

In the Matter of the Rehabilitation of:

Case No. 10 CV 1576

Segregated Account of Ambac Assurance Corporation

**REPLY BRIEF OF THE BANK OF NEW YORK MELLON IN FURTHER SUPPORT
OF ITS OBJECTION TO, AND IF NECESSARY, IN SUPPORT OF MOTION TO
MODIFY, THE ORDER FOR TEMPORARY INJUNCTIVE RELIEF**

The Bank of New York Mellon, a New York banking corporation (“BNY Mellon”), as trustee, indenture trustee or collateral agent, as the case may be (directly and/or through its affiliates), for the benefit of holders and/or secured parties of certain mortgage-backed securities, other asset-backed securities, collateralized loan obligations and collateralized debt obligations (collectively, the “Trusts”), by its attorneys, submits this Reply Memorandum of Law in Further Support of its Objection to, and if necessary, in Support of BNY Mellon’s Motion to Modify, the March 24, 2010 Order for Temporary Injunctive Relief (the “Temporary Injunction”) and in response to the Rehabilitator’s Consolidated Brief in Opposition to All Motions Scheduled to Be Heard on September 9, 2009 (“Commissioner Opp.”) and Ambac Assurance Corporation’s First and Second Briefs in Opposition to Various Motions and Objections to Injunction Order (“Ambac First Opp.” and “Ambac Second Opp.”).¹

STATEMENT OF ISSUES

The Commissioner, as Rehabilitator, and Ambac fail to demonstrate how those portions of the Temporary Injunction that BNY Mellon seeks to modify are necessary or appropriate to maintain the status quo or otherwise protect the value of the assets in the

¹ Capitalized terms not defined herein have the meaning set forth in the Brief of The Bank of New York Mellon in Objection to, and if Necessary, in Support of Motion to Modify, the Order for Temporary Injunctive Relief dated June 22, 2010 (“BNY Mellon Br.”).

Segregated Account under Wis. Stat. § 645.05(1)(k). Instead, by virtue of the Temporary Injunction, the Commissioner has impermissibly expanded Ambac's rights under the relevant Transaction Documents, while limiting Ambac's obligations to the detriment of the Trusts and those classes of holders and secured parties of such Trusts to which Ambac agreed to provide insurance.

As detailed below and in BNY Mellon's opening brief, this Court should modify the Temporary Injunction such that the parties are permitted to exercise their contractual rights consistent with the Transaction Documents, and BNY Mellon respectfully refers the Court to the proposed Amended Order for Temporary Injunctive Relief submitted on September 1, 2010, on behalf of (1) the Wells Fargo RMBS Trustee, (2) the Bank of America RMBS Trustee, (3) Deutsche Bank National Trust Company and Deutsche Bank Trust Company Americas, each acting solely in its capacity as trustee for certain securitization trusts, (4) U.S. Bank National Association, acting solely in its capacity as trustee for certain securitization trusts, and (5) The Bank of New York Mellon, in its capacity as trustee, indenture trustee or collateral agent.²

I. THE TEMPORARY INJUNCTION SHOULD BE MODIFIED TO THE EXTENT IT FAILS TO MAINTAIN THE STATUS QUO AND IMPERMISSIBLY ENJOINS AND RESTRAINS COMPLIANCE WITH THE TRANSACTION DOCUMENTS

As set forth in BNY Mellon's opening brief, the Temporary Injunction goes beyond the protection of the assets of Ambac and the rights of its policyholders, and the proposed modifications to the Temporary Injunction are necessary to maintain the status quo and to adequately protect the interests of the holders of policies allocated to the Segregated Account, many of which are represented by the trustees that have appeared in this proceeding. BNY

² The modifications to paragraphs 6, 7 and 9 in the proposed Amended Order are the subject of BNY Mellon's objections to the Temporary Injunction. BNY Mellon respectfully reserves its right to seek further modification of the Temporary Injunction in light of any subsequent decision by the appellate court regarding the May 27, 2010 Findings of Fact and Conclusions of Law or by this Court in the instant Rehabilitation Proceeding. BNY Mellon Br. at 9-10; see also Commissioner Opp. at 14 n.10.

