

In the Matter of the Rehabilitation of:

Case No. 10 CV 1576

Segregated Account of Ambac Assurance Corporation

**AFFIDAVIT OF SEAN DILWEG
IN SUPPORT OF MOTION FOR TEMPORARY
SUPPLEMENTAL INJUNCTIVE RELIEF**

2010 NOV -8 PM 7:52
DANE CO. CIRCUIT COURT

STATE OF WISCONSIN)
) ss.
COUNTY OF DANE)

Sean Dilweg, being first duly sworn on oath, states as follows:

1. I am the Commissioner of Insurance for the State of Wisconsin. This affidavit is based on personal knowledge and information acquired in my capacities as regulator of Ambac Assurance Corporation ("AAC") and as the court-appointed rehabilitator of the Segregated Account of AAC (the "Segregated Account"). I offer this affidavit in support of the accompanying Motion for Temporary Supplemental Injunctive Relief ("Motion").

2. As described below, several recent events have created new threats to the financial stability of the Segregated Account and have the potential to disrupt its orderly rehabilitation. If this Court does not grant the immediate injunctive relief requested in the Motion, there may be significant reductions in claims-paying resources that could materially hinder the existing Plan of Operation and the proposed Plan of Rehabilitation for the Segregated Account.



3. At risk are approximately \$700 million in federal income tax refunds that AAC received pursuant to a tax sharing agreement ("Tax Sharing Agreement") with its parent holding company, Ambac Financial Group, Inc. ("AFGI"). Those tax refunds form a material part of the claims-paying resources available to satisfy claims of the Segregated Account pursuant to the Secured Note and Reinsurance Agreement with AAC.

4. It is my understanding that, historically, AFGI filed a consolidated federal income tax return on behalf of itself and all of its subsidiaries, including AAC, pursuant to a tax sharing agreement (the "Tax Sharing Agreement") entered into in 1991. The Tax Sharing Agreement, including subsequent amendments to it, governs the allocation of tax payments, liabilities, and refunds between AFGI and its subsidiaries.

5. On September 25, 2009, AFGI paid AAC \$253,700,000 as AAC's share under the Tax Sharing Agreement of a federal income tax refund received by AFGI.

6. In February 2010, AFGI paid AAC \$443,940,722, as AAC's share under the Tax Sharing Agreement of another federal income tax refund received by AFGI.

7. Those two tax refunds, totaling almost \$700 million, are a significant portion of the funds supporting the Segregated Account through the Secured Note and the Reinsurance Agreement with AAC.

8. On November 1, 2010, AFGI announced in a Securities and Exchange Commission disclosure that it "intends to file for bankruptcy under Chapter 11 of the United States Bankruptcy Code by the end of the year." A copy of that announcement is attached as **Exhibit A**. That same day, AFGI failed to make a debt service payment to bondholders. It is my understanding that if AFGI does not cure that missed payment by November 30, 2010, AFGI's creditors can immediately force an involuntary bankruptcy proceeding for AFGI. AFGI could

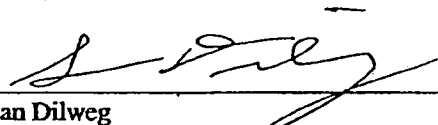
also file a voluntary petition for bankruptcy relief at any time. An ad hoc committee of AFGI's bondholder creditors have threatened that if AFGI enters bankruptcy, they will seek to have the bankruptcy court avoid the tax refund payments to AAC as a preference or fraudulent transfer and seek to impose a constructive trust over the funds in order to prevent them from being used for the rehabilitation of the Segregated Account.

9. On November 3, 2010, I learned that AFGI had received an "Information Document Request" from the U.S. Internal Revenue Service ("IRS") asking AFGI to describe its legal basis for claiming the income tax refunds that led to the payments described in paragraphs 5 and 6. A copy of that request is attached as **Exhibit B**. It is my understanding that, absent the entry of an injunction by this Court and/or a bankruptcy court having jurisdiction over AFGI to the contrary, the IRS may attempt to impose a levy on the tax refund proceeds at any time during this inquiry. If that were to occur, it would have severe adverse consequences to AAC and the Segregated Account.

