

In the Matter of the Rehabilitation of:

Case No. 10 CV 1576

Segregated Account of Ambac Assurance Corporation

**NOTICE OF MOTION AND MOTION
TO AUTHORIZE THE REHABILITATOR AND THE SEGREGATED
ACCOUNT TO PROCEED WITH PROPOSED SETTLEMENT AGREEMENT
WITH THE UNITED STATES**

**By the Commissioner of Insurance of the State of Wisconsin,
as Rehabilitator of the Segregated Account of Ambac Assurance Corporation**

NOTICE OF MOTION

TO: All Interested Parties

PLEASE TAKE NOTICE that the Court has scheduled a hearing on the motion by the Rehabilitator described below. That hearing will take place on Wednesday, June 13, 2012, commencing at 1:30 p.m., and shall proceed in the courtroom for the Lafayette County Circuit Court in Darlington, Wisconsin, the Honorable William J. Johnston, presiding by judicial designation.

PLEASE TAKE FURTHER NOTICE that any interested parties may appear telephonically pursuant to the Court's standard tele-court procedure. Any parties interested in appearing telephonically should make the appropriate arrangements in advance of the hearing by calling 800-924-5680.

PLEASE ALSO TAKE FURTHER NOTICE that any objections to the relief requested in this Motion by the Rehabilitator should be in writing, and filed and served by no later than noon (Central Time) on Wednesday, June 6, 2012.

MOTION

By this Motion, the Commissioner of Insurance of the State of Wisconsin, as court-appointed rehabilitator (the “Rehabilitator”) of the Segregated Account (the “Segregated Account”) of Ambac Assurance Corporation (“Ambac”), seeks this Court’s approval for the Rehabilitator and the Segregated Account to proceed with a proposed settlement between the United States of America on behalf of the Internal Revenue Service (the “United States”), Ambac, Ambac’s parent company Ambac Financial Group, Inc. (“AFG”), and the Official Committee of Unsecured Creditors of AFG (the “Creditors Committee”) (collectively the “Settlement Parties”), with respect to certain disputes and litigation relating, *inter alia*, to certain disputed tax refunds in the principal amount of approximately \$708 million (the “Tax Refunds”), and to the tax treatment of several billion dollars of net operating losses (“NOLs”) claimed by AFG, Ambac and other members of their consolidated tax group.

In further support of this Motion, the Rehabilitator states as follows:

1. The facts and circumstances relating to Ambac, its financial deterioration, the decision to create and allocate impaired policies to the Segregated Account, and the rehabilitation of the Segregated Account are set forth in this Court’s May 27, 2010 Findings of Fact, Conclusions of Law and Order, and in the January 24, 2011 Plan Confirmation Order.¹
2. The background facts relating to:
 - (a) allocation to the Segregated Account of claims relating to the Tax Refunds by the Board of Directors of Ambac;

¹ These Orders, and other court filings, are available on the public, court-approved web site ambacpolicyholders.com.

- (b) this Court's entry of a Supplemental Injunction Order to, among other things, prevent the United States from seizing the Tax Refunds or imposing a tax lien for such purpose;
- (c) the United States' removal of the rehabilitation proceeding to the United States District Court for the Western District of Wisconsin (the "District Court") in December 2010;
- (d) the District Court's remand of the rehabilitation proceeding to this Court in January 2011;
- (e) the United States' appeal of that remand order to the United States Court of Appeals for the Seventh Circuit (the "Seventh Circuit Court of Appeals");
- (f) the United States' initiation of an original action against the Rehabilitator, Ambac and this Court in the District Court in February 2011;
- (g) the District Court's dismissal of that action;
- (h) the United States' appeal of that dismissal order to the Seventh Circuit Court of Appeals; and
- (i) dismissal by the Wisconsin Court of Appeals, District IV, affirmed by the Wisconsin Supreme Court, of the United States' state court appeal challenging aspects of the Rehabilitator's Plan of Rehabilitation,

are discussed in the Rehabilitator's November 8, 2010 Motion for Temporary Supplemental Injunctive Relief (and supporting affidavit), in the November 8, 2010 Order for Temporary Supplemental Injunctive Relief, in *In re Rehab. of Seg. Acct. of Ambac Assurance Corp.*, 782 F. Supp. 2d 743 (W.D. Wis. 2011), in *United States v. Wisconsin State Circuit Court*, 767 F. Supp. 2d 980 (W.D. Wis. 2011), and in *Nickel v. United States*, 2012 WI 22. To avoid burdening the Court with needless repetition of facts and procedural history as to which it is likely familiar, the detailed exposition of

background facts in the above sources is incorporated here by reference and will not be separately reiterated.

3. On November 8, 2010, after this Court's entry of the Supplemental Injunction Order, AFG filed for Chapter 11 bankruptcy protection in the United States Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court"). *See In re Ambac Financial Group, Inc.*, Case No. 10-15973 (Bankr. S.D.N.Y.). The Creditors' Committee is the official representative of AFG's unsecured creditors.

4. Subsequently, the Rehabilitator and the Segregated Account became involved in discussions and negotiations among Ambac, AFG and the Creditors' Committee regarding the Settlement Parties' respective rights and claims to: (i) the approximately \$708 million in disputed tax refunds; and (ii) the several billion dollars of NOLs claimed by Ambac and AFG. Said tax refunds and NOLs are the subject of an adversary proceeding between AFG and the United States, in which the United States has disputed the amount of NOLs available to be utilized, and the amount of tax refunds eligible to be retained, by AFG, Ambac, the Segregated Account and the other members of the consolidated tax group (the "IRS Dispute"). *See Ambac Financial Group, Inc. v. United States*, Adversary Proceeding No. 10-02410 (Bankr. S.D.N.Y.) (the "Bankruptcy Court").

5. Starting in July 2011, representatives of the Rehabilitator, the Segregated Account, Ambac, AFG, the Creditors' Committee, and the United States participated in a series of mediation sessions to try to narrow or resolve various actual and potential disputes among them. These mediation sessions were conducted in New York City, with

the involvement of a retired federal district judge acting as mediator, and continued sporadically over a period of several months.

6. The mediation sessions helped lead to an agreement to resolve the disputes among the Rehabilitator, the Segregated Account, Ambac, AFG and the Creditors' Committee, the terms and conditions of which were memorialized in a series of agreements (the "AFG Agreements"). Among other things, the AFG Agreements provide the following: (i) the Ambac Subgroup (as defined below) will have the right to utilize up to \$3.65 billion of NOLs existing as of September 30, 2011 (the "Determination Date") and all new NOLs generated by the Ambac Subgroup subsequent to the Determination Date; (ii) AFG will take steps to avoid a "deconsolidation" of Ambac from AFG for federal tax purposes, which event would otherwise result in a loss or limitation of Ambac's ability to utilize NOLs as of the Determination Date; (iii) Ambac will retain the Tax Refunds; (iv) AFG and the Creditors' Committee will release and hold harmless OCI, the Rehabilitator, Ambac and the Segregated Account from actual and potential legal claims; and (v) Ambac will make certain cash payments and deliver other consideration to AFG to facilitate AFG's reorganization, to preserve NOLs for the use of the Ambac Subgroup, and to settle disputes between AFG and Ambac. As used here and in the AFG Agreements, the Ambac Subgroup includes Ambac, the Segregated Account and any direct or indirect subsidiary of theirs that would be treated as an includable corporation of an affiliated group of corporations under the Internal Revenue Code of 1986, as amended. A detailed discussion of the AFG Agreements is contained in the Rehabilitator's October 21, 2011 Motion to Authorize the Rehabilitator and the Segregated Account to Proceed under the AFG Agreements.

7. On November 10, 2011, this Court entered an Order permitting the Rehabilitator and the Segregated Account to proceed under the AFG Agreements.

8. On March 14, 2012, the Bankruptcy Court issued its Confirmation Order as to AFG's plan of reorganization, including authorization for AFG to proceed under the AFG Agreements. (*See* AFG Confirmation Order ¶ 15.)

