Support Agreement.

10 A Page 15?

11 Q No. So keep going to --

12 A Can you give me a section number?

13 Q I guess it's not in the one you have. Sorry.

14 MR. MERTZ: Your Honor, do you have a
15 version with that Exhibit A in it?

16 THE COURT: I don't know what you're
17 talking about. I saw you hand something. I don't
18 have an Exhibit A if it's supposed to be under tab 2.

19 MR. MERTZ: You have the copy. I'll
20 take a look at it.

21 Q Can you look at page 6 of that document I just handed
22 you.

23 A Yes.

24 MR. MERTZ: And my apologies it's not in
25 Your Honor's version.

1 A Yes. I got page 6.

2 Q And at the bottom, can you just review that
3 provision? No need to read it out loud, but can you
4 review it, please? Are you reading the provision
5 that is entitled "No Defaults"?

6 A Halfway through.

7 Q Okay.

8 A Yes. It continues on to page 6.

9 Q And that's Section 6.13, isn't it? The same
10 language?

11 A The same language is Section 6.13.

12 Q So that requirement for 6.13 is within the terms of
13 the RESA itself.

14 A Yes.

15 MR. KRAVIT: I object. Is this signed?
16 Is this adverted to in the agreement you're taking
17 about? Did it come at a different time? There's no
18 foundation.

19 THE COURT: Do you know anything about
20 that document?

21 THE WITNESS: Yeah. This is the term
22 sheet. In each -- the RESA had a term sheet that
23 defined the process by which the transaction would
24 take place between the two parties. It defined the
25 consideration package, and it defined the terms,

1 including -- I believe the term sheet also included
2 the deadlines, when something had to be filed before
3 they could back out. So it was the term sheet of the
4 agreement, structured agreement.

5 Q Let me close the loop on this. Can you go to the
6 first page of the document I just handed you?

7 A Yes.

8 Q And can you read the title of this document?

9 A "Segregated Account of Ambac Assurance Corporation
10 Plan Amendment Term Sheet."

11 Q Term sheet. That's what you were just referring to?

12 A Yes.

13 Q Could you please go back to tab 2, which is the RESA
14 itself.

15 A Yes.

16 Q In the very front, you've got your title page. The
17 very next page includes the recitals.

18 A Yes.

19 Q Is that right?

20 A Yes.

21 Q And can you review and read recital B.

22 A B. Exhibit A here to the rehabilitation exit term
23 sheet and the provisions hereof set forth the key
24 terms of a settlement of the deferred amounts and the
25 segregated account's exit from rehabilitation that

1 are expected to be realized through an amendment or
2 modification (the rehabilitation plan amendment) to
3 the existing plan as defined herein by the
4 Rehabilitator as defined herein.

5 Q Thank you. And if you could page through this
6 Rehabilitation Exit Support Agreement, is it, in
7 fact, signed by the parties, by Ambac, and by the
8 other policyholder groups?

9 A Yes. These were the signature pages that were
10 originally placed in escrow. Yes.

11 MR. MERTZ: No further questions. Thank
12 you.

13

14 REXCROSS-EXAMINATION

15 By Mr. Kravit:

16 Q The existence of that term sheet doesn't change your
17 testimony that if 6.13 is not in the final plan, it
18 will close anyway, it will be sufficient or sustained
19 or --

20 A Durable?

21 Q -- durable?

22 A Yes.

23 Q Is that right?

24 A It would be durable.

25 Q Thank you.

1 THE COURT: Let me ask you this.
2 Obviously, the terrain has changed since July of the
3 RESA up until today because we've had the objections.
4 You've dealt with many of the objections, and you've
5 probably been in communication with all of the
6 interested parties as you were working your way
7 through the process, and it has finally been whittled
8 down to just the Military Housing Projects' objection
9 on 6.13. So everybody involved knows that was going
10 to be at issue here.

11 Has anybody who was a signatory to the
12 RESA indicated that if 6.13 is not included in the
13 ultimate second amended plan that's approved by this
14 Court, that they are not going to sign off?

15 THE WITNESS: No one has indicated to
16 me.

17 THE COURT: You would expect that would
18 come up, wouldn't you?

19 THE WITNESS: I would expect that to
20 come up as COFINA wanted a delay. There was
21 certainly discussions of that as well, but I wasn't
22 involved in those discussion.

23 THE COURT: All right. Anything further
24 or can we let this poor man go?

25 All right. Thank you, sir. You may

1 step down.

2 We're in recess for 15 minutes.

3 (Recess taken)

4 THE COURT: We're back on the record
5 with appearances previously noted.

6 Your next witness, Mr. Mertz.

7 MR. FINERTY: Actually, Mr. Finerty.
8 The Rehabilitator calls Dennis McGettigan.

9 THE COURT: Mr. McGettigan, if you'd
10 come forward and be sworn, please, sir.

11 DENNIS McGETTIGAN,

12 was called as a witness in the above-entitled
13 matter, and after having been first duly
14 sworn, testified on oath as follows:

15

16 DIRECT EXAMINATION

17 BY MR. FINERTY:

18 Q Good morning, Mr. McGettigan.

19 A Good morning.

20 Q Can you please tell the Court, what's your current
21 occupation.

22 A I'm an investment banker.

23 Q Then generally, what's your area of expertise?

24 A Primarily -- my investment banking work is primarily
25 focused in distressed situations, financially

1 distressed situations. And most of my work is
2 focused on the areas of valuation, solvency, and
3 credit risk.

4 Q And what specific skill sets do you bring to this
5 case?

6 A I've got a great deal of skills in financial analysis
7 and quantitative analysis. Those range from
8 discounted cash flow calculations, developing
9 projections, evaluating potential losses and
10 securities, statistical analysis and so forth.

11 Q And, generally, financial modeling?

12 A Yes.

13 Q You've been asked to review and evaluate a consensual
14 transaction in this case and then render some expert
15 opinions.

16 Before we get into your background and foundation
17 and the specifics of those opinions, can you give me
18 a summary of what your two expert opinions are in
19 this case related to the consensual transaction?

20 A Yes. My opinions involve both the fairness and
21 equitableness of the transaction and durability. My
22 opinion with respect to fair and equitableness is
23 that the consideration to be provided to
24 beneficiaries of deferred amounts and general account
25 surplus notes under the consensual transaction is

1 fair and equitable to such holders and beneficiaries.

2 Q And then what about your conclusion regarding
3 durability after merger of the segregated account
4 into the general account?

5 A My conclusion is that following consummation of the
6 consensual transaction on a post-exit basis and Ambac
7 will be able to pay all of its claims in full in cash
8 on a timely basis with a margin of safety to spare.

9 Q Thank you.

10 Let's back up and talk about you, your
11 credentials, educational and training credentials.

12 First of all, tell me, where did you do your
13 undergraduate studies?

14 A I went to the Wharton School of Business of the
15 University of Pennsylvania.

16 Q And did you earn a degree?

17 A Yes, I did.

18 Q In what field?

19 A I got a bachelor of science in economics with a
20 concentration in management.

21 Q Did you attend graduate school after undergrad?

22 A Yes, I did.

23 Q Where did you do that?

24 A I got an MBA, Columbia University.

25 Q Is there a specific area focus of your MBA?

1 A Finance.

2 Q Do you hold any professional licenses?

3 A I am a licensed security supervisor under FINRA.

4 Q What is FINRA?

5 A FINRA is the Financial Institution Regulation
6 Association. It's the successor to the NASD.

7 Q And you're a FINRA securities principal; is that
8 correct?

9 A Yes, I'm a FINRA securities principal.

10 Q That allows you to supervise the investment banking
11 operations of your firm.

12 A That is correct.

13 Q Do you have any teaching experience in the area of
14 investment banking?

15 A Well, shortly after I was made a partner, I was given
16 the responsibility for training of all analysts and
17 associates, which I performed for several years.

18 Q Have you done any industry conferences or speaking to
19 attorney groups in your area of expertise?

20 A Yes, I have.

21 I have participated in a panel discussion at a
22 conference called the Distressed Investing Conference
23 as part of a panel to discuss a transaction that I
24 was involved in.

25 I also was part of a panel discussion at the very

1 beginning of the housing bust, say 2007, to the
2 restructuring bar of the American Bar Association.

3 Q So let's talk about your specific field of expertise.

4 How long have you worked in investment banking?

5 A 21 years.

6 Q What's the first job you had out of undergraduate in
7 the area?

8 A In investment banking or generally?

9 Q Generally after getting your undergraduate degree.

10 A I worked for a company called the Strategic
11 Management Group.

12 Q What did you do for them?

13 A Strategic Management Group was a company that
14 provided executive education to Fortune 500 companies
15 across America and internationally. It was founded
16 by three Wharton professors, and I was recruited out
17 of an M.B.A., class that they taught. Even though I
18 wasn't an M.B.A. they do allow a few undergraduates
19 into the class and I was able to turn that into a job
20 offer.

21 Q What's your current position?

22 A I'm currently a partner of Gordian Group.

23 Q What types of work does Gordian Group do?

24 A We mainly work in troubled situations, financially
25 distressed situations, or occasionally in what I

1 would call storied situations where there's kind of a
2 unique or specialized set of circumstances.

3 Q How long have you been employed by the Gordian Group?

4 A Since mid-1996.

5 Q How long have you been a partner in the firm?

6 A Since January 2004.

7 Q Can you give the Court just, say, two or three
8 examples of some of the more significant transactions
9 that you've been involved in as a financial adviser
10 in distressed situations.

11 A Sure. In distressed situations I was financial
12 adviser to Mississippi Chemical and its bankruptcy
13 restructuring. Mississippi Chemical at the time was
14 one of the largest producers of fertilizer in
15 America.

16 As a storied situation, I was involved in
17 providing financial advisory services to Ben &
18 Jerry's Homemade Ice Cream for several years
19 culminating in the sale of the company to Unilever in
20 2001.

21 Q Can you give us at least an example of any
22 large-scale restructurings or distressed situations
23 specifically in the financial industry.

24 A Yeah. I can think of six relevant experiences.

25 I was involved in five engagements for the

1 benefit of MBIA.

2 Q What's MBIA?

3 A MBIA is another financial guarantor much like Ambac.

4 And the engagements I was involved in, my first
5 was assisting in the remediation of an insured credit
6 associated with the former Spiegel catalog business.
7 MBIA had insured credit card securitization.

8 Q Were there any engagements for MBIA that would be
9 analogous to the work you've subsequently done at
10 Ambac?

11 A Yeah. The other four.

12 First, I worked on a remediation and surveillance
13 of a billion dollar manufactured housing portfolio
14 commencing around 2006 that was covered by a
15 secondary wrap.

16 Q Can you estimate for us over the course of your
17 career, 20-plus years, approximately how many
18 large-scale cases analogous to this have you worked
19 on?

20 A In the financial services field?

21 Q Financial services field or just in restructurings
22 and insolvencies generally.

23 A Large scale, probably in the 30 to 35 engagement
24 range.

25 Q Back in 2008, the Gordian Group was retained by OCI

1 for a discrete transactional project, right?

2 A Yes.

3 Q And then after that project, that led to another
4 engagement in 2009 that is still ongoing today,
5 right?

6 A Actually, the second engagement started also in 2008,
7 but yes, that engagement continues through this day.

8 Q Very good.

9 That engagement was memorialized in a
10 professional services agreement, right?

11 A Yes.

12 Q And that was one of the professional services
13 agreement at the opening of this case that was
14 approved by the rehabilitation court, correct?

15 A That is correct.

16 Q One of the things you've been asked to do currently
17 by the Rehabilitator is to analyze and offer expert
18 opinions on the consensual transaction of this case,
19 right?

20 A Yes.

21 Q Were you provided with the terms of the consensual
22 transaction?

23 A Yes, I was.

24 Q And those terms were memorialized in what is known as
25 the RESA or the Rehabilitation Exit Support

1 Agreement, right?

2 A That's correct.

3 Q Before we get to the specific terms, can you give me
4 a general outline of who the parties are to the RESA
5 and the consensual transaction and how it's set up.

6 A Okay. On the one hand, the parties are Ambac
7 Assurance Corporation and Ambac Financial Group.

8 On the other hand, there's a group -- the initial
9 parties were a group of distressed debt investors:
10 Canyon, CarVal, Centerbridge, and Davidson Kempner.
11 Other parties have subsequently joined, but those
12 four were the initial signatories.

13 Q That's the -- in a general sense, I know it's not
14 specific, but in a general sense, that's a majority
15 of the creditors of Ambac in the segregated and
16 general accounts, right?

17 A Yes.

18 Q Can you generally tell me the terms of the consensual
19 transaction. What does it call for?

20 A It calls for the payment of the following
21 consideration to nonaffiliate third parties.

22 Forty cents on the dollar in cash in respect of
23 either their deferred amounts or surplus notes plus
24 41 cents on the dollar of new secured notes, again,
25 on the dollar of their deferred amounts or surplus

1 notes, plus 12 and a half cents on the dollar of
2 general account surplus notes. In addition, all
3 nonaffiliate third parties experience a six and a
4 half percent discount on the amount of their claim.

5 Q You mentioned the secured note. Have you read and
6 analyzed the secured note terms?

7 A Yes, I have.

8 Q When we say "secured," what is the note secured by?

9 A The note is issued by an affiliate of Ambac. And it
10 is backed by a note in exact principal amount issued
11 by Ambac Assurance. The note that's issued to
12 investors is secured by litigation proceeds up to
13 \$1.4 billion net of reinsurance plus
14 \$350 million of -- \$350 million of market value of
15 RMBS securities.

16 Q Where is that \$1.4 billion supposed to come from?

17 A From the RMBS litigation resolutions.

18 Q So there's a value attached to the perspective RMBS
19 litigation proceeds, right?

20 A Yes.

21 Q Have you evaluated the reliability of those
22 estimates, of those valuations?

23 A Yes, I have.

24 Q What have you done to make sure the value of those
25 RMBS litigations are going to be sufficient to cover

1 the note?

2 A We've done a few things. First, we've looked at the
3 company's history with respect to RMBS litigation
4 proceeds. For example, we have found over time that
5 the company's litigation proceeds have typically been
6 greater than its litigation -- than its remediation
7 credit substantially so, for instance, in the GAPM
8 situation.

9 Q What is the remediation credit? Where would I find
10 that?

11 A The remediation credit is the entry on the company's
12 financial statements that reflects the company's
13 expectation for financial statement purposes of
14 recoveries from the RMBS litigation actions.

15 Q And those are published or filed financial statements
16 by a publicly traded company, right?

17 A They're filed both for Ambac Financial Group, which
18 is the parent of Ambac Assurance on a GAAP basis and
19 they're filed for Ambac Assurance on the statutory
20 financial basis.

21 Q So you relied on the company's published financial
22 statements. Anything else?

23 A We are aware of the damages report submitted in the
24 Capstone/Bank of America/Countrywide case.

25 Furthermore, we have been involved in some

1 summary discussions with Patterson Belknap who is
2 counsel to both the company and segregated account
3 regarding their valuation of the litigation claims.

4 And, finally, we looked notably at the Tier 2
5 transaction.

6 Q Let's talk about the Tier 2 transaction. Tell us
7 what that is.

8 A The Tier 2 transaction provides for \$240 million of
9 new money coming into Ambac Assurance Corporation.

10 Q Why is that significant to your analysis?

11 A Okay. It's significant to my analysis in respect to
12 RMBS in that the primary security, if you will, for
13 this instrument is the right to receive RMBS
14 litigation proceeds in excess of \$1.6 billion net of
15 reinsurance. And they receive all proceeds north of
16 \$1.6 billion up to the accumulated principal and
17 accrued with unpaid interest on their claim.

18 And my experience with investors such as these is
19 that this is not a loss leader investment. They
20 would not be making this investment if they did not
21 think that the money was there to pay that claim with
22 a margin of safety, mind you.

23 Q You also mentioned the discount in the transaction.
24 6.5 percent off of the amounts outstanding -- is that
25 correct? -- to deferred amount holders?

1 A And general account surplus noteholders. That is six
2 and a half points off of the deferred amount total as
3 well as the general account surplus notes with
4 accrued but unpaid interest.

5 Q And how does the discount affect the repayment of
6 principal in policy claims?

7 A Well, it lessens the bar. There's less policy claims
8 that need to be paid.

9 Q Let me rephrase that question.

10 In taking a discount or agreeing to a discount,
11 are there any deferred amount beneficiaries or
12 general account surplus noteholders in a material
13 amount that are giving away principal in the
14 discount?

15 A Oh. Certainly no general account surplus
16 noteholders. I believe there is a very small amount
17 of deferred amount beneficiaries who the discount
18 does eat into a portion of their principal at an
19 immaterial level.

20 Q So other than immaterial exceptions the consensual
21 transaction allows for the payment of principal and
22 all deferred amounts.

23 A Yes.

24 Q If this plan is approved and the transaction closes,
25 what happens next?

1 A There will be -- the segregated account will be
2 merged into the general account.

3 Q And then what does this subsequently mean once the
4 merger takes place for policyholders that had their
5 policies in the segregated account but are now in the
6 merged account?

7 A There's really two categories. According to the new
8 payment guidelines any segregated account policy that
9 presented claims commencing October 1st through the
10 date of consummation will be paid 45 cents on the
11 dollar for every validly presented claim. And then
12 upon consummation would receive 55 cents on the
13 dollar. So paid in full without accretion.

