

In the Matter of the Rehabilitation of:

Case No. 10 CV 1576

Segregated Account of Ambac Assurance Corporation

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**BRIEF BY WELLS FARGO BANK, NATIONAL ASSOCIATION,  
IN ITS CAPACITY AS TRUSTEE FOR THE BENEFIT AND PROTECTION  
OF CERTAIN BONDHOLDERS, IN SUPPORT OF ITS MOTION TO MODIFY  
TEMPORARY INJUNCTION ORDER AND TO INTERVENE**

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MURPHY DESMOND S.C.

Stephen L. Morgan, SBN 1015099

Brittany S. Ogden, SBN 1035853

*Attorneys for Wells Fargo Bank, National  
Association, in Its Capacity as Trustee for the  
Benefit and Protection of the Bondholders*

Stephen L. Morgan, SBN 1015099

Brittany S. Ogden, SBN 1035853

MURPHY DESMOND S.C.

33 East Main Street, Suite 500

Madison, Wisconsin 53703

Telephone: (608) 257-7181

Facsimile: (608) 257-4333

Steven T. Whitmer (06244114)

Kevin A. Wisniewski (06294107)

LOCKE LORD BISSELL & LIDDELL LLP

111 South Wacker Drive

Chicago, Illinois 60606

Telephone: (312) 443-1869

Facsimile: (312) 896-6569

## INTRODUCTION

Wells Fargo Bank, National Association (the “Bondholders Trustee”), submits this brief in its capacity as trustee for the benefit and protection of certain bondholders (“Bondholders”). The Bondholders Trustee respectfully moves this Court to modify the temporary injunction entered on March 24, 2010 (the “Temporary Injunction”), and to grant the Bondholders Trustee leave to intervene in this action to object to recent pre-Rehabilitation Order actions by Ambac Assurance Corporation (“Ambac”) and the Commissioner of Insurance for the State of Wisconsin (the “Commissioner”). The actions by Ambac and the Commissioner leading up to March 24, 2010 severely and inequitably prejudiced the Bondholders’ legal rights with respect to their insurance contracts issued by Ambac (the “Bondholders’ Policies”).

The Bondholders Trustee’s objections arise out of Ambac’s March 21, 2010 decision, with the approval of the Commissioner, to establish a Segregated Account pursuant to Wis. Stat. § 611.24, and to transfer the Bondholders’ Policies to the Segregated Account before this Court entered the Rehabilitation Order on March 24, 2010. To our knowledge, the Bondholders’ Policies are the only municipal bond insurance contracts Ambac transferred to the Segregated Account. All the other insurance contracts Ambac transferred to the Segregated Account relate to credit default swaps, residential mortgage backed securities and similar toxic risks.

The record to date shows that Ambac and the Commissioner have been reviewing restructurings for many months. Ambac and the Commissioner have also had discussions with other policyholders. (*See* Commissioner’s March 24, 2010 Verified Petition for Order of Rehabilitation (the “Petition for Rehabilitation”) at 4.) However, no one gave the Bondholders Trustee *any* advance notice, sought the Bondholders Trustee’s consent, or offered the Bondholders Trustee any consideration for moving the Bondholders’ Policies to the Segregated

Account. (Wilkinson Dec., Ex. A. at ¶¶ 13-14.) Instead, on March 21, 2010, the Commissioner and Ambac, an insurance company with \$8.5 billion in assets, unilaterally transferred the Bondholders' Policies to the Segregated Account, an account capitalized with a non-marketable \$2 billion dollar note with questionable value issued by Ambac, and non-marketable interests in certain affiliated limited liability companies. (See Plan of Operation at 3-4.) This was done solely for the purpose of substituting the Segregated Account in place of Ambac's obligations to the Bondholders under the Bondholders' Policies.

There are four reasons why Ambac's and the Commissioner's transfer of the Bondholders' Policies to the Segregated Account was illegal and therefore ineffectual:

1. Under well-established Wisconsin law, the attempt by Ambac and the Commissioner to transfer the Bondholders' Policies to the Segregated Account prior to the Order of Rehabilitation, without notice, without the Bondholders Trustee's consent and without providing the Bondholders with any consideration, was an ineffective novation. *Navine v. Peltier*, 48 Wis.2d 588, 594, 180 N.W.2d 613 (1970).
2. The transfer violated statutory requirements for the formation of a "Segregated Account" because the Segregated Account did not have adequate capital and surplus at the time it was formed. Wis. Stat. § 611.24(3)(a). Accordingly, Ambac did not create the Segregated Account in accordance with statutory requirements and its creation was therefore a nullity.
3. The Commissioner exceeded the authority given to him by the Wisconsin legislature in the Wisconsin Insurance Code when he attempted to modify Ambac's obligations before the rehabilitation proceeding and outside the supervision of this Court.
4. The Commissioner violated the Constitutions of the United States and Wisconsin when he approved the Segregated Account and the transfer of the Bondholders' Policies to that account, because he did not provide the Bondholders with any just compensation or due process, and because he treated the Bondholders differently from other similarly situated municipal bondholder insureds.

Accordingly, for these reasons, as set forth below in more detail, the Bondholders Trustee respectfully requests that the Court modify the Temporary Injunction and remove the Bondholders' Policies from the Segregated Account and return the policies to Ambac's General Account.

### **BACKGROUND**

In September 2000, the Director of the State of Nevada Department of Business and Industry issued numerous bonds to the Bondholders. (Wilkinson Dec., Ex. A at ¶ 2.) Since the time the bonds were issued, the Bondholders Trustee has acted as trustee for the benefit and protection of the Bondholders. *Id.* at ¶ 3. The bonds were issued for financing, in part, the construction of a four-mile monorail system, which is owned and operated by the Las Vegas Monorail Company (the "Monorail Company"). *Id.* at ¶ 6. The Monorail Company filed its voluntary petition for Chapter 11 bankruptcy protection on January 13, 2010. *Id.*<sup>1</sup>

At the time they were issued, Standard & Poor's, Moody's and Fitch IBCA, Inc. assigned the First Tier Bonds their highest ratings of "AAA," "Aaa" and "AAA," respectively, because they were insured by Ambac. *Id.* at ¶ 10. Many of the Bondholders are small, individual "mom and pop-type" investors who were seeking extremely safe investments. *Id.* at 7. For example,

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<sup>1</sup> The Bondholders Trustee serves as trustee under a Senior Indenture, dated as of September 1, 2000, between the Bondholders Trustee and the Director of the State of Nevada Department of Business and Industry, pursuant to which the Issuer's First Tier bonds (the "First Tier Bonds") were issued and are outstanding. (Wilkinson Dec., Ex. A at ¶ 5.) The proceeds of the First Tier Bonds were used for financing, in part, the acquisition, construction, improvement and/or equipping of a four-mile monorail system. *Id.* at ¶ 6. The Bondholders Trustee is vested with the sole authority to represent and to enforce the rights of the beneficiary Bondholders. *Id.* at ¶¶ 3, 5. Ambac issued a municipal bond insurance policy that insures payment of the principal and interest and accreted value on the First Tier Bonds when such payments are due. *Id.* at ¶ 8. In addition, Ambac issued a Surety Bond representing one-half of the Debit Service Reserve Requirement for the First Tier Bonds. *Id.* at ¶ 9. The Surety Bond guarantees payment of principal and interest on the First Tier Bonds, up to the maximum surety bond coverage. *Id.*

the investment purpose of the bonds for many of the Bondholders was college or retirement savings. *Id.*

Ambac Issues Insurance for the Bondholders.

At the time the bonds were issued, Ambac, a Wisconsin-domiciled stock insurance corporation, issued a \$451,448,217 municipal bond insurance policy (the “Bond Insurance Policy”), which insures payment of the principal and interest amounts to the Bondholders. *Id.* at ¶ 8. In addition, Ambac issued a \$20,991,807.50 Surety Bond (the “Surety Bond”), which guarantees payment of principal and interest amounts up to the maximum surety bond limits. *Id.* at ¶ 9. The Bond Insurance Policy and the Surety Bond are collectively referred to herein as the “Bondholders’ Policies.” Ambac estimates that its total ultimate exposure under the Bondholders’ Policies, including interest and accreted value, is approximately **\$1,163,435,771.15**. (*See* January 13, 2010 Declaration of Ambac Vice-President of Restructuring Group, Scott Zuchorski, Ex. B at 5.)

