

Hearing Date: September 21, 2011 at 10:00 A.M. (prevailing Eastern Time)
Objection Deadline: September 14, 2011 at 4:00 P.M. (prevailing Eastern Time)

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Attorneys for the Debtor and Debtor in Possession

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK**

-----X	:	
<i>In re</i>	:	Chapter 11 Case No.
	:	
AMBAC FINANCIAL GROUP, INC.,	:	
	:	Case No. 10-15973 (SCC)
Debtor.	:	
	:	
	:	
-----X		

**NOTICE OF HEARING ON DEBTOR’S MOTION PURSUANT TO SECTION 105(A)
OF THE BANKRUPTCY CODE AND BANKRUPTCY RULE 9019
FOR APPROVAL OF SETTLEMENT AGREEMENT REGARDING
PROOF OF CLAIM NUMBER 4 FILED BY THE CITY OF NEW YORK**

PLEASE TAKE NOTICE that a hearing on the annexed motion (the “Motion”) will be held before the Honorable Shelley C. Chapman, United States Bankruptcy Judge, in Room 610 of the United States Bankruptcy Court, One Bowling Green, New York, New York 10004-1408 on September 21, 2011, at 10:00 a.m. (Eastern Time), or as soon thereafter as counsel may be heard (the “Hearing”).



PLEASE TAKE FURTHER NOTICE that objections, if any, to the relief requested in the Motion (i) must comply with the Federal Rules of Bankruptcy Procedure, the Local Rules of the United States Bankruptcy Court for the Southern District of New York and the *Amended Order Pursuant to Bankruptcy Rules 2002, 9007, and 9036, and Local Rule 2002-2, Establishing Certain Notice, Case Management, and Administrative Procedures* entered on December 21, 2010 [Docket No. 75] (the “Case Management Order”), (ii) must be set forth in writing describing the basis therefor, and (iii) shall be filed electronically with the Court on the docket of *In re Ambac Financial Group, Inc.*, Case No. 10-15973 (SCC), in accordance with General Order M-399, by registered users of the Court’s case filing system and by all other parties in interest on a 3.5 inch disk.

PLEASE TAKE FURTHER NOTICE that, pursuant to Local Rule 9070-1, (i) at least one hard copy of any objections filed shall be marked “Chambers Copy” and delivered in an unsealed envelope to the chambers of the Honorable Judge Shelley C. Chapman, United States Bankruptcy Court, One Bowling Green, New York, New York 10004, not later than the next business day following the date on which such document is electronically filed, and (ii) copies of any objections filed shall be delivered by first class mail to (a) Dewey & LeBoeuf LLP, 1301 Avenue of the Americas, New York, New York 10019, Attn: Tevia Jeffries, Esq., counsel for the Debtor; (b) the Office of the United States Trustee for the Southern District of New York, 33 Whitehall Street, 21st Floor, New York, New York 10004, Attn: Brian Masumoto, Esq.; (c) Foley & Lardner LLP, 777 Wisconsin Avenue, Milwaukee, Wisconsin 53202, Attn: Frank DiCastrì, Esq., counsel for Wisconsin Office of the Commissioner of Insurance; (d) Morrison & Foerster LLP, 1290 Avenue of the Americas, New York, New York 10104, Attn: Anthony Princi, Esq., counsel for the statutory committee of creditors; (e) Corporation Counsel

for the City of New York, 100 Church Street, 5th Floor, New York, New York 10007, Attn:
Andrew G. Lipkin, Senior Counsel, counsel for the City of New York Department of Finance;
and (f) all parties who have requested notice in this chapter 11 case, so as to be received no later
than September 14, 2011, at 4:00 p.m. (Eastern Time).

PLEASE TAKE FURTHER NOTICE that objecting parties are required to
attend the Hearing and failure to appear may result in relief being granted or denied upon default.

Dated: August 31, 2011
New York, New York

/s/ Peter A. Ivanick
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**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK**

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: **Chapter 11 Case No.**
In re :
: **Case No. 10-15973 (SCC)**
AMBAC FINANCIAL GROUP, INC., :
: **Debtor.** :
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**DEBTOR'S MOTION PURSUANT TO SECTION 105(A) OF THE
BANKRUPTCY CODE AND BANKRUPTCY RULE 9019
FOR APPROVAL OF SETTLEMENT AGREEMENT REGARDING
PROOF OF CLAIM NUMBER 4 FILED BY THE CITY OF NEW YORK**

TO THE HONORABLE SHELLEY C. CHAPMAN,
UNITED STATES BANKRUPTCY JUDGE:

Ambac Financial Group, Inc., as debtor and debtor in possession in the above-captioned chapter 11 case (the "Debtor" or "Ambac"), by and through its undersigned counsel, hereby submits this motion (the "Motion"), pursuant to section 105(a) of title 11 of the United