10. On the evening of Sunday, November 7, 2010, the AAC Board of Directors voted to amend the Plan of Operation to allocate certain liabilities relating to the tax refund payments to the Segregated Account. A copy of that amendment is attached as **Exhibit C**. My office approved that amendment on November 7, 2010, in a letter from Deputy Commissioner Kimberly Shaul. A copy of that letter is attached as **Exhibit D**.

11. Given the rapidly unfolding events regarding a potential AFGI bankruptcy filing and the IRS's review of the tax refunds received by AAC, I believe that immediate injunctive relief is necessary to protect the claims-paying resources of the Segregated Account.

Dated this 7 day of November, 2010.



Sean Dilweg

Subscribed and sworn to before me
this 7th day of November, 2010.

JEFFREY SIMMONS
Notary Public, State of Wisconsin
My commission: PERMANENT

Exhibit A

AMBAC FINANCIAL GROUP INC (ABK)

8-K

Current report filing
Filed on 11/1/2010
Filed Period 10/29/2010



THOMSON REUTERS

Westlaw BUSINESS

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 8-K

CURRENT REPORT

**PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**

Date of Report (Date of earliest event reported): November 1, 2010 (October 29, 2010)

AMBAC FINANCIAL GROUP, INC.
(Exact name of Registrant as specified in its charter)

Delaware
(State
of incorporation)

1-10777
(Commission
file number)

13-3621676
(I.R.S. employer
identification no.)

One State Street Plaza, New York, New York 10004
(Address of principal executive offices) (Zip Code)

(212) 668-0340
(Registrant's telephone number, including area code)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

- Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
 - Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
 - Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
 - Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))
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Item 8.01. Other Events.

On October 29, 2010, the Board of Directors of Ambac Financial Group, Inc. (the "Company") decided not to make a regularly scheduled interest payment on the Company's 7.50% Debentures due May 1, 2023 (the "2023 Notes"). The interest payment was scheduled to be made on November 1, 2010. If the interest is not paid within 30 days of the scheduled interest payment date, an event of default will occur under the indenture for the 2023 Notes. The occurrence of an event of default would permit the holders of the 2023 Notes to accelerate the maturity of the notes. As of June 30, 2010, the Company had total indebtedness of \$1,622 million. The next scheduled payment of interest on the Company's indebtedness is November 15, 2010.

To date, the Company has been unable to raise additional capital as an alternative to seeking bankruptcy protection. As such, the Company is currently pursuing with an ad hoc committee of senior debt holders a restructuring of its outstanding debt through a prepackaged bankruptcy proceeding. There can be no assurance that any definitive agreement will be reached. If the Company is unable to reach agreement on a prepackaged bankruptcy in the near term, it intends to file for bankruptcy under Chapter 11 of the United States Bankruptcy Code prior to the end of the year. Such filing may be with or without agreement with major creditor groups concerning a plan of reorganization. The filing for bankruptcy protection would accelerate the maturity of all of the Company's indebtedness.

A significant consideration for any restructuring or reorganization is the impact, if any, on the Company's estimated \$7.0 billion net operating loss ("NOLs") tax carry forward. The Company considers the NOLs to be a valuable asset. However, the Company's ability to use the NOLs could be substantially limited if there were an "ownership change" as defined under Section 382 of the Internal Revenue Code of 1986, as amended. In general, an ownership change would occur if shareholders owning 5% or more of the Company's stock increased their percentage ownership (by value) in the Company by 50% or more, as measured over a rolling three year period beginning with the last ownership change. These provisions can be triggered by new issuances of stock, merger and acquisition activity or normal market trading. On February 2, 2010, the Company entered into a Tax Benefit Preservation Plan to reduce the risk of an ownership change resulting from the trading of the Company's stock.

If the Company files for bankruptcy protection, stock issued to the Company's debt holders in connection with a reorganization could trigger an ownership change if a significant portion of the debt being exchanged had been held by such debt holders for less than 18 months prior to the filing for bankruptcy and certain other factual or legal exceptions were not applicable. Accordingly, extensive buying of the Company's debentures prior to a bankruptcy filing by persons who could hold 5% or more of the Company's stock following a bankruptcy reorganization could substantially limit the Company's ability to use its NOLs.

