

In the Matter of the Rehabilitation of:

Case No. 10 CV 1576

Segregated Account of Ambac Assurance Corporation

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**REHABILITATOR'S RESPONSE TO RMBS HEDGE FUNDS' OBJECTION TO  
APPLICATION FOR APPROVAL OF ENGAGEMENT OF  
ROGER A. PETERSON AS FULL-TIME SPECIAL DEPUTY COMMISSIONER OF  
THE SEGREGATED ACCOUNT**

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## TABLE OF CONTENTS

INTRODUCTION .....	1
ARGUMENT .....	2
I. AS BENEFICIAL HOLDERS OF RESIDENTIAL MORTGAGE-BACKED SECURITIES, THE RMBS HEDGE FUNDS ARE NOT POLICYHOLDERS AND THEY LACK STANDING TO OBJECT TO THE APPLICATION ON BEHALF OF POLICYHOLDERS .....	2
II. THE RMBS HEDGE FUNDS' OBJECTIONS TO THE APPLICATION SHOULD BE REJECTED.....	3
A. Mr. Peterson Is Uniquely Qualified To Serve As Full-Time Special Deputy Commissioner for the Segregated Account.....	3
B. The RMBS Hedge Funds Impugn Mr. Peterson's Abilities Without Basis .....	4
C. Like The Rehabilitator, Mr. Peterson's Guiding Principle Has Been To Promote The Best Interest Of Policyholders .....	6
D. There Are No Legal Or Ethical Constraints To The Appointment.....	7
E. The Proposed Level Of Compensation Was Negotiated At Arm's Length And Is Fair And Reasonable .....	8
III. THE RMBS HEDGE FUNDS' OBJECTION IS TACTICAL, INTERPOSED TO TRY TO CREATE UNCERTAINTY IN THE MARKETPLACE THAT THEY CAN TRADE ON.....	10
CONCLUSION.....	13

## INTRODUCTION

In their Objection, a group of non-policyholder hedge funds (“RMBS Hedge Funds”) raise unfounded challenges to the suitability of Roger Peterson to serve as full-time Special Deputy Commissioner for the Segregated Account, and to the Rehabilitator’s motivations in seeking court approval of that appointment.

As explained in the Rehabilitator’s June 8, 2011 Application and below,<sup>1</sup> Mr. Peterson is uniquely qualified to assume this role based on his experience and qualifications. The Rehabilitator determined that a person dedicated full-time to the Segregated Account was needed to oversee the day-to-day rehabilitation efforts, that Mr. Peterson was the right person for the job, and that the terms and conditions of Mr. Peterson’s appointment—which were negotiated at arms length—were fair and reasonable, based on the advice of outside consultants. These determinations by the Rehabilitator are entitled to deference, and should not be subject to second-guessing by the RMBS Hedge Funds trying to use this proceeding to litigate their way to profit at the expense of the other constituents in the proceeding.

Finally, because the position of full-time Special Deputy Commissioner will be funded as an administrative expense of the Segregated Account, *no taxpayer funds* will be used to pay Mr. Peterson. Copies of the Consulting Agreement with Mr. Peterson and the third party compensation assessment report described in the Rehabilitator’s application are included as exhibits to this response. (See **Exhibit A** (6/2/11 Consulting Agreement) and **Exhibit B** (4/28/11 Nolan Company Compensation Assessment).)<sup>2</sup>

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<sup>1</sup> A hearing on the Rehabilitator’s Application is scheduled for July 8, 2011, at 1:30 p.m.

<sup>2</sup> Note that there is a one-line redaction on page 5 of Exhibit B to remove the names of the three firms because of confidentiality undertakings.

## ARGUMENT

### **I. AS BENEFICIAL HOLDERS OF RESIDENTIAL MORTGAGE-BACKED SECURITIES, THE RMBS HEDGE FUNDS ARE NOT POLICYHOLDERS AND THEY LACK STANDING TO OBJECT TO THE APPLICATION ON BEHALF OF POLICYHOLDERS**

In the January 24, 2011 Plan Confirmation Order, this Court found that the RMBS Hedge Funds' "description of themselves as 'policyholders' [of Ambac or the Segregated Account] in this proceeding is misleading and inaccurate[,]” and that the RMBS Hedge Funds “have never offered or provided proof . . . as to their standing to assert legal positions in regard to any particular RMBS trust(s) . . . [or] to identify the provisions of any particular RMBS trust indenture pursuant to which they claim to have standing to assert positions regarding the interests of a policyholder in this proceeding.” (1/24/11 Order at 51 (Findings of Fact ¶¶ 146-47).) As a result, this Court concluded that, while the RMBS Hedge Funds may be heard, they “have not demonstrated the standing to assert positions or arguments as policyholders in this proceeding.” (*Id.* at 55 (Conclusion of Law ¶ 9).)

Yet the RMBS Hedge Funds persist in framing their Objection in terms of the alleged harm Mr. Peterson's engagement as full-time Special Deputy Commissioner of the Segregated Account would cause “policyholders.” (*See* Objection at 3 (arguing that retention of Mr. Peterson would be “at the expense of the policyholders”), 4 (discussing interests of “policyholders”), 5 (arguing that proposed salary increase for Mr. Peterson is unfair when “policyholders” continue to wait for payment on claims). However, the reality is that despite their misleading suggestion to the contrary, the RMBS Hedge Funds are not “policyholders.”

## **II. THE RMBS HEDGE FUNDS' OBJECTIONS TO THE APPLICATION SHOULD BE REJECTED**

### **A. Mr. Peterson Is Uniquely Qualified To Serve As Full-Time Special Deputy Commissioner for the Segregated Account**

In appointing Mr. Peterson to serve as Special Deputy Commissioner on a full-time basis, the Rehabilitator was guided by WIS. STAT. Chapter 645, which discusses the need “[t]o obtain the ‘right’ person” with “recognized ability who will regard it both as his public duty and his private opportunity to save the company.” WIS. STAT. ANN. Ch. 645 introductory cmt.

Mr. Peterson is uniquely qualified to serve in this role. *First*, Mr. Peterson has worked at the Wisconsin Office of the Commissioner of Insurance (“OCI”) for over 23 years and, based on his proven ability, he has risen through the ranks at OCI from *Financial Examiner* (May 1988 - June 1997) to *Policy and Claim Reserve Specialist* (June 1997 - May 1998) to *Insurance Financial Examiner – Chief* (May 1998 - June 2004) to *Director – Bureau of Financial Analysis and Examinations* (June 2004 - January 2011) and to his current position as *Deputy Administrator – Division of Regulation and Enforcement* (January 2011 to the present).

In his present position as Deputy Administrator, Mr. Peterson supervises a staff of approximately 90 persons, and oversees all regulatory activities of the agency, including Financial and Market Regulation, Agent Licensing and consumer services.

In addition, Mr. Peterson has assisted in and often led the development of significant improvements in state-based insurance regulation through his involvement with the National Association of Insurance Commissioners (“NAIC”). Specifically, Mr. Peterson has chaired the following NAIC working groups:

*Financial Analysis Working Group, Chair.* Led peer review group in evaluation of potentially-troubled and nationally-significant insurers.

*Financial Analysis Handbook Working Group, Chair.* Maintained and improved financial analysis guidance and procedures used on a nationwide basis.

*Financial Analysis Research and Development Working Group, Chair.* Maintained and improved financial analysis measures, such as IRIS and FAST ratios.

Mr. Peterson also has been a member of other NAIC groups, including the *Examination Oversight Task Force*, the *Financial Examiner Handbook Technical Group* and the *Solvency Modernization Initiative Task Force*.

*Second*, Mr. Peterson's experience and knowledge with respect to Ambac and the Segregated Account are unparalleled. Aside from having two decades of experience examining insurers including Ambac, Mr. Peterson has been directly involved in assessing and addressing Ambac's financial situation since its financial situation began to decline in late 2007 and early 2008.

**B. The RMBS Hedge Funds Impugn Mr. Peterson's Abilities Without Basis**

Despite Mr. Peterson's extensive experience and qualifications, the RMBS Hedge Funds contend that "his work as [Ambac]'s regulator arguably contributed to its financial downfall[,]" and that he "should not be given *more* authority over the Segregated Account given that his actions (or inaction) contributed to its necessity in the first place." (Objection at 3, 4 (emphasis in original).) The RMBS Hedge Funds point to no evidence to support their unfounded accusation that OCI's actions (or those of Mr. Peterson, specifically) contributed to Ambac's decline,<sup>3</sup> and that accusation also conveniently ignores the fact that Ambac's competitors in the

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<sup>3</sup> During the Plan confirmation hearings, the RMBS Hedge Funds' only witness, James Schacht, declined to offer any opinion regarding OCI's lack of diligence in monitoring Ambac's financial decline. (11/19/10 Hearing Tr. at 116:11-18 ("Q. . . . You heard the testimony of the Commissioner and Mr. Peterson about OCI's monitoring of Ambac's financial condition in 2008 and 2009. Do you recall that testimony? A. I do. Q. Are you giving any opinions to the effect that OCI did not act diligently in its monitoring? A. Not at the present time."))

financial guaranty insurer market, which were regulated by other states, also all failed. In any event, what matters under WIS. STAT. § 645.33(1) is that the Rehabilitator believes that Mr. Peterson is the right person for the job. Contrary to the RMBS Hedge Funds' suggestion, Section 645.33(1) does not contemplate that the Rehabilitator must "consult[] [with] policyholders" (Objection at 3)—or in the case of the RMBS Hedge Funds, non-policyholders—before making personnel appointments regarding the administration of the rehabilitation of an insurer. Subject to court approval, the decision is the Rehabilitator's alone.