14 Any claim that is presented after the
15 consummation date will be paid in full in cash upon
16 presentment.

17 Q So the conclusion then is once the transaction closes
18 anyone in the segregated account -- or any policy in
19 the segregated account that was getting 45 cents on
20 the dollar will now get 100 cents on the dollar.

21 A They will be treated on equal footing as general
22 account policyholders.

23 Q Let's go to expert opinion No. 1. Fair and
24 equitable.

25 Now that you've looked at this transaction,

1 you've looked at the secured note, the Tier 2
2 financing, the discount, what's your conclusion about
3 whether or not this transaction is fair and equitable
4 to segregated account holders?

5 A My conclusion is that the consideration provided
6 under the consensual transaction is fair and
7 equitable to both beneficiaries of deferred amounts
8 and holders of general account surplus notes.

9 Q And you hold that opinion to a reasonable degree of
10 certainty in your field.

11 A Yes.

12 Q What's the basis for your opinion?

13 A Several bases.

14 The first basis is I compared the value that
15 would be available to segregated account policy
16 beneficiaries as well as general account surplus
17 noteholders under the status flow plan including a
18 very aggressive but hypothetical increase, set of
19 increases, in the interim payment percentage, none of
20 which OCI has approved and has any intent -- or has
21 made any statements regarding whether those will take
22 place. And I compared the value that would be
23 available to the affected holders under that adjusted
24 status quo case to what they would receive under the
25 plan and found that the plan provided greater value.

1 Q Was there any consideration give to the amount of
2 principal paid to the deferred amount holders?

3 A Principal of --

4 Q The fact that their principal is being paid
5 100 percent.

6 A Certainly, I know that meets a statutory requirement,
7 so that is a relevant point.

8 Q And then there's consideration given to the fact that
9 future claims by segregated account policyholders
10 would be at 100 percent?

11 A Yes. Absolutely there's value to long-tail
12 segregated account claimants who are currently being
13 paid 45 cents on the dollar to, again, be paid in
14 full in cash whenever they present a valid claim. So
15 that's certainly an additional point of value.

16 Q Was there also a consideration given to the quality
17 of the consideration in the consensual plan versus
18 what deferred amount holders were getting essentially
19 an IOU?

20 A Absolutely.

21 Q Can you explain why that's important.

22 A Yeah. It's -- I would say it's a very important
23 consideration and that's as follows.

24 Under the current plan segregated account holders
25 of deferred amounts or beneficiaries of deferred

1 amounts have an instrument that can be paid only upon
2 OCI's -- I'm sorry, the Rehabilitator's approval. So
3 that might not happen for a year. That might not
4 happen for ten years. Depends on conditions. And
5 the quantum of payment is at the discretion of OCI.

6 In contrast, under the plan beneficiaries receive
7 40 cents on the dollar in cash. No time and concern.
8 No question. Cash is cash.

9 Secondly, they receive a secured note worth
10 41 cents on the dollar of their claim. That, in my
11 judgment, is a superior interest instrument to the
12 deferred amount in many respects. It has a higher
13 interest rate. It has a floating interest rate. It
14 has -- it is -- the terms of the secured note require
15 it to be paid down within, I believe, seven days in
16 the event of receipt of proceeds from the -- from any
17 RMBS litigation. And it must be paid in full within
18 five years. And it is supported by an
19 Ambac Assurance financial guarantee policy.

20 So all of those factors make it materially
21 superior to the current deferred amounts that folks
22 currently hold.

23 Q Two other considerations I'd like you to explain to
24 us.

25 At the top of this topic of testimony you

1 mentioned holders -- third-party nonaffiliated
2 holders of deferred amounts. Is there differing ways
3 under this transaction that Ambac or AFG are treated?
4 A Yeah. AFG holds surplus notes in -- issued by either
5 AC or the segregated account. Due to certain
6 transaction requirements, AAC does not receive any
7 cash in the distribution. So while a nonaffiliate
8 third party receives 40 cents in cash and 41 cents in
9 new secured notes, Ambac receives no cash -- I'm
10 sorry, Ambac Financial Group receives no cash in
11 exchange for its holdings of surplus notes and
12 deferred amounts, if they still have any. They do
13 receive approximately 52 cents on the dollar in new
14 secured notes and the remainder of their
15 consideration is in surplus notes. And those surplus
16 notes I perceive to be the least valuable form of
17 consideration that's being provided in the
18 transaction. Where nonaffiliates are getting 12 and
19 a half cents on the dollar of surplus notes, Ambac, I
20 believe, is getting 42 cents.

21 Q So in your judgment has Ambac agreed to be treated
22 less favorably under the terms?

23 A Yes. Ambac Financial Group.

24 Q Ambac Financial Group.

25 You also made reference to a \$350 million pledge

1 of RMBS litigation proceeds. What was that in
2 reference to?

3 A Oh, if I said that, I misstated.

4 The secured note is -- secured note also has
5 collateral of \$350 million of market value of RMBS
6 securities, not -- they also have the right to
7 receive up to \$1.4 million -- billion dollars of RMBS
8 litigation proceeds.

9 Q So Ambac is pledging actual securities towards the
10 collateral as well.

11 A That's correct.

12 Q So then in your opinion that transaction's fair and
13 equitable to the deferred amount beneficiaries and
14 general account noteholders.

15 A Yes.

16 Q Expert opinion No. 2 regarding durability of the
17 company post-exit. Can you tell us what your opinion
18 is on that.

19 A My opinion is subsequent to the transaction -- or
20 upon consummation of the transaction Ambac will be
21 able to pay all claims in full in cash on a timely
22 basis across the relevant range of scenarios with an
23 acceptable margin of safety or room to spare.

24 Q In light of that and in your opinion, has the purpose
25 of the rehabilitation been accomplished?

1 A Yes, it has. In part because of the durability of
2 the exit but in part for other factors.

3 First off, my view is that maintaining the
4 segregated account would have -- regenerate little
5 marginal benefit in terms of further remediation of
6 the credits that were allocated to the segregated
7 account. If we kept this going on for several more
8 years, I don't see many more commutations that could
9 be done, anymore risk reduction that could be done.
10 So primary purpose of the rehabilitation met. The
11 fact that we can now exit rehabilitation under
12 durable structure suggests -- essentially
13 demonstrates that not only has it been met but we can
14 now become a fully integrated company again as
15 opposed to a company with two separate accounts, if
16 you will.

17 Q I'd like to introduce a couple of exhibits. They are
18 already exhibits in evidence, but I want to highlight
19 a couple of things. It's the expert report under
20 tab -- Tab 4 is your expert report. It's Exhibit C
21 to Dan Schwartzer's affidavit?

22 A Yes.

23 Q If you could turn to that. Specifically turn to
24 page 17 of that.

25 Have you done a calculation related to your fair

1 and equitable opinion that the deferred amount
2 beneficiaries' internal account surplus noteholders
3 are better off under this plan than they are under
4 the status quo?

5 A Yes, I have.

6 Q That's found on page 17?

7 A The summary of that analysis is found on page 17,
8 yes.

9 Q Can you give us a brief explanation of what this
10 chart is that we're looking at on page 17.

11 A Okay. We looked at the respective value available
12 under both the status quo with, again, several
13 increases in the interim payment percentage versus
14 the consensual transaction. And we did this across a
15 relevant range of market discount rates that I
16 calculated.

17 The first column, that's called status quo. I
18 draw your attention to the bottom three numbers that
19 range from 78. That relates to a 78 percent recovery
20 of deferred amount principal, a deferred amount
21 balance and/or general account surplus note balance.
22 And that number -- and that's at the lowest discount
23 rate applicable to the status quo, a 78 percent
24 recovery. And at the highest discount rate
25 applicable to the status quo, I project a 75 percent

1 recovery.

2 Compare those numbers to the far left-hand
3 column. The far left-hand column assumes --
4 estimates that the total recovery available to these
5 same beneficiaries under the transaction ranges from
6 83 percent -- in fact, actually stays at 83 percent
7 across the board, and that's a function of the fact
8 we make no assumptions of surplus note distributions
9 other than the interest payment that's contemplated
10 in the RESA at the close of the transaction.

11 All other distributions on the surplus note were
12 assumed occur at the end of the projection period in
13 2054. And I look at that and I say 83 across the
14 board is certainly superior to 78 to 75.

15 Q You've also committed your durability analysis to
16 writing in your expert report somewhere. I'm
17 searching for it. I thought it was on page 19.
18 Maybe you can find it for me.

19 A I would actually suggest page 24.

20 Q There we go. Can you explain to me what we're
21 looking at.

22 A First off, the margin of safety that we use here is
23 an economic capital construct, which means at any
24 given point in time they're taking the present value
25 of all claims-paying resources, whether investment

1 portfolio cash flows, installment premium receipts,
2 ultimate distribution of value from Ambac UK, and any
3 other cash inflows.

4 Subtracted from that are any projected cash
5 outflows associated with operating expenses, policy
6 losses, or tax for tolling payments.

7 Please note that other than the initial surplus
8 note payment -- interest payment that's contemplated
9 by the RESA, the margin of safety does not calculate
10 any distributions on surplus notes subsequent to that
11 initial interest payment.

12 So at any given time we're measuring the
13 difference between the present value of the cash
14 inflows less the present value of the cash outflows.

15 And across our four scenarios, scenario one is
16 our most optimistic scenario. And in this report we
17 calculated a margin of safety of \$1,254,000,000 in
18 present value terms.

19 And our most conservative scenario, scenario
20 four, we calculated a margin of safety of
21 \$637 million, again, in present value terms. The
22 four scenario average was not \$146 million.

23 Q So what you've just described is really your
24 financial model, right?

25 A That's, say, a metric that attempts to summarize the

1 financial model. It is important to note that like
2 any metric it has to be interpreted within the
3 context of the assumptions in the model. We have
4 always been charged with coming up with an
5 independent conservative view of the company's
6 finances, and I interpret those numbers in that
7 context.

8 Q So just by way of explanation so that the Court knows
9 what it's looking at here, scenarios one and two are
10 referred to as your base-case scenario, right?

11 A Yes. Although there are three primary variables that
12 change. So for clarification let me --

13 Q Hold on. Before you get to that, the base case and
14 then three and four are the stress-case scenarios.

15 A They're stress cases, yes.

16 Q What's the difference between base case and stress
17 case? And not in terms of assumptions, but just
18 generally in terms of what they are meant to
19 represent.

20 A Base case in general reflects less extreme
21 assumptions across the board. The stress case, you
22 would assume, as you would expect, reflects more
23 severe assumptions but at all times within what I
24 believe to be relevant range. And we have been using
25 a four-scenario model since the original disclosure

1 statement and continually updating the relevant range
2 with commutations, business developments, et cetera.

3 Q To summarize, the base cases one and two would be
4 what you would normally expect to happen. That would
5 be business as usual, right?

6 A Yes.

7 Q So I cut you off. Before you were going into
8 explaining a little bit more about your assumptions
9 and what assumptions change across the four
10 scenarios.

11 A Okay. Scenarios one and three use our base-case
12 losses, our lower loss assumptions, which are still
13 quite substantial.

14 Scenarios two and four -- I'm sorry. Let me
15 re-say that. Scenarios one and two use our base-case
16 loss assumptions. Scenarios three and four use our
17 stress-case loss assumptions. Scenarios one and two
18 use our higher values for both RMBS litigation
19 proceeds and our higher values for Ambac UK proceeds
20 that are repatriated. Although we assume that
21 doesn't occur until 2036. Scenarios two and four
22 incorporate our most conservative assumptions
23 regarding RMBS litigation proceeds as well as our
24 most conservative assumption regarding Ambac UK
25 proceeds.

1 So in effect, scenario one represents, you know,
2 the -- within our relevant range the most best -- the
3 most optimistic outcomes of all three primary
4 variables. Scenario four represents the most
5 conservative assumption of all three core variables.

6 Does that make sense?

7 Q Yes. To me.

8 A Is there a second?

9 THE COURT: I'll second that.

10 THE WITNESS: Thank you.

11 THE COURT: That is makes sense to him.

12 Q Let me ask you a little bit off-topic question here.

13 The report dated September 22nd, was there any
14 consideration given and what was the state of affairs
15 generally that you're aware of with the economy in
16 Puerto Rico?

17 A Well, Hurricane Maria hit on September 20th. And
18 there was very little visibility at that time
19 regarding what the effect would be. We knew that
20 Irma had a much more modest effect. But you really
21 didn't start getting news out of Puerto Rico until
22 after this report was filed. And I can -- that's
23 demonstrable by looking at changes in security
24 prices.

25 Q Let's back up a year.

1 A Oh, a year.

2 Q What occurred in June of 2015?

3 A In June of 2015, the then governor of Puerto Rico
4 announced that he believed that the debts of
5 Puerto Rico to be unpayable.

6 Q General obligation bonds defaulted, correct?

7 A His statement was that cumulatively, all debts were
8 unpayable. I don't believe that there -- I think
9 there was a small default of an instrumentality in
10 November, but the primary defaults occurred on
11 January 1st of 2016. There was quite a scramble on
12 the 29th and 30th of June to see whether there would,
13 in fact, be a default on July 1st, but that did not
14 occur.

15 Q You follow those developments in Puerto Rico?

16 A Yes, I do.

17 Q Do you follow how Ambac reacts to those developments
18 in Puerto Rico as well?

19 A I follow -- we have access to confidential Ambac
20 information. I also track research reports from
21 various sources. I look at securities price. I look
22 at publications in the press. I try to grab
23 information from every source that's available to me.

24 Q So is the announcement in June of 2015 and the
25 subsequent defaults of January of 2016 in Puerto Rico

1 accounted for in your September 22nd report?

2 A Yes. And, in fact, we had assumed at that time what
3 we thought were material losses with respect to
4 Puerto Rico before that announcement was made and
5 prior iterations of our model.

6 Q Can you turn to Tab 5, which is the updated
7 Dennis McGettigan expert report.

8 A Uh-huh.

9 Q A few things have changed since you filed your
10 September 22nd report. Three things in particular
11 I have in mind. Can you tell us what those are.

12 A Yes. First off, the company consummated several
13 value creation and/or derisking transactions that had
14 a net positive effect on the margin of safety.

15 Secondly, the company increased its assumptions
16 regarding loss allocation expenses which had a net
17 negative effect on margin of safety.

18 And, third, following our due diligence
19 subsequent to the filing of the September 22nd
20 report, I elected to increase prospected projected
21 losses in Puerto Rico substantially, which had the
22 largest single effect on the new margin of safety.

23 Q Let's talk about that for a second. You mentioned
24 due diligence. What type of due diligence did you do
25 to reach your revised increase Puerto Rico loss

1 estimates?

2 A I have been, first off, with Special Deputy
3 Commissioner Schwartz and Kelly Flanagan of
4 Jefferies we did our due diligence where we met with
5 government officials, business leaders, legal
6 professionals, et cetera, and members of the
7 professional financial oversight board and staff.

8 Secondly, I've been tracking research reports
9 pretty vigorously in terms of people's expectations
10 of recoveries, expectations of liquidity. Obviously
11 I've been tracking developments in government and the
12 House of Representatives and the Senate regarding
13 disaster recovery bills and so forth.

14 Have looked at market prices and particularly
15 relative market prices of various instruments and
16 have explored other areas that became interesting
17 following my further research.

18 Q And then you also have access to loss estimates of
19 the company, right?

20 A I do.

21 Q And their financial advisers?

22 A I have access to loss estimates of a company. And we
23 also did have meetings with agents who have been
24 involved -- had been involved in the mediation
25 efforts that -- prior to Hurricane Maria. So we

1 had -- so I developed some understanding of how that
2 process was moving ahead.

3 Q And obviously we've heard extensively from the COFINA
4 bondholders.

5 A Yes, we have.

6 Q If you turn to page 8 of your update to your expert
7 report. Explain to us what the effect of the margin
8 of safety has been on your updated loss estimates.

9 A At a macro-level the margin of safety declined from
10 the September 22nd report to the December 11th
11 report. We endeavored to break this out modularly so
12 people could see the effects of the three core
13 changes.

14 So if go to top of page 8, the first line is the
15 margin of safety by scenario as reflected in the
16 September 22nd report. Then we adjust for
17 accretive transactions and other updates because we
18 did also update the projection model. The model we
19 used on September 22nd started on March 31st. We
20 rolled forward as we normally do in the ordinary
21 course of business to a June 30th starting point.
22 All those adjustments on average -- and I'm looking
23 at the mean for scenario average or mean -- had an
24 average impact of increasing the margin of safety by
25 \$203 million.

1 The second set of changes was the increase in
2 loss allocation expense which are monies spent to
3 reduce the possibility of a claim or reduce the size
4 of a claim. That has an average effect across the
5 four scenarios of reducing the margin of safety by
6 \$128 million. Again, all on present value terms.

7 The most significant adjustment was the increase
8 in Puerto Rico losses. Puerto Rico losses increased
9 by more than \$400 million in our base-case scenarios
10 and by more than \$250 million in our stress-case
11 scenarios for a scenario average of \$350 million.

12 The net effect was, across the four scenarios, a
13 29 percent reduction in margin of safety on a
14 percentage basis in total dollars, a four-scenario
15 average of \$275 million in present value terms.

16 Q So in our base-case scenario, margin of safety
17 scenario one decreased from \$1,254,000,000 down to
18 \$864 million.

19 A That is correct.

20 Q And the same thing with respect to scenario four,
21 \$637 million down to \$476 million.

22 A Yes.

23 Q So then the \$64 million question is what's your
24 conclusion as to the durability of the company
25 post-exit after revising these losses?