9. The AFG Agreements also are conditioned upon the resolution of the IRS Dispute either by consummation of a settlement or by a final court judgment that does not require the Ambac Subgroup to pay the United States more than \$100 million or reduce the NOLs available to the Ambac Subgroup by more than 10%. On February 24, 2012, the Rehabilitator, the Segregated Account, Ambac, AFG and the Creditors' Committee submitted to the United States and the Department of Justice, Tax Division, a proposal to settle the IRS Dispute and related proceedings (the "Offer Letter"), which includes the following terms: (i) a payment by Ambac and/or the Segregated Account to the United States of \$100,000,000; (ii) a payment by AFG to the United States of \$1,900,000; (iii) the AFG consolidated tax group will relinquish its claim to all loss carry-forwards resulting from losses on credit default swap contracts arising on or before December 31, 2010, to the extent such loss carry-forwards exceed \$3.4 billion; and (iv) the United States will be entitled to 12.5% of any payments to AFG by Ambac associated with NOL Usage Tier C, and 17.5% of any payments to AFG by Ambac associated with NOL Usage Tier D, as such terms are defined in the Offer Letter, which is attached hereto as **Exhibit A**.

10. The consummation of a settlement agreement on the terms set forth in the Offer Letter requires the satisfaction of certain conditions and the approval of such terms by the United States, the Bankruptcy Court and this Court.

11. The United States has initiated a process to obtain the approval of the United States to accept the Offer Letter. The United States has not yet accepted the Offer Letter and there are no assurances that it will do so, that the final terms of settlement will not change, or that a settlement can be finalized within a certain period of time. Although litigation counsel for the United States was actively involved in the extensive negotiations regarding the terms and conditions set forth in the Offer Letter, there is an intricate and lengthy evaluation process by the United States which involves various levels of the federal government, including the Office of Review, the Office of the Attorney General and the Congressional Joint Committee on Taxation. During the pendency of the federal evaluation and approval process, the United States, Ambac and the Rehabilitator have jointly requested that the Seventh Circuit Court of Appeals defer oral argument on the fully-briefed, consolidated appeals pending there and, to date, that court has granted their joint request.

12. On February 24, 2012, AFG filed a Third Amended Plan of Reorganization (the "Amended Plan") with the Bankruptcy Court. The Amended Plan contains a description of the Offer Letter. (*See* Amended Plan, Ex. F, which can be obtained at <http://www.kccllc.net/ambac> under the heading "Court Documents.") In its March 14, 2012 Plan Confirmation Order, the Bankruptcy Court noted that AFG is waiting for the consent of the United States before proceeding with a motion for approval by the Bankruptcy Court.

13. As noted above, on March 5, 2012, the United States, the Rehabilitator and Ambac filed a Joint Status Report in the Seventh Circuit Court of Appeals, requesting to “continue to hold these Appeals in abeyance through not rescheduling oral arguments, with the parties filing further status reports at intervals directed by the Court.” (See 3/5/12 Joint Status Report, **Exhibit B** hereto.)

14. The Rehabilitator and the Segregated Account request an order granting this motion for authorization to proceed with the settlement with the United States in accordance with the terms of the Offer Letter. Although the Rehabilitator retains the right to withdraw the Offer Letter at any time and for any reason prior to acceptance by the other parties, the Rehabilitator considers the terms of the Offer Letter to be in the best interests of the policyholders and creditors of the Segregated Account for at least two reasons.

15. First, the settlement of the IRS Dispute and related proceedings, including the United States’ pending consolidated appeals in the Seventh Circuit Court of Appeals and the adversary proceeding in the Bankruptcy Court, will resolve the United States’ claim to the Tax Refunds at a small fraction of the contested amount and eliminate the risk and uncertainty of costly litigation that would otherwise burden and delay the rehabilitation process.

16. Second, the settlement of the IRS Dispute and related proceedings will preserve billions of dollars of NOLs for the benefit of policyholders on favorable economic terms. Specifically, Ambac and the Segregated Account will pay AFG for the NOLs on an as-needed basis according to a schedule negotiated by the parties. The NOLs

will contribute to the conservation of the claims-paying resources of Ambac and the Segregated Account as a means to offset taxable income in the future.

WHEREFORE, for the foregoing reasons, the Rehabilitator respectfully requests that the Court grant the Rehabilitator's Motion and enter the proposed Order, authorizing the Rehabilitator and the Segregated Account to proceed with the proposed IRS settlement pursuant to the terms of the Offer Letter.

Dated this 16th day of May, 2012.

FOLEY & LARDNER LLP

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EXHIBIT A

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

February 24, 2012

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Southern District of New York
U.S. Department of Justice
86 Chambers Street
New York, NY 10007

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

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

Dear Messrs Bharara and DiCicco:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(5) The parties to the closing agreement acknowledge that such agreement is the product of arm's length negotiations and supersedes all prior communications, written or oral, with respect thereto. In connection with the negotiations to enter into a closing agreement that satisfies the conditions described in this paragraph 1(c), the Parties agree that no payment shall be required to be made by any members of the Group other than as described in paragraphs 2-4.

d. Additional conditions precedent to the effectiveness of the proposed settlement are (i) AFGI (on behalf of itself, AAC, and the other members of the Group, whose written consent shall be obtained) and the IRS shall have entered into a closing agreement under section 7121 of the Code providing that neither the issuance of the Bank Settlement Notes⁴ nor the June 9, 2010 Event⁵ (A) caused

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

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

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

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

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

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

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

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

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

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

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

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

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

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February 24, 2012
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dismiss with prejudice the two cases that are currently pending before the U.S. Court of Appeals for the Seventh Circuit and captioned as *Theodore Nickel v. United States of America*, Case No. 11-1158 and *United States of America v. Wisconsin State Circuit Court for Dane County, et. al.*, Case No. 11-1419.

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

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

Messrs. Bharara and DiCicco
February 24, 2012
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10. This Offer shall be conditioned upon the satisfaction of each of the following conditions:

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

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

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

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

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

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


Respectfully submitted,

Dewey & LeBoeuf LLP

By: 
Lawrence M. Hill
Counsel for Debtor and AAC

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

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

Morrison & Foerster LLP

By: _____
Anthony Princi
Counsel for the Official Creditors
Committee

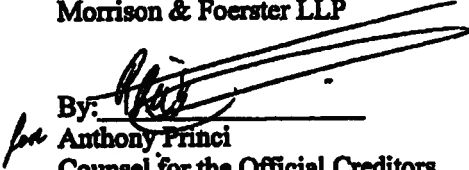
cc: Jeannette A. Vargas
Daniel P. Filor
Ellen London
Carina H. Schoenberger
Anthony T. Sheehan
Roger A. Peterson
Michael B. Van Sicklen
Edward Froelich
Robert Kovacev
Sashka Koleva

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

By: _____
Kevin G. Fitzgerald
Counsel for the Segregated
Account, the Rehabilitator, and
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Morrison & Foerster LLP

for By: 
Anthony Princi
Counsel for the Official Creditors
Committee

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

Attachment A - Updated

Deal ID	Deal Name
CDS1999-04	CBO 1999-04 (AXA2)
CDS2000-01	CBO 2000-01 (RSA and RSA Additions)
CDS2000-02	ABS 2000-02 (Rabo-Stuyvesant)
CDS2000-03	ABS 2000-03 (APEX IDM)
CDS2000-04	CBO 2000-04 (BNP Olan 2)
CDS2000-07	BARCLAYS 85/15
CDS2000-08	CBO 2000-08 (Taurus 4)
CDS2000-09	CBO 2000-09 (CL Sirius)
CDS2000-10	CBO 2000-10 (Natexis IGLOO)
CDS2000-11	CBO 2000-11 (Eirles 2)
CDS2000-12	CBO 2000-02 (Taurus 2)
CDS2000-13	CBO 2000-03 (Triplets)
CDS2000-14	TRIPLETS B
CDS2000-15	EM 2000-01 (Barclays)
CDS2000-16	EM 2000-02 (Barclays)
CDS2000-17	CDS 2006-17 (HAUS)
CDS2000-18	HAUS 2
CDS2001-01	ABS 2001-01 (Equinox)
CDS2001-02	ABS 2001-02 (Rabo-Stuyvesant 2)
CDS2001-04	ABS 2001-04 (TD Wayland 2)
CDS2001-06	ABS 2001-06 (APEX Trimaran)
CDS2001-07	ABS 2001-07 (TD Sankaty 3)
CDS2001-08	ABS 2001-08 (TD Sankaty 3)
CDS2001-09	ABS 2001-09 (TD Goldentree)
CDS2001-10	ABS 2001-10 (GSC)
CDS2001-12	CBO 2001-01 (BNP EuroLiberte)
CDS2001-13	CBO 2001-02 (Mitsui)
CDS2001-14	CBO 2001-04 (Dresdner Ace)
CDS2002-02	ABS 2002-02 (TD Goldentree 2A)
CDS2002-03	ABS 2002-03 (TD Goldentree 2B)
CDS2002-04	ABS 2002-04 (Macquarie)
CDS2002-05	ABS 2002-05 (Zing 4)
CDS2002-06	ABS 2002-06 (Provident)
CDS2002-09	ABS 2002-09 (Goldentree Loan Opportunities)
CDS2002-10	ABS 2002-10 (SVAR)
CDS2002-11	ABS 2002-11 (Bryn Mawr)
CDS2002-12	CDS 2002-12 (Landmark)
CDS2002-13	ABS 2002-13 (Rabo-Stuyvesant 4)
CDS2002-14	CDS 2002-14 (MS CARDINAL)
CDS2002-15	CDS 2002-15 (RABO CARDINAL)
CDS2002-16	CDS 2002-16 (SOCGEN CARDINAL)
CDS2002-22	CBO 2002-02 (Petra 2)
CDS2002-23	CBO 2002-03 (Jasco)
CDS2002-24	CBO 2002-04 (Mitsui 2)
CDS2002-25	CBO 2002-05 (Atlantic)
CDS2002-26	CBO 2002-06 (Petra 3)