Moreover, this Court already has had the opportunity to assess Mr. Peterson's knowledge and ability first-hand. Mr. Peterson testified at length at the Plan confirmation hearings held last November and, based on that testimony, this Court noted the following:

THE COURT: . . . This is an extremely complex and difficult situation. I have watched the testimony of the Commissioner and *especially Mr. Peterson over the . . . two days that he was on the stand*. It was as grilling a series of questionings as I've seen any witness undergo in all my years on the bench. There were questions asked by very bright, intelligent counsel, and *the answers given, the evaluation shown to have been made, the factors gathered, the procedures followed as testified to by Mr. Peterson leads me to believe, as they consistently pointed out, that they were acting in what would be the best interest of their policyholders, doing what is fair for them.*

(11/19/10 Hearing Tr. at 50:1-14 (emphasis added); *see also* 1/24/11 Order at 9-10 (Finding of Fact ¶ 22).)

At the November 30, 2010 hearing, counsel for Depfa Bank, an actual policyholder (unlike the RMBS Hedge Funds), acknowledged Mr. Peterson's impressive depth of knowledge:

MR. WELSH: . . . I will make a bit of an admission, which is that when Mr. Peterson was done on direct examination, I said to some of my colleagues here that if the Commissioner had taken him out on the road even after the March 24th in the weeks following March 24th and given policyholders affected by their transfer into the Segregated Account an opportunity to have a Q and A-type

session with him in the early months, I suspect a lot of the opposition that has been generated to the plan would have been quelled in the early days.

(11/30/10 Hearing Tr. at 165:1-10.)

**C. Like The Rehabilitator, Mr. Peterson's Guiding Principle Has Been To Promote The Best Interest Of Policyholders**

The RMBS Hedge Funds construct the following false syllogism:

*After acceding to [Ambac]'s demands* in the context of the rehabilitation process over the objection of every third party policyholder and affected party, and after ignoring input from policyholders and other affected parties to construct the plan, Mr. Peterson is now being *rewarded* with a vast multiple of his current compensation.

(Objection at 3 (emphasis added).) The premises and the conclusion in this syllogism are wrong.

*First*, there is no basis for the RMBS Hedge Funds' suggestion that the Rehabilitator has acceded to *any* demand by Ambac or has taken *any* position he believed was not in the best interest of policyholders and the public. To the contrary, the Rehabilitator has required Ambac to take major steps to restructure its affairs to protect policyholders and the public, including through the rehabilitation of the Segregated Account. As documented in the evidence at the confirmation hearing, the Rehabilitator has implemented rigorous oversight and safeguards as to Ambac's authority and actions as the management services provider.

*Second*, the Rehabilitator has not ignored the input from policyholders and others. As has been explained throughout this proceeding, the Rehabilitator's mandate under Chapter 645 is broader than the interests of any specific policyholder. Moreover, all of the regulatory choices that the Rehabilitator and his staff considered and made in this rehabilitation proceeding, including the form and content of the Plan of Rehabilitation, have been *reviewed and approved by this Court*, based on lengthy written submissions and numerous hearings. While the Rehabilitator has disagreed with the RMBS Hedge Funds' self-interested demands, that is

because those demands have been contrary to the best interests of policyholders and the public as a whole.

*Finally*, the RMBS Hedge Funds’ suggestion that Mr. Peterson is receiving a “reward[]” for taking regulatory actions that allegedly benefit Ambac is nothing more than a smear. Ambac had no input into the decision by the Rehabilitator to seek approval of Mr. Peterson as a full-time Special Deputy Commissioner for the Segregated Account. That decision—including the setting of Mr. Peterson’s compensation—was the Rehabilitator’s alone, with the advice of OCI’s general counsel and the Rehabilitator’s outside court-approved advisers. The RMBS Hedge Funds can disagree with the Rehabilitator (or this Court) about contested issues in the proceeding such as the Plan, but that disagreement does not support the RMBS Hedge Funds’ allegation that Mr. Peterson has engaged in improper “self-dealing[.]” (Objection at 3.)

**D. There Are No Legal Or Ethical Constraints To The Appointment**

Next, the RMBS Hedge Funds cite a California statute for the proposition that “other jurisdictions prohibit rehabilitators and their employees from accepting positions *with the insurers* they are charged with rehabilitating, at least for a certain period.” (Objection at 3 (emphasis added).) However, even if there were a similar statute under Wisconsin law (which there is not), the California statute on its face does not apply to the situation here. Specifically, Cal. Ins. Code § 1043 prohibits California regulators from *switching sides* and taking positions *with regulated insurers* (*i.e.*, “as an officer or director of, or serve in any position of gain or profit in, any company formed in whole or in part of the assets or funds . . . of such . . . rehabilitated person”) for a period of time *after* the regulatory proceeding has ended.

Here, setting aside the fact that the rehabilitation proceeding is ongoing, in his capacity as full-time Special Deputy Commissioner for the Segregated Account, Mr. Peterson will not be switching sides. Mr. Peterson will continue to report *to the Rehabilitator* (all under the

supervisory jurisdiction of this Court), and will continue to carry out the rehabilitation of the Segregated Account. WIS. STAT. § 645.33(1) (“The special deputy commissioner shall have all of the powers of the rehabilitator granted under this section” and “shall serve at the pleasure of the rehabilitator.”). Contrary to the RMBS Hedge Funds’ assertion, Mr. Peterson is not taking a position *with* the Segregated Account after its rehabilitation, nor as an officer, director or employee. He will serve at the pleasure of the Rehabilitator.<sup>4</sup>

**E. The Proposed Level Of Compensation Was Negotiated At Arm’s Length And Is Fair And Reasonable**

The RMBS Hedge Funds assert that Mr. Peterson’s proposed compensation is unreasonably high as compared to his present government salary (and the salary of various Wisconsin elected officials). (Objection at 4-6.)

As a threshold matter, no taxpayer funds will be used to fund the position. Moreover, it is ironic that the RMBS Hedge Funds—which employ one of the most grossly excessive manager compensation schemes in any industry—are objecting to Mr. Peterson’s proposed compensation. By way of example, the two managers (O. Francis Biondi and Brian J. Higgins) of one of the RMBS Hedge Funds (King Street Capital Management), were *each* paid \$375 million in compensation in 2009. (See Stephen Taub, *The Rich List*, AR ABSOLUTE RETURN + ALPHA (Mar. 31, 2011), 2010 WLNR 9346889, at 11). And, the \$375 million Messrs. Biondi and Higgins each received in 2009 was for co-managing a hedge fund with \$19.9 billion under management. (*Id.*) By contrast, as full-time Special Deputy Commissioner, Mr. Peterson

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<sup>4</sup> While Mr. Peterson’s compensation, like the compensation paid to other consultants and advisors to the Rehabilitator, will be paid as an administrative expense from funds available to the Segregated Account, that does not make him an officer, director or employee of the Segregated Account.

would be managing a larger, more complex and regulated entity, and would be paid \$600,000 in base compensation (or 0.16% of \$375 million).<sup>5</sup>

Moreover, as to compensation, the relevant inquiry is not what Mr. Peterson was paid at OCI (or what other Wisconsin elected officials are paid). The relevant inquiry is:

What is a reasonable level of compensation to retain “the ‘right’ person” with “recognized ability” to serve as full-time Special Deputy Commissioner for the Segregated Account?

WIS. STAT. ANN. ch. 645 introductory cmt. As explained in the Application (at 6-7), the Rehabilitator hired an outside compensation consultant, the Nolan Company, to look at this issue, and the Nolan Company concluded that the position of Special Deputy Commissioner was comparable to positions paying \$800,000 to \$1.6 million per year in the market, and that, for the purpose of hiring a single individual on a contract basis, an initial range up to \$800,000 was advisable, depending on the individual’s experience. (*See Exhibit B.*) The Rehabilitator then negotiated with Mr. Peterson at arm’s length and reached an agreement as to a level of compensation well within the range of reasonableness for the position as determined by the Nolan Company.