States Code (the “Bankruptcy Code”) and Rule 9019 of the Federal Rules of Bankruptcy Procedure (the “Bankruptcy Rules”), for an order, substantially in the form attached hereto as Exhibit A (the “Order”), (a) approving the Settlement Agreement annexed to the Order as Exhibit 1 (the “Settlement Agreement”) by and between the City of New York Department of Finance (the “City”) and the Debtor and (b) approving the immediate payment of the agreed upon settlement consideration. In further support of this Motion, the Debtor respectfully represents:

INTRODUCTION

1. By this Motion, the Debtor seeks approval of the Settlement Agreement resolving, and authorizing the satisfaction of, proof of claim number 4, pursuant to which the City asserts that the Debtor owes it approximately \$116.8 million in additional general corporation taxes and interest and that the entire amount is entitled to priority status (“Tax Claim”).

2. The Debtor disputes that it is liable for the taxes and interest giving rise to the Tax Claim. However, the Debtor recognizes that the failure to settle the Tax Claim may severely prejudice its ability to confirm its plan of reorganization. By settling the Tax Claim, the Debtor can avoid the expense of litigation, the associated delay to its plan confirmation schedule and the risk that the Tax Claim may be allowed in full and given priority status and thereby impose an impediment to a successful restructuring. Pursuant to the Settlement Agreement, the Tax Claim would be allowed as an unsecured priority claim under Bankruptcy Code § 507(a)(8) in the amount of \$3,233,611.00 and the Debtor would immediately remit \$2 million in cash (the “Cash Consideration”) and surrender \$1,233,611.00 in overpayment carry forward tax credits (the “Credit Consideration”) and collectively with the Cash Consideration, the “Settlement Consideration”) in full and final satisfaction of the Tax Claim.

3. Thus, the Debtor has determined, through the exercise of its sound business judgment and in close consultation with the Committee, that the Settlement Agreement is fair, equitable, and eminently reasonable and is in the best interests of the Debtor and its bankruptcy estate.

BACKGROUND

A. The Chapter 11 Case

4. On November 8, 2010 (the “Commencement Date”), the Debtor commenced a voluntary case under chapter 11 of the Bankruptcy Code. The Debtor continues to operate its business and manage its properties as debtor in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.

5. On November 17, 2010, the Office of the United States Trustee for the Southern District of New York (the “U.S. Trustee”) appointed a statutory committee of creditors (the “Committee”) [Docket No. 27]. No trustee or examiner has been appointed in this case.

6. The Debtor is a publicly reporting holding company and a Delaware corporation. The Debtor’s principal operating subsidiary, Ambac Assurance Corporation (“AAC”), is a Wisconsin-domiciled financial guarantee insurance company whose business includes the issuance of financial guarantee insurance policies to support public finance, structured finance and international finance transactions.

7. Additional information regarding the Debtor’s capital structure and events leading up to the commencement of the Debtor’s chapter 11 case is available in the *Affidavit of David W. Wallis in Support of the Debtor’s Chapter 11 Petition and First Day Motions and Pursuant to Local Rule 1007-2*, filed on November 8, 2010 [Docket No. 2].

B. Background of the City’s Tax Claim

8. The Debtor and certain of its direct and indirect subsidiaries (the “Combined Group”) filed combined returns in both the City and State of New York, where the Debtor is headquartered.

9. The transfers of cash deposited with the Debtor’s guaranteed investment contract (“GIC”) business, from Ambac Capital Funding, Inc. through Ambac Capital Corporation to Ambac Investments, Inc. and back, generate intercompany investment income and interest expense, which was eliminated in all Federal tax filings and in those with the City and State of New York. Investment income received from third parties and interest expense paid to GIC depositors was accounted for in those filings. However, the City sought to disallow a substantial portion of Ambac Capital Funding, Inc.’s interest expense paid or accrued to the third party holders of its GICs, which would have the result of increasing the general corporation tax (“GCT”) for the Combined Group.

C. The City’s Tax Claim and the Debtor’s Objection

10. On December 14, 2010, the City filed proof of claim number 4, asserting that the Debtor owes it \$116,817,949.00, comprised of \$77,940,995.00 in principal for general corporation tax and \$38,876,954.00 in interest thereon for the tax years commencing on January 1, 2000 and ending December 31, 2010 (the “Tax Claim”).

11. On May 23, 2011, the Debtor filed its *Objection and Request to Disallow the Claim Submitted by the City of New York Department of Finance* [Docket No. 278] objecting to the Tax Claim, denying liability for additional taxes or interest and requesting that this Court disallow the Tax Claim in its entirety.

12. On July 6, 2011, the City filed its *Response in Opposition to Ambac Financial Group, Inc.'s Objection and Request to Disallow the Proof of Claim Filed by the City of New York Department of Finance* [Docket No. 346] (the "Response").

