

Hearing Date and Time: April 29, 2013 at 10:00 a.m. (prevailing Eastern Time)

Objection Deadline: April 22, 2013 at 4:00 p.m. (prevailing Eastern Time)

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Attorneys for the Debtor and Debtor in Possession

**UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK**

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

**NOTICE OF DEBTOR'S MOTION FOR ORDER
PURSUANT TO BANKRUPTCY CODE SECTIONS 363(b) AND
105(a) AND BANKRUPTCY RULE 9019 APPROVING SETTLEMENT
WITH THE UNITED STATES**

PLEASE TAKE NOTICE that a hearing on the attached motion of Ambac Financial Group, Inc., as debtor and debtor in possession in the above-captioned case (the "Debtor"), for an order, pursuant to sections 363(b) and 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"), approving a settlement among the Debtor, the statutory committee of



creditors (the “Committee”), the United States of America (the “United States”), Ambac Assurance Corporation (“AAC”), the Segregated Account of Ambac Assurance Corporation (the “Segregated Account”), and the Office of the Commissioner of Insurance of the State of Wisconsin (“OCI”), in its respective capacities as AAC’s regulator and as rehabilitator of the Segregated Account (the “Rehabilitator”), resolving (i) the proofs of claim filed against the Debtor’s estate by the IRS and assigned claim numbers 3694 and 3699 (together, the “IRS Claims”), and (ii) the Debtor’s adversary proceeding against the United States of America, Adv. Pro. No. 10-4210 (the “IRS Adversary Proceeding,” and together with all litigation arising from or related to the IRS Claims, the “IRS Dispute”), and granting related relief (the “Motion”), all as more fully described in the Motion, will be held before the Honorable Shelley C. Chapman, United States Bankruptcy Judge, in Courtroom 621 of the United States Bankruptcy Court for the Southern District of New York (the “Bankruptcy Court”), located at One Bowling Green, New York, New York 10004, on **April 29, 2013 at 10:00 a.m. (prevailing Eastern Time)** (the “Hearing”).

PLEASE TAKE FURTHER NOTICE that objections to the Motion must (i) be in writing, (ii) conform to the Bankruptcy Rules, the Local Bankruptcy Rules for the Southern District of New York, and the amended order establishing certain notice, case management, and administrative procedures entered by the Bankruptcy Court on December 21, 2010 [Docket No. 75], (iii) state with particularity the legal and factual basis for the objection, and (iv) be filed with the Bankruptcy Court, together with a proof of service, and served so as to be actually received on or before **April 22, 2013 at 4:00 p.m. (prevailing Eastern Time)** upon: (a) the chambers of the Honorable Shelley C. Chapman, United States Bankruptcy Judge, One Bowling Green, New York, New York 10004; (b) counsel for the Debtor, Hogan Lovells US LLP, Attn: Peter Ivanick

and Allison Weiss, 875 Third Avenue, New York, New York 10022; (c) counsel for the Committee, Morrison & Foerster LLP, Attn: Anthony Princi, 1290 Avenue of the Americas, New York, New York 10104; (d) counsel for OCI, Foley & Lardner LLP, Attn: Frank W. DiCatri, 777 East Wisconsin Avenue, Milwaukee, Wisconsin 53202; (e) counsel for AAC, Sidley Austin LLP, Attn: Jonathan L. Freedman, 787 Seventh Avenue, New York, New York 10019; (f) the Office of the United States Trustee for the Southern District of New York, Attn: Brian S. Masumoto, 33 Whitehall Street, 21st Floor, New York, New York, 10004; (g) the Office of the United States Attorney for the Southern District of New York, Attn: Ellen London, Carina Schoenberger and Daniel Filor, 86 Chambers Street, 3rd Floor, New York, New York 10007; and (h) all entities which have filed a written request for notice with the Bankruptcy Court pursuant to Bankruptcy Rule 2002.

PLEASE TAKE FURTHER NOTICE that the Hearing may be adjourned from time to time by the Debtor without further notice other than (i) announcing such adjournment in open court, or (ii) filing with the Bankruptcy Court a notice of adjournment and serving such notices upon parties entitled to receive notice in the Debtor's chapter 11 case and parties which have filed objections to the Motion.

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PLEASE TAKE FURTHER NOTICE that if no objection to the Motion is timely filed and served, an order granting the relief requested in the Motion may be entered without further notice or opportunity to be heard afforded to any party.

Dated: April 8, 2013
New York, New York

Respectfully Submitted,

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**UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK**

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<i>In re</i>	:	
	:	Chapter 11
AMBAC FINANCIAL GROUP, INC.,	:	
	:	Case No. 10-15973 (SCC)
Debtor.	:	
	:	
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**DEBTOR'S MOTION FOR ORDER PURSUANT TO
BANKRUPTCY CODE SECTIONS 363(b) AND 105(a) AND BANKRUPTCY
RULE 9019 APPROVING SETTLEMENT WITH THE
UNITED STATES**

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"), hereby files this motion (the "Motion") for an order, substantially in the form attached hereto as Exhibit A, pursuant to sections 363(b) and 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”), approving a settlement, the terms of which are documented in the Offer Letter and Supplemental Offer Letter (each defined below) attached hereto as Exhibit B (the “IRS Settlement”), among the Debtor, the statutory committee of creditors (the “Committee”), the United States of America (the “United States”), Ambac Assurance Corporation (“AAC”, and together with the Debtor, “Ambac”), the Segregated Account of Ambac Assurance Corporation (the “Segregated Account”), and the Office of the Commissioner of Insurance of the State of Wisconsin (“OCI”), in its respective capacities as AAC’s regulator and as rehabilitator of the Segregated Account (the “Rehabilitator”), resolving (i) the proofs of claim filed against the Debtor’s estate by the Department of the Treasury – Internal Revenue Service (the “IRS”), which were assigned claim numbers 3694 and 3699 (together, the “IRS Claims”), and (ii) the Debtor’s adversary proceeding against the United States of America, Adv. Pro. No. 10-4210 (the “IRS Adversary Proceeding,” and together with all litigation arising from or relating to the IRS Claims, the “IRS Dispute”) and granting related relief, and respectfully represents:

PRELIMINARY STATEMENT

1. In February 2012, after extensive negotiations, the Debtor, the Committee, AAC, the Segregated Account, OCI and the Rehabilitator presented the Offer Letter, dated February 24, 2012 (the “Offer Letter”)¹ to the United States Attorney for the Southern District of New York and the United States Department of Justice, Tax Division, to settle the IRS Dispute (the “IRS Settlement”). The IRS Settlement provides, inter alia, that it will not become effective until (i) it is accepted by the United States of America, with such acceptance including a requirement

¹ At the request of the Department of Justice, on April 3, 2013, the Offer Letter was modified (the “Supplemental Offer Letter”) to change the timing of certain payments provided for in the Offer Letter. Both the Offer Letter and Supplemental Offer Letter constitute the IRS Settlement and are attached hereto as Exhibit B. A copy of the acceptance letter from the United States Department of Justice, executed on April 4, 2013, is attached hereto as Exhibit C.

that the Debtor receive a response of “no adverse criticism” from the Congressional Joint Committee on Taxation; (ii) the United States Bankruptcy Court for the Southern District of New York (the “Bankruptcy Court”) has entered an order approving the IRS Settlement and all transactions contemplated in the IRS Settlement, including the Plan (as defined below); (iii) the Debtor, on behalf of itself, AAC and other members of its consolidated tax group, and the IRS have entered into a closing agreement (the “Closing Agreement”) resolving various tax issues set forth in the Offer Letter; (iv) the Wisconsin Circuit Court of Dane County, in which the rehabilitation proceedings with respect to the Segregated Account of AAC are pending, the (“Rehabilitation Court”) has entered an order approving the transactions contemplated in the Offer Letter; (v) the IRS has issued a favorable private letter ruling providing that, upon emergence from bankruptcy, the Debtor will qualify for the exception outlined in section 382(l)(5) of title 26 of the United States Code (the “Internal Revenue Code”), without regard to Internal Revenue Code section 382(l)(5)(D); and (vi) the Debtor and AAC and/or the Segregated Account have paid the Settlement Consideration (as defined below).

2. The approval of the Bankruptcy Court and granting of related relief is a condition precedent to the effectiveness of the IRS Settlement. Moreover, the entry by the Bankruptcy Court of an order approving the IRS Settlement pursuant to Bankruptcy Rule 9019 will satisfy one of the remaining significant conditions precedent to the consummation of the Debtor’s confirmed Fifth Amended Plan of Reorganization, filed March 12, 2012 [Docket No. 927] (the “Plan”). Entry of the order approving the IRS Settlement is therefore imperative in providing the Debtor with the opportunity to emerge from bankruptcy without further expense or delay.

