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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re **AMBAC FINANCIAL GROUP, INC.,** **Debtor.**	**Chapter 11 Case No.** **10-15973 (SCC)**
AMBAC FINANCIAL GROUP, INC., **Plaintiff,** **- against -** **UNITED STATES OF AMERICA,** **Defendant.**	**Adversary Proceeding No. 10-** ________

MOTION FOR TEMPORARY RESTRAINING ORDER AND PRELIMINARY INJUNCTION PURSUANT TO SECTIONS 105(a) AND 362(a) OF THE BANKRUPTCY CODE AND RULE 7065 OF THE BANKRUPTCY RULES

Ambac Financial Group, Inc. ("AFG" or the "Debtor"), as debtor and debtor in possession, hereby moves this Court for a temporary restraining order ("TRO") and preliminary injunction, pursuant to Bankruptcy Code sections 105(a) and 362(a), Rule 65 of the Federal Rules of Civil Procedure, and Rules 7001(7) and 7065 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"), ordering the Internal

Revenue Service (the "IRS") to provide five business days' prior written notice (filed with the Court and served by electronic mail on Debtor's counsel) before taking any Enforcement Action (defined below) contrary to the State Court Injunction (defined below), whether or not such injunction remains in effect. In further support of this Motion, the Debtor respectfully represents:

PRELIMINARY STATEMENT

1. The Debtor is a holding company and has commenced this chapter 11 case with two principal goals: restructuring its debt and reorganizing around its principal wholly-owned operating subsidiary, Ambac Assurance Corporation ("AAC"), one of the largest and most vital financial guaranty insurance companies in the world. AAC's insurance policies and other financial products support a multitude of public finance, structured finance, and international finance transactions, forming the financing foundation upon which many companies, municipalities and, ultimately, a substantial number of jobs, are built. Although certain of AAC's assets are currently subject to state insurance rehabilitation proceedings, ACC's healthy corporate assets – billions of dollars of performing insured obligations – are largely free of the current rehabilitation proceedings.

2. Within less than two weeks, the Debtor and AAC will seek approval of a rehabilitation plan in the state insurance proceedings that will ensure AAC's performing assets are not placed into rehabilitation, freeing up those assets to fund a portion of the state rehabilitation plan and generate revenues and future business for AAC. Approval and implementation of the rehabilitation plan will in turn inure to the benefit of AFG and its creditors, as the future dividends generated by AAC will, as they

did before credit crisis and the rehabilitation proceedings, provide the necessary funding for AFG to meet its own obligations. The state insurance rehabilitation plan and the Debtor's chapter 11 reorganization strategy are the result of months of difficult and hard-fought negotiations among the Debtor and its affiliated non-debtor subsidiaries (collectively, "Ambac"), their regulators and their largest stakeholders.

3. Just days ago, however, the IRS informed the Debtor it may take action that, if not enjoined by this Court, will crater the Debtor's reorganization and AAC's state rehabilitation plan. Specifically, after having issued prepetition Tax Refunds (as defined below) aggregating approximately $700 million to AFG, as the tax filer of Ambac's consolidated tax group, the IRS now intends to re-assess AFG's tax liability and demand a return of the Tax Refunds, which were distributed by AFG almost entirely to AAC, pursuant to their tax sharing agreement. Under its statutory powers, the IRS can do this and more – including creating liens and levying on AAC's assets (and the assets of AFG's other non-debtor subsidiaries which are included in Ambac's consolidated tax group) – without AFG or its creditors having notice to take preemptive actions. If these events occur, AAC's rehabilitation plan will be scuttled and its performing assets will be pulled into the pending rehabilitation proceeding, effectively ending AFG's reorganization efforts in chapter 11. On November 8, 2010 the Wisconsin state court administering AAC's rehabilitation expanded the scope of its previous State Court Injunction to prevent the IRS from asserting liens against and levying upon the assets of AAC and its subsidiaries.

4. To preserve the status quo of its reorganization efforts and provide the Debtor with further opportunity to seek injunctive relief, the Debtor filed the instant

Motion, which seeks a TRO and preliminary injunction ordering the IRS to provide five business days' prior written notice (filed with the Court and served by electronic mail on Debtor's counsel) before taking any Enforcement Action contrary to the State Court Injunction, whether or not such injunction remains in effect, pending a final determination of AFG's prepetition tax liability under section 505(a) of the Bankruptcy Code. If the Court does not grant the Debtor's request for injunctive relief and the IRS places liens upon and levies AAC's assets before AFG's tax liability is determined, the IRS will single-handedly thwart AFG's reorganization proceedings, *even though it is wrong* about AFG's tax liability, without AFG having an opportunity to show it does not owe the IRS one cent. Indeed, as set forth in the adversary complaint filed concurrently with this Motion (the "Complaint"), the Debtor believes this Court will determine the Tax Refunds were based on a correct determination of its tax liabilities.[1]

5. Under these circumstances, there is no question the balance of harms clearly favor issuing an injunction. If an injunction does not issue, AFG's reorganization will effectively meet its end, robbing AFG's creditors of any chance of recovery. On the other hand, if the Court issues the limited injunction requested herein, the IRS will suffer no pecuniary harm. Instead, the status quo will be maintained, and the IRS will merely have to (i) provide notice to the Debtor (which, upon receipt of such

[1] This Motion and the Complaint are supported by (i) the Declaration of David W. Wallis in Support of Debtor's Request for Declaratory Judgment and Injunctive Relief (the "Wallis Decl."); (ii) the Declaration of Lawrence M. Hill in Support of Debtor's Request for Declaratory Judgment and Injunctive Relief (the "Hill Decl."); (iii) the Declaration of R. Wes Kirchhoff in Support of Debtor's Request for Declaratory Judgment and Injunctive Relief (the "Kirchhoff Decl."); and (iv) the Declaration of Thomas J. Staskowski in Support of Debtor's Request for Declaratory Judgment and Injunctive Relief (the "Staskowski Decl."), each of which was filed in support of the Complaint and Motion. The Motion and Complaint are also supported by the Affidavit of David W. Wallis in Support of Debtor's Chapter 11 Petition and First Day Motions (the "First Day Affidavit").

notice, may seek further injunctive relief) and (ii) wait for a ruling on its prepetition tax claim before it is able to take Enforcement Actions against AFG's subsidiaries.

6. Finally, although the federal statutes and jurisprudence interpreting them are well settled, the IRS may still attempt to argue the Court cannot issue an injunction because of the effect of the Anti-Injunction Act. The Bankruptcy Code and the United States Supreme Court precedent make clear, however, that the Anti-Injunction Act does not bar this Court from issuing the injunction the Debtor seeks. Indeed, as discussed below (*infra* ¶¶ 46-47), the Anti-Injunction Act is the codification of the federal government's sovereign immunity, which Congress has expressly waived pursuant to amendments to section 106(a) of the Bankruptcy Code. In fact, in section 106(a) Congress enumerated the statutory predicates for this Court's authority to issue the requested injunction and determine AFG's tax liability (sections 105 and 505 of the Bankruptcy Code) as exceptions to the government's sovereign immunity powers.

7. For all these reasons, the Debtor believes the Motion should be granted.

STATEMENT OF FACTS

Debtor's Bankruptcy Filing and Background

8. On the date hereof (the "Commencement Date"), the Debtor commenced a voluntary case under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code"). The Debtor continues to operate its businesses and manage its properties as a debtor in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.

9. The Debtor is a holding company and its principal wholly-owned operating subsidiary, AAC, is a Wisconsin-domiciled financial guaranty insurance company whose business includes the issuance of financial guaranty insurance policies to support public finance, structured finance, and international finance transactions. Wallis Decl. ¶ 5. AAC is subject to the insurance laws and regulations of the State of Wisconsin and is regulated by the Office of the Commissioner of Insurance of the State of Wisconsin ("OCI"). *Id.* Until 2008, when AAC stopped selling new policies because of its deteriorating financial condition and lowered credit ratings, AAC offered financial guaranty insurance on investment grade municipal finance and private structured-finance debt obligations, such as municipal bonds and residential mortgage-backed securities. First Day Affidavit ¶ 5.

10. The Debtor, through subsidiaries of AAC, also provided financial services, including investment agreements, funding conduits, and interest rate, currency, and total return swaps, principally to the clients of its financial guaranty business. AAC guaranteed its subsidiaries' performance under those agreements. First Day Affidavit ¶ 7.

AAC'S Segregated Account,
General Account and Rehabilitation Proceedings

11. On March 24, 2010, OCI approved the establishment of a segregated account of AAC (the "Segregated Account"), pursuant to Wisc. Stat. § 611.24(2), to segregate certain non-performing segments of AAC's liabilities (together, the "Segregated Account Policies"). Wallis Decl. ¶ 6. All policy obligations of AAC not allocated to the Segregated Account remain in the general account of AAC (the "General Account"). *Id.* Further, on March 24, 2010, OCI commenced rehabilitation proceedings

with respect to the Segregated Account (the "Rehabilitation Proceedings") in the District Court of Dane County, Wisconsin (the "Rehabilitation Court") to facilitate an orderly run-off and/or settlement of the liabilities in the Segregated Account, including those associated with the Segregated Account Policies. *Id.*

12. On June 7, 2010, AAC entered into a settlement agreement (the "CDS Settlement Agreement") with certain counterparties to credit default swaps (the "CDS Counterparties") in respect of collateralized debt obligations of asset-backed securities ("CDO of ABS") insured by AAC. Wallis Decl. ¶ 7. Pursuant to this agreement, in exchange for the termination of approximately $16.5 billion in par amount of CDO of ABS obligations, AAC paid to the CDS Counterparties $2.6 billion in cash and $2 billion of surplus notes of AAC, which have a scheduled maturity of June 7, 2020. *Id.* Certain other non-CDO of ABS obligations were also commuted pursuant to the CDS Settlement Agreement. *Id.*

13. On October 8, 2010, OCI filed a plan of rehabilitation with respect to the Segregated Account (the "Rehabilitation Plan") in the Rehabilitation Court. Wallis Decl. ¶ 8. The Rehabilitation Plan will, if approved, provide, *inter alia*, that holders of Segregated Account Policies shall receive, in respect of claims made, a combination of cash and surplus notes of the Segregated Account. *Id.* Subject to OCI approval, once assets of the Segregated Account are exhausted, creditors will be able look to the General Account for satisfaction of certain liabilities to satisfy the portion of claim liability not paid by the Segregated Account in cash or in Segregated Account Surplus Notes, and further, the General Account may issue surplus notes directly to holders of Segregated Account Policies. *Id.* A confirmation hearing in respect of the Rehabilitation Plan is

currently scheduled for November 15-19, 2010 in the Rehabilitation Court. *Id.* Until the Rehabilitation Plan is approved, it is anticipated that no claims will be paid on Segregated Account Policies, except as approved by the Rehabilitation Court. *Id.*

14. Although AAC has been unable to pay dividends to the Debtor for several years and will be unable to pay dividends in 2010 absent special approval from OCI, which is not expected, AAC is nevertheless one of the Debtor's most valuable assets. Wallis Decl. ¶ 9. The future value of AAC will primarily depend upon the performance of AAC's insured portfolio (*i.e.*, the ultimate losses therein relative to its claims paying resources), ongoing remediation efforts of AAC with respect to the Segregated Account Policies, and other factors, including AAC's ability to repurchase surplus notes at below face value. *Id.* The Debtor's and AAC's success in these endeavors would result in the addition of significant value to the Debtor's estate. *Id.*

Tax Refund and the IDR

15. In 2008 and 2009, the Debtor filed three claims with the IRS for tentative carryback adjustments on Form 1139 (Corporate Application for Tentative Refund) as a result of the carryback to prior taxable years of approximately $33 million and $3.2 billion of net operating loss carryovers ("NOLs") in 2008 and 2009, respectively, which resulted in AFG receiving tax refunds in December 2008, September 2009 and February 2010 aggregating approximately $700 million (the "Tax Refunds") from the IRS. Wallis Decl. ¶ 10. On October 28, 2010, the IRS sent an information document request (an "IDR") to the Debtor regarding a Form 3115 Change of Accounting Methodology Request filed in 2008 and Ambac's calculation of the Tax Refund. *Id.*; Staskowski Decl. ¶ 5; Kirchhoff Decl. ¶ 18. In addition, the IRS questioned

certain calculations underlying Ambac's reported consolidated NOLs of approximately $7.3 billion as of September 30, 2010. Wallis Decl. ¶ 10.

16. Upon receiving the IDR, the Debtor's management reviewed the potential ramifications of the IDR. Wallis Decl. ¶ 11. The Debtor determined that if the IRS were to take Enforcement Actions based upon the IDR prior to the adjudication of the Debtor's tax liability, there is a real risk OCI would quickly thereafter commence a rehabilitation of AAC's General Account, which would unravel AAC's Rehabilitation Plan and destroy the Debtor's reorganization prospects. *Id.* The numerous adverse ramifications that would result from a rehabilitation of the General Account are set forth in the Wallis Declaration. *Id.* at ¶¶ 12-23.

State Court Injunction

17. On November 8, 2010, OCI appeared before the Rehabilitation Court seeking an expansion of a previously entered injunction (as expanded, the "State Court Injunction") to prevent the IRS from asserting liens against and levying upon the assets of AAC and its subsidiaries and to prevent AFG or AFG-related parties from pursuing specific claims against the Segregated Account, the General Account, or AAC's subsidiaries (collectively, "Enforcement Actions").[2] Wallis Decl. ¶ 25.

18. Notwithstanding OCI's actions and the Rehabilitation Court's entry of the State Court Injunction enjoining the IRS, the Debtor is concerned the IRS may ignore the terms of that injunction and take an Enforcement Action. Wallis Decl. ¶ 26. Given that such actions would seriously jeopardize or destroy its reorganization

[2] The definition of Enforcement Actions is used for ease of reference only and is not intended, and shall not be deemed, to limit the scope of the State Court Injunction, the actual terms of which control.

efforts, the Debtor believes this Court should enter the TRO and preliminary injunction sought in the Motion. *Id.*

ARGUMENT

I. **This Court Has Subject Matter Jurisdiction Over the Debtor's Request for an Injunction**

19. This Court has subject matter jurisdiction over this Motion under sections 1334 and 157 of title 28 of the United States Code. Under section 1334(b), district courts have original (but not exclusive) jurisdiction of all civil actions "arising under title 11, or arising in or related to cases under title 11." *See* 28 U.S.C. §1334(b). Pursuant to the July 11, 1984 standing order entered by the District Court in accordance with 28 U.S.C. §157(a), this Court can exercise the subject matter jurisdiction granted to the District Court. *See Adams v. Zarnel (In re Zarnel)*, 619 F.3d 156, *30-31 (2d Cir. 2010).

A. Debtor's Request Under Section 505(a) for Declaratory Judgment

20. Under section 1334(b), the determination of the Debtor's tax liability under section 505(a) of the Bankruptcy Code "arises under" title 11 because the statutory provision underlying the court's power to determine the Debtor's tax liability applies only under title 11. Under section 157(b)(2), such determination is also core. *See United States v. Wilson*, 974 F.2d 514, 517 (4th Cir. 1992) (finding a proceeding under section 505 to be 'core'); *In re Rodriguez*, 387 B.R. 76, 80 (Bankr. E.D.N.Y. 2008) (same).

B. Debtor's Request for Injunctive Relief

21. The Debtor's request for an injunction under section 105 of the Bankruptcy Code pending the hearing under section 505(a) also "arises under" title 11, and "arises in" a case under title 11 because an injunction of this kind, and the standards for its issuance, are unique to title 11 and apply only in cases under title 11. In addition, this Court has 'related to' jurisdiction to issue an injunction against the IRS to protect the assets of the nondebtor subsidiaries because the dispute involves tax liability of the Debtor's consolidated tax group, and seizure or encumbrance of AAC's assets threatens AFG's survival and ability to reorganize, and thus has more than a 'conceivable effect' on the Debtor's estate. *See Kenton County Bondholders Comm. v. Delta Air Lines, Inc. (In re Delta Air Lines, Inc.)*, 374 B.R. 516, 525 (S.D.N.Y. 2007) ("The Bankruptcy Court plainly had jurisdiction under 28 U.S.C. § 1334(b) to approve this Settlement binding nondebtors because the litigation that was settled had more than a 'conceivable effect' on the bankrupt estate"). A request for an injunction pursuant to section 105 is also a core proceeding. *See Manville Corp. v. Equity Sec. Holders Comm. (In re Johns-Manville Corp.)*, 801 F.2d 60, 64 (2d Cir. 1986) (finding an injunction under section 105 to be a core proceeding). Here, the injunction would be issued to ensure the Debtor will have an opportunity for a hearing on its tax liability without being undermined by actions of the IRS against the Debtor's nondebtor subsidiaries.

