"**Standstill Period**" means the period from the effective date of this Agreement until a Termination Event occurs.

"**Termination Event**" means each of the following:

(a) The date that is 60 days after the date this Agreement becomes effective in accordance with its terms or such later date as the Parties may agree in writing.

(b) Except for the Seg Account Rehab Proceedings, an insolvency or delinquency proceeding within the meaning of Wis. Stat. § 645.03(b) is instituted by AAC or against AAC by a Third Party or a bankruptcy or insolvency proceeding is instituted by ACP or against ACP by a Third Party and, in the case of any proceeding instituted by or against AAC or ACP, such proceeding is not stayed, discharged, restrained or enjoined within 30 days.

(c) (i) Any Party other than a Policy Beneficiary breaches this Agreement in any material respect, (ii) any order is issued by the Rehabilitation Court (including by way of a modification of the Rehabilitation Court's initial order for the Seg Account Rehab Proceedings) that subjects (or purports to subject) any CDS Contract of any Policy Beneficiary to any rehabilitation proceeding or to any injunctive or other order issued by the Rehabilitation Court, or (iii) any CDS Contract of any Policy Beneficiary is transferred without its consent to any segregated account established under Wis. Stat. §611.24(2).

(d) Any court order is entered in the Seg Account Rehab Proceedings or any legal or administrative proceeding directly related to the Seg Account Rehab Proceedings or the CDS Contracts which is materially prejudicial to the rights or claims of the Policy Beneficiaries under their CDS Contracts, or ACP's rights or claims against AAC in respect thereof (except for the implementation of the Restructuring pursuant to mutually agreed and executed documentation).

(e) The termination by any Third Party of its credit default swap with AAC or ACP unless stayed, restrained or enjoined or subject to an enforceable forbearance agreement.

"**Third Party**" means a Person that is neither (a) a Policy Beneficiary nor (b) an affiliate of a Policy Beneficiary (provided that "Third Party" shall include an affiliate of a Policy Beneficiary acting with respect to any CDS Contract solely in a fiduciary capacity).

SECTION 2. Standstill Agreement.

(a) During the Standstill Period, the CDS Contracts shall not be subject to the Rehabilitation Order or any rehabilitation proceeding or order issued by the Rehabilitation Court, nor shall any CDS Contracts be allocated or transferred, without the consent of the related Policy Beneficiary, to the Segregated Account or any other segregated account established under Wis. Stat. § 611.24(2). During the Standstill Period OCI will serve the Policy Beneficiaries' Wisconsin counsel with the same notice of motions and orders being submitted by OCI in the Seg Account Rehab Proceedings that AAC and other interested parties receive, to provide the Policy Beneficiaries' Wisconsin counsel with the opportunity to advise OCI before the court acts on the submission if the Policy Beneficiaries contend that the filing may cause a Termination Event.

(b) During the Standstill Period, each Policy Beneficiary agrees that it will forbear from exercising its Enforcement Rights with respect to its CDS Contracts.

(c) During the Standstill Period, other than in a presently existing litigation outside the Rehabilitation Court, no Party shall commence any litigation, lawsuit or legal process, or seek any ex parte judgment, injunction, decree, order or ruling of any court, including the Rehabilitation Court, with respect to any CDS Contract of any Policy Beneficiary or its affiliates including, without limitation, as to the existence of any event of default or termination event or the amount, existence, character, method of calculation or validity of any loss or claim thereunder or with respect to the solvency of AAC.

(d) If after the Standstill Period any Party commences any litigation, lawsuit or other legal process with respect to any CDS Contract in the Rehabilitation Court or any other court of competent jurisdiction, such Party shall provide at least three business days' prior notice thereof to the affected Parties and shall provide such affected Parties a reasonable opportunity to appear and be heard in connection therewith.

(e) Notwithstanding the terms of this Agreement or any CDS Contract, during the Standstill Period no Policy Beneficiary shall be entitled (either individually or collectively with other holders of any obligation referenced by such CDS Contract) to direct or procure the delivery of notices of default, notices of acceleration and to take or procure or direct the taking of other steps to divert cash flows away from tranches junior to such reference obligations or to prepare for the liquidation of such reference obligation without the consent of AAC or ACP, as the case may be. During the Standstill Period, AAC and ACP shall

retain and be entitled to exercise the approval, consent, direction, voting, veto, waiver, control and other rights which ACP or AAC presently has under the relevant CDS Contracts or related agreements but for the Events and each Policy Beneficiary agrees that it shall not exercise any such rights or refuse to exercise any such rights as directed by ACP or AAC. The provisions of this Section 2(e) are not intended to prevent a Policy Beneficiary from making a request to AAC or ACP as set forth below in Section 4(j) (on the terms and conditions stated in Section 4(j)).

(f) No Policy Beneficiary shall assign, transfer or otherwise dispose of any of its rights and/or obligations under any CDS Contract (or any transaction document or other contract executed in connection with the issuance of, or related to, a CDS Contract) unless either (i) AAC, ACP and OCI have consented thereto or (ii) each assignee, transferee, replacement party, or counterparty to such disposal agrees in writing (a) to be bound by the terms of this Forbearance Agreement as if it was a "Policy Beneficiary" and (b) that such CDS Contract shall continue to be treated as a "CDS Contract" under this Agreement.

SECTION 3. Reservation of Rights; Treatment of Premiums.

(a) Reservation of Rights. Each of the Parties agrees that other than as expressly set forth herein, nothing in this Agreement, or the performance by the Parties of their respective obligations hereunder, constitutes or shall be deemed to constitute a waiver of or serve to impair any of the Parties' rights, remedies or claims under the terms of the CDS Contracts or applicable Law, all of which are hereby reserved. In furtherance of the foregoing, it is agreed that each of the Parties reserves all rights, arguments and defenses with respect to the validity and character of the CDS Contracts and all of its rights and claims thereunder.

(b) Treatment of Premiums. Premiums and other payments otherwise required to be made or to have been made by any Policy Beneficiary during the Standstill Period pursuant to the CDS Contracts contemplated by the Restructuring Outline to be commuted (the "**Payments**") shall be segregated by AAC and held in escrow during the Standstill Period. The Payments shall be released to AAC three business days after the termination of the Standstill Period (but subject to all defenses, rights, and claims of the Policy Beneficiaries and AAC and ACP whether pursuant to the CDS Contracts or otherwise), unless the Closing occurs prior to the end of the Standstill Period in which case such Payments shall not be payable and shall be discharged and released in connection with the Restructuring and the amounts held in the escrow will be returned (without interest) to each Policy Beneficiary that made such Payment.

SECTION 4. Miscellaneous.

(a) Except as specifically set forth herein, the terms of this Agreement are not intended to be, and shall not be deemed or construed to be, a cure, satisfaction, reinstatement, novation, or release of the CDS Contracts, any obligations thereunder, or any prior, existing, and/or future default or termination right thereunder. Further, for the avoidance of doubt, no Party shall be read to have waived compliance with any provisions of, or covenants under, any CDS Contract, except as expressly set forth herein.

(b) This Agreement may be executed and delivered in multiple counterparts, each of which, when so executed and delivered, shall be an original, but such counterparts shall together constitute but one and the same instrument and agreement. A facsimile or electronic copy of a signature shall have the same force and effect as an original signature.

(c) This Agreement is to be interpreted under and governed by the Laws of the State of New York without giving effect to conflicts of law provisions thereof. Each Party hereby irrevocably consents to the service of process in any such suit, action or proceeding by the mailing of copies thereof by registered or certified mail, postage prepaid, to the address provided to the Parties on Schedule I to the Confidentiality Agreement, dated as of September 30, 2009, among AAC, the Policy Beneficiaries and the other parties thereto, such service to become effective ten (10) days after such mailing. This Section 4(c) does not alter or amend the choice of law provisions contained in any CDS Contracts.

(d) Each of the Parties hereby waives to the fullest extent permitted by applicable Law any right it may have to a trial by jury with respect to any litigation directly or indirectly arising out of, under, or in connection with this Agreement. Each of the Parties hereby (i) certifies that no representative, agent or attorney of any other Party has represented, expressly or otherwise, that such other Party would not, in the event of litigation, seek to enforce the foregoing waiver and (ii) acknowledges that it has been induced to enter into this Agreement by, among other things, the mutual agreements and certifications in this Section 4(d).

(e) Each Party has had the opportunity to negotiate the terms, consult with counsel, and modify the provisions of this Agreement. Therefore, the terms of this Agreement will be considered and interpreted without any presumption, inference or rule requiring construction or interpretation of any provision of this Agreement against the interests of the drafter of this Agreement.

(f) Nothing in this Agreement constitutes a legal obligation to participate in the Restructuring or to execute any related documents and no such legal obligation shall arise except pursuant to mutually agreeable executed definitive documentation.

(g) This Agreement shall be binding upon and inure solely to the benefit of the Parties and their respective successors and permitted assigns. Nothing herein, express or implied, is intended to or shall confer upon any other Person any legal or equitable right, benefit, remedy or right of action of any nature whatsoever, arising directly or indirectly out of, based upon, or in any way related to or in connection with this Agreement.

