

COURT OF APPEALS OF WISCONSIN  
DISTRICT IV

---

In the Matter of the Rehabilitation of:

Segregated Account of  
Ambac Assurance Corporation,

Appeal No.  
2011AP000561

TED NICKEL and OFFICE OF THE  
COMMISSIONER OF INSURANCE,

Petitioners-Respondents,

AMBAC ASSURANCE,

Interested Party-Respondent,

DEPFA BANK, PLC,

Interested Party-Appellant,

ACCESS TO LOANS FOR LEARNING  
STUDENT LOAN CORPORATION,  
AURELIUS CAPITAL MANAGEMENT  
LP, BANK OF AMERICA, N.A.,  
CUSTOMER ASSET PROTECTION  
COMPANY (“CAPCO”), DEUTSCHE  
BANK NATIONAL TRUST COMPANY,  
DEUTSCHE BANK TRUST COMPANY  
AMERICAS, EATON VANCE,  
FEDERAL HOME LOAN MORTGAGE  
CORPORATION (“Freddie Mac”),  
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TREE INC., KING STREET CAPITAL  
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FARGO BANK, N.A. as Trustee for the  
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Interested Parties-Co-  
Appellants,

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**APPEAL FROM THE ORDER OF THE CIRCUIT  
COURT OF DANE COUNTY CASE NO. 10 CV 1576  
THE HONORABLE WILLIAM D. JOHNSTON  
PRESIDING**

---

**APPELLANTS DEUTSCHE BANK NATIONAL  
TRUST COMPANY AND DEUTSCHE BANK TRUST  
COMPANY AMERICAS'S REPLY**

---

Paul E. Benson, SBN 1001457  
Paul A. Lucey, SBN 1009833  
Nathan L. Moenck, SBN 1066208  
MICHAEL BEST & FRIEDRICH LLP  
100 East Wisconsin Avenue, Suite 3300  
Milwaukee, Wisconsin 53202-4108  
Tel. 414.271.6560  
Fax 414.277.0656

John M. Rosenthal, *Admitted Pro Hac Vice*  
Kristine Bailey, *Admitted Pro Hac Vice*  
MORGAN, LEWIS & BOCKIUS LLP  
One Market, Spear Street Tower  
San Francisco, California 94195  
Tel. 415.442.1000  
Fax 415.442.1001

Allyson N. Ho, *Admitted Pro Hac Vice*  
MORGAN, LEWIS & BOCKIUS LLP  
1000 Louisiana, Suite 4000  
Houston, Texas 77002  
Tel. 713.890.5000  
Fax 713.890.5001

Attorneys for DEUTSCHE BANK  
NATIONAL TRUST COMPANY, solely  
in its capacity as Trustee, and DEUTSCHE  
BANK TRUST COMPANY AMERICAS,  
solely in its capacity as Trustee

Dated: September 8, 2011

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OCI's response confirms that the Order approving the Plan should be reversed.<sup>1</sup> The Legislature's statutory framework permits OCI to pursue either rehabilitation or liquidation when faced with a failing insurer like Ambac. Whichever option it chooses, OCI must exercise its discretion within the statutory framework. Instead, OCI has created a hybrid—which it calls a “targeted rehabilitation”—comprised of statutory provisions from each regime that are most favorable to Ambac. That patchwork approach is contrary to Wisconsin law, contravenes fundamental principles of fairness and equity, and should not be permitted to stand.

## **ARGUMENT**

### **I. OCI's Response Confirms That The Plan Is An Impermissible Liquidation Of The Segregated Account To Bail Out Ambac**

OCI does not dispute that Ambac is in a precarious financial position—or that Ambac has already defaulted on the first payments due on the surplus notes. *See* Trustees Br. 14 n.2. OCI's brief even quotes the federal district court's conclusion that “the whole point of the rehabilitation is to

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<sup>1</sup> Deutsche Bank National Trust Company and Deutsche Bank Trust Company Americas, each acting solely in its capacity as trustee for certain residential mortgage-backed securitization trusts (the “Trustees”), join in the reply submitted by U.S. Bank National Association.

rehabilitate Ambac Assurance Corporation.” OCI Br. 55 (citation omitted). But no Wisconsin statute permits a segregated account to be used, as here, to bail out an entire corporation at a time of financial crisis. Indeed, Wisconsin law is to the contrary. *See* Trustees Br. 7.