The RMBS Hedge Funds do not offer any evidence to suggest that the Nolan Company’s analysis is incorrect, or that a different candidate—who would not have Mr. Peterson’s qualifications, knowledge or experience regarding Ambac, the Segregated Account or the Plan of Rehabilitation—could be retained in a timely way for an amount less than the amount negotiated with Mr. Peterson. Therefore, this objection also should be rejected.

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<sup>5</sup> The other RMBS Hedge Funds run smaller operations: Fir Tree Partners (\$5.18 billion); Monarch Alternative Capital (\$3.00 billion); Aurelius Capital Management (\$2.34 billion). (*See Katrina Dean Allen, Billion Dollar Club, AR ABSOLUTE RETURN + ALPHA* (Sept. 30, 2010), 2010 WLNR 21809737, at 2, 6, 9, 11.) The RMBS Hedge Funds have offered no evidence to suggest that their top managers do not all make far more than the amount proposed by the Rehabilitator for Mr. Peterson.

### III. THE RMBS HEDGE FUNDS' OBJECTION IS TACTICAL, INTERPOSED TO TRY TO CREATE UNCERTAINTY IN THE MARKETPLACE THAT THEY CAN TRADE ON

The RMBS Hedge Funds' litigation strategy is to throw sand in the gears of the rehabilitation proceeding at every opportunity and to capitalize on any resulting uncertainty. They are not using the litigation process to protect "policyholder interests," but rather to profit from their own speculation on the market.

By way of example, on April 1, 2011, the federal bankruptcy court in *In re Innkeepers USA Trust*, 448 B.R.131 (Bankr. S.D.N.Y. 2011), ruled that a similar hedge fund (Appaloosa) that owned beneficial interests in trusts holding commercial and residential mortgage-backed securities did not have standing as an independent party-in-interest in the Chapter 11 proceeding. 448 B.R. at 138-145. In doing so, the court noted:

Appaloosa has no privity or other relationship with the Debtors which would confer on it standing to be heard. While Appaloosa asserts [] that [it] is not a "creditor of a creditor" but rather that it holds a beneficial interest in the assets of the C-6 and C-7 Trusts, this does not change the result. As the court pointed out in *Shilo[h] Inn*, in a securitization, the investors' relationship is with the special purpose vehicle holding the assets (in this case, the C-6 and C-7 Trusts), and the right to payment comes from the cash generated by the assets, not from the debtor as originator of the assets itself. While Judge Perris recognized that the investors in *Shiloh Inn* held certificates evidencing a beneficial interest in the trust funds, she found that the investors, as certificateholders, did not have any direct interest in the obligations of the debtors. Rather, their interests were in the assets of the trusts, and the trusts were the debtors' creditors. *See In re Shiloh Inn*, 285 B.R. at 729. This comports with the Second Circuit's holding in *Refco* [505 F.3d 109, 117-19 (2d Cir. 2007)] that a creditor of a creditor is not a "party in interest" within the meaning of section 1109(b) of the Bankruptcy Code.

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Granting standing to a certificateholder would not only override the terms of the C-6 Servicing Agreement . . . but it would also *encourage and embolden other certificateholders to hire their*

*own counsel to challenge the special servicer's authority and to advance their individual and conflicting pecuniary interests. This would dramatically alter the CMBS [commercial mortgaged-backed securities] landscape and render the delegation to a special servicer meaningless. In addition, it would inevitably serve to delay and complicate bankruptcy cases as debtors are forced to litigate issues with additional parties who previously were contractually obligated to speak with one voice, that of the special servicer. The Court seeks to avoid such a scenario here. Although the Court's ruling with respect to standing is based entirely on controlling law as well as the applicable language of the C-6 Servicing Agreement, it is worth noting that to hold otherwise would, in the view of the Court, potentially cause chaos in the already-tumultuous CMBS market.*

*In re Innkeepers*, 448 B.R. at 144-145 (emphasis added).

Similarly, in this case, the RMBS Hedge Funds have no privity or other relationships with Ambac or the Segregated Account directly (and are not authorized to speak for the trustees that do have those relationships), yet are using litigation to “advance their individual and conflicting pecuniary interests” and to force the Rehabilitator “to litigate issues with additional parties who previously were contractually obligated to speak with one voice,” that of the trustees actually holding the policies at issue. *Id.* As reflected in the unrebutted testimony of Mr. Peterson at the confirmation hearing, the RMBS Hedge Funds are known for “acquiring distressed debt and trying -- attempting to maximize its value through various means, including litigation.” (11/18/10 Hearing Tr. at 124:13-125:25.)

The RMBS Hedge Funds have earned a reputation for their litigation tactics:

- “A major factor driving that uncertainty [in negotiations] is the increased presence of Aurelius [Capital Management, LP], which is well known in the bankruptcy world for its litigious, fight-for-every-last-drop style of money making. . . . Aurelius tends to buy into the unsecured junior bonds of a foundering company at cents on the dollar and then unleash an aggressive legal strategy to boost the returns those bonds get as the case is resolved.” (Michael Oneal, *New Storm Clouds Over Tribune Co. Bankruptcy; Emergence of New York Hedge Fund Aurelius Capital*

*Management Lengthens Odds of an Easy Settlement*, CHICAGO TRIBUNE (Sep. 26, 2010).<sup>6</sup>

- “Blockbuster’s other new owners consist mostly of little-known funds that try to capitalize on the demise of companies by buying their debts for pennies on the dollar. They are: . . . Monarch Alternative Capital, . . . and Stonehill Capital Management.” (Mae Anderson, *Debt, Changing Media Habits Topple Blockbuster*, ASSOCIATED PRESS (Sep. 23, 2010).)<sup>7</sup>
- “As HSG’s financial problems became manifest during the summer of 2008, the value of its debt began to decline and much of it was sold off to hedge funds that invest in bad debt, prominent among them Monarch Alternative Capital. These funds buy debt at a significant discount and then . . . seek a short-run monetary return on their investment.” (*Delays Keeping Rangers From Adopting Long-Term Strategy*, SPORTS BUSINESS JOURNAL (June 7, 2010).)<sup>8</sup>
- “[Aurelius’s chairman] learned his core strategy at [another hedge fund], buying debt on the cheap and then waging legal campaigns to recoup a far higher value. . . .” (*Aurelius Crosses the Ocean for Its Debt Bet*, WALL STREET JOURNAL (Dec. 13, 2010).)<sup>9</sup>
- “Bankruptcy experts say Aurelius is likely using the threat of such massive litigation to extract a better settlement from the senior creditors. But if the plan fails, documents suggest Aurelius would switch to another strategy: trying to discredit the Tribune Co. plan by raising questions about the suitability of several key parties who approved it: the creditors committee, [the chief restructuring officer] and the special committee of the company’s board.” (Michael Oneal, *Tribune Braces for Competing Bankruptcy Plans*, CHICAGO TRIBUNE (Oct. 29, 2010).)<sup>10</sup>

As in this last excerpt (from last October), the RMBS Hedge Funds’ strategy here—

“trying to discredit” Mr. Peterson and “rais[e] questions about [his] suitability” as Special

Deputy Commissioner—is purely tactical, designed to use litigation to advance their own narrow

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<sup>6</sup> Available at [http://articles.chicagotribune.com/2010-09-25/business/ct-biz-0926-tribune-20100925\\_1\\_bankruptcy-case-centerbridge-partners-tribune-co](http://articles.chicagotribune.com/2010-09-25/business/ct-biz-0926-tribune-20100925_1_bankruptcy-case-centerbridge-partners-tribune-co).

<sup>7</sup> Available at <http://finance.yahoo.com/news/Debt-changing-media-habits-apf-1049608580.html?x=0>.

<sup>8</sup> Available at <http://www.sportsbusinessdaily.com/Journal/Issues/2010/06/20100607/Opinion/Delays-Keeping-Rangers-From-Adopting-Long-Term-Strategy.aspx>.

<sup>9</sup> Available at <http://online.wsj.com/article/SB10001424052748703727804576011821714853378.html>.

<sup>10</sup> Available at [http://articles.chicagotribune.com/2010-10-28/business/ct-biz-1029-tribune-20101028\\_1\\_junior-creditors-aurelius-capital-management-fraudulent-conveyance](http://articles.chicagotribune.com/2010-10-28/business/ct-biz-1029-tribune-20101028_1_junior-creditors-aurelius-capital-management-fraudulent-conveyance).

pecuniary interest rather than the interest of policyholders as a whole. In the end, these hedge fund litigants will appropriately benefit from the Rehabilitator's efforts to protect the interests of all policyholders and others. However they should not benefit from their tactical attempt to discredit Mr. Peterson.

### CONCLUSION

For the reasons stated in the Application and above, the Rehabilitator requests this Court to approve the Application to appoint Roger Peterson as full-time Special Deputy Commissioner for the Segregated Account.

Dated this 1st day of July, 2011.