3. The IRS Settlement is fair, reasonable, and in the best interests of the Debtor and its estate, as evidenced by, among other things, this Motion and the declaration of David Trick in support of the Motion, attached hereto as Exhibit D (the “Trick Declaration”).

JURISDICTION

4. This Court has jurisdiction to 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 the Court pursuant to 28 U.S.C. §§ 1408 and 1409.

BACKGROUND

5. 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 assets as debtor in possession as authorized by sections 1107(a) and 1108 of the Bankruptcy Code.

6. On November 17, 2010, pursuant to section 1102 of the Bankruptcy Code, the United States Trustee for the Southern District of New York (the “U.S. Trustee”) appointed a statutory committee of unsecured creditors [Docket No. 27] (the “Committee”). No trustee or examiner has been appointed in the case.

7. The Debtor is a publically reporting holding company and a Delaware corporation. The Debtor’s principal operating subsidiary, AAC, is a Wisconsin-domiciled financial guarantee insurance company.

FACTS AND PROCEDURAL HISTORY REGARDING THE IRS DISPUTE

8. The Debtor commenced the IRS Adversary Proceeding on November 9, 2010, the day after the Commencement Date, by filing a complaint in the Bankruptcy Court against the United States of America (Case No. 10-04210) [IRS Adversary Proceeding Docket No. 1] (the “Adversary Complaint”). The Adversary Complaint seeks, among other things, a declaratory

judgment, pursuant to Bankruptcy Code section 505, that the Debtor and the members of its consolidated tax group have no tax liability for tax years 2003 through 2008 and that the Debtor is entitled to retain the full amount of approximately \$708,115,835 in tax refunds it received (the “Tax Refunds”) from carrying back losses resulting from credit default swap contracts (the “CDS Contracts”).

9. On January 13, 2011, the IRS filed a motion, pursuant to 28 U.S.C. § 157(d), to withdraw the reference of the IRS Adversary Proceeding [IRS Adversary Proceeding Docket No. 18]. The IRS’s motion to withdraw the reference has been fully briefed before the United States District Court for the Southern District of New York, which has thus far not rendered a decision with respect to such motion. *See Ambac Financial Group, Inc. v. United States*, 11 Civ. 270 (PGG) (JLC).

10. On January 19, 2011, the Bankruptcy Court approved a stipulation among the Debtor, the IRS, and the Committee permitting the Committee to intervene in the IRS Adversary Proceeding [IRS Adversary Proceeding Docket No. 21].

11. On March 2, 2011, the Bankruptcy Court entered an order implementing alternative dispute resolution procedures pursuant to Bankruptcy Code section 105(a) and General Order M-390 [IRS Adversary Proceeding Docket No. 38]. Following the entry of such order, the parties to the IRS Adversary Proceeding selected retired Judge James Robertson of JAMS, Inc. to serve as mediator (the “Mediator”) and notified the Bankruptcy Court of such selection by letter dated March 18, 2011 [IRS Adversary Proceeding Docket No. 41]. Following the appointment of the Mediator, the parties regularly met and conferred in an attempt to resolve the IRS Dispute.

12. On May 4, 2011, the IRS filed the IRS Claims. The IRS Claims, which are substantially duplicative, each assert a priority claim against the Debtor in the amount of \$807,242,027.91. On June 14, 2011, the Debtor filed an objection to the IRS Claims [Docket No. 311] (the “IRS Claims Objection”) on the grounds that the IRS Claims are premised on the assumption that the Tax Refunds were erroneously paid to the Debtor, which the Debtor believes is incorrect.

13. On October 12, 2011, the Debtor filed a motion for an order (i) determining that the IRS Claims shall be estimated pursuant to Bankruptcy Code section 502(c) and (ii) establishing procedures for the estimation of such claims pursuant to Bankruptcy Code section 505(a) [Docket No. 633] (the “IRS Claims Estimation Motion”), and a memorandum of law in support thereof [Docket No. 634] (the “Memorandum of Law”). On October 20, 2011, the Committee filed a joinder to the Debtor’s IRS Claims Estimation Motion [Docket No. 645] (the “Committee Joinder”).

14. In November 2011, after a lengthy and difficult mediation process, the parties to the IRS Dispute, acting under the guidance of the Mediator, crafted a term sheet to serve as the basis for the IRS Settlement.

15. On February 24, 2012, the Debtor, AAC, the Segregated Account, the Committee, the Rehabilitator, and OCI delivered the Offer Letter, setting forth the proposed terms for a global settlement of the IRS Dispute, to the United States Attorney for the Southern District of New York and the United States Department of Justice, Tax Division.

16. On March 14, 2012, the Bankruptcy Court entered its *Order Confirming Fifth Amended Plan of Reorganization of Ambac Financial Group, Inc.* [Docket No. 938]. The Plan

contains certain conditions precedent to effectiveness, including a condition that the Debtor enter into a settlement of the IRS Dispute.

17. On June 13, 2012, the Rehabilitation Court entered an order, attached hereto as Exhibit E, authorizing the Rehabilitator to proceed with the settlement of the IRS Dispute on the terms and conditions set forth in the Offer Letter.

18. It is the Debtor's understanding that the IRS Settlement was delivered to the Congressional Joint Committee on Taxation for review on or before October 24, 2012.

19. The Department of Justice has provided its consent to the settlement of the IRS Dispute on the terms and conditions set forth in the Offer Letter and the Supplemental Offer Letter. *See* Exhibit C.

20. Accordingly, after an exhaustive mediation process, and in a good faith effort to avoid protracted, costly, and uncertain litigation, the Debtor, the United States, AAC, the Segregated Account, the Committee, OCI, and the Rehabilitator agreed to the terms of the IRS Settlement.

21. Among the material terms of the IRS Settlement are the following:

- (i) Upon receipt by the Debtor of the executed Closing Agreement, the Debtor and the United States shall, by stipulation, dismiss with prejudice the IRS Adversary Proceeding and the motion to withdraw the reference pending before the United States District Court for the Southern District of New York, and the Debtor, the United States, the Rehabilitator, OCI, and AAC shall dismiss with prejudice the appeals relating to the rehabilitation proceedings that are pending before the United States Court of Appeals for the Seventh Circuit.
- (ii) The IRS Claims shall be deemed allowed in the aggregate amount of one hundred twenty million dollars (\$120,000,000.00), and shall be fully satisfied upon the receipt by the United States Department of the Treasury of the Settlement Consideration (as defined in subpart (iii) below).
- (iii) The Debtor shall make a payment to the United States Department of the Treasury of one million nine hundred thousand dollars (\$1,900,000) and AAC and/or the Segregated Account will pay the United States

Department of the Treasury one hundred million dollars (\$100,000,000) (the "Settlement Consideration"). The Debtor shall also pay to the United States Department of the Treasury (a) twelve and a half percent (12.5%) of any payment to the Debtor by AAC associated with the net operating loss Usage Tier C as defined in the Tax Sharing Agreement and (b) seventeen and a half percent (17.5%) of any payment to the Debtor by AAC associated with the net operating loss Usage Tier D as defined in the Tax Sharing Agreement.

- (iv) The Debtor is entitled to claim the portion of the Disputed NOLs relating to the CDS Contracts for the Applicable Tax Years to be carried forward in an amount not to exceed three billion, four hundred million dollars (\$3,400,000,000).
- (v) The Closing Agreement finally and conclusively resolves the federal income tax liability (and any liabilities in respect of interest under section 6601 of the Internal Revenue Code and additions to tax and penalties that may be imposed under the Internal Revenue Code) of Ambac's consolidated tax group to the IRS for the tax years ending December 31, 2003 through December 31, 2009.
- (vi) The Closing Agreement finally and conclusively resolves the federal income tax liability (and any liabilities in respect of interest under section 6601 of the Internal Revenue Code and additions to tax and penalties that may be imposed under the Internal Revenue Code) with respect to items of income, gain, deduction or loss related to Ambac's Disputed CDS Losses and Disputed Carry-Forward NOLs (as those terms are defined in the Closing Agreement) for tax year ending December 31, 2010.
- (vii) The effectiveness of the IRS Settlement is subject to the conditions contained in the Offer Letter and Supplemental Offer Letter, including, without limitation, (i) the entry by the Bankruptcy Court of an order approving the proposed settlement of the transactions contemplated in the Offer Letter and the Supplemental Offer Letter, (ii) the payment of the Settlement Consideration, and (iii) the execution of the Closing Agreement.