According to information presented by the Commissioner in this proceeding, around 2008, Ambac stopped writing new policies because of its deteriorating financial condition and lowered credit rating. (*See* Commissioner’s March 24, 2010 Brief in Support of Entry of Order for Rehabilitation (the “Rehabilitation Brief”) at 1-6.) At the same time, Ambac’s liabilities mounted as a number of policyholders either brought policy claims or were projected to have substantial policy claims in the near future. *Id.* These conditions led to the real possibility that Ambac would be unable to satisfy all claims made under the outstanding insurance policies. *Id.* Thus, around 2008, the Commissioner began conferring with Ambac regarding options to address its mounting financial obligations and deteriorating financial assets. *Id.*

Ambac Transfers the Bondholders' Policies To the Segregated Account.

On March 21, 2010, Ambac's board of directors, with the Commissioner's approval, voted to: (1) establish the Segregated Account that is the subject of this proceeding; and (2) take the Bondholders' Policies out of Ambac's General Account and transfer those policies to the Segregated Account, along with other liabilities. (See Petition for Rehabilitation at 8.) When deciding which liabilities should be transferred to the Segregated Account, Ambac claims to have targeted toxic risks with "material projected impairments," such as residential mortgage-backed securities ("RMBS"), collateralized debt obligations and credit default swaps. (Rehabilitation Brief at 3-4.) As explained by the Commissioner, the reason these toxic risks were transferred to the Segregated Account was to "bring [ ] stability and certainty to those policyholders that are in the general account, because they're no longer worried about RMBS eating up all the claims." (March 25, 2010 Associated Press Article, Ex. C.) But, along with these toxic risks, Ambac chose to transfer the Bondholders' Policies to the Segregated Account.

Ambac did not provide the Bondholders with any consideration in exchange for the transfer of the Bondholders' Policies to the Segregated Account, nor did Ambac provide the Bondholders Trustee with prior notice of the transfer. (Wilkinson Dec., Ex. A at ¶¶ 13-14.) Instead, the Bondholders Trustee first learned of this transfer on March 25, 2010, after the Rehabilitation Order became public. *Id.* The Bondholders Trustee has not, and does not, consent to the Bondholders' Policies being placed in the Segregated Account. *Id.* at ¶ 15. Nevertheless, pursuant to the resolution of the Ambac board, the Segregated Account purportedly became effective on March 24, 2010.

The Segregated Account Is Placed Into Rehabilitation  
and The Court Issues Temporary Injunction.

Hours after the Bondholders' Policies were transferred to the Segregated Account on March 24, 2010, the Commissioner petitioned this Court for an order to place the Segregated Account into this rehabilitation proceeding. According to the Commissioner, the Ambac board of directors authorized the initiation of these proceedings for the rehabilitation of the Segregated Account. This Court granted the Commissioner's petition and placed the Segregated Account into rehabilitation pursuant to Wis. Stat. § 645.32. According to that Order, all matters relating to the Segregated Account must be brought before this Court.

On March 24, 2010, this Court issued the Temporary Injunction, which enjoined certain actions by policyholders and other third parties having interests in the Segregated Account. The Temporary Injunction states the following:

This Order shall remain effective until further order of the Court. If any interested parties believe any portion of this Order is unwarranted by the facts or the law, such parties may seek modification or dissolution of part or all of this Order by filing a written motion with this Court no later than 90 days following the issuance of this Order. If one or more such timely motions are received, the Court may set a schedule for responsive briefing and a hearing regarding the modifications or dissolutions sought . . . .

(Temporary Injunction at 13-14 (emphasis added).)

The Bondholders Trustee, which is unquestionably an "interested party" affected by the Temporary Injunction, now moves this Court to modify the Temporary Injunction and remove the Bondholders' Policies from the Segregated Account and return the policies to Ambac's General Account.

## ARGUMENT

There are four reasons why the Court should modify the Temporary Injunction and give the Bondholders Trustee leave to intervene in this case: (1) Ambac's attempted novation of the Bondholders' Policies was ineffective as a matter of law; (2) the Segregated Account is a nullity because it was not formed in compliance with Wisconsin law; (3) the Commissioner exceeded his authority; and (4) the Commissioner's actions violated the Constitutions of the United States and Wisconsin. The Bondholders Trustee addresses each of these four points below.

### **I. AMBAC'S ATTEMPTED NOVATION OF THE BONDHOLDERS' POLICIES WAS INEFFECTIVE UNDER THE LAW.**

Under well-established Wisconsin law, Ambac's attempt to transfer the Bondholders' Policies to the Segregated Account before this Court entered the Rehabilitation Order on March 24, 2010, without notice, without the Bondholders Trustee's consent and without providing the Bondholders with *any* consideration, was an ineffective novation.

In Wisconsin, a "novation" occurs when there is a "substitution of obligations between the same parties as well as by substitution of parties." *Navine*, 48 Wis.2d at 594; *see also Siva Truck Leasing, Inc. v. Kurman Distributors, Div. of S. Abraham & Sons, Inc.*, 166 Wis.2d 58, 67, 479 N.W.2d 542 (Ct. App. 1991) ("Wisconsin recognizes novation by either substitution of obligations between the same parties or by substitution of parties").

For a novation to be effective, the burden is on the party alleging that a novation occurred to establish two points. First, "[a] clear showing of consent to a novation, either express or implied, is a prerequisite to a finding that a novation occurred." *Navine*, 48 Wis. 2d at 594. Without mutual consent, there is no novation as a matter of law. *See M & I Marshall & Ilsley Bank v. New England Builders, Inc.*, 2010 WL 173897, ¶18 (Ct. App., Jan. 20, 2010) (publication pending) ("In order to establish a novation, among other things, a party must

establish the parties' consent to the substitution of obligations"). Second, the party seeking to establish a novation must demonstrate sufficient consideration to support the new obligation. *Siva Truck Leasing, Inc.*, 166 Wis.2d at 68; *Navine*, 48 Wis.2d at 597 (finding insufficient consideration defeated claim for novation).

Here, the Bondholders' Policies were contractual agreements between the Bondholders and Ambac. When Ambac transferred the Bondholders' Policies to the Segregated Account, it attempted both the "substitution of obligations between the same parties as well as by substitution of parties." *Navine*, 48 Wis.2d at 594. Specifically, Ambac substituted its obligation to the Bondholders, and also substituted the obligor with whom the Bondholders contracted – *i.e.*, Ambac, a large insurance company – with an obligor with whom the Bondholders did *not* contract – *i.e.*, the Segregated Account, an account filled with toxic risks and questionable assets. This activity occurred before the Commissioner had any rehabilitation authority. Currently, Ambac is reporting a policyholders' surplus of nearly \$892 million and assets of \$8.5 billion. The Segregated Account, on the other hand, is capitalized by a \$2 billion note that contains numerous restrictions on its payout, and appears to have no capital or surplus. (See Plan of Operation at 3-4.) In addition, Ambac will enter into a reinsurance agreement with the Segregated Account with extremely high coverage triggers and other restrictions that put in question whether there is any legitimate risk transfer. *Id.*

At no time did the Bondholders Trustee give its consent, either express or implied, to the attempted novation. (Wilkinson Dec., Ex. A at ¶ 15.) In fact, the Bondholders Trustee first learned that Ambac was purportedly no longer the Bondholders' obligor only *after* the Ambac board of directors unilaterally transferred the Bondholders' Policies to the Segregated Account and *after* the Commissioner placed the Segregated Account into rehabilitation. *Id.* at ¶ 14.