22. Even if this Court were to determine that the Debtor's request for an injunction is non-core, the interlocutory nature of a TRO/preliminary injunction allows this Court to issue the requested injunctive relief because it is not a final order or judgment. *See Celotex Corp. v. Edwards*, 514 U.S. 300, 310 n.7 (1995) ("[T]he

Bankruptcy Court did not lack jurisdiction under §157(c)(1) to issue the Section 105 Injunction because that injunction was not a 'final order or judgment.'").

23. Finally, because the nondebtor subsidiaries' tax liability is identical to the Debtor's liability, and the determination of the Debtor's tax liability is a core proceeding, this Court's determinations against the Debtor would collaterally estop an action by the IRS against the nondebtors. Based on *Katchen v. Landy*, 382 U.S. 323 (1966) and the Ninth Circuit's recent interpretation of it in *Marshall v. Stern (In re Marshall)*, 600 F.3d 1037, 1058 (9th Cir. 2010), cert. *granted, Stern v. Marshall*, 177 L. Ed. 2d 1152; 2010 U.S. LEXIS 5746; 79 U.S.L.W. 3194 (Sept. 28, 2010), this Court can issue orders to protect the nondebtor entities because every fact and legal conclusion at issue against the nondebtor subsidiaries matches the issues to be determined in the core section 505(a) proceeding to determine the Debtor's tax liability to the IRS.

II. Debtor is Entitled to a Temporary Restraining Order and Preliminary Injunction

A. *Injunction Standard*

24. Section 105(a) empowers bankruptcy courts to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]." 11 U.S.C. § 105(a). This authority under section 105 is broader than the automatic stay provisions of section 362 and may be used to assure the orderly conduct of the reorganization proceeding. *Erti v. Paine Webber Jackson & Curtis, Inc. (In re Baldwin-United Corp. Litig.)*, 765 F.2d 343, 348 (2d. Cir. 1985). Specifically, bankruptcy courts may employ the equitable power granted by section 105(a) independently, to protect a debtor's ability to reorganize, or together with other provisions of the Bankruptcy Code, such as section 362(a), to extend the automatic stay,

and enjoin actions against nondebtors when doing so would protect the debtor's estate. *See Queenie, Ltd. v. Nygard Int'l,* 321 F.3d 282, 287 (2d Cir. 2003) ("The automatic stay can apply to nondebtors, but normally does so only when a claim against the nondebtor will have an immediate adverse economic consequence for the debtor's estate");[3] *Sec. Investor Prot. Corp. v. Bernard L. Madoff Inv. Secs. LLC*, 429 B.R. 423, 434 (Bankr. S.D.N.Y. 2010) (same); *Johns-Manville Corp. v. Asbestos Litig. Group (In re Johns-Manville Corp.)*, 40 B.R. 219, 226 (S.D.N.Y. 1984) ("Pursuant to the exercise of [Section 105] authority, the Court may issue or extend stays to enjoin a variety of proceedings which will have an adverse impact on the Debtor's ability to formulate a Chapter 11 plan."); *see also E. Air Lines, Inc. v. Rolleston (In re Ionosphere Clubs Inc.)*, 124 B.R. 635, 642 (S.D.N.Y. 1991) (section 105(a) "extends to creditor's actions against third parties, when such an injunction is necessary to protect the debtors and the parties in interest to the reorganization in their attempt to reorganize successfully").[4]

25. In determining when a section 105(a) injunction should issue, courts in this circuit apply "the traditional preliminary injunction standard as modified to fit the bankruptcy context." *Calpine*, 365 B.R. at 409 (citation omitted); *see also In re Adelphia Commc'ns Corp.*, 298 B.R. 49, 54 (S.D.N.Y. 2003) ("Because the basic purpose of [§ 105(a)] is to enable the court to do whatever necessary to aid its jurisdiction, *i.e.*,

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[3] In *Queenie*, the Second Circuit extended the automatic stay to the debtor's wholly-owned subsidiary because a claim against the subsidiary would have 'adverse economic consequences' for the debtor. *Id.* at 287.

[4] While the Second Circuit clarified in *Deutsche Bank AG, London Branch & Bear, Stearns & Co., Inc. v. Metromedia Fiber Network, Inc. (In re Metromedia Fiber Network, Inc.)*, 416 F.3d 136, 142 (2d. Cir. 2005) that powers under section 105 must derive from other provisions of the Bankruptcy Code, subsequent decisions have clarified that "[n]othing in the court's opinion [in Metromedia] affects the longstanding practice of courts utilizing section 105 to stay (as opposed to release) nondebtor litigation." *Nev. Power Co. v. Calpine Corp. (In re Calpine Corp.)*, 365 B.R. 401, 409 n.20 (S.D.N.Y. 2007); *see also In re Lyondell Chem. Co.*, 402 B.R. 571 at 587 n.33 (Bankr. S.D.N.Y. 2009).

anything arising in or relating to a bankruptcy case, ... the Second Circuit, courts in this District, and courts in other circuits have construed [§ 105] liberally to enjoin suits that might impede the reorganization process[,] ... and embraced the use of § 105 without proof of all four factors normally required for injunctions, such as inadequate remedy of law or irreparable harm") (internal quotation marks and citations omitted). Thus, courts consider the following factors, with the modifications referred to above, in determining whether to issue a preliminary injunction: "(1) whether there is a likelihood of successful reorganization; (2) whether there is an imminent irreparable harm to the estate in the absence of an injunction; (3) whether the balance of harms tips in favor of the moving party; and (4) whether the public interest weighs in favor of an injunction." *Calpine*, 365 B.R. at 409.

26. Courts have recognized, however, an exception to the irreparable harm requirement "that permits the court to issue a preliminary injunction in the bankruptcy context where the action to be enjoined is one that threatens the reorganization process." *Id.* (internal quotation marks and citations omitted); *see also In re Neuman*, 71 B.R. 567, 571 (S.D.N.Y. 1987) (quoting *Henderson v. Burd,* 133 F.2d 515, 517 (2d Cir. 1943) ("since injunctions in bankruptcy cases are authorized by statute, the usual equitable grounds for relief, such as irreparable damage, need not be shown"); *Lyondell*, 402 B.R. at 588 n.37 ("[I]t has been repeatedly held in this district that the usual grounds for injunctive relief, such as irreparable injury, need not be shown in a proceeding for an injunction under section 105(a)."); *LTV Steel Co., Inc. v. Bd. of Educ. (In re Chateaugay Corp., Reomar, Inc.)*, 93 B.R. 26, 29 (S.D.N.Y. 1988) (same). Courts

take a flexible approach to evaluating these factors, no one of which is determinative. *Calpine*, 365 B.R. at 409. As discussed below, each of these factors is established here.

B. *There is a Reasonable Likelihood of a Successful Reorganization*

27. In the bankruptcy context, the "likelihood of success" prong of the preliminary injunction standard focuses on the debtor's likelihood of a successful reorganization, rather than the debtor's likelihood of success on the merits. *See, e.g.*, *Lyondell*, 402 B.R. at 589-90; *Calpine*, 365 B.R. at 410. AFG plainly has a reasonable likelihood of a successful reorganization. Where the time to submit a chapter 11 plan has not yet expired, a debtor can demonstrate a reasonable likelihood of a successful reorganization if the debtor is actively pursuing its reorganization efforts and if the action taken against the debtor would impede the debtor's ability to file its plan. *See, e.g.*, *Lyondell*, 402 B.R. at 590 n.44 (debtors in the early states of bankruptcy need not show "detailed projections of the terms or anticipated feasibility of [a] plan of reorganization"); *Steven P. Nelson, D.C., P.A. v. G.E. Capital Corp. (In re Steven P. Nelson, D.C., P.A.)*, 140 B.R. 814, 816-17 (Bankr. M.D. Fla. 1992) ("This Chapter 11 case is still in an embryonic stage and it is clearly unreasonable to require the Debtor at this early stage of the case to make detailed projections of the terms or anticipated feasibility of its plan of reorganization.... In this connection, it should be noted that there is nothing in the record to indicate that the Debtor will not be able to successfully reorganize."); *Gathering Rest., Inc. v. First Nat'l Bank (In re Gathering Rest., Inc.)*, 79 B.R. 992, 1001 (Bankr. N.D. Ind. 1986) ("[T]he Court at the early stages must make at least a rebuttable presumption that the [debtor has] made a good faith filing and [is] making a good faith effort to reorganize.").

28. Here, AFG has had extensive discussions with its creditor constituencies prior to the date of the Debtor's chapter 11 filing regarding its reorganization efforts. First Day Affidavit ¶¶ 29-34, 40-43. Although the prevailing circumstances still left AFG no recourse but to commence this chapter 11 case, plan discussions were underway well before the filing, and, at the very least, AFG should be given the opportunity to pursue a reorganization at this nascent stage of its case. *See, e.g.*, *Sudbury, Inc. v. Escott (In re Sudbury, Inc.)*, 140 B.R. 461, 466 (Bankr. N.D. Ohio 1992) ("The evidence establishes that the Debtor is hard at work on a reorganization plan. Plaintiffs do not suggest that Debtor's effort will fail.").

C. *AFG's Entitlement to the Refund Will Likely Be Successful on the Merits*

29. Although it is not necessary to show a likelihood of success on the merits to obtain a section 105(a) injunction, that standard is plainly satisfied here as well because the Court can and should determine AFG's tax liability under section 505 and, if it does, AFG will likely prevail on the merits in establishing its prepetition tax liabilities were correctly determined.

(i) The Court Has the Authority to Determine AFG's Tax Liability

30. Section 505(a)(1) of the Bankruptcy Code, in relevant part, provides:

> [T]he court may determine the amount or legality of any tax, any fine or penalty relating to a tax, or any addition to a tax, whether or not previously assessed, whether or not paid, and whether or not contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction . . . .

11 U.S.C. § 505(a)(1).

31. Under section 505(a), this Court is empowered with the authority to determine the amount of any tax, fine, or penalty, and has ample discretion to determine a debtor's liability for any tax. *In re Cody, Inc.*, 338 F.3d 89, 92 n.1 (2d Cir. 2003) ("We have 'interpret[ed] the verb 'may' in 11 U.S.C. §505(a)(1) as vesting the bankruptcy court with discretionary authority to redetermine a debtor's taxes.") (bracketed language in original) (citing *New Haven Projects Ltd. Liability Co. v. City of New Haven (In re New Haven Projects Ltd. Liability Co.)*, 225 F.3d 283, 288 (2d Cir. 2000)).[5] The exceptions to a bankruptcy court's power and authority to determine a debtor's tax liability, enumerated in subsections 505(a)(2)(A)-(C) of the Bankruptcy Code, are inapplicable here.[6]

32. Based on the foregoing, AFG submits this Court has the power, authority, and discretion to determine the amount and legality of the taxes underlying the prepetition Tax Refunds.

(ii) This Court's Exercise of Its Authority to Determine AFG's Tax Liability is Warranted under the Circumstances

33. In *New Haven Projects*, the Second Circuit set forth a number of factors bankruptcy courts should consider in deciding whether to exercise their discretion

[5] Although the Second Circuit in *Cody* affirmed the lower court's decision to abstain from section 505(a) determination, the decision was based on the fact the tax claims at issue had already been adjudicated by a competent tribunal, a fact not presented here. *In re Cody, Inc.*, 338 F.3d at 95.

[6] Section 505(a)(2)(A) prohibits re-adjudication by bankruptcy courts of taxes that have already been contested and adjudicated in a tribunal of competent jurisdiction prior to the commencement of the case. As discussed above, the IRS refunded approximately $700 million in Tax Refunds to AFG after it filed claims for carryback adjustments relating to NOLs. No tribunal of competent jurisdiction rendered a prepetition judgment determining the amount or legality of AFG's tax liability. Section 505(a)(2)(B) is also not applicable, as AFG is not seeking a tax refund on behalf of its estate before the earlier of (i) 120 days after AFG's request for the refund from the IRS or (ii) the IRS's determination of the request, as the exception provides. Rather, AFG actually received the Tax Refunds prior to the Commencement Date. Finally, the third exception to section 505(a)(1), set forth in section 505(a)(2)(C), concerns ad valorem taxes on real and personal property, and is not implicated here.

to determine a debtor's taxes under section 505. Such factors include: (i) the complexity of the tax issue; (ii) the need to administer the bankruptcy case in an expeditious fashion; (iii) the burden on the bankruptcy court's docket; (iv) the length of time necessary to conduct the hearing and to render a decision thereafter; (v) the asset and liability structure of the debtor; and (vi) the potential prejudice to the debtor. *New Haven Projects*, 225 F.3d at 289 (citing, *e.g., Northbrook Partners, LLP v. Hennepin (In re Northbrook Partners, LLP)*, 245 B.R. 104, 118 (Bankr. D. Minn. 2000) and *In re D'Alessio*, 181 B.R. 756, 759-60 (Bankr. S.D.N.Y. 1995)).[7] The Second Circuit further noted,

> The exercise of such discretion is, of course, subject to the explicit limitations in Section 505 itself, and must be informed by the purpose underlying the statute. Specifically, in determining whether to abstain from redetermining tax liability in a given case, a court must 'assure itself that the legislative purpose for drafting this provision, namely to protect the interests of both debtors and creditors, is met. Creditors are entitled to protection from the 'dissipation of an estate's assets' in the event that the debtor failed to contest the legality and amount of taxes assessed against it. Having the bankruptcy court adjudicate the matter may also afford an alternative forum for proceedings that might otherwise delay the orderly administration of the case and distribution to the debtor's creditors.'

New Haven Projects, 225 F.3d at 288 (citing *In re Onondaga Plaza Maint. Co.*, 206 B.R. 653, 656 (Bankr. N.D.N.Y. 1997)).

34. Here, the Court should exercise its discretion to determine AFG's tax liability under section 505. *First*, although the tax issues are complex, resolution of AFG's tax liability will significantly facilitate the administration of AFG's chapter 11

[7] The *New Haven Projects* court ultimately affirmed the district court's order affirming the bankruptcy court's decision to abstain from determining the debtor's tax liability under section 505(a). However, the court based its decision on the fact that section 505 review would benefit only a single insider creditor, at the expense of other outside creditors, and thus frustrate the purposes of the statute. 225 F.3d at 290. Such circumstances are not presented here.

case. *Second,* AFG does not believe the section 505 proceeding will unduly burden the Court's docket or require an extraordinary amount of time to determine and render a decision. The issues are finite, the parties have all the information necessary to argue their cases, and, as evidenced by the filing of the TRO motion, AFG is seeking to have this Court address the tax liability as soon as practicable in its bankruptcy proceeding. *Third,* given the complexity of the asset and liability structure of AFG, which is interwoven with AAC and the other members of its consolidated tax group, this case is no way akin to no-asset chapter 7 cases in which courts often abstain from exercising section 505 authority. *See, e.g., In re Ferguson,* No. 7-92-02672, 1993 Bankr. LEXIS 2022, at *7 (Bankr. W.D. Va. Dec. 30, 1993) ("[A court] 'may and should abstain' from determining a tax controversy in a no-asset Chapter 7 case involving no parties other than the Debtor and the IRS....").

35. For these reasons, this case presents the precise scenario section 505 was intended to address. By seeking injunctive relief at the outset of its chapter 11 case, AFG hopes to stave off the IRS from changing the status quo so this Court can exercise its authority under section 505 to determine AFG's liability and safeguard AFG's ability to achieve a successful reorganization. *See New Haven Projects,* 225 F.3d at 288 (noting the purpose of section 505(a)(1) is to provide a forum for ready determination of the legality or amount of tax claims in order to expedite such decisions and avoid delaying the conclusion of the administration of bankruptcy estates if left to another forum).

(iii) AFG Will Likely Establish it is
Entitled to the Full Amount of the Refund

36. As described more fully in the Complaint, AFG submits it will prevail on the merits in establishing AFG is not liable to the IRS for any taxes and is entitled to retain the Tax Refunds. *See* Complaint at ¶¶ 42-78.

D. *A Denial of the Debtor's Motion Will Result in Irreparable Harm to Debtor's Ability to Reorganize*

37. The next factor courts consider when determining whether to grant a temporary restraining order or preliminary injunction is whether denial of the motion will result in irreparable harm to the debtor's ability to reorganize. *See, e.g.*, *Calpine*, 365 B.R. at 410 (finding irreparable harm requirement satisfied where the action to be enjoined threatens the reorganization process). Here, AFG will undoubtedly suffer irreparable harm if its request for a restraining order and preliminary injunction is not granted and the IRS ignores the State Court Injunction and takes an Enforcement Action against the Debtor's non-debtor subsidiaries. The Debtor's financial performance has always been dependent upon the financial strength of its principal operating subsidiary, AAC. *See* First Day Aff. ¶¶ 8, 16. An IRS assessment and collection effort aimed at clawing back approximately $700 million would cripple AAC and endanger AFG's ability to reorganize. Wallis Decl. ¶¶ 11, 26.