SUMMARY OF SETTLEMENT AGREEMENT

13. The City agrees to reduce the amount of the Tax Claim from \$116,817,949.00 to \$3,233,611.00.

14. Upon entry of an Order approving the Settlement Agreement, the Tax Claim will be deemed allowed as an unsecured priority claim under Bankruptcy Code § 507(a)(8) in the amount of \$3,233,611.00.

15. The Debtor will provide the Settlement Consideration to the City in full and final satisfaction of the Tax Claim and the associated liability of the Combined Group for the period January 1, 2000 to December 31, 2010.

JURISDICTION AND VENUE

16. This Court has jurisdiction to consider and determine this matter pursuant to 28 U.S.C. § 1334. This is a core proceeding pursuant to 28 U.S.C. § 157(b). Venue is proper before this Court pursuant to 28 U.S.C. §§ 1408 and 1409.

RELIEF REQUESTED

17. By this Motion, the Debtor seeks entry of an order, pursuant to section 105(a) of the Bankruptcy Code and Bankruptcy Rule 9019, approving the Settlement Agreement.

APPLICABLE AUTHORITY

18. The Court may authorize the Debtor to enter into the Settlement Agreement. Bankruptcy Rule 9019(a) provides, in part, that "[o]n motion by the [debtor-in-possession] and after notice and a hearing, the court may approve a compromise or settlement." Fed. R. Bankr. P. 9019(a). This rule empowers bankruptcy courts to approve a settlement agreement where "it is

supported by adequate consideration, is ‘fair and equitable,’ and is in the best interests of the estate.” *In re Ionosphere Clubs, Inc.*, 156 B.R. 414, 426 (S.D.N.Y. 1993). This is not a mechanical process:

There is a range of reasonableness with respect to a settlement - a range which recognizes the uncertainties of law and fact in any particular case and the concomitant risks and costs necessarily inherent in taking any litigation to completion - and the judge will not be reversed if the appellate court concludes that the settlement lies with that range.

Newman v. Stein, 464 F.2d 689, 693 (2d Cir. 1972).

19. A decision to accept or reject a compromise on settlement is within the sound discretion of the Court. *In re Ionosphere Clubs, Inc.*, 156 B.R. at 426. To exercise this discretion, the Court must

[A]pprise [herself] of all facts necessary for an intelligent and objective opinion of the probabilities of ultimate success should the claim be litigated. Further, the judge should form an educated estimate of the complexity, expense, and likely duration of such litigation, the possible difficulties of collecting on any judgment which might be obtained, and all other factors relevant to a full and fair assessment of the wisdom of the proposed compromise. Basic to this process in every instance, of course, is the need to compare the terms of the compromise with the likely rewards of litigation.

Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414, 424-25 (1968). In exercising its discretion, the bankruptcy court should be guided by “the general public policy favoring settlements.” *In re Hibbard Brown & Co., Inc.*, 217 B.R. 41, 46 (Bankr. S.D.N.Y. 1998); *see Nellis v. Shugrue*, 165 B.R. 115, 123 (S.D.N.Y. 1994) (“the general rule [is] that settlements are favored and, in fact, encouraged...”); *Vaughn v. Drexel Burnham Lambert Group, Inc. (In re Drexel Burnham Lambert Group, Inc.)*, 134 B.R. 499, 505 (Bankr. S.D.N.Y. 1991).

20. Bankruptcy courts in the Southern District of New York have applied the

following “*Iridium*” factors in determining whether a settlement should be approved:

- (A) the balance between the litigation’s possibility of success and the settlement’s future benefits;
- (B) the likelihood of complex and protracted litigation, “with its attendant expense, inconvenience, and delay;”
- (C) the paramount interests of creditors;
- (D) whether other parties in interest support the settlement;
- (E) the “competency and experience of counsel” supporting, and “[t]he experience and knowledge of the bankruptcy court judge” reviewing [the settlement];
- (F) “the nature and breadth of releases to be obtained by officers and directors;” and
- (G) “the extent to which the settlement is the product of arm’s length bargaining.”

Motorola, Inc v. Official Comm. Of Unsecured Creditors and JP Morgan Chase Bank, N.A. (In re Iridium Operating LLC), 478 F.3d 452 (2d Cir. 2009); *see also In re Chemtura Corp.*, 439 B.R. 561, 594 (Bankr. S.D.N.Y. 2010) (applying *Iridium* factors). In addition, courts in the Southern District of New York have elaborated upon these factors to include a weighing of the informed judgment, competency and experience of the debtor in possession and its counsel. *See Nellis v. Shugrue*, 165 B.R. 115, 122 (S.D.N.Y. 1994) (“[A] bankruptcy court may consider the opinions of the [debtor in possession] and [its] counsel that the settlement is fair and equitable.”); *In re Ashford Hotels, Ltd.*, 226 B.R. at 802; *In re Drexel Burnham Lambert Group*, 134 B.R. at 505.