There would have been no reason for the Bondholders Trustee to consent to the Bondholders being treated so much differently than the other policyholders of Ambac. No creditor without notice or consultation would elect to exchange an obligor holding \$8.5 billion in assets for one with no cash, marketable securities or other liquid assets. For Ambac and the Commissioner to deny the Bondholders full coverage, and at the same time apparently treat other municipal bondholders differently, is not contemplated by any law of contracts, statutory provisions of the Insurance Code or basic common sense. In addition, to treat the Bondholders differently from other similar policyholders violates the precise intent of Wis. Stat. § 645.01(4)(d), which requires treating the Bondholders to “[e]quitable apportionment of any unavoidable loss.”

In sum, for these reasons, Ambac’s transfer of the Bondholders’ Policies to the Segregated Account was an ineffective novation under the law. Accordingly, as a matter of law, there was no novation. *Navine*, 48 Wis.2d at 597. The Bondholders Trustee therefore respectfully requests that the Court modify the Temporary Injunction and remove the Bondholders’ Policies from the Segregated Account and return the policies to Ambac’s General Account.

**II. THE SEGREGATED ACCOUNT IS A NULLITY BECAUSE IT WAS NOT FORMED IN COMPLIANCE WITH WISCONSIN LAW.**

The pre-Rehabilitation Order actions by Ambac and the Commissioner also violate statutory requirements for the formation of a “Segregated Account.” Under Wisconsin law, a corporation seeking to form a Segregated Account must meet specified requirements. For example, the corporation must obtain the approval of the Commissioner, and the assets and liabilities of the account must remain separate and apart from those of the corporation. Wis. Stat.

§ 611.24(2), (3)(c). In addition, the Segregated Account must “*have and maintain*” adequate capital and surplus to cover the account’s liabilities. Wis. Stat. § 611.24(3)(a) (emphasis added).

The Segregated Account, created by Ambac and approved by the Commissioner before this Court entered the Rehabilitation Order on March 24, 2010, was clearly not established with, and does not currently maintain, adequate capital or surplus. The Plan of Operation for the Segregated Account claims that “there is an adequate amount of capital and surplus in the Segregated Account pursuant to Wis. Stat. § 611.24(3)(a).” (See Plan of Operation (attached as Tab 1 to Petition for Rehabilitation) at 4.) The Segregated Account, however, is capitalized only with a non-marketable \$2 billion dollar note with questionable value issued by Ambac and non-marketable interests in certain affiliated limited liability companies. *Id.* at 3-4. It has no cash or marketable securities or other liquid assets. *Id.* This note and the interests in the limited liability companies cannot possibly be sufficient assets to support the liabilities that have been transferred to the Segregated Account, and should not be eligible for booking as an admitted asset of the Segregated Account under statutory accounting principles. This is proven by the fact that, just hours after the Segregated Account was formed, the Commissioner determined that the Segregated Account for all intents and purposes was a financially disabled insurer, and advised the Court that:

The Segregated Account is in such condition that the further transaction of business without rehabilitation would be hazardous, financially or otherwise, to its policyholders, its creditors or the public.

(Petition for Rehabilitation at 8.) The Segregated Account could not have had adequate capital and surplus in the morning of March 24, 2010, if it was financially “hazardous” to its policyholders in the afternoon of that same day.

Because the Segregated Account did not have adequate capital and surplus at the time it was formed, the provisions of Wis. Stat. § 611.24(3)(a) were not satisfied. Accordingly, the Commissioner's approval and Ambac's establishment of the Segregated Account were a nullity. *See, e.g., Aetna Life Ins. Co. v. Mitchell*, 101 Wis.2d 90, 108, 113-14, 303 N.W.2d 639 (1981) (commissioner's rules promulgated in violation of statute were a nullity because the "Commissioner is never at liberty to substitute her judgment when the legislature has spoken in unambiguous terms. . ."). The Court should therefore order the Commissioner to remove the Bondholders' Policies from the Segregated Account and return them to Ambac's General Account.

**III. THE COMMISSIONER EXCEEDED HIS AUTHORITY WHEN HE ATTEMPTED TO MODIFY AMBAC'S OBLIGATIONS PRIOR TO THE ENTRY OF THE REHABILITATION ORDER.**

The Commissioner only has the power and authority given him by the Wisconsin legislature in the Wisconsin Insurance Code. *See Duel v. State Farm Mut. Auto. Ins. Co.*, 240 Wis. 161, 170, 1 N.W.2d 871 (1942) ("[T]he insurance commissioner has only such powers as are conferred by statute and [ ] these must be found within the four corners of the statute."). The Insurance Code sets out the Commissioner's authority separately as Commissioner and as Rehabilitator. *See generally Allianz Underwriters Ins. Co. v. Crescent Garage, Inc.*, 145 Wis.2d 287, 293, 426 N.W.2d 104 (Ct. App. 1988) (discussing the Commissioner's statutory authority as Rehabilitator).

As Rehabilitator, the Commissioner admittedly has broad power to reorder the estate's obligations to maximize distribution of the assets to all creditors fairly. However, the Ambac board's action (at the direction of the Commissioner in his capacity as Commissioner, not in his capacity as Rehabilitator) attempted to modify Ambac's obligations outside the rehabilitation

proceeding and outside the supervision of this Court. Effectively, the Commissioner, acting in his capacity as Commissioner, executed a key part of the rehabilitation plan without first placing Ambac in rehabilitation, without finalizing a plan of rehabilitation and without the statutorily mandated supervision of this Court. The Commissioner therefore exceeded his authority, and the actions he took beyond his authority are a nullity. *See, e.g., Wis. Compensation Rating & Inspection Bureau v. Mortensen*, 227 Wis. 335, 277 N.W. 679, 86 (1938) (insurance commissioner's actions in violation of statute were void because he "acted without and in excess of his powers").

**IV. THE TRANSFER OF THE BONDHOLDERS' POLICIES TO THE SEGREGATED ACCOUNT VIOLATES THE CONSTITUTIONS OF THE UNITED STATES AND WISCONSIN.**

The Commissioner violated the Constitutions of the United States and Wisconsin when he approved the Segregated Account and the transfer of the Bondholders' Policies to that account, because (1) he took the Bondholders' property without providing just compensation; (2) he did not provide the Bondholders due process; and (3) he improperly treated the Bondholders differently from the other municipal bondholder insureds.

**A. The Commissioner took the Bondholders' property without providing just compensation.**

The Commissioner's actions resulted in an unconstitutional "taking." It is axiomatic that the Constitutions of the United States and Wisconsin prohibit the Commissioner from taking the Bondholders' private property for public use, without providing just compensation. U.S. Const. amend. V, cl. 5 (private property shall not "be taken for public use, without just

compensation”);<sup>2</sup> Wis. Const. art. I, § 13 (“The property of no person shall be taken for public use without just compensation therefor”).

The Bondholders have a valid and constitutionally protected property interest in their insurance contracts with Ambac. *See, e.g., U.S. Trust Co. of N.Y. v. N.J.*, 431 U.S. 1, 19 n.16, 97 S.Ct. 1505 (1972), *reh’g denied*, 431 U.S. 975, 97 S.Ct. 2942 (1977) (“Contract rights are a form of property and as such may be taken for a public purpose provided that just compensation is paid.”); *Wis. Retired Teachers Ass’n, Inc. v. Employee Trust Funds Bd.*, 207 Wis.2d 1, 18, 558 N.W.2d 83 (1997) (recognizing that individuals have constitutionally-protected property interests in contractual rights).

When the Ambac board created and the Commissioner approved the Segregated Account, that action was taken, as a matter of law, on behalf of Wisconsin. *See, e.g., Zinn v. State*, 112 Wis.2d 417, 426-27, 334 N.W.2d 67 (1983) (state agency violated the Wisconsin Constitution when in the exercise of its statutory authority it took private property for public use without just compensation). Indeed, over the course of two years, the Commissioner worked closely with Ambac to create the Segregated Account, which the Commissioner then approved pursuant to Wis. Stat. § 611.24. Through his “extensive involvement” in implementing Ambac’s multi-step restructuring plan, the Commissioner was also apparently intricately involved in selecting which of Ambac’s liabilities should, and should not, be transferred to the Segregated Account. (*See Rehabilitation Brief at 3.*)

The actions the Commissioner took on behalf of Wisconsin severely impaired the Bondholders’ contract rights. Under the Bondholders’ Policies, the Bondholders had a

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<sup>2</sup> This constitutional principle is made applicable to the states by the Fourteenth Amendment. *See, e.g., Kelo v. City of New London*, 545 U.S. 469, 472 n. 1, 125 S.Ct. 2655, 2658 n. 1 (2005).

contractual right to make claims against an insurer with a policyholders' surplus of nearly \$892 million and assets of \$8.5 billion. The Commissioner took that contractual right and substituted it with new contracts requiring the Bondholders to make claims only against the Segregated Account that appears to have no capital or surplus.