38. Faced with these facts, OCI would be constrained to put AAC's General Account into full rehabilitation (Wallis Decl. ¶ 11), a course that would spell certain doom AFG's reorganization efforts because of the crippling effects rehabilitation would have on AAC's core businesses. For example, with respect to the $30 billion of commercial asset backed notes insured by AAC, rehabilitation would lead to defaults by

the issuers of the notes and resultant increases in significant claims against AAC. *Id.* at ¶¶ 14-15. Leaving aside the public threat these defaults would pose to the people who depend on the ongoing viability of the issuers to make a living, AAC alone would stand to see claim liabilities increase by $1 billion or more from issuer defaults. *Id.* at ¶¶ 16-17. Rehabilitation would also accelerate interest rate and currency swaps issued by AAC's affiliates, all of which are insured by AAC and would subject the General Account to further claims. *Id.* at ¶ 18.

39. These negative effects only scratch the surface. One of AAC's affiliates has entered into interest rate swaps with municipalities throughout the United States, all of which would terminate automatically in the event of a General Account rehabilitation. Wallis Decl. ¶¶ 19-20. These terminations would subject these cash-strapped municipalities to huge payment exposures they simply could not satisfy and would leave them without replacement coverage to hedge against future interest rate volatility. *Id.* at ¶¶ 20-21. But AAC's affiliate would also suffer losses, as municipal payment shortfalls would cause a mismatch for AAC's affiliate with respect to swaps it entered into with counterparties to hedge its exposure to the municipalities' positions. *Id.*

40. Further, although most of AAC's exposure to CDS was commuted in connection with the CDS Settlement Agreement, the General Account continues to be exposed to a significant book of CDS of collateralized loan obligations ("<u>CLOs</u>"). Wallis Decl. ¶ 22 As with CDS exposures generally, counterparties on these agreements have a right to assert mark-to-market termination claims in the event of a rehabilitation of AAC. *Id.* Although OCI would presumably attempt to enjoin the assertion of such mark-to-market damages, there can be no assurance that such injunctions would ultimately be

successful. *Id.* The Debtor calculates AAC's exposure to such mark-to-market damage claims in respect of the CLO book to be approximately $3 billion. *Id.* In the event that OCI fails to restrain the assertion of such damages, this $3 billion in additional policyholder claims would dilute all other policyholder claims significantly and destroy AAC's residual value to AFG. *Id.*

41. In addition to the damage to AAC discussed above, the IRS could assert liens on and could levy upon the assets of other valuable non-debtor subsidiaries of AFG included within its consolidated tax group. Hill Decl. ¶¶ 6-13; Wallis Decl. ¶ 23. These subsidiaries include (i) Everspan, an insurance company subsidiary of AAC with approximately $160-170 million of surplus, and (ii) two non-insurance subsidiaries of AAC, Ambac Financial Services, LLC ("AFS") and Ambac Capital Funding, Inc. ("AFCI"). Wallis Decl. ¶ 23. AFS engages in swap transactions with clients of AAC and the general marketplace while ACFI has a large book of guaranteed investment contract business. *Id.* If the businesses of AFS and ACFI are destroyed by an IRS Enforcement Action, both AFS and ACFI (all of whose liabilities to third parties are insured by AAC) could generate significant additional liabilities for AAC and further reduce or eliminate AAC's residual value to AFG. *Id.*

E. *The Balance of Hardships Weighs Strongly in the Debtor's Favor*

42. The disastrous consequences for the Debtor's reorganization that would result from an immediate assessment and collection of the Tax Refunds far outweigh any prejudice to the IRS from a limited notice injunction (subject to the Debtor obtaining further injunctive relief) in its ability to collect on its putative claim until the claim is determined by this Court. The injunction will be limited in scope and is designed solely to allow this Court to do precisely what section 505 of the Bankruptcy

Code permits it to do – determine AFG's tax liabilities, if any, owing to the IRS. If the injunction is not granted, the Debtor is concerned the IRS, with its sweeping, unilateral authority,[8] may elect to ignore the State Court Injunction. The IRS can then issue an assessment and levy against the assets of AAC – the subsidiary most integral to AFG's reorganization efforts – and end those efforts before AFG has even had a chance to show it is entitled to keep the Tax Refunds and does not owe the IRS one single penny.[9]

F. *Granting the Injunction Serves the Public Interest*

43. The public interest heavily favors an injunction. In issuing section 105 injunctions, courts have found that the "public interest" factor is satisfied if granting the injunction would promote a successful reorganization. *See LTV Corp. v. Back (In re Chateaugay Corp.)*, 201 B.R. 48, 72 (Bankr. S.D.N.Y. 1996) ("Public policy, as evidenced by chapter 11 of the Bankruptcy Code, strongly favors the reorganization and rehabilitation of troubled companies and the concomitant preservation of jobs and going concern values."); *Sudbury, Inc. v. Escott (In re Sudbury, Inc.)*, 140 B.R. 461, 465 (Bankr. N.D. Ohio 1992) ("Courts have generally recognized a public interest in reorganization.") (citing *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 204 (1983)); *Am. Film Techs., Inc. v. Taritero (In re Am. Film Techs., Inc.)*, 175 B.R. 847, 849 (Bankr. D. Del. 1994) (stating that in the bankruptcy context, "public interest" means promoting a

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[8] *See* Hill Decl. ¶¶ 6-13.

[9] If the IRS is allowed to short circuit this Court's tax determination by levying on AAC's assets, other important policy objectives of the Bankruptcy Code – such as affording equal treatment to similarly-situated creditors – will be undermined because there will be no reorganized structure to create long-term value for all unsecured creditors. *See, e.g.*, *Howard Delivery Serv., Inc. v. Zurich Am. Ins. Co.*, 547 U.S. 651, 655 (2006) ("[W]e are mindful that the Bankruptcy Code aims, in the main, to secure equal distribution among creditors."); *In re Ades and Berg Group Investors*, 550 F.3d 240, 244 (2d Cir. 2008) ("The chief purposes of the bankruptcy laws are to secure a prompt and effectual administration and settlement of the estate of all bankrupts within a limited period, to place the property of the bankrupt, wherever found, under the control of the court, for equal distribution among the creditors, and to protect the creditors from one another.").

successful reorganization, such that assisting the Debtor with its reorganization efforts is "one of the paramount interests of [the] court"). Here, AAC is AFG's largest and most significant asset. If the IRS is permitted to encumber and/or seize AAC's assets, then AAC's rehabilitation efforts will fail, which will inexorably result in AFG's inability to reorganize and maximize value. *See In re Adelphia Commc'ns Corp.*, 368 B.R. 140, 284 (Bankr. S.D.N.Y. 2007) ("[T]he public interest cannot tolerate any scenario under which private agendas can thwart the maximization of value for all.").

G. *The Debtor Has Satisfied the Requirements <u>for the Entry of a Temporary Restraining Order</u>*

44. The very nature of the injunction sought by the Motion requires issuance of a temporary restraining order under Rule 65, pending a hearing on the Debtor's motion for a preliminary injunction. Such a temporary restraining order is properly granted to preserve the status quo and prevent irreparable injury to a debtor's estate and its ability to reorganize pending a preliminary injunction hearing. *See Adelphia Commc'ns Corp. v. Am. Channel, LLC (In re Adelphia Commc'ns Corp.)*, No. 06-01528, 2006 Bankr. LEXIS 975, at *11 (Bankr. S.D.N.Y. June 5, 2006). Specifically, Rule 65(b) provides:

> The court may issue a temporary restraining order without written or oral notice to the adverse party or its attorney only if: (A) specific facts in an affidavit or a verified complaint clearly show that immediate and irreparable injury, loss, or damage will result to the movant before the adverse party can be heard in opposition; and (B) the movant's attorney certifies in writing any efforts made to give notice and the reasons why it should not be required.

Fed. R. Civ. P. 65(b).

45. For all of the reasons set forth above in support of the Debtor's request for a preliminary injunction, it is similarly appropriate to grant a temporary restraining order pending a hearing on the Motion, staying, restraining, and enjoining any collection efforts by the United States on its purported claims.

III. The Anti-Injunction Act Does Not Bar the Relief Requested

46. The "Anti-Injunction Act" is a section of the Internal Revenue Code providing that no court may enjoin the assessment or collection of any tax. *See* 26 U.S.C. §7421(a).[10] According to the Second Circuit and other courts, the Anti-Injunction Act codifies the government's sovereign immunity to assess and collect taxes. *See Randell v. United States*, 64 F.3d 101, 106 (2d Cir. 1995) ("[i]n the context of tax assessments and collections the government's sovereign immunity has been codified by the Anti-Injunction Act, I.R.C. § 7421(a) (1988) . . . ."); *see also Murphy v. IRS*, 493 F.3d 170, 174 (D.C. Cir. 2007) (same); *Clavizzao v. United States*, 706 F. Supp. 2d 342, 346 (S.D.N.Y. 2009) (same).

47. Congress, however, amended section 106(a) of the Bankruptcy Code to expressly waive sovereign immunity with respect to certain Bankruptcy Code sections and thereby vested this Court with the authority to enjoin governmental units such as the IRS. *See* 11 U.S.C. §106(a) ("Notwithstanding an assertion of sovereign immunity, sovereign immunity is abrogated as to a governmental unit to the extent set forth in this section with respect to the following [Bankruptcy Code sections]"). Specifically related to the relief requested herein, section 106(a) waives sovereign

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[10] Specifically, 26 U.S.C. §7421(a) provides: "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed."

immunity as to sections 105[11] and 505 of the Bankruptcy Code. *See* 11 U.S.C. §106(a). Thus, the amendment of section 106(a) demonstrates Congress's intent to permit this Court to enjoin the IRS to preserve value for the Debtor's estate and foster reorganization. This was the precise holding of Chief United States District Judge Brown and Bankruptcy Judge Gambardella, sitting jointly in *In re G-1 Holdings Inc.*, 420 B.R. 216, 281 (Bankr. D.N.J. 2009) ("In sum, the Anti-Injunction Act does not prevent this Court from issuing an order that provisionally limits the IRS from seeking to collect additional amounts from nondebtor [subsidiary]."). [12] Additionally, the United States Supreme Court ruled in *Central Virginia Community College v. Katz*, 546 U.S. 356 (2006), that the ratification of the bankruptcy clause in the Constitution was the abrogation of the states' sovereign immunity, and section 106 has made crystal clear that the federal government's sovereign immunity was waived under certain Bankruptcy Code sections. *See also Presidential Gardens Assocs. v. United States,* 175 F.3d 132, 142 (2d Cir. 1999) ("It is undisputed that 11 U.S.C. § 106 abrogates federal sovereign immunity with respect to most aspects of bankruptcy administration . . . .").

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[11] Congress is presumed to know the existing law as new statutes are passed. *See United States v. Prof'l Air Traffic Controllers Org.*, 653 F.2d 1134, 1138 (7th Cir. 1981) ("We note initially that, in interpreting the legislative history of a statute, there is a presumption that Congress was aware of the judicial construction of existing law . . . [t]hus, a newly-enacted statute is to be read in conjunction with the entire existing body of law.") (citations and quotations omitted). As it was well established at the time of section 106's amendment that section 105 could be used for injunctive relief (*see, e.g., MacArthur Co. v. Johns-Manville Corp.*, 837 F.2d 89, 93-94 (2d Cir. 1988)), Congress' inclusion of section 105 in the enumerated sections for which sovereign immunity has been waived is further evidence of Congress' intent to abrogate the Anti-Injunction Act through amended section 106 of the Bankruptcy Code.

[12] Moreover, even before section 106(a) was amended, numerous courts (including in this District) held that the Anti-Injunction Act does not preclude this Court from granting injunctive relief against the IRS. *See, e.g., In re La Difference Restaurant, Inc.*, 63 B.R. 819, 825 (S.D.N.Y. 1986); *In re Bostwick*, 521 F.2d 741, 744 (8th Cir. 1975); *In re Jon Co.*, 30 B.R. 831, 834-35 (D. Colo. 1983); *In re H & R Ice Co.*, 24 B.R. 28, 31-32 (Bankr. W.D. Mo. 1982); *In re Datair Sys. Corp.*, 37 B.R. 690, 696-97 (Bankr. N.D. Ill. 1983); *But see In re Becker's Motor Transp.*, 632 F.2d 242, 246 (3d Cir. 1980).

48. Accordingly, the relief requested in the Motion can be granted by this Court despite the Anti-Injunction Act.

WHEREFORE the Debtor respectfully requests the Court issue an order, substantially in the form attached hereto, granting (i) the relief requested herein pursuant to the proposed orders attached hereto as Exhibits A and B, and (ii) such other and further relief as the Court may deem just and appropriate.

Dated: New York, NY
November 9, 2010

DEWEY & LEBOEUF LLP

/s/ Peter A. Ivanick

Peter A. Ivanick, Esq.
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Attorneys for the Debtor and Debtor in Possession

Exhibit A

(Temporary Restraining Order)

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

In re **AMBAC FINANCIAL GROUP, INC.,** **Debtor.**	:	**Chapter 11 Case No. 10-15973 (SCC)**
AMBAC FINANCIAL GROUP, INC., **Plaintiff,** **- against -** **UNITED STATES OF AMERICA,** **Defendant.**	:	**Adversary Proceeding No. 10-________**

TEMPORARY RESTRAINING ORDER

Upon consideration of the *Motion for Temporary Restraining Order and Preliminary Injunction Pursuant to Sections 105 and 362(a) of the Bankruptcy Code and Rule 7065 of the Bankruptcy Rules* (the "Motion")[1] filed by Ambac Financial Group, Inc. ("AFG" or the "Debtor"), as debtor and debtor-in-possession in the above-captioned chapter 11 case and plaintiff in this adversary proceeding; and the Court having jurisdiction to consider the Motion and the relief requested therein pursuant to 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 the relief requested being in the best

[1] Capitalized terms used but not defined herein shall have the same meanings ascribed to those terms as used in the Motion.

interests of the Debtor and its estate and creditors; and the Court having considered and reviewed (i) the complaint for (A) a declaratory judgment determining the amount of tax liability and (B) injunctive relief (the "Complaint"), (ii) the Motion, (iii) the Declaration of R. Wes Kirchhoff (the "Kirchhoff Declaration"), (iv) the Declaration of David W. Wallis (the "Wallis Declaration"); (v) the Declaration of Thomas J. Staskowski (the "Staskowski Declaration"), and (vi) the Declaration of Lawrence M. Hill (the "Hill Declaration," and together with the Motion, the Kirchhoff Declaration, the Wallis Declaration, and the Staskowski Declaration, the "Moving Papers"), each such declaration filed pursuant to Local Bankruptcy Rule 9077-1(b) in support of the Debtor's request for declaratory and injunctive relief; and the Court being satisfied that the Moving Papers demonstrate good and proper cause pursuant to Rules 7001(7) and 7065 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"), Local Bankruptcy Rule 9077-1(b), and Rule 65(b)(1) of the Federal Rules of Civil Procedure ("FRCP") (made applicable by Bankruptcy Rule 7065) for issuance of this order; and service of the Moving Papers as provided herein providing due, proper, and sufficient notice; and the Court having determined that the legal and factual bases set forth in the Moving Papers establish just cause for the relief granted herein; and upon all of the proceedings had before the Court and after due deliberation and sufficient cause appearing therefor, this Court hereby makes the following findings of fact and conclusions of law:

1. The Debtor has made a *prima facie* case that it is likely to prevail on the Motion to obtain injunctive relief against the Defendant;

2. Failure to enter this temporary restraining order pending a hearing on the Motion would cause immediate and irreparable injury to the Debtor's estate, threatening the Debtor's ability to consummate a plan of reorganization, destroying value in the Debtor's estates, and disrupting the Debtor's administration of its chapter 11 case;

3. The issuance of a temporary restraining order appears necessary to maximize the value of the Debtor's estate and is in the best interests of the Debtor, its estate and its creditors (including Defendant);

4. Defendant does not appear to be harmed by the issuance of a temporary restraining order;

5. For the reasons set forth in the Moving Papers, the Debtor has demonstrated good cause for entry of this Order without notice to Defendant;

6. The legal and factual bases set forth in the Complaint and the Moving Papers establish just cause for the relief granted herein.