Prior to the occurrence of an event of default under the indenture for the 2023 Notes, the Company intends either (i) to pay interest on the 2023 Notes, (ii) to solicit acceptances for a prepackaged plan of reorganization and, if such solicitation is successful, then to file for bankruptcy with a related prepackaged plan or (iii) to file for bankruptcy under Chapter 11 of the United States Bankruptcy Code. Several factors may influence which of the above courses of action the Company may take, including the status of negotiations with the ad hoc committee of senior debt holders and actions required to preserve the NOLs.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Ambac Financial Group, Inc.
(Registrant)

Dated: November 1, 2010

By: /s/ David Trick
Name: David Trick
Title: Senior Managing Director, Chief Financial Officer and Treasurer

Exhibit B

Form 4564 (Rev. June 1988)	Department of the Treasury - Internal Revenue Service	Request Number AFG-FP-1
Information Document Request		
To: (Name of Taxpayer and Company Division or Branch) AMBAC Financial Group ("AFG") 200312-200812 EIN# 13-3621676		Subject: Credit Default Swaps ("CDS")
		SAIN Number 410
		Submitted to: Tom Staskowski
		Dates of Previous Requests

Description of Documents Requested

Credit Default Swaps ("CDS") - Form 3115 - NOLs

1. Please provide the complete original Form 3115 dated April 14, 2008, including all exhibits and attachments, wherein you requested permission from the Office of Chief Counsel to change Ambac Assurance Corporation's ("AAC 's ") method of accounting for credit default swap ("CDS") contracts entered into in 2005 and subsequent taxable years.
2. Please provide a letter from the Office of Chief Counsel granting the Form 3115 method change request for the taxable years in question.
3. If Ambac did not receive a Form 3115 approval letter from the Office of Chief Counsel, describe in detail, citing the relevant legal authority, the basis on which Ambac made the Form 3115 CDS mark-to-market ("MTM") method and "ordinary" character treatment changes?
4. Absent the requisite Form 3115 approval letter from the Office of Chief Counsel, describe in detail, citing specific authority, (a) the legal basis upon which Ambac claimed the Form 1139 refunds for the year(s) and amounts listed below; and (b) upon receipt of such refund(s), the legal basis Ambac had for retaining such refund(s).

FILED FORMS 1139
CORPORATION APPLICATION FOR TENTATIVE
REFUND

YEAR	REFUND	LOSS YEAR
2005	11,470,930	2007
2007	34,328,473	2008
2006	218,375,710	2008

APPLICATION OF REV. PROC. 2009-52

2007 3,814,275 2008
2006 18,154,256 2008

2005 199,328,812 2008
2004 144,929,795 2008
2003 77,713,584 2008

TOTAL REFUNDS RECEIVED TO DATE

708,115,835

AS OF THE END OF 2008 THE TP HAS IN EXCESS OF 2 BILLION LOSS CARRYFORWARD.

Information due by: November 29, 2010

From:	Name and Title of Requester Sandy Criscione, Financial Product Examiner, Badge #1000261093	Date October 28, 2010
	Office Location 110 West 44 th Street, NYC	Telephone Number (212) 719-6024

Exhibit C

**AMENDMENT NO. 1 TO PLAN OF OPERATION FOR THE SEGREGATED
ACCOUNT OF AMBAC ASSURANCE CORPORATION**

The Plan of Operation for the Segregated Account of Ambac Assurance Corporation, effective March 24, 2010 (the "Plan of Operation"), is hereby amended by this Amendment No. 1 to Plan of Operation for the Segregated Account of Ambac Assurance Corporation as follows:

Effective as of November 7, 2010, the following paragraphs are added to Section IV of the Plan of Operation, "Allocations to Segregated Account":

Liabilities to Ambac Financial Group, Inc. ("AFGI"). The Company is allocating to the Segregated Account any and all liabilities (including contingent liabilities) it has or may have, now or in the future, to its shareholder, AFGI, or any successor to AFGI, in regard to, or respecting, tax refunds and/or the July 18, 1991 Tax Sharing Agreement, as amended, provided, that such allocation shall not include any liability to AFGI pertaining to any possible misallocation of up to \$38,485,850 of tax refunds received by AAC in September 2009 and February 2010. Any such liabilities are disputed. This allocation includes, but is not limited to, any preference claim or fraudulent conveyance claim pertaining to the above-referenced subjects brought by, or on behalf of, AFGI in any bankruptcy proceeding involving AFGI by AFGI as debtor-in-possession, or a trustee or committee appointed by a bankruptcy court to pursue any such claim in regard to AFGI, or any similar state court action or claim pursued by, or on behalf of any receiver or creditor of AFGI.