22. As of the date hereof, the Plan has not gone effective, and the settlement of the IRS Dispute is the sole remaining significant condition precedent outstanding.

RELIEF REQUESTED

23. By this Motion, the Debtor respectfully requests entry of an order substantially in the form attached hereto as Exhibit A, pursuant to Bankruptcy Code sections 363(b) and 105(a)

and Bankruptcy Rule 9019, (i) approving the IRS Settlement and (ii) authorizing and directing the Debtor to enter into the IRS Settlement and take any necessary actions to consummate the transactions contemplated thereby, including, subsequent to the payment of the Settlement Consideration and execution of the Closing Agreement, the stipulated treatment of the IRS Claims and the filing of a stipulation dismissing, with prejudice, the IRS Adversary Proceeding.

BASIS FOR RELIEF REQUESTED

III. The IRS Settlement is Fair and Equitable and in the Best Interests of the Debtor and its Estate

24. Bankruptcy Rule 9019(a) provides that “[o]n motion by the trustee and after notice and a hearing, the court may approve a compromise or settlement.” In addition, Bankruptcy Code section 105(a) provides that “[t]he court may issue any order ... that is necessary or appropriate to carry out the provisions of this title.”

25. In determining whether to approve a settlement pursuant to Bankruptcy Rule 9019, courts must make an independent determination that the settlement is fair and equitable. *Protective Comm. for Indep. S'holders of TMT Trailer Ferry Inc. v. Anderson*, 390 U.S. 414, 424 (1968). That does not mean a court should substitute its judgment for the debtor's. *In re Carla Leather, Inc.*, 44 B.R. 457, 465 (Bankr. S.D.N.Y. 1984). Rather, a court should “canvass the issues and see whether the settlement ‘fall[s] below the lowest point in the range of reasonableness.’” *In re W.T. Grant Co.*, 699 F.2d 599, 608 (2d Cir. 1983).

26. In *In re Iridium Operating LLC*, the Second Circuit set forth the following list of factors that a court should consider in evaluating whether a settlement should be approved as fair and equitable:

(1) the balance between the litigation's possibility of success and the settlement's future benefits; (2) the likelihood of complex and protracted litigation, “with its attendant expense, inconvenience, and delay,” including the difficulty in collecting on the judgment;

(3) “the paramount interests of the creditors,” including each affected class’s relative benefits “and the degree to which creditors either do not object to or affirmatively support the proposed settlement;” (4) whether other parties in interest support the settlement; (5) the “competency and experience of counsel” supporting, and “[t]he experience and knowledge of the bankruptcy court judge” reviewing, the settlement; (6) “the nature and breadth of releases to be obtained by officers and directors;” and (7) “the extent to which the settlement is the product of arm’s length bargaining.”

478 F.3d 452, 462 (2d Cir. 2007) (citing *In re WorldCom, Inc.*, 347 B.R. 123, 137 (Bankr. S.D.N.Y. 2006)). *See also In re Adelphia Commc’ns Corp.*, 368 B.R. 140, 226 (Bankr. S.D.N.Y. 2007) (citing *In re Texaco Inc.*, 84 B.R. 893, 901 (Bankr. S.D.N.Y. 1988)).

27. Application of the foregoing *Iridium* factors to the IRS Settlement confirms that such agreement is fair and equitable and in the best interests of the Debtor and its estate and should therefore be approved.

28. The Benefits of the IRS Settlement Outweigh the Potential Benefits of Litigating the IRS Dispute. Because the IRS Claims assert that they are entitled to priority status under Bankruptcy Code section 507(a)(8), in order to successfully emerge from bankruptcy, the Debtor must have either fully and successfully litigated (i) the IRS Adversary Proceeding and the IRS Claims Objection, or (ii) the IRS Claims Estimation Motion, or alternatively, entered into a settlement with the IRS. *See* 11 U.S.C. § 1129(a)(9)(C) (providing that chapter 11 plans must provide for the payment in full of allowed priority tax claims in order to be confirmed). Litigating the IRS Dispute would have been counterproductive in the context of the Debtor’s chapter 11 case. Even if the Debtor were ultimately successful in litigating the IRS Dispute, which is uncertain, delaying the consummation of the Plan would jeopardize the Debtor’s reorganization. Moreover, the costs of litigating the IRS Dispute would have compounded the Debtor’s vulnerable liquidity position by adding millions of dollars in legal fees and expenses in

connection with litigating the IRS Dispute at the Bankruptcy Court level, with the possibility of extended appeals. Even absent the Debtor's vulnerable liquidity position, pursuing a strategy of litigating the IRS Dispute to a conclusion would upset the delicate state of the Debtor's relationships with the Committee, AAC, OCI, and the Rehabilitator. Additionally, if the Debtor were unsuccessful in litigating the IRS Dispute, the Debtor's estate would have lost the significant value delivered to creditors under the Plan and the Debtor would have been forced to convert its case to one under chapter 7 of the Bankruptcy Code. Bankruptcy Court approval of and entry into the IRS Settlement, on the other hand, will resolve the IRS Dispute in a manner satisfactory to the Debtor, the Committee, AAC, OCI, and the Rehabilitator, and enable the Debtor to emerge from bankruptcy with its recoveries to creditors intact. Accordingly, the benefits of the IRS Settlement far outweigh any potential benefits of litigating the IRS Dispute.

29. Litigation of the IRS Dispute Would Be Complex and Protracted. Fully litigating the IRS Dispute would require the Bankruptcy Court and any appellate courts to consider, among other things, the following: (i) whether the CDS Contracts that Ambac Credit Products LLC ("ACP"), a wholly-owned subsidiary of AAC, entered into from 2005 through 2008 (the "Post-2004 CDS Contracts") are "Notional Principal Contracts" within the meaning of Treas. Reg. §1.446-3; (ii) whether the Debtor's use and application of the "impairment" method of accounting for losses on its Post-2004 CDS Contracts clearly reflects income and the economic substance of such contracts and represents a "reasonable amortization" method with respect to such losses under section 446 of the Internal Revenue Code; (iii) whether the discount rate used by the Debtor is appropriate to calculate the CDS Contract impairment losses for tax years 2007 through 2010; and (iv) whether the Debtor's use of the "impairment" method of accounting for the first time in 2007 constituted an impermissible change in accounting method, whether the

IRS abused its discretion in withholding its consent to such change, or alternatively, whether the IRS should be estopped from arguing that such change was impermissible. Although discovery in connection with the IRS Adversary Proceeding is substantially complete, litigation of the foregoing unresolved issues would likely be complex and protracted. Moreover, given the amounts at stake, the Bankruptcy Court's decision would likely be appealed regardless of the outcome.

30. The IRS Settlement is in the Paramount Interests of Creditors. The approval of and entry into the IRS Settlement will provide the Debtor, its estate, and its creditors with significant benefits. Such approval will enable the Debtor to successfully emerge from bankruptcy without the lengthy and costly delay that would result from prosecuting the IRS Dispute.

31. The IRS Settlement is Supported by All Key Parties in Interest. As noted above, approval of and entry into the IRS Settlement would resolve the IRS Dispute in a manner satisfactory to the Debtor, the Committee, the IRS, AAC, OCI, and the Rehabilitator.

32. The IRS Settlement is the Product of Arm's-Length Bargaining Among Experienced and Independent Counsel. The IRS Settlement is the product of extensive and protracted arm's-length negotiations among the Debtor, the Committee, the IRS, AAC, OCI, and the Rehabilitator. The IRS Settlement was developed and negotiated with the aid of knowledgeable and competent counsel with significant expertise in complex litigation, tax, and bankruptcy issues. Moreover, the IRS Settlement is the product of an extensive mediation process competently managed by Judge Robertson, a retired United States District Court Judge.

IV. The Debtor's Decision to Enter into the IRS Settlement is an Appropriate Exercise of its Business Judgment

33. Bankruptcy Code section 363(b) provides, in relevant part, that “[t]he trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate.” Although this section does not set forth a standard for determining when it is appropriate for a court to authorize the use of a debtor’s assets, courts in the Second Circuit and others, in applying this section, have required that it be based upon the sound business judgment of the debtor. *See In re Boston Generating, LLC*, 440 B.R. 302, 330 (Bankr. S.D.N.Y. 2010) (citing *Comm. of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.)*, 722 F.2d 1063, 1070 (2d Cir. 1983)) (“The *Lionel* Court concluded that there has to be some articulated business justification ... for the use, sale or lease of a debtor’s property outside of the ordinary course of business. ... Thus, a court rendering a section 363(b) determination must ‘expressly find from the evidence presented ... a good business reason to grant such application.’”); *see also Official Comm. of Unsecured Creditors of LTV Aerospace and Defense Co. v. LTV Corp. (In re Chateaugay Corp.)*, 973 F.2d 141, 143 (2d Cir. 1992) (affirming sale of substantially all of a debtor’s assets where the debtor articulated a risk of loss of value of the assets).