NOW, THEREFORE, based on the foregoing and for other good and sufficient cause, it is hereby

ORDERED that the Motion is granted as to the request for a temporary restraining order pursuant to sections 105(a) and 362(a) of the Bankruptcy Code and Bankruptcy Rule 7065; and it is further

ORDERED that, pending a hearing and determination of the Debtor's request for a preliminary injunction, effective immediately and subject to the terms hereof, the Internal Revenue Service (the "IRS") shall provide at least five business days' (the "Notice Period") prior written notice (which notice shall be filed with the Court and served contemporaneously by electronic mail on Debtor's counsel) before taking any

Enforcement Action (as defined in the Motion) contrary to the State Court Injunction (defined in the Motion), whether or not such injunction remains in effect; and it is further

ORDERED that pursuant to Bankruptcy Rule 7065, the Debtor is relieved from posting any security pursuant to FRCP 65(c); and it is further

ORDERED that the Court will conduct a hearing (the "Hearing") on the Debtor's request for a preliminary injunction on ____ __, 2010 at __:00 _.m. (prevailing Eastern time); and it is further

ORDERED that entry of this Order shall be without prejudice to any creditor or party in interest seeking relief from its terms on notice to the Debtor; and it is further

ORDERED that a copy of this Order shall be served by overnight mail, postage prepaid, on or before _____ __, 2010, upon the Defendant by sending a copy of this Order with instructions that the Motion, supporting documents and other pleadings related thereto can be obtained on the Bankruptcy Court's website at *www.nysb.uscourts.gov* by registered users of the Bankruptcy Court's case filing system, and from Debtor's noticing agent in these cases, at [*www.kccllc.net*]; and it is further

ORDERED that service of the Motion as provided therein, including service upon Defendant, shall be deemed good and sufficient notice of such Motion, and service of this Order in accordance herewith shall be deemed good and sufficient service and adequate notice for all purposes, and no other or further notice of the Motion or this Order need be provided; and it is further

ORDERED that this Order shall remain in effect through and including the date on which the Court conducts a hearing on the Motion's request for entry of a

preliminary injunction, subject to (i) any further order of the Court, (ii) the Debtor's rights to request an extension or other modification of this Order, and (iii) any party's rights to request relief from or a modification of this Order on notice to the Debtor; and it is further

ORDERED that objections, if any, to the Debtor's request for a preliminary injunction shall be set forth in a writing describing the basis therefor which shall be filed with the Court electronically in accordance with General Order M-242 by registered users of the Court's electronic case filing system and, by all other parties in interest, on a 3.5 inch disk, preferably in Portable Document Format (PDF), WordPerfect or any other Windows-based word processing format (with a hard copy delivered directly to the chambers of the Hon. ___________________, United States Bankruptcy Judge, at the United States Bankruptcy Court, Room ____, United States Custom House, One Bowling Green, New York, New York, 10004-1408) and served in accordance with General Order M-242 and the Administrative Order, Pursuant to Rule 1015(c) of the Federal Rules of Bankruptcy Procedure Establishing Case Management and Scheduling Procedures, entered by the Court in these cases, so as to be actually received no later than _:00 _.m. (prevailing Eastern time) on _____ __, 2010 (the "Objection Deadline") on (i) Dewey & LeBoeuf LLP, Attorneys for the Debtor, 1301 Avenue of the Americas, New York, New York 10019 (Attn: Peter A. Ivanick, Esq. and Martin J. Bienenstock, Esq.); and (ii) the Office of the United States Trustee for the Southern District of New York, 33 Whitehall Street, New York, New York 10004 (Attn: __________, Esq.); and it is further

ORDERED that unless objections to the Debtor's request for a preliminary injunction are filed and served by the Objection Deadline, the Court may sign

an order granting the Motion in its entirety without a further hearing or notice; and it is further

ORDERED that this Court shall retain jurisdiction to, among other things, interpret, implement, and enforce the terms and provisions of this temporary restraining order.

Dated: New York, New York
_____ __, 2010 at __:_0 _.m., prevailing Eastern Time

____
UNITED STATES BANKRUPTCY JUDGE

Exhibit B

(Preliminary Injunction Order)

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

In re		
AMBAC FINANCIAL GROUP, INC.,		**Chapter 11 Case No. 10-15973 (SCC)**
Debtor.		
AMBAC FINANCIAL GROUP, INC., **Plaintiff,**		**Adversary Proceeding No. 10-______**
- against -		
UNITED STATES OF AMERICA, **Defendant.**		

PRELIMINARY INJUNCTION FOLLOWING A HEARING PURSUANT TO SECTIONS 105(a) AND 362(a) OF THE BANKRUPTCY CODE AND RULE 7065 OF THE BANKRUPTCY RULES

Upon the *Motion for Temporary Restraining Order and Preliminary Injunction Pursuant to Sections 105 and 362(a) of the Bankruptcy Code and Rule 7065 of the Bankruptcy Rules* (the "Motion")[1] filed by Ambac Financial Group, Inc. (the "Debtor"), as debtor and debtor-in-possession in the above-captioned chapter 11 case and plaintiff in this adversary proceeding, pursuant to section 105(a) of the Bankruptcy Code, Rules 7001(7) and 7065 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"), and Rule 65 of the Federal Rules of Civil Procedure ("FRCP"); and the Court having jurisdiction to consider the Motion and the relief requested therein pursuant to 28

[1] Capitalized terms used but not defined herein shall have the same meanings ascribed to those terms as used in the Motion.

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 the relief requested being in the best interests of the Debtors and their estates and creditors; and the Court having entered the Temporary Restraining Order sought by the Motion on November __, 2010 (Docket No. __, the "TRO"); and the Court having considered and reviewed (i) the complaint for (A) a declaratory judgment determining the amount of tax liability and (B) injunctive relief (the "Complaint"), (ii) the Motion, (iii) the Declaration of R. Wes Kirchhoff (the "Kirchhoff Declaration"), (iv) the Declaration of David W. Wallis (the "Wallis Declaration"); (v) the Declaration of Thomas J. Staskowski (the "Staskowski Declaration"), and (vi) the Declaration of Lawrence M. Hill (the "Hill Declaration," and together with the Motion, the Kirchhoff Declaration, the Wallis Declaration, and the Staskowski Declaration, the "Moving Papers"), each such declaration filed pursuant to Local Bankruptcy Rule 9077-1(b) in support of the Debtor's request for declaratory and injunctive relief; (viii) the affidavits of service reflecting the notice provided of the Moving Papers and notice of entry of the Court's TRO, and (xiii) the testimony, evidence, and arguments presented on the record of the hearing held before the Court on November __, 2010 (the "Hearing"); and service of the Moving Papers as provided herein providing due, proper, and sufficient notice; and the Court having determined that the legal and factual bases set forth in the Moving Papers establish just cause for the relief granted herein; and upon all of the proceedings had before the Court and after due deliberation and sufficient cause appearing therefor, this Court hereby makes the following findings of fact and conclusions of law:

1. Failure to enter this preliminary injunction pending a final determination of the Debtor's tax liability under section 505(a) of the Bankruptcy Code would cause immediate and irreparable injury to the Debtor's estate, threatening the Debtor's ability to consummate a plan of reorganization, destroying value in the Debtor's estate, and disrupting the Debtor's administration of this chapter 11 case.

2. The issuance of a preliminary injunction appears necessary to preserve and maximize the value of the Debtor's estate and is in the best interests of the Debtor, its estate, and its creditors.

3. Actions by IRS to recapture the Tax Refunds issued to Debtor in December 2008, September 2009 and February 2010, and distributed by Debtor to its wholly owned subsidiary, Ambac Assurance Corporation ("AAC"), would jeopardize the Debtor's ability to reorganize under chapter 11.

4. Absent a preliminary injunction, the IRS may make an assessment, issue a tax lien, and/or deplete funds from the Debtor's (or AAC's) bank accounts (or bank accounts of the Debtor's non-debtor subsidiaries), with the aim of recapturing the Tax Refunds the IRS determined to issue to Debtor, all before Debtor has had a fair opportunity to have a hearing in this Court to determine its tax liability, if any, to the IRS under section 505(a) of the Bankruptcy Code.

5. The injunction is in the best interests of all parties in interest in this chapter 11 case. As a whole, even the Defendant will benefit from entry of the injunction, which will ensure that the value of the Ambac consolidated tax group is preserved and maximized for all creditors. The temporary delay imposed by this injunction will not prejudice the Defendant to any degree comparable to the prejudice

that the Debtor, all creditors as a group and other parties in interest in this case would suffer if the enforcement actions were not enjoined. The issuance of a preliminary injunction will preserve the status quo pending the Court's ruling on the issues raised in the Complaint, which ruling will determine the course of this chapter 11 case. The balance of the equities therefore weighs in favor of the Debtor.

6. For these reasons, the granting of the requested injunctive relief is necessary to avoid immediate and irreparable injury to the Debtor's estate and to preserve its ability to effectuate a reorganization.

7. Due and adequate notice to the extent practicable has been given to the Defendant.

8. The legal and factual bases set forth in the Complaint, the Moving Papers, and at the Hearing establish just cause for the relief granted herein.

NOW, THEREFORE, based on the foregoing and for other good and sufficient cause, it is hereby

ORDERED that the Motion is granted in its entirety; and it is further

ORDERED that any objections to the relief sought in the Motion are overruled on their merits; and it is further

ORDERED that, pursuant to sections 105(a), 362(a), and 505(a) of the Bankruptcy Code, effective immediately and subject to the terms hereof, until such time as there is a final ruling on the Debtor's tax liability, if any, to the Internal Revenue Service (the "IRS") under section 505(a) of the Bankruptcy Code, the IRS shall provide at least five business days' (the "Notice Period") prior written notice (which notice shall be filed with the Court and served contemporaneously by electronic mail on Debtor's

counsel) before taking any Enforcement Action (as defined in the Motion) contrary to the State Court Injunction (defined in the Motion), whether or not such injunction remains in effect; and it is further

ORDERED that pursuant to Bankruptcy Rule 7065, the Debtor is relieved from posting any security pursuant to FRCP 65(c); and it is further

ORDERED that nothing contained in this Order shall prohibit any party in interest from seeking relief from the terms of this Order by filing an appropriate motion with the Court, on notice to counsel for the Debtor; and it is further

ORDERED that so long as the preliminary injunction as provided for herein remains in effect, all other matters in this adversary proceeding shall be stayed and the parties shall not serve discovery requests or engage in motion practice in this adversary proceeding (aside from motions for relief from the terms of this Order) without first obtaining leave of this Court, *provided however*, for the avoidance of doubt, that the foregoing provision shall apply only to this adversary proceeding and shall not apply to motion practice or discovery concerning other matters in the Debtor's case; and it is further

ORDERED that a copy of this Order shall be served by overnight mail, postage prepaid, within three (3) business days of entry of this Order, upon the Defendant; and it is further

ORDERED that service of the Motion and Complaint as provided therein, including service upon Defendant, shall be deemed good and sufficient notice of such Motion and Complaint, and service of this Order in accordance herewith shall be deemed

good and sufficient service and adequate notice for all purposes, and no other or further notice of the Motion or this Order need be provided; and it is further

ORDERED that this Court shall retain jurisdiction to, among other things, interpret, implement, and enforce the terms and provisions of this Order.

Dated: New York, New York
____ _, 2010 at __:__ a.m., prevailing Eastern Time

UNITED STATES BANKRUPTCY JUDGE

NYA 635103.6

EXHIBIT B

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Proposed Attorneys for the Debtor and Debtor in Possession

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re	:	**Chapter 11 Case No.**
	:	**10-15973 (SCC)**
AMBAC FINANCIAL GROUP, INC.,	:	
Debtor.	:	
AMBAC FINANCIAL GROUP, INC., **Plaintiff,**	:	**Adversary Proceeding No.**
- against -	:	**10-________**
UNITED STATES OF AMERICA,	:	
Defendant.	:	

DECLARATION OF DAVID W. WALLIS
IN SUPPORT OF DEBTOR'S REQUEST FOR
DECLARTORY JUDGMENT AND INJUNCTIVE RELIEF

I, David W. Wallis, hereby declare that the following is true to the best of my knowledge, information and belief:

1. I am President and Chief Executive Officer of Ambac Financial Group, Inc. ("AFG" or the "Debtor," and together with its nondebtor affiliates, "Ambac"). On the date hereof, AFG commenced a voluntary case under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code"). I have served as President and Chief Executive Officer of AFG since

October 21, 2008, having joined Ambac in 1996. I am familiar with the Debtor's business, financial affairs, and books and records. I am over 18 years of age, am competent to testify, and am authorized to submit this declaration (the "Declaration") on behalf of the Debtor.

2. I submit this Declaration in support of the Debtor's Motion for Temporary Retraining Order and Preliminary Injunction Pursuant to Sections 105(a) and 362(a) of the Bankruptcy Code and Rule 7065 of the Bankruptcy Rules (the "Motion"), filed by the Debtor contemporaneously herewith.

3. Except as otherwise indicated, all facts set forth herein are based upon my personal knowledge of the Debtor's business and financial affairs, information learned from my review of relevant documents, and information I have received from other members of the Debtor's management or the Debtor's advisers. If I were called to testify, I would testify competently to the facts set forth herein on that basis.

AAC'S SEGREGATED ACCOUNT, GENERAL ACCOUNT AND REHABILITATION PROCEEDINGS

4. On November 8, 2010 (the "Commencement Date"), I submitted an affidavit in support of the "first day" motions and applications filed by the Debtor and by which the Debtor seeks the relief necessary to enable the Debtor and Ambac to operate effectively, minimize certain of the potential adverse effects of the commencement of the Debtor's chapter 11 case, and preserve and maximize the value of the Debtor's estate (the "First Day Affidavit").[1] In the First Day Affidavit, I also testified to certain facts and circumstances relating to and precipitating the Debtor's chapter 11 filing.

[1] All capitalized terms used but not otherwise defined herein shall have the meanings given to such terms in the First Day Affidavit.

5. As set forth in more detail in the First Day Affidavit, the Debtor is a holding company and its principal wholly-owned operating subsidiary, Ambac Assurance Corporation ("AAC"), is a Wisconsin-domiciled financial guaranty insurance company whose business includes the issuance of financial guaranty insurance policies to support public finance, structured finance, and international finance transactions. AAC is subject to the insurance laws and regulations of the State of Wisconsin and is regulated by the Office of the Commissioner of Insurance of the State of Wisconsin ("OCI").

6. On March 24, 2010, OCI approved the establishment of a segregated account of AAC (the "Segregated Account"), pursuant to Wisc. Stat. § 611.24(2), to segregate certain non-performing segments of AAC's liabilities (together, the "Segregated Account Policies"). All policy obligations of AAC not allocated to the Segregated Account remain in the general account of AAC (the "General Account"). Further, on March 24, 2010, OCI commenced rehabilitation proceedings with respect to the Segregated Account (the "Rehabilitation Proceedings") in the District Court of Dane County, Wisconsin (the "Rehabilitation Court") to facilitate an orderly run-off and/or settlement of the liabilities in the Segregated Account, including those associated with the Segregated Account Policies. The Rehabilitation Court appointed Sean Dilweg, the Wisconsin Commissioner of Insurance, as rehabilitator of the Segregated Account (the "Rehabilitator").

7. On June 7, 2010, AAC entered into a settlement agreement (the "CDS Settlement Agreement") with certain counterparties to credit default swaps (the "CDS Counterparties") in respect of collateralized debt obligations of asset-backed securities ("CDO of ABS") insured by AAC. Pursuant to this agreement, in exchange for the termination of approximately $16.5 billion in par amount of CDO of ABS obligations, AAC paid to the CDS Counterparties $2.6

billion in cash and $2 billion of surplus notes of AAC which have a scheduled maturity of June 7, 2020. Certain other non-CDO of ABS obligations were also commuted pursuant to the CDS Settlement Agreement.

8. On October 8, 2010, OCI filed a plan of rehabilitation with respect to the Segregated Account (the "Rehabilitation Plan") in the Rehabilitation Court. The Rehabilitation Plan will, if approved, provide, *inter alia*, that holders of Segregated Account Policies shall receive, in respect of claims made, a combination of cash and surplus notes of the Segregated Account. Subject to OCI approval, once assets of the Segregated Account are exhausted, creditors will be able look to the General Account for satisfaction of certain liabilities to satisfy the portion of claim liability not paid by the Segregated Account in cash or in Segregated Account Surplus Notes, and further, the General Account may issue surplus notes directly to holders of Segregated Account Policies. A confirmation hearing in respect of the Rehabilitation Plan is currently scheduled for November 15-19, 2010 in the Rehabilitation Court. Until the Rehabilitation Plan is approved, it is anticipated that no claims will be paid on Segregated Account Policies, except as approved by the Rehabilitation Court.

9. Although AAC has been unable to pay dividends to the Debtor for several years and will be unable to pay dividends in 2010 absent special approval from OCI, which is not expected, AAC is nevertheless one of the Debtor's most valuable assets. The future value of AAC will primarily depend upon the performance of AAC's insured portfolio (*i.e.*, the ultimate losses therein relative to its claims paying resources), ongoing remediation efforts of AAC with respect to the Segregated Account Policies, and other factors, including AAC's ability to repurchase surplus notes at below face value. The Debtor's and AAC's success in these endeavors would result in the addition of significant value to the Debtor's estate.

