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Of Attorneys for Plaintiff The Confederated Tribes
of the Warm Springs Reservation of Oregon

UNITED STATES DISTRICT COURT

DISTRICT OF OREGON

PORTLAND DIVISION

**THE CONFEDERATED TRIBES OF THE
WARM SPRINGS RESERVATION OF
OREGON**, a federally recognized Indian Tribe,

Case No. 3: 10-cv-00130-KI

PLAINTIFF,

v.

AMBAC ASSURANCE CORPORATION, a
Wisconsin Corporation,

SECOND AMENDED COMPLAINT
Breach of Contract; Statutory Action
(28 U.S.C. § 1332)

DEMAND FOR JURY TRIAL

DEFENDANT.

Plaintiff The Confederated Tribes of the Warm Springs Reservation of Oregon
("Plaintiff" or "Tribe") alleges:

JURISDICTION AND VENUE

1.

This Court has subject matter jurisdiction over the claims asserted in this Complaint under 28 U.S.C. § 1332(a) because the amount in controversy exceeds \$75,000, exclusive of interest and costs, and is between citizens of different states.

2.

This Court has personal jurisdiction over Defendant because Defendant regularly conducts business within the State of Oregon and the actions giving rise to this lawsuit occurred within the State of Oregon.

3.

Venue is proper in this Court under 28 U.S.C. § 1391(a) because a substantial part of the events or omissions giving rise to the claims occurred, or a substantial part of property that is the subject of this action lies, within this district. Moreover, under 28 U.S.C. § 1391(c), Defendant is a corporation that is subject to personal jurisdiction and deemed to reside in this district.

PARTIES

4.

The Tribe is a federally recognized Indian tribe organized under a Constitution and Bylaws ratified by the members of the Tribe on December 18, 1937, and approved by the Assistant Secretary of the Department of Interior of the United States on February 14, 1938, pursuant to Section 16 of the Indian Reorganizations Act of June 18, 1934 (48 Stat. 984), as amended by the Action of June 15, 1935 (49 Stat. 378). The Tribe is the successor to the Indian signatories of the Treaty with the Tribes and Bands of Middle Oregon of June 25, 1855, 12 Stat. 963 (“1855 Treaty”).

5.

Defendant Ambac Assurance Corporation (“Defendant” or “Ambac”) is a stock insurance corporation chartered under the laws of the state of Wisconsin, with its principal place of

business in New York, New York, and, consequently, a citizen of a state other than Oregon.

Ambac's parent corporation is Ambac Financial Group, Inc.

ALLEGATIONS COMMON TO ALL CLAIMS FOR RELIEF

6.

The Tribe occupies the Warm Springs Indian Reservation, which was established by the 1855 Treaty and is approximately 640,000 acres. The Reservation is located in central Oregon and is bordered on the east by the Deschutes River, on the south by the Metolius River, on the west by the summit of the Cascade Mountain range, and on the north by the Tygh Ridge. Over ninety-nine percent (99%) of the total reservation acreage is held in trust by the United States for either the Tribe or individual Indian allottees.

7.

The headquarters of the Tribe is located in the community of Warm Springs, which is located on S. Highway 26, approximately 16 miles northwest of Madras, the nearest Oregon city, and approximately 100 miles southeast of Portland, the largest city in Oregon.

8.

The Tribe and Portland General Electric Company ("PGE") are co-licensees of the Pelton Hydroelectric Project (FERC Project No. 2030) ("Pelton Project"). The Pelton Project, composed of three sequential dams (the Round Butte Dam, the Pelton Dam and the Reregulating Dam) and certain related generating and transmission facilities, is located on the Deschutes River along the Reservation's eastern boundary. The Pelton Project operates as a modified "run of the river" system, meaning that the normal daily outflow from the Reregulating Dam is roughly equal to the daily inflow to the Pelton Project.

9.

The Round Butte Dam, which commenced operation in 1964, is the uppermost of the three dams and impounds portions of the Metolius, Crooked, and Deschutes Rivers, forming Lake Billy Chinook, a popular recreation destination. The Pelton Dam, which commenced

operation in 1958, is located seven miles downstream of the Round Butte Dam. The Pelton Dam backs up the Deschutes River to form Lake Simtustus, which extends back to the tailrace of the Round Butte Dam. The Reregulating Dam is located below Pelton Dam and commenced operation in 1958. The primary purpose of the Reregulating Dam is to redistribute the uneven discharges from the upper two dams to approximate natural river flows over the remaining length of the Deschutes River.

10.

The Round Butte generating facility has a demonstrated peaking capacity of 358 MW, and a dependable capacity of 104 MW based on the lowest water year on record. The Pelton generating facility has a demonstrated peaking capacity of 110 MW, and a dependable capacity of 38 MW based on the lowest water year on record. The Tribe is the sole owner of the generation facilities at the Reregulating Dam, but those facilities are not part of the Pelton Project.

11.

The Pelton Project was originally licensed to PGE, as the sole licensee, by the Federal Power Commission, the predecessor to FERC, under a 50-year license issued in 1951. FERC amended the license in 1980 to make PGE and the Tribe joint licensees, with each liable to the extent of their separate interests in the Pelton Project.

12.

In 1999, as the original FERC license for the Pelton Project was due to expire, the Tribe and PGE submitted separate and competing relicense applications. Thereafter, the Tribe and PGE entered into negotiations over, among other things, the future ownership and operation of the Pelton Project.

13.

In April 2000, the Tribe, PGE and the United States Department of the Interior entered into a Long-Term Global Settlement and Compensation Agreement (“GSA”). The GSA was

approved by FERC, the U.S. Congress and the Oregon Public Utility Commission. The GSA is a comprehensive agreement that establishes the relationship relating to the Pelton Project among PGE, the Tribe and the Department of the Interior for up to the next half century, and recognizes the Tribe's long-term goal of controlling all natural resources within the Reservation. Pursuant to the GSA, all claims between PGE and the Tribe were released, and the Tribe granted to PGE all the rights and easements necessary for PGE to carry out its obligations as a FERC licensee. The GSA provides the sole and exclusive means by which PGE will compensate the Tribe for all of PGE's activities in connection with the Pelton Project. In addition, PGE granted the Tribe options to purchase up to a 50.01% interest in the jointly owned facilities of the Pelton Project at net book value. The Tribe purchased an initial 33.33% interest in the jointly owned facilities of the Pelton Project, effective January 1, 2002.