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**CONSULTING AGREEMENT**

**THIS CONSULTING AGREEMENT** (the "Agreement"), is made effective as of the 2<sup>nd</sup> day of June, 2011 (the "Effective Date"), by and between the Segregated Account (the "Segregated Account") of Ambac Assurance Corporation (the "Company") and Roger A. Peterson (the "Consultant").

**WHEREAS**, Theodore K. Nickel, Commissioner of Insurance for the State of Wisconsin (the "Rehabilitator") is the Rehabilitator of the Segregated Account which was placed into rehabilitation by the Order of Rehabilitation entered by the Dane County Circuit Court (the "Rehabilitation Court") on March 24, 2010 (Case No. 10CV1576) (the "Rehabilitation Order"); and

**WHEREAS**, pursuant to the applicable provisions of Wisconsin law, the Rehabilitator has the power to appoint a Special Deputy Commissioner and to delegate the authority to administer the Segregated Account, in whole or in part, to such Special Deputy Commissioner; and

**WHEREAS**, the Rehabilitator desires to secure the services of the Consultant for the Segregated Account, in the capacity of Special Deputy Commissioner and the Consultant wishes to perform such services, on the terms and conditions set forth in this Agreement; and

**WHEREAS**, the engagement of the Consultant to administer the Segregated Account on the terms and conditions set forth herein, and the treatment of the payments due hereunder as priority administrative expenses of the Segregated Account, are subject to approval by the Rehabilitation Court.

**NOW, THEREFORE**, in consideration of the foregoing and of the respective covenants and agreements of the parties herein contained, the parties hereto agree as follows:

**1. Duties and Scope of Services.**

1.1 Position. During the Term, as defined below, the Consultant shall perform the tasks and duties described in Schedule 1 hereto for the benefit of the Segregated Account (the "Services"), together with such other services as are requested by the Rehabilitator from time to time. Notwithstanding anything that may suggest to the contrary herein, the Consultant shall be an independent contractor, and not an employee of the Rehabilitator, the Segregated Account, or the Company. The Consultant shall report to the Rehabilitator, and shall be subject to the authority of the Rehabilitator. The Consultant shall diligently and conscientiously devote his best efforts to the performance of the Services, and shall perform the Services in a timely manner with the level of expertise appropriate to the size and complexity of the business conducted by the Segregated Account. The Services will be principally performed in New York, New York in an office to be provided for the Consultant's use at the headquarters of the Company, and in Madison, Wisconsin at the Office of the Commissioner of Insurance ("OCI"); however, the Consultant may be required to travel to other locations in connection with the performance of the Services.

1.2 **Full Time Obligation.** For the duration of the Term, the Consultant shall devote his full business efforts and time to the performance of services hereunder and shall not, without the prior written approval of the Rehabilitator: (i) render services in any capacity, including as a consultant, to any other person or entity; (ii) act as a sole proprietor or partner of any other person or entity; or (iii) hold more than five percent (5%) of the equity of any business entity. The Consultant shall comply with the requirements of Wisconsin law and all policies and procedures established by the Rehabilitator, as they may be in effect or modified from time to time during the Term.

1.3 **No Conflicts.** The Consultant represents and warrants to the Rehabilitator that the Consultant is under no obligation or commitment, whether contractual or otherwise, which is inconsistent with his obligations under this Agreement. The Consultant further represents and warrants that the Consultant shall not use any trade secrets of another party without permission in the performance of the Services, including any trade secrets that belong to a prior employer or client. The Consultant has no direct or indirect investment in the stock of Ambac Financial Group, Inc.

2. **Term.** The Consultant will serve at the discretion of the Rehabilitator. The initial term during which the Consultant will perform the Services (the "Initial Term") will commence on the later of July 1, 2011 or such date as this Agreement has been approved by order of the Rehabilitation Court (the "Commencement Date"), and will expire forty (40) months thereafter, unless sooner terminated by either party as provided for herein, or as a result of the termination of the rehabilitation proceedings for the Segregated Account. The term shall be extended after the Initial Term until terminated by either party with not less than ninety (90) days advance written notice. The Initial Term plus any extension thereof as provided for herein shall be herein referred to as the "Term."

### 3. **Compensation.**

3.1 **Base Fee.** In return for the Consultant's performance of the Services, the Rehabilitator shall cause the Segregated Account to pay the Consultant a base fee of Fifty Thousand Dollars (\$50,000) per month during the Term (the "Base Fee"), payable monthly in arrears by the 15<sup>th</sup> day of the following month for each month during the Term. On the third anniversary of the Commencement Date, the Base Fee will be increased by a percentage equal to the net percentage increase in the Consumer Price Index, U.S. City Average, All Items, as published by the U.S. Department of Labor Bureau of Labor Statistics (the "CPI") for the prior two years, and any additional future increases shall also be determined in accordance with the CPI. Thereafter, the base fee will be increased annually to reflect any percentage increase in the CPI.

3.2 **Staying Bonus.** Upon completion of the Initial Term, and payable within ninety (90) days after such completion, the Segregated Account will pay the Consultant a staying bonus of Three Hundred Seventy-Five Thousand Dollars (\$375,000) provided the Consultant has not voluntarily terminated the Agreement, and it has not been terminated by the Rehabilitator for cause.

3.3 Early Termination Payment. In the event that the Agreement is terminated without cause by the Rehabilitator after the Commencement Date and prior to the expiration of the Initial Term, and provided that the Consultant executes a separation agreement that contains a release of all claims satisfactory to the Rehabilitator, the Segregated Account will pay the Consultant a severance payment equal to the staying bonus plus the lesser of: (i) twelve-months' Base Fees; or (ii) the difference between the aggregate Base Fees payable for the full Initial Term, and the Base Fees actually paid to the Consultant.

4. **Facilities and Support Services to be Provided to the Consultant.** The Segregated Account shall provide the Consultant with all necessary and suitable office facilities, computer and communications equipment, and support services to enable him to perform his duties as the Special Deputy Commissioner of the Segregated Account.

5. **Expenses.**

5.1 Transitional Housing Allowance. The Segregated Account will pay the Consultant the sum of Seven Thousand Five Hundred Dollars (\$7,500) per month for temporary housing for each of the first three months of the Initial Term.

5.2 Start-up Expenses. Within fourteen (14) days after the date of execution of the Agreement, the Segregated Account will pay the Consultant the sum of Twenty Thousand Dollars (\$20,000) to cover his anticipated costs incurred in obtaining legal counsel in this matter, moving, transportation and other costs associated with the implementation of the Agreement and transition to the New York metropolitan area.

5.3 Travel and Related Business Expenses. During the Term, the Consultant will be authorized to incur necessary and reasonable out-of-pocket expenses for transportation, meals, and lodging while traveling outside of New York, New York, and other business expenses in connection with his duties hereunder. The Rehabilitator shall cause the Segregated Account to reimburse the Consultant for such expenses upon presentation of an itemized account and appropriate supporting documentation, all in accordance with the policies for expense reimbursement maintained by the Company, or as otherwise directed by the Rehabilitator. If the Rehabilitator deems it necessary and appropriate, the Consultant may be provided with a credit or debit card or pre-funded expense account from which to pay out-of-pocket expenses incurred by the Consultant in the performance of the Services.

6. **Potential Change in Scope of Delinquency Proceedings.** Any and all of the business of the Company that is subject to delinquency proceedings under the jurisdiction of the Rehabilitator during the Term, whether or not such business is currently within the scope of the current rehabilitation proceedings, shall be deemed to be a part of the "Segregated Account" for purposes hereof.

7. **Priority Administrative Expense.** The payment obligations of the Segregated Account pursuant to this Agreement shall be considered a priority administrative expense for purposes of the rehabilitation of the Segregated Account, or any other delinquency proceeding covering any portion of the business of Ambac Assurance Corporation, as the case may be.

## 8. Termination.

8.1 Termination for Cause. This Agreement may be terminated by the Rehabilitator effective immediately upon delivery of notice to the Consultant, for "Cause." "Cause" shall include any of the following: (i) the Consultant's conviction of a criminal offense, the elements of which substantially relate to the duties or responsibilities of the position in which the Consultant is engaged; (ii) the Consultant's death, any illness or injury suffered by the Consultant that prevents the Consultant, either with or without a reasonable accommodation, from being able to perform the Services, or any other circumstances giving rise to the other than temporary unavailability of the Consultant to perform the Services; (iii) any act by the Consultant involving personal dishonesty, theft or fraud in connection with the Services; (iv) the Consultant's failure to abide by or follow any lawful direction of the Rehabilitator, which such failure, if curable, is not cured within ten (10) days after written notice thereof to the Consultant; (v) the Consultant's repeated material failure, after written notice thereof, to perform the Services in the manner called for herein; or (vi) the Consultant's violation of this Agreement, or the Consultant's grossly negligent or intentional violation of the non-disclosure obligations set forth herein or any policy established by the Rehabilitator, which violation, if curable, is not cured within ten (10) days after written notice thereof to the Consultant.

