

In the Matter of the Rehabilitation of:

Case No.: 10-CV-1576

Segregated Account of Ambac Assurance Corporation

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**BRIEF OF WELLS FARGO BANK, N.A., SOLELY IN ITS CAPACITY AS TRUSTEE FOR CERTAIN RMBS TRUSTS AND ON BEHALF OF THOSE TRUSTS' CERTIFICATEHOLDERS, IN SUPPORT OF MOTION TO MODIFY ORDER FOR TEMPORARY INJUNCTIVE RELIEF**

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Wells Fargo Bank, N.A., solely in its capacity as Trustee for certain residential mortgage-backed securities ("RMBS") trusts (the "Trusts") and on behalf of the Trusts' holders (the "Holders") of residential mortgage-backed securities (the "Wells Fargo RMBS Trustee"), respectfully submits this Brief in support of its Motion to Modify the Court's Order for Temporary Injunctive Relief, dated March 24, 2010 (the "Order"). The Wells Fargo RMBS Trustee seeks modification of the Order to amend paragraphs 6 and 9.B.2(iv) as set forth below.<sup>1</sup>

**STATEMENT OF FACTS**

**The Wells Fargo RMBS Trustee**

The Wells Fargo RMBS Trustee serves as trustee for certain Holders of securities in approximately thirty RMBS securitization transactions (each, an "RMBS Transaction"), which Holders (the "Insured Certificateholders") are the ultimate

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<sup>1</sup> The Wells Fargo RMBS Trustee reserves its right to challenge the creation of the Segregated Account and the transfer of its Policies (defined below) to the Segregated Account. The Wells Fargo Trustee further reserves its right to seek relief from the Order to the extent specific circumstances in respect of a specific RMBS Transaction (defined below) warrants such a request.

beneficiaries of financial guaranty insurance policies (collectively, the “Policies”) issued by and insurance agreements entered into by Ambac Assurance Corporation (“Ambac”). (Affidavit of Charles Brehm, sworn to May 20, 2010 (the “Brehm Affidavit”), at ¶ 2.) The Policies, which are held by the Wells Fargo RMBS Trustee for the benefit of the Insured Certificateholders, insure against certain losses incurred by, and/or allocated to, certificates held by the Insured Certificateholders. (*Id.* at ¶ 2.) The unpaid principal balance of the securities covered by the Policies is approximately \$3.63 billion. (*Id.* at ¶ 3.) Upon information and belief, the Wells Fargo RMBS Trustee, on behalf of the Insured Certificateholders, has substantial current and projected future claims against the Segregated Account described below.

**Ambac’s Control Rights Under the RMBS Documents**

Each RMBS Transaction is governed by a separate set of operative documents, which may include a pooling and servicing agreement, servicing agreements, a sale and servicing agreement, a trust agreement and/or an indenture and other related documents (the “Operative Documents”), delineating the rights and responsibilities of each of the parties to the transaction, including the trustee and the insurer. (Affidavit of Daniel M. Cohen, sworn to June 21, 2010 (the “Cohen Affidavit”), at ¶ 3.) RMBS Transactions usually also incorporate an insurance agreement, which further delineates the rights and responsibilities of the parties to the transaction vis-à-vis the insurance policy (together with the Operative Documents, the “Governing Documents”). (*Id.* at ¶ 3.)

While the terms of the Governing Documents differ from deal-to-deal, they generally allocate to Ambac broad consent and direction rights. (*Id.* at ¶ 4.) Examples

of such rights include, but are not limited to: consent to the employment of subcontractors, consent to or direction of the sale or transfer of any of the trust estate, direction of the Wells Fargo RMBS Trustee (on behalf of the trust) to institute legal proceedings after an event of default, direction of the termination of the trust after an event of default, direction of the Wells Fargo RMBS Trustee (on behalf of the trust) to waive certain past defaults, and appointment of successor parties (servicers, administrators and trustees) to perform services on behalf of the trust. (*Id.* at ¶ 4 .)

Pursuant to the terms of the Governing Documents, Ambac generally loses those control and direction rights upon the occurrence of certain defaults (each, an “Insurer Default”). (*Id.* at ¶ 5.) An Insurer Default generally occurs (among other instances) if there is a failure by Ambac to make a payment when due and/or the commencement of a rehabilitation proceeding. (*Id.* at ¶ 5.) If and when an Insurer Default occurs and Ambac loses its control and direction rights, the Governing Documents redirect these rights to certain of the investors of the applicable RMBS Transaction. (*Id.* at ¶ 5.)