14.

The original license expired on December 31, 2001. FERC issued a new license to PGE and the Tribe, as joint licensees, on June 21, 2005. Between December 31, 2001 and June 21, 2005, PGE and the Tribe operated the Pelton Project under annual licenses.

15.

On October 10, 2003, the Tribe issued Hydroelectric Revenue Bonds, Series 2003 (Pelton-Round Butte Project) (Taxable Auction Rate Securities) (CUSIP: 934312 AA 7) in an aggregate principal amount of \$50,000,000 ("2003 ARS Bonds" or "Bonds"). The 2003 ARS Bonds were issued by the Tribe to finance and refinance costs of acquiring its ownership interest in the Pelton Project and of improvements related thereto, to pay issuance costs, and to fund reserves. The 2003 ARS Bonds were 30-year bonds, maturing on February 1, 2033.

16.

Auction rate securities ("ARS") such as the 2003 ARS Bonds are long-term variable-rate instruments with interest rates that reset at frequent, periodic Dutch auctions. In a Dutch auction for ARS, buy orders are filled beginning from the lowest interest rate bid until all securities

available for sale are matched with purchase orders. The rate at which the final sell order is filled is known as the “clearing rate,” and that rate applies to the entire issue of the ARS, including all other buy orders, as well as to the securities of existing holders that chose to hold, and not sell, their securities in the auction.

17.

ARS auctions are generally held every 7, 14, 28, or 35 days. For the Tribe’s 2003 ARS Bonds, auctions were held every 28 days. Orders to purchase or sell ARS at auctions can be placed only through designated broker-dealers that manage the auctions of the ARS that they have underwritten. These broker-dealers, collect “buy” and “sell” orders, and then forward them to the designated auction agent that administers the Dutch auction.

18.

If the “buy” orders received by the auction agent are insufficient to purchase all the ARS offered for sale at a particular auction, the auction “fails.” Until the next successful auction, the ARS holders are unable to sell the securities that they hold (unless they can do so in a secondary market) and the interest rate on all of the ARS jumps to a “penalty” rate.

19.

A key factor affecting the marketability of ARS is the credit rating of the issue. The higher the credit rating, the more likely the ARS will be marketable and the auctions successful, both of which will result in lower interest rates and avoidance of the “penalty” triggered by a failed auction. For the Tribe’s 2003 ARS Bonds, the penalty rate was seventeen percent (17%), which was triggered by, among other things, a failed auction and the credit rating for the 2003 ARS Bonds being rated below A2 by Moody’s Investor’s Service (“Moody’s”) or below A by Standard and Poor’s (“S&P”).

20.

At the time immediately before the Tribe issued the 2003 ARS Bonds, S&P assigned the 2003 ARS Bonds a rating of BBB-, which was S&P’s lowest investment grade rating. Moody’s

assigned the 2003 ARS Bonds a rating of A3, which is Moody's lowest Upper Medium Grade rating.

21.

The BBB- (S&P) and A3 (Moody's) natural (or unenhanced) credit ratings of the Tribe's 2003 ARS Bonds meant that the Bonds would likely have had limited investor demand and higher financing costs, in the form of higher interest rates, when compared to other ARS bonds that carried a AAA (S&P) or Aaa (Moody's) credit rating. The natural credit rating also increased the likelihood of a failed auction, thereby exposing the Tribe to the risk of the penalty rate of seventeen percent (17%).

22.

To sell the 2003 ARS Bonds at lower interest rates, to improve the marketability of the Bonds, and to reduce the risk of a failed auction, the Tribe decided to purchase "credit enhancement" in the form of financial guarantee insurance from Ambac. Ambac was well known as a "monoline" insurer, providing one type of insurance—guarantee insurance to protect against the risk of default for public finance obligations such as the Tribe's 2003 ARS Bonds. For Ambac's credit enhancement financial guarantee policies to be financially feasible, the premiums paid for such insurance must be less than the expected additional interest to be paid on unenhanced bonds, when compared to the expected interest to be paid on credit enhanced bonds over the life of such bonds.

23.

Ambac provided credit enhancement to ARS bond issuers such as the Tribe by issuing insurance policies to guarantee the issuer's payment obligations to the bondholders and also to guarantee the issuer's payment obligations to the counterparties on "swap agreements," which issuers commonly entered into to hedge interest rate risk for variable rate bonds such as ARS. The issuance of financial guarantee policies effectively transferred the credit risk—*i.e.*, the risk of issuer's default on principal and/or interest payments—from the bondholders to Ambac,

thereby improving or “enhancing” the credit rating of the bonds to the Ambac’s premier credit rating, which was triple-A.

24.

Ambac’s ARS bond guarantee policies insure payment to bondholders or swap counterparties. Bondholders and swap counterparties are the direct beneficiaries of the Ambac policies but there is an essential indirect benefit to the issuer. The essential benefit that the Ambac guarantee policies provide to the issuer is the credit enhancement. The credit enhancement is for the issuer the sole and fundamental purpose of obtaining the guarantee policies and without it the issue would not purchase the guarantee policies.

25.