1 A The company is durable post-exit.

2 Q Meaning it has the capacity to pay on a going-forward
3 basis 100 percent.

4 A It has the ability to pay all presented claims when
5 due in full in cash on a post-exit basis.

6 Q I don't want to spoil the surprise for the end of
7 your testimony, but there's been some additional
8 commutations that would increase that margin of
9 safety; is that correct?

10 A That is correct. And those have occurred from
11 December 12th through the end of 2017.

12 I think one of -- if I can say this, our
13 projections are -- you know, reflect our best
14 estimates at any given time. However, the company,
15 if I could use a phrase one of my partners uses, it's
16 like an atom in motion. As soon as we reflect a
17 transaction, there's more derisking opportunities in
18 the pipeline. And so at any given -- so the
19 company's financial position is not static. And I
20 expect -- we do not incorporate those in the
21 projections until such transactions are consummated.
22 But I know that there is a funnel of opportunities
23 that the company is evaluating today.

24 Q Very good. I've got a couple more questions on your
25 model and its application and then we'll have a

1 transition over to discuss Puerto Rico again.

2 You've already discussed a little bit about the
3 methodology that you've used in preparing these four
4 scenarios. Do you have anything to add to that to
5 make sure that we've got your full calculus and the
6 full methodology you used to develop this financial
7 model out?

8 A I would say that we have been charged since the
9 beginning of our engagement with coming up with a
10 conservative, independent view. We obviously get
11 Ambac financial information, but we also get
12 information from other parties and we use this model
13 as imputed with judgment since, really, the
14 beginning. Accordingly -- and it is certainly
15 possible that two sets of people can look at the same
16 information and come to different judgments. Our
17 judgment -- what's reflected in the model reflects
18 our best judgment regarding the relevant range of
19 outcomes in this situation at this time.

20 Q So you've used this model before to evaluate other
21 commutations, right?

22 A Yes.

23 Q Are you familiar with the bank settlement agreement?

24 A Yes, I am.

25 Q So we're going to dial the clock back to about 2009,

1 2010, right?

2 A Yes.

3 Q Can you tell me what is the bank settlement agreement
4 and generally what it involved.

5 A The bank settlement agreement had three primary
6 outcomes.

7 It resolved -- it involved the settlement of
8 approximately \$16.5 billion of housing-related
9 collateralized debt obligations between, on one hand,
10 AAC and, on the other hand, 16 international banks.
11 And those claims were settled for \$2.6 billion in
12 cash and \$2 billion of general account surplus notes.

13 Secondly --

14 Q Before you get to secondly, approximately how many --
15 what dollar value of obligation is at stake in this
16 consensual transaction?

17 A Okay. The net par was about \$16.5 billion. As part
18 of this process, the banks and Ambac agreed to have a
19 third party evaluate the losses associated with these
20 claims.

21 Q Oh, no. Hold on. I'm asking you a different
22 question.

23 The bank settlement agreement involved
24 \$16 billion in obligations, you testified to.

25 A Yes.

1 Q Contrast that with the current consensual transaction
2 that we just talked about --

3 A Less than \$4 billion.

4 Q Okay. About 25 percent. All right.

5 A Yeah.

6 Q Sorry to interrupt. Go ahead.

7 A I apologize.

8 But for context, the \$2.6 billion in cash and
9 \$2 billion in surplus notes compared to what were
10 estimated economic damages in present value terms of
11 somewhere between \$7.6 billion and \$9.1 billion. So
12 it was a very accretive transaction. And our
13 analysis of it was that it would provide for a --
14 combined with a rehabilitation and implementation of
15 an interim payment percentage, it would provide for
16 durable coverage in the general account.

17 Q And you were, in fact, asked by OCI to give an
18 opinion as to durability in the general account and
19 its ability to pay claims after consummation of that
20 transaction, weren't you?

21 A That's correct.

22 Q What was your conclusion?

23 A That it was durable.

24 Q Were there any objections to the bank settlement
25 agreement?

1 A I believe there were. And I believe that they were
2 overruled.

3 Q And the bank settlement agreement was subsequently
4 approved by the rehabilitation court, right?

5 A Yes. In June 2010.

6 Q After the transaction closed, has the company, in
7 fact, been able to pay its general account claims in
8 full ever since?

9 A Yes.

10 Q Are there any other transactions, significant
11 commutations or major transactions that you've
12 applied the same durability model to?

13 A Probably the next one of note would be the exercising
14 of certain call options associated with some of the
15 general account surplus notes issued in the bank
16 settlement agreement.

17 Q That would be the 2012 call option issue that came
18 before the Court?

19 A That's right. Yeah. I think the call options
20 expired in the second week of June. So in late
21 April, early May, we worked with the Rehabilitator
22 and other advisers to determine whether it was in the
23 best interest of policyholders generally to implement
24 that transaction. We came to the conclusion that
25 implementing the transaction was in the best interest

1 of the policyholders; and, secondly, that after
2 giving the effect to the payments associated with
3 exercising the call options the general account would
4 be durable.

5 Q And, in fact, ever since then has the general account
6 been durable? Been able to pay its claims on a
7 going-forward basis?

8 A Yes.

9 Q Why don't you give us the second example you
10 mentioned.

11 A Yeah, the other example would be in the second
12 quarter of 2014, when the Rehabilitator decided to
13 increase the interim payment percentage from 25 cents
14 on the dollar to 45 cents on the dollar for
15 segregated account claims. That decision requires an
16 effective true-out payment. So to the extent that
17 policyholders had previously been paid 25 cents on
18 the dollar, the increase to 45 cents required that
19 the true-up folks who were to get paid 25 cents up to
20 45 cents.

21 Q You had conducted a durability analysis to find out
22 if the company had enough money to make those
23 payments.

24 A Yeah. Increasing the IPP to 45 percent generated
25 more than \$1 billion in cash outflows to third

1 parties. We did have to perform a durability
2 analysis and determine its general account was
3 durable with respect to that transaction.

4 Q In fact, the company has been durable ever since you
5 rendered that opinion, correct?

6 A That is correct.

7 Q It's been able to pay its claims?

8 A That's correct.

9 Q Are you aware of any unpaid general account claims?

10 A No, I am not.

11 Q So the current iteration of the model that you've
12 used to render an opinion on the consensual
13 transaction is the same model or an earlier iteration
14 of the one that you used back in 2010 for the bank
15 settlement agreement?

16 A Earlier iteration based on the facts and market
17 conditions and circumstances that existed at that
18 time.

19 Q And you'd expect the same outcome with respect to
20 your durability opinion with respect to the
21 consensual transaction as you've experienced with the
22 prior commutation, right?

23 A Yes. We've been looking at this for a long time.

24 MR. FINERTY: Your Honor, I'm going to
25 switch topics over to address just a couple of the

1 COFINA objections and then the reinvestment rate
2 objections and then I can get to Mr. Kravit. If
3 now's a good time to take a lunch break, maybe it's a
4 good topic change point.

5 THE COURT: It would be a good time for
6 a break. I'm concerned everybody getting a lunch
7 with this big crowd downstairs. There is a
8 restaurant across the street. You can ask others
9 whether it's any good. Do you need an hour and a
10 half or an hour?

11 MR. KRAVIT: I prefer an hour. I'd like
12 to really try to get done today, Judge.

13 MR. FINERTY: I agree.

14 THE COURT: We'll be back at 1:00.
15 We're in recess. Thank you.

16 (Lunch recess taken)

17 THE COURT: We're back on the record
18 with appearances previously noted.

19 Before we get going, first of all,
20 Ms. Neider, I neglected to allow you to question
21 Mr. Schwartzer. If you want that opportunity, I'll
22 certainly allow you to have it.

23 MS. NEIDER: Thank you, Your Honor.

24 THE COURT: But hearing nothing at this
25 point, we'll go ahead with the continued direct

1 examination of Mr. McGettigan.

2 Mr. Finerty.

3 BY MR. FINERTY:

4 Q Mr. McGettigan, I want to clean up one issue related
5 to the RESA that we talked about earlier.

6 You indicated that the consensual transaction
7 provides for the payment of principal of all
8 outstanding deferred amounts but with an immaterial
9 exception. You recall that?

10 A I do recall that.

11 Q Are you aware that RESA had been amended from the
12 original RESA with a September of 2017 amendment?

13 A Yes, I am.

14 Q And you've read that document?

15 A Yes, I have.

16 Q And that provides for the payment of that remaining
17 outstanding principal that's not covered by the
18 transaction?

19 A It ensures that all deferred loss amounts which are
20 the principal component are paid in full.

21 Q So the net result at closing of the consensual
22 transaction will be that all principal of outstanding
23 amounts due under the segregated account and general
24 account, surplus noteholders will be paid in full; is
25 that right?

1 A Yes, that is correct.

2 Q All right. Let's turn to a couple of issues related
3 to Puerto Rico. And we've already talked a little
4 bit about Puerto Rico and Hurricane Maria being
5 included in your supplemental report.

6 But there was an objection raised by the COFINA
7 bondholders in an argument made that there was a
8 possibility that the COFINA bondholders could receive
9 no recovery or have no recovery or get zero.

10 Are you familiar with that objection?

11 A I do recall that objection.

12 Q Okay. As a foundational matter, let me get a few
13 things out.

14 COFINA bonds are issued by an instrumentality of
15 the Commonwealth of Puerto Rico, right?

16 A Yes. One that's established by statute.

17 Q Can you contrast those -- first of all, how are those
18 repaid?

19 A From the proceeds of the sales and use tax.

20 Q And that's tax on what?

21 A That's a tax on clothing, food, restaurant meals,
22 furniture --

23 Q Basic staples.

24 A Staples.

25 Q Can you contrast that with general obligation bonds

1 issued by the Commonwealth?

2 A They are backed by the full faith and credit of --
3 generally of the Commonwealth but particularly from,
4 say, property taxes or income taxes or similar sorts
5 of taxes.

6 There's also provision in Puerto Rico
7 constitution for them to claw back revenue from
8 certain entities, certain revenue bonds under certain
9 specific instances.

10 Q And the general obligation bonds are the ones we
11 referred to earlier when we were discussing the
12 default of January of 2016.

13 A They were not the only bonds to default at that time.
14 I believe at least four -- at least three or four
15 different issues related to Puerto Rico defaulted at
16 that time of which Ambac insured two.

17 Q And is it correct to say that the COFINA issue is
18 really a dispute over whether or not the general
19 obligation bondholders can draw upon the sales and
20 use tax that are dedicated to the COFINA bondholders
21 to be repaid, right?

22 A Yes.

23 Q And their argument -- the general obligation
24 bondholders is that the COFINA structure itself is
25 unconstitutional under Puerto Rico's constitution,

1 correct?

2 A That is their argument.

3 Q And you've read Puerto Rico's constitution, haven't
4 you?

5 A I have read pieces of Puerto Rico's constitution.

6 Q But that's the issue that we've also discussed
7 previously and at the pretrial being subject to
8 mediation before the federal judges in New York,
9 right?

10 A That's right.

11 Q Did you consider the possibility that COFINA bonds --
12 well, first of all, Ambac owns a certain percentage
13 now of COFINA bonds, right?

14 A Yeah. I believe it's around 57 percent.

15 Q So there's still some outstanding that they insure,
16 right?

17 A That is correct.

18 Q Have you considered the possibility that COFINA
19 bondholders have a zero recovery?

20 A I considered the possibility that that could occur
21 and rejected it for a variety of reasons.

22 Q Why did you reject it?

23 A First and foremost, I believe that -- I work on the
24 assumption that laws that have been validly
25 established by the statute -- by the legislation of

1 the Commonwealth of Puerto Rico, signed into law by
2 the governor are, you know, are the law today. No
3 monies that have been provided to -- that have been
4 allocated to COFINA have been distributed anywhere
5 else. I assume that law will be valid.

6 Q So you've assumed the law is valid and enforceable.

7 A Yes.

8 Q Any other market or financial reasons or market
9 indicators that you believe indicate that COFINA is
10 valid?

11 A Well, I take -- I don't believe that market pricing
12 is dispositive in terms of recovery levels. However,
13 relative pricing is very interesting.

14 I note, for instance, that senior COFINA bonds
15 traded around 40 cents on the dollar. In contrast,
16 general obligation bonds traded around 24, 25 cents
17 on the dollar, about a 50, 55 percent premium. I
18 look at that and I say, at this point sophisticated
19 investors are making determinations that the COFINA
20 bond indenture will be valid and that -- because you
21 want to be paying 40 cents for something that's worth
22 zero; and, secondly, the ultimate recovery on COFINA
23 bonds will be superior through that of the general
24 obligation bonds. And that would be inconsistent
25 with a zero COFINA outcome.

1 Q One of the criticisms of your report by the COFINA
2 bondholders was that market prices for bonds apply a
3 greater loss than Ambac could withstand.

4 A Hmm.

5 Q If you turn to Tab 8 in your binder, these are the
6 charts that the COFINA bondholders put in there.

7 A Yeah. Well --

8 Q The first one is actually the COFINA price chart and
9 the second one is the G.O. or general obligation bond
10 price charts. What do you deduce from those two
11 charts?

12 First of all, do the short-term bond prices
13 reflect a concern about durability in your mind?

14 A No, they don't.

15 I would say that these bond prices tell me
16 several things.

17 First, I do -- it's obviously indicative of
18 concerns regarding short-term value lost as well as
19 the potential for a long-term diminution of value.
20 And I do believe that -- while I believe that
21 Puerto Rico will recover, I do believe that the
22 distributable value available on restructuring has
23 declined as a result of Hurricane Maria, and that's
24 reflected in the increase in loss assumptions in the
25 supplemental report.

1 In terms of the prices, I once again would
2 reference the fact that COFINA here was trading just
3 about -- looks like it was just at 40. It's
4 really -- it's bounced around between 38 and 40 since
5 the end of this graph, since I think this graph ends
6 in mid-November. The G.O. bonds have traded down
7 just a little to 23 to 24. So my earlier point holds
8 this with graph.

9 Finally, I make a point that people buy and sell
10 bonds for all kinds of reasons just like those of us
11 in everyday life buy and sell securities for all
12 kinds of reasons. I'm sure some people in this room
13 sold some securities during December for tax
14 planning. I would expect that some investors in
15 these bonds saw the example of Hurricane Maria and
16 said we've been in the steal for two or three years,
17 now it's going to take two or three or four more
18 years to resolve this. I don't have that patience.
19 So to suggest that these prices represent intrinsic
20 value I think is a misrepresentation.

21 Q And really, too, the COFINA bonds mature and pay
22 when?

23 A The ones we insure -- we insure two series. They're
24 both capital appreciation bonds, so no interest is
25 payable until the final day of maturity. The smaller

1 series comes due in 2047. The other series comes due
2 in 2054.

3 Q Are there any other practical concerns that would
4 lead you to believe that a COFINA zero outcome is
5 outside the relevant range of possibilities?

6 A Well, I do note that over the last ten years more
7 than \$200 billion of municipal market debt has been
8 sold that are securitizations of future tax revenue,
9 which is what COFINA is.

10 Q You're talking about sales of bonds outside of
11 COFINA?

12 A Outside of COFINA.

13 Q Outside of Puerto Rico.

14 A Outside of Puerto Rico. Outside -- you know,
15 New York has done it. California's done it,
16 Massachusetts has done it. Many states have done
17 this. Many cities and municipalities have done this.
18 I believe Chicago is setting up something similar as
19 we speak.

20 If this sort of structure were deemed to be
21 unconstitutional, that would create problems both for
22 Puerto Rico in terms of their -- impairing their
23 access to capital to restructure as well as create
24 chaos in a municipal market.

25 Q Are there any other instances that you can think of

1 in which this municipal bond structure has actually
2 been upheld in court?

3 A Yeah. I'm sorry, yes. In respect to the
4 Orange County municipal bankruptcy, which I think
5 goes back about 20 years, there was specific language
6 that addressed under what conditions the statutory
7 lien could be established. It was determined in
8 Orange County that certain language resulted in the
9 perfection of a statutory lien. And the COFINA
10 structure has language that mirrors the Orange County
11 language.

12 THE COURT: Does that even bear any
13 relationship here where the challenge is under the
14 Puerto Rican constitution, not just generally whether
15 these are accepted throughout the states?

16 THE WITNESS: I think it does. Because
17 at the end of the day these -- you know, these
18 rulings at some level have to be uniform for markets
19 to function. If a statutory lien has the same
20 language in Puerto Rico as it does in California --
21 if an instrument has the same language in Puerto Rico
22 versus California but over here it's a statutory lien
23 and over here it's something else, that creates a
24 challenge for financial markets. There have to be
25 some standards.

1 THE COURT: Well, sure, but the
2 standards, at least in Puerto Rico, have to conform
3 with the Puerto Rican constitution, apparently, and
4 they're willing -- at least somebody's taking the
5 position that it doesn't matter what the markets say,
6 it's unconstitutional.

7 THE WITNESS: They have taken that
8 position. In my own personal view that is a position
9 that has been taken to drive the parties to a
10 mediated resolution.

11 THE COURT: Maybe I should try that.

12 THE WITNESS: Lock everybody in a room,
13 right?

14 THE COURT: Right. And spout untenable
15 legal propositions.

16 BY MR. FINERTY:

17 Q One last question. I won't belabor the COFINA point
18 anymore.

19 Assume the unthinkable happens and there is a
20 ruling of unconstitutionality from a federal district
21 court judge, it's upheld on appeal out to 2054,
22 COFINA gets zero. Is there any -- what's the net
23 impact on Ambac? And can you tell definitively?