8.2 Termination without Cause. The Rehabilitator may terminate the Agreement without Cause at any time, for any reason or no reason at all, with or without notice.

8.3 Voluntary Termination. The Consultant may voluntarily terminate this Agreement at any time for any reason or no reason at all, with ninety (90) days advance written notice.

8.4 Automatic Termination upon Entry of a Termination Order. This Agreement shall automatically terminate upon the effective date of the entry of a Termination Order terminating any and all delinquency proceedings with respect to the Segregated Account.

8.5 Effect of Termination. The payments provided for under this Agreement shall fully discharge all responsibilities of the Rehabilitator, the Segregated Account, and the Company to the Consultant. Upon the termination of this Agreement for any reason, the Consultant shall cease providing Services and shall immediately surrender and deliver to the Rehabilitator any and all reports, working papers and documents of every kind prepared by or for the Rehabilitator relating to the Segregated Account and/or the Services including, but not limited to, any works in progress. The termination of this Agreement shall not limit or otherwise affect any of the Rehabilitator's obligations under Section 12 and the Consultant's obligations under Sections 10 and 11.

9. **Source of Payment.** The parties anticipate that all amounts payable under this Agreement shall be drawn under the terms of the Secured Note given from the Company to the Segregated Account in connection with the Rehabilitation and shall be paid out of the funds or assets of the Segregated Account. If the Rehabilitator deems advisable, the Consultant may receive an advance monthly retainer in an amount determined by the Rehabilitator.

**10. Relationship of the Parties; Independent Contractor; No Employee**

**Benefits.** Notwithstanding any provision hereof, the Consultant is an independent contractor and the Consultant is not, by virtue of this Agreement, an employee, partner or joint venturer of the Rehabilitator, the Segregated Account, or the Company. Absent the Rehabilitator's prior written approval, the Consultant shall not bind or attempt to bind the Rehabilitator, the Segregated Account, or the Company to any contract. The Consultant shall accept any directions issued by the Rehabilitator pertaining to the goals to be attained and the results to be achieved by the Consultant, but the Consultant shall be solely responsible for the manner and hours in which the Services are performed under this Agreement. The Consultant shall submit accurate and complete records to the Rehabilitator on a monthly basis, or more frequently at the request of the Rehabilitator, setting forth a reasonably detailed description of the tasks performed by the Consultant during each day during the Term, and the expenses incurred thereon. The Consultant shall not, by virtue of this Agreement, be eligible to participate in any of the Company's employee benefit plans, fringe benefit programs, group insurance arrangements or similar programs. Neither the Rehabilitator, the Segregated Account, nor the Company shall provide workers' compensation, disability insurance, Social Security or unemployment compensation coverage or any other statutory benefit to the Consultant. The Consultant shall comply at the Consultant's expense with all applicable provisions of workers' compensation laws, unemployment compensation laws, federal Social Security law, the Fair Labor Standards Act, federal, state and local income tax laws, and all other applicable federal, state and local laws, regulations and codes relating to terms and conditions of employment required to be fulfilled by employers or independent contractors. The Consultant agrees to indemnify the Rehabilitator, the Segregated Account, and the Company from any and all claims, damages, liability, settlement, attorneys' fees and expenses, as incurred, on account of the foregoing, provided however, that he receives prompt written notice by the Company of any such proposed, suspected or actual claims, liability or settlement, and prior to the Company incurring any legal fees or costs associated therewith, so he may address and/or defend as necessary.

**11. Confidentiality.** The Consultant shall receive and have access to information that is privileged and confidential. Both during and after the Term of this Agreement, the Consultant agrees to strictly preserve and protect the privileged and confidential nature of this information, except as the Rehabilitator shall authorize in writing addressed to the Consultant. Privileged and confidential information shall include, but not be limited to any and all statements, models, projections, analyses, business strategies, data, calculations and any and all materials in connection therewith concerning the financial condition or business or operations of the Segregated Account, but does not include any documents, records or information that have become publicly available other than by reason of the failure of the Consultant to comply with this Agreement. The Consultant hereby acknowledges that each term and condition contained in this paragraph 11 is necessary to preserve the confidentiality of the information furnished to the Consultant and that the Consultant's failure to comply with any such term or condition would result in irreparable damage to the Company and the Segregated Account in an amount that is impossible to quantify. At such time as the Rehabilitator requests, the Consultant shall return to the Rehabilitator or its designated representatives or shall destroy all copies of the information in any form whatsoever (including any notes, reports, transmittal letters or other writings prepared by the Consultant). Upon the request of the Rehabilitator, the Consultant shall certify any such destruction in writing.

**12. Indemnification.** The Segregated Account shall enter into an Indemnification Agreement for the benefit of the Consultant in the form attached hereto as Exhibit A.

**13. Approval by Rehabilitation Court.** The obligations of the parties hereunder shall be fully conditioned on the issuance by the Rehabilitation Court of an Order approving the terms and conditions hereof, and the final disposition of any appeal of that Order.

**14. Notices.** All notices, requests, approvals and consents and other communications required or permitted under this Agreement shall be in writing and shall be sent to the addresses specified below:

If to the Segregated Account or the Rehabilitator:

Theodore K. Nickel, Commissioner  
State of Wisconsin Office of the  
Commissioner of Insurance  
125 South Webster Street  
Madison, Wisconsin 53703-3474  
Facsimile: (608)264-6228

And a copy to:

Frederick C. Nepple, General Counsel  
State of Wisconsin Office of the  
Commissioner of Insurance  
125 South Webster Street  
Madison, Wisconsin 53703-3474  
Facsimile: (608)264-6228

If to the Consultant:

Roger A. Peterson  
Ambac Assurance Corporation -- Segregated Account  
One State Street Plaza  
New York, New York 10004  
Facsimile: \_\_\_\_\_

With a copy to:

Fox & Fox  
124 West Broadway  
Monona, Wisconsin 53716  
Attn: Randall B. Gold  
Facsimile: (608) 258-9105

**15. Miscellaneous Provisions.**

15.1 Trade Secret Laws Not Limited. Nothing in this Agreement shall limit the time period or the Consultant's duties, responsibilities or obligations under Wisconsin's, or other applicable state's, trade secrets laws, including but not limited to Wis. Stat. § 134.90 et seq.

15.2 Modifications and Waivers. No provision of this Agreement shall be modified, waived or discharged unless the modification, waiver or discharge is agreed to in writing and signed by the Consultant and the Rehabilitator. No waiver by either party of any breach of, or of compliance with, any condition or provision of this Agreement by the other party shall be considered a waiver of any other condition or provision or of the same condition or provision at another time.

15.3 Withholding. All payments made under this Agreement shall be subject to reduction to reflect any taxes or other charges required to be withheld by law.

15.4 No Assignment. This Agreement and all rights and obligations of the Consultant hereunder are personal to the Consultant and may not be transferred or assigned by the Consultant at any time. The rights of the Rehabilitator under this Agreement shall be automatically assigned to any successor to the Rehabilitator pursuant to applicable law.

15.5 Execution in Counterparts and Delivery by Facsimile or by other Electronic Means. This Agreement may be executed using two or more counterparts, each of which shall be deemed an original but all of which together constitute one and the same Agreement. This Agreement shall be deemed executed and delivered upon the exchange of executed documents by facsimile transmittal or scanned signature pages transmitted by electronic mail. Immediately following the exchange of executed documents by facsimile transmittal or electronic mail, the parties shall transmit signed original documents to each other, but the failure of either party to comply with this requirement shall not render this Agreement void or otherwise unenforceable.

16. **Governing Law.** This Agreement shall be interpreted in accordance with and governed by the laws of the State of Wisconsin, without giving effect to the principles of conflicts of laws.

17. **Venue.** Any action or proceeding arising out of this Agreement may be brought against either party in the Rehabilitation Court, and each party consents to the jurisdiction of such court in any such action or proceeding and waives any objection to venue laid therein.

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**18. Entire Agreement.** This Agreement is the entire agreement between the parties with respect to its subject matter, and except as recited above there are no other representations, understandings or agreements between the parties relative to such subject matter.

**IN WITNESS WHEREOF**, each of the Segregated Account and the Consultant have caused this Agreement to be signed and delivered by its duly authorized representative.