21. In determining whether to approve a proposed settlement, a bankruptcy court need not conduct a “mini-trial” to determine the merits of the underlying litigation or the numerous issues of law and fact raised by the dispute and resolved by the settlement. Instead, “[t]he court’s responsibilities are to ‘familiarize itself with all facts necessary for an intelligent and objective

opinion, canvass the issues, and see whether the settlement falls below the lowest point in the range of reasonableness.”’ *In re Ashford Hotels, Ltd.*, 226 B.R. at 802 (quoting *In re W.T. Grant Co.*, 699 F.2d 599, 608 (2d Cir. 1983)); see *In re Purofied Down Prods. Corp.*, 150 B.R. 519, 522 (S.D.N.Y. 1993); *Nellis v. Shugrue*, 165 B.R. at 123-24 (bankruptcy judge need not be aware of the particulars of each respective claim resolved by a settlement agreement before approving the agreement).

22. The Debtor submits that the Settlement Agreement represents a fair and equitable settlement that falls well within the range of reasonableness. Because the proposed Settlement Agreement satisfies the *Iridium* factors for approval of a compromise, the Debtor should be authorized to enter into the Settlement Agreement pursuant to Bankruptcy Rule 9019.

A. The Probability of Success of the City’s Claim

23. The Settlement Agreement fully, finally, and forever resolves, discharges and settles any and all general corporation tax liabilities of the Combined Group for the period January 1, 2000 to December 31, 2010. The Debtor submits that continued litigation with the City over the Tax Claim exposes the estate to substantial cost, delay to its confirmation schedule (and accompanying costs) and will likely distract key personnel from the important task of reorganizing the Debtor.

24. The Debtor believes that the City would have difficulty proving its claim at trial. However, in light of the complexity of the dispute as to the interpretation of the New York City allocation regulations and the application of the same to interest income and expense generated as a result of the Debtor’s subsidiaries’ GIC business, it is impossible to predict the outcome of a trial on the allowance of the Tax Claim. Moreover, the burden of proof arguably falls upon the Debtor to establish that the City’s disallowance of certain interest income expense deductions

was improper and the applicable rules for tracing of such expense have yet to be the subject of a precedentially binding decision. Accordingly, the degree of proof necessary to establish such tracing is unsettled. Thus, while the Debtor believes that it would prevail on the objection were it litigated, it recognizes that this is an unsettled area regarding proof and such proof may subject the Debtor to considerable expense and the risk of an adverse decision.

25. Significantly, if the Tax Claim was allowed as filed it would be a priority claim pursuant to Bankruptcy Code 507(a)(8) and therefore, the Debtor would be obligated to pay the entire claim amount within five years of emergence from bankruptcy. The Debtor may not be in a position to satisfy such an obligation and, in any event, such an obligation would threaten the feasibility of its plan. Thus, in order to establish the feasibility of its plan, among other things, the Debtor would be forced to pay the Tax Claim in full upon the effective date of its plan of reorganization. The Debtor lacks the resources to make a \$116.8 million cash payment at this time. As a result, the allowance of the Tax Claim in full as a priority claim would severely impair, if not render impossible, the Debtor's ability to emerge from bankruptcy and would likely turn the Debtor's case from a reorganization to a liquidation. Furthermore, litigating the Tax Claim would be costly and could possibly involve expensive and time-consuming discovery. As such, the Debtor believes that the compromise reflected in the Settlement Agreement is well within the range of acceptable outcomes the Debtor could achieve through litigation of the Tax Claim, in particular given that (i) the City has agreed to accept the Settlement Consideration in full and final satisfaction of the Tax Claim and (ii) the Debtor expects to realize significant savings in professional fees once the settlement is final.

26. As set forth above, the disputes underlying the Tax Claim involve a multitude of issues and arguments by both sides. Given the complexity of the Tax Claim and the difficulty in

predicting the outcome thereof, the Debtor submits that settlement in these circumstances is appropriate.

B. The Likelihood of Complex and Protracted Litigation

27. The pending dispute could significantly delay confirmation of the Debtor's plan of reorganization. Indeed, the Parties have been disputing the appropriate allocation of the Debtor's investment income and other components of the GCT since 2006. Accordingly, it is likely that the continued litigation of the Tax Claim, along with any appeals, would result in the delay of the confirmation of the Debtor's plan of reorganization and would require significant time and resources of the Debtor.

28. Absent the Settlement Agreement, the Debtor's estate will be further diminished by payment of administrative expense claims under Bankruptcy Code Section 503(b)(4) for professional fees rendered in connection with the Tax Claim. The Debtor estimates that the anticipated cost to the Debtor of litigating the Tax Claim could, depending upon discovery, approach or possibly even exceed the \$2.0 million Cash Consideration (and the \$1,233,611.00 Credit Consideration) the Debtor has agreed to pay in connection with the Settlement Agreement. Further, if the Tax Claim is not resolved, the Debtor's management would likely be distracted by discovery demands and other litigation related activities at a time when their attention is best served reorganizing the Debtor. For this reason alone the proposed Settlement Agreement is a timely, cost-effective resolution of the Tax Claim.