Unable to muster authority to support its position, OCI attempts—but fails—to distinguish the Trustees’ authorities. In *Carpenter*, unlike here, the entire company had been placed in liquidation—and the policyholders were allowed to opt out. *Carpenter v. Pac. Mut. Life Ins. Co.*, 74 P.2d 761, 770-71 (Cal. 1937) (en banc). *Carpenter*—to which OCI devotes an entire section of its brief—thus permitted the plan there precisely *because* it accorded policyholders the protections denied them here.

OCI insists (at 48-50) that opt out is not required but cannot distinguish caselaw directly to the contrary. *See Foster v. Mut. Fire, Marine & Inland Ins. Co.*, 614 A.2d 1086, 1093-94 (Pa. 1992) (“Under [*Carpenter*], creditors must fare at least as well under a rehabilitation plan as they would under a liquidation”); *Carpenter*, 74 P.2d at 777. The law is clear, and “requires ... that the creditor or policyholder

receive the liquidated value of his contract rights without any unreasonable delay.” COUCH ON INSURANCE § 5:29 (2011).

OCI is left to argue (at 40) that it has done this before. But in that instance, adequate assets were transferred to the segregated account. 11/16/2010 Tr. 157:15–159:18. That is not so here—and OCI does not even attempt to argue otherwise. Instead, OCI insists that the Segregated Account passes muster because it has “*access*” to most of the General Account’s assets. OCI Br. 20 (emphasis added). The statutory standard is “adequacy,” however, *not* “access.”

Given Ambac’s precarious financial situation, OCI’s assurances provide little (if any) comfort. OCI admits it “retain[s] the discretion to determine when, and to what extent, surplus notes are paid.” OCI Br. 59-60, 61. OCI offers no justification for paying Segregated Account policyholders 75 percent in notes but General Account holders 100 percent in cash, or for engaging in the pretense that Segregated Account policyholders are being paid 100 percent in cash. OCI does not dispute that the notes are worth only pennies on the dollar, or that Ambac has already defaulted on the notes. Ambac’s claims of access thus do not

alter the conclusion that the Circuit Court reversibly erred in approving such a woefully undercapitalized plan.

**II. Contrary To OCI's Assertions, The Trustees Simply Seek The Equitable Treatment To Which They Are Entitled By Law**

OCI argues that the Trustees seek “equal” treatment, while the law provides only for “equitable” treatment. OCI Br. 41. But OCI’s semantic quibbles cannot change that the Plan does not accord Segregated Account policyholders the equitable treatment to which they are entitled by law.

Wisconsin law requires that “[n]o subclasses shall be established within any class.” Wis. Stat. § 645.68. OCI does not dispute that the Segregated Account policies are in the same line of business as General Account policies—or that segregated accounts may only be used to segregate different lines of business. Trustees Br. 6, 22.

The Plan, however, unlawfully assigns some policyholders to the Segregated Account, while others in the same class—or business line—remain in the General Account. Moreover, Segregated Account policyholders do not have the option to receive liquidation value of their claims, but will be paid 75 percent in notes of dubious

value—while General Account policyholders are paid 100 percent in cash.

OCI's sole excuse for treating Segregated Account policyholders inequitably is that otherwise "collateral damage" would occur. OCI Br. 63. But OCI has never provided an actual example of that undefined term or any tangible explanation of what it means.

### **III. OCI Cannot Avoid The Force Of The Trustees' Novation Argument**

OCI does not address the Trustees' novation argument except to refer the Court to briefing in a related appeal. OCI Br. 57. Nothing in that briefing refutes the Trustees' argument that the Plan's forced transfer of the trust policies to the Segregated Account is an illegal novation.

OCI's primary argument is that Wisconsin Statute § 601.01(7) has superseded the common law on which the Trustees rely. That is not so, because the statute is not inconsistent with the common law. *See Ervin v. City of Kenosha*, 159 Wis. 2d 464, 476, 464 N.W.2d 654 (1991) (legislative intent to change common law must be clearly expressed).

No statute allows Ambac to unilaterally force policyholders to accept a new insurer. Nor does any statute authorize OCI to impose such a novation (particularly for the benefit of an insurer that is not itself in rehabilitation). And there is no merit to OCI's contention that segregated accounts are not separate from the insurer that forms them. *See* Wis. Stat. § 611.24(3)(e) & comments (each segregated account "shall be deemed an insurer" and is "expected to function and survive like a separate corporation").

