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

SUPPLEMENTAL OBJECTION OF DEUTSCHE BANK NATIONAL TRUST COMPANY, DEUTSCHE BANK TRUST COMPANY AMERICAS, AND U.S. BANK NATIONAL ASSOCIATION, EACH ACTING SOLELY IN ITS CAPACITY AS TRUSTEE FOR CERTAIN SECURITIZATION TRUSTS, IN SUPPORT OF THE OBJECTION TO THE PROPOSED PLAN OF REHABILITATION

Deutsche Bank National Trust Company and Deutsche Bank Trust Company Americas (collectively, "Deutsche Bank"), and U.S. Bank National Association ("US Bank", and together with Deutsche Bank, the "Trustees") each acting solely in its capacity as trustee for certain residential mortgage-backed securities ("RMBS"), other asset-backed securities, collateralized loan obligation and/or collateralized debt obligation trusts (collectively, the "Trusts") insured by Ambac Assurance Corporation and/or its affiliates ("Ambac"), respectfully submit this supplemental objection in response to the Rehabilitator's late-filed supplementations and amendments to the Disclosure Statement and Plan, and revised Order Modifying and Confirming the Plan, and in support of their objection to the October 8, 2010 Plan of Rehabilitation filed by the Commissioner of Insurance of the State of Wisconsin ("OCI"), as Rehabilitator of the Segregated Account of Ambac (the "Proposed Plan").

In documents filed on the eve of the hearings regarding the Proposed Plan, OCI responded to some, but not all, of the objections raised by the Trustees. OCI's filings, however, do not cure the Trustees' objections. The Trustees file this Supplemental Objection to address OCI's late-filed modifications and alterations to the Proposed Plan and Disclosure Statement, and the Trustees do not repeat herein their prior unrebutted objections.

I. Argument

A. OCI's Unexplained Placement of AAC Liabilities Into the Segregated Account is Improper.

AFGI, Ambac's parent corporation, filed for bankruptcy protection on November 8, 2010 – the same day that objections to the Proposed Plan and Disclosure Statement were due. On the last business day before the hearings commenced, OCI filed an amendment to the Disclosure Statement purporting to place all of Ambac's liability with respect to AFGI into the Segregated Account. (Amendment to Disclosure Statement, pg. 2). Consistent with its prior filings in these proceedings, OCI provides no analysis or legal support justifying its attempt to offload its liabilities to its parent corporation into the Segregated Account.

Further, and again without explanation, OCI also seeks to place all Ambac liabilities to the Internal Revenue Service into the Segregated Account. (Amendment to Disclosure Statement, pgs. 2, 3). OCI does not identify any proper purpose for this eleventh hour maneuver and does not put forth any legal authority permitting it. Unilaterally "dumping" these AAC liabilities into the Segregated Account, while providing no analysis and support, is yet another example of OCI's misuse of the alleged rehabilitation of the Segregated Account to benefit Ambac. The placement of the AFGI and IRS liabilities into the Segregated Account is impermissible and should not be sanctioned by this Court.

B. The Proposed Amendments to Article 4.04 of the Proposed Plan do not Address the Trustees' Objections.

Although OCI added some additional language to Article 4.04 of the Proposed Plan "in order to clarify the Rehabilitator's intent" with respect to Sections 4.04(g) and 4.04(h), OCI failed to address the objection of the Trustees with respect to Article 4.04. (Amendment to Disclosure Statement, pg. 4). Specifically, the Trustees object to Article 4.04, as amended, (as well as the new unilaterally imposed "Proof Of Policy Claim Form") to the extent that it still

attempts to require that Holders of Claims transfer to Ambac all of their interests, including their interests against third-parties, or that Ambac be entitled to recover the full amount of all recoveries, reimbursements and other payments, including with respect to claims that are not *paid* in full *in cash*. Such an improper forced transfer of contractual and financial rights, including to an entity that is not in rehabilitation, has no legal support and exceeds OCI's authority.

C. The Discharge, Release and Injunction Section, as Amended, Exceeds the Authority of OCI and is Impermissible.

Any release of claims in a rehabilitation plan must bear some relationship to rehabilitation itself. *See Koken v. Fidelity Mut. Life Ins. Co.*, 803 A.2d 807, 817 (Pa. Cmmw. Ct. 2002). Further, any indemnification provision in a rehabilitation plan must be connected to actions taken with respect to the actual rehabilitation. *See id.* at 814. Notwithstanding these basic principles of law, OCI sets forth a modified Discharge, Release and Injunction section that suffers from the same fatal flaws as its originally proposed version—namely that it contains unreasonably broad releases, includes releases with no nexus to the rehabilitation, and improperly seeks to protect and insulate certain parties (including parties unrelated to the rehabilitation) from any claims whatsoever.

By way of example, OCI apparently still seeks to insulate OCI and Ambac from all of their actions taken with respect to Ambac and the General Account, not merely actions taken with respect to the Segregated Account. OCI cannot credibly claim that only the Segregated Account is being rehabilitated, yet compel policyholders to release Ambac for claims related solely to Ambac. Additionally, OCI's carve out of claims that are not released includes only claims of "intentional fraud" and "willful misconduct." (Order Modifying and Confirming Plan, pg. 2). OCI's back-door attempt to insulate Ambac and OCI's gross negligence is

improper. Lastly, the release language remains unreasonably broad, seeking to protect innumerable parties (some unrelated to the rehabilitation, including Ambac, former members of Ambac, agents of Ambac, etc.) from all claims, including claims unrelated to the rehabilitation. As an example, the release proposed by OCI would insulate an action against a former Ambac employee who, through an intentional tort or gross negligence, converts or destroys property that is to be distributed under the Plan. OCI's revisions to this section do not cure the objections raised by the Trustees.