- CDS2002-27
- CDS2002-31
- CDS2003-04
- CDS2003-07
- CDS2003-08
- CDS2003-09
- CDS2003-10
- CDS2003-14
- CDS2003-16
- CDS2004-01
- CDS2004-02
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- CDS2005-40
- CDS2005-41
- CDS2005-44
- CDS2005-50
- CDS2005-51
- CDS2005-53
- CDS2005-54
- CDS2005-55
- CDS2005-56
- CDS2005-58
- CDS2006-02

- CDS 2002-31 (Provide Residence 2)
- CDS 2003-04 (EMERALD A)
- ABS 2003-07 (Carlyle Loan Opportunities)
- CDS 2003-08 (EMERALD B)
- ABS 2003-09 (Promus)
- CDS 2003-10 (RENDITE)
- CBO 2003-01 (UFJ Ruby)
- CDS 2003-16 (PROVIDE ORANGE)
- Synthetic ABS 2004-1 (Pooled Property Catastrophe)
- CDS 2004-02 (MOUNTAIN CAPITAL)
- ABS 2004-03 (SISF)
- CDS 2004-11 (HSBC GULF STREAM 2)
- CDS 2004-13 (HSBC VERITAS)
- ABS 2004-16 (Harbourmaster)
- CDS 2004-17 (CHEYNE)
- ABS 2004-20 (Stone Tower)
- ABS 2004-22 (RAMP)
- ABS 2005-01 (Stanton)
- ABS 2005-06 (Swiss Re Landmark V)
- CDS 2005-07 (GALAXY IV CLASS A-1)
- CDS 2005-08 (GALAXY IV CLASS A-2)
- ABS 2005-10 (Class V Funding)
- ABS 2005-11 (BSAM Calyon)
- ABS 2005-12 (BSAM SocGen)
- ABS 2005-13 (BSAM Barclays)
- ABS 2005-15 (Palmer Square)
- CDS 2005-16 (RAMP II)
- ABS 2005-18 (Belle Haven)
- CDS 2005-19 (CREDIT GENESIS I)
- CDS 2005-20 (CREDIT GENESIS II)
- ABS 2005-21 (SISF II)
- ABS 2005-27 (Alesco VIII CIBC)
- CDS 2005-26 (ALESCO VIII CIBC 2)
- ABS 2005-29 (Alesco VIII HSBC)
- ABS 2005-30 (Duke Funding Calyon)
- ABS 2005-31 (Duke Funding Dresdner A-1B1)
- DUKE FUNDING DRESDNER A-1B2
- CDS 2005-33 (BERNARD LOAN INVESTORS)
- ABS 2005-34 (Pascal)
- CDS 2005-40 (GALAXY V IXIS A-1)
- CDS 2005-41 (GALAXY V IXIS A-2)
- ABS 2005-44 (Stone Tower II)
- CDS 2005-50 (EUROCREDIT OPPORTUNITIES)
- CDS 2005-51 (EUROCREDIT REVOLVER)
- ABS 2005-53 (Hereford)
- ABS 2005-54 (Tremonia)
- CDS 2005-55 (ALESCO IX)
- CDS 2005-56 (Master Funding)
- MBS 2005-02 (Armor)
- DUKE FUNDING IV

CDS2006-04 (SANKATY III RBS A-1A)
 CDS2006-05 (SANKATY III RBS A-1A)
 CDS2006-06 (SANKATY III RBS A-1B)
 ABS 2006-08 (Tricadia)
 ABS 2006-14 (Abbey Millerton)
 ABS 2006-15 (RBS Millerton)
 ABS 2006-16 (SocGen Millerton)
 ABS 2006-17 (Barclays Millerton)
 ABS 2006-18 (Longshore)
 ABS 2006-21 (Lancer)
 CDS 2006-26 (SWIFT TRUST IX)
 ABS 2006-28 (WG Horizons)
 CDS 2006-29 (EUROCREDIT ICG TAP)
 ABS 2006-30 (Belle Haven II Rabobank)
 ABS 2006-31 (Belle Haven II Barclays)
 ABS 2006-32 (Belle Haven II Abbey)
 ABS 2006-33 (Belle Haven II BBVA)
 ABS 2006-34 (Rockwall)
 DIVERSEY HARBOR A-1M
 DIVERSEY HARBOR A-1Q
 ABS 2006-37 (Tricadia II)
 ABS 2006-38 (Belle Haven II UBS)
 CDS 2006-39 (Belle Haven II LEHMAN)
 ABS 2006-40 (SISF III Super Senior)
 CDS 2006-41 (EUROCREDIT ICG RBC)
 ABS 2006-42 (SISF III AAA)
 ABS 2006-43 (SISF III Aa3)
 ABS 2006-44 (SISF III A3)
 CDS 2006-48 (EUROCREDIT OPPORTUNITIES)
 ABS 2006-50 (Ballantyne Re)
 DUKE FUNDING V
 Cairn II
 ABS 2006-53 (Ridgeway A-1M)
 ABS 2006-54 (Ridgeway A-1Q) ABS 2006-54 (Ridgeway A-1Q)
 ABS 2006-59 (ESP Funding I IXIS)
 ABS 2006-60 (ESP Funding I A-1R)
 ABS 2006-61 (ESP Funding I A-1T1)
 CDS 2006-62 (EUROCREDIT OPPS TAP A-3)
 CDS 2006-63 (EUROCREDIT OPPS VF-3 REVOLVER)
 ABS 2006-64 (McKinley A-1 Abbey)
 MCKINLEY A-1 CIBC
 CDS 2006-70 (Korea FM A-1A)
 ABS 2006-79 (McKinley A-1 BNPP)
 MCKINLEY A-1 IXIS
 ABS 2006-81 (Clydesdale A-1 ML)
 ABS 2006-83 (Osprey)
 ABS 2006-85 (Venture A-1A ML)
 ABS 2006-86 (Venture A-1A HSBC)
 ABS 2006-87 (Bacchus)
 ABS 2007-02 (Citation A-1 UBS)
 CITATION A-1 CIBC

CDS2007-04
CDS2007-05
CDS2007-07
CDS2007-10
CDS2007-11
CDS2007-12
CDS2007-13
CDS2007-14
CDS2007-17
CDS2007-20
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CDS2007-33
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CDS2007-34
CDS2007-35
CDS2007-39
CDS2007-40
CDS2007-47
CDS2007-48
CDS2007-50
CDSUK2001-03
CDSUK2001-11
CDSUK2001-15
CDSUK2001-16
CDSUK2001-18
CDSUK2002-21
CDSUK2002-28
CDSUK2002-29
CDSUK2002-30
CDSUK2003-15
CDSUK2006-62
CDSUK2006-63