#### **IV. OCI Cannot Justify The Plan's Overbroad Immunity Provisions**

OCI attempts to justify the Plan's overbroad (and unlawful) immunity provisions by conclusorily asserting that without them, OCI could not obtain the cooperation of other entities and individuals necessary to implement the Plan. OCI Br. 79. That argument fails because it ignores the plain language of the rehabilitation statute, which expressly limits the individuals and entities entitled to immunity. *See* Wis. Stat. § 645.08(2).

#### **V. OCI Fails To Excuse The Plan's Unlawful Transfer Of Subrogation Rights**

OCI claims (at 73) that the transfer of Segregated Account policyholders' subrogation rights to Ambac was

necessary to avoid violating contractual covenants in General Account policies. That argument not only betrays that the true purpose of the Plan is to rehabilitate Ambac as a whole, but also confirms that stripping those rights from the Segregated Account policyholders exceeds OCI's mandate.

OCI characterizes these recoveries as “always [having] resided in Ambac’s General Account and ... never [having been] allocated to the Segregated Account.” OCI Br. 73. But that ignores: (i) the Plan’s plain language, which states that a Segregated Account policyholder is “deemed to have *assigned* its rights relating to that payment ... to [Ambac]” (J.A.610, § 4.04(h)); (ii) that subrogation rights always belonged to the Segregated Account policyholders; and (iii) that the creation and funding of the Segregated Account itself was unlawful and void. *See* Trustees Br. 5-11.

Glossing over the inequities—i.e., that as the new “holder” of subrogation rights, Ambac must be paid 100 percent in cash, while the Segregated Account policyholders are forced to accept 75 percent in notes of dubious value—OCI suggests that any inequity is theoretical and may be remedied by the Plan’s alternative resolution scheme or the Circuit Court’s authority to modify the Plan. OCI Br. 75.

Those assurances ring hollow, given that the cash payment ratio may be modified by OCI at any time (J.A.616, § 7.02) and Ambac has already defaulted on its payments.

**VI. OCI Does Not Dispute The Burdens Imposed By The Plan On The Trustees**

OCI does not dispute the administrative burdens that the Plan would impose on the Trustees. Instead, OCI argues that: (i) any burdens are addressed by Section 8.02 of the Plan (which purportedly protects the trustees from third-party liability), and (ii) OCI is willing to address any problems. OCI Br. 81-82.<sup>2</sup>

Those assurances are both insufficient and irrelevant. It is OCI's burden to fashion a Plan that is equitable at the outset. Wis. Stat. § 645.32(1). The Plan does not satisfy that standard. Instead, the Plan permits Ambac to reap the benefits of OCI's "targeted rehabilitation," while placing the burdens on the Trustees.

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<sup>2</sup> Some RMBS policyholders argue that the Trustees do not even come within the scope of Wisconsin Statute § 645.08(2) in the first instance. RMBS Br. 7-8. That is incorrect. As the RMBS policyholders concede, Section 8.02 applies to the Trustees insofar as they are implementing the Plan, thereby making them OCI's "agents" in that regard. As OCI's agents, they unquestionably fall within the statute. Wis. Stat. § 645.08(2).

## CONCLUSION

The Circuit Court's Order should be reversed.

Dated this 8th day of September, 2011.

Respectfully submitted,

DEUTSCHE BANK NATIONAL  
TRUST COMPANY, solely in its  
capacity as Trustee, and DEUTSCHE  
BANK TRUST COMPANY  
AMERICAS, solely in its capacity as  
Trustee,  
By Their Attorneys,

/s/ Nathan L. Moenck  
Paul E. Benson, SBN 1001457  
Paul A. Lucey, SBN 1009833  
Nathan L. Moenck, SBN 1066208  
MICHAEL BEST & FRIEDRICH LLP  
100 East Wisconsin Avenue, Suite 3300  
Milwaukee, Wisconsin 53202-4108  
Tel. 414.271.6560  
Fax 414.277.0656