Accordingly, the commencement of this rehabilitation proceeding and/or the failure of Ambac to pay amounts due in respect of the Policies, as Insurer Defaults, should, under the terms of the Governing Documents, result in Ambac losing control rights and those control rights passing to Insured Certificateholders and/or other investors of the applicable RMBS Transaction. (*Id.* at ¶ 6.)

Regardless of who is entitled to exercise control and direction rights, the Governing Documents require that a party who wishes to direct the Wells Fargo RMBS Trustee to take a specific action indemnify the Wells Fargo RMBS Trustee. (*Id.* at ¶ 7.)

The Governing Documents generally provide that the indemnification take the form of an indemnity or security against the costs, expenses and liabilities that may be incurred by the taking of the directed action, which indemnity or security must be acceptable to the Wells Fargo RMBS Trustee. (*Id.* at ¶ 7.)

**The Commencement of this Action and the Order for Temporary Injunctive Relief**

On March 24, 2010, the Policies were transferred to the Segregated Account, which contains approximately \$68 billion in Ambac policies, of which approximately \$36 billion are RMBS-related policies. (See Ambac Financial Group, Inc.'s ("ABK") Form 10-K, filed April 9, 2010 (copy attached as Exhibit A to the Affidavit of Bryan K. Nowicki in Support of Motion to Modify Order for Temporary Injunctive Relief Filed by Certain RMBS Policyholders (the "Nowicki Affidavit"), sworn to April 30, 2010) (the "ABK Form 10-K"), at 4.) On that same date, the Commissioner of Insurance of the State of Wisconsin (the "Commissioner") filed a Verified Petition for Order of Rehabilitation in the Circuit Court for Dane County, commencing this action (the "Rehabilitation").

On March 24, 2010, this Court entered its Order of Rehabilitation and an Order for Temporary Injunctive Relief (the "Order"). Paragraph 6 of the Order provides, in relevant part, as follows (emphasis added):

All persons and entities are hereby enjoined and restrained from: (i) taking any action to exercise any approval, consent, direction, voting, veto, or other right (the "Rights") that the Segregated Account or the Allocated Subsidiaries may have (or that the Segregated Account, the Allocated Subsidiaries or Ambac would have but for the occurrence of the Events or the financial condition of the Segregated Account, the Allocated Subsidiaries, or the Ambac General Account) under any agreements relating to policies or contracts allocated to the Segregated Account or

contracts with any Allocated Subsidiary, including any credit derivative transaction agreements (including credit default swaps), interest rate or currency rate swap agreements, basis swap agreements, total return swap agreements, indentures, trust deeds, collateral management or administration agreements, credit or loan agreements, residential mortgage-backed security transaction documents, guarantee investment certificates, custodial account agreements, note purchase agreements, or other financing or transaction documents of any kind (collectively, "Transaction Documents"); or (ii) willfully failing to take any action directed to be taken (including any direction to omit to take action) under any Transaction Documents pursuant to the exercise by the Rehabilitator of such Rights that the Segregated Account or the Allocated Subsidiaries may have (*or that the Segregated Account, the Allocated Subsidiaries or Ambac would have but for the occurrence of the Events or the financial condition of the Segregated Account, the Allocated Subsidiaries, or the Ambac General Account*). Wis. Stat. § 645.05(b), (d), (g), (k).

Paragraph 9.B. of the Order sets forth certain mandates and prohibitions specifically in respect of insurance policies and agreements issued in respect of RMBS transactions. Subparagraph 2 of said paragraph, in relevant part, prohibits any person from:

Willfully failing to take any action . . . (iv) as directed by the Rehabilitator as "controlling party" or a term with similar effect, howsoever designated under the RMBS Transaction Documents . . . provided, however, that the Segregated Account may provide to any Trustee under any RMBS Transaction Documents, to the extent such agreements permit such Trustee to request the same, reasonable indemnity to the Trustee in connection with any such direction, such indemnity to consist of an administrative claim in an amount to be determined by the Rehabilitator, subject to Court approval, with any amounts owing to the Trustee pursuant to such indemnity . . . to be treated as an administrative cost within the meaning of Wis. Stat. § 645.68(1).<sup>2</sup>

Although interested persons were afforded no opportunity to be heard prior to entry of the Order, the Court explicitly permitted any interested party to move for

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<sup>2</sup> An essentially identical prohibition applies to "Other Structured Finance Transactions." *See* Order ¶ 9.C.2.iv.

modification or dissolution of the Order within 90 days of issuance of the Order. (See Order ¶ 12.)