TAX REFUND AND IDR

10. As further set forth in my First Day Affidavit, in 2008 and 2009, the Debtor filed three claims with the IRS for tentative carryback adjustments on Form 1139 (Corporate Application for Tentative Refund) as a result of the carryback to prior taxable years of approximately $33 million and $3.2 billion of net operating loss carryovers ("NOLs") in 2008 and 2009, respectively, which were reported in Ambac's consolidated federal income tax returns. Based upon these claims, in December 2008, September 2009 and February 2010, the IRS refunded to AFG $11,470,930, $252,704,185 and $443,940,722 (the "Tax Refunds"), respectively, on account of NOLs generated in respect of AAC's credit-default swaps. On October 28, 2010, the IRS sent an information document request (an "IDR") to the Debtor regarding a Form 3115 Change of Accounting Methodology Request filed in 2008 and Ambac's calculation of the Tax Refund. In addition, the IRS questioned certain calculations underlying Ambac's reported consolidated NOLs of approximately $7.3 billion as of September 30, 2010.

11. Upon receiving the IDR, I and other members of the Debtor's management reviewed the potential ramifications of the IDR. We determined that if the IRS were to take enforcement actions based upon the IDR prior to the adjudication of the Debtor's tax liability, there is a real risk OCI would quickly thereafter commence a rehabilitation of AAC's General Account, which would unravel AAC's Rehabilitation Plan and destroy the Debtor's reorganization prospects.

EFFECTS OF REHABILITATON OF AAC'S GENERAL ACCOUNT

12. In the event of a rehabilitation of AAC's General Account, billions of dollars in par amount of insured obligations may be adversely affected which, in turn, would have a detrimental effect on the amounts available to pay all policyholders, including those amounts

allocated to the Segregated Account in connection with the anticipated funding of the Segregated Account.

13. AAC's decision-making process in establishing the Segregated Account, apart from the General Account, as compared to the alternative of a full rehabilitation, reflects the desire to avoid unnecessarily subjecting the vast majority of AAC's policies to the uncertainty, ambiguity, and financial consequences of rehabilitation.

14. One of the segments of AAC's business that would be most adversely affected by such an event is the commercial asset backed portfolio, including whole business securitizations and rental car lease securitizations.

15. In the commercial asset backed segment of AAC's business, AAC has insured approximately $20 billion of notes. With few exceptions, these deals are generally performing and AAC does not currently expect to incur a loss in respect of these transactions. However, many of these transactions require significant ongoing attention in that there are covenants embedded in the documents pursuant to which the notes were issued that contemplate that AAC may be permitted to grant waivers and variances to the issuers of the notes, easing compliance requirements with such covenants, so long as AAC continues to perform its obligations to make payments under its policy on such transaction and so long as no rehabilitation occurs with respect to the General Account. A rehabilitation of the General Account would result in a loss of this right to grant particular waivers and variances from specific covenants, and could subject the issuers of these notes to constraints they are unable to meet. At the time the notes were issued, the issuers relied on the ability to seek waivers and variances from AAC if the need were to arise. If AAC is unable on an ongoing basis to grant these waivers and variances, then the issuer may be in default of these provisions. The consequences of such a default often include a

provision which requires cash that would otherwise have been released to the issuer directly or indirectly, to be used instead to pre-pay the insured notes. While this feature in theory reduces AAC's own exposure, when applied indiscriminately it may precipitate cross defaults, liquidity crises or bankruptcy filings by issuers or their affiliates, all of which could easily have been avoided.

16. Triggering events of default in these transactions can have far-reaching consequences, not only for AAC and its policyholders, but for the issuers of these securities and their affiliates, and for the substantial number of men and women who depend on these issuers and their affiliates for their livelihood.

17. The potential increase in claims against AAC that could arise as a result of these provisions in the event of a rehabilitation of the General Account is difficult to quantify because it involves many contingencies and subjective evaluations. The examples described above are indicative and illustrative examples of this issue. These are not the only transactions potentially affected, and the potential harm is difficult to quantify. However, taking into consideration solely a subset of commercial asset-backed deals, where the size of the deal, its structure, or credit quality suggests that the issue could be particularly relevant, one could assume a potential increase in claims of $1 billion or more.

18. There are other segments of AAC's business that would also be affected by a rehabilitation of the General Account. AAC insures the obligations of its affiliates that issue interest rate and currency swaps and investment agreements. A rehabilitation of the General Account would accelerate the obligations of these affiliates, and result in increased claims on the resources of the General Account.

19. Additionally, there is potential harm to the public connected with these segments of AAC's business in the event of a rehabilitation of the General Account. Municipalities which have entered into interest rate swaps with an AAC affiliate are particularly vulnerable. In the event of a rehabilitation of the General Account, there would be an automatic termination of the interest rate swap agreements between AAC's affiliate and the other parties to these agreements which, in many cases, are U.S. municipalities that entered into these swaps to hedge their exposure to the risk of a change in interest rates. Typically, the municipality counterparties would issue floating rate debt and simultaneously enter into an interest rate swap where it would make periodic payments to AAC's affiliate at a fixed rate of interest and receive from AAC's affiliate a periodic payment based on a floating rate of interest. The effect of this arrangement is to lock in a fixed interest rate for the municipality, protecting it from fluctuations in floating interest rates, but give the municipality greater access to the debt markets that issuing floating rate debt allowed.

20. As noted, in the event of a rehabilitation of the General Account, there is an automatic termination of these interest rate swaps. Since these interest rate swaps were typically entered into some years ago when interest rates were higher, upon a termination of the arrangement there would be a single large payment due from the municipality to AAC's affiliate. Similarly, because AAC's affiliate hedged its obligations under these interest rate swaps with other financial institutions, upon an automatic termination of the entire portfolio precipitated by a rehabilitation of the General Account, AAC's affiliate would in turn owe large payments to the

financial institutions with which it hedged its own exposure under the swap agreements with the municipalities.[2]

21. Unfortunately, many of these municipalities will not have sufficient resources to make these large payments. This will have serious consequences for AAC, because the municipality's non-payment or shortfall will cause a mismatch for AAC's affiliate with the amount paid to financial institutions with which it hedged these exposures. It will also have serious consequences for the relevant municipalities. The amounts involved are significant, and could even result in Chapter 9 bankruptcy proceedings with respect to these municipalities. Moreover, it would leave the municipality exposed to future interest rate risks on a going forward basis with respect to the floating rate debt it issued. In the past, it might have been possible for a municipality to replace the interest rate swap between itself and AAC's affiliate by entering into a replacement swap, and it might have been possible for the municipality to finance the termination payment it owed to AAC's affiliate upon such a replacement by entering into an agreement with the new replacement swap provider. However, the market for municipal interest rate swaps has changed dramatically since the beginning of the credit crisis and there are far fewer participants in that market today than there were previously. Under the present circumstances, many of the municipalities that have interest rate swap agreements with AAC's affiliate would have a difficult time finding a replacement swap provider or any way to finance the termination payment the municipality owes to AAC's affiliate upon an automatic termination occasioned by a rehabilitation of the General Account.

22. Further, although most of AAC's exposure to CDS was commuted in connection with the CDS Settlement Agreement, the General Account continues to be exposed to a

[2] If interest rates were higher today than when these contracts were entered into (but there are not), the payment obligation would run in the opposite direction and AAC's affiliate would owe a single large payment to the municipality.

significant book of CDS of collateralized loan obligations ("CLOs"). As with CDS exposures generally, counterparties on these agreements have a right to assert mark-to-market termination claims in the event of a rehabilitation of AAC. Although OCI would presumably attempt to enjoin the assertion of such mark-to-market damages, there can be no assurance that such injunctions would ultimately be successful. We calculate AAC's exposure to such mark-to-market damage claims in respect of the CLO book to be approximately $3 billion. In the event that OCI fails to restrain the assertion of such damages, this $3 billion in additional policyholder claims would dilute all other policyholder claims significantly and destroy AAC's residual value to AFG.

23. In addition to the damage to AAC discussed above, any IRS actions taken against the other valuable non-debtor subsidiaries of AFG included within its consolidated tax group aimed at recapturing the Tax Refunds could have negative effects on AFG. These subsidiaries include (i) Everspan, an insurance company subsidiary of AAC with approximately $160-170 million of surplus, and (ii) two non-insurance subsidiaries of AAC, Ambac Financial Services, LLC ("AFS") and Ambac Capital Funding, Inc. ("AFCI"). AFS engages in swap transactions with clients of AAC and the general marketplace while ACFI has a large book of guaranteed investment contract business. If the businesses of AFS and ACFI are destroyed by IRS enforcement actions, both AFS and ACFI (all of whose liabilities to third parties are insured by AAC) could generate significant additional liabilities for AAC and further reduce or eliminate AAC's residual value to AFG.

TERM SHEET AND EXTENSION OF SEGREGATED ACCOUNT INJUNCTION

24. As set forth in more detail in the First Day Affidavit, in conjunction with the Segregated Account Rehabilitation Proceedings, the Rehabilitation Court issued an order

enjoining certain actions by Segregated Account Policyholders and other Segregated Account counterparties, including the assertion of damages or acceleration of losses based on early termination and the loss of control rights in insured transactions (the "Segregated Account Injunction").

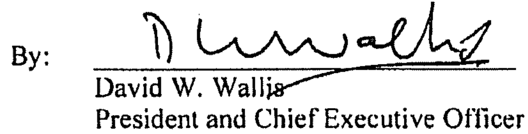
25. Yesterday, OCI appeared before the Rehabilitation Court and informed it that negotiations regarding unresolved liabilities amongst the Debtor, an *ad hoc* committee of AFG's senior noteholders (the "Ad Hoc Committee") and OCI continued through this past weekend and culminated in a non-binding term sheet (the "Term Sheet"). As described in detail in the First Day Affidavit, the Term Sheet contains an agreement to allocate to the Segregated Account (a) any and all liabilities AAC has or may have, now or in future, to AFG or any successor to AFG in respect of (i) the TSA, (ii) the Tax Refunds and (iii) any liabilities in respect of any preference or fraudulent conveyance claims pertaining to the AFG Tax Liabilities (collectively, the "Allocated AFG Claims") and (b) any and all liabilities AAC has or may have, now or in future, to the IRS and/or the U.S. Treasury in respect of (i) taxes imposed under the Internal Revenue Code of 1986, as amended, for taxable periods ending on or prior to December 31, 2009, and (ii) the Tax Refunds (the "Tax Liabilities"). The Rehabilitator also sought and was granted an expansion of the Segregated Account Injunction to prevent the IRS from asserting liens against and levying upon the assets of AAC and its subsidiaries and to prevent AFG or AFG-related parties from pursuing the Allocated AFG Claims against the Segregated Account, the General Account or AAC's subsidiaries.

26. Notwithstanding OCI's actions and the Rehabilitation Court's entry of the order expanding the Segregated Account Injunction to enjoin the IRS, the Debtor believes the IRS may elect to ignore the terms of the expanded Segregated Account Injunction and take enforcement

actions to recapture the Tax Refunds. Given that such actions would seriously jeopardize or destroy its reorganization efforts, the Debtor believes this Court should enter the temporary retraining order and preliminary injunction sought in the Motion.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Executed on November 8, 2010 in New York, New York.

By: 

David W. Wallis
President and Chief Executive Officer

EXHIBIT C

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re: AMBAC FINANCIAL GROUP, INC. *Debtor.*	Case No. 10-15973-scc New York, New York November 9, 2010 2:59 p.m.

TRANSCRIPT OF CHAP 11 HEARING RE
ADVERSARY PROCEEDING: 10-04210-SCC
AMBAC FINANCIAL GROUP, INC. VS. UNITED STATES OF AMERICA
DOC #2 MOTION FOR TEMPORARY RESTRAINING ORDER
AND PRELIMINARY INJUNCTION
DOC# 3 DEBTOR'S MOTION FOR INTERIM ORDER ESTABLISHING
PROCEDURES FOR CERTAIN TRANSFERS OF EQUITY INTERESTS IN AND
CLAIMS AGAINST THE DEBTOR AND SCHEDULING A FINAL HEARING
DOC# 4 DEBTOR'S MOTION FOR INTERIM ORDER
(I) AUTHORIZING DEBTOR TO CONTINUE USING EXISTING CASH
MANAGEMENT SYSTEM AND BANK ACCOUNTS AND HONOR RELATED
PREPETITION OBLIGATIONS, (II) EXTENDING DEBTORS TIME
TO COMPLY WITH SECTION 345(B) OF THE BANKRUPTCY CODE,
AND (III) SCHEDULING A FINAL HEARING
DOC# 5 DEBTOR'S MOTION FOR ORDER ESTABLISHING CERTAIN
NOTICE, CASE MANAGEMENT, AND ADMINISTRATIVE PROCEDURES
DOC# 7 DEBTOR'S MOTION FOR ORDER (I) EXTENDING TIME TO
FILE SCHEDULES AND STATEMENT OF FINANCIAL AFFAIRS, AND
(II) WAIVING REQUIREMENT TO FILE EQUITY LIST AND SERVE
NOTICE OF COMMENCEMENT ON EQUITY HOLDERS
BEFORE THE HONORABLE SHELLEY C. CHAPMAN
UNITED STATES BANKRUPTCY JUDGE

1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25

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1 THE COURT: Good afternoon. Please be seated. Mr.
2 Bienenstock, how are you?
3 MR. BIENENSTOCK: Fine. Thanks, Your Honor. And
4 thanks for hearing us this afternoon.
5 THE COURT: Certainly. All right. We're ready when
6 you are.
7 MR. BIENENSTOCK: Shall I start and would you prefer I
8 stand here or over there?
9 THE COURT: Why don't we have whoever's going to speak
10 come to the podium and I think we have a few folks on the phone.
11 So let me find out who is on the phone. Is anyone on the phone,
12 please?
13 (No response.)
14 THE COURT: All right. My understanding is that we're
15 on listen only, so I won't require parties on the phone to
16 identify themselves.
17 Okay, Mr. Bienenstock.
18 MR. BIENENSTOCK: Thank you, Your Honor and we very
19 much appreciate the Court giving us time on very short notice to
20 have these first day hearings in the Chapter 11 case of AMBAC
21 Financial Group, Inc. Our plan if it's okay with the Court is
22 for me to make some introductions and provide the Court a
23 snapshot of the company and the case and then with the help of
24 some of my colleagues here to get into the first day motions.
25 THE COURT: Okay.

1 MR. BIENENSTOCK: So as not to hold any suspense, we
2 do think we're very fortunate in having a stipulation with the
3 Internal Revenue Service which would obviate a dispute in that
4 regard in connection with the papers we filed this morning.
5 Because it only happened recently, it will be oral. We will ask
6 the Court to so order it.
7 THE COURT: Okay.
8 MR. BIENENSTOCK: But I think we're in agreement and
9 the United States Attorney will definitely correct me if I get
10 anything wrong.
11 THE COURT: I'm sure he will. Okay.
12 MR. BIENENSTOCK: Okay. Your Honor, first with me at
13 counsel table is my partner, Peter Ivanick and my colleague,
14 Allison Weiss of Dewey & LeBoeuf.
15 THE COURT: Okay.
16 MR. BIENENSTOCK: He'll blush a bit, but my partner
17 Peter Ivanick and Ms. Weiss have a specialty that I certainly
18 don't have, and I don't know how many of them are in the country
19 that do. There's an interface between the bankruptcy law and
20 insurance insolvency law that is critical in this case. Few
21 people in the country understand it and can deal with it and at
22 least on our side, these people actually can.
23 And I don't want to get too far ahead of ourselves,
24 but just to give Your Honor a flavor of the types of issues that
25 come up; we're all accustomed to federal preemption. When it

1 comes to insurance, there's something called reverse preemption.
2 And under the McCarran Ferguson Act at 15 U.S.C. 1012(b),
3 Congress has legislated that "No act of Congress shall be
4 construed to invalidate, impair or supersede any law enacted by
5 any state for the purpose of regulating the business of
6 insurance unless such act specifically relates to the business
7 of insurance."
8 That may or may not actually be litigated in this
9 case. We hope not but it basically changes the normal calculus
10 in the sense that the insurance company at issue here is a
11 subsidiary, goes by a state set of rules that have supremacy
12 over some of our rules such as our preference statutes. So a
13 preview of things perhaps to come or not but we do have people
14 who understand it, who can brief it well for the Court if it
15 ever comes up.
16 THE COURT: All right.
17 MR. BIENENSTOCK: Now who is Ambac? Ambac is a
18 company known conventionally as a monoline insurance company.
19 It is quite substantial. Its subsidiary, Ambac Assurance
20 Corporation, and in turn subsidiaries of what we call AAC, have
21 insured a notional amount of approximately 367 billion dollars
22 of different types of debt.
23 Of that 367 billion dollars of commitments to insured
24 debt, approximately 67 billion are in what AAC calls the
25 segregated account. The segregated account is an account under