John M. Rosenthal, *Admitted Pro Hac  
Vice*  
Kristine Bailey, *Admitted Pro Hac Vice*  
MORGAN, LEWIS & BOCKIUS LLP  
One Market, Spear Street Tower  
San Francisco, California 94195  
Tel. 415.442.1000  
Fax 415.442.1001

Allyson N. Ho, *Admitted Pro Hac Vice*  
MORGAN, LEWIS & BOCKIUS LLP  
1000 Louisiana, Suite 4000  
Houston, Texas 77002  
Tel. 713.890.5000  
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**FORM AND LENGTH CERTIFICATION**

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I hereby certify that this brief conforms to the rules contained in § 809.19(8)(b) and (c) of the Wisconsin Statutes for a brief produced with a proportional serif font. The length of this brief is 1540 words.

Dated this 8th day of September, 2011.

Respectfully submitted,

DEUTSCHE BANK NATIONAL  
TRUST COMPANY, solely in its capacity  
as Trustee, and DEUTSCHE BANK  
TRUST COMPANY AMERICAS, solely  
in its capacity as Trustee,  
By Their Attorneys,

/s/ Nathan L. Moenck

Paul E. Benson, SBN 1001457

Paul A. Lucey, SBN 1009833

Nathan L. Moenck, SBN 1066208

MICHAEL BEST & FRIEDRICH LLP

100 East Wisconsin Avenue, Suite 3300

Milwaukee, Wisconsin 53202-4108

Tel. 414.271.6560

Fax 414.277.0656

John M. Rosenthal, *Admitted Pro Hac  
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Kristine Bailey, *Admitted Pro Hac Vice*

MORGAN, LEWIS & BOCKIUS LLP

One Market, Spear Street Tower

San Francisco, California 94195

Tel. 415.442.1000

Fax 415.442.1001

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MORGAN, LEWIS & BOCKIUS LLP

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**CERTIFICATION OF COMPLIANCE WITH RULE  
809.19(12)**

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I hereby certify that:

I have submitted an electronic copy of this brief,  
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**CERTIFICATE OF SERVICE**

---

I hereby certify that on September 8, 2011, I served by first class mail, postage prepaid and/or electronic mail, this brief upon counsel listed below.

*Ted Nickel and Office of the  
Commissioner of Insurance, State  
of Wisconsin*  
c/o Michael B. Van Sicklen  
David G. Walsh

Served three (3) copies pursuant to Wis. Stat. § 809.19(8) by first class mail.

Matthew R. Lynch  
Foley & Lardner LLP  
150 East Gilman Street  
P.O. Box 1497  
Madison, WI 53701-1497  
Email: mvansicklen@foley.com  
Email: dwalsh@foley.com  
Email: mlynch@foley.com

c/o Kevin G. Fitzgerald  
Andrew A. Oberdeck  
Foley & Lardner LLP  
777 E. Wisconsin Ave.  
Milwaukee, WI 53202  
Email: kfitzgerald@foley.com  
Email: aoberdeck@foley.com

*Ambac Assurance*  
c/o Daniel W. Stolper  
Barbara A. Neider  
Stafford Rosenbaum LLP  
222 W. Washington Ave., Ste. 900  
P.O. Box 1784  
Madison, WI 53701-1784  
Email: dstolper@staffordlaw.com

Served three (3) copies  
pursuant to Wis. Stat. §  
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mail.

Peter A. Ivanick  
William G. Primps  
Lynn Roberts  
Emily L. Saffitz  
Dewey & LeBoeuf LLP  
1301 Avenue of the Americas  
New York, NY 10019-6092  
Email: wprimps@dl.com  
Email: esaffitz@dl.com  
Email: pivanick@dl.com  
Email: lwroberts@dl.com

Todd L. Padnos  
Dewey & LeBoeuf LLP  
1950 University Avenue, Ste. 500  
East Palo Alto, CA 94303-2225  
Email: tpadnos@dl.com

*Wells Fargo Bank*  
c/o Stephen L. Morgan  
Brittany S. Ogden  
Jennifer M. Krueger  
Murphy Desmond S.C.  
33 East Main Street, Suite 500  
P.O. Box 2038  
Madison, WI 53701-2038  
Email:  
smorgan@murphydesmond.com  
Email:  
bogden@murphydesmond.com  
Email:  
jkrueger@murphydesmond.com

Served three (3) copies  
pursuant to Wis. Stat. §  
809.19(8) by first class  
mail.