24 A Well, it's difficult to say definitively. What is
25 known is that over the next 40 years, the minimum

1 pledge sales tax base amount that has been sold to
2 COFINA is \$58 billion in nominal terms. If that
3 \$58 billion isn't going to COFINA but is going
4 elsewhere, it would be -- it's practically impossible
5 for that money not to filter down to other
6 instruments that Ambac insures.

7 For instance, we insure general obligation bonds.
8 If general obligation bonds as a class I think have
9 \$23 billion of debt service over the life of all
10 outstanding bonds, add \$58 billion to the total,
11 they're probably going to have a high bit of
12 recovery.

13 Secondarily, as a result, if the G.O. bonds have
14 a bit of recovery, there probably won't be a need for
15 perpetual clawback of certain revenue bonds which
16 seems to be something that is, if not contemplated, a
17 concern in the Puerto Rico restructuring and which in
18 our conservative assessment we have incorporated in
19 the projections.

20 Q So even a COFINA zero could have some net benefit to
21 Ambac's other issuances that it insures.

22 A Yeah. There should be offsetting effects.

23 Q So does -- at the end of the day, all of those things
24 under consideration, does that objection cause you to
25 change your opinion or question your opinion on

1 durability?

2 A No, it does not.

3 Q One of the other objections we discussed rather
4 extensively at the pretrial conference was the
5 assumption in your original report of a 5.1 percent
6 reinvestment rate.

7 A Uh-huh.

8 Q First of all, can you define for me what is a
9 reinvestment rate?

10 A The reinvestment rate is the projected return on
11 monies that are available for reinvestment. Not on
12 the entire -- not the projected return on the entire
13 portfolio that Ambac holds.

14 In any given year, a relatively small amount of
15 money might be available for reinvestment after
16 payment of cash outflow such as operating expenses,
17 losses, and tax and toll repayments.

18 So I think one of the disconnects in some of
19 their filings versus our analysis ultimately came to
20 there were assumptions that were made that similarly
21 aren't the entire Ambac portfolio would flip to a
22 three percent yield or three and a half percent
23 yield, where, in fact, in any given -- you know, in
24 any given year there might only be \$200 million or
25 \$150 million of the company's portfolio available for

1 reinvestment in a post-transaction

2 \$3 billion portfolio. So the effect of that

3 assumption is muted over time.

4 Q For example, how would part of that portfolio become
5 cash available for investments?

6 A Two ways, really. For the most part, if a bond
7 matures and -- if a bond matures and there's the
8 amount of bond maturity -- amount of money from a
9 bond that matures or interest generated from the
10 portfolio overall is not offset entirely by cash
11 outflows, that would be how money would become
12 available for reinvestment.

13 Q And you've looked at Ambac's entire investment
14 portfolio, haven't you?

15 A Yes. Our investment -- our -- the financial
16 projections model is quite granular. We actually --
17 as opposed to looking at categories, we -- when we
18 update, say, for June 30th, 2017, we take the
19 company's actual investment portfolio as of that time
20 and the projected cash flows associated with each
21 instrument and rerun them out.

22 Q Not to confuse things, but what would have been --
23 has the historical returns on that portfolio been in
24 recent years?

25 A The compound annual return on that portfolio from,

1 I'd say, February 2010 through September 2017 was
2 8.3 percent.

3 Q But you're not making any long-term assumptions about
4 whether or not they can maintain that level of return
5 on their entire portfolio, are you?

6 A No.

7 Q Your reinvestment rate really only applies to a small
8 sliver of that investment portfolio it becomes
9 available as cash to reinvest?

10 A Also, there is a ramp-up period. For 2018, I believe
11 the reinvestment rate's assumed to be 4.6 percent.
12 For the stub of 2017 it's assumed to be 4.3. And we
13 get to 5.1 percent in 2020.

14 Q But the confusion created by the objection was they
15 were referring to overall portfolio returns. You're
16 referring to only the small sliver of reinvestment
17 rate cash that becomes due periodically or that
18 becomes available periodically.

19 A Yeah. Also, I'd note that there are some years where
20 there is no -- you know, there is no cash available
21 for reinvestment. There are certain clean spikes.
22 Certainly notable ones in 2037, 2038, and, again, I
23 think maybe in 2033. In those cases, in effect, the
24 math is 5.1 percent times zero.

25 Q Okay. I can do that.

1 All right. So your 5.1 percent reinvestment
2 rate, why in your view is that a reasonable
3 assumption?

4 A We took a look at -- well, first off, we've had --
5 we've worked with the companies in investment
6 portfolio professionals for many years, probably
7 preceding the start of the rehabilitation
8 proceedings. So we have a general understanding of
9 their objectives, their goals, what sectors they're
10 interested in, so forth.

11 Secondly, OCI in its role as a regulator approves
12 the company's investment guidelines which sets limits
13 on specific sectors. What percentage of assets can
14 be in corporate bonds. What percentage of assets can
15 be in high yield bonds. What percentage of assets
16 can be dedicated to holdings of AAC insured
17 instruments. So on and so forth. And that begins to
18 define a little bit of what might be possible.

19 And finally, we take a look at the Wisconsin
20 Administrative Code which talks about what categories
21 for investments are available generally to insurance
22 companies and what limitations are set on those.

23 So considering all those factors together, our
24 belief was that given current market conditions it's
25 reasonable to have a more modest reinvestment rate to

1 start, but long term we believe 5.1 percent is a
2 reasonable number.

3 Q Okay. Let me ask a slightly different question then.

4 In looking at Ambac's investment portfolio,
5 approximately what percentage of their portfolio
6 earns more than, for example, six percent?

7 A Post-transaction, that would be at least 60 percent.

8 Q So 60 percent already earns 100 basis points more
9 than your assumption.

10 A That's right.

11 Q What percentage of the portfolio is fixed income?

12 A It's all -- debt securities, there are some variable
13 rate instruments in there. I'd say the vast majority
14 is fixed coupon. So in the absence of default you
15 know your yield and maturity with a fixed coupon debt
16 instrument.

17 Q I didn't hear that last part. So are you saying you
18 know what you're going to get?

19 A If you had a fixed coupon debt instrument and you
20 hold it to maturity, when you purchase that
21 instrument, you hold it to maturity in the absence of
22 a default or some kind of credit loss event, you know
23 your yield of maturity.

24 Q That raises another good point. Have you had the
25 opportunity to observe the portfolio management -- I

1 guess it's strategies of Ambac in the course of
2 working with them over the years?

3 A Yes, I have.

4 Q How would you characterize their investment strategy?

5 A It's opportunistic. It is well run. I have a great
6 deal of confidence that prudent decisions have been
7 made in the past and will be made in the future.

8 Q Is there a lot of turnover in the portfolio?

9 A No. It is -- geez, let me think of this. I'll give
10 you an example.

11 Q I want to get a characterization here first before
12 you get on to the examples.

13 Are we talking about a buy and hold?

14 A Yes, very much so.

15 Q Okay.

16 A Very much so. If five percent of the portfolio turns
17 over in a quarter, that's a big quarter.

18 Q Now, you were going to give me an example.

19 A That, in fact, was my example. Sorry.

20 Q Let's take another example.

21 A Okay.

22 Q Ambac owns some Military Housing bonds. Are you
23 familiar with that?

24 A I am aware of that.

25 Q Do you know approximately how much?

1 A I think in total they own a little north of
2 \$2 million in statutory carrying value of those
3 bonds.

4 Q What is the yield on that Military Housing bond
5 portfolio?

6 A I believe the average yield -- there's several
7 instruments, but I think the average yield of that
8 subsector is 9.9 percent, give or take.

9 Q Have you gotten any indication from the company that
10 they intend to sell any portion of that Military
11 Housing bond portfolio?

12 A No. My expectation and assumption is that's going to
13 be held until maturity.

14 Q Held to maturity would be consistent with 95 percent
15 of the rest of its portfolio.

16 A Yes, it would. In general, consistent with Ambac's
17 policy with respect to instruments of that type.

18 Q The implication from some questioning of
19 Mr. Schwartz was that there was some litigation
20 undertaken to drive up the price of those bonds for
21 the benefit of Ambac. Would the short-term bond
22 price have any impact on the portfolio if it's held
23 to maturity?

24 A It would not.

25 Q Would it be consistent with Ambac's investment

1 strategy to turn those Military Housing bonds over
2 quickly?

3 A Not what I've observed over the course of ten years.

4 Q And what is the general availability of investments
5 paying 9.1 to 9.9 percent that could replace
6 something with that type of a yield if they were to
7 sell it in the short term?

8 A There may be small opportunity, small mispricings
9 available on long-term bonds, but you'd really have
10 to hunt them out. It would be challenging to replace
11 that yield.

12 Q While we're on the topic of Military Housing, let's
13 talk about Section 6.13.

14 You have in your folder -- or in your binder you
15 have your expert report. If you could turn to
16 page 5, footnote 5.

17 A Okay.

18 Q That should be Tab No. 4.

19 A Okay.

20 Q Can you tell us what that says about Section 6.13.

21 A And this is footnote 5. "Further, my opinion assumes
22 that the plan will be consummated in accordance with
23 the terms and conditions set forth in that document
24 including Section 6.13."

25 Q And to paraphrase, you assume 6.13 is in the plan and

1 you assume it's enforceable, right?

2 A I was asked to provide an opinion on the plan, and I
3 assumed that all elements of the plan are
4 enforceable.

5 Q What's your understanding of what Section 6.13 of the
6 plan attempts to accomplish?

7 A It attempts to wipe the slate clean, if you will, and
8 provide a fresh start for the merged entity following
9 consummation of the transaction.

10 Q Okay. Are there any current defaults that you're
11 aware of in the segregated account?

12 A No.

13 Q Or the general account?

14 A No.

15 Q So 6.13, does that extinguish any pending insurance
16 claims?

17 A No.

18 Q Are you aware of any specific provision in any
19 specific contract that 6.13 was intended to cure?

20 A No. I viewed it as a protective measure.

21 Q So it applies to all current and future allegations
22 of default.

23 A Yes. Well, related to the establishment of the
24 segregated account, the allocation of -- it's not
25 meant to say that there might never be a default in

1 the future, but only to -- it's limited to defaults
2 associated with segregated account operations,
3 establishment, so forth.

4 Q That's a very good point. Let's talk about that for
5 a second.

6 The defaults that this is intended to cure are
7 defaults that arise as a result of OCI establishing
8 the segregated account.

9 A That is correct.

10 Q And it doesn't make a distinction between segregated
11 account policies or general account policies, does
12 it?

13 A Not as I recall in the plan.

14 Q Can you attach a specific dollar value to 6.13 in
15 your model?

16 A No, I cannot.

17 Q So is 6.13 in any way determinative of durability?

18 A No, it is not.

19 Q If durability doesn't hang in the balance, is 6.13 at
20 least material to durability?

21 A It could be material.

22 Q And how is that?

23 A Well, it comes down to the issue of control rights.

24 Control rights are part of an insurance contract.

25 And control rights allow the financial guarantor, the

1 entity that is insuring timely payment and interest,
2 with certain rights in the event that a credit starts
3 performing less well. They take on various forms
4 depending on the sort of credit it is.

5 The control rights that might be associated with
6 an RMBS instrument are different than those that
7 might be associated with a municipal finance policy,
8 for instance.

9 However, those control rights allow the entity
10 that is on the hook for the principal and interest to
11 take steps to potentially minimize loss and reduce
12 the possibility -- reduce the size of a loss if, in
13 fact, a loss does result.

14 Q You followed the developments in Ambac's Military
15 Housing investment portfolio, right?

16 A Military Housing's insured exposure portfolio. Yeah.

17 Q So you're familiar with the Military Housing
18 litigations that Mr. Kravit was referring to earlier.

19 A Yes, I am.

20 Q Put aside the issue of control rights for a second,
21 and can you tell me, is there any distinction
22 between -- or is there any connection between control
23 rights on one hand and the ratings downgrade that was
24 referenced in earlier testimony on the other hand?

25 A I believe the ratings downgrade applies to the surety

1 bond. And I believe control rights apply to the bond
2 that was issued that will be outstanding for 50 years
3 that funded the development of the various Military
4 Housing projects.

5 Q Okay. That's a good point to jump into this topic.

6 Can you explain to the Court in these Military
7 Housing projects who's who? Who are the developers?
8 Who are the bondholders? Who are the trustees? Who
9 is the insurance company? Et cetera.

10 A The insurance company is Ambac Assurance Corporation.

11 The bondholders are the investors that purchase
12 bonds issued by the Military Housing entities. The
13 Military Housing entities are, I believe, generally
14 set up as LLCs that have issued debt and have equity
15 underneath that were -- and that equity was invested
16 by the developers.

17 Q So the developer, Mr. Kravit's clients, what do they
18 own?

19 A They're equity investors.

20 Q Does the insurance policy or any part of the
21 insurance policy insure any losses the equity owners
22 may have?

23 A No. The wrap on the insurance bond -- on the bonds
24 issued by any of the Military Housing, Military
25 Housing bonds ensures timely payment of principal and

1 interest on those bonds.

2 Q All right. Let's further make a distinction between
3 the surety bond that you referred to earlier and the
4 insurance policy.

5 A Okay.

6 Q What does the surety bond do? And where does it fit
7 in the model of this project?

8 A My understanding is that the surety bond effectively
9 takes the place of a one-year debt service reserve.
10 Monies that would be available in the event that
11 there's a temporary shortfall or a shortfall in the
12 project's ability to make principal and interest
13 payments. So the surety bond would be liable to
14 supplement as-needed principal and interest --
15 scheduled principal and interest payments. After
16 that is exhausted, then the surety bond is no longer
17 applicable and then future losses are covered under
18 the wrap on the bond.

19 Q And then you've worked with surety bonds in your
20 profession before, haven't you?

21 A Yes.

22 Q So you've worked with surety bonds. Is there
23 typically a credit rating requirement of the
24 underlying issuer of the surety bond?

25 A I believe so. Yes.

1 Q In other words, the surety bond assures payments, so
2 you want to have a credit-worthy insurer issuing that
3 bond, right?

4 A Yes.

5 Q Is there usually a credit rating requirement on an
6 insurance policy?

7 A Well, in the financial guarantee industry, for the
8 most part, insurance policies were issued only by AAA
9 entities like Ambac in 2007 and other financial
10 guarantors.

11 Having said that, I am not aware of any
12 requirement that such credit rating be maintained
13 subsequent to issuance of a particular policy.

14 Q So the declining --

15 A As a general rule.

16 Q Okay. So the decline in that credit rating of Ambac
17 related to the surety bond, not the insurance policy,
18 would that be correct?

19 A That is my understanding.

20 Q Let me ask the question differently.

21 The loss of control rights that we had been
22 discussing or the control rights, are control rights
23 found related to the insurance policy or are they in
24 the surety bond?

25 A They're the insured bond. The control rights go hand

1 in glove with the insured bond.

2 Q With the bond, but --

3 A With the bond.

4 Q The surety bond --

5 A I'm sorry. The --

6 Q -- or the insurance policy?

7 A The insurance policy goes hand in glove with the wrap
8 bond, not the surety bond.

9 Q Okay. Got it.

10 In 2008, when Ambac's credit rating was
11 downgraded, could that have triggered a loss of
12 control rights?

13 A I don't believe so.

14 Q Then let me ask you this question that tied into
15 6.13.

16 Is 6.13 a provision that could resolve or in any
17 way impact the credit downgrade that Ambac incurred
18 in 2008?

19 A No. That's a -- that's up to the rating agencies.

20 Q What is a -- I want to get back to this issue, too,
21 of who's who.

22 The Military Housing projects are equity owners.
23 They borrowed money to build these projects. The
24 bondholders are the ones who lent the money; is that
25 right?

1 A No, the bondholders bought the bonds. Yes.

2 Q They're insured by Ambac.

3 A Yep.

4 Q If there's a default, who receives payment under the
5 insurance policy?

6 A If there's a default, the bondholders do.

7 Q That actually goes through a trustee, though, right?

8 A I believe so. Yeah. There would have to be.

9 Q But the insurance policy's for the benefit of the
10 bondholders?

11 A Yes. For the people who own the debt that was issued
12 by the Military Housing project in question.

13 Q What is a credit enhancer default?

14 A As I understand it, what has been alleged is that a
15 credit enhancer default has resulted from -- it's
16 assumed to -- it's alleged to have resulted from
17 OCI's establishment of the segregated account and
18 allocation of policies to the segregated account.

19 Q Do you have a legal opinion as to whether or not the
20 Ambac creditor credit enhancer default has occurred
21 in any of the Military Housing --

22 MR. KRAVIT: Is he a lawyer?

23 MR. FINERTY: He's going to answer no,
24 if that helps.

25 THE COURT: Subject to the tie-up, I'll

1 allow it.

2 THE WITNESS: So stipulated.

3 Q Okay. But you've been involved with the segregated
4 account from the start, right?

5 A That's correct.

6 Q Were you involved in any of the decisions as to which
7 policies to put in the segregated account or keep in
8 the general account?

9 A More tangentially. Most of that work product was
10 done -- there was so much work to do to get -- to
11 establish the segregated account that the advisory
12 team at Ambac broke into teams. And the allocation
13 of policies beyond the obvious RMBS in terms of, say,
14 contractual issues was really left with more of a
15 legal team. We had our hands full with CDOs and
16 RMBS and student loans.