1 currently the supervision of the Wisconsin Insurance
2 Commissioner. And with us in court today is Frank DiCastri of
3 Foley & Lardner, representing OCI.
4 While I'm on introductions, Your Honor, we also have
5 in court as attorneys, Tony Princi of Morrison Foerster who
6 represents the ad hoc committee of bondholders at AFG and his
7 colleague, Gary Lee. Just to finish the introductions from the
8 company we have David Wallis, the President and Chief Executive
9 Officer, the General Counsel, Kevin Doyle and Executive Vice
10 President, Michael Callen, Chairman of the Board and Wes
11 Kirchhoff, its Tax Director.
12 And to the extent, if any, that any of the first day
13 motions require any disputed facts which we don't anticipate, we
14 have the right people here.
15 THE COURT: Okay.
16 MR. BIENENSTOCK: Getting back to AAC, Your Honor, 67
17 billion of what it's guaranteed approximately is in what we call
18 the segregated account that's subject to a rehabilitation
19 proceeding in Wisconsin. For the next two weeks my partner,
20 Peter Ivanick, is going to be in Wisconsin, hopefully getting
21 approved a rehabilitation plan for that segregated account.
22 It's not too much of an exaggeration to say that the
23 hopes and prayers of Ambac Financial Group, Inc.'s creditors
24 ride with the future solvency and significant value of AAC.
25 Although we all are familiar with the crisis that occurred let's

1 say notionally at Lehman's filing in September of 2008, the fact
2 is that most of the debt AAC guaranteed we do not believe will
3 default or there will be any exposure on but there's a time
4 where that will prove to be true or not true and there will be a
5 time hopefully when substantial benefits can be reaped by our
6 creditors from the value of AAC.
7 Because of the fact that the guarantees of other
8 peoples' debts, other entities' debts including municipalities'
9 debts, are based on a variety of different contracts. It won't
10 surprise the Court to know that a lot of those contracts go into
11 default if precipitous things happen to AAC. That is why we
12 needed to file the pleadings we filed this morning for
13 declaratory judgment in connection with whether AAC and the tax
14 group and AFG primarily owes any taxes to the IRS. As explained
15 in our papers, we received consensually approximately 700
16 million dollars of tax refunds the last three years and were
17 just recently advised that the IRS may or may not take action to
18 take it back.
19 Under the IRS rules and regulations and statutes,
20 there are various provisions entitling them to seize things in
21 enforcement before we have notice and before there's a trial on
22 the merits. If that happened, many of our, the contracts of AAC
23 would go into default. The consequence of default would be very
24 similar to the Lehman filing. Counterparties would be entitled
25 to sell their collateral. The flood of collateral on the market

1 would depress its value. Therefore, the liabilities would go
2 way up and the asset value of the collateral we have would go
3 way down.
4 I think in the Lehman situation, forty to seventy
5 billion dollars of loss was occasioned simply because of the
6 bankruptcy default. That's why it's the difference here between
7 having value for our creditors, and perhaps very substantial
8 value, and in not allowing there to be a default vis-à-vis our
9 contracts by any precipitous action. And I want to emphasize,
10 we are in no sense at war with the IRS. We don't think they
11 feel they're at war with us.
12 THE COURT: Okay.
13 MR. BIENENSTOCK: We pay all of our taxes. We're not
14 aggressive in taking tax positions. If we owe taxes, we want to
15 pay them completely. What we have to guard against is the
16 possibility that a precipitous action would inadvertently create
17 tremendous loss that would have ripples probably far beyond
18 Ambac if other cases are a guide and might cause loss
19 unnecessarily and we are, as I hope today's stipulation
20 evidences, we think we're on track at least to try to resolve
21 this with the IRS. If not, what our stipulation provides with
22 the IRS is the IRS agrees as requested in our papers that it
23 will not take enforcement action against Ambac Financial Group,
24 Inc. or its subsidiaries or their assets, absent giving us five
25 business days notice first. That would enable us to come to

1 court. And that agreement by consent will last until a date the
2 Court assigns for having and deciding the preliminary injunction
3 motion that we've made. We've agreed with the Department of
4 Justice that it will file its answering brief by Friday,
5 December 31. The debtor will file its reply brief by Tuesday,
6 January 18. There will then be a hearing if we haven't
7 otherwise --
8 THE COURT: On the PI.
9 MR. BIENENSTOCK: On the PI -- if we haven't otherwise
10 resolved things.
11 THE COURT: Okay.
12 MR. BIENENSTOCK: And the stipulation will go through
13 the hearing through the Court's decision.
14 THE COURT: Okay.
15 MR. BIENENSTOCK: And at that point whatever happens.
16 I think I got --
17 THE COURT: All right. But it's possible that in that
18 five day window it would be wonderful if everyone keeps talking
19 to each other.
20 MR. BIENENSTOCK: Right.
21 THE COURT: But the purpose of the stipulation is to
22 enable you to come in and seek an actual preliminary injunction.
23 MR. BIENENSTOCK: Right.
24 THE COURT: Correct?
25 MR. BIENENSTOCK: Yes, Your Honor.

1 THE COURT: All right.

2 MR. BIENENSTOCK: Now if -- I think since I've put

3 that on the record, if I might defer to the US Attorney for a

4 moment, Mr. Cordaro, because if that's okay we would ask the

5 Court to so order the stipulation.

6 THE COURT: Okay.

7 MR. CORDARO: Thank you, Mr. Bienenstock. Joseph

8 Cordaro, Assistant United States Attorney, Southern District of

9 New York.

10 Yes, Your Honor, we have agreed to a stipulation and

11 the government just having received these papers in the recent

12 past, I just wanted to be sure that there's no misunderstanding.

13 As I understand our agreement, that the -- that we would give

14 five days notice before taking any enforcement action contrary

15 to the state court injunction which the government has seen yet

16 but we're willing to agree to that.

17 THE COURT: I think you're -- all right. Let's be

18 clear on this because I think you're relief was broader than

19 that.

20 MR. BIENENSTOCK: Well I said five business days. I

21 think that's okay with the IRS.

22 THE COURT: No, but --

23 MR. CORDARO: Yes.

24 THE COURT: But Mr. Cordaro just referred to the state

25 court injunction. My understanding of the relief that you'll

1 want is any action; five days notice of any action with respect
2 to --
3 MR. BIENENSTOCK: Well, okay. Your Honor, the
4 reconciling factor is the state court injunction is very broad
5 and in our view. Any action would trip it. But Mr. Cordaro is
6 correct. What we agreed to is any action that violates the
7 state court injunction, whether or not it's in effect --
8 THE COURT: Okay.
9 MR. BIENENSTOCK: -- requires five business days'
10 notice to us in advance.
11 THE COURT: All right. But is that -- I guess my
12 question is is that broad enough to encompass -- the state court
13 injunction is broad enough by its terms to encompass any action
14 that the IRS would take against a non-debtor subsidiary with
15 respect to the tax refunds.
16 MR. BIENENSTOCK: Yes, Your Honor.
17 THE COURT: I just want to make sure it's fully
18 protected.
19 MR. BIENENSTOCK: Yes, Your Honor.
20 THE COURT: All right.
21 MR. CORDARO: Then that's fine with the government,
22 Your Honor.
23 THE COURT: All right?
24 MR. BIENENSTOCK: Yes, Your Honor.
25 THE COURT: All right. Then I will so order the

1 record in that regard. Mr. Bienenstock, could you once again
2 read those dates?
3 MR. BIENENSTOCK: Yes. The government's answering
4 brief by December 31 which is a Friday. The debtors' reply
5 brief by January 18 which is a Tuesday. We think that Monday is
6 a holiday, so we made it the Tuesday.
7 THE COURT: It's Martin Luther King Day probably;
8 right? Right. Okay. Very well.
9 MR. CORDARO: Thank you, Your Honor.
10 THE COURT: Thank you. Thank you for your prompt
11 response, Mr. Cordaro.
12 MR. CORDARO: Thank you.
13 MR. BIENENSTOCK: Okay.
14 THE COURT: Okay.
15 MR. BIENENSTOCK: Your Honor, the other piece of good
16 news which my colleague Allison Weiss will embellish on a bit I
17 think, is that while we haven't filed a proposed Chapter 11 plan
18 with our petition, we have been in discussions with the
19 bondholders and their group for quite some time. We have a non-
20 binding understanding and we are very hopeful it will quickly
21 become a binding understanding and lead to the Chapter 11 plan.
22 So our goal here is to at all costs protect the
23 insurance company. Everyone, all our creditors are aligned and
24 we need to protect the insurance company. And the value of that
25 in the future will be down to the benefit of our creditors in

1 what we think should be a successful reorganization.

2 THE COURT: Okay.

3 MR. BIENENSTOCK: And unless the Court has questions,

4 I would like to turn things over to Allison Weiss to go through

5 the first day motions.

6 THE COURT: All right. Very well.

7 MR. BIENENSTOCK: Or at least some of them.

8 THE COURT: That's great. Thank you, Mr. Bienenstock.

9 MR. BIENENSTOCK: Thank you.

10 MS. WEISS: Good afternoon, Your Honor. Allison

11 Weiss --

12 THE COURT: Good afternoon, Ms. Weiss.

13 MS. WEISS: -- from Dewey and LeBoeuf. Before

14 addressing the administrative and operational motions, we have

15 asked the Court to consider today, I would like to first provide

16 the Court with some additional background regarding the debtor

17 and the events leading up to the filing.

18 THE COURT: Okay.

19 MR. BIENENSTOCK: For a more detailed discussion, I

20 refer you to the affidavit of David Wallis, the debtor's

21 President and Chief Executive Officer in support of our first

22 day motions. Mr. Wallis is present in the courtroom today and

23 available to testify.

24 Because AAC's financial guarantee and financial

25 services businesses were devastated in the financial crisis

EXHIBIT D

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF WISCONSIN

UNITED STATES OF AMERICA, Plaintiff v. WISCONSIN STATE CIRCUIT COURT FOR DANE COUNTY; THEODORE K, NICKEL, COMMISSIONER OF INSURANCE OF THE STATE OF WISCONSIN, as Rehabilitator of the Segregated Account of Ambac Assurance Corporation; and AMBAC ASSURANCE CORPORATION Defendants.	Case No. 11-cv-99

COMPLAINT

The United States of America brings this action, pursuant to 26 U.S.C. § 7402, at the direction of the Attorney General of the United States:

(1) to enjoin the Wisconsin State Circuit Court of Dane County (Hon. William D. Johnston, presiding) ("State Court") from enforcing, and the court-appointed Rehabilitator and Ambac from attempting to enforce, an *ex parte* injunction the State Court issued on November 8, 2010, in *In the Matter of the Rehabilitation of Segregated Account of Ambac Assurance Corporation*, Case Number 2010CV001576 ("the state rehabilitation action"), to the extent that injunction purports to restrain and enjoin the United States Internal Revenue Service from, *inter alia*, collecting (or possibly even assessing) any potential federal tax liability owed by Ambac Assurance Corporation and other members of its consolidated tax group (which might exceed $700 million);

(2) to enjoin the State Court from enforcing, or the court-appointed Rehabilitator and Ambac from attempting to enforce, the decision and order of January 21, 2011, confirming the rehabilitation plan for the Segregated Account, insofar as that order purports to make the November 8 Injunction permanent, purports to assert exclusive state jurisdiction over certain federal tax liabilities of Ambac and other members of its consolidated tax group, and otherwise purports to bind the United States;

(3) to enjoin the State Court from conducting any other proceedings that further violate the Anti-Injunction Act (26 U.S.C. § 7421) and/or the sovereign immunity of the United States;

(4) to determine that the November 8 Injunction and those parts of the January 21 Order that purport to restrain the United States, assert exclusive state court jurisdiction over federal tax liabilities, or bind the United States to the allocation of the potential tax liability, violate the Anti-Injunction Act, violate the sovereign immunity of the United States, and violate various other federal tax statutes and Treasury regulations and are therefore null and void; and

(5) to quash those orders so that they may not become the subject of future contempt proceedings should the United States take any action that would otherwise violate the terms of the State Court's orders.[1]

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[1] As the allegations below reflect, this action is being filed in the wake of an order of this Court rejecting the United States' attempt to remove the State Court proceeding, and therefore remanding it, on the premise that the McCarran-Ferguson Act makes inapplicable the removal provisions of the Judicial Code. The United States has appealed the remand order but its appealability is uncertain (the Seventh Circuit has called for briefing on the issue of jurisdiction for the appeal). Regardless of whether the McCarran-Ferguson Act preempts the Judicial Code's removal provisions, the United States maintains that it does not preempt the tax Anti-Injunction Act, 26 U.S.C. § 7421(a) and cannot preempt sovereign immunity. Section 7402(a) of the

(continued...)

For its complaint, the United States alleges as follows:

Jurisdiction and Parties

1. Jurisdiction exists pursuant to 26 U.S.C. § 7402(a) and 28 U.S.C. §§ 1331 and 1340, and venue is proper under 28 U.S.C. § 1391(b).

2. The Wisconsin State Circuit Court of Dane County ("State Court") is a court organized under the laws of the State of Wisconsin and is found within this federal judicial district. To the extent that the State Court is not subject to the process of this Court (and the United States maintains that, as a matter of federal law, it is, notwithstanding any State law to the contrary), the United States alternatively seeks relief against Judge Johnston solely in his official capacity as presiding judge in the rehabilitation action.

3. Ambac Assurance Corporation ("Ambac") is an insurance company domiciled in and organized under the laws of the State of Wisconsin. Ambac is a wholly owned subsidiary of Ambac Financial Group Inc. (AFGI), a holding company headquartered in New York City. For purposes of this Complaint, the term "Ambac" refers to all affiliates and subsidiaries of Ambac Assurance Corporation except AFGI. Ambac is named in this Complaint because it may wish to

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[1] (...continued)
Internal Revenue Code specifically gives the federal district courts, "at the instance of the United States," authority to enforce any of its provisions, including § 7421(a), and provides that this authority is "in addition to" all other remedies available to the United States in the federal district courts. This provision reflects the full implementation of Article III of the Constitution's provision that the Judicial Power extends to "Controversies to which the United States shall be a party," and that this Court thus has no authority to abstain. Additionally, since there has been no final judgment (after the exhaustion of appeals) in the State Court specifically addressing the sovereign immunity and jurisdiction issues raised in this complaint, this "collateral attack" on the State Court's orders is proper under well-established Supreme Court precedent. *See United States v. United States Fidelity & Guaranty Co.*, 309 U.S. 506 (1940) (holding that order in rehabilitation proceeding could be collaterally attacked as a violation of sovereign immunity unless that issue was actually raised and finally adjudicated in the first proceeding); *Travelers Indemnity v. Bailey*, 129 S.Ct. 2195, 2206 n. 6 (2009) (citing *United States Fidelity & Guaranty* as permitting "a collateral attack on subject-matter jurisdiction . . . 'where the issue is the waiver of [sovereign] immunity.'").

defend the orders of the State Court in the rehabilitation action or may seek to enforce the orders of the State Court against the United States.

4. The Segregated Account of Ambac Assurance Corporation (the "Segregated Account") is a separate account within Ambac created pursuant to Wisconsin insurance statutes. Since March 24, 2010, the Segregated Account has been subject to rehabilitation proceedings in the State Court.

5. Theodore K. Nickel is the Commissioner of Insurance of the State of Wisconsin (hereinafter, "Commissioner" or "Rehabilitator"), and is named in this Complaint because he is the rehabilitator of the Segregated Account in the rehabilitation action and may wish to defend the orders of the State Court therein or may seek to enforce the orders of the State Court against the United States.

Factual Background

6. Ambac Assurance Corporation participated in a consolidated tax group for federal income tax purposes. Ambac Assurance Corporation's parent, AFGI, filed a consolidated federal income tax return on behalf of itself and all of its subsidiaries.

7. Under federal tax law, each and every member of a consolidated tax group is severally liable for the tax liabilities of the entire group, and the IRS may collect the entire tax liability of the consolidated tax group from any member of that group. 26 C.F.R. §§ 1.1502-6; 1.1502-78.

8. Also as a matter of federal tax law, while the members of a consolidated tax group may allocate tax liabilities for internal accounting purposes, "No agreement entered into by one or more members of the group with any other member of such group or with any other person shall in any case have the effect of reducing the liability prescribed under this section." 26 C.F.R. § 1.1502-6(c).

9. Based on losses claimed by the AFGI consolidated tax group in 2007 and 2008, AFGI received approximately $700 million in "tentative" tax refunds pursuant to 26 U.S.C. § 6411. Section 6411 requires the IRS to provide a "tentative" refund within 90 days of an application by a corporate taxpayer that reports it has overpaid tax due to a net operating loss ("NOL") carryback, among other situations, after a limited IRS examination (which limitation precludes the IRS from questioning the merits of the claimed loss that generates the carryback). This refund is "tentative" because the IRS "retains the right to conduct a more thorough audit of the taxpayer's application later and recapture any funds that it has erroneously paid.'" *Coca-Cola v. United States*, 87 Fed. Cl. 253, 256-57 (Fed. Cl. 2009), citing 26 U.S.C. § 6213(b)(3) & Treas. Reg. § 301.6213-1(b)(2).

