

UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF WISCONSIN

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

**AMBAC ASSURANCE CORPORATION'S MEMORANDUM OF
LAW IN OPPOSITION TO THE IRS'
MOTION FOR A PRELIMINARY INJUNCTION**

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Ambac Assurance Corporation (“Ambac”) submits this memorandum of law in opposition to the motion for a preliminary injunction and for an expedited ruling (the “Motion”) filed by the United States of America (the “IRS”) on February 9, 2011.¹

PRELIMINARY STATEMENT

Just one month ago, this Court decided that it lacked subject matter jurisdiction to grant the very same relief that the IRS seeks in its Motion -- to dissolve an injunction entered by the Circuit Court for Dane County (the “Rehabilitation Court”). More specifically, in the January 14, 2011 Opinion and Order issued in Action No. 10-cv-778-bbc (the “Remand Order”), this Court found that the McCarran-Ferguson Act precluded the exercise of federal jurisdiction to interfere with a pending state court proceeding (the “Rehabilitation Proceeding”) to rehabilitate a segregated account of Ambac (the “Segregated Account”), which was formed pursuant to Wis. Stat. §611.24(2). Alternatively, the Court found that the principles set forth in *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943), would have supported abstention.

Despite the Court’s thorough analysis and clear ruling on subject matter jurisdiction and abstention, the IRS has filed the instant case in which it seeks a second bite at the federal judicial apple. But there is no reason to reach a different result here, where the IRS has repackaged the same application for relief in the form of a newly-filed action, as opposed to a removal petition. The Motion should be denied and this action should summarily be dismissed for lack of subject matter jurisdiction for the very same reasons stated by the Court in the Remand Order. Alternatively, this Court should abstain

¹ Ambac joins the opposition to the Motion filed by the Wisconsin Commissioner of Insurance (the “Commissioner”). Although Ambac has been named as a defendant in this action, and therefore has the right to be heard on this Motion, it notes that neither the complaint nor the Motion seeks any specific relief from Ambac.

from exercising jurisdiction under *Burford* and *Colorado River Water Conservation District v. United States*, 424 U.S. 800 (1976). Given the lack of jurisdiction and clear basis for abstention, there is no reason to reach the merits of the IRS' Motion for a preliminary injunction, which is completely devoid of merit in any event.

The IRS has not come close to satisfying the test for a preliminary injunction. It has no chance of success on the merits, in light of the McCarran-Ferguson Act and the Supreme Court's holding in *Fabe*. Exhortations about sovereign immunity and the Anti-Injunction Act, which are misplaced, do not cure the defects in jurisdiction. There is no chance the IRS will ultimately prevail in overriding Wisconsin's carefully-crafted priority statute, as the IRS' own regulations appear to concede. Nor can the IRS demonstrate irreparable harm, or that the balance of hardships (or the public interest) tips in its favor. If the IRS has an objection with the Injunction Order, it has an effective remedy -- it can proceed (as every other claimant and creditor has done) in the Rehabilitation Court. Allowing the IRS to proceed in this Court would, on the other hand, substantially impede the rehabilitation proceedings by introducing a specter of uncertainty to the proceedings and potentially delaying consummation of the already-approved plan. It would also increase the risk of inconsistent adjudications and impose unnecessary costs on Ambac, thereby reducing the amount available to pay policyholder claims.

It is unfortunate that, having spent considerable time and money opposing the remand petition, Ambac and the Commissioner are being forced to relitigate the very same issues decided previously. It appears that the sole (and transparent) reason for this wasteful procedure is so that the IRS can obtain a ruling that, unlike the Remand Order, is facially appealable to the Seventh Circuit, yet equally untenable.

STATEMENT OF FACTS

This action is a collateral attack upon a state court insurance rehabilitation proceeding. The Court is already familiar with the Rehabilitation Proceeding, which was removed as Action No. 10-cv-778-bbc. Ambac incorporates by reference the detailed statement of facts provided in the Commissioner's opening brief in support of its motion to remand that case to state court.² Snyder Decl. Ex. 4, at 6-19. Additionally, the Court described the factual background at pages 2-7 of its Remand Order.

This Court previously determined, in its Remand Order, that the McCarran-Ferguson Act precluded the exercise of federal subject matter jurisdiction to impair the functioning of the Rehabilitation Proceeding. Because it remanded the case for lack of subject matter jurisdiction, this Court declined to decide the motion filed by the IRS to dissolve the state court Order for Temporary Supplemental Injunctive Relief, issued November 8, 2010 (the "Injunction Order"). Remand Order at 2, 21. Instead, this Court advised that the IRS may "present its challenges to the state court." *Id.* at 19-20.