17 Q You were part of the team that developed the
18 structure of the segregated account and made --

19 A Yeah.

20 Q -- the decision to set it up and finance it
21 specifically in a manner in which it was financed,
22 right?

23 A Yes, I was.

24 Q With the secured note and the reinsurance agreement,
25 right?

1 A That's correct.

2 Q And there was attention paid in setting up that
3 structure to avoiding defaults in general account
4 policies, wasn't there?

5 A Yes, there was.

6 Q So if the mere establishment of the segregated
7 account were to cause defaults in general account
8 policies even though it was -- general account
9 policies are not in the segregated account, would
10 that be consistent or inconsistent with the intent
11 back in 2010 --

12 A That was inconsistent.

13 MR. KRAVIT: That's leading and
14 suggestive. This is expert --

15 THE COURT: It's also well established
16 in both the Nickel decision and what I decided back
17 when I was dealing with the issue of MHPI's motion a
18 year and a half ago. There's no real dispute here
19 would be inconsistent with what the intention was.

20 Your point, it doesn't matter whether it
21 was inconsistent. It happened anyway, right?

22 MR. KRAVIT: Yes, sir.

23 THE COURT: All right.

24 Overruled. Let's go.

25 Q In your experience in insolvency matters,

1 Mr. McGettigan, when a company comes out cleanly out
2 of the process -- well, let me ask the question a
3 little differently.

4 In your experience in insolvency matters, is the
5 language that you've read in 6.13 of the plan
6 consistent with other confirmation orders that you've
7 read?

8 A Yes. That's true.

9 Q Would you consider that language to be fairly
10 standard?

11 A Yes. I mean, the purpose of coming out of any
12 reorganization is for a fresh start and to resolve --
13 have all issues be resolved.

14 Q Did you consider the effects that if 6.13 is not in
15 the plan, did you consider the possible monetary
16 effects on your financial model?

17 A No, I did not.

18 Q And why not?

19 A Because while control rights have value, not
20 everything that has value can be quantified.

21 Q Can you explain for me what would need to occur
22 before you could value a control right.

23 A Let's -- as a basic foundational point, control
24 rights have value primarily in situations where
25 credit quality is deteriorating. Right?

1 So as we sit here today, defaults have been
2 alleged but not affirmed. There's -- then assuming
3 the plan is confirmed, there's a question of whether
4 that cures the defaults.

5 If there's -- if there is a default and it's not
6 cured, then the question is what happens to the
7 control rights? Do they go to the bondholders? Do
8 they go to the trustee? Do they go to the equity
9 holders? Do they disappear into the ether? Don't
10 know.

11 And then from there, once those legal issues have
12 been resolved, the question becomes when would they
13 be applied?

14 If I've got a credit that's covering -- that has
15 interest coverage of five times, in other words, it's
16 got \$5 of operating income for every dollar of debt
17 service, my control rights aren't really necessary to
18 preserve the credit at that point in time.

19 Q That raises a good point. What role does a control
20 right play for an insurance company in avoiding
21 defaults?

22 A If a credit becomes troubled, not necessarily unable
23 to pay its debt service but operating performance
24 declines, control rights can provide what I would
25 call trip wires, if you will, that allow the insurer

1 to take steps in an attempt to improve the
2 creditworthiness of the credit in question.

3 Q Let's talk about an example specific to these
4 Military Housing policies. Some of these policies --
5 in one that you're familiar with has a debt service
6 ratio, right?

7 A Yes.

8 Q What is a debt service ratio?

9 A A debt service ratio is the ratio of operating income
10 for the fiscal year of the project -- I'm sorry,
11 operating cash flow divided by principal and interest
12 paid.

13 Q So what's the purpose of having that in a contract?

14 A First off, the way to read it if, say, if a debt
15 service ratio is 1.2, what it's saying is we have
16 \$1.20 of operating cash flow for every dollar of debt
17 service that we have.

18 Q You have to have a 20 percent cushion --

19 A Yeah.

20 Q -- to be able to pay the interest and principal on
21 your debts.

22 A And obviously higher is better and lower is worse.

23 Q So these contracts contain debt service ratio.

24 A Uh-huh.

25 Q What would happen if that debt service ratio went

1 below what's called for in the contract?

2 A In that case, Ambac may have certain control rights.

3 Say, for instance, the one that I'm familiar
4 with, Ambac may have the ability to approve the
5 operating budget for the following year and, you
6 know, require changes in how money might be spent
7 versus the original budget proposed by the developer.

8 Q So then in that case you do have the possibility of
9 avoiding a default by exercising control rights.

10 A At minimum, it allows Ambac Assurance to endeavor to
11 improve the creditworthiness of the exposure to the
12 insurers.

13 Q Are there control rights in Ambac policies other than
14 the Military Housing policies?

15 A I'm not aware of an Ambac insurance policy that does
16 not have a control right -- or control rights,
17 plural.

18 Q So they're in every other policy you're aware of.

19 A It kind of goes hand in glove. Ultimately, I guess
20 it goes down to moral hazard, right?

21 Q That was going to be my next question.

22 What would be the effect, if it's not strictly
23 financial at this point, of Ambac not having control
24 rights or having those control rights in the hands of
25 some other entity?

1 A Well, let's take the case where Ambac still insures
2 debt but has no control rights. Let's say credit
3 deteriorates on a given project and a trip wire is
4 hit. Perhaps those control rights rest with the
5 bondholders or the trustee. Now the bondholders and
6 the trustee may choose to be diligent and endeavor to
7 work together to improve the creditworthiness of the
8 project or, ultimately, knowing that there's an
9 Ambac Assurance policy backing principal and interest
10 payments, they might not spend as much time on that
11 to ensure credit quality as, say, Ambac would whose
12 money is at risk.

13 Q That's the moral hazard you just described?

14 A Yes.

15 Q Mr. McGettigan, my last question on this 6.13. Are
16 you familiar with generally the OCI's plan or the
17 tools, I guess, available to regulate Ambac after
18 plan confirmation or after exit?

19 A Yes.

20 Q Would 6.13, in your view, also cover defaults that
21 would be alleged as a result of OCI's post-exit
22 regulation?

23 A I don't believe I can answer that.

24 Q Okay. I didn't think so.

25 Let me turn to one other topic, a happier topic,

1 before we conclude with your testimony.

2 A Okay.

3 Q If you could pull out -- or turn to Tab 7 in your
4 binder, please, I think it is.

5 A Okay. Yes. I have that open.

6 Q There's been a couple of other commutations in the
7 last few weeks. Can you generally tell us what those
8 are. Without reference, necessarily to the exhibit,
9 tell us what those commutations are.

10 A Since the December 11th report, there have been two
11 commutations. One involved a group of, let's say,
12 ten RMBS trusts that were subject to closeout calls.
13 When collateral becomes small enough, it's possible
14 to negotiate a conclusion to the trust. That has
15 several benefits for Ambac.

16 First, it reduces tail risk, so if there's a
17 housing collapse in 2022, this collateral will not be
18 a problem for Ambac.

19 Secondly, in -- broadly, in respect to these
20 close-out transactions, Ambac's projected losses on
21 these deals -- actually, let me rephrase that.

22 Gordian's projected losses on these deals were
23 less than the amount of money that was required to
24 execute these transactions. So these transactions
25 standing on their own were accretive. That was the

1 only thing that happened. Margin of safety would
2 have increased from where we were on December 11th.

3 Q Can you tell us what you mean by accretive.

4 A That, simply put, the margin of safety would have
5 increased.

6 Q And then the other big settlement of interest is
7 what?

8 A Is the settlement with the COFINA bondholders.

9 Q And can you tell us about that -- the settlement's
10 effect generally on the margin of safety.

11 A That, too, was accretive. That, again, standing
12 alone in the absence of the RMBS closeout call
13 transaction would have increased the margin of safety
14 from where we were on December 11th. So both of
15 those transactions together on average increased the
16 margin of safety by about \$45 million from where we
17 were less than a month ago.

18 Q And that's reflected in your exhibit?

19 A Yes. In Tab 7 of the exhibit, basically it's a
20 similar bridge. We take the margin of safety by
21 scenario and on average -- and the four-scenario
22 average from the December 11th report, and then the
23 net effect of the two transactions we spoke of is
24 calculated here in the second line. And it ranges
25 from \$46 million in scenario one, a low of

1 \$44 million in scenario three, and an average of
2 \$45 million across the board.

3 Q The way to read this is the end result as of today,
4 margin of safety in scenario one is \$910 million and
5 in the stress case, scenario four, is \$521 million?

6 A Yes, that is a way to read that.

7 Q That's in excess of what OCI has indicated as a
8 sufficient margin of safety, correct?

9 A As was the prior report and the report before that.
10 Yes.

11 And if I could make a final point, I can't stress
12 enough.

13 In my December 11th report, I mention that the
14 company had a funnel of derisking opportunities that
15 involved approximately \$2.5 billion of net par
16 outstanding. The RMBS collapse transactions reduced
17 that number by about \$200 million. There's still,
18 just even based on where we were in December,
19 \$2.3 billion of derisking opportunities that the
20 company's evaluating, negotiating, so forth, some of
21 which will come to pass, some of which will not come
22 to pass. As that funnel gets resolved, new ones will
23 develop.

24 Q So your point is this is ordinary and customary to --

25 A Yeah.

1 Q -- make these transactions and could add to the
2 margin of safety.

3 A Yes.

4 Q All right. To recap your opinion, your expert
5 opinion on fairness and reasonableness of the
6 consensual transaction is?

7 A I'm sorry. Please --

8 Q Your opinion on the fairness and reasonableness of
9 the consensual transaction.

10 A The transaction is fair and equitable to holders
11 of -- to beneficiaries of deferred amounts and
12 holders of general account surplus notes.

13 Q And it's also your opinion that the company is
14 durable post-exit and can pay its bills in cash --
15 can pay its policy claims in cash when presented?

16 A In full, in cash, and timely when presented. Yes.

17 Q You hold those opinions to the reasonable degree of
18 certainty in your field of expertise?

19 A Yes, I do.

20 Q Thank you. No further questions.

21 THE COURT: Do you wish to question,
22 Ms. Neider?

23 MS. NEIDER: I see you looking at me.
24 No questions.

25 THE COURT: Mr. Kravit, any questions

1 for this witness?

2 MR. KRAVIT: Just a couple.

3 MR. FINERTY: I'd just like to clarify,
4 I think Mr. Kravit knows this, we've agreed to a
5 one-hour limitation on his cross-examination. We're
6 about 45 minutes into it.

7 MR. KRAVIT: I'll be brief.

8 I will say that there's a half hour of
9 testimony here that's not in any piece of paper they
10 ever gave us. It's an entire, complete surprise. I
11 would ask the Court's indulgence. I don't think I'll
12 be that long, but I don't want to be limited.

13 THE COURT: Let's see where we go.

14 MR. KRAVIT: Thank you, sir.

15 MR. FINERTY: The purpose of the
16 stipulation was just not to take all day.

17 THE COURT: Right. And we'd like to get
18 out of here --

19 MR. KRAVIT: That was not my plan.

20 THE COURT: Nobody's flying out today to
21 New York, I can tell you that. I would rebook to
22 Miami Beach.

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CROSS-EXAMINATION

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BY MR. KRAVIT:

Q Let's just get a couple of quick things out of the way.

Your opinion is that this deal is fair and equitable as written, correct?

A Yes.

Q And by that you mean fair and equitable to all the parties that are affected including policyholders, correct?

A Actually, my opinion is that the deal is fair and equitable to holders of deferred amounts and general account -- sorry, to beneficiaries of deferred amounts and holders of general account surplus notes.

Q So not policyholders.

A I was asked to determine an opinion -- to provide an opinion regarding the treatment of those specific entities.

Q Okay. So you weren't asked to render an opinion consistent with the statutes that require the judge to find that the deal is fair and equitable not just to the parties you mentioned but also to the policyholders. You were not asked that.

A I was -- I don't believe that this is in conflict with the statute, as I understand it.

1 MR. KRAVIT: Move to strike the answer.

2 Read the question.

3 THE COURT: Overruled; but can you
4 re-state it.

5 (Question read)

6 A I was asked to provide the opinion that I provided.

7 Q And it does not include an opinion as to whether this
8 resolution is fair and equitable to the
9 policyholders.

10 A To policyholders who were not holders of deferred
11 amounts or policyholders who are not holders of
12 general account surplus notes.

13 Q I don't really understand that. But if you look
14 at -- the statute we're under is §645.05. This deal
15 is asking this Court to issue an injunction that is
16 supposed to be necessary and proper to prevent any
17 threatened or contemplated action that might lessen
18 the value of the insurers' assets or prejudice the
19 rights of policyholders, creditors or shareholders or
20 the administration of the proceeding. So that's the
21 statute.

22 A Uh-huh.

23 Q Does your opinion say that this deal is fair and
24 equitable to the rights of policyholders? It's one
25 of the subjects. Do you have an opinion on that or

1 don't you?

2 A I don't have an opinion on that.

3 Q All right. Thank you.

4 You agree, do you not, that the MHPI group that I
5 represent are policyholders?

6 A Actually, I don't know that that's true.

7 Q All right. Let me read you the definition of
8 policyholders in Wisconsin law which is Wis. Stat. --
9 Wisconsin Statute 600.03(37).

10 A Uh-huh.

11 Q Policyholder means the person who controls the policy
12 by ownership, payment of premiums, or otherwise.
13 That's the law.

14 Is MHPI a policyholder under that definition?

15 A I don't know.

16 Q Well, they pay the premiums, don't they? You know
17 that.

18 A I know that the premiums are paid.

19 Q Okay. So for ten years of your association with
20 Ambac and your testimony here today, you don't know
21 whether MHPI pays the premiums on the insurance
22 policies at issue?

23 A I don't know whether that's the legal entity that
24 pays the premiums. I know the premiums are paid.

25 Q All right. So if MHPI is a policyholder, is this

1 deal fair to them?

2 A I don't have an opinion on that.

3 Q You were involved in 2015 when Ambac, the
4 nonsegregated account Ambac decided to sue MHPI; am I
5 right?

6 A I was an adviser to the SDC, the respected segregated
7 account, and to OCI in respect to the general
8 account. Yes.

9 Q Were you consulted in any way about the decision to
10 sue in seven courts -- not in Wisconsin -- MHPI?

11 A I was aware that there were discussions, but the
12 legal team handled that.

13 Q Were you aware that the claim in every single suit is
14 that MHPI is to replenish or create a fund under
15 these complicated agreements for \$200 million? Did
16 you know that?

17 A I know that now. Yes.

18 Q You didn't know that before?

19 A I did not know the exact amount. I knew that they
20 were involved with that surety.

21 Q Do you know of any other claim in the whole Ambac
22 book where Ambac affirmatively tried to get a
23 policyholder to pay money in a court other than
24 Wisconsin?

25 A Well, all the RMBS litigation.

1 Q Is RMBS in the segregated account or in the regular?

2 A The RMBS policies are in the segregated account. I
3 believe the RMBS litigation, both the general account
4 and segregated account, are parties to that
5 litigation.

6 Q All right. In the general account, do you know of
7 any other party besides MHPI that has been sued and
8 out-of-state litigation seeking money?

9 A I think there's been lawsuits filed in Puerto Rico.
10 And I'm sure that there are others that I can't
11 recall as I sit here.

12 Q Let me back up and ask you this.

13 If it's the case that 6.13 so-called cures a
14 default anywhere -- I think by its terms expects to
15 cure defaults everywhere and anywhere; am I right?
16 Ambac defaults.

17 A Only Ambac -- Ambac Assurance defaults related to the
18 establishment of the segregated account, allocation
19 of the policy management -- with that qualifier.

20 Q Do you understand the claims in the seven Ambac suits
21 against MHPI to involve that issue?

22 A Yes, I do.

23 Q So it is expected, is it not, that 6.13 will resolve
24 that issue fully and finally in favor of Ambac.
25 Correct?

1 A Yes.

2 Q So in effect, by instituting 6.13 this Court will be
3 deciding seven cases where Ambac has put this very
4 issue in dispute elsewhere, correct?

5 A That is certainly the request of the Court.

6 Q You heard this morning that three of these different
7 state courts have summary judgment on this issue
8 fully briefed and ready for decision. You heard
9 that, right?

10 A Yes, I did hear that.

11 Q You do know that in seven cases no decision has been
12 made definitively yet on that issue, correct?

13 A That's correct.

14 Q Isn't this Ambac's attempt to jump into this Court to
15 solve a problem that reversed the choices that Ambac
16 made to go to all these seven state courts because
17 they're not getting the results they want?

18 MR. FINERTY: Objection. Argumentative
19 and no foundation.

20 THE COURT: Sustained.

21 I get the point. Sustained.

22 MR. KRAVIT: Thank you, sir.

23 Q Okay. Having heard that discussion, is the deal --
24 6.13 in this deal fair and equitable to policyholder
25 MHPI, in your opinion?

1 A I'm not prepared to provide opinion on that right
2 now.

3 Q So you can't say it is fair and equitable to MHPI,
4 can you?

5 A And I can't say it's can't. I can that it's not.

6 Q Let's talk about durability. If one point -- I'm
7 sorry, 6.13 is out of this agreement, just that
8 provision, is the plan that you're approving still
9 durable?