Ambac has been a leading financial guaranty insurer for public finance bonds since 1971. In 2003, Ambac was one of the leading financial guarantee insurers in the world. Ambac first obtained an triple-A credit rating in 1979. Between that date and time the Tribe issued the 2003 ARS Bonds, Ambac’s credit rating never declined regardless of market conditions. In 2003, Ambac understood that its triple-A credit rating was essential to its business and that its financial guarantee insurance was a form of credit enhancement that benefitted issuers of securities. In its 2002 Annual Report to the Securities and Exchange Commission (“SEC”), Ambac stated, subject to criminal penalty, the following regarding its financial guarantee and credit enhancement business:

“Ambac Assurance has earned triple-A ratings, the highest ratings available from Moody’s Investors Service, Inc. * * *, Standard and Poor’s Ratings Services * * *, Fitch Inc * * * and Rating and Investment Information, Inc. * * *. *These ratings are an essential part of Ambac Assurance’s ability to provide credit enhancement.*

“* * * * *

“*Financial guarantee insurance is a form of credit enhancement that benefits both the issuer [(i.e., the Tribe)] and the investor. Issuers benefit because their securities are sold with a higher credit rating than securities of the issuer sold without credit enhancement, resulting in interest cost savings and greater marketability. In addition for complex financings, and obligations of issuers that are not well known by investors, credit enhanced obligations receive greater market acceptance than obligations without credit enhancement.*” Ambac

Financial Group, Inc., Form 10-K, filed: March 28, 2003 (period: December 31, 2002) (“2002 Annual Report”), at 1, 3 (emphasis added).

Ambac made similar statements regarding the importance of its triple-A credit rating at least as far back as 1996. *See* Ambac Financial Group, Inc., Form 10-K405, filed: March 31, 1997 (period: December 31, 1996), at 2.

26.

Beginning in the mid-1990s, Ambac began steadily increasing its participation in an area of the financial guarantee business beyond public finance bond insurance. The new and expanding business focused on issuing financial guarantee insurance for structured finance obligations, such as mortgage backed and other asset backed securities both in the United States and international markets. At the end of 1996, Ambac had guaranties outstanding for over \$131 billion in bonds and other securities, 91% of which were for U.S. public finance obligations (taxable and tax exempt bonds) and only 9% were for U.S.-structured finance obligations (mortgage-backed and other asset-backed securities). *Id.* at 12. By the end of 2003, Ambac had guaranties outstanding for almost \$426 billion, only 53% of which were for U.S. public finance obligations; the remaining 47% were for U.S. structured finance obligations and international finance. *See* Ambac Financial Group, Inc., Form 10-K, filed: March 15, 2004 (period: December 31, 2003), at 11. Over the six years from 1996 to 2003, Ambac’s structured finance and international finance business increased almost 1700%.

27.

In 2003, the Tribe relied on Ambac’s gold-plated reputation as a leading monoline financial guarantee insurer when it entered into a written Insurance Agreement with Ambac to purchase two financial guarantee insurance policies to enhance the credit rating of its 2003 ARS Bonds. A copy of the Insurance Agreement is attached as Exhibit 1. Pursuant to the Insurance Agreement the Tribe agreed to purchase, and Ambac agreed to issue a financial guarantee policy insuring certain payments of the Tribe to the bondholders (“Bond Policy”). A copy of the Bond Policy is attached as Exhibit 2. The Tribe also agreed to purchase, and Ambac

agreed to issue, a financial guarantee policy, in the form of a surety bond, from Ambac guaranteeing the Tribe's obligations under a Swap Agreement with Citibank, N.A. to hedge against a high variable interest rate for the 2003 ARS Bonds ("Swap Policy"). A copy of the Swap Policy is attached as Exhibit 3. The combined premium for both the Bond and Swap Policies was approximately \$5.1 million, which the Tribe was obligated to pay on or before October 10, 2003, the closing date for the issuance of the 2003 ARS Bonds.

28.

Ambac issued both the Bond and Swap Policies effective October 10, 2003, and the Tribe paid the entire premium of approximately \$5.1 million on or before that date. That same date, Ambac executed a written Certificate of Bond Insurer, which provided, among other things, that the \$5.1 million premium represented a "*reasonable charge for the transfer of credit risk*" from the bondholders to Ambac. A copy of the Certificate of Bond Insurer is attached as Exhibit 4.

29.

The Tribe's sole purpose in purchasing financial guarantee insurance from Ambac was to enhance the credit rating of its 2003 ARS Bonds, thereby lowering its interest rate costs by improving the marketability of the Bonds and reducing the risk of a failed auction. The Tribe purchased those policies in material reliance on Ambac's stated strict underwriting and risk exposure standards and its then triple-A credit rating. Based upon the Tribe purchasing Ambac's credit enhancing financial guarantee policies, S&P and Moody's gave the 2003 ARS Bonds their highest credit ratings, AAA and Aaa respectively.

30.

Ambac was aware of and understood that the Tribe's sole purpose in purchasing Ambac's financial guarantee insurance was to enhance the credit rating of its 2003 ARS Bonds. In the Insurance Agreement, Ambac expressly relied on the fact that the Tribe was issuing the 2003 ARS Bonds pursuant to, in part, its Tribal Bond Ordinance and Tribal Resolution No. 10285, dated June 2, 2003. Copies of the Tribal Bond Ordinance and Resolution No. 10286 are attached

as Exhibits 5 and 6. The Tribal Bond Ordinance expressly provided that the Tribe was authorized to enter into contracts to obtain, “Credit Enhancement Devices,” which the Ordinance defined as:

“‘Credit Enhancement Device’ means a letter of credit, line of credit, *bond insurance policy or other device or facility used to enhance the creditworthiness or marketability of any Bonds.*” WSTC §§ 730.002(c); 730.009(c).

31.

Tribal Resolution No. 10286 authorized the Tribe to enter into the Insurance Agreement with Ambac. The Resolution also authorized the Tribe to issue the 2003 ARS Bonds together with an interest rate swap agreement as long as Tribe’s underwriter, Citigroup Global Markets, Inc., (“Citigroup”) and its financial advisor, Seattle-Northwest Securities Corporation, certified that under then current market conditions the Tribe would achieve annual debt service savings of no less than \$100,000. Both the underwriter and the financial advisor issued such certifications based on the assumption that the 2003 ARS Bonds would maintain triple-A credit rating as a result of the financial guarantee insurance provided by Ambac. Copies of the certifications are attached as Exhibits 7 and 8.