C. The Paramount Interests of Creditors

29. The Settlement Agreement is beneficial to the Debtor's creditors and estate for at least two significant reasons. First, the proposed Settlement Agreement will resolve one of the two largest disputed claims against the Debtor, thereby providing much needed predictability

with respect to the Debtor's claims pool and reserve in anticipation of the confirmation of a plan of reorganization. Second, the proposed Settlement Agreement preserves value for the estate as it requires no further payment from the Debtor beyond the Settlement Consideration and allows for the avoidance of further costly litigation, thus increasing the amount available for the payment of creditors' claims. The proposed Settlement Agreement is therefore in the best interests of the Debtor's creditors.

30. Furthermore, the Committee was an active participant in the negotiation of the Settlement Agreement. The Committee reviewed the terms of the Settlement Agreement and supports the Settlement Agreement as being in the best interest of both the Debtor's estate and its creditors.

D. The Proposed Settlement Agreement Satisfies the Remaining *Iridium* Factors

31. For the reasons stated above the Debtor and the Committee believe that the paramount interests of all parties are best served by approval of the Settlement Agreement. Moreover, the last three *Iridium* factors are satisfied because the Settlement Agreement was negotiated and proposed by parties without collusion, in good faith, and from arms' length bargaining positions. Indeed, the Settlement Agreement was achieved only after arms' length negotiations – including meetings and numerous communications among the Debtor, the Committee and the City. The Debtor and the City also extensively discussed the Debtor's financial condition and ability to satisfy the Tax Claim.

32. In sum, the Debtor has determined, exercising its sound business judgment, that the Settlement Agreement is fair, equitable, and eminently reasonable. Moreover, the timely resolution of the Tax Claim is in the best interests of the Debtor and all of its creditors. The Debtor therefore submits that the Settlement Agreement is fair and reasonable and well within the range of litigation possibilities. Accordingly, the Debtor respectfully requests that the Court

approve the Settlement Agreement pursuant to section 105(a) of the Bankruptcy Code and Bankruptcy Rule 9019.

IMMEDIATE PAYMENT OF THE SETTLEMENT CONSIDERATION IS NECESSARY

33. The “doctrine of necessity” permits the bankruptcy court to authorize the payment of prepetition claims prior to confirmation. To invoke the rule, however, the debtor must show that the payment is “critical to the debtor’s reorganization.” *In re Financial News Network, Inc.*, 134 Bankr. 732, 736 (Bankr. S.D.N.Y. 1991); *accord In re NVR L.P.*, 147 Bankr. 126, 128 (Bankr. E.D. Va. 1992) (“the proponent of the payment must show substantial necessity”); *In re Eagle-Picher Indus., Inc.*, 124 Bankr. 1021, 1023 (Bankr. S.D.N.Y. Ohio 1991) (payment must be “necessary to avert a serious threat to the Chapter 11 process”); *In re Chateaugay Corp.*, 80 Bankr. 279, 287 (S.D.N.Y. 1987) (payment necessary to “permit the greatest likelihood of survival of the debtor and payment of creditors in full or at least proportionately”) (*cf. In re Chateaugay Corp.*, 89 F.3d 942, 950 (2d Cir. 1996) (debtor may separately classify similar claims and pay one class in full if necessary for the debtor’s future viability and effective reorganization)).

34. Here, the Debtor, in conjunction with the Committee, negotiated a significant discount (approximately \$113 million) of the Tax Claim. Among the City’s conditions for accepting such a substantial discount of its claim was the immediate payment of the Settlement Consideration. While the immediate payment of a pre-petition claim deviates from normal bankruptcy procedure, immediate payment of the Settlement Consideration is warranted to effectuate the prompt settlement of one of the largest claims against the Debtor’s estate, thereby removing one of the primary obstacles to the confirmation of a plan of reorganization of the Debtor at relatively nominal cost. The Settlement Agreement represents one of the best possible

resolutions of the Tax Claim insofar as it avoids costly and time consuming litigation of the Tax Claim, preserving the Debtor's estate for its rehabilitative efforts or, in the unlikely event of liquidation, for the benefit of its creditors.

35. Furthermore, as discussed above, if the Tax Claim were not resolved pursuant to the Settlement Agreement, the Tax Claim might be an allowed priority claim of approximately \$116.8 million, payable in full upon the confirmation of the Debtor's plan of reorganization. Payment of such an amount upon confirmation would render the Debtor's plan of reorganization infeasible and thus could force the Debtor to liquidate. Since the prompt resolution of the Tax Claim through the pre-confirmation payment of the Settlement Consideration is absolutely necessary for the confirmation of a feasible plan of reorganization, the doctrine of necessity warrants the authorization of the Debtor's pre-confirmation payment of the Settlement Consideration in full and final satisfaction of the Tax Claim.