**THE SEGREGATED ACCOUNT OF AMBAC  
ASSURANCE CORPORATION:**

By: 

\_\_\_\_\_  
Theodore K. Nickel, Rehabilitator

**CONSULTANT:**

  
\_\_\_\_\_  
Roger A. Peterson

Schedule 1

**SERVICES**

**Schedule 1 to Consulting Agreement**  
**By and Between the Segregated**  
**Account and Roger A. Peterson**

The special deputy commissioner will serve as the official with primary responsibility for oversight and strategic management or, as appropriate, management of the Segregated Account, including any and all of the business of Ambac Assurance Corporation that is subject to rehabilitation proceedings under the jurisdiction of the Commissioner of Insurance for the State of Wisconsin (the "Rehabilitator") during the term, as defined for purposes of the Consulting Agreement ("Segregated Account"), of Ambac Assurance Corporation (the "Company"), including:

- 1) Review and approval of Segregated Account budget.
- 2) Review and approval of costs allocated to Segregated Account.
- 3) Management and supervision of Segregated Account consultants, advisors, attorneys and any Segregated Account employees.
- 4) Business planning, including preparation and submittal of annual business plans and quarterly goals and priorities to the Rehabilitator for approval and execution of those plans, goals and priorities.
- 5) Oversight of services provided by the Company to the Segregated Account pursuant to the Management Services Agreement, including through regular (not less than weekly) meetings with the Company CEO and senior management.
- 6) Oversight or as appropriate, management of the analysis and approval of business functions and decisions made as part of the derisking of the Segregated Account. This includes work to be done in conjunction with the rehabilitation plan. This includes all business functions within the Segregated Account, including, but not limited to claims payment, commutations and changes to other insurance contracts within the Segregated Account.
- 7) Prioritization, evaluation, and approval of potential commutations and alternative claim resolution initiatives consistent with the guidelines established by the Rehabilitator, including day to day involvement with the management services provider on the development of such proposals and the underlying analysis and assumptions.
- 8) Supervision and direction to, or as appropriate, management of the functional teams as set up through the management structure.
- 9) Regular (not less than monthly) reports to the Rehabilitator.
- 10) Report to OCI staff as requested.

- 11) Prepare or supervise the timely and proper preparation and submission of all Segregated Account reports, including to the Rehabilitator and the Rehabilitation Court.
- 12) Oversight, and evaluation as appropriate, of credit risk management processes, contract litigation, loan servicing and loss mitigation, reserving processes, claim procession and payments, surplus note issuance and payments,
- 13) Interaction with the Company board members, policyholders, and other stakeholders as needed to conduct the business of the Segregated Account.
- 14) Serve as the principal representative of the Rehabilitator for the purposes of court proceedings, including serving as witness or affiant for the purposes of making representations to the Rehabilitation Court for the purposes of proceedings relating to approval of transactions or related to seeking approval of, or implementing, the rehabilitation plan. Carry out, or supervise, the due diligence appropriate to performing this function.

CONFIDENTIAL

Exhibit A

**INDEMNIFICATION AGREEMENT**

**Exhibit A to Consulting Agreement**  
**By and Between the Segregated**  
**Account and Roger A. Peterson**

INDEMNIFICATION AGREEMENT

This Indemnification Agreement is made by and between Roger A. Peterson (the "Special Deputy Commissioner") and the Segregated Account of Ambac Assurance Corporation (the "Segregated Account"), to be effective as of the Effective Date, as defined below (the "Effective Date").

RECITALS

A. The Special Deputy Commissioner is a party to a Consulting Agreement with the Segregated Account dated June 2, 2011 (the "Consulting Agreement"), pursuant to which the Special Deputy Commissioner will provide certain Services (as defined in the Consulting Agreement) in the capacity of Special Deputy Commissioner in connection with the rehabilitation of the Segregated Account (including any and all of the business of Ambac Assurance Corporation that is subject to delinquency proceedings under the jurisdiction of the Commissioner of Insurance for the State of Wisconsin (the "Rehabilitator") during the term of the Consulting Agreement).

B. The Segregated Account has agreed to the matters set forth in this Agreement to facilitate such engagement. The execution and delivery by the Segregated Account of this Agreement is a material inducement to the willingness of the Special Deputy Commissioner to enter into the Consulting Agreement and provide the Services. Accordingly, the Segregated Account hereby agrees with the Special Deputy Commissioner as follows:

COVENANTS

1. **Indemnity and Contribution.** The Segregated Account agrees to indemnify and hold harmless the Special Deputy Commissioner to the full extent lawful against any and all claims, actions, demands, suits, awards, obligations, allegations of wrong-doing, losses, damages, liabilities, costs and expenses as incurred (including all reasonable fees and disbursements of counsel and all reasonable travel and other out-of-pocket expenses incurred in connection with investigation of, preparation for and defense of any pending or threatened claim and any litigation or other proceeding arising therefrom, whether or not in connection with pending or threatened litigation or other proceeding in which the Special Deputy Commissioner is or may be a party) arising out of or related directly or indirectly to the Services, the provision or procurement of the provision of the Services, or the Special Deputy Commissioner's engagement under the Consulting Agreement; provided, however, there shall be excluded from such indemnification any such claims, actions, demands, suits, awards, obligations, allegations of wrong-doing, losses, damages, liabilities, costs or expenses that arise primarily out of or are based primarily upon any action or failure to act by the Special Deputy Commissioner, other than an action or failure to act undertaken at the request or with the consent of the Segregated

Account, that is found in a final judicial determination (or a settlement tantamount thereto) to constitute bad faith, willful misconduct or gross negligence on the part of the Special Deputy Commissioner. In the event that the foregoing indemnity is unavailable or insufficient to hold the Special Deputy Commissioner harmless, then the Segregated Account shall contribute to amounts paid or payable by the Special Deputy Commissioner in respect of such claims, actions, demands, suits, awards, obligations, allegations of wrong-doing, losses, damages, liabilities, costs and expenses in such proportion as appropriately reflects the relative benefits received by, and, if applicable law does not permit allocation solely on the basis of benefits, fault of, the Segregated Account and the Special Deputy Commissioner in connection with the matters as to which such claims, actions, demands, suits, awards, obligations, allegations of wrong-doing, losses, damages, liabilities, costs and expenses relate and other equitable considerations, subject to the limitation that in any event the Special Deputy Commissioner's contributions in respect of such claims, actions, demands, suits, awards, obligations, allegations of wrong-doing, losses, damages, liabilities, costs and expenses will not exceed the amount of fees actually received by the Special Deputy Commissioner pursuant to the Consulting Agreement. For purposes hereof, relative benefits to the Segregated Account, collectively, on the one hand, and the Special Deputy Commissioner, on the other hand, of the Services shall be deemed to be in the same proportion that the total value received or contemplated to be received by the Segregated Account, collectively, and/or its policyholders, Ambac Assurance Corporation, or the policyholders or security holders thereof in connection with such transaction bears to the fees paid to the Special Deputy Commissioner pursuant to the Consulting Agreement.

If the Special Deputy Commissioner becomes involved in any threat or assertion of a claim, litigation or investigation with respect to the Consulting Agreement, then the Special Deputy Commissioner shall be compensated, separately from any fees due to him under the Consulting Agreement, for the time expended by the Special Deputy Commissioner, whether at or in preparation for meetings, depositions, trial or otherwise, at the hourly rates then in effect for the Special Deputy Commissioner or, if no such rate is then in effect, then at a commercially reasonable hourly rate that the Special Deputy Commissioner shall have proposed and the Rehabilitator shall have approved. The payment, indemnity and contribution agreements of the Segregated Account under this Section 1 shall be in addition to any liability which the Segregated Account otherwise may have and to any rights that the Special Deputy Commissioner may otherwise have, and shall be binding upon any successors and assigns of the Segregated Account and inure to the benefit of any successors, assigns, heirs and personal representatives of the Special Deputy Commissioner.

The Segregated Account will not, without the prior written consent of the Special Deputy Commissioner, settle any litigation relating to the Special Deputy Commissioner's engagement under the Consulting Agreement unless such settlement includes an express, complete and unconditional release of the Special Deputy

Commissioner with respect to all claims asserted in such litigation or relating to the Special Deputy Commissioner's engagement under the Consulting Agreement; such release to be set forth in an instrument signed by all parties to such settlement.

The Segregated Account acknowledges and agrees that the State of Wisconsin, OCI and all of its officers, agents and employees, including, without limitation, the Rehabilitator, will not be obligated to hold harmless or indemnify the Segregated Account, the Special Deputy Commissioner, or any of their respective partners, affiliates, members, subsidiaries, directors, officers, employees, consultants, contractors or agents from any suit, action, or claim, regardless of the character, and regardless of whether brought for or on account of any injuries or damages received by any entity, persons or property resulting from the act or omission of the State, OCI or any of their officers, agents or employees, or otherwise.

2. Priority Administrative Expense. The payment obligations of the Segregated Account pursuant to this Agreement shall be considered a priority administrative expense for purposes of the rehabilitation of the Segregated Account, or any other delinquency proceeding covering any portion of the business of Ambac Assurance Corporation, as the case may be.


3. Governing Law; Jurisdiction. This Agreement shall be governed by and construed in accordance with the laws of the State of Wisconsin without regard to the conflicts of laws provisions thereof. Any right to trial by jury with respect to any claim, action, suit or proceeding arising out of this Agreement or any of the matters contemplated hereby is waived.