34. As described above, the IRS Settlement provides for the stipulated reduction of the IRS Claims and for the stipulated dismissal of pending litigation relating to the IRS Adversary Proceeding in exchange for payments by the Debtor and compromises among the parties regarding the treatment of certain tax obligations. As evidenced by the Trick Declaration, the Debtor, in its business judgment, believes that approval of and entry into the IRS Settlement is in the best interest of the Debtor and its estate.

35. Accordingly, the Debtor respectfully requests entry of an order substantially in the form attached hereto as Exhibit A, pursuant to Bankruptcy Code sections 363(b) and 105(a) and

Bankruptcy Rule 9019, (i) approving the IRS Settlement, (ii) authorizing and directing the Debtor to effectuate the IRS Settlement and take any other actions as may be reasonably necessary to consummate the transactions contemplated thereby, including the stipulated treatment of the IRS Claims and the filing of a stipulation dismissing, with prejudice, the IRS Adversary Proceeding, and (iii) granting related relief and such other and further relief as the Bankruptcy Court deems just and proper.

Notice

36. Notice of this Motion has been provided by first class mail, overnight mail, e-mail, fax, or hand delivery to (i) the U.S. Trustee, (ii) counsel for the Committee, (iii) counsel for OCI and the Rehabilitator, (iv) the Office of the United States Attorney for the Southern District of New York, and (v) all entities which have filed a written request for notice with the Bankruptcy Court pursuant to Bankruptcy Rule 2002. The Debtor submits that no other or further notice need be provided.

No Previous Request

37. No previous request for the relief sought herein has been made by the Debtor to the Bankruptcy Court.

[Remainder of page intentionally left blank]

WHEREFORE, the Debtor respectfully requests entry of an order substantially in the form attached hereto as Exhibit A, (i) approving the IRS Settlement; (ii) authorizing and directing the Debtor to effectuate the IRS Settlement and take any other actions as may be reasonably necessary to consummate the transactions contemplated thereby, including, subsequent to the payment of the Settlement Consideration and execution of the Closing Agreement, the stipulated treatment of the IRS Claims and the filing of a stipulation dismissing, with prejudice, the IRS Adversary Proceeding; and (iii) granting related relief and such other and further relief as the Bankruptcy Court deems just and proper.

Dated: April 8, 2013
New York, New York

Respectfully Submitted,

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Attorneys for the Debtor and Debtor in Possession

EXHIBIT A

(Proposed Order)

**UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK**

In re

AMBAC FINANCIAL GROUP, INC.,

Debtor.

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Chapter 11

Case No. 10-15973 (SCC)

**ORDER PURSUANT TO BANKRUPTCY CODE SECTIONS 363(b) AND 105(a) AND
BANKRUPTCY RULE 9019 APPROVING SETTLEMENT WITH THE
UNITED STATES**

Upon the motion (the “Motion”)¹ of Ambac Financial Group, Inc., as debtor and debtor in possession in the above-captioned case (the “Debtor”), for an order, pursuant to Bankruptcy Code sections 363(b) and 105(a) and Bankruptcy Rule 9019, approving the IRS Settlement, substantially in the form attached to the Motion as Exhibit B, among the Debtor, the United States (pursuant to the Closing Agreement), the Committee, AAC, the Segregated Account, OCI, and the Rehabilitator, resolving the IRS Dispute and granting related relief, all as more fully set forth in the Motion; and the Bankruptcy 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 the Bankruptcy Court pursuant to 28 U.S.C. §§ 1408 and 1409; and due and proper notice of the Motion and the deadline for objecting thereto having been provided; and the Bankruptcy Court having determined that the IRS Settlement is fair and equitable and that its approval is in the best interests of the Debtor and its estate, and that the legal and factual

¹ Capitalized terms used but not defined herein shall have the meanings set forth in the Motion.

bases set forth in the Motion and the Trick Declaration establish just cause for the relief granted herein; and after due deliberation and sufficient cause appearing therefor, it is hereby

ORDERED that the Motion is granted; and it is further

ORDERED that pursuant to Bankruptcy Code sections 363(b) and 105(a) and Bankruptcy Rule 9019, the IRS Settlement is hereby approved in all respects; and it is further

ORDERED that the Debtor is hereby authorized and directed to effectuate the IRS Settlement and take any other actions as may be reasonably necessary to consummate the transactions contemplated thereby, including, without limitation, subsequent to the payment of the Settlement Consideration and execution of the Closing Agreement, the entry of a stipulation dismissing the IRS Adversary Proceeding with prejudice; and it is further

ORDERED that the IRS Claims shall be deemed allowed in an aggregate amount of \$120,000,000.00 as a priority claim and the Debtor shall direct its claims agent to modify the claims register to reflect the terms of this order; and it is further

ORDERED that the IRS Claims shall be deemed fully satisfied upon payment by the Debtor and AAC and/or the Segregated Account of the Settlement Consideration; and it is further

ORDERED that nothing in this order shall be deemed to modify any obligation owed by the Debtor, the Committee, the United States, AAC, the Segregated Account, OCI, or the Rehabilitator pursuant to the IRS Settlement; and it is further

ORDERED that notwithstanding the potential applicability of Bankruptcy Rule 6004(h), the terms and conditions of this order shall be immediately effective and enforceable upon its entry; and it is further

ORDERED that the Bankruptcy Court shall retain jurisdiction to hear and determine all matters arising from or related to the implementation, interpretation, and/or enforcement of this order.

Dated: _____, 2013
New York, New York

THE HONORABLE SHELLEY C. CHAPMAN
UNITED STATES BANKRUPTCY JUDGE

EXHIBIT B

(IRS Settlement)

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SUBMITTED PURSUANT TO FRE 408 AND
WISCONSIN STATUTE SECTION 904.08
FOR SETTLEMENT PURPOSES

February 24, 2012

Preet Bharara, Esq.
United States Attorney
Southern District of New York
U.S. Department of Justice
86 Chambers Street
New York, NY 10007

John A. DiCicco, Esq.
Principal Deputy Assistant Attorney General
Tax Division
United States Department of Justice
Washington, D.C. 20530

Re: *Ambac Financial Group, Inc. v. United States*, Adv. Proc. No. 10-4210
(Bankr. S.D.N.Y., filed Nov. 9, 2010);
In the Matter of the Rehabilitation of Segregated Account of Ambac Assurance Corp., No. 2010CV1576 (Wis. Cir. Ct. for Dane Cnty. Jan. 24, 2011), *petition for review granted*, No. 2011AP987 (Wis. Aug. 31, 2011);
In the Matter of the Rehabilitation of Segregated Account of Ambac Assurance Corporation, 782 F. Supp. 2d 743 (W.D. Wis. 2011), *appeal docketed*, No. 11-1158 (7th Cir. Jan. 19, 2011); and
United States v. Wisconsin State Circuit Court for Dane County, et al., 767 F. Supp. 2d 980 (W.D. Wis. 2011), *appeal docketed*, No. 11-1419 (7th Cir. Feb. 22, 2011).

Dear Messrs Bharara and DiCicco:

Dewey & LeBoeuf LLP is a New York limited liability partnership.

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This letter constitutes an offer to settle the above-referenced proceedings on the terms described below. The settlement would be between the United States, on the one hand, and Ambac Financial Group, Inc. ("Debtor" or "AFGI"), Ambac Assurance Corporation ("AAC"), the Official Committee of Unsecured Creditors of AFGI ("Official Creditors Committee"), the Segregated Account of Ambac Assurance Corporation (the "Segregated Account")¹, the court-appointed Rehabilitator of the Segregated Account (the "Rehabilitator") and the Wisconsin Office of the Commissioner of Insurance ("OCI"), on the other hand (collectively, the United States, AFGI, AAC, Official Creditors Committee, Segregated Account, Rehabilitator and OCI are referred herein as the "Parties").²

¹ On March 24, 2010, the Wisconsin Office of the Commissioner of Insurance ("OCI") approved the establishment of a segregated account of AAC, pursuant to Wis. Stat. section 611.24(2), to segregate certain non-performing segments of AAC's liabilities. All policy obligations of AAC not allocated to the Segregated Account remain in the general account of AAC; and, in addition, the Segregated Account contains a secured note issued by the general account (the "Secured Note"). Further, on March 24, 2010, OCI commenced rehabilitation proceedings with respect to the Segregated Account in the District Court of Dane County, Wisconsin to facilitate an orderly run-off and/or settlement of the liabilities in the Segregated Account.