36. Moreover, if the Debtor was forced to liquidate despite the resolution of the Tax Claim, the pre-confirmation payment of the Tax Claim would result in the best possible outcome for the Debtor because settling the Tax Claim at such a substantial discount would eliminate a significant claim against the Debtor's estate, thereby maximizing the proceeds available to the Debtor's creditors upon liquidation. Indeed, the Debtor and the Committee considered the risk and impact of a conversion to chapter 7 and determined that it still made sense to enter into the Settlement Agreement and make the immediate payment of the Cash Consideration.

NOTICE

37. Notice of this Motion has been provided by facsimile, electronic mail transmission, overnight delivery and/or hand delivery to (i) the U.S. Trustee, (ii) counsel to the Wisconsin Office of the Commissioner of Insurance, (iii) counsel to the Committee, (iv) counsel

to the City, and (v) those parties who have requested notice pursuant to Rule 2002 as of the date of this Motion. The Debtor submits that no other or further notice need be provided.

NO PREVIOUS REQUEST

38. No previous request for the relief sought herein has been made by the Debtor to this or any other court.

CONCLUSION

WHEREFORE the Debtor respectfully requests an order, substantially in the form annexed hereto as Exhibit A, approving the Settlement Agreement, pursuant to section 105(a) of the Bankruptcy Code and Bankruptcy Rule 9019, and granting such further relief as may be just or proper.

Dated: August 31, 2011
New York, New York

/s/ Peter A. Ivanick _____
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Attorneys for the Debtor and Debtor in Possession

EXHIBIT A

Proposed Order

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK**

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In re : **Chapter 11 Case No.**
 :
AMBAC FINANCIAL GROUP, INC., :
 : **Case No. 10-15973 (SCC)**
 : **Debtor.** :
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**ORDER, PURSUANT TO SECTION 105(A) OF THE BANKRUPTCY CODE
AND BANKRUPTCY RULE 9019, APPROVING SETTLEMENT AGREEMENT
REGARDING PROOF OF CLAIM NUMBER 4 FILED BY THE CITY OF NEW YORK**

Upon the motion dated August 31, 2011 (the “Motion”)¹ of Ambac Financial Group, Inc., as debtor and debtor in possession in the above-captioned chapter 11 case (the “Debtor”), for an order approving the Settlement Agreement (the “Settlement Agreement”) all as more fully described in the Motion; and the Court having jurisdiction to consider the Motion and the relief requested therein in accordance with 28 U.S.C. § 1334; and consideration of the Motion and the relief requested therein being a core proceeding pursuant to 28 U.S.C. § 157(b); and venue being proper before this Court pursuant to 28 U.S.C. §§ 1408 and 1409; and due and proper notice of the Motion having been provided to (i) the Office of the United States Trustee for the Southern District of New York, (ii) counsel to the Office of the Commissioner of Insurance of the State of Wisconsin, (iii) counsel to the statutory committee of creditors, (iv) counsel to the City, and (v) those parties who have requested notice pursuant to Bankruptcy Rule 2002, as of the date of this Motion; and it appearing that no other or further notice need be provided; and the terms of the Settlement Agreement being fair and reasonable and well within

¹ All capitalized terms used but not defined herein shall have the meaning ascribed to them in the Motion or the Settlement Agreement, as applicable.

the range of litigation possibilities, and sound business reasons existing for entry into the Settlement Agreement by the Debtor; and the Court having determined that the relief sought in the Motion reflects an exercise of the Debtor's sound business judgment and is in the best interests of the Debtor, its estate and creditors, and all parties in interest, and that the legal and factual bases set forth in the Motion establish just cause for the relief granted herein; and after due deliberation and sufficient cause appearing therefor, it is:

ORDERED that the Motion is granted; and it is further

ORDERED that, pursuant to section 105(a) of the Bankruptcy Code and Bankruptcy Rule 9019, the Settlement Agreement annexed hereto as Exhibit 1 is hereby approved in its entirety; and it is further

ORDERED that the Tax Claim is deemed allowed as an unsecured priority claim under 11 U.S.C. §507(a)(8) in the amount of \$3,233,611.00 and the balance of the Tax Claim is disallowed with prejudice; and it is further

ORDERED that the Debtor is authorized to make an immediate cash payment of \$2,000,000.00 to the City and surrender overpayment carry forward tax credits in the amount of \$1,233,611.00 in full and final satisfaction of the Tax Claim and any and all tax liability of the Debtor and the Combined Group for the period January 1, 2000 to December 31, 2010; and it is further

ORDERED that the Debtor is authorized to take all actions necessary to effectuate the relief granted pursuant to this Order in accordance with the Motion; and it is further

ORDERED that this Court shall retain jurisdiction with respect to all matters within its jurisdiction arising from or related to the implementation of this Order.