Steven T. Whitmer  
Kevin Wisniewski  
Locke Lord Bissell & Liddell LLP  
111 S. Wacker Dr.  
Chicago, IL 60606  
Email: swhitmer@lockelord.com  
Email:  
kwisniewski@lockelord.com

*Wells Fargo Bank/Trustee for  
RMBS Certificate Holders*  
c/o Jane C. Schlicht  
Cook & Franke S.C.  
660 E. Mason Street  
Milwaukee, WI 53202  
Email: schlicht@cf-law.com

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mail.

Michael E. Johnson  
William B. Macurda  
Cele Ogawa  
Alston & Bird LLP  
90 Park Avenue  
New York, NY 10016  
Email:  
michael.johnson@alston.com  
Email: bill.macurda@alston.com  
Email: cele.ogawa@alston.com

*The Bank of New York Mellon*  
c/o Laura E. Callan  
Thomas Solheim  
Solheim Billing & Grimmer, S.C.  
One S. Pinckney Street, Suite 301  
P.O. Box 1644  
Madison, WI 53701-1644  
Email: lcallan@sbglaw.com  
Email: tsolheim@sbglaw.com

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Dale C. Christensen, Jr.  
Thomas Ross Hooper  
Seward & Kissel LLP  
One Battery Park Plaza  
New York, NY 10004  
Email: christensen@sewkis.com  
Email: hooper@sewkis.com

*Federal Home Loan Mortgage Corporation (Freddie Mac)*  
c/o David I. Cisar  
Susan E. Lovern  
Owen Thomas Armstrong, Jr.  
von Briesen & Roper, s.c.  
411 East Wisconsin Avenue, Suite 700  
P.O. Box 3262  
Milwaukee, WI, 53201-3262

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Email: dcisar@vonbriesen.com  
Email: slovern@vonbriesen.com  
Email:  
oarmstrong@vonbriesen.com

Christopher J. Stroebel  
von Briesen & Roper, s.c.  
Three S. Pinckney Street, Ste. 1000  
Madison, WI 53703  
Email: cstroebel@vonbriesen.com

Craig S. Bloomgarden  
Manatt, Phelps & Phillips, LLP  
11355 West Olympic Boulevard  
Los Angeles, CA 90064  
Email: cbloomgarden@manatt.com

Marcia D. Alazraki  
Manatt, Phelps & Phillips, LLP  
7 Times Square  
New York, NY 10036  
Email: malazraki@manatt.com

*Federal National Mortgage  
Association (“Freddie Mae”)*  
c/o Rodney W. Carter  
Davis & Kuelthau, S.C.  
300 North Corporate Dr., Ste. 150  
Brookfield, WI 53045-5804  
Email: rcarter@dkattorneys.com

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c/o David M. Schlecker  
Reed Smith LLP  
599 Lexington Avenue  
New York, NY 10022  
Email: dschlecker@reedsmith.com

*Aurelius Capital Management, LP,  
Fir Tree, Inc., King Street Capital,  
L.P., King Street Capital Master  
Fund, Ltd., Monarch Alternative  
Capital LP, and Stonehill Capital  
Management LLC*

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*RMBS Policy Holders*  
c/o Bryan K. Nowicki  
R. Timothy R. Muth  
Jessica Hutson Polakowski  
Reinhart Boerner Van Deuren s.c.  
22 E. Mifflin Street, Suite 600  
Madison, WI 53703  
Email: bnowicki@reinhartlaw.com  
Email: tmuth@reinhartlaw.com  
Email:  
jpolakowski@reinhartlaw.com

John B. Simon  
David M. Greenwald  
Michael T. Brody  
Andrew J. Olejnik  
Jenner & Block LLP  
353 N. Clark Street  
Chicago, IL 60654  
Email: dgreenwald@jenner.com  
Email: jsimon@jenner.com  
Email: mbrody@jenner.com  
Email : aolejnik@jenner.com

Patrick J. Trostle  
Mark Lightner  
Jenner & Block LLP  
919 Third Avenue, 37th Floor  
New York, NY 10022  
Email: ptrostle@jenner.com  
Email: mlightner@jenner.com

*Eaton Vance Management,*  
Gregory T. Everts  
Quarles & Brady  
P.O. Box 2113  
Madison, WI 53701-2113  
Email: greg.everts@quarles.com

