

In the Matter of the Rehabilitation of:

Case No. 10 CV 1576

Segregated Account of Ambac Assurance Corporation

**MOTION TO APPROVE GLOBAL SETTLEMENT AGREEMENT
WITH THOSE LEHMAN BROTHERS ENTITIES
IN CHAPTER 11 BANKRUPTCY PROCEEDINGS**

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

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 Court approval to enter into a Global Settlement Agreement dated October 14, 2010 (the "Settlement Agreement") between the Segregated Account, other Ambac-related entities, and several Lehman Brothers entities that are currently the subject of bankruptcy proceedings pending in the United States Bankruptcy Court for the Southern District of New York. The Settlement Agreement involves mutual releases of claims by and between the Segregated Account, other Ambac entities, and various Lehman Brothers entities. The facts set forth in this motion are contained in the accompanying Affidavit of David Barranco ("Barranco Affidavit").

In support of this motion, the Rehabilitator states as follows:

1. The background facts relating to Ambac, the creation of the Segregated Account, and the rehabilitation of the Segregated Account are set forth in Findings of Fact Nos. 1-6, 19-32, 36 of this Court's May 27, 2010 Findings of Fact and Conclusions of Law (Dkt. 136), and are incorporated here by reference.

2. The parties to the Settlement Agreement include the Segregated Account, Ambac Assurance Corporation (“Ambac”), Ambac Credit Products, LLC (“Ambac Credit Products”), Ambac Financial Services, LLC (“Ambac Financial Services”), Lehman Brothers Holdings Inc. (“Lehman Holdings”), Lehman Brothers Special Financing Inc. (“Lehman Special Financing”), and Lehman Brothers Derivative Products Inc. (“Lehman Derivative Products”). A complete list of the parties to the Settlement Agreement is included in the Barranco Affidavit. Hereafter, the Ambac-related entities that are parties to the Settlement Agreement shall be referred to as the “Ambac Parties” and the Lehman Brothers-related entities that are parties to the Settlement Agreement shall be referred to as the “Lehman Parties.”

3. Beginning on September 15, 2008, the Lehman Parties filed petitions for relief under chapter 11 of the United States Bankruptcy Code. Those cases are being jointly administered by the United States Bankruptcy Court for the Southern District of New York (the “Bankruptcy Court”) as Case No. 08-13555 (JMP).

4. Under the Settlement Agreement, the Lehman Parties and the Ambac Parties grant each other and their affiliates general releases of all present and future legal claims arising from transactions, actions, or omissions occurring on or before the effective date. The Settlement Agreement also contains provisions designed to preserve the rights of the Segregated Account and the other Ambac Parties to pursue related claims against third parties that are not Lehman Parties.

5. Although the releases are general, each side has certain known legal claims that would be released by the Settlement Agreement. The claims released by the Lehman Parties are known as the “Belle Haven CDS Claim,” the “FIP CDS Claim,” the “CDS Set-Off Claim,” and the “Premium Clawback Claim.” The claims released by the Ambac Parties are known as the

“RMBS Claims” and the “CAPCO Subrogation Claim.” Those specific released claims are described below.

A. The Lehman Parties’ Released Claims

1) Belle Haven CDS Claim

6. With respect to the Belle Haven CDS Claim, the Lehman Parties are releasing a purported claim for approximately \$160 million. The Belle Haven CDS Claim relates to a credit default swap transaction that Ambac insured. In May 2006, Lehman Special Financing and Ambac Credit Products entered into a credit default swap agreement in which Lehman Special Financing bought protection from Ambac Credit Products against the risk of default on certain securities. Ambac issued a financial guaranty insurance policy guaranteeing Ambac Credit Products’ obligations under the agreement. That policy (No. SF0812BE) is allocated to the Segregated Account.

7. In September 2008, Ambac Credit Products terminated the Belle Haven CDS Agreement as a result of Lehman Holdings filing for bankruptcy protection. Ambac Credit Products believes that the termination was proper under the terms of the CDS Agreement. The Lehman Parties, on the other hand, contend that the Ambac Parties owe approximately \$160 million in damages.