### ARGUMENT

**I. PARAGRAPHS 6 AND 9.B.2(IV) SHOULD BE AMENDED TO PERMIT HOLDERS TO DIRECT RMBS TRUSTEES, AND TO PERMIT RMBS TRUSTEES TO ACCEPT SUCH DIRECTIONS, WHERE DIRECTION OR CONTROL RIGHTS HAVE SHIFTED FROM AMBAC TO THE HOLDERS**

Paragraphs 6 and 9.B.2(iv) of the Order should be amended to permit Holders to direct RMBS trustees, and to permit RMBS trustees to accept such directions and refuse any directions delivered by the Commissioner in his capacity as Rehabilitator of the Segregated Account, where the relevant Governing Documents provide that direction or control rights have shifted from Ambac to Holders, due to the rehabilitation of the Segregated Account, the failure of Ambac or the Segregated Account to make a payment when due, or otherwise.

As described above, the Wells Fargo RMBS Trustee serves as trustee in respect of RMBS transactions in which the relevant Governing Documents extended certain direction and control rights to Ambac. The Governing Documents provide, however, that upon the occurrence of an Insurer Default, such as the failure to make a payment when due or an insurer rehabilitation, Ambac is no longer entitled to exercise those rights. Instead, the power to exercise those rights is redirected to certain Holders, including Insured Certificateholders. In short, Ambac's right to wield direction and control rights was dependent on it fulfilling its duties as certificate insurer. Since the commencement of the Rehabilitation, Ambac has ceased performing those duties, even as the Wells Fargo

RMBS Trustee has continued to pay premiums and other amounts. Under the Governing Documents, Ambac should no longer have the power to direct or control the Wells Fargo RMBS Trustee.

In their current form, however, paragraphs 6 and 9.B.2(iv) of the Order effectively nullify the control-shifting provisions of the Governing Documents by permitting Ambac (or the Commissioner) to continue to exercise direction and control rights, and obligating the Wells Fargo RMBS Trustee to follow any Ambac directions, notwithstanding the creation of the Segregated Account, the commencement of the Rehabilitation, and the failure of Ambac or the Segregated Account to pay amounts owed under the Policies.<sup>3</sup> As such, the Order extends a benefit to Ambac and the Segregated Account that Ambac never secured at the time it agreed to issue the Policies. Conversely, the Order strips Holders of direction and control rights that they demanded, expected and negotiated for at the time they agreed to purchase their certificates. Paragraphs 6 and 9.B.2(iv) should be modified to restore the parties to their respective rights as contemplated by the Governing Documents.

Neither the Commissioner nor Ambac has made any showing that the continued exercise of direction and control rights is necessary to achieve an orderly and effective rehabilitation of the Segregated Account. The restoration to Holders of their bargained-for rights need not have any impact on the financial condition of Ambac or the

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<sup>3</sup> While there is some ambiguity in paragraphs 6(i) and 9.B.2(iv) as to whether the Order is intended to interfere with the Governing Documents' control-shifting provisions, paragraph 6(ii) makes clear that the Order is so designed. *See* Order ¶ 6(ii) (enjoining any person from taking any action directed by the Commissioner "that the Segregated Account, the Allocated Subsidiaries or Ambac would have but for the occurrence of the Events or the financial condition of the Segregated Account, the Allocated Subsidiaries, or the Ambac General Account.").

Segregated Account. Any certificateholder that exercises direction or control rights would still be subject to the restraints imposed by the Order. Thus, for example, no certificateholder could direct the Wells Fargo RMBS Trustee to sue Ambac or the Segregated Account for failing to pay amounts due under the Policy. They likewise could not direct the Wells Fargo RMBS Trustee to cease paying premiums or other amounts.