Mellon Br. at 6-8. The opposition briefs of the Commissioner and Ambac do not support a finding to the contrary.

First, the Commissioner and Ambac appear to misapprehend BNY Mellon's position regarding Paragraphs 9(b)(1)(i) and 9(b)(1)(ii) of the Temporary Injunction, treating BNY Mellon's position regarding the rights of parties other than Ambac under the Transaction Documents as a variation of BNY Mellon's argument regarding Ambac's control rights, and questioning whether such rights in fact exist (Commissioner Opp. at 38 n.47; Ambac Second Opp. at 6). The Commissioner and Ambac's argument, however, ignores the overbreadth of these provisions when applied to the Transaction Documents. For example, Paragraph 9(b)(1)(i), on its face, would appear to prevent the holders of certificates issued by a Trust from directing the Trustee to declare an Event of Default where there has been a default by the servicer under the applicable Transaction Documents, even though such rights exist under the Transaction Documents notwithstanding Ambac's rights as a "controlling party" and failing to take such action could in and of itself "lessen the value of the insurer's assets" and "prejudice the rights of policyholders" – the very outcome the Commissioner purports to seek to avoid.

Second, the Commissioner misconstrues BNY Mellon's intent in seeking to modify the Temporary Injunction with regard to the rights of Ambac as a "controlling party." BNY Mellon does not seek to enable holders to declare Events of Default that arise out of the action taken by Ambac or the Commissioner in this rehabilitation proceeding (Commissioner Opp. at 38). Instead, BNY Mellon simply seeks to preserve the status quo. That is, Ambac's rights as a "controlling party" under the Transaction Documents exist side-by-side with the rights of the holders and other parties under the Transaction Documents and are enforceable under the Transaction Documents only when Ambac has complied with its payment obligations.

Otherwise, such rights revert to the other parties to the Transaction Documents as set forth therein. Having failed to comply with its obligations under the Transaction Documents, Ambac's rights under the Transaction Documents should not be expanded beyond the status quo, and the Temporary Injunction should be modified accordingly. BNY Mellon Br. at 7.

Finally, with regard to BNY Mellon's objection to the indemnification provisions of Paragraphs 9(B)(2)(iv) and 9(C)(2)(ii) of the Temporary Injunction, the Commissioner and Ambac assert that an administrative claim against the Segregated Account is an adequate indemnity under the Transaction Documents. Commissioner Opp. at 41; Ambac Second Opp. at 7-8. Again, the Commissioner and Ambac misconstrue BNY Mellon's position – i.e., BNY Mellon seeks to modify the Temporary Injunction because it impermissibly requires that such indemnity be acceptable. Under the Transaction Documents, however, an acceptable indemnity is one the trustee – not a “controlling party” – deems to protect the trustee adequately from any risk of loss arising out of a controlling party's direction, which could, for example, include an indemnity from the Ambac General Account. The removal of BNY Mellon's discretion to refuse to accept an indemnity – from the Segregated Account or otherwise – impermissibly expands Ambac's rights under the Transaction Documents and is not authorized by Wis. Stat. § 645.05(1)(k) or this Court's power to preserve the status quo. BNY Mellon Br. at 8.

Accordingly, BNY Mellon seeks modification of the Temporary Injunction to permit the parties to the Transaction Documents to exercise any and all rights under the Transaction Documents to the extent such rights do not arise out of the “Events” or the financial condition of the Segregated Account or Ambac or arise out of the Commissioner, Ambac or the Segregated Account's failure to comply with the Transaction Documents.