2) FIP CDS Claim

8. With respect to the FIP CDS Claim, the Lehman Parties are releasing a purported claim for approximately \$15 million. The FIP CDS Claim arises from an August 2006 credit default swap agreement between Lehman Special Financing and Ambac Credit Products relating to a commercial mortgage-backed securities transaction involving an Italian entity named Fondo Immobili Pubblici (“FIP”). Ambac issued a financial guaranty insurance policy to guarantee

Ambac Credit Products' obligations under the agreement. That policy (No. SF0835BE) is allocated to the Segregated Account. The Lehman Parties contend that they have the right to terminate the FIP CDS Agreement and that, if they do terminate, they are entitled to a \$15 million payment from the Ambac Parties. The Ambac Parties contest both the Lehman Parties' right to terminate and the amount of the claimed payment.

3) CDS Set-Off Claim

9. With respect to the CDS Set-Off Claim, the Lehman Parties are releasing a claim for approximately \$100,000. The CDS Set-Off Claim relates to a financial guaranty insurance policy guaranteeing Ambac Financial Services' obligations in a September 2003 master swap agreement ("AFS Swap Agreement") with Lehman Special Financing. The policy (No. SWLP0189BE) is allocated to the Segregated Account.

10. In September 2008, Ambac Financial Services terminated the AFS Swap Agreement because Lehman Special Financing filed for bankruptcy. In December 2008, Lehman Special Financing owed Ambac premium for the FIP and Belle Haven transactions described above. Ambac Financial Services set off approximately \$100,000 of the unpaid premium against amounts Ambac Financial Services owed Lehman Special Financing as a result of the termination of the AFS Swap Agreement. The Ambac Parties contend that the set-off is permissible under the AFS Swap Agreement. The Lehman Parties contend that the set-off is unenforceable.

4) Premium Clawback Claim

11. With respect to the Premium Clawback Claim, the Lehman Parties are releasing a claim for approximately \$300,000. The Premium Clawback Claim relates to a financial guaranty insurance policy that Ambac issued with respect to certain obligations of Lehman Derivative

Products, but which was later terminated. In July 2008, Lehman Derivative Products made two premium payments totaling approximately \$300,000. Lehman Derivative Products subsequently filed for bankruptcy. The Lehman Parties now contend that those premium payments were impermissible preferences and must be returned. The Ambac Parties dispute that claim.

B. The Ambac Parties' Released Claims

1) RMBS Claims

12. With respect to the RMBS Claims, the Ambac Parties are releasing claims for which they estimate they would ultimately recover less than \$35 million to \$52.5 million. On September 21 and 22, 2009, Ambac filed a total of 60 proofs of claim against various Lehman Parties in the Bankruptcy Court. Many of those proofs of claim are duplicative, because Ambac was required to file separate proofs of claim against multiple Lehman Brothers entities in order to fully protect its rights. The proofs of claim relate to claims the Ambac Parties have against the Lehman Parties for, among other things, alleged breach of contract in connection with financial guaranty insurance policies that Ambac issued for various residential mortgage-backed securities ("RMBS") transactions. All of the policies are allocated to the Segregated Account. A list of the relevant policies is attached as an exhibit to the Barranco Affidavit.

13. The Segregated Account's current incurred and expected losses on the Lehman Parties' RMBS policies are approximately \$350 million. The Segregated Account currently estimates that, if the Ambac Parties prevailed on all of their claims, that resultant total claim would be treated as an allowed unsecured claim in the Lehman bankruptcies and that the Ambac Parties would recover only approximately 10% to 15% of that total pursuant to projected chapter 11 reorganization plans. As a result, the Segregated Account estimates that it would recover less

than \$35 million to \$52.5 million if it is successful on all of its proofs of claim. If it prevailed on only a portion of those claims, the recovery would be less.