32.

At the time that Ambac issued the financial guarantee policies, it was aware of and understood that the Tribe purchased the enhanced credit rating for the 2003 ARS Bonds with the expectation that the credit enhancement would continue for the life of the Bonds. Ambac knew that the 2003 ARS Bonds were 30-year bonds and that the Tribe was relying on Ambac to seek to maintain its triple-A credit rating for the life of the Bonds. Ambac also knew how the ARS market worked and that any decrease in its credit rating below triple-A during the life of the 2003 ARS Bonds would affect the marketability of the Bonds and create the risk of failed auctions, thereby subjecting the Tribe to the risk of having to pay a “penalty” interest rate or the “maximum” interest rate of seventeen percent (17%).

33.

The Tribe materially relied on Ambac's statements in its 2002 Annual Report to the SEC, a copy of which is attached as Exhibit 9, in issuing the 2003 ARS Bonds. The Tribe expressly incorporated Ambac's 2002 Annual Report filing by reference into its Final Limited Offering Memorandum, which was its official disclosure document to prospective purchasers of the Bonds. *See* Exhibit 10. A condition of closing was that Ambac certify the "accuracy and completeness" of the information contained in its 2002 Annual Report. *See* Bond Purchase Agreement ¶ 8(d)(20), a copy of which is attached as Exhibit 11. Ambac fulfilled that condition by providing the Tribe with an October 10, 2003 letter from its Vice-President and Assistant General Counsel, Stephen M. Ksenak. *See* Exhibit 12.

34.

Ambac's statements in its 2002 Form 10-K filing were materially misleading in two respects: (1) Ambac failed to disclose the existence and extent of its risk exposure to the *subprime* mortgage market; and (2) Ambac failed to disclose its limited view of the scope of its obligation to seek to provide credit enhancement over the life of the 2003 ARS Bonds.

35.

With respect to its risk exposure to the *subprime* mortgage market, Ambac failed to disclose to the Tribe that it was in the business of insuring large dollar amounts of *subprime* mortgage-backed securities. Instead, Ambac generically stated that it sought to work with "*higher quality, well-capitalized issuers*" and that it analyzed the "*quality of the underlying assets,*" the structure of the securitization, the experience and financial strength of the servicer of the underlying assets and the credit quality of the issuer. *Id.* (emphasis added). Ambac's statements created the impression that it only guaranteed high quality mortgage-backed securities, which was not true and materially misleading.

36.

Ambac failed to disclose to the Tribe that from 1998 through 2001 Ambac had

guaranteed almost ***\$1.2 billion of subprime mortgage-backed securities***. Ambac's Form 10-K filed on February 29, 2008 (period ending December 31, 2007) ("2007 Annual Report"), at 56. In 2002, Ambac doubled its subprime exposure, guaranteeing ***another \$1.1 billion of subprime mortgage-backed securities***. *Id.* In 2003, Ambac again more than doubled its exposure to subprime mortgage by guaranteeing an ***additional \$2.2 billion of subprime mortgage-backed securities***. *Id.* Based on the Tribe's information and belief, Ambac's disclosures in its 2007 Annual Report, a copy of which is attached as Exhibit 13, were the first time that any Ambac annual report to the SEC expressly acknowledged that its mortgage-backed securities financial guarantee business included insuring *subprime* mortgage-backed securities.

37.

Ambac's failure to disclose to the Tribe in 2003 the existence, extent, and risks with its expanding subprime mortgage-backed securities business made its partial representations to the Tribe about its participation in structured finance business materially misleading. Ambac's failure to disclose the material facts about its increasing involvement in the subprime mortgage market prevented its credit enhancement customers, like the Tribe, from being able to evaluate the risks associated with the changing nature of Ambac's business and the implications of such changes for the continued future existence of Ambac's triple-A credit rating.

38.

Regarding Ambac's view about the scope of its obligation to seek to provide credit enhancement to the Tribe, Ambac represented to the Tribe that its financial guarantee insurance was a "form of credit enhancement" that benefitted the issuer because its securities are sold with a "higher credit rating than securities of the issuer sold without credit enhancement, resulting in interest cost savings and greater marketability." Ambac's 2002 Annual Report at 3. Ambac also represented that its triple-A credit rating was an "essential part" of its ability to provide credit enhancement. Ambac's 2002 Annual Report at 1. Taken together those statements were misleading in light of the fact that Ambac failed to disclose to the Tribe that Ambac believed it

had no duty to seek to continue to provide credit enhancement for the 2003 ARS Bonds and that Ambac's view was that credit enhancement formed no basis of its bargain with the Tribe. The misleading nature of Ambac's statement touting its credit enhancement insurance is especially material for the Tribe because of the fact that the Bonds were ARS bonds, which had to be marketed for sale every 28 days for the 30-year life of the Bonds. Ambac was well-aware that the Tribe was counting on Ambac to do what it reasonably could to maintain its triple-A credit rating for the life of the Bonds, in order to achieve the Tribe's interest cost savings to be achieved for the Ambac credit enhancement insurance. In filings in this action, Ambac revealed to the Tribe for the first time that it never believed that it had a duty to seek to continue to maintain its triple-A credit rating and that it never believed that providing credit enhancement for the Tribe's 2003 ARS Bonds was part of its bargain with the Tribe.

39.