There is no dispute that the Commissioner formed the Segregated Account for the use and benefit of the public. The Commissioner underscores this point in his recent submission to this Court:

[T]he creation and rehabilitation of the Segregated Account offers the greatest protection and most equitable treatment of policyholders, creditors, and the public given the deteriorating financial condition of Ambac and the varying terms and risks associated with the policies allocated to the Segregated Account.

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These restructuring efforts have sought to protect the interests of all policyholders and the public by maximizing policyholder claims payment resources and avoiding punitive termination provisions, by providing an orderly and equitable claims payment process, and by minimizing disruptions in cover to the greatest possible extent.

(Rehabilitation Brief at 1, 20 (emphasis added).)

Because the Commissioner took these actions for the public, he was required to provide the Bondholders with "just compensation." *See, e.g., U.S. Trust Co. of N.Y.*, 431 U.S. at 19 n.16 ("Contract rights are a form of property and as such may be taken for a public purpose provided that just compensation is paid.") The Commissioner did not provide the Bondholders with *any* compensation, however, even though his actions likely diminished the Bondholders' contract rights by hundreds of millions of dollars.

**B. The Commissioner did not provide the Bondholders due process.**

When the Commissioner took these actions, he did not provide the Bondholders with *any* due process. Although the Commissioner had discussions with other policyholders before creating and approving the Segregated Account (*see* Petition for Rehabilitation at 4), he did not give the Bondholders Trustee advance notice or seek the Bondholders Trustee's consent. (Wilkinson Dec., Ex. A at ¶ 14.) This was a violation of the Due Process Clauses of the federal and state Constitutions. *See* U.S. Const. amend. XIV, § 1; Wis. Const. art. I, § 1; *County of Kenosha v. C&S Management, Inc.*, 223 Wis.2d 373, 393, 588 N.W.2d 236 (1999) (“While the language used in the two constitutions [the United States and Wisconsin’s] is not identical ... the two provide identical procedural due process protection.”).

The Commissioner cannot remedy his constitutional violations through an after-the-fact hearing, because the Bondholders were entitled to notice and an opportunity for a hearing **prior** to the state’s deprivation of their property rights. *See Logan v. Zimmerman Brush Co.*, 455 U.S. 422, 436, 102 S.Ct. 1148 (1982);<sup>3</sup> *see also Milwaukee Dist. Council 48 v. Milwaukee County*, 2001 WI 65, ¶48, 244 Wis.2d 333, 627 N.W.2d 866 (“The fundamental requisite of due process of law is the opportunity to be heard”) (citations omitted). Indeed, the Commissioner was required to give the Bondholders a hearing at a “meaningful time and in a meaningful manner.” *Milwaukee Dist. Council 48*, 2001 WI at ¶48 (citations omitted); *Capoun Revoc. Trust v. Ansari*, 2000 WI App. 83, ¶¶15-18, 234 Wis.2d 335, 610 N.W.2d 129.

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<sup>3</sup> A post-deprivation hearing is only constitutionally adequate in limited and extreme circumstances, such as where a pre-deprivation hearing was not possible. *See Logan*, 455 U.S. at 436 (“absent ‘the necessity of quick action by the State or the impracticality of providing any predeprivation process,’ a post-deprivation hearing ... would be constitutionally inadequate.”) (citations omitted). Here, where the Commissioner has been reviewing restructurings for two years (*see* Rehabilitation Brief at 2-3), he cannot reasonably contend that a pre-deprivation hearing was not possible.

**C. The Commissioner Treated the Bondholders differently.**

The Commissioner's actions contravene the Equal Protection Clauses of the Constitutions because he treated the Bondholders differently from other similarly situated municipal bondholders. *State ex rel. O'Neil v. Town of Hallie*, 19 Wis.2d 558, 567, 120 N.W.2d 641 (1963) (the Equal Protection Clause of the 14th Amendment is violated when a statute is "applied and administered by public authority with an evil eye and an unequal hand, so as practically to make unjust and illegal discriminations between persons in similar circumstances, material to their rights . . ." (citing *Yick Wo v. Hopkins*, 118 U.S. 356, 6 S.Ct. 1064 (1886))).

According to the Chairman of Ambac's Board, "virtually the entire insured municipal portfolio remains outside the rehabilitation proceedings." (See Ambac's March 25, 2010 Press Release, Ex. D). Nevertheless, the Commissioner chose to place the Bondholders' First Tier municipal bonds in the Segregated Account, along with toxic risks such as credit default swaps and residential mortgage backed securities. Apparently, the sole basis for the Commissioner's decision was that the Bondholders' claims are imminent and substantial, while the other municipal bondholder insureds' claims are not. That was not a valid legal basis for the Commissioner's disparate treatment of the Bondholders.

In sum, because the Commissioner's actions violated the Bondholders' constitutional property, due process and equal protection rights, those actions had no legal effect. *Bohlman v. Green Bay & M. Ry. Co.*, 40 Wis. 157, 1876 WL 3915, at \*3 (1876) (commissioner's award violated the constitution and was therefore void). The Court should modify the Temporary Injunction and remove the Bondholders' insurance contracts from the Segregated Account and return the contracts to Ambac's General Account.

**CONCLUSION**

For these reasons, the Bondholders Trustee respectfully requests that the Court (1) modify the Temporary Injunction and grant the Bondholders Trustee leave to intervene, (2) enter an Order removing the Bondholders' Policies from the Segregated Account and return those policies to Ambac's General Account, and (3) grant such other and further relief as the Court deems necessary.

**MURPHY DESMOND S.C.**

*Attorneys for Wells Fargo Bank, National  
Association, in Its Capacity as Trustee of the  
Bondholders*

By: 

Stephen L. Morgan  
State Bar Number: 1015099

Brittany S. Ogden  
State Bar Number: 1035853  
33 East Main Street, Suite 500  
Madison, Wisconsin 53703  
Telephone: (608) 257-7181  
Facsimile: (608) 257-4333

Steven T. Whitmer (06244114)  
Kevin A. Wisniewski (06294107)  
LOCKE LORD BISSELL & LIDDELL LLP  
111 South Wacker Drive  
Chicago, Illinois 60606  
Telephone: (312) 443-1869  
Facsimile: (312) 896-6569

In the Matter of the Rehabilitation of:

Case No. 10 CV 1576

Segregated Account of Ambac Assurance Corporation

**DECLARATION OF GAVIN WILKINSON IN SUPPORT OF WELLS FARGO BANK, NATIONAL ASSOCIATION, IN ITS CAPACITY AS TRUSTEE FOR THE BENEFIT AND PROTECTION OF CERTAIN BONDHOLDERS, IN SUPPORT OF ITS MOTION TO MODIFY TEMPORARY INJUNCTION AND TO INTERVENE**

State of Minnesota    )  
                                          ) ss  
County of Hennepin    )

Gavin Wilkinson, being first duly sworn, on oath, deposes and states as follows in this

Declaration:

1. I am over 21 and am competent to testify. If called, I would testify consistently with this Declaration. All testimony is based on my own personal knowledge, unless otherwise noted.

2. I am a Vice President for Corporate Trust Services at Wells Fargo Bank, National Association, which is the indenture trustee (the "Bondholders Trustee") on the First Tier bonds (the "First Tier Bonds") issued to certain bondholders (the "Bondholders") in September 2000 by the Director of the Nevada Department of Business and Industry for the benefit of the Las Vegas Monorail Company.

3. One of my job responsibilities in my role as Vice President for Corporate Trust Services is to oversee the proper administration of the First Tier Bonds. Since September 2000, the Bondholders Trustee has acted for the benefit and protection of the Bondholders.