ABS 2007-05 (Ballantyne Re 2)
ABS 2007-07 (Citation A-1 BNPP)
888 Tactical Fund, Ltd.
Class V Funding III, Ltd.
Kleros Preferred Funding VI, Ltd.
ABS 2007-13 (Penta A-1)
ABS 2007-14 (Rockwall II HBOS)
ABS 2007-17 (Rockwall II SocGen)
CDS 2007-20 (Sankaty High Yield Partners III)
ABS 2007-23 (Avenue VI HBOS)
Fiorente Funding
ABS 2007-29 (Fore CLO A-1A HBOS)
ABS 2007-30 (Fore CLO A-1B HBOS)
ABS 2007-31 (Ocean Trails II ML)
ABS 2007-33 (Ridgeway II A-1A)
ABS 2007-43 (Ridgeway II A-1B)
ABS 2007-44 (Ridgeway II A-1C)
ABS 2007-34 (Adam Square)
AA CDO Squared Bespoke
CDS 2007-39 (SISF IV AAA)
CDS 2007-40 (SISF IV AA2)
ABS 2007-55 (Citicorp Mortgage Trust 2007-1)
ABS 2007-56 (Citicorp Mortgage Trust 2007-2)
ABS 2007-58 (Wood Street)
DEPFA AG MEDHOME
ABS UK 2001-01 (JPM BWBI Bistro)
CDS UK 2001-15 (DEPFA Provide Home SR)
CDS UK 2001-16 (DEPFA Provide Home JR)
CDSUK2001-18 (DEPFA PFAND MEDHOME)
CBO UK 2002-01 (BGB Rhea)
CDS UK 2002-28 (Provide Residence SR)
CDS UK 2002-29 (Provide Residence JR)
CDSUK2002-30 (AAREAL PROVIDE HOME)
SMBC 03
CDS UK 2006-62 (ATLAS III)
CBO UK 2006-01 (SMBC 06)

Attachment B

<u>Policy Number</u>	<u>CDS Policy Name</u>
CDS2002-07	Carlisle High Yield Partners IV, Ltd
CDS2002-08	Carlisle High Yield Partners IV, Ltd
CDS2002-17	Intercontinental CDO S.A.
CDS2002-18	Mayfair Euro CDO I BV
CDS2002-19	Castle Hill I - INGOTS, Ltd.
CDS2002-20	Castle Hill I - INGOTS, Ltd.
CDS2003-02	Gulf Stream - Compass CLO Ltd.
CDS2003-03	Longhorn CDO III, Ltd.
CDS2003-05	Forest Creek CLO Ltd. Class IA Notes
CDS2003-06	Pacifica CDO, Ltd. Class A1 Notes
CDS2003-11	GSC Partners CDO Fund, Limited
CDS2003-12	Avery Point CLO, Limited
CDS2003-13	Landmark III CDO Limited
CDS2004-04	Canyon Capital CLO 2004-1Limited
CDS2004-05	Canyon Capital CLO 2004-1Limited
CDS2004-06	Canyon Capital CLO 2004-1Limited
CDS2004-07	Canyon Capital CLO 2004-1Limited
CDS2004-08	Whitehorse Ltd. 2004-1A
CDS2004-09	Gulf Stream - Compass CLO Ltd.
CDS2004-10	Gulf Stream - Compass CLO Ltd.
CDS2004-12	Veritas CLO Ltd. 2004-1A
CDS2004-14	Stanfield Modena CLO, Ltd. 2004-1A
CDS2004-15	Stanfield Modena CLO, Ltd. 2004-1A
CDS2004-18	Essential Public Infrastructure Capital Plc
CDS2004-19	TIB Diversified Payment Rights Finance Company
CDS2004-21	Avenue CLO Fund Ltd.
CDS2005-02	Field Point I, Limited
CDS2005-03	Field Point II, Limited
CDS2005-04	Helios Series I Multi Asset CBO, Ltd. Class A
CDS2005-05	Landmark V CDO Ltd.
CDS2005-09	Hamlet Leveraged Loan Fund BV Class A
CDS2005-14	Black Diamond International Funding
CDS2005-17	National Collegiate Student Loan Trust
CDS2005-22	GEM VIII LTD
CDS2005-23	GEM VIII LTD
CDS2005-24	ACA CLO Limited
CDS2005-25	Avenue CLO Fund Ltd.
CDS2005-26	Avenue CLO Fund Ltd.
CDS2005-35	NYLIM FLATIRON CLO LTD
CDS2005-36	NYLIM FLATIRON CLO LTD
CDS2005-37	NYLIM FLATIRON CLO LTD
CDS2005-38	Galaxy V CLO, Ltd
CDS2005-39	Galaxy V CLO, Ltd
CDS2005-42	Gulf Stream - Compass CLO Ltd.
CDS2005-43	National Collegiate Student Loan Trust
CDS2005-45	York Enhanced Strategies Fund, LLC
CDS2005-46	CLYDESDALE CLO 2001-1 LTD
CDS2005-47	CLYDESDALE CLO 2001-1 LTD
CDS2005-48	Gleneagles CLO, Ltd
CDS2005-49	OWS CLO I Ltd
CDS2005-52	Turkiye Garanti Bankasi A.S.
CDS2006-01	York Enhanced Strategies Fund, LLC
CDS2006-03	Kennecott Funding LTD
CDS2006-07	Whitehorse III Ltd
CDS2006-09	Japan Finance Corporation for Municipal Enterprises
CDS2006-10	Aurora Military Housing LLC
CDS2006-11	Aurora Military Housing LLC

CDS2006-12	Aurora Military Housing LLC
CDS2006-13	Aurora Military Housing LLC
CDS2006-19	Vector Limited
CDS2006-20	Vector Limited
CDS2006-22	Transurban Finance Company Pty Ltd
CDS2006-23	Race Point III CLO Ltd
CDS2006-24	Jay Street Market Value CDO I Ltd
CDS2006-25	Leopard CLO IV
CDS2006-27	Avenue CLO III, LTD
CDS2006-45	Fairway Loan Funding Company
CDS2006-46	Fairway Loan Funding Company
CDS2006-47	ACA CLO 2006-1 LTD
CDS2006-49	FIP Funding Srl
CDS2006-55	Laurelin B.V.
CDS2006-56	Laurelin B.V.
CDS2006-57	Oak Hill Credit Opportunities Funding
CDS2006-58	Oak Hill Credit Opportunities Funding
CDS2006-66	Cadogan Square CLO III B.V.
CDS2006-67	Mayport CLO, Ltd
CDS2006-68	Mayport CLO Ltd
CDS2006-69	Yapi Kredit DPR Finance Company
CDS2006-71	Korea First Mortgage No. 6 Ltd
CDS2006-72	Korea First Mortgage No. 6 Ltd
CDS2006-73	Harbourmaster 7 CLO B.V.
CDS2006-74	Harbourmaster 7 CLO B.V.
CDS2006-75	Ocean Trails CLO I
CDS2006-76	Cairn CLO I B.V.
CDS2006-77	Cairn CLO I B.V.
CDS2006-78	Cairn CLO I B.V.
CDS2006-82	Clydesdale CLO 2006, Ltd
CDS2006-84	Venture VII CDO Ltd.
CDS2007-01	Whitehorse IV, Ltd.
CDS2007-06	German Residential Funding plc
CDS2007-08	Oak Hill Securities Fund II
CDS2007-09	Golden Knight II CLO, Ltd.
CDS2007-15	Reliance Rail Pty Limited
CDS2007-16	Reliance Rail Pty Limited
CDS2007-18	Harvest CLO V P.L.C.
CDS2007-19	Harvest CLO V P.L.C.
CDS2007-21	Avenue CLO VI, Ltd
CDS2007-22	ABCLO 2007-1, Ltd
CDS2007-24	Theatre (Hospitals) plc
CDS2007-25	Theatre (Hospitals) plc
CDS2007-26	OHSF II Financing, Ltd
CDS2007-28	Dublin Oak Ltd
CDS2007-30	Fore CLO Ltd 2007-1
CDS2007-32	Ocean Trails CLO II
CDS2007-37	ACA Euro CLO 2007-1 PLC
CDS2007-38	ACA Euro CLO 2007-1 PLC
CDS2007-41	Kinney Hill Credit Opportunities Fund, Ltd
CDS2007-42	Kinney Hill Credit Opportunities Fund, Ltd
CDS2007-43	Waterfront CLO 2007-1, Ltd
CDS2007-44	Euro-Galaxy II CLO B.V.
CDS2007-45	Laurelin II B.V.
CDS2007-46	Cairn CLO II B.V.
CDS2007-49	Energy Partnership (Gas) Pty Ltd
CDS2007-51	Ares XI CLO
CDS2007-52	Avoca Credit
CDS2007-53	Laurelin II B.V.
CDS2007-54	Cairn CLO II B.V.
CDS2007-55	Laurelin II B.V.
CDS2007-56	Cairn CLO II B.V.