2) **CAPCO Subrogation Claim**

14. With respect to the CAPCO Subrogation Claim, the Ambac Parties are releasing a contingent subrogation claim of indeterminate value. The CAPCO Subrogation Claim relates to a reinsurance agreement between Ambac and Customer Asset Protection Company (“CAPCO”) providing approximately \$137 million of reinsurance coverage. The reinsurance agreement is allocated to the Segregated Account.

15. None of the Lehman Parties are parties to the reinsurance agreement. Any claim the Ambac Parties might have against the Lehman Parties would be as a subrogee to CAPCO’s direct claims against the Lehman Parties.

16. To date, Ambac has not suffered any losses under the reinsurance agreement. No claims have been submitted against CAPCO for which CAPCO may seek reinsurance payments from Ambac or the Segregated Account. However, in order to protect its interests, Ambac filed a proof of claim against certain of the Lehman Parties in the Bankruptcy Court. CAPCO has also filed a proof of claim in the Bankruptcy Court and appears willing to pursue its claims against the Lehman Parties.

Conclusion

17. The Rehabilitator believes that the Settlement Agreement is in the best interest of the Segregated Account. The Settlement Agreement eliminates the possibility of significant damage awards against the Segregated Account, while releasing claims for which the chance of receiving a meaningful recovery is uncertain. Prosecuting and defending the claims that are being released would cost the Segregated Account and Ambac millions of dollars in attorney


fees. The claims are factually and legally complicated, and the fact that the Lehman Parties are in bankruptcy adds another layer of procedural complexity and expense to any litigation. In addition, while the value of legal claims must always be discounted due to the risk of losing on the merits, the value of the claims against the Lehman Parties must be further reduced due to the likelihood that the Bankruptcy Court would require the Segregated Account to accept pennies on the dollar under reorganization plans for any damages it was awarded. Finally, the Settlement Agreement preserves the Segregated Account's right to pursue related legal claims against third parties who are not in bankruptcy like the Lehman Brothers entities and, thus, may be more capable of paying a judgment.

WHEREFORE, the Rehabilitator respectfully requests that the Court grant the Rehabilitator's Motion to Approve Global Settlement Agreement With Those Lehman Brothers Entities in Chapter 11 Bankruptcy Proceedings. A proposed order is attached.

Dated this 19th day of October, 2010.

FOLEY & LARDNER LLP

By:


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

In the Matter of the Rehabilitation of:

Case No. 10 CV 1576

Segregated Account of Ambac Assurance Corporation

**NOTICE OF MOTION TO APPROVE GLOBAL SETTLEMENT
AGREEMENT WITH THOSE LEHMAN BROTHERS ENTITIES
IN CHAPTER 11 BANKRUPTCY PROCEEDINGS**

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

TO: All Parties-in-Interest

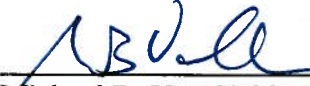
PLEASE TAKE NOTICE that the Commissioner of Insurance of the State of Wisconsin, as Rehabilitator of the Segregated Account of Ambac Assurance Corporation ("Rehabilitator"), has scheduled a hearing on Friday, November 5, 2010, at 10 a.m. before Judge William D. Johnston at the Lafayette County Courthouse, 626 Main Street, Darlington, Wisconsin, at which time the Rehabilitator will ask the Court to approve a Global Settlement Agreement With Those Lehman Brothers Entities in Chapter 11 Bankruptcy Proceedings, as detailed more fully in the Rehabilitator's accompanying Motion requesting such approval.

PLEASE TAKE FURTHER NOTICE that if no objections to the Motion are received on or before Wednesday, November 3, 2010, the Rehabilitator will request that the hearing be cancelled and that the Court enter the Order approving the settlement that is filed with the Motion.

Dated this 19th day of October, 2010.