(h) For the avoidance of doubt, the obligations and covenants of the Policy Beneficiaries shall be several and not joint or joint and several. Each Policy Beneficiary acknowledges that it has, independently and without reliance upon any other Policy Beneficiary and based on such documents and information as it has deemed appropriate, made its own analysis and decision to enter into this Agreement and with respect to the Restructuring. Each Policy Beneficiary also acknowledges that it will, independently and without reliance upon any other Policy Beneficiary and based on such documents and information as it shall from time to time deem appropriate, continue to make its own decisions in taking or not taking action under or based upon this Agreement, the Restructuring or any related agreement or any document furnished hereunder or thereunder.

(i) This Agreement shall become effective as to each party upon (x) the execution and delivery of a counterpart hereto by AAC, ACP and each Policy Beneficiary and (y) the establishment of the Segregated Account and the commencement of the Seg Account Rehab Proceedings as contemplated by the Restructuring Outline by 11:59 p.m. (CDT), Wednesday, March 24, 2010.

(j) With respect to any CDS Contracts contemplated to be commuted by the Restructuring Outline, AAC agrees to not unreasonably withhold or delay any request made during the Standstill Period by the Policy Beneficiary party thereto to exercise any rights to take steps to mitigate its losses with respect to the obligations referenced by such CDS Agreement by issuing notices that cause cash flows from more junior obligations to be diverted in favor of such reference obligations, so long as in AAC's reasonable judgment such steps do not (a) prejudice or impair any existing rights or interests of AAC or ACP under such CDS Agreement or any related agreement (notwithstanding the occurrence of the Events), including, without limitation, any rights to approve any liquidation or other irrevocable action that would permit the Policy Beneficiary to make a claim under the CDS Agreement on an other than pay-as-you-go basis or (b) prejudice, result in, cause, accelerate in time, or adversely affect or increase

any claims against, or liabilities of, ACP or AAC under any CDS Contract to which ACP or AAC would not have been subject to had such action not been taken or been taken in an alternative manner directed by AAC or ACP. If a disagreement about a request under this Section 4(j) arises between a Policy Beneficiary and AAC or ACP, those parties shall bring such disagreement to OCI's attention for guidance and resolution.

(k) The credit default swap agreements relating to the insurance policies identified pursuant to the Plan of Operation disclosed to the Policy Beneficiaries on the date hereof as being allocated to the Segregated Account, including, but not limited to, those identified on the attached Schedule Two, shall not constitute CDS Contracts for the purpose of this Agreement.

[Signature Page Follows]

IN WITNESS WHEREOF, the Parties have caused this Agreement to be duly executed and delivered as of the day and year first written above.

[SCHEDULES OMITTED]

STATE OF WISCONSIN CIRCUIT COURT DANE COUNTY

In the Matter of the Rehabilitation of:

Segregated Account of Ambac Assurance Corporation

Case No. 10-CV-1576

AMBAC ASSURANCE CORPORATION'S BRIEF IN OPPOSITION TO (i) CERTAIN RMBS INVESTORS' MOTION SEEKING EXPEDITED RELIEF AND TO MODIFY ORDER FOR TEMPORARY INJUNTIVE RELIEF; AND (ii) LVM BONDHOLDERS' EMERGENCY MOTION TO ENJOIN CONSUMMATION OF THE PROPOSED SETTLEMENT BETWEEN AMBAC AND CERTAIN CDS COUNTERPARTIES

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INTRODUCTION

Ambac Assurance Corporation ("Ambac") submits this memorandum of law in opposition to:

(i) the emergency motion submitted by Aurelius Capital Management, LP, Fir Tree, Inc., King Street Capital, L.P., King Street Capital Master Fund, Ltd., Monarch Alternative Capital LP, and Stonehill Capital Management LLC and their respective managed funds (collectively, the "RMBS Investors") seeking:

a. modification of the Order for Temporary Injunctive Relief dated March 24, 2010 (the "Injunction Order") to enjoin Ambac from finalizing the Statement of Intent with certain Settling Counterparties (as those terms are defined in the Injunction Order), commuting any policies or entering into any other transactions outside of the ordinary course of its business that may divert assets from the General Account pending this Court's ruling on the remaining portions of the RMBS Investors' motion;

b. expedited discovery regarding the formation of the Segregated Account, the adequacy of its capitalization, the sufficiency of the General Account to support the Segregated Account and the impact consummation of the proposed settlement (the "CDS Settlement") with the Settling Counterparties (a/k/a the "Bank Group") will have on the adequacy of the General Account to fund an equitable rehabilitation of the Segregated Account;

c. modification of the Injunction Order to remove the policies held by the RMBS Investors from the Segregated Account and returning them to the General Account; and

d. an order declaring that the establishment of the Segregated Account was invalid due to non-compliance with the Wisconsin Insurance Statutes and violations of the United States and Wisconsin Constitutions; and

(ii) the emergency motion (together with the RMBS Investors' motion, the "Motions") submitted by certain beneficial holders of the Las Vegas

Monorail Project Revenue Bonds (the "LVM Bondholders," and, together with the RMBS Investors, "Movants") seeking to enjoin consummation of the CDS Settlement with the Bank Group.

PRELIMINARY STATEMENT

The instant "emergency" Motions are entirely without merit. Movants ask this Court to enjoin Ambac, which is not in rehabilitation, from finalizing and consummating a commutation agreement with the Bank Group on terms Ambac has determined, in the exercise of its business judgment (and the Wisconsin Office of the Commissioner of Insurance ("OCI") has supported and is expected to approve, in the exercise of its statutory oversight), to be fair, reasonable and in the best interest of all Ambac policyholders (in both the Segregated Account and the General Account). Under the terms of the CDS Settlement, members of the Bank Group will receive a combination of cash and surplus notes representing approximately 43.3% of their claims (a discount of 56.7%), as estimated by a neutral appraiser. Surely, this is a fair compromise.

Contrary to Movants' speculation, the aggregate consideration to be paid to the Bank Group under the CDS Settlement is *significantly less generous than* the consideration OCI anticipates providing for Movants and the other Segregated Account policyholders under the anticipated plan of rehabilitation for the Segregated Account. Consummation of the CDS Settlement will thus *increase* Movants' ultimate recovery under the plan. Enjoining or delaying the CDS Settlement for even a brief period, on the other hand, will not only threaten Ambac's ability to consummate (and thus obtain the benefits of) the CDS Settlement, but will almost certainly trigger a chain reaction that could inflict billions of

dollars of collateral damage on Ambac (described below), which would inure to the substantial detriment of all policyholders in the Segregated Account, including Movants.

In short, the equities weigh heavily against Movants. A failure to consummate the CDS Settlement would almost certainly lead to immediate assertion of substantial mark-to-market damage claims (estimated by BlackRock to be $12.9 billion) against Ambac by the Bank Group. Acceleration and assertion of such claims could well plunge the General Account into rehabilitation and substantially dilute the amounts available to pay all policyholders, which is the very result the Segregated Account was designed to avoid. As explained in the briefing in support of the Verified Petition, if the proposed settlement is not consummated and the Ambac General Account becomes the subject of rehabilitation proceedings, additional adverse consequences for Ambac, its policyholders and the public at large are likely to occur. These consequences include (i) the potential for additional claims involving billions of dollars in par amount of insured obligations against Ambac, which would further dilute the amount available to pay policyholders, including those allocated to the Segregated Account, and (ii) the potential triggering of a wave of defaults on the part of issuers of commercial asset-backed securities, which may, in turn, precipitate cross-defaults, liquidity crises and/or bankruptcy filing by issuers or their affiliates, thereby inflicting substantial harm on the millions of men and women who depend on these issuers and their affiliates for their livelihood. By contrast, any injury to Movants allegedly resulting from the CDS Settlement is merely speculative, inchoate and predicated on a fundamental misunderstanding of the terms of the CDS Settlement.

Not surprisingly, Movants fail to cite a single case in Wisconsin (or elsewhere) in which a court has enjoined an insurer (in or out of rehabilitation) from settling a claim with

one policyholder at the request of another policyholder. Nor have Movants cited any authority for the proposition that this Court's approval of any settlement between Ambac and policyholders in the General Account is required. The Cooperation Agreement certainly does not require such approval – all it says is that Ambac may not enter into any transaction in excess of $5 million *without the Segregated Account's prior written consent*. Subject to finalization and documentation of the CDS Settlement, that written consent is expected by OCI, as the Rehabilitator of the Segregated Account. Indeed, the CDS Settlement cannot close without it.

Quite simply, Movants have no right of action against Ambac, and have not come close to demonstrating either standing or the reasonable probability of success on the merits required to obtain emergency injunctive relief in Wisconsin. Nor have Movants demonstrated any basis for modifying the temporary injunction entered upon the formation of the Segregated Account, which expressly contemplated, and thus permitted the parties to finalize, the CDS Settlement. The relief Movants seek would thus alter, not preserve, the *status quo*. Nor does OCI's role in brokering and endorsing the CDS Settlement provide Movants with any basis for intervening in, or objecting to, the settlement, as Wisconsin law plainly prohibits Movants (or any other policyholder or third party) from second-guessing or seeking judicial review of the determination that the terms of the CDS Settlement are fair, reasonable and in the best interests of all policyholders.

Recognizing this, the RMBS Investors devote the lion's share of their brief to a series of disjointed and ultimately irrelevant attacks on the decision to establish the Segregated Account, the procedures followed in setting up the Segregated Account, the allocation of policies to that Account, and the constitutional implications of the foregoing.