10. AFGI allocated the $700 million to Ambac Assurance Corporation in accordance with an internal allocation agreement.

11. Ambac Assurance Corporation submitted to the Commissioner a request to establish a segregated account for certain toxic policies pursuant to Wisconsin Statute § 611.24(2), which allows an insurance corporation to establish an account for "any part of its business." According to the legislative comments in the Wisconsin statute, a segregated account is the equivalent of a "corporation within a corporation," with the "basic idea behind segregated accounts" being that "different operations" within the insurance company "can be kept independent without formally creating a separate corporation." Wis. Stat. § 611.24 cmts. When properly done, some of an insurance corporation's business is placed into a separate account and insulated from the rest of the company's business. *Id.*

12. Ambac Assurance Corporation placed into its segregated account some of its insurance policies and some of its other potential liabilities. It did not (and has not) placed all of its assets and liabilities into the Segregated Account.

13. On March 24, 2010, the Insurance Commissioner filed a petition in the State Court to rehabilitate the Segregated Account under the Wisconsin insurance insolvency statutes, Chapter 645 of the Wisconsin Statutes. That petition was granted that same day, and the Commissioner was named rehabilitator of the segregated account.

14. As a result of the order of rehabilitation, the Segregated Account came under the custody of the State Court, and the State Court has restrained the holders of policies and liabilities in the Segregated Account from seeking to collect from the assets of either Ambac or the Segregated Account except as approved by the State Court.

15. By contrast, Ambac itself (excepting only the Segregated Account) is not subject to rehabilitation, and is not within the custody of the State Court. For that reason, any claims of policyholders of policies not consigned to the Segregated Account, or of creditors whose liabilites were not consigned to the Segregated Account, are paid out of the general assets of Ambac in the regular course without the restraints of the State Court's control.

16. On October 28, 2010, the IRS sent AFGI an information document request seeking information relating to the basis for the tentative refunds. Shortly thereafter, AFGI (Ambac's parent) filed for Chapter 11 bankruptcy protection and filed an adversary proceeding in the bankruptcy court to determine its tax liability as to the tentative refunds pursuant to 11 U.S.C. § 505(a). That action remains pending in the Southern District of New York.

17. On Sunday, November 7, 2010, Ambac purported to allocate to its Segregated Account any federal tax liabilities it has or may ever have for all tax years prior to and including

December 2009 and specifically any liabilities it may have with respect to the $700 million tentative tax refunds. The Commissioner approved the allocation, and filed a "Notice" with the State Court on November 8, 2011, the same day that AFGI filed for bankruptcy.

18. Additionally, on November 8, 2010, the Commissioner sought and obtained from the State Court the November 8 Injunction, which, in pertinent part, purports to enjoin the United States Internal Revenue Service from:

> 3. . . . commencing or prosecuting any actions, claims, lawsuits or other formal legal proceedings in regard to . . . [Ambac's potential federal tax liabilities] in any state, federal or foreign court, administrative body or other tribunal against: (a) the Segregated Account; (b) any subsidiary of Ambac whose stock, limited liability company member interests or other forms of ownership interests were allocated to the Segregated Account . . .; (c) Ambac Assurance Corporation . . . ; (d) any subsidiary of Ambac; or (e) the Rehabilitator. This Court has exclusive jurisdiction over any such actions, claims or lawsuits.
>
> 4. . . . taking any prejudgment or other steps to transfer, foreclose, sell, assign, garnish, levy, encumber, attach, dispose of, or exercise purported rights in or against any property or assets of the Segregated Account, Ambac, . . . or Ambac subsidiaries in respect of [Ambac's potential federal tax liabilities.]

In paragraph 2 of the Injunction, the Wisconsin State Court noted that the "Order is made in furtherance of the allocation" of Ambac's tax liabilities "to the Segregated Account."

19. Because the Commissioner chose to seek the November 8 Injunction *ex parte* and without notice to the United States, the United States had no opportunity to contest this action before the Injunction was entered by the State Court. The United States first learned of the Notice and the November 8 Injunction when it received a letter dated November 8 from the Commissioner's outside counsel containing a copy of the November 8 Injunction. The United States was never served with a subpoena or properly made a defendant in the State Court action.

20. By its terms, the November 8 Injunction enjoins the IRS from taking any action to collect Ambac's potential federal tax liability, not just from the Segregated Account, but from

Ambac Assurance Corporation and its subsidiaries. Additionally, while the Injunction is ambiguous, the United States is concerned that the Rehabilitator may try to argue that the Injunction also bars the assessment of tax by the IRS.

Removal and Remand of Rehabilitation Action

21. On December 8, 2010, the United States filed a timely Notice of Removal with this Court, which was assigned Civil Action No. 10-CV-778, and filed a copy with the State Court .

22. The removal notice was premised primarily on the November 8 Injunction as a proceeding against the United States under 28 U.S.C. § 1442 to the extent the Injunction was construed to enjoin the United States.

23. The United States followed the removal notice with a motion to dissolve the November 8 Injunction. That motion was filed in this Court on December 17, 2010. The motion to dissolve the injunction was predicated on the United States' assumption that the removal was valid. The United States' removal and motion to dissolve filed only in this Court did not constitute a general appearance in the State Court.

24. Also on December 17, 2010, the Commissioner filed a motion to remand the case to State Court.

25. On January 14, 2011, this Court granted the motion to remand on the ground that "the McCarran-Ferguson Act can restrict the right of removal to federal court in cases in which a state statute governing insurance sets up a comprehensive framework for state rehabilitation proceedings to be conducted in state court and removal would impair that framework." This Court declined to rule on the merits of the United States' motion to dissolve the Injunction based on the Anti-Injunction Act and sovereign immunity.[2]

---

[2] The United States has appealed the remand order to the Seventh Circuit Court of Appeals,
(continued...)

26. This Court delivered the state court record back to the State Court on January 20, 2011.

State Court's January 21 Order

27. On January 21, 2011, the State Court signed a Decision and Order confirming the rehabilitation plan. Subsequently, on January 24, 2011, the State Court entered the decision in its record.

28. The January 21 Order purports to make Ambac's potential federal tax liability "subject to the jurisdiction of this [State] Court and the priority structure adopted by the Plan."

29. The January 21 Order also purports to make permanent the November 8 Injunction against the IRS and to bind the IRS to the allocation of Ambac's potential federal tax liability to the Segregated Account.

30. The United States was not notified of and did not participate in the December state court hearings on the Commissioner's motion to confirm his plan. And the January 21 Order did not address any of the United States' arguments regarding the Anti-Injunction Act or sovereign immunity that had been included in its motion to dissolve filed in this Court after removal and before remand.

Commissioner's Attempt To Preempt Federal Review

31. On February 7, 2011, the Commissioner, notwithstanding that the State Court had already purported to make the injunction against the United States permanent, belatedly requested the State Court to issue a ruling specifically on the motion to dissolve that the United States had filed in federal court after removal and before remand, and further requested that the

[2] (...continued)
Case No. 11-1158. That appeal remains pending although the Court of Appeals has requested briefing on whether it has jurisdiction in light of 28 U.S.C. § 1447(d).

State Court schedule a hearing on an "expedited" basis as soon as the State Court's schedule would allow. The Commissioner likely filed this motion because the United States had, several days earlier, filed a jurisdictional memorandum in the Court of Appeals for the Seventh Circuit that indicated that the United States was considering filing a lawsuit brought under this Court's original jurisdiction. In seeking an expedited hearing, the Commissioner chose not to inform the State Court of the pending appeal by the United States to the Seventh Circuit, or of the United States' stated intent to file an original federal action. The Commissioner's claimed basis for its request for an expedited hearing was a purported need to "clarify" the November 8 Injunction. In fact, the Commissioner sought to have the State Court improperly adjudicate the issues of subject-matter jurisdiction and sovereign immunity that must properly be adjudicated in federal court, and to do so in haste in an attempt to preempt the pending Seventh Circuit appeal and this impending action.

Count I
Injunctive Relief

32. The State Court's orders against the United States enjoin or restrain the United States from collecting (and possibly assessing) federal taxes. As such, those orders violate the Anti-Injunction Act, 26 U.S.C. § 7421(a), which explicitly provides that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person."

33. The State Court's orders also violate the sovereign immunity of the United States by purporting, in the absence of an express statutory waiver of the sovereign right to be immune from suit, to bind the United States to the allocation of any tax liability of Ambac's consolidated tax group to the Segregated Account, and from otherwise enjoining collection of any tax.

34. The State Court's orders also violate the federal consolidated-return tax regulations by purporting to allocate all pre-2010 tax liabilities of Ambac's consolidated tax group to the Segregated Account, binding the IRS to that allocation, and restraining the IRS from collecting these consolidated tax liabilities from Ambac or any other members of the consolidated tax group.

35. Accordingly, the State Court lacked any jurisdiction, authority, or right to issue (1) the November 8 Injunction, and (2) those parts of the January 21 Order that purport to make the November 8 Injunction permanent, assert exclusive state jurisdiction over pre-2010 federal tax liabilities of Ambac, and otherwise purport to bind the United States. Those orders were and are null and void as a matter of federal law. Any future orders the State Court may make regarding Ambac's potential federal tax liabilities will also be made without jurisdiction, authority, or right, and would likewise be null and void.

36. The McCarran-Ferguson Act, 15 U.S.C. § 1012(b), does not affect this result for several reasons, including: (1) the Seventh Circuit has held the Internal Revenue Code is "in the absence of language evidencing a different purpose, [] to be interpreted so as to give a uniform application to a nationwide scheme of taxation,"[3] and because neither McCarran-Ferguson nor Wisconsin state insurance statutes provide such language, insurance companies cannot therefore claim an exemption from the provisions of the Internal Revenue Code based on state law; (2) neither McCarran-Ferguson nor the Wisconsin state insurance laws contain an express waiver of the sovereign immunity of the United States (and, in any event, no state statute could achieve that purpose without an explicit unambiguous delegation by Congress which the McCarran-Ferguson Act does not do); (3) the state statutes at issue do not regulate the business of insurance

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[3] *Modern Life & Acc. Ins. Co. v. Comm'r,* 420 F.2d 36, 37-38 (7th Cir. 1969).

in the narrow sense that the Supreme Court has defined that term; (4) the relevant provisions of the Internal Revenue Code relate to the business of insurance; (5) the relevant provisions of the Internal Revenue Code do not impair the state statutes. In fact, only one of these five propositions need be true for McCarran-Ferguson to be ineffective against the Anti-Injunction Act. Also, sovereign immunity is not the result of an Act of Congress. To the contrary, it is the absence of a statute specifically waiving that immunity that protects the United States from suit. Thus, the McCarran-Ferguson Act, which limits only the application of acts of Congress, cannot waive or otherwise affect the United States' immunity from suit.

37. This Court has both jurisdiction and the obligation to enjoin the State Court from engaging in proceedings, or issuing or enforcing orders against the United States that violate the Anti-Injunction Act and as to which the United States has not waived sovereign immunity, and which the State Court lacked jurisdiction or power to make.

38. The Court also has jurisdiction and the obligation to enjoin the Commissioner and Ambac from applying to the State Court for further orders or proceedings against the United States, or for seeking to enforce orders of the State Court, in violation of the Anti-Injunction Act or sovereign immunity.

39. Through the conduct described above, the State Court has substantially interfered with the enforcement of the federal internal revenue laws. Unless enjoined by this Court, Ambac and the Commissioner are likely to continue to request, and the State Court is likely to continue to issue, orders that interfere with federal tax administration.

40. Defendants' conduct is causing irreparable injury to the United States, and the United States has no adequate remedy at law. Defendants' conduct, unless enjoined, may cause a substantial loss of revenue to the United States Treasury, specifically a potential $700 million

federal tax liability that may be rendered effectively uncollectible except from the non-existent assets of the Segregated Account. It is also likely to encourage the future manipulation of state insurance laws and insolvency proceedings by other corporate taxpayers with insurance company affiliates to artificially shed insurer-taxpayers of consolidated federal tax liabilities by contriving to allocate such liabilities to a separate account or subsidiary, placing that separate entity in rehabilitation, and foreclosing the IRS from collecting those liabilities from the rest of the consolidated group. The United States includes these allegations for the sake of completeness in what is a unique circumstance, because the State Court's injunction appears to be completely unprecedented. But, the United States maintains that it is not required to demonstrate harm from the State Court Injunction because sovereign immunity and 26 U.S.C. § 7421(a) simply bar such an injunction, regardless of any showing of harm.

41. Additionally, the requested injunction will serve the public interest.

Count II
Judgment Determining the State Court Orders To Be Void and/or Quashing Them

42. The United States re-alleges paragraphs 1 through 41 as though fully set forth herein.

43. In addition or, in the alternative if this court is unwilling to enjoin the State Court or finds it unnecessary to do so based on the relief requested in this Count, the United States is entitled to a determination that the November 8 Injunction and those parts of the January 21 Order that purport to restrain the IRS, assert exclusive state court jurisdiction over federal tax liabilities, or bind the IRS to the allocation of the potential tax liability, violate the Anti-Injunction Act, the sovereign immunity of the United States and the consolidated tax statutes and regulations in the Internal Revenue Code and are therefore null and void and of no effect. The United States is further entitled to an order quashing those state court orders so that they may not

become the subject of any future contempt proceedings should the United States take any action that violates the terms of those orders.

WHEREFORE, the United States prays that this Court

(a) enjoin the Wisconsin State Circuit Court of Dane County (Hon. William D. Johnston, presiding) from enforcing, and the Rehabilitator and Ambac from seeking to enforce, the November 8, 2010 injunction, purporting to restrain and enjoin the Internal Revenue Service from, *inter alia*, collecting (and possibly assessing) any federal tax liability owed by Ambac Assurance Corporation and other members of its consolidated tax group;

(b) enjoin the State Court from enforcing, and the Rehabilitator and Ambac from seeking to enforce, the decision and order of January 21, 2011, confirming the rehabilitation plan for the Segregated Account, insofar as that order purports to make the November 8 Injunction permanent, asserts exclusive state jurisdiction over certain federal tax liabilities of Ambac, and otherwise purports to bind the United States;

(c) enjoin the State Court from conducting proceedings directed at further violating the Anti-Injunction Act (26 U.S.C. § 7421) and/or the sovereign immunity of the United States; and/or

(d) determine that the November 8 Injunction and those parts of the January 24 Order that purport to restrain the IRS, assert exclusive state court jurisdiction over federal tax liabilities, or bind the IRS to the allocation of the potential tax liability, violate the Anti-Injunction Act, the sovereign immunity of the United States and the consolidated tax statutes and regulations in the Internal Revenue Code and are therefore null and void and of no effect; and therefore enter an order quashing said orders; and

(f) for such other and further relief as may be or become appropriate.

Respectfully submitted,

February 9, 2011

UNITED STATES DEPARTMENT OF JUSTICE

/s/ Robert J. Kovacev

ROBERT J. KOVACEV
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/s/ Hilarie Snyder

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CIVIL COVER SHEET

The JS 44 civil cover sheet and the information contained herein neither replace nor supplement the filing and service of pleadings or other papers as required by law, except as provided by local rules of court. This form, approved by the Judicial Conference of the United States in September 1974, is required for the use of the Clerk of Court for the purpose of initiating the civil docket sheet. (SEE INSTRUCTIONS ON THE REVERSE OF THE FORM.)

I. (a) PLAINTIFFS
United States of America

(b) County of Residence of First Listed Plaintiff ______
(EXCEPT IN U.S. PLAINTIFF CASES)

(c) Attorney's (Firm Name, Address, and Telephone Number)
Robert J. Kovacev, Hilarie Snyder, Department of Justice Tax Division, P.O. Box 7238 Ben Franklin Station, Washington, DC 20044, 202-307-6541; 202-307-2708

DEFENDANTS
Wisconsin State Circuit Court For Dane County, Theodore K. Nickel, Commissioner of the Insurance For the State of Wisconsin, as Rehabilitator of the Segregated Account of Ambac Assurance et al.

County of Residence of First Listed Defendant: Dane County
(IN U.S. PLAINTIFF CASES ONLY)

NOTE: IN LAND CONDEMNATION CASES, USE THE LOCATION OF THE LAND INVOLVED.