Dated: _____, 2011
New York, New York

THE HONORABLE SHELLEY C. CHAPMAN
UNITED STATES BANKRUPTCY JUDGE

EXHIBIT 1

Settlement Agreement

SETTLEMENT AGREEMENT

THIS **SETTLEMENT AGREEMENT** (the “Agreement”) is made as of August 31, 2011 by and between the CITY OF NEW YORK DEPARTMENT OF FINANCE (the “City”) and AMBAC FINANCIAL GROUP, INC. (“AFG”) on behalf of itself and all of its affiliates that are or were members of the combined tax group for purposes of filing general corporation tax returns with the City for one or more tax years during the period from January 1, 2000 through and including December 31, 2010 (collectively, the “Combined Group”). The City and AFG are also referred to herein each as a “Party” and collectively as the “Parties.”

RECITALS

- A. For each of the tax years 2000 through and including 2009, AFG and certain members of the Combined Group filed a combined general corporation tax return with the City.
- B. As of November 8, 2010, the liability of AFG and the members of the Combined Group for taxes owed to the City for tax years 2000 through 2009 had been the subject of a pending dispute.
- C. On November 8, 2010 (the “Commencement Date”), AFG commenced a voluntary case (the “Chapter 11 Case”) under chapter 11 of title 11 of the United States Code (the “Bankruptcy Code”). AFG continues to operate its business and manage its assets as debtor in possession as authorized by sections 1107(a) and 1108 of the Bankruptcy Code.
- D. On December 14, 2010, the City filed proof of claim number 4 in the Chapter 11 Case, asserting that AFG owes it \$116,817,949.00, comprised of \$77,940,995.00 in principal and \$38,876,954.00 in interest thereon for the tax years commencing on January 1, 2000 and ending December 31, 2010 (the “Tax Claim”). Similarly, the City contends that each of the members of the Combined Group is severally liable to the City in the same amount for the same tax period.
- E. On May 23, 2011, AFG filed its *Objection and Request to Disallow the Claim Submitted by the City of New York Department of Finance* [Docket No. 278] objecting to the Tax Claim.
- F. On July 6, 2011, the City filed its *Response in Opposition to Ambac Financial Group, Inc.’s Objection and Request to Disallow the Proof of Claim Filed by the City of New York Department of Finance* [Docket No. 346] (the “Response”).
- G. The Parties desire to resolve their differences without further resort to litigation and, as a result of the Parties’ good faith and arm’s length negotiations, have agreed to the settlement set forth herein.

AGREEMENT

In consideration of the foregoing and such other good and valuable consideration discussed below, the Parties agree as follows:

1. Tax Periods Affected This Agreement will resolve any and all remaining tax liability of AFG and the Combined Group to the City for the period from January 1, 2000 through and including December 31, 2010 (the "Relevant Tax Period").

2. Disposition of the Tax Claim The Tax Claim shall be allowed as an unsecured priority claim under 11 U.S.C. § 507(a)(8) in the total amount of \$3,233,611.00. The balance of the Tax Claim shall be disallowed with prejudice. The Tax Claim shall be deemed to be satisfied in full by the Settlement Consideration discussed below.

3. Settlement Consideration **In full and final satisfaction of the Tax Claim and all tax liability owed by AFG and the Combined Group to the City for the Relevant Tax Period, the City shall:** (i) receive a cash payment of two million dollars (\$2,000,000.00) from AFG (the "Cash Consideration") and (ii) apply in settlement of the Tax Claim, rather than refund or apply to any other tax claim or tax period, the \$1,233,611.00 in funds currently on deposit with the City as a result of payments previously made by AFG to the City prior to the Commencement Date (the "Credit Consideration" and collectively with the Cash Consideration, the "Settlement Consideration").

4. Transfer of Settlement Consideration Upon entry of a final non-appealable order: (i) AFG will remit the Cash Consideration to the City and (ii) AFG and the Combined Group shall be deemed to have surrendered all right, title and interest in and to the Credit Consideration. For purposes of this Agreement, a final non-appealable order shall mean an order entered by the Bankruptcy Court authorizing AFG to consummate this Agreement, unless any objection to such order shall have been properly made and overruled, in which case the time for filing a notice of appeal from such order shall have lapsed without any stay in effect or notice of appeal having been filed, or if any notice of appeal has been filed and a stay obtained, such appeal has been finally adjudicated.