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Jeffrey W. Spear  
Joel M. Walker  
Kenneth M. Argentieri  
Duane Morris LLP  
600 Grant Street, Suite 5010  
Pittsburgh, PA 15219  
Email:  
jmwalker@duanemorris.com  
Email:  
jwspear@duanemorris.com  
Email:  
kmargentieri@duanemorris.com

*Nuveen Asset Management,  
Restoration Capital Management  
LLC, Stone Lion Capital Partner  
LP, LVM Bondholders*  
c/o Noreen Joy Parrett  
Connie L. O'Connell  
Parrett & O'Connell  
10 East Doty Street, Suite 621  
Madison, WI 53703  
Email:  
nparrett@parrettoconnell.com  
Email:  
coconnell@parrettoconnell.com

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mail.

Philip Bentley  
Amy Caton  
Susan Jacquemot  
Kramer Levin Naftalis & Frankel  
LLP  
1177 Avenue of the Americas  
New York, NY 10036  
Email:  
pbentley@kramerlevin.com  
Email: acaton@kramerlevin.com  
Email:  
siacquemot@kramerlevin.com

*Depfa Bank plc*  
c/o Grant C. Killoran  
Seth E. Dizard  
Gregory W. Lyons  
O'Neil, Cannon, Hollman, DeJong  
& Laing S.C.  
111 E. Wisconsin Avenue, Ste.  
1400  
Milwaukee, WI 53202  
Email: grant.killoran@wilaw.com  
Email: seth.dizard@wilaw.com  
Email: greg.lyons@wilaw.com

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mail.

c/o Michael C. Weed  
Thomas J. Welsh  
Andrew K. Davidson  
Orrick, Herrington & Sutcliffe LLC  
400 Capitol Mall, Suite 3000  
Sacramento, CA 95814-4497  
Email: mweed@orrick.com  
Email: tomwelsh@orrick.com  
Email: adavidson@orrick.com

*One State Street, LLC*  
c/o Anne M. Bensky  
Kathleen G. McNeil  
Garvey McNeil & Associates, S.C.  
One Odana Court  
Madison, WI 53719  
Email:  
mcneil@gmmattorneys.com  
Email:  
bensky@gmmattorneys.com

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mail.

c/o Mark I. Bane  
Ropes & Gray LLP  
1211 Avenue of the Americas  
New York, NY 10036  
Email: mark.bane@ropesgray.com

c/o D. Ross Martin  
Andrew G. Devore  
Ropes & Gray  
Prudential Tower  
800 Boylston Street  
Boston, MA 02199-3600  
Email: ross.martin@ropesgray.com  
Email:  
andrew.devore@ropesgray.com

*Access to Loans for Learning  
Student Loan Corporation AND  
Lloyds TSB Bank plc*  
c/o Lawrence Bensky  
Law Office of Lawrence Bensky,  
LLC  
10 E. Doty Street, Ste. 800  
Madison, WI 53703  
Email: lbensky@bensskylaw.com

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mail.

c/o James C. Owen  
McCarthy, Leonard & Kaemmerer  
400 S. Woods Mill Road  
Chesterfield, MO 63017  
Email: jowen@mlklaw.com

*Wilmington Trust Co./Wilmington  
Trust FSB*  
c/o Jane C. Schlicht  
Cook & Franke S.C.  
660 E. Mason Street  
Milwaukee, WI 53202  
Email: schlicht@cf-law.com

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mail.

c/o Michael E. Johnson  
William B. Macurda  
Cele Ogawa  
Alston & Bird LLP  
90 Park Avenue  
New York, NY 10016  
Email:  
michael.johnson@alston.com  
Email: bill.macurda@alston.com  
Email: cele.ogawa@alston.com

*Bank of America*  
c/o Jane C. Schlicht  
Cook & Franke S.C.  
660 East Mason Street  
Milwaukee, WI 53202-3877  
Email: schlicht@cf-law.com

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Michael E. Johnson  
William B. Macurda  
Cele Ogawa  
Brian Cox  
Alston & Bird LLP  
90 Park Avenue  
New York, NY 10016  
Email:  
michael.johnson@alston.com  
Email: bill.macurda@alston.com  
Email: cele.ogawa@alston.com  
Email: brian.cox@alston.com