FOLEY & LARDNER LLP

By:



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

In the Matter of the Rehabilitation of:

Case No. 10 CV 1576

Segregated Account of Ambac Assurance Corporation

AFFIDAVIT OF DAVID BARRANCO

STATE OF NEW YORK)
) ss.
COUNTY OF NEW YORK)

David Barranco, being first duly sworn on oath deposes and states as follows:

1. I am employed as a Managing Director of Ambac Assurance Corporation (“Ambac”), where I have worked for more than eleven years. I currently serve as the head of Ambac’s restructuring and commutations group. Prior to that, and among other things, I was responsible for managing Ambac’s surveillance of, and risk management for, residential mortgage-backed securities. I am one of three Ambac managing directors who meet weekly with OCI’s Deputy Commissioner, Kimberly Shaul, and OCI’s Director of the Bureau of Financial Analysis and Examinations, Roger Peterson, to report on Ambac’s provision of management services for the Segregated Account, pursuant to the Management Services Agreement between the Segregated Account and Ambac. My reports to OCI at those meetings have included discussions and analyses of the issues addressed in the Global Settlement Agreement with Lehman Brothers entities that is currently before the Court. The statements in this affidavit are based on my personal knowledge and a review of the business records of Ambac.

2. On October 14, 2010, Ambac Assurance Corporation (“Ambac”), the Segregated Account of Ambac Assurance Corporation (the “Segregated Account”), and Ambac Credit Products, LLC (Ambac Credit Products”), and Ambac Financial Services, LLC (“Ambac Financial Services”), entered into a Global Settlement Agreement (“Settlement Agreement”) with Lehman Brothers Holdings Inc. (“Lehman Holdings”), Lehman Brothers Special Financing Inc. (“Lehman Special Financing”), and Lehman Brothers Derivative Products Inc. (“Lehman Derivative Products”). The following other Ambac-related and Lehman Brothers-related entities are also parties to the Settlement Agreement:

Ambac-Related Parties

- Ambac Financial Group, Inc.
- Everspan Financial Guarantee Corp.
- Ambac Private Holdings, LLC
- Ambac Capital Services, LLC
- Ambac Capital Corporation
- Ambac Capital Funding, Inc.
- Ambac Investments, Inc.
- Ambac AII Corp.
- Connie Lee Holdings, Inc.

Lehman Brothers-Related Parties

- Lehman Brothers Commercial Corporation
- Lehman Brothers Commodity Services Inc.
- Lehman Brothers OTC Derivatives Inc.
- Lehman Brothers Financial Products Inc.
- Lehman Commercial Paper Inc.
- Lehman Scottish Finance L.P.

- BNC Mortgage LLC
- CES Aviation LLC
- CES Aviation V LLC
- CES Aviation IX LLC
- LB 2080 Kalakauna Owners LLC
- LB 745 LLC
- LB Preferred Somerset LLC
- LB Rose Ranch LLC
- LB Somerset LLC
- Luxembourg Residential Properties Loan Finance S.A.R.I.
- Merit LLC
- PAMI Statler Arms LLC
- Structured Asset Securities Corporation

Hereafter, the Ambac-related entities that are parties to the Settlement Agreement shall be referred to as the “Ambac Parties” and the Lehman Brothers-related entities that are parties to the Settlement Agreement shall be referred to as the “Lehman Parties”.

3. Under the Settlement Agreement, the Lehman Parties and the Ambac Parties grant each other and their affiliates general releases of all present and future legal claims arising from transactions, actions, or omissions occurring on or before the effective date. The Settlement Agreement also contains provisions designed to preserve the rights of the Segregated Account and the other Ambac Parties to pursue related claims against third parties that are not Lehman Parties. In particular, the provisions are designed to ensure that Ambac retains its right to pursue claims against third parties who were involved in residential mortgage-backed securities transactions with Lehman Brothers-related entities.

4. Although the releases are general, each side has certain known legal claims that would be released by the Settlement Agreement. The claims released by the Lehman Parties are known as the “Belle Haven CDS Claim,” the “FIP CDS Claim,” the “CDS Set-Off Claim,” and the “Premium Clawback Claim.” The claims released by the Ambac Parties are known as the “RMBS Claims” and the “CAPCO Subrogation Claim.”