None of these objections go to the merits of the CDS Settlement or OCI's approval thereof, and need not be decided at the hearing on May 25, 2010. Those objections (which themselves are meritless) will be addressed and resolved in due course at the appropriate time. The sole focus of the hearing on May 25, 2010 should be on the issue of whether Movants have any legal basis to enjoin the CDS Settlement.

STATEMENT OF FACTS

Ambac is a Wisconsin-domiciled stock insurance corporation authorized to transact surety and financial guaranty insurance. Verified Petition for Order of Rehabilitation ("Verified Petition") ¶2. It is regulated by OCI. Ambac and its subsidiaries provide financial guarantee products and other financial services to clients around the world in both the public and private sectors. *Id.* ¶4.

Until 2008, when it became unable to originate new business because of lower credit ratings caused by the general economic downturn and turmoil in the credit and mortgage markets, Ambac offered financial guarantee insurance on investment grade public finance debt obligations, like those held by the LVM Bondholders, and structured-finance debt obligations, including residential mortgage-backed securities, like those held by the RMBS Investors. *Id.* ¶¶4, 4(a), 5. Ambac also guaranteed some structured finance obligations indirectly, whereby a non-insurance, wholly-owned Ambac subsidiary would enter into credit-default swaps ("CDS") with counterparties, such as members of the Bank Group, that protected the counterparties from defaults of the underlying security issuer and Ambac would, in turn, guarantee the financial obligations of its subsidiary. *Id.* ¶4(a).

The RMBS Investors supporting the emergency motion claim to own approximately $1 billion par face amount of Ambac-wrapped residential mortgage-backed securities ("RMBS"). This represents only about 3% of the Ambac-wrapped RMBS. Movants

together account for approximately 2% of the net par outstanding in the Segregated Account. When compared to the total outstanding Ambac policies in both Accounts, Movants represent less than 0.4% of the net par outstanding. *See* Affidavit of Roger A. Peterson, sworn to on May 20, 2010 ("Peterson Aff."), ¶38.

Ambac's Deteriorating Financial Condition and Efforts to Address its Increasing ABS CDO Exposures

Beginning in 2008, credit ratings agencies, including Moody's and Standard & Poor's, have downgraded Ambac's credit ratings several times from their highest investment grade ratings, Aaa and AAA, to, as of April 30, 2010, Caa2 and R, respectively. Affidavit of Cathleen J. Matanle, sworn to on May 20, 2010 ("Matanle Aff.") ¶7. Since early 2008, two categories of exposures have driven Ambac's reported losses, loss reserves, and impairments: (i) residential mortgage backed securities ("RMBS"); and (ii) collateralized debt obligations with underlying mortgage backed security exposures ("ABS CDOs"). *Id.* ¶8.

Since the beginning of 2008, RMBS policy claims and loss reserves for future expected claims increased substantially; Ambac has paid over $2 billion in claims in respect of such RMBS securities, and has set aside significant reserves for future claims. *Id.* ¶9. Ambac's ABS CDO exposures are executed in the form of credit default swaps ("CDS") between an Ambac affiliate and a financial institution counterparty. *Id.* ¶10. Some of Ambac's exposures under these CDS contracts were commuted on a bilateral basis in 2008 and 2009 pursuant to agreements among the counterparty financial institution, Ambac's affiliate party to the original CDS contract, and Ambac. These bilateral agreements were submitted to OCI, and OCI issued its "non-disapproval" of them. *Id.* ¶11.

Ambac's Negotiations with the Bank Group, the BlackRock Appraisal and the CDS Settlement

In the Fall of 2009, Ambac became aware that the financial institutions who are parties to CDS in respect of the ABS CDOs were forming a group to negotiate with Ambac regarding a global commutation of these exposures. Ambac, which had previously negotiated several bilateral commutations with some of these financial institutions, renewed overtures to the financial institutions in the developing Bank Group, collectively and individually, with an eye toward a beneficial global settlement or further beneficial bilateral arrangements. Although a global commutation was desirable, the dynamics of reaching a global commutation were viewed as particularly challenging, in light of the divergent interests of the various members of the Bank Group. *Id.* ¶12.

In late 2009, OCI became more vocal in advocating a global commutation, and in early 2010 OCI assumed an active role in the negotiations. *Id.* ¶13. OCI took "an active role in overseeing, evaluating, and facilitating the discussions between Ambac and the Bank Group." Peterson Aff. ¶17. The negotiations were complex, protracted and conducted entirely at arms'-length. Matanle Aff. ¶13. Serious disagreements existed that needed to be resolved with regard to the amount and range of economic and market value losses suffered by each financial institution, and numerous other issues. The parties ultimately agreed that it would be beneficial for all to retain an independent third-party professional to perform a claim appraisal as a neutral. The parties, with OCI's concurrence, thereafter agreed to retain BlackRock Financial Management, Inc. ("BlackRock"), an organization having substantial expertise in valuing the securities comprising ABS CDOs, as a neutral third-party liability appraiser to estimate the value of the Bank Group's claims, in strict confidence, for the purpose of facilitating the parties' efforts to reach a global settlement. *Id.* ¶17.

BlackRock was selected by the Bank Group and Ambac because of this expertise as well as its previous experience in performing independent appraisal services for bank group members in situations where other financial guarantors like Ambac sought to commute their troubled ABS CDO policies. In its engagement related to this matter, BlackRock insisted that its analyses were proprietary and highly complex and had to be performed under the protection of confidentiality agreements. In addition, aspects of BlackRock's work were kept confidential within the Bank Group. Each bank received detailed calculations only with respect to their own exposures and received only high level aggregated information regarding the other banks' exposures. In conducting its analysis, BlackRock was given access to Ambac's books and records regarding these exposures. BlackRock calculated what it viewed as the valuations of the Bank Group's claims under three different scenarios, which it called: "base case," "stress case" and "mark-to-market case." *Id.*

BlackRock's "base case" valuation is based on certain assumptions made by BlackRock with respect to housing price depreciation, mortgage default rates, and other relevant housing and mortgage industry statistics that were prevailing at the time the independent analysis was performed. BlackRock's "stress case" valuation is based on the assumption that actual experience will be worse than the prevailing industry statistics that were used in the "base case." BlackRock's "mark-to-market case" determines the value of the claims on Ambac's policies based on BlackRock's estimate of the value of the ABS CDO security being analyzed, using a mid-market fair value. A "mark-to-market" payment would arise if there were a successful exercise by the Bank Group of their rights to terminate the CDSs and receive market value-based termination payments. *Id.* ¶18.

In calculating what it viewed as the "base case" and "stress case" valuations, BlackRock determined the timing of cash shortfalls that would result in claims for payment from Ambac. In general, the majority of shortfalls in these ABS CDOs occur at the deals' maturities when principal is due; earlier shortfalls for interest payments are substantially smaller. This schedule of projected claims payments was then discounted by BlackRock to a present value amount using a discount rate equivalent to the interest rate on the related debt obligation issued by the ABS CDO and specified in the relevant CDS contract. BlackRock's mark-to-market case is calculated based upon a current termination and therefore is already expressed in present value dollars. *Id.* ¶19.

Under BlackRock's "base case" valuation, BlackRock's view of the present value of the Bank Group's claims is $8.7 billion. Under BlackRock's "stress case" valuation, BlackRock's view of the present value of the Bank Group's claims is $10.4 billion. Under BlackRock's "mark-to-market" valuation, BlackRock's view of the value of the Bank Group's claims is $12.9 billion. *Id.* ¶20.[1]

There are differing views of the appropriate way to take into account or weigh these various scenarios. If one were to give equal weight to all three BlackRock scenarios, the average of the three scenarios is $10.6 billion. Measured against this amount, the consideration being paid to the Bank Group represents 43.3% of their claims (a discount of 56.7%). Approximately 24.5% of that claim amount would be paid in cash, and 18.8% would be paid in surplus notes. The Bank Group is using this approach, *i.e.*, an equal

[1] These estimates exceeded the $3.8 billion in reserves that Ambac had posted as of the end of 2009, which were calculated using a different methodology dictated by statute. While Ambac stands by its estimate for reserve purposes, the values that were used in settlement negotiations were substantially higher, and the resulting settlement, which requires a cash payment of $2.6 billion, will permit Ambac to release the balance of the impairment.

weighting of all three BlackRock scenarios, to establish an allocation for the settlement. *Id.* ¶21.

On March 24, 2010, Ambac reached a non-binding agreement with the Bank Group which would commute all of the outstanding CDS in respect of ABS CDOs. In exchange for commuting approximately $16.7 billion in net par exposure of ABS CDOs, Ambac would transfer to the Bank Group in the aggregate (i) $2.6 billion in cash and (ii) $2 billion of newly issued surplus notes of Ambac. The details of the proposed settlement between Ambac and the Bank Groups were publicly disclosed in Ambac's Current Report on Form 8-K filed with the Securities and Exchange Commission on March 25, 2010 *See* Matanle Aff. Exhibit 1, at 4. Ambac is currently negotiating the terms of the settlement agreement with the Bank Group. The Bank Group also entered into forbearance agreements to allow the parties a brief period of time, originally envisioned as 60 days, to negotiate and execute the settlement agreement. The 60 days expire on May 23, 2010, but, as the Court was informed in a letter sent by OCI counsel and agreed to by Ambac counsel on May 6, 2010, no settlement will be consummated prior to the close of the hearing scheduled for May 25, 2010. *Id.* ¶15; *see also id.* ¶13.