In February 2008 Ambac acknowledged *for the first time* in an annual report to the SEC that its structured finance business included guaranteeing *subprime* residential mortgage-backed securities:

“Structured Finance includes the securitization of a variety of asset types such as mortgage loans, home equity loans, auto loans, student loans, credit card debt, leases, operating assets and CDOs where the majority of the underlying collateral risks are situated in the United States. Additionally, Ambac's structured finance business encompasses both secured and unsecured debt issued by investor-owned utilities. Included within the operating asset sector are securitizations of aircraft, rental car, shipping container and rail cars fleets, as well as film rights, franchise fees, pharmaceutical royalties, and intellectual property. Included within CDOs [(Collateralized Debt Obligations)] are transactions that contain significant risks to the Residential Mortgage-Backed Securities (“RMBS”) market, *including subprime borrowers*.” Ambac Form 10-K filed on February 29, 2008 (period ending December 31, 2007), at 8. (Emphasis added.)

40.

In the 2007 Annual Report, Ambac announced that it was *suspending all structured finance businesses* for six months in order to accumulate capital and that it was *discontinuing underwriting certain structured finance businesses*, including collateralized debt obligations and mortgage backed securities. *Id.*

41.

At about this same time, the Tribe's 2003 ARS Bonds had their first failed auction. Thereafter, the 2003 ARS Bonds experienced uninterrupted failed auctions until the Tribe refinanced the Bonds in November 2009. The failed auctions resulted in The Tribe's payment of a "penalty" interest rate for all of the outstanding 2003 ARS Bonds.

42.

By the summer of 2007, the subprime mortgage crisis that hit Wall Street was in full effect. The subprime mortgage crisis hit especially hard the financial guarantee companies like Ambac, which had insured many billions of dollars of subprime mortgage bonds. As a result, S&P and Moody's began a review of the capital adequacy of the financial guarantee industry, including Ambac, in the fall of 2007. In late-December 2007, following the rating agency reviews, Ambac's triple-A rating was affirmed by both S&P (with "negative outlook") and Moody's. Then, on January 16, 2008, Moody's put Ambac's triple-A rating on review for possible downgrade. On January 18, 2008, S&P placed Ambac's triple-A rating on Credit Watch Negative, and on February 25, 2008, S&P continued Ambac on Credit Watch Negative

43.

On June 5, 2008, S&P downgraded Ambac's credit rating to AA and placed it on Credit Watch Negative, and on June 19, 2008, Moody's downgraded Ambac to Aa3 with negative outlook. On August 14, 2008, S&P reaffirmed Ambac's AA rating and placed it on negative outlook. On November 5, 2008, Moody's downgraded Ambac's credit rating to Baa1 with developing outlook. On November 19, 2008, S&P lowered its credit rating on Ambac to A with a negative outlook. On March 4, 2009, Moody's placed Ambac on review for possible downgrade and on April 13, 2009, downgraded Ambac to Ba3. On June 24, 2009, S&P downgraded Ambac to BBB and placed it on Credit Watch Negative.

44.

S&P's June 2009 downgrade of Ambac's credit rating combined with the failed auctions for the 2003 ARS Bonds triggered the maximum penalty interest rate of seventeen percent (17%) for all of the outstanding Bonds beginning in July 2009. Faced with such an exorbitant interest rate, the Tribe was forced to refinance the 2003 ARS Bonds by issuing new fixed interest rate bonds with higher interest rates than those forecasted when it issued the 2003 ARS Bonds. The costs that the Tribe incurred from the interest rate increase and the refinancing of the 2003 ARS Bonds were directly caused by Ambac's credit rating downgrade.

45.

Before and during the issuance of the 2003 ARS Bonds, Citigroup, the underwriter and sole broker-dealer for the Bonds, was actively engaged in the illegal manipulation of its ARS auctions. Without making appropriate disclosures under federal securities laws to investors and issuers of ARS securities, Citigroup illegally intervened in ARS auctions for which it served as broker-dealer in one or more of the following ways: to prevent failed auctions; to set "market" rates; or to prevent "all-hold auctions." While the Tribe was aware that Citigroup could elect to participate in auctions for its own account, Citigroup did not disclose that it participated to prevent failed auctions and to set clearing rates at levels that it deemed desirable. As a result, Citigroup prevented the Tribe from knowing whether the historic clearing rates of ARS, which the Tribe was using as the basis for its interest cost savings projections, represented true market demand or were the result of Citigroup's market manipulation.

46.

Ambac materially aided Citigroup in its commission of fraud on the Tribe. Citigroup's securities fraud on the Tribe would not have occurred without Ambac's participation in the Tribe's issuance of the 2003 ARS Bonds. Citigroup required as a condition of closing proof that Ambac had issued the Bond Policy and Swap Policy and that, based on the issuance of the Bond Policy, the Bonds had received Moody's and S&P ratings of Aaa and AAA respectively. *See*

Bond Purchase Agreement, Exhibit 11, ¶¶ 8(d)(19) and (20). The Tribe would not have issued the 2003 ARS Bonds without Ambac's Bond Policy and Swap Policy and its then triple-A credit rating because those were all needed in order for the Tribe to achieve its projected interest cost savings.

47.

In 2006, the Securities and Exchange Commission ("SEC") issued an Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Section 15(b) of the Securities Exchange Act of 1934, a copy of which is attached as Exhibit 14, against Citigroup. The Order arises out of Citigroup's violations of federal securities laws in its role as a broker dealer in the ARS market from January 1, 2003 through June 30, 2004, which included intervention in auctions to prevent failed auctions, to set a "market" rate, and to prevent all-hold auctions without proper disclosures to the issuers and investors of the securities. The SEC also ordered Citigroup to provide its issuers of ARS, including the Tribe, with a written description of Citigroup's auction practices and procedures. Citigroup provided the Tribe with such a written description in November 2006, a copy of which is attached as Exhibit 15, which was the first time that Citigroup disclosed to the Tribe the nature and extent of its ARS market manipulation.

48.

As a result of Ambac's conduct, the Tribe has been damaged in an amount exceeding \$15 million.

FIRST CLAIM FOR RELIEF

(Breach of Contract—Breach of the Covenant of Good Faith and Fair Dealing)

49.

The Tribe re-alleges paragraphs 1 through 48 as though set forth fully herein.

50.