5. **Belle Haven CDS Claim:** The Belle Haven CDS Claim relates to a credit default swap transaction that Ambac insured. In May 2006, Lehman Special Financing and Ambac Credit Products entered into a credit default swap agreement in which Lehman Special Financing bought protection from Ambac Credit Products against the risk of default on securities issued as part of the transaction identified as the Belle Haven ABS CDO 2006-1. Ambac issued a financial guaranty insurance policy guaranteeing Ambac Credit Products’ obligations under the agreement. That policy (No. SF0812BE) is allocated to the Segregated Account.

6. In September 2008, Ambac Credit Products terminated the Belle Haven CDS Agreement as a result of Lehman Holdings filing for bankruptcy protection. Ambac Credit Products believes that the termination was proper under the terms of the CDS Agreement and Ambac Credit Products does not owe the Lehman Parties any additional payments. The Lehman Parties claim that Ambac owes approximately \$160 million as a mark-to-market payment.

7. **FIP CDS Claim:** The FIP CDS Claim grows out of a August 2006 credit default swap agreement between Lehman Special Financing and Ambac Credit Products relating to a commercial mortgage-backed securities transaction involving an Italian entity named Fondo Immobili Pubblici (“FIP”). Ambac issued a financial guaranty insurance policy to guarantee Ambac Credit Products’ obligations under the agreement. That policy (No. SF0835BE) is

allocated to the Segregated Account. The Lehman Parties contend that they have the right to terminate the FIP CDS Agreement and that, if they do terminate, they are entitled to a \$15 million mark-to-market payment from the Ambac Parties. The Ambac Parties contest the Lehman Parties' right to terminate and the amount of the claimed payment.

8. **CDS Set-Off Claim:** The CDS Set-Off Claim relates to a financial guaranty insurance policy guaranteeing Ambac Financial Services' obligations in a September 2003 master swap agreement ("AFS Swap Agreement") with Lehman Special Financing. The policy (No. SWLP0189BE) is allocated to the Segregated Account. In September 2008, Ambac Financial Services terminated the AFS Swap Agreement because Lehman Holdings filed for bankruptcy. In December 2008, Lehman Special Financing owed Ambac premium for the FIP and Belle Haven transactions described above. Ambac Financial Services set off approximately \$100,000 of the unpaid premium against amounts Ambac Financial Services owed Lehman Special Financing as a result of the termination of the AFS Swap Agreement. The Ambac Parties believe the set-off is permissible under the AFS Swap Agreement. The Lehman Parties claim that the set-off is unenforceable.

9. **Premium Clawback Claim:** The Premium Clawback Claim relates to a financial guaranty insurance policy that Ambac issued with respect to certain obligations of Lehman Brothers Derivative Products. Ambac and Lehman Brothers Derivative Products later mutually terminated the policy. In July 2008, Lehman Brothers Derivative Products made two premium payments totaling approximately \$300,000. Lehman Brothers Derivative Products subsequently filed for bankruptcy. The Lehman Parties now claim that those premium payments were impermissible preferences and must be returned. The Ambac Parties dispute that claim.

10. **RMBS Claims:** On September 21 and 22, 2009, Ambac filed 60 proofs of claim against some of the Lehman Parties in the Bankruptcy Court. Many of those proofs of claim are duplicative, because for certain individual transactions Ambac was required to file separate proofs of claim against multiple Lehman Brothers entities in order to fully protect its rights. The proofs of claim relate to, among other things, alleged breaches of contract in connection with financial guaranty insurance policies that Ambac issued for various residential mortgage-backed securities (“RMBS”) transactions. All of the policies are allocated to the Segregated Account. A list of the relevant policies is attached to this affidavit as **Exhibit A**.

11. The current incurred and expected losses on the RMBS policies that are the subject of the proofs of claim are approximately \$350 million. The Ambac Parties estimate that they would recover only approximately 10% to 15% of their total losses attributable to the Lehman Parties under a chapter 11 reorganization plan. As a result, the Ambac Parties estimate that they would recover no more than \$35 million to \$52.5 million if they are successful on all of their proofs of claim. If they prevail on only a portion of those claims, the recovery would be less.