D. OCI's "Liquidation Analysis" is Fatally Flawed and Necessitates Rejection of the Proposed Plan.

The Proposed Plan, as amended, still does not provide an "opt-out" election, which is a fatal defect under *Carpenter*, *Neblett* and *ELIC*. *See Carpenter v. Pacific Mut. Life Ins. Co.*, 10 Cal. App. 2d 307, 74 P.2d 761 (Cal. 1937) (en banc) ("*Carpenter*"), *aff'd sub nom. Neblett v. Carpenter*, 305 U.S. 297 (1938) ("*Neblett*"); *Commercial National Bank in Shreveport v. Garamendi, et al.*, 14 Cal. App. 4th 393; 17 Cal. Rptr. 884 (1993) ("*ELIC*"). OCI's filed version of the Proposed Plan also did not include a liquidation analysis showing that policyholders would receive more under the Proposed Plan than they would receive if Ambac was liquidated. This was a critical failure of proof that precluded approval of the Proposed Plan.

On the eve of hearings regarding the Plan, OCI filed an amendment to the Disclosure Statement that included OCI's "Liquidation Analysis." (Amendment to Disclosure Statement, pgs. 6-9). OCI's untimely liquidation analysis is perfunctory, at best, and was provided at the last possible moment prior to the start of hearings, without the benefit of discovery and with inadequate opportunity for policyholders to access information controlled by OCI and Ambac that would be needed to: (i) understand the factual and legal foundation of the analysis, and (ii) if appropriate, contest the conclusions and projections set forth in the analysis. Under these

circumstances, the Proposed Plan cannot be approved because a properly disclosed and tested liquidation analysis is a prerequisite for approval of a rehabilitation plan.

OCI's liquidation analysis also is clearly deficient and incomplete, in part because: (1) the liquidation analysis is hypothetical, providing a valuation as of March 24, 2010, instead of a future date at which the value of the claims against the estate and the assets of the estate are determinable (which requires an analysis that allows time to take into account post-petition settlements that are in the best interest of the liquidation estate); (2) it ignores the Bank Settlement of the CDS policies, and it therefore includes $16.3 billion in CDS claims of the "mark-to-market" type; and (3) the analysis does not deduct from the asset side of the balance sheet the $2.3 billion in cash cost of the CDS settlement. Further, there are a number of assertions in the liquidation analysis that are illogical and/or unexplained, including, but not limited to:

- the CDS claims liability is grossly overstated;
- the non-CDS policy claims for losses incurred after the date of the liquidation order increased drastically from the original disclosure statement;
- a reduction in policy liabilities for remediation recoveries is not included;
- Future Losses on the non-CDS policies are treated as receiving no higher than a class 5 priority in the event of liquidation;
- CDS claims for "mark-to-market" recoveries are treated as senior to the Non-CDS claims;
- claims for unearned premiums are treated as having the same priority as Non-CDS "Future Loss" claims and CDS "mark-to-market" claims; and
- all assets of Ambac were not included.

These issues directly impact the recovery percentage under a liquidation scenario. OCI should have calculated and confirmed the proper recovery percentages and then compared them to the pay-out percentages under the Proposed Plan in terms of certainty, timing and amount. These failures also underscore why the Proposed Plan should have included an opt-out alternative.

E. The Evidence Does not Support OCI's Suggested Findings of Fact

The Trustees specifically object to the following proposed findings of fact because they are inaccurate and contrary to the evidence presented during the hearings concerning the Proposed Plan.

- Finding of Fact Number 1 (Order Modifying and Confirming the Plan, pg. 3). The Trustees object to this Finding of Fact to the extent that it states or suggests that the Rehabilitator was not required to submit a Disclosure Statement, that the Disclosure Statement "explains the terms" of the Plan, and that the Disclosure Statement "provides extensive, detailed information regarding the current and projected financial condition of the Segregated Account and the General Account of Ambac."
- Finding of Fact Number 3 (Order Modifying and Confirming the Plan, pgs. 3, 4). The Trustees object to this Finding of Fact because the proposed factual statement that the "determinations by the Rehabilitator are rational, are based on a well grounded, detailed investigation and analysis of the facts and circumstances relevant to developing the Plan, and are well within the Rehabilitator's areas of expertise and discretion" are wholly unsupported by the evidentiary record.
- Finding of Fact Number 4 (Order Modifying and Confirming the Plan, pg. 4). The Trustees object to this Funding of Fact in its entirety to the extent that it states or suggests that payment of policy claims through some combination of cash and "Surplus Notes" constitutes "complete satisfaction of such claims." because it is contrary to the evidentiary record.

II. Conclusion

Based on the foregoing, the Trustees respectfully request that the Court reject the Proposed Plan, as amended, and grant such other relief as the Court deems just and equitable. The Trustees also reassert their prior objections to these proceedings, including their objections relating to the prior findings of fact and conclusions of law which were premature and wholly unsupported by the evidence.

Respectfully submitted,

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