4. I make this declaration in support of the Bondholders Trustee's April 5, 2010 Motion to Modify Injunction and to Intervene.

The First Tier Municipal and Surety Bonds

5. The Bondholders Trustee serves as trustee under a Senior Indenture, dated as of September 1, 2000, between the Bondholders Trustee and the Director of the State of Nevada Department of Business and Industry, pursuant to which the First Tier Bonds were issued and are outstanding.

6. The proceeds of the First Tier Bonds were used for financing, in part, the acquisition, construction, improvement and/or equipping of a four-mile monorail system, which is owned and operated by the Las Vegas Monorail Company (the "Monorail Company"). The Monorail Company filed its voluntary petition for Chapter 11 bankruptcy protection on January 13, 2010.

7. Many of the Bondholders are small, individual "mom and pop-type" investors, who I understand were seeking extremely safe investments. For example, it is my general understanding that the investment purpose of the First Tier Bonds for many of the Bondholders was college or retirement savings.

The Bondholders' Insurance Contracts

8. At the time the First Tier Bonds were issued, Ambac Assurance Corporation ("Ambac") issued a \$451,448,217 municipal bond insurance policy (the "Bond Insurance Policy"), which insures payment of the principal and interest and accreted value on the First Tier

Bonds to the Bondholders. Ambac received substantial premiums for the issuance of the Bond Insurance Policy.

9. In addition, Ambac issued a \$20,991,807.50 Surety Bond (the "Surety Bond"), representing one-half of the "Debit Service Reserve Requirement," which guarantees payment of principal and interest amounts up to the maximum surety bond limits. Ambac also received substantial premiums for the issuance of the Surety Bond. Below, I refer to the Bond Insurance Policy and the Surety Bond collectively as the "Bondholders' Policies."

10. At the time they were issued, Standard & Poor's, Moody's and Fitch IBCA, Inc. assigned the First Tier Bonds their highest ratings of "AAA," "Aaa" and "AAA," respectively, because they were insured by Ambac.

11. The Bondholders Trustee fully expected that, under the Bondholders' Policies, Ambac would make payments on the First Tier Bonds if the Las Vegas Monorail Company did not make the required payments, because Ambac had agreed to make such payments when Ambac issued the policies for substantial premium amounts.

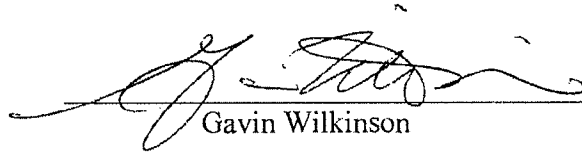
#### The Transfer of the Bondholders' Policies To the Segregated Account

12. From my review of the court filings in this matter, it is my understanding that, on March 21, 2010, Ambac's board of directors, with the approval of the Commissioner of Insurance for the State of Wisconsin, voted to (1) establish the Segregated Account that is the subject of this proceeding, and (2) take the Bondholders' Policies out of Ambac's General Account and transfer those policies to the Segregated Account, along with other liabilities.

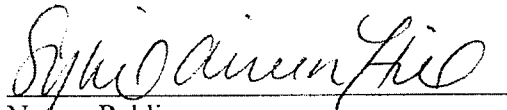
13. Ambac did not provide the Bondholders or the Bondholders Trustee with any consideration in exchange for the transfer of the Bondholders' Policies to the Segregated Account.

14. In addition, Ambac did not provide me or anyone else connected with the Bondholders Trustee with any prior notice of the transfer of the Bondholders' Policies to the Segregated Account. Instead, the Bondholders Trustee first learned of this transfer on March 25, 2010, after the Rehabilitation Order became public.

15. In my capacity as the person who oversees the administration of the First Tier Bonds, the Bondholders Trustee has not and does not consent to the Bondholders' Policies being placed in the Segregated Account.

  
Gavin Wilkinson

Subscribed and sworn to before me this 5th day  
of April, 2010.

  
Notary Public  
State of Minnesota



E-filed January 13, 2010

1 FENNEMORE CRAIG, P.C.  
Laurel E. Davis (NV Bar No. 3005)  
2 Craig S. Dunlap (NV Bar No. 4974)  
Jeffrey S. Steffen (NV Bar No. 9912)  
3 Bank of America Plaza, Suite 1400  
300 South Fourth Street  
4 Las Vegas, Nevada 89101  
Telephone: (702) 692-8000  
5 Facsimile: (702) 692-8064  
ldavis@fclaw.com

6 MCDERMOTT WILL & EMERY LLP  
7 William P. Smith (IL Bar No. 6187205)\*  
James W. Kapp III (IL Bar No. 6239269)\*  
8 Miles W. Hughes (IL Bar No. 6279176)\*  
227 West Monroe Street, Suite 4400  
9 Chicago, Illinois 60606-5096  
Telephone: (312) 372-2000  
10 Facsimile: (312) 984-7700

11 \* Pro Hac Vice Applications Pending  
12 Attorneys for Ambac Assurance Corporation

13 UNITED STATES BANKRUPTCY COURT  
14 DISTRICT OF NEVADA

15 In re  
16 LAS VEGAS MONORAIL COMPANY,  
a Nevada non-profit corporation,  
17 Debtor.

Chapter 11  
No. BK-S-10-10464-LBR  
Date of Hearing: TBD  
Time of Hearing: TBD  
Location: 300 Las Vegas Blvd. South  
Courtroom #1  
Las Vegas, Nevada 89101

21 DECLARATION OF SCOTT ZUCHORSKI IN SUPPORT OF  
22 MOTION OF AMBAC ASSURANCE CORPORATION FOR DISMISSAL  
23 OF CHAPTER 11 PROCEEDING PURSUANT TO 28 U.S.C §1334  
24 AND SECTIONS 109(d) AND 1112(b) OF THE BANKRUPTCY CODE  
25  
26

1 Scott Zuchorski declares as follows:

2 1. My name is Scott Zuchorski. I am currently a Vice-President in the Restructuring  
3 Group at Ambac Assurance Corporation ("Ambac"). I have held this position since the group  
4 was formed in May 2009. Ambac is a Wisconsin-domiciled stock insurance corporation  
5 regulated by the Office of the Commissioner of Insurance of the State of Wisconsin.  
6

7 2. I joined Ambac in July 2002 as an analyst in Ambac's Public Finance Portfolio  
8 Risk Management division. From January 2004 to January 2006, I worked as an Assistant Vice-  
9 President in the same division. In January 2006, I became a Vice-President in the division. I held  
10 such title until May 2009, when I assumed my present position.

11 3. In my current position, I am responsible for the management of Ambac's various  
12 interests in distressed or troubled transactions in Ambac's book of business. I have personally  
13 been involved in the management of Ambac's interests with respect to the Las Vegas Monorail  
14 Company ("LVMC") since August 2005, when I became the surveillance analyst responsible for  
15 the LVMC transaction. Since August 2005, I have, among other things, analyzed the ridership  
16 and revenues of LVMC, visited various locations of LVMC, discussed numerous business and  
17 legal issues with LVMC and its constituency in the State of Nevada, and generally monitored  
18 Ambac's interests with respect to LVMC.  
19

20 4. I make this Declaration in support of Ambac Assurance Corporation's Motion For  
21 Dismissal of Chapter 11 Proceeding Pursuant to 28 U.S.C. § 1334 and Sections 109(d) and  
22 1112(b) of the Bankruptcy Code (the "Motion").<sup>1</sup>  
23  
24  
25

26 <sup>1</sup> All terms not otherwise defined herein shall have the meaning ascribed to such terms in the Motion.

1           5. I have personal knowledge of the facts set forth herein, or have learned these facts  
2 from persons and sources who reported to me or upon whom I relied in the ordinary course of  
3 duties and responsibilities as a Vice-President of the Restructuring Group. The documents  
4 attached to this Declaration were copied or prepared in the ordinary course of business by Ambac  
5 employees. In addition, I am generally familiar with all of the documents referenced in this  
6 Declaration, including, without limitation, the Tax Certificate and Agreement, dated September  
7 20, 2000 (the "Tax Agreement"), between LVMC and the Director of the State of Nevada  
8 Department of Business and Industry (the "Director"), LVMC's Articles of Incorporation, and  
9 LVMC's Bylaws. (True and correct copies of the Tax Agreement, LVMC's Articles of  
10 Incorporation, and LVMC's Bylaws are attached hereto as Exhibits "A", "B" and "C"  
11 respectively).