10 A Yes.

11 Q Do you have any conception, has anyone ever told you
12 that if 6.13 is out of this plan, that the closing
13 will not take place, that the plan will be delayed in
14 any way, that anyone will pull out of the plan?

15 A I've not had any of those discussions.

16 Q You don't think that will happen, do you?

17 A I don't really know what would happen.

18 Q Okay. In the lawsuits that MHPI is subject to in the
19 seven states, do you understand that Ambac is seeking
20 a payment of \$200 million?

21 A I understand that they were seeking a payment of
22 \$200 million, I believe, in two cases. As I think
23 you raised this morning, the statute of limitation
24 has passed, so I'm assuming those are dead in the
25 water.

1 Q Do you know why it took seven years for Ambac to
2 tumble to the fact that they might have these rights?

3 A I have -- I have no idea.

4 Q You weren't on the team that decided whether MHPI was
5 to go into segregated or ordinary account, were you?

6 A I'm sorry?

7 Q Were you on the team that decided whether MHPI, Ambac
8 assureds were to go into the segregated account
9 versus staying in Ambac's main account?

10 A What I testified to earlier was that we were
11 primarily focused on some of the financial and
12 economic issues associated with certain sectors.
13 However, I am -- was broadly aware that there were
14 allocations being made to preserve control rights and
15 contract rights where appropriate in devising the
16 segregated account, which policies would be allocated
17 to the segregated account.

18 Q So you were involved or not involved in the decision
19 to put the policies related to MHPI in -- to not put
20 that in the segregated account. Let me ask it again.
21 You either were or weren't involved in the
22 decision Ambac made to put -- to not put MHPI in the
23 segregated account, correct?

24 A I was aware that I was not a decision-maker.

25 Q Did you agree or disagree with the decision to not

1 put MHPI in the segregated account?

2 A I didn't have an opinion on it at that time.

3 Q Did you know at that time whether or not control
4 rights were at risk in the policies related to MHPI?

5 A I did understand the control rights were an issue at
6 MHPI; and my understanding is that's why it was
7 retained in the general account, among other reasons.

8 Q Okay. So at some point, notwithstanding the fact
9 that MHPI was in the general account, Ambac, which it
10 was free to do, went ahead and went to seven states
11 and sued to add collateral, right?

12 A That is my understanding. Yes.

13 Q Now, you said there is no money allocated or no money
14 impact that you can compute related to the
15 elimination of 6.13 in this report, right?

16 A No. It's too fact-and-credit specific.

17 Q You heard this morning Mr. Schwartz testify that
18 \$15 million of legal fees have been reserved for the
19 litigations?

20 A Yeah, I did hear that. I apologize that that is
21 incorporated in the projections.

22 Q You agree, do you not, that \$15 million is not
23 material to the closing of this rehabilitation, is
24 it?

25 A No. We picked up \$45 million in 25 days.

1 Q So if 6.13 was eliminated at least from the financial
2 part that we heard about today, it wouldn't make any
3 difference in terms of the durability or the
4 closing --

5 A With due respect, I think that's stretching it too
6 far. I believe that were an outcome to occur, that
7 would result in the loss of control rights that would
8 impair Ambac's ability to manage its credit
9 exposures. And while it's not possible to quantify
10 that credit or the value of control rights, because
11 it may well be that all MHPI projects perform
12 perfectly, have very big debt coverage ratios, have
13 no issues, and no need to have a control right ever
14 exercised. And that makes the values zero. It is --

15 Q I'm sorry, sir.

16 A Please.

17 Q The attempt is in seven cases, five now because two
18 have been dismissed, to force MHPI to deposit
19 \$200 million of project funds to do absolutely
20 nothing other than sit in front of Ambac's exposure,
21 correct?

22 A My understanding is that the money is to serve as a
23 surety bond, but several places of a surety bond,
24 yes.

25 Q So Ambac would still be collecting premium for a risk

1 that now it is behind \$200 million, right?

2 A Actually, they're collecting risk on the -- on the
3 bond that they insured, the several hundred million
4 dollars worth of bonds that they insured, and they
5 collect that premium whether there's a surety bond or
6 not.

7 Q So it's a pretty good gig for Ambac. They get to get
8 off the exposure side and force \$200 million plus
9 other control rights to control, as you said earlier,
10 control basic general distributions, budgets on the
11 lender side.

12 A I disagree with that characterization.

13 Q When Ambac bought \$72 million worth of MHPI bonds,
14 they became, in effect, the lender for at least that
15 portion, correct?

16 A For that portion, yeah.

17 Q And they assumed those lender rights in addition to
18 whatever other control rights they had as an insurer,
19 correct?

20 A Whatever rights the lenders have. Yes.

21 Q Don't you find it inequitable to have Ambac on both
22 sides of the transaction? That is, that as the
23 insurer that causes -- that is a default because of
24 its change in rating; that on the other side they can
25 take advantage of their own change in rating to file

1 a lawsuit to force my client to put \$200 million out?

2 MR. FINERTY: Objection. Argumentative
3 and compound.

4 THE COURT: Overruled on both of the
5 counts.

6 A Could you please repeat the question.

7 (Judge read the question)

8 A I think there's two separate instruments here. The
9 change in credit rating involves a surety bond and a
10 surety bond is what's at issue in the litigations,
11 the five remaining and the two that have been
12 addressed.

13 Purchase of the nonsurety bond at the end of the
14 day is an asset liability matching issue, and I don't
15 find that inequitable at all.

16 I don't really have an opinion as to the
17 appropriateness of the litigation regarding the
18 surety bond issue.

19 Q You're a bond expert. If they bought \$120 million
20 face value bond for \$72 million, that's a good deal,
21 right? Can be?

22 A It can be.

23 Q If those bonds are now supported by an influx of
24 capital, \$200 million, the value of those bonds are
25 going to go up, right?

1 A It could.

2 Q It could or it will?

3 A It could. These are long-tenure bonds.

4 Q The trade --

5 A It's credit positive. Does it steer the fleet? Is
6 it a material change? I don't have an opinion on
7 that. I've not studied that bond.

8 Q But you did have an opinion that the investment
9 strategy of Ambac is "opportunistic;" am I correct?

10 A That is correct.

11 Q So it's pretty opportunistic while you are seeking
12 advantage from my clients, MHPI, to buy the
13 underlying bonds and then force on the other side an
14 influx of capital to make the bonds more valuable.

15 A I think that -- or my view was that regardless of
16 whether a new surety bond is posted or whether
17 \$200 million or whatever the surety bond is on those
18 specific -- surety bond requirement is on the
19 specific bonds purchased, I believe Ambac will be
20 holding on to those bonds, the nonsurety bonds, until
21 maturity.

22 Q But they don't have to. OCI could come in and say,
23 hey, you just made a gigantic profit on this. We
24 want you to take in the profit, realize it.

25 A OCI doesn't operate that way. I can't recall any

1 time where there's been a specific issue with respect
2 to realize a profit on a trade.

3 Q Did you know that OCI had to approve the purchase of
4 these D tranche bonds?

5 A I'm sure they did.

6 Q So why did Ambac go out of its way in 2015 to
7 purchase these D tranche bonds to have to have OCI
8 approve it?

9 A I'm going to assume that it was part of their asset
10 liability-matching strategy.

11 MR. KRAVIT: Move to strike.

12 Q You can't assume. Do you know?

13 A I don't know.

14 THE COURT: Sustained.

15 Q I want to talk for a minute about this aspirational
16 argument that Ambac has made. That is that it will
17 be great to emerge from this rehabilitation with no
18 strings attached. That whether or not 6.13 is a
19 monetary issue, it should be there because, really,
20 we just need a clean insurance company afterwards.

21 Is that an argument that you made with
22 Mr. Finerty? Did I understand that right?

23 A I don't think it's an argument. My statement, as I
24 recall, was that in resolutions of restructuring such
25 as this, it is normal to resolve all issues and not

1 have things hanging around that relate to, you know,
2 past actions.

3 Q Sure. In any restructuring you've done has an issue
4 been attempted to be resolved in a provision like
5 6.13 where there is ongoing litigation which 6.13 is
6 meant to affect?

7 A If there's outstanding litigation in -- that can't be
8 resolved as part of a resolution -- and I have seen
9 litigation be resolved or settled or releases
10 granted -- litigation trusts are often set up.

11 Q Do you think it's the appropriate role of the
12 rehabilitation judge to take the issue of whether or
13 not there's been a default that Ambac has taken to
14 other courts to resolve it here in a rule? Do you
15 think that's right?

16 A I don't have an opinion on that.

17 Q For sure it would be good for Ambac to do that,
18 right? It would be clean. It would emerge clean,
19 right?

20 A Oh. Emerging clean is --

21 Q That's good.

22 A -- to be desired.

23 Q Right. Okay.

24 But it's aspirational. It has to -- you've not
25 had another situation like this where the actual

1 rehabilitation order takes out seven litigations,
2 have you?

3 A Well, this is the first rehabilitation confirmation
4 hearing I've been a part of, so -- by definition.

5 Q Okay. So all that experience you're telling
6 Mr. Finerty about how you've seen these orders is
7 limited to this case?

8 A Well, and corporate bankruptcies.

9 Q This is different than a corporate bankruptcy,
10 though, right?

11 A I have been advised of that. Yes.

12 Q You agree, do you not, that the MH -- Military
13 Housing policies are not in the segregated account?

14 A That's correct.

15 Q And they were never treated as if they were in the
16 segregated account, correct?

17 A That's correct.

18 Q It's only now at the closure of this proceeding with
19 Rule 6.13 implemented where the rights of the
20 policyholder MHPI would be affected, correct?

21 Prior to entry of this order Ambac acted like
22 MHPI was an ordinary policyholder and MHPI acted and
23 responded to that litigation as if there were no
24 restrictions from this rehabilitation, correct?

25 A That is correct.

1 Q But by this order that Ambac seeks, Ambac seeks to
2 directly resolve and interfere in that litigation, do
3 you agree?

4 A I don't agree. I think that might be an effect, but
5 I don't know if it was drafted with that specific
6 purpose in mind.

7 MR. KRAVIT: That's all.

8 THE COURT: What other purpose would
9 there be?

10 THE WITNESS: I mean, there could be any
11 other entity that has a potential default or default
12 argument.

13 THE COURT: Right. But Mr. Schwartzer
14 tells us he's not aware of anything like that.

15 THE WITNESS: And that may well be true,
16 but things spring out of the woodwork. I mean, there
17 are more than 3,000 policies.

18 THE COURT: No. I understand.

19 THE WITNESS: Yeah.

20 MR. KRAVIT: That's all I have, Judge.

21

22 REDIRECT EXAMINATION

23 BY MR. FINERTY:

24 Q Can I go back to the fair and equitable opinion that
25 you were just questioned on.

1 Was there a policyholder-by-policyholder analysis
2 done to determine whether it's fair and equitable to
3 any particular policyholder?

4 A No.

5 Q In fact, COFINA would be an example. Was there any
6 consideration given to all policyholders in looking
7 at the overall transaction itself?

8 A Looking at all policyholders, we were looking to see
9 whether they could be paid in full in cash timely
10 with an adequate margin of safety.

11 Q Good point. Let's assume, as Mr. Kravit did, that
12 the MHPI project owners are policyholders.

13 A Okay.

14 Q If they had a claim after the exit of the segregated
15 account from rehabilitation, how much on the dollar
16 would they be paid for that claim?

17 A 100 cents.

18 Q Would you consider that fair and equitable?

19 A Yes.

20 MR. KRAVIT: I'm going to object to the
21 backdoor nature of it. He said he had no opinion
22 about the fairness and equity.

23 THE COURT: He just developed that. I
24 think the point is that as policyholders
25 independently of this issue with the seven lawsuits,

1 if they have a claim under the policy, they're going
2 to be treated like everyone else and that's fair and
3 equitable, which he already said.

4 MR. KRAVIT: Fair enough. Withdraw it.

5 THE COURT: Well played.

6 MR. FINERTY: No further questions.

7 THE COURT: All right. Anything --

8 Ms. Neider?

9 MS. NEIDER: No, Your Honor. Thank you.

10 THE COURT: Anything further,

11 Mr. Kravit?

12 MR. KRAVIT: No, sir.

13 THE COURT: That you wish to withdraw?

14 Thank you, sir. You may step down.

15 THE WITNESS: Thank you very much.

16 THE COURT: Any further witnesses,

17 Counsel?

18 MR. FINERTY: If I could have a short
19 five-minute break to convene with my group, I would
20 appreciate that, and we can let the Court know the
21 rest of the schedule for the rest of the day.

22 THE COURT: Let me tell you what I'm
23 thinking and ask you to see whether this is something
24 that is even allowed in a proceeding of this nature.

25 As you well know, I'm a late-comer to

1 the rehabilitation here particularly and as a
2 rehabilitation court throughout the state of
3 Wisconsin with the retirement of Judge Johnston.

4 In ordinary litigation, even high-stake
5 litigation like this, I would at this point, given
6 what I know about this case, bring the parties in and
7 see if we could resolve the issue.

8 Now, I don't know if that's possible
9 because I don't know whether we'd have to bring in
10 150 lawyers and talk to them or whether I can bring
11 in Ms. Neider, yourself, Mr. Finerty, and Mr.
12 Kravit as well as Mr. Schwartz, and see whether
13 there's a common ground that could be met on this
14 issue. Is that something that is even allowed in
15 these proceedings or do we court potential problems
16 that we don't want to court by doing something like
17 that?

18 MR. FINERTY: I think that not only is
19 that allowed, it would be helpful. The Rehabilitator
20 would have no objection to it. I can -- if I spend
21 five minutes with Mr. Kravit, I think we could
22 probably advise you as to whether or not that would
23 be something that would be useful.

24 THE COURT: Would I need to involve
25 anyone -- I understand everyone's interested here but

1 nobody seems to be taking a very active role other
2 than the three parties. Is there any need to involve
3 anyone other than Ambac, the Rehabilitator, and the
4 MHPI folks?

5 MR. FINERTY: No. Those would be the --
6 the two parties and the one integral --

7 THE COURT: And the one sort of hanging
8 on the edge nonparty party.

9 MR. FINERTY: Thank you.

10 THE COURT: We'll take a recess, and
11 then let us know when you're ready.

12 MR. FINERTY: Thank you.

13 (Recess taken)

14 THE COURT: We're back on the record
15 with appearances previously noted.

16 Your next witness, Mr. Finerty.

17 MR. FINERTY: The Rehabilitator calls
18 David Barranco.

19 THE COURT: Mr. Barranco, if you'd come
20 forward and be sworn, please, sir.

21 DAVID BARRANCO,
22 was called as a witness in the above-entitled
23 matter, and after having been first duly
24 sworn, testified on oath as follows:

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DIRECT EXAMINATION

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BY MR. FINERTY:

Q Mr. Barranco, can you state your name and spell your last name for the court reporter, please.

A My name is David Barranco. Last name is spelled B-A-R-R-A-N-C-O.

Q What's your current occupation?

A I am a senior managing director and head of risk management for Ambac Assurance Corporation.

Q How long have you held that position?

A I've held this position for approximately a year and three months.

Q Prior to that position what was your role with the company?

A My role was senior managing director of risk management.

Q And how long have you been with Ambac?

A I've been with Ambac for 18 years.

Q In your current position what type of day-to-day duties do you hold?

A My responsibilities are for Ambac's insured portfolio which comprises about \$65 billion of exposure across more than 2,000 policies.

Q As of today, in rough numbers, approximately how many policies are in the segregated account of Ambac

1 Assurance Corporation?

2 A I don't know the specific number, but probably less
3 than, you know, 500 at this point in time.

4 Q And then overall in the general account,
5 approximately how many policies are in the general
6 account?

7 A Close to 2,000.

8 Q Earlier we had some testimony about something known
9 as control rights. Are you familiar with those?

10 A Yes.

11 Q And Mr. McGettigan's testimony was to the effect that
12 he had not seen an Ambac policy that doesn't come
13 with control rights. Can you confirm that?

14 A There would be very few Ambac policies without some
15 form of control rights.

16 Q What's your understanding of what control rights are
17 as it relates to insurance policies?

18 A Control rights kind of are -- underpin most of our
19 transactions, our policies. What they are could be a
20 right to approve amendments, consents and waivers.
21 Could be the right to remove a servicer. It could be
22 the right to ask -- require additional capital be put
23 into a transaction. Various credit -- negotiated
24 creditor rights that are in the transaction.

25 Q So the witnesses who testified regarding control

1 rights previously are not Ambac employees,
2 Mr. McGettigan and Mr. Schwartz, right?

3 A Correct.

4 Q Maybe you could give the Court a flavor as an Ambac
5 executive exactly how a control right in a specific
6 instance might operate.

7 A Okay. Yeah, certainly over the last ten years
8 following the financial crisis, control rights have
9 been particularly important to us. I think a couple
10 good examples are MBS. MBS are mortgage-backed
11 securities, are probably Ambac's most troubled
12 exposure. Control rights were very important in
13 those transactions in trying to mitigate losses.

14 So, for example, we were able to use our control
15 rights to switch the servicing of a number of
16 transactions. So that's to -- where servicing was
17 really poor and our rights triggered, we were able to
18 move the servicing of those portfolios,
19 mortgage-backed securities, to something a little bit
20 more effective.

21 Our estimate of the savings over the last eight
22 or ten years or so is \$300 to \$400 million of avoided
23 losses. That's one example.