CDS2007-57	Avoca Credit
CDS2007-58	Powercor Australia LLC
CDS2007-59	Nexus Australia Management Pty - \$A486m MBIA-wrapped medium term notes due 8/31/2015
CDS2007-60	National Collegiate Student Loan Trust
CDS2007-61	Sanef
CDS2007-62	Sanef

APPENDIX A

**THE
BANK OF
NEW
YORK Mellon**

ESCROW AGREEMENT

between

THE SEGREGATED ACCOUNT
OF AMBAC ASSURANCE CORPORATION,

UNITED STATES OF AMERICA

and

THE BANK OF NEW YORK MELLON

Dated as of _____, 2012

ACCOUNT NUMBER(S) _____

SHORT TITLE OF ACCOUNT _____

THIS ESCROW AGREEMENT made this _____ day of 2012 (the "Escrow Agreement") by and between THE BANK OF NEW YORK MELLON ("Escrow Agent"), the Segregated Account of Ambac Assurance Corporation, a segregated account established in accordance with Wis. Stat. § 611.24(2) (the "Segregated Account"), and the United States of America ("USA").

Whereas, on November 8, 2010, Ambac Financial Group, Inc., a Delaware corporation ("AFG"), commenced a voluntary case under chapter 11 of the United States Bankruptcy Code, known case number 10-15973 (SCC) (the "Bankruptcy Case"), in the United States Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court").

Whereas, on November 9, 2010, AFG commenced an adversary proceeding in connection with the Bankruptcy Case against USA, entitled Ambac Financial Group, Inc. and The Official Committee of Unsecured Creditors v. United States of America and known as Adv. Pro. No. 10-4210 (SCC) (the "Adversary Proceeding"), seeking, in part, to obtain an injunction and a declaration that AFG applied the proper accounting method with respect to losses on certain credit default swap contracts (the "CDS Contracts").

Whereas, on May 5, 2011, USA filed its proofs of claim in the Bankruptcy Case against AFG, thereby asserting a priority claim against AFG in the amount of \$807,242,021.91 (the "IRS Claims"). The IRS Claims seek the return of the tentative tax refunds received by the AFG tax group (the "Group") resulting from the claimed recognition of losses in 2007 and 2008 with respect to the CDS Contracts. AFG filed its objection to the IRS Claims on June 5, 2011.

Whereas, USA has also sought to assert legal rights against AFG's subsidiary, Ambac Assurance Corporation ("AAC"), under Treas. Reg §§ 1.1502-6(a) and 1.1502-78(b)(2), with respect to any deficiency or underpayment of federal taxes against the Group.

Whereas, the Office of the Commissioner of Insurance of the State of Wisconsin ("OCI") approved the creation of the Segregated Account, which OCI then placed into rehabilitation in the Wisconsin Circuit Court of Dane County (the "Rehabilitation Court") on March 24, 2010 in the matter entitled In the Matter of Rehabilitation Segregated Account of Ambac Assurance

Corporation and known as Case Number 10-CV-1576 (the "Rehabilitation Case") and in which the Wisconsin Commissioner of Insurance was appointed as the rehabilitator of the Segregated Account (the "Rehabilitator").

Whereas, by order dated November 7, 2010, the Rehabilitation Court approved the allocation of AAC's federal tax liability for all prior tax years, including any liability it may have with respect to the IRS Claims, to the Segregated Account, and issued an injunction enjoining *inter alia* USA from taking certain action against the property and assets of AAC and the Segregated Account.¹

Whereas, on December 8, 2010, USA removed the Rehabilitation Case to the United States District Court for the Western District of Wisconsin (the "District Court"). The Rehabilitator thereafter moved to remand the Rehabilitation Case back to the Rehabilitation Court, and on January 14, 2011, that motion was granted by the District Court. USA thereupon appealed that decision to the United States Court of Appeals for the Seventh Circuit (the "Seventh Circuit"). On February 9, 2011, USA filed a complaint and a motion for a preliminary injunction in the District Court seeking, *inter alia*, to enjoin enforcement of the injunction issued by the Rehabilitation Court and the Confirmation Order against USA in a case entitled United States of America v. Wisconsin State Circuit Court for Dane County and known as Case No. 11-cv-099. The District Court dismissed that suit for lack of subject matter jurisdiction on February 18, 2011, and USA filed a notice of appeal on February 22, 2011. The appeals at the Seventh Circuit are pending as Appeal Nos. 11-1158 and 11-1419 (collectively, the "Federal Appeals").

Whereas, AFG, AAC, the Segregated Account and USA, among others, have negotiated in regard to the terms of an offer letter that would, upon acceptance by USA and the satisfaction of the other conditions set forth therein, resolve, among other things, their disputes relative to the Adversary Proceeding, the CDS Contracts, the Federal Appeals and the IRS Claims (the "Offer Letter").

Whereas, the effectiveness of the Offer Letter is conditioned upon, among other things, the entry by the Segregated Account and USA into a mutually acceptable escrow agreement relative to the establishment and maintenance of an escrow account holding a balance of \$100 million in cash, cash equivalents and qualifying securities and other investments (the "Escrow Condition").

Whereas, the Segregated Account and USA wish to satisfy the Escrow Condition through the entry into this Escrow Agreement.

¹ It is acknowledged that the United States disputes that the allocation and injunction are effective as to it.

The Segregated Account, USA and Escrow Agent hereby agree that, in consideration of the mutual promises and covenants contained herein, Escrow Agent shall hold in escrow and shall distribute Escrow Property in accordance with and subject to the following Instructions and Terms and Conditions:

I. INSTRUCTIONS:

1. Escrow Property

Within ten calendar days of the last to occur of the following two events:

(a) the execution and delivery of this Escrow Agreement by the parties hereto; and

(b) the delivery of the fully executed final Offer Letter to the USA.

the Segregated Account shall draw upon the Secured Note approved by the Rehabilitation Court on March 24, 2010 and use such proceeds to fund a deposit with the Escrow Agent no less than \$100 million in aggregate fair market value of (i) cash, (ii) cash equivalents, (iii) municipal bonds, corporate bonds and/or asset-backed securities having a rating of at least A-, A-, A3 from either Standard & Poor's, Fitch Ratings or Moody's Corporation, respectively, and (iv) securities and investments issued by USA or backed by the full faith and credit of USA (each, a "Qualifying Investment" and collectively, the "Qualifying Investments"). This escrow agreement shall not be effective unless and until the Escrow Agent actually receives a sum of not less than \$100 million in aggregate fair market value of Qualifying Investments.

The foregoing property, plus all interest, dividends and other distributions and payments thereon (collectively the "Distributions") received by Escrow Agent, less funds distributed in accordance with this Escrow Agreement, are collectively referred to herein as "Escrow Property."

2. Investment of Escrow Property

The Escrow Agent shall invest, or reinvest, the Escrow Property in Qualifying Investments in accordance with the written investment directions from the Segregated Account or from AAC in its capacity as management services provider for the Segregated Account. The Segregated Account directly, or through AAC as management services provider, may issue subsequent written investment directions at any time, subject only to the requirement that the Escrow Property be invested in Qualifying Investments.

Escrow Agent shall have no liability for any loss arising from or related to any such investment other than in accordance with paragraph 5 of the Terms and Conditions.

3. Distribution of Escrow Property

Escrow Agent is directed to hold and distribute the Escrow Property in the following manner:

Promptly following receipt of a written instruction from the Segregated Account, which may be issued at any time, Escrow Agent shall distribute the portion of the Escrow Property in excess of \$100 million in value (the "Excess Escrow Property") to the Segregated Account in accordance with the wiring instructions provided by the Segregated Account. The Escrow Property less the Excess Escrow Property is hereafter referred to as the "Net Escrow Property."