12  
13  
14           6. If called to testify, I am competent to attest to the facts set forth herein.

15           **LVMC and the Monorail**

16           7. LVMC owns and manages the Las Vegas Monorail (the "Monorail"). The  
17 Monorail is a seven-stop, elevated train system that travels along a 3.9-mile route near the Las  
18 Vegas Strip.

19           8. In 2000, LVMC was organized by the State of Nevada as a nonprofit corporation.  
20 LVMC is exempt from federal income taxation and from state sales and use taxation. LVMC's  
21 Articles of Incorporation provide that LVMC was organized to acquire, develop, operate,  
22 maintain and improve the Monorail, and to obtain financing for the acquisition, construction,  
23 installation, operation, maintenance and improvement of the Monorail. As a tax-exempt  
24

25  
26

1 nonprofit corporation, all of LVMC's property, assets, profits and net revenues are irrevocably  
2 dedicated to the public purposes for which it was formed.

3 9. The Monorail was originally owned by MGM Grand-Bally's Monorail Limited  
4 Liability Company (the "Original Owner"), a joint venture between MGM Grand Monorail, Inc.,  
5 and Bally's Grand, Inc. In 2000, the Original Owner sold the Monorail to LVMC.

6  
7 **LVMC Certifies it is a State Instrumentality in Connection with the Bond Financing**

8 10. LVMC financed its acquisition of the Monorail with the proceeds of the following  
9 three series of tax-exempt governmental bonds issued by the Director: (a) the \$451,448,217.30  
10 original principal amount 1st Tier Series 2000 (the "1st Tier Bonds"); (b) the \$149,200,000  
11 original principal amount 2nd Tier Series 2000 (the "2nd Tier Bonds" and, collectively with the  
12 1st Tier Bonds, the "Senior Bonds"); and (c) the \$48,500,000 original principal amount 3rd Tier  
13 Series 2000.

14  
15 11. In connection with the Director's issuance of the Bonds, LVMC certified,  
16 acknowledged and agreed under Section 1.8 of the Tax Agreement that it is "an instrumentality of  
17 the State of Nevada" and is "controlled by the Governor of the State of Nevada."

18 12. Ambac insured the payment of scheduled amounts of principal and interest on the  
19 1st Tier Bonds pursuant to its Municipal Bond Insurance Policy Number 17548BE, dated  
20 September 20, 2000 (the "Policy"). Ambac also guaranteed payments from the Debt Service  
21 Reserve Fund for the 1st Tier Bonds in an amount not to exceed \$20,991,807.50 under Surety  
22 Bond (No. SB1080BE) (the "Surety") it issued to the Trustee. In addition, Ambac owns \$8.5  
23 million in principal amount of 1st Tier Bonds.  
24  
25  
26

1 13. As of the date of the Motion, Ambac has made payments under the Policy or  
2 Surety in the aggregate amount of \$20,532,771.15 due to LVMC's failure to pay required  
3 installments of interest on the 1st Tier Bonds as and when due under the Financing Agreement  
4 and the Senior Indenture. If LVMC never makes another payment on the 1st Tier Bonds, then  
5 Ambac estimates that its total exposure under the Policy and Surety will be approximately  
6 \$1,163,435,771.15.<sup>2</sup>  
7

8 14. The key documents and agreements relating to the Senior Bonds and LVMC's  
9 ownership and operation of the Monorail are as follows:

- 10 A. The Tax Agreement;
- 11 B. The senior indenture, dated as of September 1, 2000 (the "Senior  
12 Indenture"), between the Director and Wells Fargo Bank, N.A., as Trustee  
13 (the "Trustee"), pursuant to which the Senior Bonds were issued (a true  
14 and correct copy of the Senior Indenture is attached hereto as Exhibit "D");
- 15 C. The financing agreement, dated as of September 1, 2000 (the "**Financing**  
16 **Agreement**"), between the Director and LVMC, pursuant to which the  
17 proceeds of the Bonds were loaned to LVMC (a true and correct copy of  
18 the Financing Agreement is attached hereto as Exhibit "E"); and
- 19 D. The Clark County Monorail Franchise Agreement, dated as of December 2,  
20 1998, between Clark County, Nevada, and MGM Grand-Bally's Limited  
21 Liability Company, under which the Monorail franchise was granted to  
22 LVMC (a true and correct copy of the Clark County Monorail Franchise  
23 Agreement is attached hereto as Exhibit "F").

24 15. The Trustee holds perfected security interests in certain property and interests of  
25 LVMC (collectively, the "Collateral") as security for the payment of the Senior Bonds. The  
26 Collateral consists, in part, of (a) all moneys received by the Director or the Trustee for the  
account of the Director pursuant to the Financing Agreement for the benefit of the Senior Bonds,

<sup>2</sup> This figure includes remaining direct principal and interest exposure claims paid to date.

1 (b) all amounts held in any fund or account established under the Senior Indenture (except for  
2 amounts held in the Indemnification Account of the Contingency Fund or in the Rebate Fund (as  
3 defined in the Financing Agreement)) (the "Trust Funds"), (c) rights under certain of LVMC's  
4 contracts, and (d) proceeds of the foregoing, including Project Revenues as proceeds of the  
5 Franchise Agreement.  
6

7 16. As a consequence of LVMC's ongoing payment defaults in respect of the Senior  
8 Bonds, LVMC is required under the Financing Agreement to transfer all of its revenues, promptly  
9 upon receipt, to the Trustee for deposit in the Revenue Fund established under the Senior  
10 Indenture. With a few recent exceptions, LVMC for has been depositing its revenues with the  
11 Trustee for almost three years.  
12

13 State Control of LVMC

14 17. LVMC was created by the State of Nevada. The Governor of the State of Nevada  
15 (the "Governor") has significant control and influence over LVMC, as evidenced by the  
16 following:

- 17 A. All appointments to LVMC's board of directors (the "Board") must be  
18 approved by the Governor.
- 19 B. The Board must notify the Governor of its recommendation to reappoint or  
20 replace a director whose term is expiring, and if the Governor disapproves  
21 of the Board's first two nominees, then the Governor may appoint the  
22 successor director without Board input or approval.
- 23 C. The Governor may remove any director from LVMC's Board for cause.  
24 No director may be removed from office by the Board without the  
25 Governor's approval. If the Governor disapproves of the Board's  
26 recommendation for removal, the director shall not be removed from the  
Board.
- D. LVMC must obtain the Governor's approval of its annual budgets,  
financial reports, any material alterations to its annual budget or financial

- 1 reports, any major expenditures for enhancements or repairs of the  
2 Monorail, and any proposed changes to the rate schedule. If the Governor  
3 disapproves of any such matter, the Board cannot proceed with such action.
- 4 E. The Governor has the right to inspect and audit all of LVMC's books,  
5 records, and documents of every kind.
- 6 F. LVMC's Articles of Incorporation and Bylaws may not be amended or  
7 repealed with the approval of the Governor.
- 8 G. Net earnings and residual assets inure solely to the benefit of the Governor  
9 or a designated Nevada state agency.
- 10 H. The Governor established the initial fare schedule for the Monorail.

11 18. Upon the dissolution of LVMC, all of its assets remaining after the discharge of its  
12 liabilities must be distributed to the Governor or to a designated agency of the State of Nevada.

13 19. LVMC is subject to public records and open meetings requirements, as set forth in  
14 the Governor's Certificate. (A true and correct copy of the Governor's certificate is attached  
15 hereto as Exhibit "G", a true and correct copy of the agenda of LVMC's Board meeting on  
16 November 18, 2009 is attached hereto as Exhibit "H").