Creation of the Segregated Account

As Ambac's financial condition deteriorated, OCI began to monitor Ambac's financial health more closely. Verified Petition ¶5. As this occurred, there were numerous discussions within Ambac and, increasingly over time, between Ambac and OCI and its professional advisors regarding the troubled segments of Ambac's business and what to do to protect policyholders. Discussions encompassed a wide range of subjects, including restructurings, commutations, Form D requests and Commissioner non-disapprovals, among

other things. Verified Petition ¶7. OCI became increasingly active and involved in connection with Ambac's activities as it undertook an evaluation of numerous restructuring options. *Id.* ¶8. After several months of discussions and considerations of different rehabilitation and restructuring options, OCI and its advisors decided to carry out a three-part restructuring and rehabilitation plan, which OCI determined was "the approach best calculated to fairly and equitably promote the best interest of Ambac's policyholders and creditors, and the public generally." *Id.*

The first component of the plan was the establishment of the Segregated Account. Although OCI considered placing all of Ambac into rehabilitation, that alternative was rejected "because it appeared likely to trigger material damages to the detriment of all policyholders." Peterson Aff. ¶9(a). Particularly worrisome to OCI was the prospect that, in the event of a full rehabilitation, counterparties in commercial asset-backed security transactions would assert the right to "declare [certain] defaults and [, in some cases,] accelerate payment of principal and interest on performing deals." *Id.* ¶9(a)(ii). OCI was concerned that a full rehabilitation, by itself, could, in certain commercial asset-backed security transactions -- including those with little or no impairments -- constitute a default. As a consequence, numerous issuers of asset-backed securities could be placed into default even if they are fully performing their contractual obligations. These innocent borrowers could face acceleration of principal and interest. As a result, these "corporate issuers would be forced to raise capital at a time of reduced credit availability and lower asset values . . . [and] any shortfall in the affected corporate issuers' ability to make those accelerated damage payments could fall on Ambac." *Id.* All told, OCI estimated that a full rehabilitation could cause collateral damage resulting from asserted defaults of ABS policies

in excess of $1 billion on top of the more than $8 billion in additional claims Ambac could face from the Bank Group. *Id.* ¶9(a)(iv).

OCI worked closely with its outside advisors and Ambac to identify policies best suited for inclusion in the Segregated Account. *Id.* ¶10. Movants' policies were among the policies allocated to the Segregated Account. RMBS policies were a "clear-cut choice" for the Segregated Account because "actual and projected impairments on RMBS are substantial and short-term" – according to OCI, Ambac would have paid an estimated $300 million in RMBS claims from just March 25, 2010 to April 30, 2010. *Id.* ¶11. Therefore, paying the RMBS claims in full and in cash as they accrued "would have jeopardized the financial security of all Ambac policyholders. . . ." *Id.* The insurance policies providing coverage to the LVM Bondholders were also allocated to the Segregated Account, as the Las Vegas Monorail exposure current projects extremely high losses. *Id.* ¶13.

In the end, only a small percentage (fewer than 1,000 out of approximately 15,000) of Ambac's policies were placed in the Segregated Account. Only those categories of policies and individual policies with projected material impairments and/or containing or related to contracts containing triggers allowing policyholders upon certain specified events to exercise termination or remedial rights or to strip Ambac of all or some of its material rights were allocated to the Segregated Account. *Id.* ¶¶9-10. Policies (a) without material projected impairments, (b) for which the collateral damage of rehabilitation would outweigh the benefits, and/or (c) for which the policyholders signed a binding agreement to forbear from the exercise of contractual triggers, and to commute certain impaired exposures at a substantial discount to likely loss levels, were left in the General Account. *Id.* ¶12.

The second component of OCI's plan involves the rehabilitation of the Segregated Account. Because the policies allocated to the Segregated Account represent the most dangerous and debilitating exposures for Ambac, on March 24, 2010, the same day the Segregated Account was created, OCI petitioned this Court for an Order of Rehabilitation for the Segregated Account. OCI made clear that Ambac, or the "General Account," would remain outside of the ambit of these rehabilitation proceedings. *See* Verified Petition at 1: Order of Rehabilitation, dated March 24, 2010. As explained by OCI, "[a]n orderly run-off of the Segregated Account . . . will result in a larger and fairer distribution to claimants and creditors of both the Segregated Account and Ambac than other alternatives." Verified Petition ¶8(c).

The third component of OCI's plan to restructure Ambac was to support Ambac's efforts to negotiate a global commutation (at a substantial discount), outside of the rehabilitation process, of Ambac's exposures to the fourteen large financial institutions that comprise the Bank Group with respect to a particularly troubled ABS CDO segment of Ambac's policy portfolio. *Id.* ¶¶2, 7, 17. OCI was particularly concerned with the claims of the Bank Group because of, *inter alia*, the possible assertion of catastrophically large mark-to-market claims. *Id.* ¶¶27-29. As explained by Mr. Peterson, the policies issued to protect the Bank Group "represent the greatest concentration of projected economic losses to Ambac as well as the largest potential source of collateral damage through the possibility of major 'market value' damages (also referred to as 'mark-to-market' damages.)." *Id.* ¶17.

The ABS CDO exposures with the Bank Group were left in the General Account because, as described above, prior to the creation to the Segregated Account, with the direct involvement and support of the Commissioner. Ambac had entered into a non-binding

Statement of Intent with the Bank Group that, if consummated, would result in the commutation of all of the outstanding ABS CDO credit swaps guaranteed by Ambac (having a total potential exposure estimated by BlackRock to be approximately $12.9 billion), in exchange for a payment by Ambac of $2.6 billion in cash and $2 billion in newly issued surplus notes (the economic terms of which are expected to be the same in all material respects to the terms of any surplus notes that may be issued to policyholders in the Segregated Account under the plan of rehabilitation OCI currently envisions). Matanle Aff. ¶22; Peterson Aff. ¶43.

No matter how one looks at the CDS Settlement, one thing is clear: the members of the Bank Group have agreed to accept a substantial discount on their claims, as estimated by BlackRock, thereby increasing the likely recoveries of policyholders in the Segregated Account while avoiding all of the collateral damage that a full rehabilitation of Ambac would almost inevitably entail.

OCI, after independently assessing BlackRock's estimates with its own professional advisors, concluded that those estimates were in line with its own concurrent and ongoing assessment, and advised the parties that it was supportive of the settlement and likely to approve it when finalized. Indeed, the Commissioner found the Statement of Intent to be a "meaningful and positive development for all policyholders of both the Segregated and General Accounts." OCI Brief in Support of Entry of Order for Rehabilitation at 3. Movants apparently disagree.

ARGUMENT

Both the RMBS Investors and the LMV Bondholders seek to temporarily enjoin Ambac from entering into the CDS Settlement with the Bank Group. But this application is not made in a vacuum. It is presented in the context of an Injunction Order already issued

by this Court paving the way for Ambac, with the approval and guidance of OCI, to conclude the very settlement that the Movants wish to enjoin. Recognizing this procedural posture, the RMBS Investors style their application as a motion to "amend" the existing Injunction Order. Thus, the substance of the Motions is an application for a preliminary injunction that has the effect of upsetting a delicate balance created by this Court's existing Injunction Order. Under these circumstances, the standards for imposing a preliminary injunction and for modifying an existing injunction are both pertinent.

A temporary injunction is "not to be issued lightly." *Werner v. A. L. Grootemaat & Sons, Inc.*, 80 Wis. 2d 513, 520, 259 N.W.2d 310, 313 (1977); *Sch. Dist. of Slinger v. Wisconsin Interscholastic Athletic Ass'n*, 210 Wis. 2d 365, 370, 563 N.W.2d 585, 588 (Ct. App. 1997). A party seeking to obtain a temporary injunction carries the burden of persuasion and must establish: (1) reasonable probability of success on the merits; (2) lack of an adequate alternative remedy at law; and (3) irreparable injury if the injunction is not granted. *Werner*, 80 Wis. 2d at 520; *see also Minuteman, Inc. v. L.D. Alexander*, 147 Wis. 2d 842, 859, 434 N.W.2d 773, 780 (1989).

Where modification of an injunction is sought, courts "fashion a remedy to the particular facts," as "failure to do so would render equity as sterile and as arbitrary in its relief as the old common-law courts. . . ." *Town of Fond du Lac v. City of Fond du Lac*, 22 Wis. 2d 525, 531-32, 126 N.W.2d 206, 210 (1964) (holding that the circuit court abused its discretion in part by failing to balance the private and public rights when modifying an injunction).

Finally, Wisconsin courts have long held that if the public has an interest in whether a temporary injunction is issued, that interest must be considered. *Ward v. Sweeney*, 106

Wis. 44, 48-49, 82 N.W. 169, 170 (1900); *see also Kuntz v. Werner Flying Serv., Inc.*, 257 Wis. 405, 409, 43 N.W.2d 476, 478-79 (1950).

I. Movants Have no Reasonable Probability of Success on the Merits

Movants are total strangers to the contracts that are the subject of the CDS Settlement and have no right to interfere with them. Whatever objections they may have to the establishment of the Segregated Account do not give Movants standing to interfere with a settlement reached with a policyholder whose policy remains in the General Account. But even if Movants had a legal basis to be heard on the merits of the Settlement, they would have no grounds to complain. The Settlement is a reasonable compromise that serves the interest of Ambac and all of its policyholders, including Movants.

