

---

In the Matter of the Rehabilitation of:

Case No. 10 CV 1576

Segregated Account of Ambac Assurance Corporation

---

**MOTION FOR TEMPORARY SUPPLEMENTAL INJUNCTIVE RELIEF**

---

Pursuant to the authority granted under Chapter 645 of the Wisconsin Statutes, the Office of the Commissioner of Insurance (“OCI”) and the Commissioner, as Rehabilitator (the “Rehabilitator”) of the Segregated Account of Ambac Assurance Corporation (the “Segregated Account”), hereby moves the Court for immediate temporary injunctive relief in order to protect the interests of policyholders and creditors of the Segregated Account, as well as the public: Wis. Stat. §§ 645.01(4) & 645.05(1). The requested injunction would supplement the existing injunction granted by this Court on March 24, 2010.

The requested relief is limited in nature to address exposures related to the newly allocated disputed contingent liabilities specified in Amendment No. 1 to the Plan of Operation for the Segregated Account. The grounds for this Motion are set forth below.

1. As detailed in the attached affidavit of the Rehabilitator, several events recently transpired that have created new threats to the financial stability of the Segregated Account and have the potential to disrupt its orderly rehabilitation. (*See* Affidavit of Sean Dilweg (“Dilweg Aff.”) ¶ 2.) Immediate action by this Court is necessary to maintain the status quo and protect Segregated Account policyholders and other claimants from potentially significant reductions in available claims-paying resources. Absent immediate injunctive relief by this Court, these reductions may materially hinder the existing Plan of Operation and the Rehabilitator’s proposed Plan of Rehabilitation for the Segregated Account. (*See id.*)

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

3. Historically, AFGI filed a consolidated federal income tax return on behalf of itself and all of its subsidiaries, including AAC. (*See id.* ¶ 4.) The Tax Sharing Agreement, including subsequent amendments to it, governs the allocation of tax payments and tax refunds between AFGI and its subsidiaries. (*See id.*)

4. On September 25, 2009, AFGI paid AAC \$253,700,000, as AAC’s share under the Tax Sharing Agreement of a federal income tax refund received by AFGI. (*See id.* ¶ 5.)

5. In February 2010, AFGI paid AAC \$443,940,722, as AAC’s share under the Tax Sharing Agreement of another federal income tax refund received by AFGI. (*See id.* ¶ 6.)

6. Those two tax refunds, totaling almost \$700 million, are a significant portion of the funds supporting the subsequently established Segregated Account through the Secured Note and the Reinsurance Agreement with AAC. (*See id.* ¶ 7.)

7. On November 1, 2010, AFGI announced in a Securities and Exchange Commission disclosure that it “intends to file for bankruptcy under Chapter 11 of the United States Bankruptcy Code by the end of the year.” (*See id.* ¶ 8, Ex. A.)

8. That same day, AFGI failed to make a debt service payment to bondholders. (*See id.* ¶ 8.) It is the Rehabilitator’s understanding that if AFGI does not cure that missed payment by November 30, 2010, AFGI’s creditors can immediately force an involuntary bankruptcy

proceeding for AFGI. (*See id.*) AFGI could also file a voluntary petition for bankruptcy relief at any time. (*See id.*)

9. An ad hoc committee of AFGI's bondholder creditors have threatened that if AFGI enters bankruptcy, they will seek to have the bankruptcy court avoid the tax refund payments to AAC as a preference or fraudulent transfer and seek to impose a constructive trust over the funds in order to prevent them from being used for the rehabilitation of the Segregated Account. (*See id.* ¶ 8.)