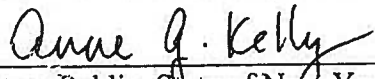
12. **CAPCO Subrogation Claim:** The CAPCO subrogation claim is a contingent claim that currently has no identifiable value. The CAPCO Subrogation Claim relates to a reinsurance agreement between Ambac and Customer Asset Protection Company (“CAPCO”) providing approximately \$137 million of reinsurance coverage. The reinsurance agreement is allocated to the Segregated Account. None of the Lehman Parties are parties to the reinsurance agreement. Any claim the Ambac Parties might have against the Lehman Parties would be as a subrogee to CAPCO’s direct claims against the Lehman Parties. To date, Ambac has not

suffered any losses under the reinsurance agreement. No claims have been submitted to CAPCO for which CAPCO can seek reinsurance payments from Ambac or the Segregated Account. However, in order to protect its interests, Ambac filed a proof of claim against certain of the Lehman Parties in the Bankruptcy Court. CAPCO has also filed a proof of claim in the Bankruptcy Court and appears willing to pursue its claims against the Lehman Parties.

Dated this 19th day of October, 2010.


David Barranco

Subscribed and sworn to before me
this 19th day of October, 2010.


Notary Public, State of New York.
My Commission: _____

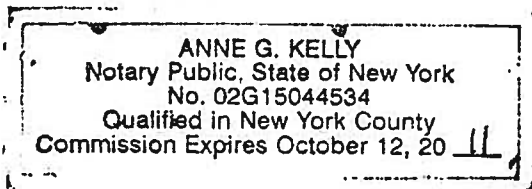


EXHIBIT A

List of Ambac Financial Guaranty Policies Related to RMBS Proofs of Claim

AB0488BE
AB0574BE
AB0734BE
AB0741BE
AB0758BE
AB0791BE
AB0808BE
AB0839BE
AB0856BE
AB0860BE
AB0861BE
AB0870BE
AB0892BE
AB0931BE
AB0947BE
AB0967BE
AB0970BE
AB1079BE
AB1081BE
AB1094BE
AB1103BE
AB1105BE
AB1113BE

In the Matter of the Rehabilitation of:

Case No. 10 CV 1576

Segregated Account of Ambac Assurance Corporation

**ORDER GRANTING THE REHABILITATOR'S MOTION
TO APPROVE GLOBAL SETTLEMENT AGREEMENT WITH THOSE LEHMAN
BROTHERS ENTITIES IN CHAPTER 11 BANKRUPTCY PROCEEDINGS**

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

This matter came before the Court on the Motion of the Commissioner of Insurance of the State of Wisconsin, as court-appointed rehabilitator of the Segregated Account of Ambac Assurance Corporation. The Court has reviewed and considered the Rehabilitators' Motion, together with the files and prior Court proceedings in this rehabilitation case, and based thereon finds and concludes that the relief sought in the Motion is supported by good cause and advances the best interest of the Segregated Account and this rehabilitation.

NOW, THEREFORE, for good cause shown, it is hereby ORDERED that the Court GRANTS the Rehabilitator's October 19, 2010 motion and approves the entry by the Rehabilitator and the Segregated Account into that certain Global Settlement Agreement dated October 14, 2010 between Ambac Assurance Corporation, the Segregated Account, Ambac Credit Products, LLC, Ambac Financial Services, LLC, Lehman Brothers Holdings Inc., Lehman Brothers Special Financing Inc., Lehman Brothers Derivative Products Inc. and the other Ambac-related entities and Lehman Brothers-related entities identified in the October 19, 2010

Affidavit of David Barranco filed with the Rehabilitator's motion. The parties are hereby authorized and directed to proceed in accordance with said Release Agreement.

Dated this ____ day of October, 2010.

BY THE COURT:

The Honorable William D. Johnston, Presiding