A. Movants Lack Standing to Enjoin the Proposed Settlement

1. Movants Lack Standing against Ambac

Movants seek to enjoin Ambac from entering into the CDS Settlement with the Bank Group, but fail to identify any legal basis on which they may sue or any substantive right that would be abrogated by the CDS Settlement. Movants are not parties to any of the financial guaranty policies issued to protect the Bank Group. Nor do they have any rights as third-party beneficiaries under such policies. *See Schell v. Knickelbein*, 77 Wis. 2d 344, 349, 252 N.W.2d 921, 925 (1977) ("In order to entitle a stranger to a contract to recover thereon, the contract must indicate an intention to secure some benefit to such third party.") (quotation omitted).

Movants have not cited a single case holding that a non-party can seek to enjoin a settlement between an insurer and its policyholder. Indeed, even co-insureds on the same policy cannot block settlements that exclude them. *See, e.g., Homsy v. Floyd (In re Vitek, Inc.)*, 51 F.3d 530, 537 (5th Cir. 1995) (finding no support for a general principle of

insurance law that forbids an insurer from settling with an insured at the disadvantage of another insured); *Anglo-American Ins. Co. v. Molin*, 670 A.2d 194, 198-99 (Pa. Commw. Ct. 1995) (denying preliminary injunction and observing that nothing prevents insurer from settling with one of its co-insureds to the disadvantage of another).

The only case cited in support of Movants' novel argument is an unreported decision from Louisiana. *Alexander v. Savings Life Ins. Co.*, No. 87-1477, 1987 U.S. Dist. LEXIS 5839 (E.D. La. June 30, 1987). *See* Brief in Support of Emergency Motion to Order for Temporary Injunctive Relief filed by Certain RMBS Investors and Motion Seeking Expedited Relief ("RMBS Br.") at 17-19. While the RMBS Investors describe this decision as addressing an "informal rehabilitation process," the insurer was actually under "voluntary supervision" by the insurance commissioner, which is wholly different from rehabilitation. In rehabilitation, the Commissioner acts pursuant to well-established statutory authority. Not only do these statutes give OCI broad discretion in determining how best to revitalize an insurer, but they, with limited exception, deny policyholders standing to second-guess these decision. Furthermore, nothing in *Alexander* remotely supports a right to enjoin an insurer that is *not in rehabilitation*, *i.e.*, the General Account, from entering into settlement agreements with its policyholders.

Movants also rely upon Wis. Stat. §601.01, which "mandate[s] that . . . policyholders, claimants and insurers are treated *fairly and equitably*." RMBS Br. at 6. But it is well-established that Section 601.01 "does not by its terms impose a duty, the breach of which could be actionable" and "does not by express language confer upon any group a right of action." *Kranzush v. Badger State Mut. Cas. Co.*, 103 Wis. 2d 56, 76-77, 307 N.W.2d 256, 266-67 (1981); *see also Marino v. Cont'l Cas. Co.*, 308 F. Supp. 2d 906, 909 (E.D. Wis.

2003) (finding that Wisconsin insurance statutes 600-655 "create no private right of action and afford no basis on which . . . relief . . . could be granted" and "[i]n and of themselves . . . they provide no remedies"). To the contrary, the Wisconsin legislature empowered OCI, not individual policyholders, to enforce the insurance statutes. *See* Wis. Stat. § 601.64; *Marino*, 308 F. Supp. 2d at 909.

Finally, the LVM Bondholders seek, in the alternative, to intervene in this proceeding pursuant to Section 803.09(1) of the Wisconsin Statutes. Notably, they cite no case holding that intervention is appropriate in an insurance rehabilitation proceeding conducted by OCI. This is not surprising given that individual policyholders lack standing to enforce insurance statutes. Further, the one case that the LVM Bondholders do cite involved an application to intervene in a receivership to obtain payment (under a contract to which it was a party) for goods supplied to the receiver. *See M&I Marshall & Isley Bank v. Urquhart Co.*, 2005 WI 225, ¶9, 287 Wis. 2d 623, 632, 706 N.W.2d 335, 339-40 (Ct. App. 2005). Here, Movants are attempting to interfere in the commutation of a contract to which they are not party or a beneficiary and in which they have no rights. Procedural rules, such as the general intervention statute, cannot "abridge, enlarge, or modify the substantive rights of any litigant." Wis. Stat. §751.12; *see also Amchem Prods., Inc., et al. v. Windsor*, 521 U.S. 591, 611 (1997) ("[R]ules of procedure shall not abridge, enlarge or modify any substantive right." (quotation omitted)).[2]

[2] Additionally, Movants may be precluded from bringing these motions by provisions in the indentures governing their investments. Under standard "limitations on suits" provisions in indentures, bondholders delegate to a trustee the right to brings suits and to enforce remedies. Hence, bondholders are contractually precluded from bringing collective claims on their own without first asking the trustee to do so. Trustees typically have 60 days to react to such requests. Thus, Movants may very well lack standing to sue under the terms of their own governing agreements.

2. Movants' Objections to the Establishment of the Segregated Account are Irrelevant and Premature

In order to distract attention from the fact that they have no legal right to derail the CDS Settlement, the RMBS Investors spend much of their brief attacking the creation of the Segregated Account as invalid or unconstitutional and arguing that their policies should be moved to the General Account.[3] These arguments are entirely irrelevant to the question at hand – whether there is any basis to enjoin Ambac from entering into the CDS Settlement with the Bank Group.

As explained above, Movants had no legal right to prevent Ambac from settling with another policyholder before the Segregated Account came into existence. The creation of the Segregated Account did not magically endow them with standing to interfere with Ambac's every action. *See Minn. Mining & Mfg. Co. v. H & W Motor Express Co.*, 507 N.W.2d 622, 625 (Minn. Ct. App. 1993) ("The insolvency of the insurer should not give the insured rights it otherwise would not have had."). To the contrary, the Segregated Account was intended to have the opposite effect, *i.e.*, to insulate Ambac from a relatively small number of highly-impaired policies, such as those held by Movants, that jeopardized Ambac's ability to meet its obligations to the vast majority of its other policyholders.

Even if the objections of the RMBS Investors to the establishment of the Segregated Account and/or to the inclusion of their policies in that Account are ultimately successful, they still would have no legal basis to prevent Ambac from completing commutation transactions with other policyholders. Thus, any objections to the creation of the Segregated Account are entirely irrelevant to the matter at hand: the execution of the CDS Settlement.

[3] Only the RMBS Investors have included an attack upon the Segregated Account as part of their motion. The LVM Bondholders' motion is confined to whether Ambac can proceed with the CDS Settlement.

Ambac reserves the right to address the arguments raised at pages 23 to 29 of the RMBS Brief, which are directed to the creation and composition of the Segregated Account, after it has the opportunity to consider *all* such objections, including any filed by the overwhelming majority of policyholders that have not attempted to prevent Ambac from completing the CDS Settlement with the Bank Group.[4] Ambac notes that OCI has addressed these issues in response to the instant motions, and Ambac generally supports OCI's position on these subjects.

3. **Movants Lack Standing Against OCI**

To the extent Movants' complain about OCI's close participation in the settlement process and its anticipated approval of the Settlement under the terms of the Cooperation Agreement, they lack standing to challenge these discretionary governmental actions. Although Wisconsin insurance law permits "any person whose interests are substantially affected" to seek judicial review of a *summary order*, it does not grant a similar right to seek review of other discretionary acts by OCI. Wis. Stat. §645.21(4). Had the Wisconsin legislature wished to grant the same third-party standing to challenge discretionary acts of OCI that it granted for challenges to summary orders, it presumably would have done so simply by making Wis. Stat. §645.21(4) applicable to any OCI action, rather than just summary orders. *See* 2A Norman J. Singer & J.D. Shambie Singer, *Sutherland on Statutes and Statutory Construction* §46:5 (7th ed. 2007) ("[W]here the legislature has employed a term in one place and excluded it in another, it should not be implied where excluded.").

Here, at the same time OCI sought the entry of a rehabilitation order for the Segregated Account, it supported Ambac's efforts to settle claims with certain

[4] The same is true of the RMBS Investors' requests for discovery on these same issues, which should not be entertained at this time.

counterparties of the General Account, both of which constitute discretionary acts. *See* Brief In Support of Entry of Order For Rehabilitation at 25. Wisconsin insurance law grants OCI discretion to take the actions necessary to ensure efficient and equitable administration of assets and to fashion a rehabilitation plan that will protect the rights of policyholders and ensure the future viability of Ambac. Indeed, OCI has "broad discretion" to "try to remove the causes of [Ambac's] difficulties" and ensure the "successful continuation of the business." *See* 1 Lee R. Russ & Thomas F. Segalla, *Couch on Insurance* §§5:18, 22, 24 (3d ed. 2008). Here, OCI not only contemplated the Statement of Intent when approving the creation of the Segregated Account, but relied upon it to maintain the solvency of the General Account and prevent a full rehabilitation of Ambac. Verified Petition ¶8; *see generally* Brief In Support of Entry of Order For Rehabilitation.