17 **LVMC's Public Purpose**

18 20. LVMC was organized to acquire and operate the Monorail for the public benefit  
19 and to issue bonds, payable out of the revenues derived from the Monorail, to pursue such a  
20 public purpose.

21 21. LVMC is organized as a nonprofit public benefit corporation without capital stock.  
22 LVMC's Articles of Incorporate provide that no part of LVMC's net earnings, if any, either  
23 during its existence or upon its dissolution, shall inure to the benefit of any individual, or any  
24 director, officer or member thereof, or any person, firm or corporation, except the Governor or a  
25 designated agency of the State of Nevada. In addition, the property, assets, profits and net  
26

1 revenues of LVMC have been irrevocably dedicated to the operation and maintenance of the  
2 Monorail for the public improvement.

3 I declare under penalty of perjury that the foregoing is true and correct to the best of my  
4 knowledge and belief.

5 EXECUTED this 13th day of January, 2010.  
6

7  
8 /s/ Scott Zuchorski  
9 SCOTT ZUCHORSKI  
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# Ambac may seek bankruptcy after regulators step in

By EILEEN AJ CONNELLY (AP) – 6 days ago

NEW YORK — Bond insurer Ambac Financial Group said again that it may seek bankruptcy protection after state regulators took control of some of its most troubled assets.

The news Thursday sent the company's already devalued stock into a tailspin.

The Wisconsin insurance commissioner on Wednesday ordered Ambac's main operating subsidiary, Ambac Assurance Corp., which is based in that state, to set up a segregated account for policies related to risky structured finance transactions. Those include the credit default swaps and residential mortgage-backed securities held by major Wall Street banks that helped to accelerate the national financial crisis.

Commissioner Sean Dilweg is seeking to take control of the segregated account, and received court approval to temporarily halt any payments on claims on those policies. Ambac was paying \$120 million a month in claims on the policies, and shelled out about \$1.4 billion for them in 2009. In an interview, Dilweg said this week's action was in part taken to avoid the March payments.

"My view of the company became that it is financially hazardous," Dilweg said. The agency has been watching Ambac's condition for two years, he said, and it became clear it was time to act.

Dilweg said the move was meant to make sure "policyholders are all treated fairly." The toxic assets were moved to a segregated account to protect the rest of the company.

All told, the assets moved to the segregated account add up to about \$63 billion. A small amount of policies backed by student loans remain in the general account but will move to the segregated account after they are assessed, he said.

"This brings stability and certainty to those policyholders that are in the general account, because they're no longer worried about RMBS eating up all the claims," Dilweg said.

The commissioner said he has a plan to address policy claims and other liabilities in the segregated account, which will go before a special court for approval. After the moratorium period on payments is passed, it is expected that policyholders will receive part of their claims in cash and the remaining percentage in deferred payment obligation. There is no time frame for working out the segregated account. Determining the amount that will be distributed in cash and deferred obligations will be part of the process in the coming months, Dilweg said.

Ambac Financial, as it did in November, said that it believes it has enough cash to get through the second financial quarter of 2011. But it is highly unlikely that Ambac Assurance will be able to make dividend payments to Ambac Financial in the foreseeable future while the policies in the segregated account are dealt with.

The company said it may consider restructuring its debt through a prepackaged bankruptcy proceeding, or seek bankruptcy protection if it cannot reach a deal with major creditors.

Bond insurers such as Ambac have traditionally made money by backing municipal bonds that rarely default. They typically pay steady dividends, with little risk. But during the housing market boom, lenders started issuing riskier mortgages and investment banks packaged them into complex bonds.

For insurers like Ambac and several competitors, the new bonds were an opportunity to generate enormous profit, just like investment banks were seeing. But when the housing bubble burst, the claims on bond insurance came rolling in.

Ambac Assurance is backing the segregated account with \$2 billion of notes that will be used to help pay claims.

Ambac has a separate pool of risky obligations — collateralized debt obligations of asset-backed securities — that was not put into the segregated account, because it reached a nonbinding agreement on the terms of a settlement to commute them. "We're in the process of negotiating to tear those up," said spokesman Peter Poillon.

Dilweg said his office has been involved in the discussions about those obligations. They could be moved to the segregated account if the negotiations fail, but he doesn't think that will be needed.

The parent company said it doesn't think the creation of the segregated account or Wisconsin's plans for its rehabilitation — paying down or settling the obligations — constitutes a default under the terms of its lenders.

The parent company last filed financial results in September, posting losses of \$573 million for the third quarter 2009. Earlier this month, Ambac said it was unable to file fourth-quarter or full-year 2009 results because of the ongoing discussions regarding with the Wisconsin insurance commissioner and the pool of CDOs it is negotiating to commute.

It posted 2008 losses of \$5.6 billion, but said in a regulatory filing 2009 results would be "significantly better."

The Wisconsin insurance commissioner set up a Web site linking to court papers and questions and answers about the segregated account and the proceedings, <http://www.ambacpolicyholders.com>.

Ambac's stock traded over \$95 a share just two years ago, but hasn't topped \$2.09 in the past 52 weeks.

In heavy trading Thursday, shares of Ambac Financial Group Inc. dropped 13.5 cents, or 17 percent, to close at 66 cents.

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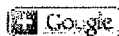
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## CORRECTING and REPLACING Ambac Establishes Segregated Account for Certain Policies

Company Release - 03/25/2010 01:20

Wisconsin Insurance Department to Oversee Rehabilitation of the Segregated Account

Ambac in Settlement Negotiations with CDO of ABS Counterparties

NEW YORK--(BUSINESS WIRE)-- The sentence following Contact Information for Policyholders and Investors should read: Additionally, OCI has established resources for policyholders at the following web address: [www.ambacpolicyholders.com](http://www.ambacpolicyholders.com) (sted [www.ambacocidocsite.com](http://www.ambacocidocsite.com)).

The corrected release reads:

AMBAC ESTABLISHES SEGREGATED ACCOUNT FOR CERTAIN POLICIES

Wisconsin Insurance Department to Oversee Rehabilitation of the Segregated Account

Ambac in Settlement Negotiations with CDO of ABS Counterparties

Ambac Financial Group, Inc. (NYSE: ABK) (Ambac) announced today that, at the direction of the Office of the Commissioner of Insurance of the State of Wisconsin ("OCI"), Ambac Assurance Corporation ("AAC"), Ambac's principal operating subsidiary, has established a segregated account for certain of AAC's liabilities, primarily policies related to credit derivatives, residential mortgage-backed securities ("RMBS") and other structured finance transactions. This action derives from OCI's view that immediate action is necessary to address AAC's financial position. In conjunction with the establishment of the segregated account, OCI has commenced rehabilitation proceedings with respect to liabilities contained in the segregated account in order to facilitate an orderly run-off and/or settlement of those specific liabilities. In addition, Ambac announced that it has reached a non-binding agreement on the terms of a proposed settlement agreement with several counterparties to commute substantially all of its remaining collateralized debt obligations of asset-backed securities ("CDOs of ABS").

The segregated account established by AAC at OCI's direction will contain: (i) certain policies insuring or relating to credit default swaps; (ii) all of its RMBS obligations (some of which will be allocated to the segregated account after it is established); (iii) certain other identified policies insuring troubled credits; (iv) certain student loan policies; and (v) certain other contingent liabilities including, but not limited to all of AAC's liabilities as reinsurer under certain reinsurance agreements. The segregated account is supported by a \$2 billion secured note issued by AAC and an aggregate excess of loss reinsurance agreement provided by AAC.

Pursuant to the verified petition filed on March 24, 2010 by OCI in connection with the rehabilitation proceedings with respect to the segregated account, OCI has stated that within approximately six months it will seek the rehabilitation court's approval for a plan of rehabilitation in connection with the segregated account. The verified petition states that the plan of rehabilitation will provide, among other things, that policies in the segregated account shall receive in respect of claims made, a combination of cash and surplus notes. Prior to approval of the plan of rehabilitation, claims in respect of segregated account liabilities will not be paid.

Policy obligations not transferred to the segregated account remain in the general account of AAC, and such policies are not subject to and, therefore, not directly impacted by, the segregated account rehabilitation plan. AAC is not, itself, in rehabilitation proceedings.