The Tribe entered into a contract with Ambac for Ambac to provide credit enhancing financial guarantee insurance for the 2003 ARS Bonds and to improve the bonds' marketability, to reduce the risk of failed auctions, and to reduce the interest rate paid to pay to bondholders and the swap payment paid to the swap counterparty.

51.

As part of its contract with Ambac, the Tribe purchased the Bond and Swap Policies to guarantee payment of the Tribe's obligations to the bondholders and to the swap counterparty, Citibank. For the policies, the Tribe paid up front premiums to Ambac totaling approximately \$5.1 million.

52.

The Tribe's contract with Ambac includes an implied covenant of good faith and fair dealing. Under the implied covenant of good faith and fair dealing Ambac covenants that it will not engage in any acts or conduct that will prevent or undermine the Tribe's receipt of the benefits of the contract, which for the Tribe was entirely the benefit of having Ambac's triple-A credit rating for the 30 year life of the Tribe's 2003 ARS Bonds.

53.

Ambac materially breached the implied covenant of good faith and fair dealing by issuing financial guarantees for risky collateralized debt obligations and other risky asset backed securities, such as structured securities backed by subprime mortgages, which resulted in a downgrading of Ambac's credit rating in 2008, a mere five years into the life of the 2003 ARS Bonds.

54.

Ambac's breach of the implied covenant of good faith and fair dealing has caused damages to the Tribe exceeding \$15 million, which includes premiums, additional finance costs resulting from the interest rate increases and the cost of refinancing the 2003 ARS Bonds through the issuance of new bonds in 2009.

SECOND CLAIM FOR RELIEF

(Tortious Breach of the Covenant of Good Faith and Fair Dealing)

55.

The Tribe re-alleges paragraphs 1 through 48 as though set forth fully herein.

56.

By entering into a contract to provide credit enhancing financial guarantee insurance to the Tribe for the 30-year life of the 2003 ARS Bonds, Ambac entered into a special relationship with the Tribe. Ambac was fully aware that the Tribe was dependent on Ambac's maintenance of Ambac's triple-A credit rating over the 30-year life of the 2003 ARS Bonds in order to realize the projected interest cost savings. Ambac retained full control to exercise its judgment on the Tribe's behalf in maintaining its triple-A credit rating, thereby imposing a standard of care on Ambac to use reasonable care in maintaining its credit rating.

57.

Ambac breached its reasonable standard of care owed to the Tribe by issuing risky financial guarantees for collateralized debt obligations and other asset backed securities such as subprime mortgages, which resulted in a downgrading of Ambac's credit rating in 2008, a mere five years into the life of the 2003 ARS Bonds.

58.

Ambac's breach has caused damages to the Tribe exceeding \$15 million, which includes, premiums, additional finance costs resulting from the interest rate increases and the cost of refinancing the 2003 ARS Bonds through the issuance of new bonds in 2009.

THIRD CLAIM FOR RELIEF

(Oregon Securities Fraud—Count 1: Violation of ORS 59.135)

59.

The Tribe re-alleges paragraphs 1 through 48 as though set forth fully herein.

60.

Ambac violated ORS 59.135 in connection with the purchase and sale of the 2003 ARS Bonds in one or more of the following particulars:

- (1) Ambac omitted to state to the Tribe that it had guaranteed many billions of dollars of *subprime* mortgage-backed securities, which made its statements regarding its involvement in mortgage-backed securities market misleading in the light of the circumstances under which they were made;
- (2) Ambac omitted to state to the Tribe that Ambac believed that it had no duty to seek to continue to provide credit enhancement for the 2003 ARS Bonds, which made its statements regarding the benefits the Tribe would obtain as a result of Ambac's triple-A credit rating misleading in the light of the circumstances under which they were made; and
- (3) Ambac failed to disclose to the Tribe Ambac's view that credit enhancement formed no basis for its bargain with the Tribe, thereby making its partial disclosures that its financial guarantee insurance was a "form of credit enhancement" that benefitted the Tribe misleading under the circumstances in which they were made.

61.

Ambac's above-alleged omissions to state material facts and misleading statements were material because the omitted facts would have assumed actual significance in the Tribe's deliberations and would have significantly altered the total mix of information available to the

Tribe in considering whether to purchase credit enhancing financial guarantee insurance from Ambac and whether to issue its Bonds as ARS.

62.

The Tribe reasonably relied on Ambac's misrepresentations and failure to disclose material facts by entering into the Insurance Agreement with Ambac and purchasing the Bond Policy and Swap Policy from Ambac in connection with its issuance of the 2003 ARS Bonds.

63.

Ambac knew its above-alleged omissions to state material facts and misleading statements to the Tribe were false and misleading or acted with reckless disregard as to their truth or falsity or materially misleading nature.

64.

Ambac's violations of ORS 59.135 have caused damage to the Tribe for which Ambac is liable, pursuant to ORS 59.137, in excess of \$15 million, in the form of up front premiums, additional finance costs resulting from the interest rate increases and the cost of refinancing the 2003 ARS Bonds through the issuance of new bonds in 2009.

65.

Pursuant to Oregon law, the Tribe is entitled to recover its reasonable attorney fees.

(Count 2: Materially Aiding Citigroup's Securities Fraud)

66.

The Tribe re-alleges paragraphs 1 through 48 as though set forth fully herein.

67.

Citigroup violated ORS 59.135 in connection with the purchase and sale of the 2003 ARS Bonds in one or more of the following particulars:

- (1) Citigroup omitted to state to the Tribe that it was regularly intervening in ARS auctions for which it served as broker-dealer in order to prevent failed auctions, which made Citigroup's statements to the Tribe regarding its involvement in ARS

auctions misleading in the light of the circumstances under which they were made;

- (2) Citigroup omitted to state to the Tribe that it was regularly intervening in ARS auctions for which it served as broker-dealer in order to set a “market” rate, which made Citigroup’s statements to the Tribe regarding its involvement in ARS auctions misleading in the light of the circumstances under which they were made; and
- (3) Citigroup omitted to state to the Tribe that it was regularly intervening in ARS auctions for which it served as broker-dealer in order to prevent “all-hold” auctions, which made Citigroup’s statements to the Tribe regarding its involvement in ARS auctions misleading in the light of the circumstances under which they were made.