24 Another example, we have this -- again, control
25 rights are very important to us in working out a

1 troubled credit. There's kind of a famous Ambac
2 credit called Local Insight Media. YellowPage
3 securitization. Very bad transaction. It was a
4 proper workout. Our control rights allowed us to go
5 in there and try to really step in the shoes of the
6 bondholders to try and fix the situation. We lost
7 money, but it was -- our actions saved somewhere
8 between \$10 and \$30 million.

9 There are numbers of these types of examples in
10 smaller size but add up to certainly a large amount
11 over the last ten years. Kind of that precedent
12 having those control rights has really been
13 beneficial to us.

14 Q Would you agree or disagree with Mr. McGettigan that
15 even though you can put a dollar figure on prior
16 instances where the companies exercise control
17 rights, that they're difficult to value or
18 fact-specific on a going-forward basis?

19 A I think that's right. You can't say exactly how much
20 they're worth. I look to the historical precedent
21 and think about those examples I just gave and think
22 about -- there's no reason to believe that that --
23 they won't be as equally as valuable going forward.
24 But you're correct. You can't put an exact dollar on
25 them.

1 Q Are you familiar with Section 6.13 of the proposed
2 second amended plan?

3 A Yes.

4 Q Mr. Kravit used an exhibit where he took an excerpt
5 out of 6.13. I'm going to hand it to you. You can
6 ignore some of the handwriting on it.

7 Is that 6.13 that you reviewed previously?

8 A Yes.

9 Q What's your understanding of what that section of the
10 second amended plan attempts to accomplish?

11 A To me, this kind of underpins, you know, all what
12 I've just spoke about in terms of control rights and
13 making sure that we still have our control rights,
14 whether they're segregated account or general account
15 policies going forward. This is -- gives us the
16 ability here to make sure that we can continue to do
17 what we've been doing all these years to save
18 capital. To make sure that there is no -- there's no
19 perceived default as a result of the rehabilitation
20 proceedings.

21 Q Is there any limitation as far as your understanding
22 is concerned that 6.13 would be limited to certain
23 policies?

24 A No.

25 Q Would it be applicable generally to all general

1 account policies?

2 A Yeah. Again, I look at this -- as stated before, we
3 have control rights in all of our policies. It's
4 kind of a precedential thing in the monoline
5 industry, having those control rights. So whether it
6 was, again, segregated account or general account
7 policies, having this in here is extremely important
8 to the way we look at our risks going forward.

9 Q Does 6.13 in any way extinguish a right to make an
10 insurance claim under any of Ambac's policies?

11 A No.

12 Q Are you aware of any limitation that 6.13 would
13 create for the payment of claims?

14 A The absence of 6.13? If you'd repeat your question.

15 Q Yes. Is 6.13 in any way intended to impede the
16 payment of claims or to give Ambac a defense to
17 payment of claims?

18 A No.

19 Q Let me ask the last and probably most obvious
20 question.

21 Is 6.13 in this plan specifically to address the
22 claims and counterclaims of the Military Housing
23 parties here today?

24 A Not specifically to the Military -- that certainly
25 falls in. We have \$6 billion in Military Housing

1 exposure. As I said before, it's the whole continuum
2 of exposure that Ambac has. \$65 billion of exposure
3 and 15 percent of that is adversely classified. So
4 control rights on all -- particularly on that part of
5 the exposure is very important. So Military Housing,
6 yes. It's really the continuum. It's a precedent
7 that we have when we look at the 6.13.

8 Q And your understanding is 6.13 applies well beyond
9 just the military housing portfolio.

10 A Yes.

11 MR. FINERTY: I have no further
12 questions at this time.

13 MS. NEIDER: Richard Slack.

14 THE COURT: Welcome, sir.

15 MR. SLACK: Thank you, Your Honor.

16 Where's the best place for me to ask a
17 couple questions?

18

19 CROSS-EXAMINATION

20 BY MR. SLACK:

21 Q Mr. Barranco, you testified about a number of prior
22 matters at Ambac where control rights have been
23 important.

24 Are there any current matters where control
25 rights are important to Ambac?

1 A Yes. Probably first and foremost is Puerto Rico.
2 Ambac has more than \$2 billion of exposure to
3 Puerto Rico and its various instrumentalities. A
4 significant workout for us. Our control rights in
5 terms of trying to make sure that we get the best
6 recoveries we can, having a seat at the table are
7 critically important. That's probably the best
8 example of control rights.

9 Also Military Housing. The obligation to fund
10 the debt service surety. That is -- contributing the
11 \$200 million, that's important, too. That's another
12 example of control rights where we're stepping into
13 the shoes of the bondholders to -- for a negotiated
14 covenant someone has to perform on. Those are two
15 examples of control rights.

16 Q Now, with respect to the Military Housing matter that
17 you just referred to, do you have an understanding as
18 to what the issue is in the litigations concerning
19 Ambac's control rights?

20 A Yes. Yes.

21 Q And can you tell the Court what your understanding
22 is.

23 A My simple understanding is that the various Military
24 Housing parties are using the -- what happened in the
25 segregated account as a -- sort of as an excuse to

1 get out of the obligation to fund something that was
2 a bargained-for covenant, so to speak. It was
3 something that was bargained for. We're using what
4 happened in the segregated account, where this is a
5 general account policy, to not meet that obligation.

6 Q Now, you've talked about some examples in the past
7 where control rights have been important and you
8 talked about some current matters.

9 Are there any matters at Ambac that you expect in
10 the future are going to be important to use the
11 control rights that you have in contracts?

12 A Absolutely. You know, whether it's segregated
13 account or general account. I spoke about the
14 15 percent of our portfolio which is adversely
15 classified, that meaning having some sort of credit
16 issue, those control rights that we've exercised in
17 the past and we'll plan to continue to exercise going
18 forward. That is very important to our risk
19 management job.

20 I think about, example here, somewhere north of a
21 billion dollars worth of student loan exposure that
22 is not performing. Private student loans, lots of
23 defaults and what have you.

24 Our control rights that I anticipate being able
25 to use going forward, whether it's moving the special

1 servicing or what have you to help write these
2 transactions are of paramount importance to us.

3 Q Now, have you heard the term adversely classified
4 exposure?

5 A Yes.

6 Q What's your understanding of that? How does that
7 play into Ambac's business?

8 A You know, I'm head of risk management. My job is to
9 make sure that we mitigate any sort of losses,
10 potential losses or avert potential problems coming
11 out, these adversely classified credits. Now, they
12 don't -- I said there's 15 percent of our portfolio.
13 Doesn't mean we're going to lose money in all of
14 them, but they have some credit issues. Our control
15 rights are probably that first order to help try and
16 right that situation.

17 Q Is it fair to say the control rights are important
18 throughout that 15 percent of your portfolio?

19 A Yes.

20 Q Now, Mr. Barranco, why is 6.13 so important to the
21 preservation of your control rights?

22 A 6.13 to me is -- that is -- with the absence of 6.13
23 we run this risk of other people saying, hey, you
24 know, because of what happened in the segregated
25 account we don't have to -- you don't have this right

1 to -- these control rights, Ambac. You don't have
2 the right to try and fix the situation.

3 So for me 6.13 is kind of a fundamental aspect of
4 how -- I look at this portfolio of risk that we have
5 that's going to go on for 30 or 40 years and how to
6 kind of mitigate that risk.

7 Q Has the company considered what would happen if the
8 Military Housing argument that's being forwarded that
9 the segregated account affects the ability to use
10 control rights, how that argument if successful would
11 affect the rest of the portfolio?

12 A It could be potentially very negative. A
13 precedent-setting challenge to us.

14 If Puerto Rico -- if we -- someone said, hey,
15 look at what these Military Housing guys are doing,
16 Ambac doesn't have any control rights here and it
17 impacts our ability to work out Puerto Rico. Maybe
18 whatever other credits that might come down the pipe.

19 To me it's very important to make sure we
20 maintain control rights in order to do what we've
21 been doing, which is to help save capital and benefit
22 policyholders.

23 MR. SLACK: Thank you, You Honor. I
24 don't have any more questions.

25 THE COURT: Mr. Kravit, any cross?

CROSS-EXAMINATION

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BY MR. KRAVIT:

Q Mr. Barranco, have you sued -- has Ambac affirmatively sued any Puerto Rican entity on any Puerto Rican bond?

A We have -- yes. We have three or four sets of litigation that are out there today. I don't recall exactly which instrumentalities. We insure about seven different instrumentalities. Between the lift on the stay and the Title 3, which is kind of the bankruptcy of some of these Puerto Rican instrumentalities, we were able to -- we filed three or four different lawsuits.

Q Okay. Puerto Rican risks, are they in the segregated account or ordinary account?

A They are in the general account.

Q They're in the general account.

And did any of your policies that you're suing on regarding Puerto Rico -- by the way, when did you initiate those lawsuits?

A The most recent lawsuits were -- I recall maybe the first three days of May of this past year.

Q When was the first one?

A First one, I don't recall specifically, but over the past two or three years there's probably a couple

1 other ones that were --

2 Q Did any of them have the policy provisions that are
3 in the MHPI?

4 A I don't know.

5 Q You don't know? How can you compare them then?

6 A I'm sorry. The control provision -- can you rephrase
7 your question?

8 Q My question is, any lawsuit out of the general
9 account where you said you needed control rights and
10 you filed lawsuits, did they have the policy and
11 provisions that are in the MHPI policies?

12 A The policy provisions, if you're -- just to clarify,
13 maybe if you're talking about control rights, control
14 rights can be different in each transaction. They're
15 negotiated differently.

16 So -- I'm just saying that if Military Housing --
17 you know, these six or seven transactions there was a
18 provision there that we sued on, that might be unique
19 to those transactions.

20 What we've litigated over in Puerto Rico are
21 different but yes, they're all part of the general
22 account and, yes, they are broadly part of our
23 control rights.

24 MR. KRAVIT: Okay. I move to strike the
25 answer as nonresponsive.

1 THE COURT: Overruled.

2 Q I think what you said, it's not the same -- did you
3 just say it's not the same policy provisions as are
4 in MHPI?

5 A What I said was that the policy provisions or the
6 control rights in each transaction are different. So
7 if there was -- in Military Housing, for example, if
8 there was a provision that someone failed to fund up
9 the surety, that is a particular action, a control
10 right that we had that allowed us to sue for --
11 assuming nonperformance.

12 In Puerto Rico, the control rights, they're not
13 paying. You know, that's a different kind of --

14 Q Yeah, they're not paying. That's the reason you sued
15 them; am I right?

16 A That's maybe a simplified version of it. There are a
17 number of different levels of why we're suing.

18 Q When your insureds don't pay, you sue them, right?

19 A Not all the time.

20 Q Sometimes you -- because they failed, you eat the
21 loss; but to the extent you think they're solvent,
22 you sue them for premium, right?

23 A No. I think when -- again, this is part of risk
24 mitigation. When someone doesn't pay, you use your
25 control rights, you look at what you have to best

1 mitigate the situation. What is your best avenue to
2 go forward? What are your rights under this
3 particular document and what are -- what's the
4 context? What are the economic assets?

5 Q In the Military Housing program, has there ever been
6 a nonpayment?

7 A No.

8 Q And has any of the Military Housing program
9 classified, as you call it?

10 A Yes.

11 Q Okay. What?

12 A We have -- my recollection of the ones that are
13 specifically involved in the litigation, at least one
14 of those is an adversely classified credit.

15 Q Which project and which lawsuit is that?

16 A Ft. Leavenworth, which is in Kansas.

17 Q And that is the only one of the seven lawsuits on the
18 sheet.

19 MR. KRAVIT: Can you give him the sheet
20 if it's up there.

21 A My recollection is Carlisle Picatinny. Is that one
22 of the seven? I just don't recall.

23 Q If it's still up there. If not I'll get --

24 A I don't have the --

25 THE COURT: Have we marked the other

1 exhibits?

2 MR. KRAVIT: His were all tab marked
3 numbers. You could put anything you want on it.

4 MR. FINERTY: We have it marked. The
5 stickers were the exhibits from the filings. We'll
6 have to go back -- if that was to be No. 1, that's
7 great.

8 THE COURT: We'll mark this Exhibit 1
9 and then we'll deal with the notebook at the
10 conclusion.

11 Exhibit 1 is in front of the witness.

12 MR. KRAVIT: Thank you.

13 Q Take a look at Exhibit 1 and tell me which lawsuit in
14 this list relates to a classified loan --
15 classified --

16 A So in our -- of our adversely classified credits, the
17 second one down, which is Ambac Assurance Corp. vs.
18 Carlisle Picatinny, that is an adversely classified
19 credit.

20 The last one on the list, which is Ambac
21 Assurance Corporation vs. Ft. Leavenworth Frontier
22 Heritage Communities, is an adversely classified
23 credit.

24 Q And there's five other ones that you did not -- that
25 are not adversely classified that you sued, right?

1 A Yes.

2 Q And the reason for suing those?

3 A For failure to meet the obligation to fund up the
4 debt service surety.

5 Q In all cases in all the paperwork on those loans
6 Ambac had a requirement to be AA rated; am I right?

7 A I don't know that specifically.

8 Q The covenant that the MHPI bargained for was that
9 Ambac would be AA rated. Yes or no?

10 A I don't know specifically if it's AA. I don't know
11 the detail specifically.

12 Q If I'm right that the covenant was that Ambac had to
13 be AA rated, that would be something that the parties
14 bargained for just as you were saying they bargained
15 for control rights, correct?

16 A Yes. A credit rating would be something that would
17 be typically bargained for.

18 Q The fact that Ambac couldn't maintain a AA credit
19 rating is of no fault of MHPI; am I right?

20 A No.

21 Q I'm not right?

22 A I'm sorry. It's no fault that the credit rating of
23 the surety provider is not AA.

24 Q All right. So MHPI would have rights, whatever they
25 are, under this bargained-for agreement in case Ambac

1 couldn't hang a AA rating; am I right?

2 A Typically -- in this case, I'm not sure what their
3 rights were, if they were different than the -- but
4 yes.

5 Q In any event, you were involved in the decision made
6 by Ambac back in 2015 to sue all the MHPI
7 partnerships, or whatever they were, right?

8 A No.

9 Q You were not.

10 A No.

11 Q On other than default grounds, default and payment,
12 is Ambac suing anyone else in the general account?

13 A I don't recall -- I can't -- I don't know that for a
14 fact.

15 Q You're the head of risk management. You've been
16 there 16 years. The fact is no one other than MHPI
17 is being sued for something other than default. Yes
18 or no?

19 A The question was in the general account?

20 Q Yes, sir.

21 A I can't think of anything that's currently -- that
22 meets that definition.

23 Q Can you think of anything in the last five years that
24 meets that definition?

25 A I don't know. I don't recall.

1 Q Can you think of any insured, any policyholders where
2 Ambac has purchased a tranche of bonds related to
3 that policyholder other than MHPI?

4 A Is the question have other financial guarantors
5 purchased debt that are insured by that particular
6 insurance company?

7 Q Could you read the question, please.

8 (Question read by the judge)

9 A Ambac has purchased, invested in a number of
10 different securities that were insured by Ambac over
11 the past ten years. I think we just announced,
12 actually, last week that we had purchased a
13 significant amount of Puerto Rico COFINA bonds.

14 Q You're aware, are you not, that there was a purchase
15 of MHPI D tranche bonds for \$72 million in 2015?

16 A I'm aware that there was an investment in a
17 securitization tranche -- transaction originated by,
18 I think it was Freddie Mac that included a number of
19 our insured Military Housing bonds.

20 Q You bought them at a significant discount, correct?

21 A I don't recall the price exactly, but they were --
22 they're not cash-flowing bonds so you typically buy
23 them at a discount.

24 Q And you agree, do you not, that Ambac is suing MHPI
25 to put \$200 million into the entity that these bonds

1 support.

2 A I'm aware that Ambac is involved in litigation with
3 approximately seven Military Housing transactions of
4 the 35 that we insure, and that some of those
5 transactions may be in the Freddie Mac transaction.

6 Q Do you know enough about the value of bonds to have
7 an opinion as to whether adding \$200 million that is
8 ahead of Ambac's insurance will make it less likely
9 that Ambac will ever have to pay on an insurance
10 policy?

11 A Could you say that again. Rephrase the question,
12 please.

13 Q Do you know enough about bonds to have an opinion as
14 to whether if MHPI's required to pay \$200 million
15 based on your so-called control rights, lenders'
16 rights, that that will cover -- that will be ahead of
17 the Ambac policies?

18 MR. SLACK: Your Honor, I'm going to
19 object to the form of the question.

20 THE COURT: In what respect?

21 MR. SLACK: I think it starts out by
22 asking him about the bonds and then talks at the end
23 about whether it's going to be ahead of the policies.
24 I don't think the question, quite frankly, makes any
25 sense that way.

1 THE COURT: Does it make any sense to
2 you?

3 THE WITNESS: Parts of it do. The
4 entire thing doesn't.

5 THE COURT: Try again, Mr. Kravit.

6 MR. KRAVIT: All right. Thank you.

7 Q Ambac is seeking to put \$200 million into the MHPI
8 from the developer; am I right?

9 A Ambac is seeking for, yes, for the MHPI to
10 collateralize up to \$200 million.

11 Q And Ambac is doing that not just in cases where it
12 says the loan is classified. It's doing it in all
13 the cases for MHPI, right?

14 A It's doing it in all the transactions where there is
15 this covenant violation.

16 Q And you agree, do you not, that Ambac is on both
17 sides of those transactions as a bond owner and as an
18 insurer.