5. Release of AFG and the Combined Group Effective upon the transfer of the Settlement Consideration, the City shall be deemed to have released AFG and each member of the Combined Group from any and all claims relating to the Tax Claim and any other general corporation tax claim that the City may have for the tax period from January 1, 2000 through and including December 31, 2010 (collectively, with the Tax Claim, the "Tax Claims") and including, without limitation, as defined in section 101(5) of the Bankruptcy Code, defaults, obligations, rights, damages, causes of action, demands, suits, judgments, remedies, setoffs, recoupments, defenses, debts, and liabilities of any kind or nature whatsoever, under any legal

theory, including under contract, tort, or otherwise, whether at law, in equity, or otherwise, whether known or unknown, matured or unmatured, fixed or contingent, liquidated or unliquidated, disputed or undisputed, asserted or unasserted, suspected or unsuspected, foreseen or unforeseen, direct or indirect, choate or inchoate, now existing or hereafter arising that the City may now have, has ever had or may in the future have, against AFG or a member of the Combined Group, which relate to the Tax Claims and occurring from the beginning of time through and including the date of this Agreement.

6. **Counterparts** This Agreement may be executed in several counterparts (including by facsimile transmission or electronic transmission of a portable document format file), each of which shall be an original and all which together shall constitute a single agreement.

7. **Amendments** No amendment, modification or waiver in respect of this Agreement will be effective unless in writing (including writing evidenced by facsimile transmission or electronic transmission of a portable document format file) and executed by each of the Parties.

8. **Severability** If any term or other provision of this Agreement is invalid, illegal or incapable of being enforced under any law or public policy, all other terms and provisions of this Agreement shall nevertheless remain in full force and effect for so long as the economic or legal substance of the settlement is not affected in any manner materially adverse to either Party hereto. Upon such determination that any term or other provision is invalid, illegal or incapable of being enforced, the Parties shall negotiate in good faith to modify this Agreement so as to effect the original intent of the parties as closely as possible in an acceptable manner so that the settlement is consummated as originally contemplated to the greatest extent possible.

9. **Entire Agreement** This Agreement sets forth the entire understanding and agreement between the Parties as to the matters covered herein and supersedes and replaces any prior understanding, agreement or statement of intent, in each case, written or oral.

10. **Binding Nature** The terms and provisions of this Agreement shall be binding in all respects on, and shall inure to the benefit of, the Parties, their estates and their respective successors and assigns, including any trustee, receiver, conservator, rehabilitator, liquidator, or superintendent relating to the reorganization, rehabilitation, liquidation, conservation or dissolution of any of the Parties. The members of the Combined Group are third-party beneficiaries of this Agreement and the terms and provisions of this Agreement benefiting the members of the Combined Group shall be binding and inure to their benefit and to the benefit of their respective successors and assigns.

11. Joint Drafting This Agreement is the product of negotiations between the Parties and any rule of construction that ambiguities are to be resolved against the drafting Party shall not apply in the interpretation of this Agreement.

12. AFG's Representation AFG acknowledges and agrees that in entering into this Agreement the City has relied on AFG's statements relating to its financial condition as set forth in the Disclosure Statement of Ambac Financial Group, Inc., dated July 8, 2011, and the Plan of Reorganization annexed thereto [Docket No. 387], which have been filed in the Chapter 11 Case, and AFG represents that such statements were true and correct when made.


13. No Admissions This Agreement reflects a compromise of a disputed claim and shall not be construed as an admission against any Party's interest and shall not be used as or deemed to be evidence of any liability by any Party in any proceeding before the Bankruptcy Court or any other court, except in a proceeding to enforce the terms of this Agreement.

14. Choice of Law and Forum This Agreement shall be governed by and construed in accordance with the laws of the State of New York without regard to the conflict of law principles thereof. All disputes arising out of or related to the Agreement shall be subject to the exclusive jurisdiction of the United States Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court"). To the extent the Bankruptcy Court does not exercise its jurisdiction over any dispute arising out of or relating to this Agreement, such dispute(s) shall be subject to the exclusive jurisdiction of the courts located within the State of New York.

15. Condition to Effectiveness This Agreement shall not be effective and shall have no force and effect unless and until this Agreement shall have been approved by an order of the Bankruptcy Court.

IN WITNESS WHEREOF, AFG, on behalf of itself and each member of the Combined Group, and the City each caused this Agreement to be executed by its duly authorized representative, as of the date first above written.

MICHAEL A. CARDOZO
Corporation Counsel of the City of New York
Attorney for the City of New York Department of Finance

By: 
Andrew G. Lipkin
Senior Counsel

AMBAC FINANCIAL GROUP, INC.
On behalf of itself and each member of the Combined Group

By: _____
Name:
Title:

IN WITNESS WHEREOF, AFG, on behalf of itself and each member of the Combined Group, and the City each caused this Agreement to be executed by its duly authorized representative, as of the date first above written.

MICHAEL A. CARDOZO
Corporation Counsel of the City of New York
Attorney for the City of New York Department of Finance

By: _____
Andrew G. Lipkin
Senior Counsel

AMBAC FINANCIAL GROUP, INC.
On behalf of itself and each member of the Combined Group

By: David Trick
Name:
Title: **David Trick**
Senior Managing Director,
CFO and Treasurer