² In this letter, the term "IRS" means the Internal Revenue Service; the term "Code" means the Internal Revenue Code of 1986, as amended; the term "Group" means the "affiliated group" (as defined in Section 1504(a) of the Code) of which AFGI is the common parent, and AAC (including the Segregated Account) is one of the members and the term "CDS Contracts" means all the CDS contracts identified in Attachment A as the pay-as-you-go credit default swap contracts and other CDS contracts with respect to which items of income, gain, deductions, or loss were reflected in any of the federal income tax returns filed by the Group for the tax years ending December 31, 2005, December 31, 2006, December 31, 2007, December 31, 2008, December 31, 2009 or December 31, 2010; the term "CDS Contracts" does not include the CDS contracts identified in Attachment B as CDS contracts with respect to which items of income, gain, deductions, or loss were not reflected in any of the federal income tax returns filed by the Group for the tax years ending December 31, 2005, December 31, 2006, December 31, 2007, December 31, 2008, December 31, 2009 or December 31, 2010; the term "Confirmation Order" means the plan of rehabilitation confirmation order; the term "Bank Settlement Notes" means the surplus notes issued by AAC on June 7, 2010 pursuant to the Settlement Agreement, dated June 7, 2010, among AAC and certain financial institutions as well as the issuance by the Segregated Account of \$50 million in surplus notes on July 29, 2010 in connection with a separate settlement, and the term "Plan of Reorganization" means AFGI's reorganization plan submitted to the United States Bankruptcy Court for the Southern District of New York as finally amended and confirmed.

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On November 8, 2010, AFGI filed a voluntary case under Chapter 11 of Title 11 of the United States Code seeking bankruptcy protection ("Bankruptcy Case"). On November 9, 2010, AFGI commenced an adversary proceeding in connection with the Bankruptcy Case against the United States ("Adversary Proceeding"), seeking, in part, to obtain an injunction and a declaration that the Debtor applied the proper accounting method with respect to losses on the CDS Contracts. The Adversary Proceeding is captioned *Ambac Financial Group, Inc. and The Official Committee of Unsecured Creditors v. United States of America*, Adv. Pro. No. 10-4210 (SCC). On May 5, 2011, the United States filed its proofs of claim in the Bankruptcy Case against AFGI, thereby asserting a priority claim against the Debtor of \$807,242,021.91 ("IRS Claims"). The IRS Claims seek the return of the tentative tax refunds received by the Group resulting from the claimed recognition of losses in 2007 and 2008 with respect to the CDS Contracts. The Debtor filed its objection to the IRS Claims on June 5, 2011.

The United States has also sought to assert legal rights against AAC, under Treas. Reg §§ 1.1502-6(a) and 1.1502-78(b)(2), with respect to any deficiency or underpayment of federal taxes against the Group. As authorized by statute, OCI approved the creation of the Segregated Account, which OCI then placed into rehabilitation in the Wisconsin Circuit Court of Dane County (the "Rehabilitation Court") on March 24, 2010, with the Wisconsin Commissioner of Insurance appointed as Rehabilitator. By order dated November 7, 2010, the Rehabilitation Court approved the allocation of AAC's federal tax liability for all prior tax years, including any

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liability it may have with respect to the IRS Claims to the Segregated Account.³ On December 8, 2010, the United States removed the Wisconsin rehabilitation proceeding involving the Segregated Account to the United States District Court for the Western District of Wisconsin (the "District Court"). The Rehabilitator moved to remand the proceeding to the Rehabilitation Court, and on January 14, 2011, that motion was granted by the District Court. The United States appealed that decision to the United States Court of Appeals for the Seventh Circuit. On February 9, 2011, the United States filed a complaint and a motion for a preliminary injunction in the District Court seeking, inter alia, to enjoin enforcement of the injunction issued by the Rehabilitation Court and the Confirmation Order against the United States in a case captioned *United States of America v. Wisconsin State Circuit Court for Dane County*, Case No. 11-cv-099. The District Court dismissed that suit for lack of subject matter jurisdiction on February 18, 2011, and the United States filed a notice of appeal on February 22, 2011. The appeals at the Seventh Circuit are pending as Appeal Nos. 11-1158 and 11-1419.

On March 9, 2011, the United States appealed the Order of Confirmation entered by the Rehabilitation Court on January 24, 2011. That appeal, No. 2011-AP-987, was dismissed by the Wisconsin Court of Appeals. The Wisconsin Supreme Court subsequently granted the United States' Petition for Review. The matter has been briefed, argued before, and submitted for decision to the Wisconsin Supreme Court.

AFGI, AAC, the Official Creditors Committee, the Segregated Account, the Rehabilitator, and OCI offer to resolve and settle the disputes described above to avoid the

³ It is acknowledged that the United States disputes that this allocation was effective as to it.

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burden, expense and uncertainty of litigation. The terms of this offer (the "Offer") are as follows:

1. The proposed settlement shall not be effective until this offer has been accepted by the United States, such acceptance including having received a response of "no adverse criticism" from the Congressional Joint Committee on Taxation to effectuate the transactions contemplated in this letter, and the conditions in 28 C.F.R. § 0.163 relating to the settlement of appeals authorized by the Solicitor General shall also have been satisfied, and each of the other conditions below in this paragraph 1 have been satisfied.

- a. The Rehabilitation Court shall have entered an order approving the transactions contemplated in this letter.
- b. The United States Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court") shall have entered an order approving the stipulated dismissal with prejudice of the Adversary Proceeding and approving the other transactions contemplated in this letter, including the Plan of Reorganization.
- c. AFGI (on behalf of itself, AAC, and the other members of the Group) and the IRS shall have entered into a closing agreement under section 7121 of the Code that provides as follows:
 - (1) The closing agreement finally and conclusively resolves the federal income tax liability (and any liabilities in respect of interest under section 6601 of the Code and additions to tax and penalties that may be imposed under the Code with respect to this income tax liability) of the Group for

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the tax years ending December 31, 2003 through and including December 31, 2009.

- (2) The closing agreement also finally and conclusively resolves the federal income tax liability (and any liabilities in respect of interest under section 6601 of the Code and additions to tax and penalties that may be imposed under the Code with respect to this income tax liability) of the Group for the tax year ending December 31, 2010, but only with regard to any income, gain, deduction, or loss on the Group's CDS Contracts.
- (3) The Group (and each of its members) will relinquish all claim to all loss carry-forwards, whether characterized as capital or ordinary, resulting from losses on the CDS Contracts arising on or before December 31, 2010, which might otherwise be available to the Group (or any of its members) to offset future taxable income of the Group (or any of its members) to the extent that these carry-forwards exceed \$3,400,000,000. The \$3,400,000,000 of losses shall be ordinary loss carry-forwards. The Group has also claimed losses that have arisen separate and apart from its CDS Contracts (the "non-CDS NOLs"), but the closing agreement will not address the non-CDS NOLs, to which the IRS reserves all of its rights.
- (4) Nothing contained in the closing agreement or settlement shall be considered an acceptance by the United States of AFGI's tax accounting methodology with respect to the CDS contracts nor an admission by AFGI

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that there were faults in its tax accounting methodology with respect to the CDS contracts. No inference shall be made from the execution of the closing agreement or settlement by the United States regarding the appropriate treatment of credit default swaps for federal income tax purposes.

- (5) The parties to the closing agreement acknowledge that such agreement is the product of arm's length negotiations and supersedes all prior communications, written or oral, with respect thereto. In connection with the negotiations to enter into a closing agreement that satisfies the conditions described in this paragraph 1(c), the Parties agree that no payment shall be required to be made by any members of the Group other than as described in paragraphs 2-4.
- d. Additional conditions precedent to the effectiveness of the proposed settlement are (i) AFGI (on behalf of itself, AAC, and the other members of the Group, whose written consent shall be obtained) and the IRS shall have entered into a closing agreement under section 7121 of the Code providing that neither the issuance of the Bank Settlement Notes⁴ nor the June 9, 2010 Event⁵ (A) caused

⁴ The IRS reserves its right to request a written opinion to be provided by KPMG relating to issues regarding the \$50 million in surplus notes issued on July 29, 2010, and to withhold a final conclusion on the issues set out above prior to receiving such written opinion.

⁵ The "June 9, 2010 Event" refers to AAC's nonpayment of dividends in full to the holders of the auction market preferred shares (AMPS) for six consecutive dividend payment dates thereby entitling the holders of the AMPS, subject to OCI's approval, to elect two members of the board of directors of AAC.