4. Miscellaneous. This Agreement may be executed in two or more counterparts, all of which together shall be considered a single instrument. This Agreement constitutes the entire agreement, and supersedes all prior agreements and understandings (both written and oral) of the parties hereto with respect to the subject matter hereof, and cannot be amended or otherwise modified except in writing executed by the parties hereto. The provisions hereof shall inure to the benefit of and be binding upon the respective successors and assigns of the parties hereto.

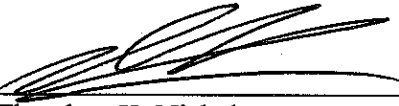
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Executed and delivered by the parties to be effective as of the Effective Date.

**SPECIAL DEPUTY COMMISSIONER:**

  
Roger A. Peterson

**THE SEGREGATED ACCOUNT OF AMBAC  
ASSURANCE CORPORATION**

By:   
Theodore K. Nickel  
Rehabilitator



ROBERT E. NOLAN COMPANY

# Special Deputy Commissioner over the Segregated Account of Ambac Assurance Company

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## Compensation Assessment for OCI

Steven M. Callahan, CMC®  
Practice Development Director

4/28/2011

Table of Contents

Executive Overview .....2

Introduction.....2

Situation.....3

Alternative Approaches.....3

Compensation Analysis .....4

*Consulting Firm Bids*.....5

*Existing AAC Executive Compensation* .....5

*Prior Compensation Analysis*.....6

*Salary Work-up for Existing Regulatory Leader* .....7

Summary .....8

## Executive Overview

An objective evaluation of potential compensation for the role of Special Deputy Commissioner over the Segregated Account of Ambac Assurance Company was requested by the OCI. To ensure appropriate consideration was given to the options, the evaluation included a review of difference sources of potential compensation levels, including consulting vendor bids, existing executive salaries, market studies, and a baseline work-up using a generalized public servant salary.

The result of the study indicates a range of \$350k to \$800k depending upon the level of expertise and experience in the following categories:

- Regulatory
- Legal
- Product
- Company practices and policies
- Operations management
- Business transitions / discontinuations / runoffs

More specifically, an individual with solid regulatory background and an understanding of the legal, product, and company practices could be expected to receive around \$500k per year, while an existing company executive with in-depth product, company, and operations management experience could expect to receive around \$750k per year. The range takes into account the SA/GA structure as well as allows for adjustments based upon individual experience and expertise.

As a comparison, a proven transition specialist with in-depth insurance industry and operational experience would likely cost closer to \$1M per year, which may or may not be appropriate for the GA/SA structure where the GA holds the resources and the Special Deputy is a purchaser of services.

## Introduction

Ambac Assurance Company (AAC) was separated into two separate accounts, a Segregated Account (SA) for blocks of business deemed to be at risk (approximately \$30 Billion of \$320 Billion Total Net Par Outstanding) and a General Account (GA) for the remaining business. Both accounts share staff from the GA providing these services to the SA under a Management Agreement. The SA is under OCI's oversight and is undergoing rehabilitation.

Under the current structure of the GA / SA and the approved Management Services Agreement (MSA) and Cooperation Agreement, the GA controls the operational functions and staff while the majority of policy claims and settlements are likely to occur in the SA under the control of the Rehabilitator.

Over the last several years the involvement of OCI has been extensive and has required a significant dedication of resources both onsite in New York as well as locally from Wisconsin. The amount of expert resources required by this rehabilitation is expected to remain high for several years to come, contributing to OCI's interest in finding appropriately effective options.

In anticipation of a possible need for alternative resourcing, the rehabilitation statutes (Wisconsin Statute 645.33(2)) allows OCI to appoint a representative to carry out the duties of overseeing the rehabilitation of the Segregated Account (SA) at the request and direction of the Rehabilitator.

### Situation

The challenges of managing the General Account, supporting the rehabilitation of the Segregated Account create a need for dedicated oversight of the Segregated Account's rehabilitation at a commitment level exceeding typical OCI oversight.

To address these challenges, OCI has determined that the best course of action is to exercise its option to appoint a full time representative in the role of "Special Deputy Commissioner over the Segregated Account of Ambac Assurance Company" (hereafter referred to as Special Deputy) as authorized by Wis. Stat. 645.33(2) to be separately contracted directly with the SA. The Special Deputy will be charged with overseeing the rehabilitation and ensuring the efficient and effective functioning of the Management Services Agreement from the perspective of the policyholders, with particular focus on claims resolutions, asset preservation, risk management, and other factors as deemed appropriate and material.

The remainder of this document entails an evaluation of compensation for this role.

### Alternative Approaches

AAC's specialized insurance products and complex liabilities along with the inherent complexity of the Wisconsin-specific rehabilitation process require technical industry knowledge, regulatory expertise, management skills, and ability to drive consensus on a wide range of operational issues. The runoff nature of the operation also brings with it the challenges of restructuring operations to optimize policyholder recoveries.

It was determined that ideal requirements for a Special Deputy role would include:

- Understanding regulatory perspectives and Wisconsin's rehabilitation process.
- Technical knowledge of the financial insurance industry products.
- Commutation negotiation, settlement, and claims processing experience.
- Experience working with attorneys and litigation matters.
- Leadership and management experience with large organizational structures.
- Restructuring knowledge and experience.

In determining how best to fill the role, four alternatives were considered:

1. Insurance Regulatory Leader with industry knowledge and relationships.
2. National Executive Search to identify and hire a qualified runoff specialist.
3. Consulting Firm with interim management and restructuring services.
4. Ambac Employee.

A thoughtful review of the options determined that the solution most likely to cost-effectively satisfy the necessary technical requirements, minimize the operational demands on OCI, ensure public credibility, and bring the necessary familiarity with the operations of AAC, in particular the SA, would be the Insurance Regulatory Leader (#1).

The benefits of an Insurance Regulatory Leader in the role were considered to be:

- Technical knowledge of regulatory requirements and financial insurance industry.
- Existing potential candidates.
- Credibility established with personnel, policyholders and board of directors.
- Linkage to OCI practices well developed, minimizing future OCI involvement.
- Familiarity with situation high if one of identified candidates selected.
- Cost expected to be equal to or less than other proposed solutions.

The key identified weakness to a single person solution was the lack of backup and staff depth that would come with using a consulting firm. The offset would be the higher cost, which impacted policyholder value, and the fact that this depth did not exist in any of the other options. Given tight links to staff at OCI as well as supporting contract expertise, it was felt that this risk was being sufficiently mitigated.

Having available candidates with the prerequisite expertise as well as in-depth knowledge of the situation provides a significant advantage for Option #1.

### Compensation Analysis

Given the unique nature of the job, in particular the separation of a single company into a General Account and Segregated Account structure, comparatives to directly equivalent roles were not readily available. Instead, market values were derived from using several alternative approaches:

- Consulting Firm Bids
- Existing AAC employee compensation
- Prior compensation analysis conducted for AAC by JAI and RE Nolan separately
- Salary work-up for existing regulatory leader

Using each of the above approaches to generate an acceptable range based upon candidate skills was deemed the most equitable approach.

### **Consulting Firm Bids**

An evaluation of compensation should first take under consideration the costs associated with external offers from professional consultants who have assessed the role and submitted a proposal for providing the management expertise necessary. These will typically be the higher end of the range as it offers the depth and breadth of a firm's staffing to assist in the role, including backup in the event the specific designee is unable to perform their duties. Conversely, there is likely to be limited awareness of regulatory perspectives and processes, which is critical to offloading the burden from OCI. Company, product, and risk specific awareness is likely to be less as well, depending upon the firm's previous involvement.

Based on the bids received, the upper bound for compensation can be reasonably established:

- Consulting firm \$1.2M to \$2.4M per year

This range is based upon information received from the firms each of which offered their services in filling the role of either Special Deputy or Executive Leadership. Most of the received bids did contemplate a more involved role with the GA and management of resources than may be currently being considered.

### **Existing AAC Executive Compensation**

Given the Special Deputy will be acting as a member of AAC's leadership team and will be assuming direct responsibility for the Segregated Account, which involves a large and complex block of at-risk business, a review of existing AAC compensation is appropriate. For this purpose, it is worth noting that the BOD for AAC has established the parameters of executive compensation to be in the 25<sup>th</sup> to 50<sup>th</sup> percentile of the NY area and market represented, and has used externally provided detailed compensation studies to validate total compensation (provided by Johnson and Associates, Inc). Recent salary increases have moved compensation to the median or above in an effort to ensure effective retention of key players.

In substantiation of using a comparison to existing executives in determining a range for the Special Deputy, one of the examples found during research was that involving New Hampshire's liquidation of the Home Insurance Company (2004). In this instance, a market analysis was done for the Liquidator (Commissioner Roger Sevigny) by Ernst & Young's Human Capital Practice with the purpose to "(1) identify the competitiveness of the Special Deputy Liquidator's current compensation to comparative market levels (other companies in liquidation and distressed situations as well as "healthy" insurance companies of similar size) and (2) recommend any pertinent modifications to the Special Deputy Liquidator's compensation" (public record, letter to Commissioner Sevigny dated August 27, 2004).