II. THE TEMPORARY INJUNCTION SHOULD BE MODIFIED TO PERMIT THE TRUSTS TO PLACE INTO ESCROW PAYMENTS OWED TO AMBAC PENDING THE COURT’S REVIEW OF THE REHABILITATION PROCEEDING

Under New York law, certain of the Trusts have a right of setoff that permits the reduction of their obligations to make premium and other payments to Ambac by the amount of outstanding payments owed by Ambac. BNY Mellon Br. at 8-9. Contrary to the Commissioner’s assertions, BNY Mellon does not seek to escrow premiums “indefinitely” or for the purpose of depriving Ambac of assets (Commissioner Opp. at 41-42; see also Ambac Second Opp. at 8-11). Instead, BNY Mellon seeks the requested limited relief to the extent permitted by the Transaction Documents and applicable law so that any setoff rights are preserved, while all premium payments are maintained in escrow, pending the review and approval by this Court of the final plan of Rehabilitation, and any modifications to the parties’ payment obligations set forth therein, to be submitted by the Commissioner.

III. BNY MELLON IS ENTITLED TO OBJECT WITHOUT INTERVENTION AND MAY ALSO INTERVENE IN THIS PROCEEDING PURSUANT TO WIS. STAT. §803.09(1)

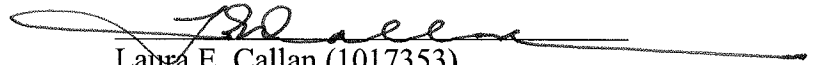
As set forth in its opening brief (BNY Mellon Br. at 10), BNY Mellon contends that intervention in this proceeding is not necessary for BNY Mellon’s objection to the Temporary Injunction to be heard by this Court, and both the Commissioner and Ambac have likewise asserted that formal intervention is not necessary. Commissioner Opp. at 7; Ambac First Opp. at 5. Should the Court conclude, however, that intervention is necessary, then BNY Mellon respectfully submits that its role as trustee, indenture trustee and/or agent and the interests it represents thereby sufficiently satisfy the requirements of Wis. Stat. § 803.09(1) to intervene as right for the reasons set forth in its opening brief. BNY Mellon Br. at 10-11.

CONCLUSION

For the reasons as set forth above, BNY Mellon, as trustee, indenture trustee and/or collateral agent (directly and/or through its affiliates) for the benefit of holders and secured parties of the Trusts for which Ambac, BNY Mellon or its affiliates, and/or the Trusts and other related parties (including holders, directly or indirectly, of securities issued by certain Trusts) entered into insurance policies that have been allocated to the Segregated Account or have otherwise been affected by this Rehabilitation Proceeding, respectfully requests an Order:

1. Modifying the Temporary Injunction to permit the parties to the Transaction Documents to exercise their rights under the Transaction Documents to the extent such rights do not arise out of the “Events” or the financial condition of the Segregated Account or Ambac or arise out of the Commissioner, Ambac or the Segregated Account’s failure to comply with the Transaction Documents;
2. Modifying the Temporary Injunction such that the Trusts are permitted, as allowed under the corresponding Transaction Documents and/or applicable law, to remit payments for insurance policies allocated to the Segregated Account into escrow accounts pending the Court’s review of the Rehabilitation Proceeding, without any resulting prejudice to their coverage rights;
3. Modifying the Temporary Injunction such that the Trusts are not subject to the Temporary Injunction to the extent any related policies were improperly transferred to the Segregated Account;
4. If the Court deems it necessary, granting BNY Mellon leave to intervene in this proceeding for the purposes of its Objection to, and if necessary, Motion to Modify, the Temporary Injunction as a matter of right; and
5. Granting such other and further relief as is just and proper.

Dated this 1st day of September, 2010.



Laura E. Callan (1017353)
Thomas P. Solheim (1014522)
Solheim Billing & Grimmer, S.C.
One South Pinckney Street, Suite 301
PO Box 1644
Madison, WI 53701-1644
Telephone (608) 282-1200
Facsimile (608) 282-1218
Attorneys for The Bank of New York Mellon

Of Counsel:
(Admitted *pro hac vice*)

Dale C. Christensen, Jr.
Thomas Ross Hooper
Seward & Kissel LLP
One Battery Park Plaza
New York, New York 10004
Telephone: (212) 574-1200
Facsimile: (212) 480-8421

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CERTIFICATE OF SERVICE

I hereby certify that on this 1st day of September 2010, I caused a true and correct copy of the following document to be served by first-class mail on the individuals listed below:

1. Reply Brief of The Bank of New York Mellon in Further Support of its Objection to, and if Necessary, in Support of Motion to Modify, the Order for Temporary Injunctive Relief.