Attorneys (If Known)

II. BASIS OF JURISDICTION (Place an "X" in One Box Only)

- ☒ 1 U.S. Government Plaintiff
- ☐ 3 Federal Question (U.S. Government Not a Party)
- ☐ 2 U.S. Government Defendant
- ☐ 4 Diversity (Indicate Citizenship of Parties in Item III)

III. CITIZENSHIP OF PRINCIPAL PARTIES (Place an "X" in One Box for Plaintiff and One Box for Defendant) (For Diversity Cases Only)

	PTF	DEF		PTF	DEF
Citizen of This State	☐ 1	☐ 1	Incorporated *or* Principal Place of Business In This State	☐ 4	☐ 4
Citizen of Another State	☐ 2	☐ 2	Incorporated *and* Principal Place of Business In Another State	☐ 5	☐ 5
Citizen or Subject of a Foreign Country	☐ 3	☐ 3	Foreign Nation	☐ 6	☐ 6

IV. NATURE OF SUIT (Place an "X" in One Box Only)

CONTRACT
- ☐ 110 Insurance
- ☐ 120 Marine
- ☐ 130 Miller Act
- ☐ 140 Negotiable Instrument
- ☐ 150 Recovery of Overpayment & Enforcement of Judgment
- ☐ 151 Medicare Act
- ☐ 152 Recovery of Defaulted Student Loans (Excl. Veterans)
- ☐ 153 Recovery of Overpayment of Veteran's Benefits
- ☐ 160 Stockholders' Suits
- ☐ 190 Other Contract
- ☐ 195 Contract Product Liability
- ☐ 196 Franchise

REAL PROPERTY
- ☐ 210 Land Condemnation
- ☐ 220 Foreclosure
- ☐ 230 Rent Lease & Ejectment
- ☐ 240 Torts to Land
- ☐ 245 Tort Product Liability
- ☐ 290 All Other Real Property

TORTS

PERSONAL INJURY
- ☐ 310 Airplane
- ☐ 315 Airplane Product Liability
- ☐ 320 Assault, Libel & Slander
- ☐ 330 Federal Employers' Liability
- ☐ 340 Marine
- ☐ 345 Marine Product Liability
- ☐ 350 Motor Vehicle
- ☐ 355 Motor Vehicle Product Liability
- ☐ 360 Other Personal Injury

PERSONAL INJURY
- ☐ 362 Personal Injury - Med. Malpractice
- ☐ 365 Personal Injury - Product Liability
- ☐ 368 Asbestos Personal Injury Product Liability

PERSONAL PROPERTY
- ☐ 370 Other Fraud
- ☐ 371 Truth in Lending
- ☐ 380 Other Personal Property Damage
- ☐ 385 Property Damage Product Liability

CIVIL RIGHTS
- ☐ 441 Voting
- ☐ 442 Employment
- ☐ 443 Housing/ Accommodations
- ☐ 444 Welfare
- ☐ 445 Amer. w/Disabilities - Employment
- ☐ 446 Amer. w/Disabilities - Other
- ☐ 440 Other Civil Rights

PRISONER PETITIONS
- ☐ 510 Motions to Vacate Sentence

Habeas Corpus:
- ☐ 530 General
- ☐ 535 Death Penalty
- ☐ 540 Mandamus & Other
- ☐ 550 Civil Rights
- ☐ 555 Prison Condition

FORFEITURE/PENALTY
- ☐ 610 Agriculture
- ☐ 620 Other Food & Drug
- ☐ 625 Drug Related Seizure of Property 21 USC 881
- ☐ 630 Liquor Laws
- ☐ 640 R.R. & Truck
- ☐ 650 Airline Regs.
- ☐ 660 Occupational Safety/Health
- ☐ 690 Other

LABOR
- ☐ 710 Fair Labor Standards Act
- ☐ 720 Labor/Mgmt. Relations
- ☐ 730 Labor/Mgmt.Reporting & Disclosure Act
- ☐ 740 Railway Labor Act
- ☐ 790 Other Labor Litigation
- ☐ 791 Empl. Ret. Inc. Security Act

IMMIGRATION
- ☐ 462 Naturalization Application
- ☐ 463 Habeas Corpus - Alien Detainee
- ☐ 465 Other Immigration Actions

BANKRUPTCY
- ☐ 422 Appeal 28 USC 158
- ☐ 423 Withdrawal 28 USC 157

PROPERTY RIGHTS
- ☐ 820 Copyrights
- ☐ 830 Patent
- ☐ 840 Trademark

SOCIAL SECURITY
- ☐ 861 HIA (1395ff)
- ☐ 862 Black Lung (923)
- ☐ 863 DIWC/DIWW (405(g))
- ☐ 864 SSID Title XVI
- ☐ 865 RSI (405(g))

FEDERAL TAX SUITS
- ☒ 870 Taxes (U.S. Plaintiff or Defendant)
- ☐ 871 IRS—Third Party 26 USC 7609

OTHER STATUTES
- ☐ 400 State Reapportionment
- ☐ 410 Antitrust
- ☐ 430 Banks and Banking
- ☐ 450 Commerce
- ☐ 460 Deportation
- ☐ 470 Racketeer Influenced and Corrupt Organizations
- ☐ 480 Consumer Credit
- ☐ 490 Cable/Sat TV
- ☐ 810 Selective Service
- ☐ 850 Securities/Commodities/ Exchange
- ☐ 875 Customer Challenge 12 USC 3410
- ☐ 890 Other Statutory Actions
- ☐ 891 Agricultural Acts
- ☐ 892 Economic Stabilization Act
- ☐ 893 Environmental Matters
- ☐ 894 Energy Allocation Act
- ☐ 895 Freedom of Information Act
- ☐ 900Appeal of Fee Determination Under Equal Access to Justice
- ☐ 950 Constitutionality of State Statutes

V. ORIGIN (Place an "X" in One Box Only)

☒ 1 Original Proceeding ☐ 2 Removed from State Court ☐ 3 Remanded from Appellate Court ☐ 4 Reinstated or Reopened ☐ 5 Transferred from another district (specify) ☐ 6 Multidistrict Litigation ☐ 7 Appeal to District Judge from Magistrate Judgment

VI. CAUSE OF ACTION

Cite the U.S. Civil Statute under which you are filing **(Do not cite jurisdictional statutes unless diversity)**:
26 U.S.C. section 7402

Brief description of cause:
Injunctive Relief

VII. REQUESTED IN COMPLAINT:

☐ CHECK IF THIS IS A **CLASS ACTION** UNDER F.R.C.P. 23

DEMAND $

CHECK YES only if demanded in complaint:
JURY DEMAND: ☐ Yes ☑ No

VIII. RELATED CASE(S) IF ANY

(See instructions): JUDGE Crabb DOCKET NUMBER 10-cv-778

DATE: 02/09/2011

SIGNATURE OF ATTORNEY OF RECORD: /s/ Robert J. Kovacev & Hilarie Snyder

FOR OFFICE USE ONLY

RECEIPT # ______ AMOUNT ______ APPLYING IFP ______ JUDGE ______ MAG. JUDGE ______

INSTRUCTIONS FOR ATTORNEYS COMPLETING CIVIL COVER SHEET FORM JS 44

Authority For Civil Cover Sheet

The JS 44 civil cover sheet and the information contained herein neither replaces nor supplements the filings and service of pleading or other papers as required by law, except as provided by local rules of court. This form, approved by the Judicial Conference of the United States in September 1974, is required for the use of the Clerk of Court for the purpose of initiating the civil docket sheet. Consequently, a civil cover sheet is submitted to the Clerk of Court for each civil complaint filed. The attorney filing a case should complete the form as follows:

I. (a) Plaintiffs-Defendants. Enter names (last, first, middle initial) of plaintiff and defendant. If the plaintiff or defendant is a government agency, use only the full name or standard abbreviations. If the plaintiff or defendant is an official within a government agency, identify first the agency and then the official, giving both name and title.

(b) County of Residence. For each civil case filed, except U.S. plaintiff cases, enter the name of the county where the first listed plaintiff resides at the time of filing. In U.S. plaintiff cases, enter the name of the county in which the first listed defendant resides at the time of filing. (NOTE: In land condemnation cases, the county of residence of the "defendant" is the location of the tract of land involved.)

(c) Attorneys. Enter the firm name, address, telephone number, and attorney of record. If there are several attorneys, list them on an attachment, noting in this section "(see attachment)".

II. Jurisdiction. The basis of jurisdiction is set forth under Rule 8(a), F.R.C.P., which requires that jurisdictions be shown in pleadings. Place an "X" in one of the boxes. If there is more than one basis of jurisdiction, precedence is given in the order shown below.

United States plaintiff. (1) Jurisdiction based on 28 U.S.C. 1345 and 1348. Suits by agencies and officers of the United States are included here.

United States defendant. (2) When the plaintiff is suing the United States, its officers or agencies, place an "X" in this box.

Federal question. (3) This refers to suits under 28 U.S.C. 1331, where jurisdiction arises under the Constitution of the United States, an amendment to the Constitution, an act of Congress or a treaty of the United States. In cases where the U.S. is a party, the U.S. plaintiff or defendant code takes precedence, and box 1 or 2 should be marked.

Diversity of citizenship. (4) This refers to suits under 28 U.S.C. 1332, where parties are citizens of different states. When Box 4 is checked, the citizenship of the different parties must be checked. (See Section III below; federal question actions take precedence over diversity cases.)

III. Residence (citizenship) of Principal Parties. This section of the JS 44 is to be completed if diversity of citizenship was indicated above. Mark this section for each principal party.

IV. Nature of Suit. Place an "X" in the appropriate box. If the nature of suit cannot be determined, be sure the cause of action, in Section VI below, is sufficient to enable the deputy clerk or the statistical clerks in the Administrative Office to determine the nature of suit. If the cause fits more than one nature of suit, select the most definitive.

V. Origin. Place an "X" in one of the seven boxes.

Original Proceedings. (1) Cases which originate in the United States district courts.

Removed from State Court. (2) Proceedings initiated in state courts may be removed to the district courts under Title 28 U.S.C., Section 1441. When the petition for removal is granted, check this box.

Remanded from Appellate Court. (3) Check this box for cases remanded to the district court for further action. Use the date of remand as the filing date.

Reinstated or Reopened. (4) Check this box for cases reinstated or reopened in the district court. Use the reopening date as the filing date.

Transferred from Another District. (5) For cases transferred under Title 28 U.S.C. Section 1404(a). Do not use this for within district transfers or multidistrict litigation transfers.

Multidistrict Litigation. (6) Check this box when a multidistrict case is transferred into the district under authority of Title 28 U.S.C. Section 1407. When this box is checked, do not check (5) above.

Appeal to District Judge from Magistrate Judgment. (7) Check this box for an appeal from a magistrate judge's decision.

VI. Cause of Action. Report the civil statute directly related to the cause of action and give a brief description of the cause. **Do not cite jurisdictional statutes unless diversity.** Example: U.S. Civil Statute: 47 USC 553
Brief Description: Unauthorized reception of cable service

VII. Requested in Complaint. Class Action. Place an "X" in this box if you are filing a class action under Rule 23, F.R.Cv.P.

Demand. In this space enter the dollar amount (in thousands of dollars) being demanded or indicate other demand such as a preliminary injunction.

Jury Demand. Check the appropriate box to indicate whether or not a jury is being demanded.

VIII. Related Cases. This section of the JS 44 is used to reference related pending cases if any. If there are related pending cases, insert the docket numbers and the corresponding judge names for such cases.

Date and Attorney Signature. Date and sign the civil cover sheet.

EXHIBIT E

STATE OF WISCONSIN CIRCUIT COURT DANE COUNTY

CIRCUIT COURT
10 NOV -8 PM 3:07
DANE COUNTY, WI

In the Matter of the Rehabilitation of:

Segregated Account of Ambac Assurance Corporation

Case No. 10 CV 1576

ORDER FOR TEMPORARY SUPPLEMENTAL INJUNCTIVE RELIEF

Based on the Motion for Temporary Supplemental Injunctive Relief filed by the Commissioner of Insurance for the State of Wisconsin, as Rehabilitator (the "Rehabilitator") of the Segregated Account of Ambac Assurance Corporation (the "Segregated Account"), and the pleadings, motions, briefs and exhibits on file in this case, as well as oral argument, this Court finds that the temporary supplemental injunctive relief requested by the Rehabilitator is reasonable and necessary to promote the equitable and orderly rehabilitation of the Segregated Account, a Wisconsin-domiciled insurer under Wis. Stat. § 611.24(3)(e). The Court further finds that the requested injunctive relief relates to, and is necessary for, the regulation of the business of insurance as part of this proceeding and is authorized by Chapter 645 of the Wisconsin Statutes. The Court further finds that this Court has exclusive jurisdiction over matters relating to this rehabilitation proceeding.

NOW THEREFORE, IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that the Rehabilitator's Motion for Temporary Supplemental Injunctive Relief is GRANTED, and the following temporary supplemental injunctions are hereby ENTERED:

1. The relief specified in this Order is complementary and supplementary to the relief set forth in the March 24, 2010 Injunction Order entered by this Court in the Segregated Account Proceeding. All provisions of the March 24, 2010

Injunction Order remain in full force and effect as to all policies, contracts, liabilities, and disputed contingent liabilities that have been allocated to the Segregated Account on or before the date of this Order.

2. This Order is made in furtherance of the allocation of disputed contingent liabilities to the Segregated Account, as detailed in Amendment No. 1 to the Plan of Operation filed November 8, 2010 (hereinafter "Allocated Disputed Contingent Liabilities"), as approved in the resolution adopted by the Ambac Assurance Corporation Board of Directors on November 7, 2010.

3. Ambac Financial Group, Inc. ("AFGI"), any successor-in-interest, including any debtor-in-possession, trustee or committee appointed by a bankruptcy court to pursue claims on behalf of or in regard to AFGI, any state court receiver of AFGI, all persons or entities purporting to be creditors of AFGI, the United States Internal Revenue Service, and all other federal and state governmental entities (collectively, the "Enjoined Parties"), are enjoined and restrained from commencing or prosecuting any actions, claims, lawsuits or other formal legal proceedings in regard to the Allocated Disputed Contingent Liabilities in any state, federal or foreign court, administrative body or other tribunal against: (a) the Segregated Account; (b) any subsidiary of Ambac whose stock, limited liability company member interests, or other forms of ownership interests were allocated to the Segregated Account—namely, Ambac Credit Products, LLC, Ambac Conduit Funding, LLC, Juneau Investments, LLC, and Aleutian Investments, LLC (the "Allocated Subsidiaries"); (c) Ambac Assurance Corporation ("Ambac" or the "Ambac General Account") in respect of the Segregated Account or policies

(including financial guarantee insurance policies and surety bonds), contracts, liabilities, or disputed contingent liabilities allocated to the Segregated Account; (d) any subsidiary of Ambac, including Connie Lee Holdings, Inc.; Everspan Financial Guarantee Corp.; Ambac Private Holdings, LLC; Ambac Assurance UK Limited; Ambac Japan Co., Ltd.; Contingent Capital Company, LLC; SP Note Investor I, LLC; Ambac Capital Services, LLC; SP Aircraft Holdings, LLC; SP Aircraft Owner I, LLC; SP Aircraft Owner II, LLC; SP Aircraft Owner III, LLC; Ambac Capital Corporation; Ambac Capital Funding, Inc.; AE Global Holdings, LLC; AE Global Asset Funding, LLC; AE Global Investments, LLC; Ambac Asset Funding Corporation; Ambac Investments, Inc.; Ambac AII Corp.; AME Holdings, LLC; AME Asset Funding, LLC; AME Asset Funding, LLC; and AME Investments, LLC (collectively, the "Ambac Subsidiaries"), in respect of the Segregated Account or policies (including financial guarantee insurance policies and surety bonds), contracts, liabilities, or disputed contingent liabilities allocated to the Segregated Account; or (e) the Rehabilitator. Wis. Stat. § 645.05(1)(f). This Court has exclusive jurisdiction over any such actions, claims or lawsuits.

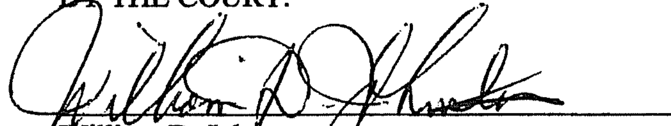
4. The Enjoined Parties are hereby also enjoined and restrained from taking any prejudgment or other steps to transfer, foreclose, sell, assign, garnish, levy, encumber, attach, dispose of, or exercise purported rights in or against any property or assets of the Segregated Account, Ambac, the Allocated Subsidiaries, or the Ambac Subsidiaries in respect of the Allocated Disputed Contingent Liabilities. Wis. Stat. § 645.05(1)(d), (g), (h), (k).

5. This Order shall remain effective until further order of the Court. Counsel for the Rehabilitator shall promptly serve copies of this Order on AFGI, the Department of Treasury – Internal Revenue Service, and any other party-in-interest the Rehabilitator believes is directly affected by this Order, including those who have appeared in these rehabilitation proceedings. If any interested parties believe any portion of this Order is unwarranted by the facts or the law, such parties may seek modification or dissolution of part or all of this Order by filing a written motion with this Court no later than 45 days following the issuance of this Order. If one or more such timely motions are received, the Court may set a schedule for responsive briefing and a hearing regarding the modifications or dissolutions sought. The originals of any such motions shall be filed with the Dane County Circuit Court (with courtesy copies mailed to the undersigned, care of the Clerk of the Lafayette County Circuit Court) and served on counsel for the Rehabilitator.

Signed at 8:38 CST
William D. Johnston
Circuit Judge

Dated this 8th day of November, 2010.

BY THE COURT:



William D. Johnston
Lafayette County Circuit Court Judge,
Presiding by Judicial Assignment Order