The Net Escrow Property, subject to reinvestment in accordance with paragraph 2 above and replacement with other Qualifying Investments of equal or greater value, shall be maintained uninterrupted and undiminished from the date of its receipt forward until it is used for the purpose of making a voluntary settlement payment by the Segregated Account to USA in accordance with a joint written instruction from the Segregated Account and USA; provided, however, that the Segregated Account shall be entitled to fund the settlement payment to USA, otherwise replace the Net Escrow Property, with other funds equal to the value of the Net Escrow Property, in which case the Escrow Agent shall distribute the Net Escrow Property to the Segregated Account. Contemporaneous with the distribution of any Net Escrow Property under this paragraph, Escrow Agent shall distribute any as yet undistributed Excess Escrow Property to the Segregated Account in accordance with the wiring instructions provided by the Segregated Account or AAC as its management services provider.

Otherwise, the Net Escrow Property, subject to reinvestment in accordance with Paragraph 2 above and replacement with other Qualifying Investments of equal value, shall be maintained uninterrupted and undiminished until the date on which the Seventh Circuit issues a ruling with respect to the Federal Appeals (the "Federal Appeals Determination Date). Upon the Federal Appeals Determination Date, Escrow Agent shall distribute the Net Escrow Property, along with any as yet undistributed Excess Escrow Property, to the Segregated Account in accordance with the wiring instructions provided by the Segregated Account.

Except as provided above or as directed in a joint written instruction from the Segregated Account and USA, Escrow Agent shall not distribute any Escrow Property to USA.

4. No Improvement in USA's Rights

Neither the entry into this Escrow Agreement nor the consummation of the transactions contemplated hereunder is intended to improve or modify the USA's rights vis-à-vis AAC, the Segregated Account or the priority of USA's rights relative to policyholders and other creditors of the Segregated Account and AAC. The sole purpose of this Escrow Agreement is to assure that the Segregated Account has at least \$100 million of assets during the time periods indicated in this Agreement. Prior to the distribution of the Net Escrow Property, neither AAC nor the Segregated Account shall in any way encumber or obligate the Net Escrow Property.

Neither the fact of this Escrow Agreement nor physical evidence of this Escrow Agreement shall be admissible as evidence in any dispute between the USA and either the Segregated Account and/or AAC pertaining to collection activity by the USA or in connection with any litigation pertaining to the priority of the USA's rights as a claimant relative to policyholders and other creditors of the Segregated Account and AAC. As between the USA and the Segregated Account and AAC, this Escrow Agreement is part of a settlement negotiation subject to Federal Rule of Evidence 408 and its Wisconsin counterpart, Wis. Stat. § 904.08. The USA, however, reserves the right to introduce evidence of this Escrow Agreement should AAC, the Segregated Account, or any related party move to dismiss any pending litigation as moot on the grounds that no assets will be available to pay any claims by the USA.

The USA shall not have any more or less right to attach, seize, lien or levy any of the funds in the Escrow Account than as to the assets remaining in the Segregated Account. The USA shall take no action of any kind against any of the Escrow Property inconsistent with the stipulation between AFG and the USA so ordered by the Bankruptcy Court on the record of the proceedings in the Bankruptcy Case on November 9, 2010. The distribution of Escrow Property by the Escrow Agent to the Segregated Account upon the Federal Appeals Determination Date shall be automatic, shall not require any signature consent, or instructions from the USA and the USA shall not attempt to restrict that transfer to the Segregated Account through any collection or court action, or otherwise in any respect.

5. Addresses

Notices, instructions and other communications shall be sent to Escrow Agent, Corporate Trust Administration, 101 Barclay Street-Floor 8W, New York, New York 10286, Attn: Matthew Louis, Insurance Trust and Escrow Group, Fax Number 212-815-5877 and to the Segregated Account and USA as follows:

The Segregated Account of Ambac Assurance Corporation
Care of its Counsel:
Kevin Fitzgerald
Foley & Lardner LLP
777 East Wisconsin Avenue
Milwaukee, WI 53202
Email: kfitzgerald@foley.com

and

Roger Peterson
Special Deputy Commissioner of the Segregated Account
of Ambac Assurance Corporation
c/o Ambac Assurance Corporation
One State Street Plaza
New York, NY 10004
Email: RogerA.Peterson@Wisconsin.Gov

and

Ambac Assurance Corporation, as Management Services Provider to
The Segregated Account of Ambac Assurance Corporation
Attention: Brent Lammers
One State Street Plaza
New York, NY 10004
Email: blammers@ambac.com

Tax Division, Appellate Section
United States Department of Justice
P.O. Box 502
Washington, D.C. 20044
Attention: Gilbert S. Rothenberg

Notices may be served electronically.

6. Compensation

- (a) The Segregated Account shall pay Escrow Agent an annual fee of \$5,000, payable upon execution of this Escrow Agreement and thereafter on each anniversary date of this Escrow Agreement for so long it remains in effect. The annual fee shall not be pro-rated for any portion of a year.
- (b) The Segregated Account shall pay all activity charges per the fee schedule attached hereto as Exhibit A.
- (c) The Segregated Account shall be responsible for and shall reimburse Escrow Agent for all reasonable expenses, disbursements and advances incurred or made by Escrow Agent in connection with this Escrow Agreement ("Escrow Agent Expenses") following the

receipt of a detailed invoice setting forth such Escrow Agent Expenses.

II. TERMS AND CONDITIONS:

1. The duties, responsibilities and obligations of Escrow Agent shall be limited to those expressly set forth herein and no duties, responsibilities or obligations shall be inferred or implied. With respect to the subject matter of this Escrow Agreement, Escrow Agent shall not be subject to, nor required to comply with, any other agreement between any of the parties, even though reference thereto may be made herein, or to comply with any direction or instruction (other than those contained herein or delivered in accordance with this Escrow Agreement) from an Authorized Person at the Segregated Account and USA. Escrow Agent shall not be required to, and shall not, expend or risk any of its own funds or otherwise incur any financial liability in the performance of any of its duties hereunder.
2. This Escrow Agreement is for the exclusive benefit of the parties hereto and their respective successors hereunder, and shall not be deemed to give, either express or implied, any legal or equitable right, remedy, or claim to any other entity or person whatsoever.
3. If at any time Escrow Agent is served with any judicial or administrative order, judgment, decree, writ or other form of judicial or administrative process which in any way affects Escrow Property (including but not limited to orders of attachment or garnishment or other forms of levies or injunctions or stays relating to the transfer of Escrow Property) (an "Escrow Property Order"), Escrow Agent is authorized to comply therewith in any manner as it or its legal counsel of its own choosing deems appropriate; and if Escrow Agent complies with any such judicial or administrative order, judgment, decree, writ or other form of judicial or administrative process, Escrow Agent shall not be liable to any of the parties hereto or to any other person or entity even though such order, judgment, decree, writ or process may be subsequently modified or vacated or otherwise determined to have been without legal force or effect; provided, however, that Escrow Agent provides prompt notice of the Escrow Property Order to each of the other parties hereto; and provided further that each such other party is given a sufficient period of time in which to elect to contest the Escrow Property Order at its own expense.
4. On or prior to the execution of this Escrow Agreement, the Segregated Account and USA each agree to furnish to Escrow Agent a Letter of Designation, specifying the persons at

the respective party authorized to provide written instructions to Escrow Agent (the "Authorized Persons"). Each of the Segregated Account and USA shall provide a new Letter of Designation in connection with any change to the identities of such respective Authorized Persons.

5. (a) Escrow Agent shall not be liable for any action taken or omitted or for any loss or injury resulting from its actions or its performance or lack of performance of its duties hereunder in the absence of gross negligence or willful misconduct on its part. In no event shall Escrow Agent be liable (i) for acting in accordance with or relying upon any instruction, notice, demand, certificate or document from any Authorized Person at the Segregated Account or USA, (ii) for any consequential, punitive or special damages or (iii) for an amount in excess of the value of the Escrow Property, valued as of the date of loss or injury.

(b) Following sufficient notice to the Segregated Account and USA and the prior written consent of each party, Escrow Agent may consult with legal counsel at the expense of the Segregated Account as to any matter relating to this Escrow Agreement (provided that they shall only be responsible for reasonable and documented legal fees and expenses for such counsel), and Escrow Agent shall not incur any liability in acting in good faith in accordance with any advice from such counsel.

(c) Escrow Agent shall not incur any liability for not performing any act or fulfilling any duty, obligation or responsibility hereunder by reason of any occurrence beyond the control of Escrow Agent (including but not limited to any act or provision of any present or future law or regulation or governmental authority, any act of God or war, or the unavailability of the Federal Reserve Bank wire or telex or other wire or communication facility).