10. On November 3, 2010, the Rehabilitator learned that AFGI had received an "Information Document Request" from the Internal Revenue Service ("IRS") asking AFGI to describe its legal basis for claiming the income tax refunds that led to the payments described in paragraphs 4 and 5. (*See id.* ¶ 9, Ex. B.) It is the Rehabilitator's understanding that, absent the entry of an injunction by this Court to the contrary, the IRS may attempt to impose a levy on the tax refund proceeds at any time during this inquiry. (*See id.* ¶ 9.) If that were to occur, it would have severe consequences for AAC and the Segregated Account. (*See id.*)

11. On the evening of Sunday, November 7, 2010, the AAC Board of Directors voted to allocate certain liabilities relating to the two tax refund payments to the Segregated Account. (*See id.* ¶ 10.) Specifically, the Board voted to amend the Plan of Operation to add the following two provisions:

*Liabilities to Ambac Financial Group, Inc. ("AFGI").* The Company is allocating to the Segregated Account any and all liabilities (including contingent liabilities) it has or may have, now or in the future, to its shareholder, AFGI, or any successor to AFGI, in regard to, or respecting, tax refunds and/or the July 18, 1991 Tax Sharing Agreement, as amended. Any such liabilities are disputed. This allocation includes, but is not limited to, any preference claim or fraudulent conveyance claim pertaining to the above-referenced subjects brought by, or on behalf of, AFGI in any bankruptcy proceeding involving AFGI by AFGI as debtor-in-possession, or a trustee or committee appointed by a bankruptcy court to pursue any such claim in regard to AFGI, or any similar

state court action or claim pursued by, or on behalf of any receiver or creditor of AFGI.

*Liabilities to the Internal Revenue Service (“IRS”) and/or the United States Department of the Treasury (“U.S. Treasury”).* The Company is allocating to the Segregated Account: (i) any and all liabilities (including contingent liabilities) it has or may have, now or in the future, to the IRS and/or the U.S. Treasury in regard to, or in respect of, taxes imposed under the Internal Revenue Code of 1986, as amended (“Federal Taxes”), for taxable periods ending on or prior to December 31, 2009; and (ii) to the extent not described in clause (i), any and all liabilities (including contingent liabilities) the Company has or may have, now or in the future, to the IRS and/or the U.S. Treasury in regard to, or respect of, any Federal Tax refunds that were received prior to November [5], 2010 by the Company, AFGI or their affiliates. Any such liabilities are disputed.

(*See id.* ¶ 10, Ex. C.) OCI has approved that amendment. (*See id.*, Ex. D.)

12. With the present motion, the Rehabilitator seeks to supplement the March 24, 2010 Injunction Order to ensure that any disputes regarding claims of AFGI or its bankruptcy creditors or the IRS pertaining to the tax refund payments to AAC will be litigated in this proceeding, and that any remedies available for such liability will be implemented in accordance with a plan of rehabilitation proposed and approved in accordance with Wisconsin law governing the business of insurance. This injunctive relief is intended to supplement, rather than replace, the injunction entered by this Court on March 24, 2010. The terms of the injunction are set forth in the proposed order filed with this motion.

13. Wis. Stat. § 645.05(1) grants this Court broad power to issue a temporary or permanent injunction to prevent, among other things, “[t]he levying of execution against the insurer or its assets,” and “[a]ny other threatened or contemplated action that might lessen the value of the insurer’s assets or prejudice the rights of policyholders . . . or the administration of the proceeding.” Wis. Stat. § 645.05(1)(h) and (k).

14. Injunctive relief under Chapter 645 is appropriate here. Immediate entry of the temporary injunction is necessary to ensure that all legal disputes affecting the Segregated Account continue to be adjudicated by this Court, avoid a significant disruption and delay of these proceedings, prevent potential claimants such as the IRS and AFGI's creditors from circumventing the priority scheme for equitable distribution established by Wisconsin insurance law, and preserve the claims-paying resources of the Segregated Account. Permitting parties such as the IRS and AFGI's creditors to pursue their claims in other forums would prejudice the administration of these proceedings.