68.

Citigroup’s above-alleged omissions to state material facts and misleading statements were material because the omitted facts would have assumed actual significance in the Tribe’s deliberations and would have significantly altered the total mix of information available to the Tribe in considering whether to issue the 2003 ARS Bonds.

69.

The Tribe reasonably relied on Citigroup’s misrepresentations and failure to disclose material facts by issuing the 2003 ARS Bonds.

70.

Citigroup knew its omissions to state material facts and misleading statements to the Tribe were false and misleading or acted with reckless disregard as to their truth or falsity or materially misleading nature.

71.

Ambac materially aided Citigroup in its violation of ORS 59.135, which would not have occurred without Ambac's participation in the Tribe's issuance of the 2003 ARS Bonds.

72.

Ambac's materially aiding of Citigroup's violations of ORS 59.135 has caused damage to the Tribe for which Ambac is liable, pursuant to ORS 59.137, in excess of \$15 million.

73.

Pursuant to Oregon law, the Tribe is entitled to recover its reasonable attorney fees.

FOURTH CLAIM FOR RELIEF

(Negligence)

74.

The Tribe re-alleges paragraphs 1 through 48 as though set forth fully herein.

75.

By issuing risky financial guarantees for collateralized debt obligations and other asset backed securities such as subprime mortgages that jeopardized Ambac's triple-A credit rating, Ambac created a foreseeable risk of harm to the Tribe, which the law protects against negligent invasion.

76.

Ambac's conduct was reasonable in light of the risk and caused harm to the Tribe, which is within the general type of injuries that made Ambac's conduct negligent.

77.

Ambac's negligence has caused damage to the Tribe in excess of \$15 million, in the form of up front premiums, additional finance costs resulting from the interest rate increases and the cost of refinancing the 2003 ARS Bonds through the issuance of new bonds in 2009.

FIFTH CLAIM FOR RELIEF
(Statutory Tort—ORS 746.075)

78.

The Tribe re-alleges paragraphs 1 through 48 as though set forth fully herein.

79.

Ambac violated ORS 746.075 as follows:

- (1) Ambac misrepresented to the Tribe the benefits and advantages of the financial guarantee policies that it was soliciting to the Tribe by stating that Ambac's financial guarantee insurance is a form of credit enhancement that is a benefit to the issuer of securities when Ambac believed that credit enhancement formed no part of its bargain with the Tribe; and
- (2) Ambac obtained the Tribe's \$5.1 million premium by means of omitting to state that (a) Ambac had guaranteed billions of dollars of *subprime* mortgage-backed securities, which made Ambac's statements regarding its involvement in mortgage-backed securities market misleading in light of the circumstances under which they were made, and (b) Ambac believed that it had no duty to seek to continue to provide credit enhancement for the 2003 ARS Bonds and that credit enhancement formed no basis of its bargain with the Tribe, which made Ambac's statements regarding its financial guarantee insurance being a "form of credit enhancement" that benefitted the Tribe misleading in light of the circumstances under which they were made.

80.

Ambac's misleading statements and omissions to state facts were material because the omitted facts would have assumed actual significance in the Tribe's deliberations and would have significantly altered the total mix of information available to the Tribe in considering whether to purchase credit enhancing financial guarantee insurance from Ambac.

81.

The Tribe reasonably relied on Ambac's omissions to state material facts and materially misleading statements by entering into the Insurance Agreement with Ambac and purchasing the Bond Policy and Swap Policy from Ambac in connection with its issuance of the 2003 ARS Bonds.

82.

Ambac knew its omissions to state material facts and materially misleading statements to the Tribe were false and misleading or acted with reckless disregard as to their truth or falsity or materially misleading nature.

83.

The Tribe, as purchaser of Ambac's financial guarantee policies, is within the class of persons that the legislature intended to protect by ORS 746.075.

84.

Ambac's violation of ORS 746.075 has resulted in damages to the Tribe, which are the type of harm that the legislature intended to prevent, in excess of \$15 million, in the form of up front premiums, additional finance costs resulting from the interest rate increases and the cost of refinancing the 2003 ARS Bonds through the issuance of new bonds in 2009.

SIXTH CLAIM FOR RELIEF

(Negligence Per Se)

85.

The Tribe re-alleges paragraphs 1 through 48, 60 through 64, 67 through 72, and 79 through 84 as though set forth fully herein.

86.

Ambac has violated ORS 59.135 and ORS 746.075. As a result of Ambac's statutory violations, the Tribe has been injured. The Tribe is a member of the class of persons meant to be

protected by ORS 59.135 and ORS 746.075, and the type of injury suffered by the Tribe is of a type that ORS 59.135 and ORS 746.075 were enacted to prevent.

87.

Ambac's acts of negligence per se have caused damage to the Tribe in excess of \$15 million, in the form of up front premiums, additional finance costs resulting from the interest rate increases and the cost of refinancing the 2003 ARS Bonds through the issuance of new bonds in 2009.

SEVENTH CLAIM FOR RELIEF

(Rescission)

88.

The Tribe re-alleges paragraphs 1 through 48, 50 and 51 as though set forth fully herein.

89.

The Tribe's primary purpose in purchasing Bond and Swap Policies from Ambac was to obtain the triple-A credit enhancement for the 2003 ARS Bonds. That primary purpose was mutually understood by both Ambac and the Tribe.

90.

The Tribe's primary purpose was completely frustrated by the downgrading of Ambac's credit rating below S&P's AAA rating or Moody's Aaa rating. That "frustration" was the result of circumstances that the parties mutually assumed would not occur, and, thus, the risk of the frustrating circumstance occurring is not allocated to the Tribe.

91.