B. Even if Movants Had Standing, They Would Have No Reasonable Probability of Success in Challenging the Settlement

Even if Movants had a right to challenge the CDS Settlement, which they do not, their objections to the Settlement would still fail. First, Court approval is not required to conclude the CDS Settlement. Second, Movants' attack upon the CDS Settlement is premised on certain misconceptions. Finally, once the basic facts are understood, it becomes clear that the CDS Settlement is a reasonable compromise that is beneficial for Ambac and its policyholders. The only certainty about the high-stakes litigation against the Bank Group almost certain to ensue in the absence of the CDS Settlement is that it would be long and expensive. The outcome, on the other hand, would be highly uncertain such that this dispute is better resolved now on reasonable terms that avoid the potentially devastating consequences of not settling.

1. <u>No Court Approval is Required for the Settlement</u>

A fundamental premise of the LVM Bondholders' motion is that the proposed CDS Settlement requires Court approval. *See* LVM Bondholders' Brief In Support of Emergency Motion to Enjoin Consummation of the Proposed Settlement Between Ambac and Certain CDS Counterparties ("LVM Br.") at 11-14. The RMBS Motion is more equivocal on this point, but nonetheless takes the position that Court approval should be required. *See* RMBS Br. at 21. Putting aside the fact that neither Movant has standing to raise such challenges, both are wrong for the reasons described below.

The starting point in addressing the need for Court approval is the incontestable fact that the policies that are subject to the CDS Settlement are in the General Account, not the Segregated Account. Peterson Aff. ¶16. Only the activities of the Segregated Account are subject to review by this Court. Except as constrained by the Cooperation Agreement, which is addressed below, it is business as usual for the General Account policies. Thus, Movants have no more right to object to Ambac's settlements with other policyholders than they had before creation of the Segregated Account, *i.e.*, none whatsoever.

As Movants note, Section 1.02 of the Cooperation Agreement between the General Account and the Segregated Account requires approval of the Segregated Account before the General Account can enter into transactions exceeding a certain dollar value. Where the Movants go wrong is in relying on this approval requirement as a "hook" to bring the entire Settlement before the Court. Nowhere does the Cooperation Agreement state that the Segregated Account must have a court order in hand before providing its consent. *See* Verified Petition, Plan of Operation, Tab B. As the LVM Bondholders acknowledge, "not every single action taken by the rehabilitator requires judicial review and approval." LVM

Br. at 13. The only Wisconsin authority cited in support of their assertion that the Commissioner must obtain Court approval before providing consent to the Settlement is Wis. Stat. §645.33(2).[5] LVM Br. at 11-14. But this statute concerns actions taken by the rehabilitator "to reform and revitalize the insurer." This reference to "the insurer" plainly means the company subject to rehabilitation, not an insurance company that is outside rehabilitation. The Commissioner's approval of the Settlement is not an action to "reform and revitalize" the Segregated Account, but is instead directed to the well-being of the General Account. Thus, Court approval of OCI's expected consent to the proposed CDS Settlement is not required.

2. Movants Are Incorrect about Key Settlement Terms

Ambac has provided public disclosures describing the material terms of the proposed CDS Settlement, but it appears that Movants have misconstrued them. While Movants complain that they lack adequate information about the CDS Settlement, they elected to file the instant Motions before Ambac could negotiate confidentiality agreements with them that would have provided additional information. Ambac hopes to allay Movants' concerns by setting the record straight in this Response.

a. Terms of the Surplus Notes

First, Movants incorrectly speculate about the terms of the surplus notes to be issued to the Bank Group as part of the Settlement. *See* Affidavit of Dan Gropper, dated April 30, 2010 ("Gropper Aff.") ¶ 19; LVM Br. at 14. The proposed settlement calls for Ambac to pay the Bank Group $2.6 billion in cash and $2.0 billion in the form of surplus notes. Similarly, the Commissioner has announced that policyholders in the Segregated Account

[5] The LVM Brief includes a "see also" citation to Wis. Stat. §645.32, but this statute concerns the insurer in rehabilitation and has no application to the General Account. LVM Br. at 12.

are expected to receive a combination of cash and surplus notes. As currently contemplated, there will be no material difference between the economic terms of the notes issued to the Bank Group, on the one hand, and to the Segregated Account policyholders, on the other hand. Matanle Aff. ¶22; Peterson Aff. ¶43.

b. **Value of the CDS Settlement**

Second, Movants are wrong about the percentage of its claims that the Bank Group is to recover. Valuation of these claims is uncertain and subjective, which makes it difficult to say with precision what percentage of the value of a claim is being paid in settlement. In order to provide common ground for negotiations with the Bank Group, both sides retained BlackRock to perform a claim appraisal as a neutral. BlackRock's methodology in valuing the Bank Group claim was highly complicated and proprietary. Accordingly, confidentiality agreements prevent Ambac from describing it in detail. Ambac can say, however, that BlackRock performed three different valuations, using different sets of assumptions. As described in more detail in the Matanle Affidavit, these three different valuations were referred to by BlackRock as the "base" case, the "stress" case, and the "mark-to-market" case. In general terms, the base case provided the lowest valuation, the mark-to-market case provided the highest valuation, and the stress case was in the middle.

The Commissioner has announced that policyholders in the Segregated Account will receive a combination of cash and surplus notes valued at 100 percent of their claims. One of the few things that can be said with relative certainty is that this recovery compares favorably to the total recovery of the Bank Group under the CDS Settlement as measured by BlackRock. In contrast, using the average of BlackRock's estimates, the Bank Group will recover total compensation (cash plus surplus notes) of 43.3% of its claim. Based upon this neutral appraisal, the Bank Group is settling its claim at a substantial discount.

Recognizing this fact, Movants shift their focus away from total compensation, a measure by which they will fare better than the Bank Group, to the cash component of compensation. Starting with the Commissioner's announcement that they are likely to receive 25 percent of their claims in cash, Movants assert that the Bank Group will receive 67 percent of its claim in cash. Gropper Aff. ¶19. Ambac assumes that Movants derived their 67 percent number by dividing the $2.6 billion in cash called for by the CDS Settlement by Ambac's reported reserves at year end 2009 for the Bank Group claim was $3.8 billion. But this was not the number that the neutral claims evaluator used during settlement negotiations. Insurance reserves are calculated according to statutory accounting principles. While Ambac stands by that figure for the purpose for which it was calculated, the third-party appraiser that the parties agreed to use as a neutral in their settlement negotiations estimated the Bank Group's damages based upon different assumptions. Using the average of the three valuations generated by BlackRock, the cash to be paid under the Settlement is 24.5% of the value of the Bank Group's claim. While these calculations are only estimates, it is inaccurate to suggest that the Bank Group is getting a much better deal than Movants.

c. **<u>Upstreaming of Cash</u>**

Movants' papers create the impression that the CDS Settlement affirmatively requires Ambac to pay $52 million in dividends to its parent corporation. RBMS Br. at 16; LVM Br. at 9. This is a mischaracterization. There is no contemplation or intention that Ambac will pay any dividends to its parent in connection with the proposed CDS Settlement. This provision of the proposed settlement would add additional restrictions with respect to the amount or purpose of any potential future dividends that might otherwise be made, in addition to the existing restrictions requiring OCI approval. Matanle Aff. ¶40.

d. <u>Use of NOLs</u>

Finally, and perhaps most confusingly, Movants suggest that the Settlement somehow disadvantages them by allowing Ambac's affiliates to make use of the tax benefit provided by Ambac's recent and sizeable net operating losses. RMBS Br. at 16-17. As is the case with dividends, Movants have it backwards. First, the CDS Settlement contemplates amending the corporate tax sharing agreement so as to preclude any member of the consolidated group from using any portion of the NOLs without compensating the member of the group whose NOLs are being used (unless Ambac would not otherwise have been in a position to use those NOLs itself). Matanle Aff. ¶¶37-38. This represents a *greater* restriction on the use of Ambac's NOLs than existed previously, which contained no restrictions whatsoever. The amendment also would limit the purposes for which Ambac's parent can make use of the NOLs to a single purpose relating to "cancellation of indebtedness" ("COD") income. *Id.* ¶38. The amendment thus benefits Movants in several ways. Second, the sheer size of the available NOLs (approximately $6 billion), given the potential amount of COD income, makes it extremely unlikely under the current circumstances that Ambac would be able to use all of these NOLs, and thus the ability of Ambac's parent to use a portion of these NOLs for a limited purpose does not disadvantage Ambac. *Id.* ¶39.

3. **<u>The CDS Settlement is a Reasonable Compromise</u>**

Finally, Movants' core assertion is that the CDS Settlement is unfair to them because it pays the Bank Group more than it deserves for its claim. In support of this argument, the LVM Bondholders identify a number of potential problems and pitfalls that the Bank Group would encounter in litigation against Ambac. These include the argument that the CDS Agreements held by the Bank Group are not truly insurance agreements and should be

subordinated, and that the Bank Group would not be entitled to recover mark-to-market damages. LVM Br. at 14-17.

If Ambac must litigate against the Bank Group, it might assert the very same arguments raised in the LVM brief. Without prejudice to its right to take these positions, it is also fair to say that litigation of the Bank Group's claims and Ambac's defenses would be complicated and likely to raise issues of first impression, rendering the outcome uncertain. Indeed, the LVM Bondholders cite no controlling authority on the issue of subordination, for example, and are somewhat circumspect in describing the merits of this defense. *See* LVM Br. at 14 (referring to "serious questions" about subordination such that the Bank Group "may not be" entitled to priority); 16 (referring to "real doubt" as to whether the Bank Group had "policies" and that they "may very well" be entitled to less favorable treatment).