Attorneys for Ambac Assurance

Daniel W. Stolper
Stafford Rosenbaum LLP
222 W. Washington Avenue, Suite 900
P.O. Box 1784
Madison, WI 53701

William G. Primps
Emily L. Saffitz
Allison H. Weiss
Peter A. Ivanick
Lynn Roberts
Henry J. Ricardo
Richard W. Reinthaler
Dewey & Leboeuf LLP
1301 Avenue of the Americas
New York, NY 10019

Todd L. Padnos
Dewey & Leboeuf LLP
1950 University Avenue, Suite 500
East Palo Alto, CA 94303

**Attorneys for Sean Dilweg, Commission
of Insurance of the State of Wisconsin**

David G. Walsh
Michael B. Van Sicklen
Matthew R. Lynch
Foley & Lardner LLP
150 East Gilman Street
Madison, Wisconsin 53701

Kevin G. Fitzgerald
Andrew A. Oberdeck
Foley & Lardner LLP
777 E. Wisconsin Avenue
Milwaukee, WI 53202

Attorneys for Wells Fargo, N.A. in its Capacity as Trustee of the Bondholders

Steven T. Whitmer
Kevin A. Wisniewski
Lock Lord Bissell & Liddell LLP
111 S. Wacker Drive
Chicago, IL 60606

Stephen L. Morgan
Murphy Desmond SC
33 East Main Street, Suite 500
P.O. Box 2038
Madison, Wisconsin 53701

Attorneys for LVM Bondholders

Philip Bentley
Amy Canton
Susan Jacquemot
Kramer Levin Naftalis & Frankel LLP
1177 Avenue of the Americas
New York, NY 10036

Noreen J. Parrett
Parrett & O'Connell LLP
10 East Doty Street, Suite 621
Madison, Wisconsin 53703

Attorneys for HSBC Bank USA. National Association

Randall D. Crocker
Susan E. Lovern
Christopher J. Stroebel
von Briesen & Roper s.c.
411 East Wisconsin Avenue, Suite 700
Milwaukee, Wisconsin 53202

Pieter Van Tol
Hogan Lovells US LLP
875 Third Avenue
New York, NY 10022

Attorneys for Aurelius Capital Management LP; Fir Tree, Inc.; King Street Capital Management LP; Monarch Alternative Capital LP; Stonehill Capital Management LLC; and RMBS Policyholders

R. Timothy Muth
Bryan K. Nowicki
Jessica L. Polakowski
Reinhart Boerner Van Deuren S.C.
22 East Mifflin Street, Suite 600
Madison, Wisconsin 53703

John B. Simon
David M. Greenwald
Jenner & Block LLP
353 N. Clark Street
Chicago, IL 60654

Patrick J. Trostle
Jenner & Block LLP
919 Third Avenue, 37th Floor
New York, NY 10022

Attorneys for Federal Home Loan Mortgage Corporation

David I. Cisar
Susan E. Lovern
Christopher J. Stroebel
von Briesen & Roper s.c.
411 East Wisconsin Avenue, Suite 700
Milwaukee, Wisconsin 53202

Robert A. Zeavin
Craig S. Bloomgarden
Manatt, Phelps & Phillips, LLP
11355 W. Olympic Blvd.
Los Angeles, CA 90064

Marcia D. Alazraki
Manatt, Phelps & Phillips, LLP
7 Times Square
New York, NY 10036

**Attorney for Wells Fargo Bank, N.A. in
its Capacity as Trustee for Certain RMBS
Certificateholders**

Jane C. Schlicht
Cook & Franke S.C.
660 East Mason Street
Milwaukee, Wisconsin 53202

Michael E. Johnson
William B. Macurda
Cele Ogawa
Alston & Bird LLP
90 Park Avenue
New York, NY 10016

**Attorneys for Access to Loans for
Learning Student Loan Corporation
and Lloyds TSB Bank plc**

Lawrence Bensky
Law Office of Lawrence Bensky, LLC
10 E. Doty Street, Suite 800
Madison, WI 53703