The Tribe is entitled to rescind the contract and be put in the position it was before entering the contract. To be restored to the position it was in before the contract the Tribe is entitled to receive payment of \$15 million, which includes repayment of the premiums paid for the Ambac guaranty insurance, repayment of the additional finance costs that resulted from the

interest rate increases and repayment of the cost of refinancing the 2003 ARS Bonds through the issuance of new bonds in 2009.

EIGHTH CLAIM FOR RELIEF

(Unjust Enrichment)

92.

The Tribe re-alleges paragraphs 1 through 47 as though set forth fully herein.

93.

The Tribe conferred a benefit on Ambac through its purchase of the Bond and Swap Policies for premium payment totaling approximately \$5.1 million. Ambac is aware that it has received that benefit. Under the circumstances, it would be unjust to allow Ambac to retain the insurance premium/purchase price payments made by the Tribe for the Bond and Swap Guaranty Insurance Policies.

94.

The Tribe is entitled to recover the amount of unjust enrichment received by Ambac in an amount in excess of \$5.1 million.

NINTH CLAIM FOR RELIEF

(Oregon Common Law Fraud)

95.

The Tribe re-alleges paragraphs 1 through 48 as though set forth fully herein.

96.

Ambac made material misrepresentations of fact to the Tribe in one or more of the following particulars:

- (1) Ambac failed to disclose to the Tribe that it had guaranteed billions of dollars of *subprime* mortgage-backed securities, which made Ambac's statements regarding its involvement in mortgage-backed securities market misleading in light of the circumstances under which they were made;

- (2) Ambac omitted and failed to disclose to the Tribe that it believed that it had no duty to seek to continue to provide credit enhancement for the 2003 ARS Bonds and that credit enhancement formed no basis of its bargain with the Tribe, which made Ambac's statements regarding its financial guarantee insurance being a "form of credit enhancement" that benefitted the Tribe misleading in light of the circumstances under which they were made; and
- (3) Ambac misrepresented to the Tribe the benefits and advantages of the financial guarantee policies that it was soliciting to the Tribe by stating that Ambac's financial guarantee insurance was a form of credit enhancement that is a benefit to the issuer of securities when Ambac believed that credit enhancement formed no part of its bargain with the Tribe.

97.

Ambac's misrepresentations and failures to disclose facts were material because they affected the reasonable conduct of the Tribe. The facts that Ambac failed to disclose would have assumed actual significance in the Tribe's deliberations and would have significantly altered the total mix of information available to the Tribe in considering whether to purchase credit enhancing financial guarantee insurance from Ambac.

98.

The Tribe reasonably relied on Ambac's misrepresentations and failure to disclose material facts by entering into the Insurance Agreement with Ambac and purchasing the Bond Policy and Swap Policy from Ambac in connection with its issuance of the 2003 ARS Bonds.

99.

Ambac knew its omissions to state material facts and materially misleading statements to the Tribe were false and misleading or acted with reckless disregard as to their truth or falsity or materially misleading nature.

100.

Ambac's violations of Oregon's securities laws have caused damage to the Tribe in excess of \$15 million, in the form of up front premiums, additional finance costs resulting from the interest rate increases and the cost of refinancing the 2003 ARS Bonds through the issuance of new bonds in 2009.

WHEREFORE, plaintiff The Confederated Tribes of the Warm Springs Reservation of Oregon prays for a judgment in its favor and against defendant Ambac Assurance Corporation as follows:

1. On plaintiff's **FIRST CLAIM FOR RELIEF**, for judgment against defendant for money damages in an amount exceeding \$15 million to be proven at trial;
2. On plaintiff's **SECOND CLAIM FOR RELIEF**, for judgment against defendant for money damages in an amount exceeding \$15 million to be proven at trial;
3. On plaintiff's **THIRD CLAIM FOR RELIEF (Count 1)**, for judgment against defendant for money damages in an amount exceeding \$15 million to be proven at trial, and for plaintiff's attorney fees;
4. On plaintiff's **THIRD CLAIM FOR RELIEF (Count 2)**, for judgment against defendant for money damages in an amount exceeding \$15 million to be proven at trial, and for plaintiff's attorney fees;
5. On plaintiff's **FOURTH CLAIM FOR RELIEF**, for judgment against defendant for money damages in an amount exceeding \$15 million to be proven at trial;
6. On plaintiff's **FIFTH CLAIM FOR RELIEF**, for judgment against defendant for money damages in an amount exceeding \$15 million to be proven at trial;
7. On plaintiff's **SIXTH CLAIM FOR RELIEF**, for judgment against defendant for money damages in an amount exceeding \$15 million to be proven at trial;
8. On plaintiff's **SEVENTH CLAIM FOR RELIEF**, for judgment against defendant for money damages in an amount exceeding \$15 million to be proven at trial;

9. On plaintiff's **EIGHTH CLAIM FOR RELIEF**, for judgment against defendant for money damages in an amount exceeding \$5.1 million to be proven at trial;

10. On plaintiff's **NINTH CLAIM FOR RELIEF**, for judgment against defendant for money damages in an amount exceeding \$15 million to be proven at trial;

11. For plaintiff's costs and disbursements; and

12. For such other relief as the court deems equitable and just.

DATED this 27th day of September, 2010.

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CERTIFICATE OF SERVICE

I hereby certify that I served the foregoing SECOND AMENDED COMPLAINT on:

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by causing a full, true, and correct copy thereof to be sent by the following indicated method or methods, on the date set forth below:

- ☐ by mailing in a sealed, first-class postage-prepaid envelope, addressed to the last-known office address of the attorney, and deposited with the United States Postal Service at Bend, Oregon.
- ☐ by hand delivery.
- ☐ by sending via overnight courier in a sealed envelope.
- ☐ by faxing to the attorney at the fax number that is the last-known fax number for the attorney's office.
- ☒ by electronic service (CM/ECF system transmission).

DATED this 27th day of September, 2010.

KARNOPP PETERSEN LLP

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