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AAC to fail to be a member of the “affiliated group” (as defined in section 1504(a) of the Code) of which AFGI was the common parent, or (B) resulted in an “ownership change” with respect to AAC for purposes of section 382 of the Code, and (ii) the Internal Revenue Service shall have issued a favorable private letter ruling (“PLR”) providing that upon emergence from bankruptcy AFGI would qualify for the Code section 382(l)(5) exception, without regard to section 382(l)(5)(D); the PLR will be based solely on the information and representations included in the private letter ruling request that shall be submitted by AFGI to the IRS within 60 days of the date of this Offer (the “Original PLR Request”). The condition precedent described in this subparagraph 1(d)(ii) will be satisfied upon the IRS’s issuance of such a PLR based upon the Original PLR Request. In connection with the negotiations relating to (i) and (ii) of this paragraph 1(d), the Parties agree that no payment shall be required to be made by any members of the Group other than as described in paragraphs 2 - 4.

- e. Another condition precedent to the effectiveness of the proposed settlement is that the United States and the Segregated Account shall enter into a separate and independent agreement to create and maintain an escrow account holding a balance of not less than \$100 million in cash or Qualifying Investments as defined in the Escrow Agreement -(the “Escrow Account”). The terms and conditions of
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the Escrow Account are set forth in the form of Escrow Agreement attached hereto as Appendix A.

- f. Approval of the terms of the proposed settlement agreement as set forth herein by the AFGI and AAC Boards of Directors (the "Boards"). Written notice will be provided to the United States within five (5) days of the Boards' vote whether to accept or reject the terms of the Offer, and, after May 31, 2012, approval shall be deemed to have occurred unless notice to the contrary is provided to the United States.

2. Within ten (10) business days following satisfaction of all conditions set forth in paragraph 1: (i) AFGI will pay the United States Department of the Treasury one million nine hundred thousand dollars (\$1,900,000); and (ii) AAC and/or the Segregated Account will pay the United States Department of the Treasury one hundred million dollars (\$100,000,000). The manner in which AAC and/or the Segregated Account effectuates the payment to the IRS will not be construed as a concession of any legal issue by any of the Parties. The payments that are described in the first sentence of this Paragraph 2 and the payments described in paragraphs 3 and 4 will be in full and final satisfaction of the federal income tax liability (and any liabilities in respect of interest under section 6601 of the Code and additions to tax and penalties that may be imposed under the Code with respect to this income tax liability) of the Group to the IRS for (i) the tax years ending December 31, 2003 through December 31, 2009; and (ii) the tax year ending December 31, 2010, but only with regard to items of income, gain, deduction, or loss on the Group's CDS Contracts. Effective at the time of the payment described in the first sentence of

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this paragraph 2, the Group (and all of its members, including AAC) shall waive forever any right to claim any overpayment of any federal income tax, liability (and any overpayment of interest, additions to tax, or penalties with respect to this income tax liability) of the Group for any tax period ended prior to January 1, 2010 and any right to claim any overpayment of any federal income tax liability (and any overpayment of interest, additions to tax, or penalties with respect to this income tax liability), of the Group with regard to items of income, gain, deduction, or loss on the CDS Contracts for the tax year ended December 31, 2010. No portion of the AFGI and AAC payments will be attributable to additions to tax or other penalties under chapter 68 of the Code. No portion of the AFGI and AAC payments, and no portion of the Tier C and Tier D IRS Payments described in paragraphs 3 and 4 below, shall be claimed as a deduction or other tax benefit on any federal tax return for the year of this settlement or any future year.

3. Following the effectiveness of the Tax Sharing Agreement between AFGI and AAC, which is attached as Exhibit A to the Plan of Reorganization (the "TSA"), and the satisfaction of all conditions set forth in paragraph 1, AFGI will pay the IRS an amount equal to twelve and a half percent (12.5%) of any payment made to AFGI by AAC associated with the net operating loss ("NOL") Usage Tier C as defined in the TSA (the "Tier C IRS Payment"). The Tier C IRS Payment, if any, shall be made within five (5) business days following AFGI's receipt of the Tier C payment, if any, made by AAC to AFGI.

4. Following the effectiveness of the TSA and the satisfaction of all conditions set forth in paragraph 1, AFGI will pay the IRS an amount equal to seventeen and a half percent (17.5%) of any payment made to AFGI by AAC associated with the NOL Usage Tier D as

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defined in the TSA (the "Tier D IRS Payment"). The Tier D IRS Payment, if any, shall be made within five (5) business days following AFGI's receipt of the Tier D payment, if any, made by AAC to AFGI.

5. With respect to the Tier C and Tier D payments made by AAC to AFGI, AFGI will disclose in its annual federal tax return the amount of such payments received from AAC for the applicable year. The right of the IRS to receive the Tier C IRS and Tier D IRS Payments shall not be treated for federal income tax purposes or any other purpose as an equity interest in AFGI or in AAC, and AFGI's failure to make Tier C IRS and Tier D IRS Payments will not give the IRS a claim against the Segregated Account, the general account of AAC, or any subsidiary of AAC.

6. Following the satisfaction of all conditions set forth in paragraphs 1 and 2, OCI, the Segregated Account, the Rehabilitator, and AAC will, upon the request of the United States, state in writing to the court that they support any motion brought by the United States seeking to vacate (i) the Opinion and Order entered on January 14, 2011 by the United States District Court for the Western District of Wisconsin in the proceeding captioned *Theodore Nickel v. United States of America*, Case No. 10-cv-778 and (ii) the Opinion and Order entered on February 18, 2011 by the United States District Court for the Western District of Wisconsin in the proceeding captioned *United States of America v. Wisconsin State Circuit Court for Dane County*, Case No. 11-cv-099.

7. Following the satisfaction of all conditions set forth in paragraphs 1 and 2, upon stipulation, the United States, the Rehabilitator, OCI, AAC and the Segregated Account, shall

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dismiss with prejudice the two cases that are currently pending before the U.S. Court of Appeals for the Seventh Circuit and captioned as *Theodore Nickel v. United States of America*, Case No. 11-1158 and *United States of America v. Wisconsin State Circuit Court for Dane County, et. al.*, Case No. 11-1419.

8. Following the satisfaction of all conditions set forth in paragraphs 1 and 2, the IRS Claims filed in AFGI's Chapter 11 Bankruptcy Case, presently pending before the United States Bankruptcy Court for the Southern District of New York, shall be deemed allowed in the amount of \$120,000,000.00 which will be fully satisfied upon receipt by the United States Department of the Treasury of the payments described in paragraph 2 and the payment, if any, described in paragraphs 3 and 4 above, and the IRS Claims will be deemed disallowed in any greater amount. The \$120,000,000.00 offer is for settlement purposes only and the Segregated Account and AAC shall have no liability for any unpaid portion of this claim following satisfaction of the conditions in paragraphs 1 and 2, *supra*. Furthermore, no cancellation of debt income shall arise with respect to the Group should no payments be made pursuant to paragraphs 3 and 4 above, or should such payments fail to bring the aggregate of payments, including those described in paragraph 2 above, to an amount equal or exceeding \$120,000,000.

9. Following the satisfaction of all conditions set forth in paragraphs 1 and 2, by stipulation, the United States and AFGI shall dismiss with prejudice the Adversary Proceeding, presently pending before the United States Bankruptcy Court for the Southern District of New York (Case No. 10-4210) and the motion to withdraw the reference, presently pending before the United States District Court for the Southern District of New York.

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10. This Offer shall be conditioned upon the satisfaction of each of the following conditions:

- a. The Seventh Circuit Court shall hold off rescheduling oral argument and not issue any dispositive order, judgment or other ruling on the merits with respect to appeal No. 11-1158 or Appeal No. 11-1419.
- b. Between the time the Offer is submitted to the United States and such time as the parties either (1) satisfy all the conditions for the settlement to be effective set forth in paragraphs 1 and 2 above or (2) determine that said conditions will not be satisfied, the United States will not submit any claim in the Rehabilitation Court or Bankruptcy Case or take any other collection action (whether by assessment, levy, or by asserting the existence of a lien, or otherwise) with respect to any federal income tax liability presently being asserted by the United States as to AFGI, AAC or any other member of the Group for the 2010 tax year or any prior tax year, and will not seek to remove the rehabilitation proceeding from the Rehabilitation Court or object to any motion of the Rehabilitator (except as to any motion that is inconsistent with the settlement terms set forth herein). The United States, nevertheless, retains the right to submit a claim in the Rehabilitation Court or in the Bankruptcy Case if such is necessary to satisfy a claims deadline established by the Rehabilitation Court or the Bankruptcy Court.