Every settlement is a compromise of one's litigation position and the CDS Settlement is no exception. The LVM Bondholders' assertions about the Bank Group's claim, equivocal as they are, could be right, but they could also turn out to be wrong. Even if Movants had any right to object to the CDS Settlement, which they do not, Ambac would not need to prove that it will lose the case in order to justify a settlement. By analogy, the standard for court approval of settlements under the Bankruptcy Code is that it must not "fall below the lowest point in the range of reasonableness." *Vaughn v. Drexel Burnham Lambert Group, Inc. (In re Drexel Burnham Lambert Group, Inc.)*, 134 B.R. 499, 505 (Bankr. S.D.N.Y. 1991) (quotation omitted); *see also Cosoff v. Rodman (In re W.T. Grant Co.)*, 699 F.2d 599, 608 (2d Cir. 1983). As explained in greater detail above, the proposed CDS Settlement easily meets that test. By BlackRock's metrics, the total compensation to

be paid to the Bank Group reflects a substantial discount from the estimated value of its claim, which accounts for the risks of litigation.

But here, litigating instead of settling poses risk beyond the conventional concerns present in every litigation, such as exposure to damages (here, a nearly $13 billion claim), expense and distraction. Ambac faces the additional risk that the mere assertion of the Bank Group's claim in court could plunge the policies currently in the General Account into rehabilitation, thus defeating the goal of creating the Segregated Account in the first place. The precise sequence of events that would unfold after a collapse of the CDS Settlement is uncertain, but there is a substantial risk that assertion of the Bank Group's claim would trigger a devastating domino effect.

Ambac notes, for example, that Sections 555 and 556 of the Bankruptcy Code provide that certain rights to accelerate and terminate securities and forward contracts are not subject to the automatic stay in bankruptcy. 11 U.S.C. §556. The Bank Group would surely argue, either directly or by analogy, that its claims for "mark-to-market" damages provided under ISDA contracts cannot be halted by a rehabilitation proceeding. Unchecked by a judicial stay, a nearly $13 billion claim against Ambac could, in-turn, trigger defaults in numerous other transactions in which Ambac serves as insurer. *See* Point III, *infra*. As explained more fully below, this could result in a multiplication of claims against Ambac, and could cause undue hardship for numerous third-parties. While Ambac would attempt to fend off such a chain of events, failing to settle with the Bank Group would raise a host of uncertainties.

Finally, Movants' complaints about the CDS Settlement seem rooted in a false belief that they are entitled to ensure that no one gets a better deal than they do. This is simply not

the law. Although they assert the right to be treated "fairly and equitably" under Wis. Stat. §601.01(2), they avoid addressing what these words actually mean. *See, e.g.*, RMBS Br. at 13. Fair and equitable treatment in insurer rehabilitation does not require identical treatment of policyholders. In *Carpenter v. Pacific Mutual Life Ins. Co.*, 74 P.2d 761 (Cal. 1937), *aff'd sub nom. Neblett v. Carpenter*, 305 U.S. 297 (1938), the California Insurance Department split Pacific Mutual Life into two separate companies, one profitable and the other not. The plan was approved over objections of policyholders remaining with the non-profitable business on the grounds that they had the statutory option of being paid the liquidation value of their claims, and were being treated at least that well. *Carpenter* illustrates that there is no prohibition against treating sub-sets of policyholders differently as long as they receive no less than the liquidation distribution to which they would be entitled.

II. Movants Fail to Show Irreparable Harm

The party seeking an injunction must show a sufficient probability that another party's future conduct will cause irreparable harm. *Werner*, 80 Wis. 2d at 521. Irreparable harm is that which is not adequately compensable in damages. *Id.* at 524; *see also Minuteman, Inc.*, 147 Wis. 2d at 859 (affirming the circuit court's finding that a temporary injunction should be denied in part because "damages represented an adequate remedy at law"). This element is entirely lacking.

All that Movants can allege is speculative future harm on the theory that any money that Ambac pays to someone else could mean less money for them. For example, the RMBS Investors allege that "any settlements . . . *could* substantially limit the recovery by the RMBS Policyholders" and that Ambac's actions "*may* irreparably harm the RMBS Policyholders and other similarly situated policyholders." RMBS Br. at 20 (emphasis added). These alleged injuries rest upon layers of unfounded assumptions and are "merely

feared as liable to occur at some indefinite time." *Wisconsin Gas Co., et al. v. Fed. Energy Regulatory Comm'n*, 758 F.2d 669, 674 (D.C. Cir. 1985) (quotation omitted) (denying stay pending appeal). Movants identify no specific obligation that Ambac has to them, or even to the Segregated Account, that can be met today, but that will not be met as the direct result of entering into the contemplated CDS Settlement. Thus, Movants fail to show a "clear and present need for equitable relief." *Id.*

Indeed, the very same argument could be made about any substantial payment made to settle the numerous claims that Ambac currently faces. In effect, Movants argue for a complete paralysis of Ambac's ability to commute, renegotiate or otherwise resolve its enormous financial obligations. Inaction is not a viable option for Ambac and its policyholders, and is not one that OCI would tolerate. It therefore comes as no surprise that only a very small minority of Ambac's policyholders support these Motions. When compared to the total number of Ambac polices in both the Segregated and General Accounts, Movants represent less than 0.4% of the net par outstanding. Peterson Aff. ¶38.

Further, the allegations of irreparable harm are grounded solely in financial loss, while the very definition of irreparable harm is injury that may not be remedied by an award of monetary damages. *See Werner*, 80 Wis. 2d at 524; *Nettesheim v. S.G. New Age Prods., Inc.*, 2005 WI App 169, ¶21, 285 Wis. 2d 663, 667, 702 N.W.2d 449, 455 (Ct. App. 2005) ("To obtain an injunction, the moving party must . . . establish that the injury would be irreparable-not adequately compensable by money damages. . . .").

Finally, as described above and in the Peterson and Matanle affidavits, Movants cannot demonstrate that they will suffer any harm, let alone financial harm, as a result of the CDS Settlement. Movants' claim of irreparable harm fails to take into account the benefit to

all policyholders, including Movants, of removing the cloud of an enormous claim against Ambac by the Bank Group. Ambac recognizes that because they did not participate in the settlement discussions leading to the proposed Settlement, [6] Movants may have misapprehended certain features of the CDS Settlement. Ambac had hoped to address Movants' concerns by providing them with additional information, but they filed their motions before an appropriate confidentiality agreement could be negotiated. Peterson Aff. ¶39. Now that OCI and Ambac have explained the CDS Settlement in greater detail, Ambac trusts that Movants will recognize that the CDS Settlement is actually in their own (and all other policyholders') financial interest. No compromise is perfect, but it is very difficult to argue that this compromise is not reasonable in light of the consequences of not reaching a settlement, which are described below.

III. The Equities and the Public Interest Weigh Heavily Against Movants

Where, as here, a movant seeks to upset an injunction already in place, courts must "fashion a remedy to the particular facts," as "failure to do so would render equity as sterile and as arbitrary in its relief as the old common-law courts. . . ." *Town of Fond du Lac*, 22 Wis. 2d at 531-32 (holding that the Circuit Court abused its discretion in part by failing to balance public and private rights when modifying an injunction).

The existing Injunction Order, entered by this Court upon the application of the Commissioner, strikes a careful balance of the crucial policy considerations, including the best interest of policyholders and the public at large. The Commissioner has determined that a full rehabilitation of Ambac would be detrimental to these interests. Peterson Aff. ¶9(a). Any disruption of the current regime would jeopardize OCI's objective of minimizing losses

[6] Of course, Movants were not entitled to participate in this process and these negotiations were confidential.

and dislocation by confining rehabilitation to the Segregated Account. Wisconsin courts have consistently held that if the public has an interest in whether a temporary injunction is issued, that interest must be considered. *See Ward*, 106 Wis. at 44; *see also Kuntz*, 257 Wis. at 409.

The Commissioner has also determined that the best interest of policyholders in the Segregated Account would be served by allowing Ambac and the Bank Group to negotiate the final terms of, and (subject to OCI's final approval) consummate, the proposed CDS Settlement. Enjoining the CDS Settlement, even for a short time, would risk the Bank Group's assertion of a claim in an amount estimated by a neutral claims evaluator to be approximately $12.9 billion (over $8.2 billion more than what they will receive in the CDS Settlement) as soon as its forbearance period expires. Peterson Aff. ¶32. Such a development would pose a clear and present danger to OCI's plan to limit rehabilitation to the Segregated Account. For example, even if these policies could be transferred to the Segregated Account, such an enormous claim would compete for scarce resources with other Segregated Account policies, including those held by the Movants, and raise new questions as to the capitalization of the Segregated Account. Any significant change in capital would threaten the viability of rehabilitating something less than the entire company. The Bank Group's claim would be similarly disruptive within the General Account, increasing the risk that the General Account itself would enter rehabilitation.