Keeping in mind that this was in 2004 and in New Hampshire, E&Y's analysis found that the Special Deputy Liquidator's compensation of \$600,000 was not sufficiently

competitive and recommended the addition of an incentive bonus target of \$400,000 and a “stay” bonus of \$400,000 bringing the total achievable compensation to \$1.4M. Some adjustments were made for missing benefits (25% value), with the end result in the 50<sup>th</sup> percentile and still being below the other Home Insurance Company executive compensation, which according to the study averaged in the 50<sup>th</sup> to 75<sup>th</sup> percentile.

Home Insurance Company was a liquidation of the entire company where the Special Deputy was the senior-most executive in charge. The appointed Special Deputy, Peter Bengelsdorf, was an experienced industry executive having held positions as an Executive Vice President and CFO at several companies as well as having served as Special Deputy Liquidator and Special Deputy Commissioner in a number of instances.

Using this approach with AAC, and based on since-increased 2009 executive salary levels, the range for operational expertise to risk and financial expertise for existing executives over both the GA and SA is:

- Existing AAC Executive Compensation \$885k to \$1.2M per year

As a comparative basis, it is worth noting that in 2009 the Managing Directors made between \$200k and \$600k (including bonus). Based on the determination of the extent to which the SA mirrors this level of accountability, the range can be adjusted accordingly.

**Prior Compensation Analysis**

The BOD utilized Johnson and Associates, Inc. for reviews of compensation practices and equity reportable to the compensation committee. These reviews were engaged to ensure equitable practices, and entailed collecting and compiling information on both a broad financial services market basis as well as a more focused Guarantor perspective for similar positions. The companies involved in the analysis are included in the report and cover a reasonable range to ensure balance.

For purposes of this review, the 2009 report that was conducted is used as one benchmark against industry compensation levels for lead executives. While 25<sup>th</sup> and 75<sup>th</sup> percentiles were provided as well, the Market Median is reported here.

	Broad Market	Guarantor
• Divisional CEO	\$1.2M	n/a
• Head of Portfolio Management	\$1.3M	\$1M to \$2M
• Chief Risk Officer	\$1.2M	\$1M to \$2M
• Business Unit COO	\$800k	n/a
• CAO	\$725	\$600k to \$1M

From the 2009 Compensation Analysis conducted by Johnson and Associates, Inc., the range for a Business Unit Leader would seem to fall in the \$600k to \$1M range.

In addition to this analysis, RE Nolan was asked to conduct a review of the market compensation in 2010 as part of the initial considerations being given to the appointment of a Special Deputy. Taking a similar but less detailed approach than Johnson and Associates, Inc., Nolan reviewed the publicly reported salaries of similarly positioned executives in the financial services market. The results of this analysis were consistent with previous work and included companies like Radian Group, PMI Group, and MGIC (note that XL Capital and Max Capital were also reviewed but the results were considerably higher):

- CFO \$1M to \$1.6M
- COO \$870k to \$1.6M

Based on this analysis, the 2010 numbers appeared slightly higher but still supported compensation in the \$800k to \$1.2M range for an executive with both operational and risk management responsibilities and experience within the industry.

As indicated by both market compensation reviews, depending upon the breadth of the role being led and the experience of the executive in charge, the compensation for an experienced Business Unit Leader with both expense and risk responsibilities range on the low end around the \$800k total annual compensation mark. To the extent that the SA represents a less complex block of business or operation, the compensation will need to be adjusted accordingly.

#### *Salary Work-up for Existing Regulatory Leader*

Given that the desired and optimal approach is to leverage an identified resource deeply familiar with both AAC and the Wisconsin regulatory environment, the one other reasonableness check is to take a bottom-up approach to base-lining the salary. It is important to note that this approach does not generate a market competitive rate but instead a baseline salary that can then be incremented based upon the market rate of the role, cost of alternative sourcing methods, and adjustments for level of experience and expertise. It is important that existing candidates with the appropriate experience be paid a competitive salary for the role being taken regardless of their current positions salary if they are qualified to do the job – that is the basis for market rates.

For purposes of this workup, a baseline salary of \$125,000 per year for an experienced and tenured public servant in the state of Wisconsin was used. The work-up and associated logic follows, recognizing this is a ballpark approach to estimating equivalency:

- Baseline \$125,000
- Add-on for NY market (x.75) \$86,000
- Subtotal \$211,000
- Salary to Contract Conversion (1.7\*) \$360,000

\*The salary to contract conversion represents the risk element and loss of tenure based benefits that are the result of shifting from a salary to a contract labor basis. One

common approach is to base the conversion on a contract base of a 220 day work year versus a salary base of a 365 day one (or a factor of about 1.7).

- Salary Work-up Baseline \$360k

As a simple cross-foot, this translates to an hourly rate assuming 220 work days per year and roughly 8 hours per day of \$210, which is consistent with the rates charged for qualified technical, regulatory, financial, or legal expertise.

The potential shift of an experienced Department of Insurance regulator to a contracted full-time role as Special Deputy for liquidations or rehabilitations does occur, as it is a reasonable leveraging of expertise for the benefit of policyholders. One excellent example of this transition is Mr. Randy Lamberjack, President of Noble Consulting Services. Mr. Lamberjack has acted as a contracted Special Deputy in a number of regulatory actions, including Medical Insurance, Standard Life, and Benicorp Insurance Company. Prior to operating as an independent contractor specializing in supporting regulatory actions, Mr. Lamberjack was the Chief Examiner/Deputy Commissioner of the Indiana Department of Insurance under former Governor Evan Bayh. His transition is one example of how regulatory expertise can be leveraged on a contract basis for the benefit of policyholders of a company undergoing a rehabilitation or liquidation.

### Summary

Using several different methods to determine a market rate range for the role of Special Deputy Commissioner of the Segregated Account results in the following baseline and ranges:

Consulting firm	1.2M to \$2.4M per year
Existing AAC Executive Compensation	\$885k to \$1.2M per year
Market Compensation Reviews	\$800k to \$1.6M per year
Salary Work-up Baseline	\$360k

In evaluating the compensation level for the selected individual, it will be important to factor in their experience against that of the determinants for the market rates. The Baseline provides an equitable entry point for the technically proficient with limited open market experience in the role being requested while the upper ends establish a competitive compensation level that would be used to attract an established and proven industry executive with directly applicable experience.

Given the unique nature of the split GA/SA structure, and the regulatory insights required, it is unlikely that an exact match to the necessary skills will be found. With that in mind, an evaluation of the individual applying against the underlying requirements for the job will provide the final basis for determining the exact level of compensation within this range.

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For purposes of hiring a single individual on a permanent or contract basis, an initial range of \$400k to \$800k should be used with the final result being based on the level of expertise and experience being brought to the job.

In the event the consulting firm approach is selected, the costs will be higher offset by the increased staff depth and breadth available. An RFP process is the best approach in this event, as it lets the market determine the value, although insights into a probable range of costs have been provided by prior work.

To determine the appropriate total compensation for the individual to be hired, the gradients of specific expertise to generalized leadership should be considered. The following diagram provides a context for considering the various skills that may be involved in the job, leaving the degree or weight of each to be determined by those defining the specific job duties:

	Baseline	Regulations & Legal	Products & Risks	Company Policies	Operations	Top Tier
Regulatory	XXXXXX	XXXXXX	XXXXXX	XXXXXX	XXXXXX	XXXXXX
Legal		XXXXXX	XXXXXX	XXXXXX	XXXXXX	XXXXXX
Product			XXXXXX	XXXXXX	XXXXXX	XXXXXX
Company				XXXXXX	XXXXXX	XXXXXX
Operations					XXXXXX	XXXXXX
Shutdowns						XXXXXX
	<b>\$350k</b>	<b>\$450k</b>	<b>\$575k</b>	<b>\$750k</b>	<b>\$880M</b>	<b>\$1.0M</b>

Ideally, the selection of an individual for this role and more importantly the determination of the appropriate salary would be conducted objectively based on a matching of existing knowledge, skills, abilities, and experience against those required by the job. Since the availability of the appropriate regulatory experience is so limited, working with the qualified identified candidates to determine the degree to which they have additional experience as noted and the extent to which that experience adds incremental and necessary value to the process of rehabilitation will determine the most equitable salary range.

Upon determination of the appropriate salary, care should be taken to craft a contract that protects both OCI and the selected individual by incorporating adequate coverage of incentives, sunset clauses, liability protections, and adjustments for expansions or contractions in responsibility. Consistent with these clauses will be the need for a clear definition of the extent of the operational level of the role, areas and degrees of direct responsibilities, and handling interactions with external agencies, the media, the BOD, AAC / AFG leadership, and supporting consultant staff. It will be important to have the role clarified to ensure adequate authority over the rehabilitation process as well as avoid any confusion over lines of reporting or decision-making responsibility.