15. Moreover, with respect to the IRS's potential levy against the refunds received by AAC, the injunction is necessary to ensure that the federal government's claims receive the appropriate priority under Wisconsin's insurance laws. Under Chapter 645, federal government claims are behind policyholder loss claims in priority. *See Wis. Stat. § 601.68(1)(3) and (3c)*. The United States Supreme Court has made it clear that, under the McCarran-Ferguson Act, state insurance law affording priority to policyholder claims ahead of claims of the federal government reverse pre-empts federal law to the contrary. *See United States Department of Treasury v. Fabe*, 508 U.S. 491 (1993) (holding that Ohio insurance law superseded contrary federal law to the extent it prioritized policyholder and administrative claims ahead of federal claims).

16. Similarly, any judgment resulting from preference, fraudulent conveyance, or similar avoidance power claims brought by AFGI or its bankruptcy successors or creditors would be a Class VI subordinate claim under Wis. Stat. § 645.68(6). Under the McCarran-Ferguson Act, the adjudication and treatment of such claims are the proper subject of state insurance delinquency proceedings. *See Baldwin-United Corp. v. Garner*, 678 S.W.2d 754, 758 (Ark. 1984) ("If any meaning is to be given to the congressional exclusion of insurance companies

from the Bankruptcy Act and the mandate of the McCarran-Ferguson Act, it must be that the determination of rights among an insurance company's creditors must be left to state proceedings.”). *See also In re Med. Care Mgmt. Co.*, 361 B.R. 863, 872-76 (Bankr. M.D. Tenn. 2003) (applying McCarran-Ferguson in deference to state delinquency proceedings in light of “the obvious intent of the state legislature to consolidate all liquidation proceedings in one special court”); *In re Amwest Ins. Group, Inc.*, 285 B.R. 447 (Bankr. C.D. Cal. 2002) (deferring to state-court delinquency proceedings under McCarran-Ferguson because “the Department of Insurance is in the best position to control any financial shifts that may affect an insurer, and make sure that the interests of policyholders are not jeopardized” and because interpreting a tax-sharing agreement in parallel proceedings could “impair the progress of an orderly liquidation”).

17. AAC and the Segregated Account have meritorious defenses to each of the newly allocated disputed contingent liabilities. In regard to the bankruptcy preference, fraudulent conveyance, or similar avoidance power claims, the refunds were timely paid, were in strict conformance with the Tax Sharing Agreement, and resulted in AAC receiving the tax refund proceeds to which it was lawfully entitled. In regard to the IRS contingent disputed claim, it is at an early, information-gathering stage, and the Rehabilitator has been advised by AFGI and its advisors that the tax refunds were proper and the IRS inquiry ultimately will not lead to any change in AAC's entitlement to retain the refunds.

18. Given the rapidly unfolding events regarding the likely imminent AFGI bankruptcy filing and the IRS's review of the tax refunds received by AFGI and allocated to AAC, the Rehabilitator has asked that the Court issue the injunction on an emergency, *ex parte* basis. If the injunction is granted, the Commissioner will promptly serve copies of the order on AFGI, the IRS, and any other party-in-interest the Rehabilitator believes is directly affected by the order. The Rehabilitator proposes that parties-in-interest who believe any portion of the


injunction is unwarranted by the facts or the law be permitted to file written motions seeking modification or dissolution of the injunction within 45 days of its entry.

19. For all of the reasons set forth above, the Commissioner respectfully requests that this Court grant this Motion for Temporary Supplemental Injunctive Relief.

Dated this 8th day of November, 2010.

FOLEY & LARDNER LLP

By



Michael B. Van Sickle, SBN 1017827

Jeffrey A. Simmons, SBN 1031984

Matthew R. Lynch, SBN 1066370

150 East Gilman Street  
Post Office Box 1497  
Madison, Wisconsin 53701  
Telephone: (608) 257-5035  
Facsimile: (608) 258-4258

*Attorneys for Petitioner Sean Dilweg,  
Commissioner of Insurance of the State of  
Wisconsin*