6. Unless otherwise specifically set forth herein, Escrow Agent shall proceed as soon as practicable to collect any checks or other collection items at any time deposited hereunder. All such collections shall be subject to Escrow Agent's usual collection practices or terms regarding items received by Escrow Agent for deposit or collection. Escrow Agent shall not be required, or have any duty, to notify anyone of any payment or maturity under the terms of any instrument deposited hereunder, nor to take any legal action to enforce payment of any check, note or security deposited hereunder or to exercise any right or privilege which may be afforded to the holder of any such security.
7. Escrow Agent shall provide, to the attention of the Authorized Persons, monthly statements identifying

transactions, transfers or holdings of Escrow Property, and the fair market value thereof, and each such statement shall be deemed to be correct and final upon receipt thereof by the Depositors unless Escrow Agent is notified in writing to the contrary within thirty (30) business days of the date of such statement. If any such monthly statement shall show that the fair market value of the Escrow Property is less than \$100 million, the Segregated Account shall, within 10 days of the date of such statement, deposit Qualifying Investments with the Escrow Agent in such amounts as shall be necessary to restore the fair market value of the Escrow Property to \$100 million. If any such statement shall show that the fair market value of the Escrow Property is greater than \$100 million, the Segregated Account shall be entitled, upon written request of solely the Segregated Account, to the immediate distribution of the Excess Escrow Property.

8. Escrow Agent shall not be responsible in any respect for the form, execution, validity, value or genuineness of documents or securities deposited hereunder, or for any description therein, or for the identity, authority or rights of persons executing or delivering or purporting to execute or deliver any such document, security or endorsement.
9. Notices, instructions or other communications, other than the monthly statements described in paragraph 7 above, shall be in writing, shall be executed by an Authorized Person of the Segregated Account and USA and shall be delivered to the address set forth in the "Addresses" provision herein (or to such other address as may be substituted therefor by written notification to Escrow Agent, the Segregated Account or USA). Notices to Escrow Agent shall be deemed to be given when actually received by Escrow Agent's Insurance Trust and Escrow Unit of the Corporate Trust Division. Escrow Agent is authorized to comply with and rely upon any notices, instructions or other communications reasonably believed by it to have been sent or given by an Authorized Person at the Segregated Account or USA. Whenever under the terms hereof the time for giving a notice or performing an act falls upon a Saturday, Sunday, or banking holiday, such time shall be extended to the next day on which Escrow Agent is open for business.
10. The Segregated Account shall be liable for and shall reimburse and indemnify Escrow Agent and hold Escrow Agent harmless from and against any and all claims, losses, liabilities, costs, damages or expenses (including reasonable attorneys' fees and expenses) (collectively, "Losses") arising from or in connection with or related to this Escrow Agreement or being Escrow Agent hereunder

(including but not limited to Losses incurred by Escrow Agent in connection with its successful defense, in whole or in part, of any claim of gross negligence or willful misconduct on its part), provided, however, that nothing contained herein shall require Escrow Agent to be indemnified for Losses caused by its negligence or misconduct.

11. (a) The Segregated Account and USA, acting jointly, may remove Escrow Agent at any time by giving to Escrow Agent thirty (30) calendar days' prior written notice. Escrow Agent may resign at any time by giving 30 calendar days' prior written notice thereof.

(b) Within ten (10) calendar days after giving the foregoing notice of removal to Escrow Agent or receiving the foregoing notice of resignation from Escrow Agent, the Segregated Account and USA shall jointly agree on and appoint a successor Escrow Agent. If a successor Escrow Agent has not accepted such appointment by the end of such 10-day period, Escrow Agent may apply to a court of competent jurisdiction for the appointment of a successor Escrow Agent or for other appropriate relief. The costs and expenses (including reasonable attorneys' fees and expenses) incurred by Escrow Agent in connection with such proceeding shall be paid by the Segregated Account.

(c) Upon receipt of the identity of the successor Escrow Agent, Escrow Agent shall either deliver the Escrow Property then held hereunder to the successor Escrow Agent, less Escrow Agent's fees, costs and expenses or other obligations owed to Escrow Agent, or hold such Escrow Property (or any portion thereof), pending distribution, until all such fees, costs and expenses or other obligations are paid.

(d) Upon delivery of the Escrow Property to successor Escrow Agent, Escrow Agent shall have no further duties, responsibilities or obligations hereunder.

12. (a) In the event of any ambiguity or uncertainty hereunder or in any notice, instruction or other communication received by Escrow Agent hereunder, Escrow Agent may, in its sole discretion, refrain from taking any action other than retain possession of the Escrow Property; provided that Escrow Agent notifies the Segregated Account and USA in writing that such an ambiguity or uncertainty exist; and provided further that the Segregated Account and USA, acting jointly, may provide written instructions to Escrow Agent signed by an Authorized Person at each party which eliminate such ambiguity or uncertainty.

(b) In the event of any dispute between or conflicting claims by or among the Segregated Account and USA with respect to any Escrow Property, Escrow Agent shall be entitled, in its sole discretion, to refuse to comply with any and all claims, demands or instructions with respect to distribution of such Escrow Property so long as such dispute or conflict shall continue, and Escrow Agent shall not be or become liable in any way to the Segregated Account or USA with respect to any such claims, demands or instructions. Escrow Agent shall be entitled to refuse to act until, in its sole discretion, either (i) such conflicting or adverse claims or demands shall have been determined by a final order, judgment or decree of a court of competent jurisdiction, which order, judgment or decree is not subject to appeal, or settled by agreement between the conflicting parties as evidenced in a writing satisfactory to Escrow Agent or (ii) Escrow Agent shall have received security or an indemnity reasonably satisfactory to it sufficient to hold it harmless from and against any and all Losses which it may incur by reason of so acting. Escrow Agent may, in addition, elect, in its sole discretion, to commence an interpleader action or seek other judicial relief or orders as it may deem, in its sole discretion, necessary. The costs and expenses (including reasonable attorneys' fees and expenses) incurred in connection with such proceeding shall be paid by the Segregated Account.

13. Solely as to any legal action initiated by Escrow Agent in regard to this Escrow Agreement: this Escrow Agreement shall be interpreted, construed, enforced and administered in accordance with the internal substantive laws (and not the choice of law rules) of the State of New York, and the Segregated Account and USA hereby submit to the personal jurisdiction of and each agrees that all proceedings relating hereto shall be brought in a federal court located within the City and State of New York; the Segregated Account and USA hereby waive the right to trial by jury and to assert counterclaims against Escrow Agent in any such proceedings; and the Segregated Account and USA waive personal service of process and consent to service of process by certified or registered mail, return receipt requested, directed to it at the address last specified for notices hereunder, and such service shall be deemed completed ten (10) calendar days after the same is so mailed.
14. Except as otherwise permitted herein, this Escrow Agreement may be modified only by a written amendment signed by all the parties hereto, and no waiver of any provision hereof shall be effective unless expressed in a writing signed by the party to be charged.

15. The rights and remedies conferred upon the parties hereto shall be cumulative, and the exercise or waiver of any such right or remedy shall not preclude or inhibit the exercise of any additional rights or remedies. The waiver of any right or remedy hereunder shall not preclude the subsequent exercise of such right or remedy.
16. Each of the parties hereto hereby represents and warrants (a) that this Escrow Agreement has been duly authorized, executed and delivered on its behalf and constitutes its legal, valid and binding obligation and (b) that the execution, delivery and performance of this Escrow Agreement by such party does not and will not violate any applicable law or regulation.
17. The invalidity, illegality or unenforceability of any provision of this Escrow Agreement shall in no way affect the validity, legality or enforceability of any other provision; and if any provision is held to be enforceable as a matter of law, the other provisions shall not be affected thereby and shall remain in full force and effect.
18. This Escrow Agreement shall constitute the entire agreement of the parties with respect to the subject matter and supersedes all prior oral or written agreements in regard thereto.
19. This Escrow Agreement shall terminate upon the distribution of all Escrow Property. The provisions of these Terms and Conditions shall survive termination of this Escrow Agreement and/or the resignation or removal of Escrow Agent.
20. Other than with respect to required filings with the Bankruptcy Court or other filings required to be made by AAC, the Segregated Account, AFG, or the United States in compliance with applicable law, no printed or other material in any language, including prospectuses, notices, reports, and promotional material which mentions "The Bank of New York Mellon" by name in connection with this Escrow Agreement or the rights, powers, or duties of the Escrow Agent under this Escrow Agreement shall be issued by any other parties hereto, or on such party's behalf, without the prior written consent of Escrow Agent.
21. The headings contained in this Escrow Agreement are for convenience of reference only and shall have no effect on the interpretation or operation hereof.
22. This Escrow Agreement may be executed by each of the parties hereto in any number of counterparts, each of which counterpart, when so executed and delivered, shall be

deemed to be an original and all such counterparts shall together constitute one and the same agreement.