Michael Callen, Chairman of the Board of Directors, commented, "The Board has worked diligently over the past two years to forge the best possible outcome for Ambac and its various stakeholders. In light of OCI's determination to take some sort of rehabilitative action with respect to Ambac Assurance, the Board has determined, after thoughtful and careful consideration, that compliance with the direction of OCI to establish the segregated account of Ambac Assurance and to consent to the terms of the proposed settlement agreement of our CDO of ABS portfolio is the best alternative available. The actions taken today, together with the proposed settlement if effected, commute substantially all of our CDO of ABS exposure at a substantial discount to the expected present value of potential claims."

Mr. Callen commented further, "While certain structured finance asset classes and other credits have been segregated for rehabilitation, virtually the entire insured municipal portfolio remains outside the rehabilitation proceedings. The Ambac Board and management team are committed to continuing to work hard to manage our resources effectively in the service of all constituents."

The proposed settlement agreement with CDO of ABS counterparties provides that AAC will pay in the aggregate (i) \$2.6 billion in cash and (ii) \$2.0 billion of newly issued surplus notes of AAC. The surplus notes will have a maturity date of ten years from the date of the closing. Interest on the surplus notes will be payable at the annual rate of 5.1%. All payments of principal and interest on the surplus notes will be subject to the prior approval of OCI. If OCI does not approve the payment of interest on the surplus notes, such interest will accrue and compound annually until paid. The terms of the proposed settlement agreement, as negotiated to date, may change prior to the closing or the transactions as contemplated by the proposed settlement agreement may not close at all.

Counterparties to credit default swaps insured by AAC representing a significant portion of the net notional amount outstanding as of December 31, 2009, have agreed to temporarily forebear from accelerating the obligations of AAC under such credit default swaps or asserting any claims against AAC or any affiliate of AAC based upon the segregated account rehabilitation proceedings.

Additional Information

EXHIBIT D-1

Management believes that it will have sufficient liquidity to satisfy its needs through the second quarter of 2011. However, as a result of the rehabilitation actions taken by OCI, it is highly unlikely that AAC will be able to make dividend payments to Ambac for the foreseeable future. While Ambac does not believe the segregated account rehabilitation constitutes an event of default under its bond indenture, Ambac may consider, among other things, a negotiated restructuring of its debt through a prepackaged bankruptcy proceeding or may seek bankruptcy protection without agreement concerning a plan of reorganization with major creditor groups.

Further information about topics covered in this press release can be found in the Form 8-K to be filed by Ambac at [www.sec.gov](http://www.sec.gov) or on Ambac's web site at [www.ambac.com](http://www.ambac.com).

#### About Ambac

Ambac Financial Group, Inc., headquartered in New York City, is a holding company whose affiliates provide financial guarantees and financial services to clients in both the public and private sectors around the world. Ambac's principal operating subsidiary, Ambac Assurance Corporation, a guarantor of public finance and structured finance obligations, has a Caa2 rating (developing outlook) from Moody's Investors Service, Inc. and a CC rating (outlook developing) from Standard & Poor's Ratings Services. Ambac Financial Group, Inc. common stock is listed on the New York Stock Exchange (ticker symbol ABK).

#### Contact Information for Policyholders and Investors

Investors can call Ambac's information line:

from within the U.S.: 866 933-3063

from outside the U.S.: 212 502-1206

Additionally, OCI has established resources for policyholders at the following web address: [www.ambacpolicyholders.com](http://www.ambacpolicyholders.com)

#### Contact Information for Media

Members of the media can contact the Company or its Public Relations representatives via email by sending requests or questions to: [media@ambac.com](mailto:media@ambac.com)

#### Forward-Looking Statements

This release contains statements that may constitute "forward-looking statements" within the meaning of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Any or all of management's forward-looking statements here or in other publications may turn out to be wrong and are based on Ambac's management current belief or opinions. Ambac's actual results may vary materially, and there are no guarantees about the performance of Ambac's securities. Among events, risks, uncertainties or factors that could cause actual results to differ materially are: (1) Ambac's liquidity is currently insufficient to fund its needs beyond the near term and failure to successfully execute on its current strategies could result in it running out of liquidity; (2) as a result of Ambac Assurance's deteriorating financial condition, regulators could commence delinquency proceedings; (3) difficult economic conditions, which may not improve in the near future, and adverse changes in the economic, credit, foreign currency or interest rate environment in the United States and abroad; (4) the actions of the U. S. Government, Federal Reserve and other government and regulatory bodies to stabilize the financial markets; (5) the risk that market risks impact assets in our investment portfolio or the value of our assets posted as collateral in respect of investment agreements and interest rate swap and currency swap transactions; (6) market spreads and pricing on insured CDOs and other derivative products insured or issued by Ambac; (7) the risk that holders of debt securities or counterparties on credit default swaps or other similar agreements seek to declare events of default or seek judicial relief or bring claims alleging violation or breach of covenants by Ambac or one of its subsidiaries; (8) default by one or more of Ambac Assurance's portfolio investments, insured issuers, counterparties or reinsurers; (9) inadequacy of reserves established for losses and loss expenses; (10) changes in capital requirements whether resulting from downgrades in our insured portfolio or changes in rating agencies' rating criteria or other reasons; (11) the risk that we may be required to raise additional capital, which could have a dilutive effect on our outstanding equity capital and/or future earnings; (12) our ability or inability to raise additional capital, including the risks that regulatory or other approvals for any plan to raise capital are not obtained, or that various conditions to such a plan, either imposed by third parties or imposed by Ambac or its Board of Directors, are not satisfied and thus potentially necessary capital raising transactions do not occur, or the risk that for other reasons the Company cannot accomplish any potentially necessary capital raising transactions; (13) credit risk throughout our business, including credit risk related to residential mortgage-backed securities and collateralized debt obligations ("CDOs") and large single exposures to reinsurers; (14) changes in Ambac's and/or Ambac Assurance's credit or financial strength ratings; (15) risks relating to the re-launch of Connie Lee as Everspan Financial Guarantee Corp.; (16) competitive conditions, pricing levels and reduction in demand for financial guarantee products; (17) credit and liquidity risks due to unscheduled and unanticipated withdrawals on investment agreements; (18) legislative and regulatory developments, including the Troubled Asset Relief Program and other programs under the Emergency Economic Stabilization Act and other similar programs; (19) changes in accounting principles or practices relating to the financial guarantee industry or that may impact Ambac's reported financial results; (20) the risk of volatility in income and earnings, including volatility due to the application of fair value accounting, required under ASC Topic 815, to the portion of our credit enhancement business which is executed in credit derivative form, and due to the adoption of ASC Topic 944, which, among other things, introduces volatility in the recognition of premium earnings and losses; (21) the risk that our underwriting and risk management policies and practices do not anticipate certain risks and/or the magnitude of potential for loss as a result of unforeseen risks; (22) operational risks, including with respect to internal processes, risk models, systems and employees; (23) factors that may influence the amount of installment

premiums paid to Ambac; (24) the risk of litigation and regulatory inquiries or investigations, and the risk of adverse outcomes in connection therewith, which could have a material adverse effect on our business, operations, financial position, profitability or cash flows; (25) the risk that reinsurers may dispute amounts owed us under our reinsurance agreements; (26) changes in tax laws; (27) other factors described in the Risk Factors section in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2008 and also disclosed from time to time by Ambac in its subsequent reports on Form 10-Q and Form 8-K, which are or will be available on the Ambac website at [www.ambac.com](http://www.ambac.com) and at the SEC's website, [www.sec.gov](http://www.sec.gov); and (28) other risks and uncertainties that have not been identified at this time. Readers are cautioned that forward-looking statements speak only as of the date they are made and that Ambac does not undertake to update forward-looking statements to reflect circumstances or events that arise after the date the statements are made. You are therefore advised to consult any further disclosures we make on related subjects in Ambac's reports to the SEC.

Source: Ambac Financial Group, Inc.

Contact: Ambac Financial Group, Inc. Peter Poillon, 212-668-0340 [www.ambac.com](http://www.ambac.com)