*Assured Guaranty Corp. &  
Goldman Sachs & Co., Inc.*  
James E. Bartzen  
Earl H. Munson  
Boardman Suhr Curry & Field LLP  
One S. Pinckney Street, Ste. 400  
P.O. Box 927  
Madison, WI 53701-0927  
Email:  
emunson@boardmanlawfirm.com  
Email:  
jbartzen@boardmanlawfirm.com

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CN Franklin Reddick III  
Akin Gump Strauss Haver & Feld  
2029 Century Park East, Ste. 2400  
Los Angeles, CA 90067  
Email: freddick@akingump.com

*KnowledgeWorks Foundation, As  
The Administrator of the Ohio  
Centric Student Loan Program  
AND  
Treasurer of the State of Ohio*  
c/o Melissa A. Kern  
Frost Brown Todd LLC  
1103 Boundary Road  
Middleton, WI 53562  
Email: mkern@fbtlaw.com

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mail.

c/o Greg E. Mitchell  
Frost Brown Todd LLC  
2800 Lexington Financial Center  
250 W. Main Street  
Lexington, KY 40507  
Email: gmittell@fbtlaw.com

c/o Jeffrey A. Lipps  
Joel E. Sechler  
Carpenter Lipps & Leland LLP  
280 Plaza Suite 1300  
280 N. High Street  
Columbus, OH 43215  
Email: lipps@carpenterlipps.com  
Email: sechler@carpenterlipps.com

*PNC Corporation AND Customer  
Asset Protection Company  
("CAPCO")*  
c/o John Franke  
Gass Weber Mullins LLC  
309 N. Water Street, Ste. 700  
Milwaukee, WI 53202  
Email:  
franke@gasswebermullins.com

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mail.

c/o Peter D. Laun  
Jones Day  
500 Grant Street, Ste. 4500  
Pittsburgh, PA 15219  
Email: pdlaun@jonesday.com

*Attorneys for U.S.A.*  
c/o Robert J. Kovacev  
Hilarie Snyder  
Tax Division, U.S. Dept. of Justice  
P.O. Box 7238  
Washington, DC 20044  
Email:  
Robert.j.kovacev@usdoj.gov  
Email: hilarie.e.snyder@usdog.gov

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*Countrywide Home Loans  
Servicing L.P.*  
c/o Bruce G. Arnold  
Whyte Hirschboeck Dudek S.C.  
555 E. Wells Street, Suite 1900  
Milwaukee, WI 53202-3819  
Email: barnold@whdlaw.com

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mail.

c/o Thomas M. Pyper  
Cynthia L. Buchko  
Whyte Hirschboeck Dudek S.C.  
333 E. Main Street, Suite 300  
Madison, WI 53703  
Email: tpyper@whdlaw.com  
Email: cbuchko@whdlaw.com

*HSBC Bank U.S.A. N.A.*  
c/o Randall D. Crocker  
Susan E. Lovern  
von Briesen & Roper, s.c.  
411 E. Wisconsin Ave., Suite 700  
P.O. Box 3262  
Milwaukee, WI, 53201-3262  
Email: rcrocker@vonbriesen.com  
Email: slovern@vonbriesen.com

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mail.

Christopher J. Stroebel  
von Briesen & Roper, s.c.  
Three S. Pinckney Street, Ste. 1000  
Madison, WI 53703  
Email: cstroebel@vonbriesen.com

Pieter Van Tol  
Hogan Lovells US LLP  
875 Third Avenue  
New York, NY 10022  
Email:  
pieter.vantol@hoganlovells.com

*The Bank Insureds*  
c/o James A. Friedman  
Brady Williamson  
Anthony G. Gaughan  
Godfrey & Kahn, S.C.  
P.O. Box 2719  
Madison, WI 53701-2719  
Email: jfriedman@gklaw.com  
Email: bwilliamson@gklaw.com  
Email: agaughan@gklaw.com

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Michael P. Carroll  
Donald S. Bernstein  
Avi Gesser  
Davis Polk & Wardwell LLP  
450 Lexington Avenue  
New York, NY 10017  
Email:  
donald.bernstein@davispolk.com  
Email:  
michael.carroll@davispolk.com  
Email: avi.gesser@davispolk.com

/s/ Nathan L. Moenck  
Nathan L. Moenck