Accordingly, paragraphs 7 and 9.B.2(iv) of the Order should be amended to permit Holders to direct RMBS trustees, and to permit RMBS trustees to accept such directions and refuse any directions delivered by the Commissioner in his capacity as Rehabilitator of the Segregated Account, in accordance with the terms of the relevant Governing Documents.

**II. IN THE ALTERNATIVE, PARAGRAPH 9.B.2(IV) SHOULD BE AMENDED TO REQUIRE THAT, AS A PREREQUISITE TO DIRECTING THE TRUSTEE, THE COMMISSIONER BE REQUIRED TO PROVIDE AN INDEMNITY PAYABLE FROM THE GENERAL ACCOUNT**

If the Court declines to modify paragraphs 7 and 9.B.2(iv) of the Order to restore the control-shifting rights contemplated by the Governing Documents, it should modify paragraph 9.B.2(iv) of the Order to require that the Commissioner be required to provide an indemnity against claims or liabilities that will be payable from Ambac's General Account.

The Governing Documents provide that the Wells Fargo RMBS Trustee is entitled to demand that any party directing it to take action provide it an indemnity against claims or liabilities that might result from acting on such direction. These



indemnification provisions are designed to ensure that the Wells Fargo RMBS Trustee faces no personal liability for acting in accordance with its duties under the Governing Documents and does not ultimately have to bear individually any expenses associated with following such a direction. For that reason, the Wells Fargo RMBS Trustee is entitled to insist that the proposed indemnity is acceptable to it before it proceeds to act on the direction. (*See* Cohen Aff. ¶ 7.)

Although paragraph 9.B.2(iv) confirms that the Commissioner, when exercising direction or control rights, must provide an RMBS trustee an indemnity, it abrogates the trustee's right to consider whether the proposed indemnity adequately protects it against risk of liability and to reject an unacceptable arrangement. Instead, Paragraph 9.B.2(iv) compels RMBS trustees in all instances to accept an indemnity in the form of an administrative claim against the Segregated Account. While such protection might be adequate in certain circumstances, there will certainly be other circumstances where a claim against an entity with no cash assets will be woefully inadequate. So long as the Commissioner is permitted to exercise control rights notwithstanding the implication of the Governing Documents' control-shifting provisions, it should not be permitted to wield such powers in a manner that leaves RMBS trustees exposed to the risk of potentially significant liability without recourse to a creditworthy indemnitor or identifiable liquid assets.

Although the Governing Documents permit the Wells Fargo RMBS Trustee to set the terms of an acceptable indemnity, the Wells Fargo RMBS Trustee recognizes that the financial condition of Ambac and the Segregated Account impose practical constraints on

the type of indemnity that can reasonably be expected. Accordingly, the Wells Fargo RMBS Trustee respectfully requests that the Commissioner be required to provide an indemnification payable by Ambac's General Account whenever it exercises direction or control rights. Such an indemnity would give the Wells Fargo RMBS Trustee reasonable assurance that liquid assets will be available to it in the event it is subject to a claim as a result of heeding the Commissioner's direction. It would also better incentivize the Commissioner appropriately to balance any desired direction against any risks attendant to the directed action.

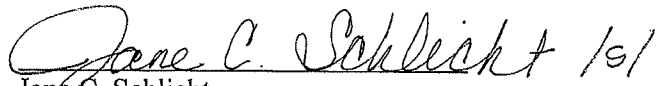
Paragraph 9.B.2(iv) of the Order should thus be modified to require that the Commissioner be required to provide an indemnity payable from Ambac's General Account as a prerequisite to his exercise of direction or control rights.

#### **CONCLUSION**

For the foregoing reasons, the Wells Fargo RMBS Trustee respectfully requests that the Court enter an order modifying paragraphs 6 and 9.B.2(iv) of the Order to permit Holders to direct RMBS trustees, and to permit RMBS trustees to accept such directions and refuse any directions delivered by the Commissioner in his capacity as Rehabilitator of the Segregated Account, where the relevant Governing Documents provide that direction or control rights have shifted from Ambac to Holders. In the alternative, the Wells Fargo RMBS Trustee requests that Paragraph 9.B.2(iv) be modified to require that the Commissioner be required to provide an indemnity payable from Ambac's General

Account as a prerequisite to his exercise of direction or control rights.

Dated this 22<sup>nd</sup> day of June, 2010.



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