11. The Segregated Account, OCI, AAC and the United States shall each be free to write the Wisconsin Supreme Court (and to respond to representations made in contacts by other

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parties) with respect to the United States' appeal to that court, No. 2011-AP-987, if the Supreme Court has not before then issued its final decision with respect to that appeal. In those written submissions, no party shall request a stay or dismissal of the proceedings before the Wisconsin Supreme Court.


If, prior to the consummation of this proposed settlement, the Wisconsin Supreme Court issues a ruling that is favorable to the United States and that results in a remand to either the Wisconsin Court of Appeals or the Rehabilitation Court, the United States will promptly move to stay proceedings in the court to which proceedings have been remanded and will later dismiss with prejudice its case then pending before the Wisconsin Court of Appeals or the Rehabilitation Court, and any objection to the Rehabilitation Court's orders, upon satisfaction of the conditions set forth in paragraphs 1 and 2.

12. The Offer is valid unless and until withdrawn in writing by the Debtor, AAC, OCI, the Segregated Account or the Official Creditors Committee.

13. Except as to the terms contained herein in paragraph 1.e, no term contained within this Offer will have any force or effect if settlement is not consummated.

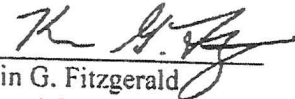
Respectfully submitted,

Dewey & LeBoeuf LLP

By: 
Lawrence M. Hill
Counsel for Debtor and AAC

Messrs. Bharara and DiCicco
February 24, 2012
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Foley & Lardner LLP

By: 
Kevin G. Fitzgerald
Counsel for the Segregated
Account, the Rehabilitator, and
OCI

Morrison & Foerster LLP

By: _____
Anthony Princi
Counsel for the Official Creditors
Committee

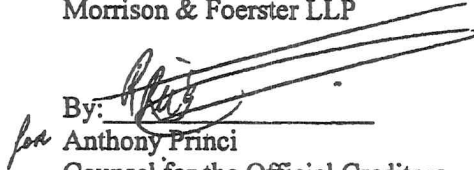
cc: Jeannette A. Vargas
Daniel P. Filor
Ellen London
Carina H. Schoenberger
Anthony T. Sheehan
Roger A. Peterson
Michael B. Van Sicklen
Edward Froelich
Robert Kovacev
Sashka Koleva

Messrs. Bharara and DiCicco
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Page 15

Foley & Lardner LLP

By: _____
Kevin G. Fitzgerald
Counsel for the Segregated
Account, the Rehabilitator, and
OCI

Morrison & Foerster LLP

By:  _____
Anthony Princi
Counsel for the Official Creditors
Committee

cc: Jeannette A. Vargas
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SUBMITTED PURSUANT TO FRE 408 AND
WISCONSIN STATUTE SECTION 904.8
FOR SETTLEMENT PURPOSES

April 3, 2013

Preet Bharara, Esq.
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Principal Deputy Assistant Attorney General
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Washington, DC 10530

Ambac Financial Group, Inc. v. United States, Adv. Proc.No. 10-4210 (Bankr. S.D.N.Y., filed Nov. 9, 2010);
In the Matter of the Rehabilitation of Segregated Account of Ambac Assurance Corp., No. 2010CV1576 (Wis. Cir. Ct. for Dane Cnty. Jan. 24, 2011) *petition for review granted*, No. 2011AP987 (Wis. Aug. 31, 2011);
In the Matter of the Rehabilitation of Segregated Account of Ambac Assurance Corporation, 782 F. Supp. 2d 743 (W.D. Wis. 2011), *appeal docketed*, No. 11-1158 (7th Cir. Jan. 19, 2011); and
United States v. Wisconsin State Circuit Court for Dane County, et al., 767 F. Supp. 2d 980 (W.D. Wis. 2011), *appeal docketed*, No. 11-1419 (7th Cir. Feb. 22, 2011)

Dear Messrs. Bharara and DiCicco:

On February 24, 2012, Ambac Financial Group, Inc. (“Debtor” or AFGI”), Ambac Assurance Corporation (“AAC”), the Official Committee of Unsecured Credits of AFGI (“Official Creditors Committee”), the Segregated Account of Ambac Assurance Corporation (the

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Preet Bharara, Esq.
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“Segregated Account”), the court-appointed Rehabilitator of the Segregated Account (the “Rehabilitator”) and the Wisconsin Office of the Commissioner of Insurance (“OCI”), presented a settlement offer (“Settlement Letter”) to settle the above-referenced proceedings. This letter modifies and supplements the terms of the Settlement Letter, as follows:

- (i) Paragraph 1(b) of the Settlement Letter is modified by deleting reference to the dismissal of the Adversary Proceeding. As modified, paragraph 1(b) shall read: “The United States Bankruptcy Court for the Southern District of New York (the “Bankruptcy Court”) shall have entered an order approving the proposed settlement of the transactions contemplated in this letter, including the Plan of Reorganization.
- (ii) Paragraph 1(c)(6) shall be added to the Settlement Letter to state: “The closing agreement shall be executed only upon the satisfaction of all other conditions set forth in paragraphs 1 and 2 of the Settlement Letter and the entry of an order of the United States Bankruptcy Court for the Southern District of New York, in the Chapter 11 bankruptcy proceeding of *In re Ambac Financial Group, Inc.* Chap 11 Case No. 10-15973, approving the terms of this settlement between AFGI, on behalf of itself and as agent for the members of AFGI and Subsidiaries consolidated group, and the United States.”
- (iii) Paragraph 2 of the Settlement Letter is modified by deleting the first sentence “Within ten (10) business days following satisfaction of all conditions set forth in paragraph 1: (i) AFGI will pay the United States Department of the Treasury one million nine hundred thousand dollars (\$1,900,000); and (ii) AAC and/or the Segregated Account will pay the United States Department of the Treasury one hundred million dollars (\$100,000,000).” The first sentence in paragraph 2 shall read: “Following satisfaction of all conditions set forth in paragraph 1, except the reference to a closing agreement within paragraphs 1(c) and (d), AFGI and the United States shall meet at which time the United States will deliver to AFGI an executed closing agreement in accordance with the Settlement Letter upon confirmation that: (i) AFGI has paid the United States Department of the Treasury one million nine hundred thousand dollars (\$1,900,000); and (ii) AAC and/or the Segregated Account has paid the United States Department of the Treasury one hundred million dollars (\$100,000,000).”

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The remainder of paragraph (2) in the Settlement Letter will remain unchanged. The amount to be paid by AAC and/or the Segregated Account pursuant to paragraph 2 of the Settlement Letter may be funded in accordance with paragraph 3 of the Escrow Agreement, dated as of March 8, 2012 (the “Escrow Agreement”), between the Segregated Account, the United States of America and The Bank of New York Mellon, as escrow agent, in which case the Segregated Account and the United States of America shall take such actions as are required by the Escrow Agreement to effect such funding. Alternatively, the amount to be paid by AAC and/or the Segregated Account pursuant to paragraph 2 of the Settlement Letter may be funded in cash, in which case the Segregated Account and the United States of America shall take such actions as may be necessary to terminate the arrangements effected by the Escrow Agreement and return all Escrow Property (as defined in the Escrow Agreement) to the Segregated Account.

It is further agreed that paragraph 9 shall be modified by removing from that paragraph reference to the satisfaction of all conditions set forth in paragraphs 1 and 2. As modified, paragraph 9 shall read: “Following receipt by the Taxpayer of the executed closing agreement in accordance with the terms of the Settlement Letter, as modified by this letter, by stipulation, the United States and AFGI shall dismiss with prejudice the Adversary Proceeding, presently pending before the United States Bankruptcy Court for the Southern District of New York (Case No. 10-4210) and the motion to withdraw the reference, presently pending before the United States District Court for the Southern District of New York.”

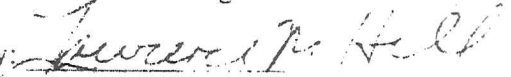
Preet Bharara, Esq.
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It is further agreed that the private letter ruling dated October 25, 2012 issued by the Internal Revenue Service (PLR-117798-12) to Ambac Financial Group, Inc. satisfies the requirements set forth in paragraph 1(d)(ii) of the Settlement Letter.


All terms and conditions of the Settlement Letter will remain unchanged except as expressly provided for in this letter.

Respectfully submitted,

Shearman & Sterling LLP

By: 
Lawrence M. Hill
Counsel for debtor and AAC

Foley & Lardner LLP

By: 
Kevin G. Fitzgerald
Counsel for the Segregated
Account, the Rehabilitator,
and OCI

Morrison & Foerster LLP

By: _____
Anthony Princi
Counsel for the Official
Creditors Committee


Preet Bharara, Esq.
Page 4

It is further agreed that the private letter ruling dated October 25, 2012 issued by the Internal Revenue Service (PLR-117798-12) to Ambac Financial Group, Inc. satisfies the requirements set forth in paragraph 1(d)(ii) of the Settlement Letter.