23. Escrow Agent does not have any interest in the Escrowed Property deposited hereunder but is serving as escrow holder only and having only possession thereof. The Segregated Account shall pay or reimburse the Escrow Agent upon request for any transfer taxes or other taxes relating to the Escrowed Property incurred in connection herewith and shall indemnify and hold harmless the Escrow Agent any amounts that it is obligated to pay in the way of such taxes. Any payments of income from this Escrow Account shall be subject to withholding regulations then in force with respect to United States taxes. The Segregated Account will provide the Escrow Agent with appropriate W-9 forms for tax identification, number certifications, or W-8 forms for non-resident alien certifications. It is understood that the Escrow Agent shall be responsible for income reporting only with respect to income earned on investment of funds which are a part of the Escrow Property and is not responsible for any other reporting.
24. The Segregated Account agrees to indemnify and hold harmless the Escrow Agent against any and all claims, losses, damages, liabilities, judgments, costs and expenses (including reasonable attorney's fees) (collectively, "Losses") incurred or sustained by the Escrow Agent as a result of or in connection with the Escrow Agent's reliance upon and compliance with instructions or directions given by facsimile or electronic transmission, provided, however, that such losses have not arisen from the negligence or misconduct of the Escrow Agent, it being understood that the failure of the Escrow Agent to verify or confirm that the person giving the instructions or directions and who is identified on the Letter of Designation, is in fact, an Authorized Person, does not constitute negligence or misconduct.
25. Any of the obligations in this Escrow Agreement of the Segregated Account to pay fees, costs or expenses of the Escrow Agent shall constitute first priority administrative expenses of the Segregated Account under Wis. Stat. § 645.68.

[The balance of this page has been left blank intentionally and the signature page follows immediately below.]

IN WITNESS WHEREOF, each of the parties has caused this Escrow Agreement to be executed by a duly authorized officer as of the day and year first written above.

THE SEGREGATED ACCOUNT OF AMBAC ASSURANCE CORPORATION

By: _____
Name:
Title:

UNITED STATES OF AMERICA

By: _____
Name:
Title:

THE BANK OF NEW YORK MELLON, as Escrow Agent

By: _____
Name:
Title:

EXHIBIT B

**UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT**

THEODORE NICKEL,)	
)	
Plaintiff-Appellee)	
)	
v.)	No. 11-1158
)	
UNITED STATES OF AMERICA,)	
)	
Defendant-Appellant)	

UNITED STATES OF AMERICA,)	
)	
Plaintiff-Appellant)	
)	
v.)	
)	
WISCONSIN STATE CIRCUIT COURT)	
FOR DANE COUNTY;)	No. 11-1419
THEODORE NICKEL, Commissioner of)	
Insurance of the State of Wisconsin,)	
as Rehabilitator of the Segregated)	
Account of Ambac Assurance Corporation;)	
AMBAC ASSURANCE CORPORATION,)	
)	
Defendants-Appellees)	

JOINT STATUS REPORT

Upon the filing of the United States' reply brief, the Court calendared the above-captioned, consolidated appeals for oral argument ("these Appeals"). Because of progress in ongoing negotiations directed

towards a settlement that would include these Appeals, the Office of the Wisconsin Commissioner of Insurance and the Commissioner of Insurance, Theodore Nickel, appellees herein, filed a motion with the Court on January 30, 2012, requesting the postponement of oral argument. The other active appellee, Ambac Assurance Corporation (Ambac), and the appellant, the United States, supported the requested postponement. By order dated January 31, 2012, this Court granted the motion for postponement and directed the parties to file a status report by March 5, 2012. This Joint Status Report is submitted pursuant to that order.

1. After Ambac, a Wisconsin-domiciled insurance company, experienced financial difficulty, the Wisconsin Commissioner of Insurance commenced a Wisconsin state court rehabilitation proceeding as to Ambac's Segregated Account, Dane County, Wisconsin Case No. 10-CV-1576 (the "Rehabilitation Proceeding"), and Ambac's corporate parent company, Ambac Financial Group, Inc. ("AFGI"), filed a voluntary petition for Chapter 11 bankruptcy relief in the United States Bankruptcy Court for the Southern District of New York, Case No. 10-15973. A bankruptcy court adversary proceeding was

commenced by AFGI against the United States, Adv. Proc. No. 10-4210 (Bankr. S.D.N.Y., commenced November 9, 2010) in regard to the claims of the United States pertaining to tentative federal tax refunds of approximately \$708 million obtained by the Ambac consolidated tax group. Other litigation involving the United States related to those tax refunds, and procedural and jurisdictional issues related thereto, arose. That additional litigation consists of the two actions in the United States District Court for the Western District of Wisconsin, which are the subject of these Appeals, and an appeal by the United States from the Rehabilitation Proceeding that presently is pending in the Wisconsin Supreme Court, captioned as Appeal No. 2011AP987.

2. On February 24, 2012, counsel for AFGI and Ambac; counsel for the segregated account, its rehabilitator, and the Wisconsin Insurance Commissioner; and counsel for the official creditors committee in the Bankruptcy Court submitted to counsel for the United States a formal written settlement offer (the "Offer"). This formal settlement offer followed months of negotiations between counsel for the parties, including mediation with a retired federal judge pursuant an order issued by the New York bankruptcy court.

3. That Offer, if accepted by the United States and thereafter consummated, would result, among other things, in the dismissal of these Appeals. As stated in the above-noted motion to postpone oral argument, however, “[a]ny agreement about settlement requires the United States to engage in a time-consuming, multi-level evaluation and approval process. Additionally, the Commissioner will need to obtain formal approval from the Wisconsin rehabilitation court, and AFGI to obtain formal approval from the New York bankruptcy court.” The Offer is also conditioned upon these Appeals not being decided while the Offer remains outstanding.

4. Because the settlement Offer has only recently been submitted, the United States is just beginning its formal evaluation process, and the above-noted approvals of the Bankruptcy Court and of the Wisconsin Circuit Court have not yet been obtained by AFGI and the Rehabilitator, but those processes are expected to proceed as contemplated by the parties.

5. The parties respectfully submit that the Court should continue to hold these Appeals in abeyance through not rescheduling oral argument, with the parties filing further status reports at intervals

directed by the Court. The parties suggest that the intervals for future reports be set at approximately 90 days. Separate and apart from any court-specified status report, the parties will promptly advise the Court if there is a material change—positive or negative—in their settlement efforts pursuant to the Offer.

6. Counsel for the other active parties to these Appeals have reviewed this report and have authorized us to file this report on their behalf and to represent that they support the request for further adjournment of oral argument as stated herein.

/s/ Anthony T. Sheehan
ANTHONY T. SHEEHAN
Attorney – Tax Division
U.S. Department of Justice
Post Office Box 502
Washington, D.C. 20044
Telephone: (202) 514-4339
Anthony.T.Sheehan@usdoj.gov
Counsel for the United States

Dated this 5th day of March, 2012

CERTIFICATE OF SERVICE

I hereby certify that on March 5, 2012, I electronically filed the foregoing joint status report with the Clerk of the Court for the United States Court of Appeals for the Seventh Circuit using the CM/ECF system. Participants in the case who are registered CM/ECF users will be served by the CM/ECF system. I further certify that a participant in the case is not a CM/ECF user. I have mailed the foregoing document by First-Class Mail, postage prepaid, to the following non-CM/ECF participant:

Peter A. Ivanick, Esquire
Dewey & LeBoeuf, LLP
1301 Avenue of the Americas
New York, NY 10019-6092

/s/ Anthony T. Sheehan

ANTHONY T. SHEEHAN

Attorney

In the Matter of the Rehabilitation of:

Case No. 10 CV 1576

Segregated Account of Ambac Assurance Corporation

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

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

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

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

Dated this ____ day of _____, 2012.

BY THE COURT:

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