Liabilities to the Internal Revenue Service ("IRS") and/or the United States Department of the Treasury ("U.S. Treasury"). The Company is allocating to the Segregated Account: (i) any and all liabilities (including contingent liabilities) it has or may have, now or in the future, to the IRS and/or the U.S. Treasury in regard to, or in respect of, taxes imposed under the Internal Revenue Code of 1986, as amended ("Federal Taxes"), for taxable periods ending on or prior to December 31, 2009; and (ii) to the extent not described in clause (i), any and all liabilities (including contingent liabilities) the Company has or may have, now or in the future, to the IRS and/or the U.S. Treasury in regard to, or respect of, any Federal Tax refunds that were received prior to November 7, 2010 by the Company, AFGI or their affiliates. Any such liabilities are disputed.

In all other respects, the Plan of Operation effective March 24, 2010, shall continue to govern the operation of the Segregated Account of Ambac Assurance Corporation.

Exhibit D



State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Jim Doyle, Governor
Sean Dineen, Commissioner

Wisconsin.gov

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Madison, Wisconsin 53707-7873
Phone: (608) 266-3585 • Fax: (608) 268-9935
E-Mail: oclinformation@wisconsin.gov
Web Address: ocl.wi.gov

November 7, 2010

Mr. Kevin J. Doyle
Senior Vice President and General Counsel
Ambac Assurance Corporation
One State Street Plaza
New York, New York 10004

Re: Request for Approval of Amendment No. 1 to Plan of Operation for the
Segregated Account of Ambac Assurance Corporation

Dear Mr. Doyle:

The Office of the Commissioner of Insurance for the State of Wisconsin ("OCI") has reviewed the request (the "Request") to amend the Plan of Operation for the Segregated Account of Ambac Assurance Corporation by way of Amendment No. 1 to the Plan of Operation ("Amendment No. 1"), effective November 7, 2010. Pursuant to Amendment No. 1, Ambac Assurance Corporation (the "Company") will allocate to the Segregated Account certain disputed, contingent liabilities, if any, to its sole shareholder, Ambac Financial Group, Inc. (the "Disputed Shareholder Liabilities") and certain disputed, contingent liabilities, if any, to the Internal Revenue Service and/or the United States Department of the Treasury (the "Disputed Tax Liabilities").

Amendment No. 1 is hereby approved. OCI makes the following findings of fact and conclusions of law related to its approval of the Request:

1. OCI finds that following the allocation of the Disputed Shareholder Liabilities and Disputed Tax Liabilities to the Segregated Account, the Segregated Account will continue to have an adequate amount of capital and surplus by way of the Secured Note and the Excess of Loss Reinsurance Agreement.
2. OCI finds that the allocation of the Disputed Shareholder Liabilities and Disputed Tax Liabilities is not contrary to the law and serves the interests of the public and policyholders.
3. OCI finds that allocation of the Disputed Shareholder Liabilities and Disputed Tax Liabilities preserves claims-paying resources for the benefit of all policyholders and provides fair and equitable treatment of policyholders and creditors

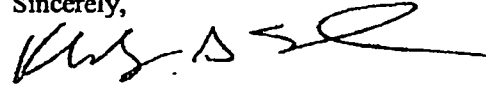
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under the Wisconsin Insurers Rehabilitation and Liquidation Act, and was not done with the intent to hinder, delay, or defraud present or future creditors of the Company.

4. OCI finds that the allocation of the Disputed Shareholder Liabilities and Disputed Tax Liabilities does not constitute a fraudulent conveyance within the meaning of Wis. Stat. § 645.52 or the Uniform Fraudulent Transfer Act and its predecessor act, the Uniform Fraudulent Conveyance Act.

If you have questions on this or any other matter in which I might be of some assistance, please do not hesitate to contact me.

Sincerely,

A handwritten signature in black ink, appearing to read 'Kimberly A. Shaul', with a long horizontal flourish extending to the right.

Kimberly A. Shaul
Deputy Commissioner of Insurance