As explained in the Matanle Affidavit (¶24):

> In the absence of the forbearance agreement . . . there is a substantial risk that the Bank Group may assert a termination and claim mark-to-market damages against the General Account in an amount, which BlackRock estimates to be $12.9 billion. If the proposed settlement is not consummated and the Bank Group asserts such mark-to-market claims against Ambac, this would result in dilution of the amounts available to pay all policyholders, including

> policyholders in the Segregated Account. Even an assertion of BlackRock's base case or stress case claims would exceed the consideration contemplated in the proposed settlement and result in dilution of the amounts available to pay all policyholders, including the policyholders in the Segregated Account. Further, in this instance, the payment of such base or stress cases when contractually due, well into the future, would likely postpone the release of cash to other policyholders until the future amount and the adequacy of resources is known. Accordingly, the proposed settlement with the Bank Group is better for Ambac and its policyholders than failing to consummate this proposed settlement, when compared to the consideration to Segregated Account policyholders that OCI expects to propose under the anticipated plan of rehabilitation of the Segregated Account.

Moreover, as discussed in more detail below, if the proposed settlement is not consummated and the Ambac General Account becomes the subject of rehabilitation proceedings, there are additional consequences to Ambac, its policyholders and the public. These consequences include a potential for additional claims which would further dilute the amount available to pay policyholders, including those allocated to the Segregated Account. *Id.* ¶25.

A full rehabilitation could affect all of Ambac's policyholders, even though the vast majority of them "have problem-free policies with little or no projected claim payments." Peterson Aff. ¶9(a)(v). In the event of a rehabilitation of Ambac's General Account, billions of dollars in par amount of insured obligations would be adversely affected, which, in turn would have a detrimental effect on the amounts available to pay all policyholders, including policies currently allocated to the Segregated Account. It would also adversely affect the public at large. Matanle Aff. ¶26.

One of the segments of Ambac's business that would be most adversely affected by such an event is the commercial asset backed portfolio, including whole business securitizations and rental car lease securitization. *See* Affidavit of Stephen C. Vaughan, sworn to on May 17, 2010, ¶¶9-10 (describing negative consequences to Sonic Corp. that

could result from rehabilitation of the General Account); Affidavit of Kate Lavelle, sworn to on May 17, 2010, ¶9 ("A termination of the insurance policy could cause (a) a rapid amortization of the notes, resulting in a very substantial restriction of operational cash available to DBI [Dunkin' Brands, Inc.] for use in its operations, or (b) cause an immediate acceleration of all of DBI's existing notes, either of which would result in a substantial disruption of DBI's business and operations."); Affidavit of R. Scott Massengill, sworn to on May 17, 2010, ¶7 (affirming that an Ambac bankruptcy could lead to foreclosure and liquidation of vehicles and other adverse effects on Hertz's liquidity, business, financial condition and results of operations). Similar concerns expressed by Ambac's policyholders led the Commissioner to embrace the Segregated Account approach in the first place. Peterson Aff. ¶9(a)(iii).

In certain commercial asset-backed security transactions insured by Ambac, a full rehabilitation, *by itself*, could arguably constitute a default. *Id.* ¶9(a)(ii). As a consequence, numerous issuers of asset-back securities, which are essentially borrowers in structured financing transactions, could be placed into default even if they are fully performing their contractual obligations. Through no fault of their own, these unwitting borrowers could face acceleration of principal and interest. Ambac could be responsible for any deficiency that the borrowers could not pay, potentially increasing Ambac's liabilities by in excess of a billion dollars. *Id.* ¶9(a)(iv). As explained by Ms. Matanle:

> In the commercial asset backed segment of Ambac's business, Ambac has insured approximately $20 billion of notes. With few exceptions, these deals are generally performing and Ambac does not currently expect to incur a loss in respect of these transactions. However, many of these transactions require significant ongoing attention in that there are covenants embedded in the documents pursuant to which the notes were issued that contemplate that Ambac may permit waivers and variances from complying with such covenants, so long as Ambac continues to perform its obligations to make

> payments under its policy on such transaction and so long as no rehabilitation occurs with respect to the Ambac General Account. A rehabilitation of the Ambac General Account would result in a loss of this right to grant particular waivers and variances from specific covenants, and could subject the issuers of these notes to constraints they are unable to meet. At the time the notes were issued, the issuers relied on the ability to go to Ambac and seek waivers and variances if the need were to arise. If Ambac is unable to grant these waivers and variances, then the issuer may be in default of these provisions. The consequences of such a default often include a provision which requires cash that would otherwise have been released to the issuer directly or indirectly to be used to pre-pay the insured notes. While this feature in theory reduces Ambac's exposure, when applied indiscriminately it may precipitate cross defaults, liquidity crises or bankruptcy filings by issuers or their affiliates, all of which could easily have been avoided.

Matanle Aff. ¶29.

In short, triggering events of default in these transactions can have far-reaching consequences, not only for Ambac and its policyholders, but for the issuers of these securities and their affiliates, and for the millions of men and women who depend on these issuers and their affiliates for their livelihood. *Id.* ¶30. Although the potential increase in claims against Ambac that could arise as a result of these provisions in the event of a rehabilitation of the Ambac General Account is difficult to quantify because it involves many contingencies and subjective evaluations, the potential harm is real and could be material. *Id.* ¶31.[7]

There are other segments of Ambac's business that would be similarly affected by a rehabilitation of the Ambac General Account. For example, Ambac insures the obligations of its affiliates that issue interest rate and currency swaps and investment agreements. A rehabilitation of the Ambac General Account would accelerate the obligations of these affiliates, and result in increased claims on the resources of the General Account. The

[7] The examples described above and in the Lavelle, Vaughan and Massengill Affidavits are indicative and illustrative examples of this issue. They are not the only transactions potentially affected. Although the potential harm is difficult to quantify, Ambac's belief, based on a preliminary analysis of a handful of the deals, is that the potential increase in claims could be $1.1 billion or more. Matanle Aff. ¶31.

potential harm to the public (and, in particular, to municipalities who have entered into interest rate swaps with an Ambac affiliate) in the event of a rehabilitation of the Ambac General Account is palpable. As explained by Ms. Matanle:

> In the event of a rehabilitation of the Ambac General Account, there would be an automatic termination of the interest rate swap agreements between Ambac's affiliate and the other parties to these agreements which, in many cases, are U.S. municipalities that entered into these swaps to hedge their exposure to the risk of a change in interest rates. Typically, in these instances the municipality would issue floating rate debt and simultaneously enter into an interest rate swap where it would make periodic payments to Ambac's affiliate at a fixed rate of interest and receive from Ambac's affiliate a periodic payment based on a floating rate of interest. The effect of this arrangement is to lock in a fixed interest rate for the municipality, protecting it from fluctuations in floating interest rates, but give the municipality the greater access to the debt markets that issuing floating rate debt allowed.

Id. ¶33. A full rehabilitation of Ambac would result in an automatic termination of these swap agreements. Since the interest rate swaps were typically entered into some years ago when interest rates were higher, upon a termination of the arrangement there would be a single large payment due from the municipality to Ambac's affiliate. Although Ambac's affiliate hedged its obligations under these exposures, unfortunately, many of the municipalities do not have sufficient resources to make these large payments. This will have serious consequences for Ambac and, more importantly, for the relevant municipalities. For the amounts involved are significant and could even result in Chapter 9 bankruptcy proceedings with respect to these municipalities while leaving them exposed to future interest rate risk. *Id.* ¶¶34-35.

In short, the collateral harm that could befall Ambac, its policyholders and the public if the Injunction Order is amended to halt the CDS Settlement, although unquantifiable and

unpredictable, is real and substantial, and clearly outweighs any potential harm Movants may suffer.[8] For that reason alone, the instant motions should be denied.

IV. Movants' Requests for Discovery Should Be Denied

Both Movants request "expedited" discovery concerning the CDS Settlement. For all the reasons described above, Movants have no right to object to the CDS Settlement, much less the right to engage in intrusive discovery regarding confidential settlement negotiations. Whether discovery would yield any material new information about the settlement is highly questionable. What is certain is that discovery, even so-called "expedited" discovery, would cost money, cause delay and lead to additional discovery demands. As explained in greater detail above and in the Peterson and Matanle Affidavits, any delay carries a substantial risk of destroying the CDS Settlement. Simply put, delay and embroilment in discovery could make the CDS Settlement, which is not yet binding, seem less attractive to the Bank Group. By placing the CDS Settlement in jeopardy, discovery is not in the best interest of policyholders or the public.

[8] Although Movants' request for injunctive relief should be denied for a host of reasons, the inability, or unwillingness, to post a bond sufficient to compensate Ambac for its damages should it be determined later that any preliminary injunction issued was improvidently granted -- damages that could conceivably exceed $10 billion -- would itself warrant a denial of the requested relief. Under Wisconsin law, "the court or judge *shall*, require a bond of the party [or parties] seeking an injunction, with sureties, to the effect that he or she will pay to the party enjoined such damages, not exceeding an amount to be specified, as he or she may sustain by reason of the injunction if the court finally decides that the party was not entitled thereto." Wis. Stat. §813.06 (emphasis added); *see also Becker v. Becker*, 66 Wis. 2d 731, 735-736, 225 N.W.2d 884, 886 (1975) (requiring a bond for continuation of temporary injunction).

CONCLUSION

For all of the foregoing reasons, both the RMBS Investors' motion to modify the Injunction Order and the LVM Bondholders motion to enjoin Ambac from proceeding with the CDS Settlement with the Bank Group should be denied.

Dated: May 20, 2010.

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