19 A As a bond owner of --

20 Q The underlying D tranche bonds.

21 A The underlying -- the transaction which you're
22 referring to is a securitization of a number of
23 different Military Housing transactions that were
24 owned by Freddie Mac. And we own the D tranche of
25 that particular securitization.

1 Q All right. That's true. Now, listen to what I ask
2 you, please. All right?

3 It's the case, is it not, that the
4 \$200 million that Ambac is seeking will benefit the
5 bonds that it purchased. True?

6 A I don't know that.

7 Q You don't know that?

8 A No.

9 Q Well, then why is Ambac seeking the \$200 million?

10 A Ambac is seeking the \$200 million on the direct
11 insurance exposure that it has. In all of these
12 transactions the bargain for a number of different
13 covenants, this was one of the covenants. The
14 trigger was tripped and this is -- the remedy is for
15 the developers or sponsors to put in the funds to
16 collateralize the debt service surety.

17 Q Do you agree that the trigger that was tripped was
18 that Ambac lost its rating?

19 A The trigger that was tripped was a ratings trigger.
20 That was --

21 Q And it was Ambac's ratings trigger.

22 A Yes.

23 MR. SLACK: Your Honor, can he let the
24 witness finish the answer before he interrupts?

25 THE COURT: Would you please,

1 Mr. Kravit? You're being a little bit aggressive.

2 MR. KRAVIT: I'm getting testy, Your
3 Honor, but he is answering beyond what I'm asking.
4 I'll adapt.

5 THE COURT: I'm sure you can deal with
6 it.

7 MR. KRAVIT: I'll adapt. Thank you.

8 Read back the question and the answer,
9 please.

10 (Question and answer read)

11 Q You agree, do you not, that a trigger -- that the
12 trigger that caused Ambac to sue my clients to put in
13 \$200 million was a ratings default on Ambac's part?

14 A The trigger was not the reason we defaulted -- I'm
15 sorry, we litigated. It was the fact that the
16 obligation -- the developers failed to meet that
17 obligation to fund.

18 Q And the obligation to fund came about because Ambac
19 lost its rating, correct?

20 A It happened because of a downgrade to Ambac.

21 Q So I'm right.

22 A Yes.

23 Q It's because Ambac lost its appropriate rating,
24 correct?

25 A The trigger in the transaction, as I think you've

1 said, is AA and Ambac was no longer AA, so it tripped
2 that trigger. Yes.

3 Q Don't you see the irony in the fact that Ambac took
4 advantage of its own perfidy in order to sue my
5 clients to get \$200 million?

6 MR. SLACK: Objection, Your Honor.
7 Argumentative.

8 THE COURT: Sustained.

9 I'm not sure irony is in the rules of
10 evidence. We can do a whole section on it.

11 Q Do you think it is fair and equitable for Ambac to be
12 suing MHPI for \$200 million on the basis of its own
13 ratings decline?

14 A I don't look at it that way. I look at these are the
15 negotiated covenants in the transaction. We are
16 stepping into the shoes of the bondholders, the
17 policyholders, and we're just doing what we're
18 supposed to be doing to protect the transactions.

19 Q Now, you know that the transactions themselves are
20 50-year transactions with the U.S. military; am I
21 right?

22 A Yes.

23 Q And you also know that as part of the same documents
24 that you are exploiting for Ambac's purpose there is
25 an obligation upon the MHPI developers to update,

1 fix, repair, and replace the housing; am I right?

2 A Yes.

3 Q And you agree, do you not, that there's only one set
4 of cash flow to do that, and that is the cash that's
5 earned on the property, right?

6 A Yeah. It's the -- yeah, the pledge -- yeah, pledge
7 revenues.

8 Q Correct.

9 So if the pledge revenues don't go into the
10 property, where do they go?

11 A After paying bondholders, they go to the developers.

12 Q And so what Ambac has done by suing MHPI is to take
13 cash flow away from the property and the developers
14 but the property to use it as a cushion for itself,
15 correct?

16 A No.

17 Q What's wrong with that?

18 A Ambac is -- this is a structural feature of this
19 transaction was a debt service surety. The
20 negotiated position, bargained-for position was if
21 the debt service surety provider didn't have a
22 certain rating, that it had to be replaced or
23 collateralized. It just seems doing exactly what a
24 negotiated lender, borrower-type of situation what
25 should be done.

1 Q And so Ambac is free to exercise its control rights
2 on both sides of the transaction in derogation of the
3 policyholders' interest and requirement under its
4 contracts to repair and replace these real
5 properties.

6 MR. SLACK: Objection. Argumentative.

7 THE COURT: Sustained.

8 Q It is clear, it is not, that Ambac gave no
9 consideration to the requirements of the MHPI
10 developers to develop its properties in the 50-year
11 program when it sued for \$200 million.

12 A Could you repeat the question? I'm not sure what
13 you're asking.

14 Q Okay. Ambac gave no consideration to the requirement
15 on the MHPI developers to continue developing its
16 property when it took the \$200 million, right? When
17 it tried to take \$200 million.

18 A No. I don't think one has to do with the other.

19 Q So Ambac has no obligation to policyholders when --
20 concerning whether to use so-called covenant defaults
21 to obtain extra money.

22 MR. SLACK: Your Honor, I'm going to
23 object to the form of the question.

24 THE COURT: Sustained.

25 MR. KRAVIT: All right, sir.

1 Q I think you said earlier that you do not sue every
2 person who's out of covenant, right?

3 A No. More often than not the -- if there's a covenant
4 that's breached, the other side performs.

5 Q So you either do or don't sue every person who's out
6 of covenant?

7 A We don't sue -- we don't sue everyone that is out of
8 covenant because sometimes it's resolved.

9 Q Okay. Did you make any attempt to resolve with MHPI?

10 A My -- yeah. My understanding, wasn't directly
11 involved at that point in time. It was over a number
12 of years that this was a series of back-and-forth
13 discussions between the Army, the developers, and
14 Ambac.

15 Q Yet, it's Ambac who decided seven years after this
16 alleged default to make a lawsuit, right?

17 A It was Ambac exercising its control right that was
18 bargained for, negotiated for to support the
19 transaction and for the benefit of the policyholders
20 and Ambac.

21 Q And what Ambac did was then file lawsuits in seven
22 different states or be subject to declaratory
23 judgments in at least one of those states that was
24 filed by my client, right?

25 A Yes.

1 Q So that was Ambac's unilateral decision to go outside
2 of Wisconsin or any other court outside of the
3 rehabilitation that part of Ambac was in and file
4 lawsuits in foreign courts, right?

5 MR. SLACK: Your Honor, I'm going to
6 object again as to both argumentative and, really,
7 beyond any scope of anything we had on direct.

8 THE COURT: Well, I think its more
9 pertinent objection is cumulative.

10 Haven't we heard this from a number of
11 sources at this point? I get your point, Mr. Kravit.
12 Let's move on.

13 MR. KRAVIT: Okay. Thank you.

14 Q Is Ambac satisfied with the relief it is obtaining in
15 the seven courts where there are or were cases
16 pending?

17 THE COURT: You mean like the two
18 dismissals?

19 MR. KRAVIT: Exactly, sir.

20 A Are we satisfied?

21 Q Yes.

22 A Probably not.

23 Q Okay. And did you know that in three of the cases
24 the actual issue that 6.13 seeks to resolve has been
25 briefed, summary judgment motions by both parties,

1 and is under advisement?

2 A No.

3 Q You did not know that.

4 A Did not know that.

5 Q Okay. You agree, do you not, that the purpose of
6 6.13 is to resolve that issue in Ambac's favor?

7 A I'm aware of what 6.13 is for in the context of the
8 amended plan and what it means to -- generally.

9 Q If 6.13 is not entered into as part of this plan by
10 the Court, does Ambac lose any money, cash money?

11 A What I said before is you can't maybe necessarily
12 quantify exactly what it is, but certainly the
13 potential for loss is whether it's MHPI-related or
14 other transaction --

15 Q I'm only talking about MHPI.

16 MR. SLACK: Your Honor, he was still in
17 the process of answering the question.

18 MR. KRAVIT: He's answering the wrong
19 question and going outside. It's cross.

20 THE COURT: Regardless, I'm not
21 sustaining the objection to the question. I'm
22 sustaining your objection to jumping the witness.
23 Let's not talk over him, please.

24 Q You may finish if you have more to say.

25 A I don't have more to say.

1 THE COURT: Why don't you put another
2 question to him, Mr. Kravit.

3 Q If 6.13 is not part of this plan, will there be any
4 quantifiable economic harm to Ambac from the MHPI
5 lawsuits?

6 A As I said, it's difficult to quantify exactly what
7 that could be today. But the potential there is --
8 the potential is certainly there. Particularly given
9 that a couple of these credits are adversely
10 classified.

11 Q All the credits, sir?

12 A A couple of them are.

13 Q So you're using the whole thing as a classified
14 credit now?

15 A Look, we're in the risk management business. We have
16 \$6 billion of exposure to these Military Housing
17 transactions. They go out, as you pointed out, for
18 50 years, whatever it is. There's a lot of potential
19 inherent risks, whether it's base closing, changing
20 in the reimbursement of BHA, which is that basic
21 housing alliance. From a risk management perspective
22 there are a lot of things that can go wrong.

23 Q You're the risk manager, and that's priced into the
24 price of the insurance, isn't it?

25 A It's bargained for in terms of the premium but it's

1 also bargained for in terms of control rights to make
2 sure we can control --

3 Q Let's go back to this. Even if MHPI wins in the
4 civil litigations, they continue to pay premiums,
5 correct?

6 A For now, yes.

7 Q Well, that's what they're obligated to do. Have they
8 ever not paid premiums?

9 A No.

10 Q Ambac will not -- even if MHPI wins, Ambac will not
11 be required to post any collateral, correct?

12 A Post any collateral for what?

13 Q To reserve any funds, post any collateral. If MHPI
14 wins, what happens to Ambac financially?

15 A What happens to Ambac financially is, again, from a
16 risk management perspective, is the basic tools that
17 we have to make sure we mitigate risk are impaired.

18 Q But no loss that you can quantify today. Zero.

19 A There's no loss that I can say specifically what it's
20 going to be based upon that. As described, the
21 potential for loss is --

22 Q So you want 6.13 on the potential for loss; is that
23 right?

24 MR. SLACK: Objection to the form of the
25 question. Argumentative.

1 THE COURT: Overruled.

2 I get your point, Mr. Kravit.

3 MR. KRAVIT: Okay.

4 Q Is there any impact at all on the Wisconsin taxpayer
5 funds by MHPI winning or losing the cases that you
6 brought in the seven places?

7 A I don't know.

8 Q In this plan, you understand this plan is not seeking
9 to use any of the Wisconsin taxpayer funds, correct?

10 A Yes.

11 Q Besides seeking \$200 million, Ambac has used its
12 so-called control rights to divert smaller amounts of
13 cash flow from the MHPI projects, correct?

14 A Could you maybe be more specific.

15 Q Do you know whether it has happened or not?

16 A I don't know.

17 Q All right. That's all I have.

18 THE COURT: Redirect, Mr. Finerty?

19 MR. FINERTY: Nothing from the
20 Rehabilitator.

21 THE COURT: Any redirect -- or recross
22 or whatever it is.

23 MR. SLACK: Just a couple questions.

24 THE COURT: I think you are redirect.

25 Go ahead.

RECROSS-EXAMINATION

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BY MR. SLACK:

Q Mr. Barranco, you had in a couple of your answers talked about that -- in general that the reasons that you sued were because the Military Housing folks were -- had covenant violations. Can you describe more specifically what the obligations were that Military Housing folks didn't adhere to before you sued?

A Sure. Amongst these are very complex transactions. There are a number of covenants. But one impacting the debt service surety was, as described, a ratings trigger. That ratings trigger I understand to be AA. By that -- by that rating not being there, being downgraded creates an obligation for the developer in this case to either replace the surety or to collateralize it. That was kind of a negotiated portion -- part of the transaction amongst many other covenants.

Q Now, you had also talked about -- a number of times about the fact that the control rights and what you just described in terms of Ambac's rights there were bargained for. Is that your understanding? That the parties bargained for those rights that you just talked about?

1 MR. KRAVIT: Objecting. Asked and
2 answered.

3 THE COURT: It has been asked and
4 answered, and I've heard it was negotiated, so --

5 Q One last question. Is it typical for the policies
6 that Ambac has and where it has control rights, were
7 those part policies to have some kind of a trigger
8 much like the Military Housing contracts where Ambac
9 would lose those rights if it was in rehabilitation?

10 A Just to understand the question correctly, there are
11 lots of covenants in any sort of transaction. Like
12 any sort of lender or borrower-type of situation
13 where the covenant is violated, there are certain
14 remedies. I'm not sure that has -- what that has to
15 do with the rehabilitation in this particular case
16 other than as 6.13 is saying is that -- the
17 assumption is there is no default and that we can
18 continue to exercise our control rights.

19 Q I guess the question is, is 6.13 directed only to
20 Military Housing or is there a risk that if 6.13
21 isn't there, that Ambac would lose its control rights
22 in other policies?

23 A I'm sorry. Yes. That is -- may have touched upon
24 this before, but that is the -- I described that we
25 have -- 15 percent of our exposure is adversely

1 classified. And control rights have been a big part
2 of that in trying -- to mitigate losses over the last
3 ten years or so. My every expectation is that we'll
4 continue to do so.

5 So it is not just Military Housing. Military
6 Housing is \$6 billion of exposure that just happens
7 to be around there for a long time. We have lots of
8 other -- we have another \$60 billion of exposure that
9 we have to be concerned about.

10 MR. SLACK: No further questions.

11 MR. KRAVIT: Just one.

12

13 RECROSS-EXAMINATION

14 BY MR. KRAVIT:

15 Q Is there any other case besides the Military Housing
16 Projects where Ambac sued because of a covenant
17 default based on Ambac's downgrade?

18 A I can't -- I don't recall a specific example. I
19 can't think of one.

20 MR. KRAVIT: All right. That's it.

21 THE COURT: Redirect by either?

22 MR. FINERTY: No, Your Honor.

23 THE COURT: Thank you, sir. You may
24 step down.

25 Mr. Finerty, any further witnesses?

1 MR. FINERTY: Nothing further, Your
2 Honor.

3 A few logistical things. Other than
4 that, the Rehabilitator would rest.

5 THE COURT: Any further evidence from
6 Ambac?

7 MS. NEIDER: No, Your Honor.

8 THE COURT: And from your clients,
9 Mr. Kravit?

10 MR. KRAVIT: We were not given the
11 opportunity to present any evidence, Your Honor.
12 Thank you.

13 THE COURT: Thanks for reminding me.
14 That was a pretty brilliant move on my part. Thank
15 you.

16 Mr. Finerty, you had some housekeeping?

17 MR. FINERTY: Yeah. On the exhibits, we
18 had marked 1 through 8 in the binders that were
19 presented, so what I'd like to do is remark Exhibit 1
20 that we just marked, make that -- would be actually
21 13 because we go 1 through 8 in the binders. The
22 affidavit of Daniel Schwartz would be 9 that the
23 Court admitted today. Same thing with 10 would be
24 the Barranco affidavit and 11 would be the Ksenak
25 affidavit. And then Mr. Kravit's listed cases would

1 be 12. And 13 would be the 6.13 excerpt that a
2 number of the witnesses referred to.

3 THE COURT: Can you make that change
4 wherever we say Exhibit 1 dealing with -- in the
5 transcript? No?

6 THE COURT REPORTER: I don't even know
7 what you are talking about.

8 THE COURT: Yes, we'll do that. We'll
9 take care of it.

10 Any other housekeeping details?

11 MR. FINERTY: No, other than the
12 adjourned date and logistics of the briefing that we
13 discussed.

14 THE COURT: Right.

15 The evidence is closed. We are having
16 an adjourned date for purposes of the ruling. And
17 that would be January 22nd, I believe, at
18 1:00 p.m. -- 1:30, I beg your pardon. The parties
19 will be briefing, providing their closing arguments
20 by brief.

21 We had set January 15 for the initial
22 brief. The Court is closed on January 15. That's
23 Martin Luther King Jr. Day. I would request that you
24 exchange them if you are working that day and that
25 they are timely filed with the Court on January 16.

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And with respect to the reply, that
would be on the 9th, Friday, and we'll reconvene at
1:30 on the 22nd.

Is there anything further that we can
accomplish or not today?

MR. FINERTY: No, Your Honor. Thank you
very much.

THE COURT: Thank you, all. We are
adjourned. And I'll hang up.

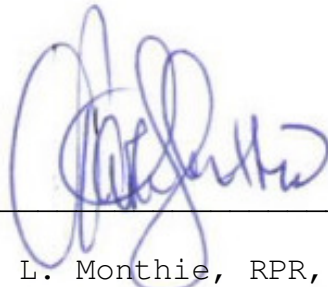
(Adjourned at 4:14 p.m.)

1 STATE OF WISCONSIN)
2) SS
3 COUNTY OF DANE)
4

5 I, TARA L. MONTHIE, Official Court Reporter
6 for Dane County Circuit Court, Branch 9, do hereby
7 certify that I took in shorthand the above-entitled
8 proceedings held on the 4th day of January, 2018, I
9 reduced the same to a written transcript, and that it
10 is a true and correct transcript of my notes and the
11 whole thereof.

12 Dated this 8th day of January, 2018.

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Tara L. Monthie, RPR, CRR
Official Court Reporter

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