James C. Owen
McCarthy, Leonard & Kaemmerer
400 S. Woods Mill Road
Chesterfield, MO 63017

Attorneys for the Bank Insureds

James A. Friedman
Brady C. Williamson
Anthony J. Gaughan
Godfrey & Kahn S.C.
One East Main Street, Suite 500
P.O. Box 2719
Madison, Wisconsin 53701-2719

Donald S. Bernstein
Michael P. Carroll
Avi Gesser
Davis Polk & Wardwell LLP
450 Lexington Avenue
New York, NY 10017

**Attorneys for U.S. Bank National
Association; Deutsche Bank National Trust
Company, solely in its capacity as Trustee;
and Deutsche Bank & Trust Company
Americas, solely in its capacity as Trustee**

Paul E. Benson
Paul A. Lucey
Michael Best & Friedrich LLP
100 E Wisconsin Ave Ste 3300
Milwaukee, WI 53202-4124

Nathan L. Moenck
Michael Best & Friedrich LLP
One South Pinckney Street, Suite 700
Madison, Wisconsin 53703

John M. Rosenthal
Kristine E. Bailey
Morgan Lewis & Bockius LLP
One Market, Spear Street Tower
San Francisco, CA 94105-1596

Leah M. Houghton
Morgan Lewis & Bockius LLP
225 Franklin Street, 16th Floor
Boston, MA 02110-4104

John C. Goodchild III
Morgan Lewis & Bockius LLP
1701 Market St.
Philadelphia, PA 19103-2921

Attorneys for PNC Corporation

John Franke
Gass Weber Mullins LLC
309 N. Water Street, Suite 700
Milwaukee, WI 53202

Peter D. Laun
Jones Day
500 Grant Street, Suite 4500
Pittsburgh, PA 15219-2514

Attorneys for Depfa Bank plc

Grant C. Killoran
Seth E. Dizard
Gregory W. Lyons
O'Neil, Cannon, Hollman, Dejong
& Laing S.C.
111 East Wisconsin Avenue, Suite 1400
Milwaukee, Wisconsin 53202

Michael C. Weed
Thomas J. Welsh
Andrew K. Davidson
Orrick, Herrington & Sutcliffe LLC
400 Capitol Mall, Suite 3000
Sacramento, CA 95814-4497

**Attorneys for KnowledgeWorks
Foundation, as the Administrator of the
Ohio Centric Student Loan Program**

Melissa A. Kern
Frost Brown Todd LLC
1103 Boundary Road
Middleton, WI 53562

Greg E. Mitchell
Frost Brown Todd LLC
2800 Lexington Financial Center
250 W. Main Street
Lexington, KY 40507

Jeffrey A. Lipps
Carpenter Lipps & Leland LLP
280 Plaza Suite 1300
280 N. High Street
Columbus OH 43215

Attorneys for One State Street, LLC

Anne M. Bensky
Kathleen G. McNeil
Garvey McNeil & Associates, S.C.
One Odana Court
Madison, WI 53719

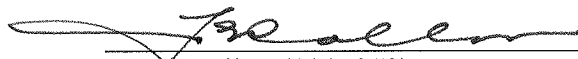
Mark I. Bane
Ropes & Gray LLP
1211 Avenue of the Americas
New York, NY 10036

D. Ross Martin
Ropes & Gray LLP
One International Place
Boston, MA 02110

**Attorneys for Assured Guaranty
Corporation and Goldman Sachs & Co.,
Inc.**

Earl H. Munson
James E. Bartzen
Boardman, Suhr, Curry & Field LLP
One S. Pinckney Street, 4th Floor
P.O. Box 927
Madison, WI 53701-0927

C.N. Franklin Reddick III
Richard K. Welsy
Akin Gump Strauss Hauer & Feld LLP
2029 Century Park East, Suite 2400
Los Angeles, CA 90067-3010



Laura Callan (1017353)
Solheim Billing & Grimmer, S.C.
U.S. Bank Plaza
P.O. Box 1644
Madison, WI 53701-1644
(608) 282-1200
Attorneys for The Bank of New York Mellon