All terms and conditions of the Settlement Letter will remain unchanged except as expressly provided for in this letter.

Respectfully submitted,


Shearman & Sterling LLP

By: 
Lawrence M. Hill
Counsel for debtor and AAC

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Kevin G. Fitzgerald
Counsel for the Segregated
Account, the Rehabilitator,
and OCI

Morrison & Foerster LLP

By: 
Anthony Princi
Counsel for the Official
Creditors Committee

Preet Bharara, Esq.
Page 5

Acknowledged and Agreed:

UNITED STATES OF AMERICA

By: _____

Cc: Daniel P. Filor
Ellen London
Carina H. Schoenberger
Anthony T. Sheehan
Roger A. Peterson
Michael B. Van Sicklen
Edward Froelich
Robert Kovacev
Sashka Koleva
Jeanette A. Vargas

EXHIBIT C

(DoJ Acceptance Letter)

Image Not
Available

Tax Division

*Please reply to: Office of Review
Post Office Box 310
Ben Franklin Station
Washington, D.C. 20044*

KK:AR:ETPerelmuter

CMN 2011100390

April 4, 2013

By Telecopier and Regular Mail

Lawrence M. Hill, Esquire
SHEARMAN & STERLING, LLP
599 Lexington Avenue
New York, NY 10022-6069

Re: Ambac Financial Group, Inc. v. United States,
Adv. Proc. No. 10-4210 (Bankr. S.D.N.Y.); In the Matter
of the Rehabilitation of Segregated Account of Ambac Assurance
Corp., No. 10 CV 1576 (Wis. Circuit Court for Dane County);
Theodore K. Nickel v. United States (7th Cir. - No. 1158);
United States v. Wisconsin State Circuit Court for Dane County,
et al. (7th Cir. - No. 11-1419)

Dear Mr. Hill:

This refers to your offer dated February 24, 2012, as supplemented and modified by letter dated April 3, 2013, submitted on behalf of Ambac Financial Group, Inc. and Ambac Assurance Corporation. This offer has been

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accepted on behalf of the Attorney General on the terms set forth therein.
The Internal Revenue Service is being informed of this action.

Sincerely yours,

Kathryn Keneally
Assistant Attorney General

By:

A handwritten signature in black ink, appearing to read 'Ann Reid', with a large, stylized 'R'.

Ann Reid
Acting Chief, Office of Review

EXHIBIT D

(Trick Declaration)

**UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK**

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

**DECLARATION OF DAVID TRICK IN SUPPORT OF DEBTOR'S MOTION
FOR ORDER PURSUANT TO BANKRUPTCY CODE SECTIONS 363(b) AND 105(a)
AND BANKRUPTCY RULE 9019 APPROVING SETTLEMENT WITH THE UNITED
STATES**

I, David Trick, hereby declare as follows:

1. I am Chief Financial Officer of Ambac Financial Group, Inc., as debtor and debtor in possession in the above-captioned case (the "Debtor").

2. I submit this declaration (the "Declaration") in support of the Debtor's motion for an order, pursuant to Bankruptcy Code sections 363(b) and 105(a) and Bankruptcy Rule 9019, approving the Debtor's entry into the IRS Settlement, the terms of which are documented in the Offer Letter and the Supplemental Offer Letter, both of which are attached to the Motion as Exhibit B, among the Debtor, the Committee, the United States, AAC, the Segregated Account, OCI, and the Rehabilitator, resolving the IRS Dispute (the "Motion").¹ Except as otherwise indicated, all facts set forth in this Declaration are based upon my personal knowledge, my review of the relevant documents, or my experience. If I were called to testify, I could and would testify competently to the facts set forth herein.

¹ Capitalized terms used but not defined in the Order shall have the meanings set forth in the Motion.

3. The IRS Dispute concerns whether the Debtor was entitled to receive approximately \$708,115,835 in Tax Refunds from carrying back losses resulting from CDS Contracts. Immediately following the commencement of the Debtor's bankruptcy case, the Debtor filed an Adversary Complaint seeking, among other things, a declaratory judgment that the Debtor is entitled to retain the Tax Refunds. The IRS, which disputes the Debtor's position, filed the IRS Claims, which are substantially duplicative and each asserts a priority claim against the Debtor in the amount of \$807,242,027.91.

4. Because the IRS Claims assert that they are entitled to priority status and chapter 11 plans must provide for the payment in full of allowed priority tax claims, in order to have confirmed the Plan and successfully emerged from bankruptcy, the Debtor must have either fully and successfully litigated the (i) IRS Adversary Proceeding and the IRS Claims Objection or (ii) the IRS Claims Estimation Motion, or alternatively, entered into a settlement with the IRS.

5. Litigating the IRS Dispute would be counterproductive to the Debtor's chapter 11 case. Even if the Debtor were ultimately successful in litigating the IRS Dispute, which is uncertain, delaying the confirmation and consummation of the Plan would have jeopardized the Debtor's reorganization as the Debtor's liquidity is insufficient to sustain a lengthy and unpredictable delay in Plan consummation.

6. Moreover, the costs of litigating the IRS Dispute would have compounded the problems associated with delaying the Debtor's emergence from bankruptcy by adding considerable legal fees and expenses in connection with litigating the IRS Dispute at the Bankruptcy Court level, with the possibility of extended appeals.

7. Even absent the Debtor's liquidity problems, pursuing a strategy of litigating the IRS Dispute to a conclusion would have upset the delicate state of the Debtor's relationships

with the Committee, AAC, OCI, and the Rehabilitator, all of whose support was necessary to confirm and consummate the Plan.

8. Additionally, if the Debtor were unsuccessful in litigating the IRS Dispute, the Debtor's estate would lose the significant value delivered to creditors under the Plan and the Debtor would likely have to convert its case to one under chapter 7 of the Bankruptcy Code.

9. Bankruptcy Court approval of and entry into the IRS Settlement, on the other hand, resolves the IRS Dispute in a manner satisfactory to the Debtor, the Committee, AAC, OCI, and the Rehabilitator and enables the Debtor to successfully emerge from chapter 11.

I hereby declare under penalty of perjury that the foregoing is true and correct.

Dated: April 8, 2013
New York, New York

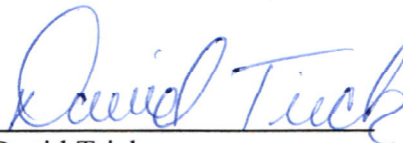

David Trick
Chief Financial Officer
Ambac Financial Group, Inc.

EXHIBIT E

(Rehabilitation Court Order)

STATE OF WISCONSIN

CIRCUIT COURT

DANE COUNTY

In the Matter of the Rehabilitation of:

Segregated Account of Ambac Assurance Corporation

2012 JUN 14 AM 11:11 Case No. 10 CV 1576
DANE CO. CIRCUIT COURT

**ORDER AUTHORIZING THE REHABILITATOR AND THE SEGREGATED
ACCOUNT TO PROCEED WITH PROPOSED SETTLEMENT AGREEMENT
WITH THE UNITED STATES**

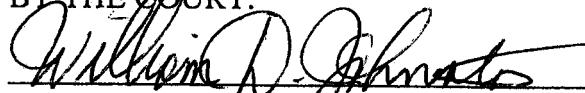
This matter came before the Court for a hearing on the Rehabilitator's Motion To Authorize the Rehabilitator and the Segregated Account to Proceed With Settlement Agreement With the United States (the "Motion"). The Motion came before the Court on proper advance written notice for hearing in open court. Appearances were noted on the record. All interested parties were afforded the opportunity to appear and be heard on the Motion.

The Court having considered the Rehabilitator's Motion and the information provided at the hearing, it is hereby **ORDERED** as follows:

- 1) The Rehabilitator's Motion is **GRANTED**.
- 2) The Rehabilitator and the Segregated Account are authorized to proceed in accordance with the terms and conditions of the Offer Letter, which was attached to the Motion, and, if the Offer is accepted by the United States, to then carry out all transactions necessary to effectuate the settlement pursuant to the terms and conditions set forth in the Offer Letter.

Dated this 13th day of June, 2012.

BY THE COURT:

A handwritten signature in black ink, appearing to read "William D. Johnston", written over a horizontal line.

Honorable William D. Johnston
Lafayette County Circuit Court Judge
Presiding by Judicial Appointment