Instead of doing what this Court advised, the IRS filed a notice of appeal from the Remand Order on the next business day, January 18, 2011, mischaracterizing the Remand Order as "declining to dissolve an injunction." *See* IRS Notice of Appeal (No. 11-1158) Jan. 18, 2011 at 1. On January 20, 2011, the Seventh Circuit issued an order directing the IRS to file a memorandum explaining why the appeal should not be dismissed for lack of jurisdiction in light of the rule that "an order remanding a case to state court based on a

² Recognizing that this action presents "largely the same arguments" as the IRS' removal petition, the IRS has made all briefs from that case (Action No. 10-cv-778-bbc) part of the record by appending them to the Declaration of Hilarie Snyder, filed on February 11, 2011 ("Snyder Decl."). *See* Memorandum of Law in Support of United States' Motion for Preliminary Injunction and for Expedited Ruling by February 17, 2011 ("IRS Br.") at 2.

lack of subject matter jurisdiction . . . is not reviewable on appeal.” Order (No. 11-1158) Jan. 20, 2011 at 1. The IRS filed a responsive memorandum on February 1, 2011, effectively arguing for a judicially-crafted exception to 28 U.S.C. §1447(d), which provides that remand orders for lack of subject matter jurisdiction are not “reviewable on appeal or otherwise.” *See* IRS Jurisdictional Memorandum (Action No. 11-1158) Feb. 1, 2011. The Commissioner responded to this memorandum on February 7, 2011, explaining once again why subject matter (as well as appellate) jurisdiction was lacking, to which the IRS replied on February 9, 2011. *See* Wisconsin Commissioner of Insurance’s Response to United States’ Jurisdictional Memorandum (Action No. 11-1158) Feb. 7, 2011; IRS Reply to Response to Jurisdictional Memorandum (Action No. 11-1158) Feb. 9, 2011.

On January 24, 2011, after the case was transferred back to state court, the Rehabilitation Court entered an order confirming the Plan of Rehabilitation that had been proposed by the Commissioner before removal (the “Confirmation Order”). Additionally, the Commissioner asked the Rehabilitation Court to schedule a hearing to decide the IRS’ still pending motion to dissolve the Injunction Order, which had been filed in this Court and was fully briefed, but which this Court expressly declined to decide for lack of jurisdiction. *See* Snyder Decl. Ex. 1. The Rehabilitation Court then scheduled a hearing for February 23, 2011 relating to the Commissioner’s “request for hearing on the United States Internal Revenue Service’s Motion to dissolve supplemental injunction.” *See* Second Declaration of Michael B. Van Sicklen, filed February 15, 2011 (“Van Sicklen Decl.”) ¶ 7. This was nothing more than a hearing to discuss how to proceed, rather than a hearing on the merits. *Id.* Ex. 4.

Before formal notice of the February 23 hearing had arrived in the mail, and without waiting for the Seventh Circuit to decide whether it had jurisdiction to hear the IRS' appeal from the Remand Order, the IRS filed the instant action on February 9, asking this Court a second time to dissolve the Injunction Order, which is the exact same relief the IRS previously sought in this Court. This is nothing more than a procedural maneuver on the IRS' part to bring before the Seventh Circuit both the determinations made by this Court in the Remand Order, which is otherwise unreviewable, and the motion to dissolve (rather than have the Rehabilitation Court decide it).³ Of course, if the IRS does not want the Rehabilitation Court to decide its motion to dissolve, all the IRS has to do (but has not done) is withdraw the motion.⁴

The IRS filed the instant Motion on February 9, 2011, urgently seeking to enjoin the February 23 hearing in state court, which it (incorrectly) characterized as an attempt "to keep important questions of federal law and sovereign immunity from being decided by federal courts." *See* IRS Br. at 3-5. On February 11, 2011, the Commissioner asked the state court to adjourn the February 23 hearing in light of the filing of the instant Motion. *See* Van Sicklen Decl Ex. 4. That has now occurred.

³ The IRS does not explain why it brought suit in this Court rather than seek leave to do so in the Bankruptcy Court overseeing the chapter 11 case filed by Ambac's parent, which: (i) is already addressing Ambac's tax liabilities; (ii) has jurisdiction over *both* the IRS, which pursuant to Bankruptcy Code section 106(a), has explicitly waived sovereign immunity under Bankruptcy Code section 505 (which allows the Bankruptcy Court to determine any tax, not just the debtor's tax) and the Commissioner (which has appeared in the chapter 11 proceedings); and (iii) has entered an order, pursuant to the automatic stay provisions of the Bankruptcy Code, precluding the IRS from commencing *any action* (including this action) against Ambac without five days prior notice. This suggests, once again, that by suing here, the IRS is engaging in blatant forum-shopping.

⁴ When the IRS removed to federal court and filed its motion to dissolve the Injunction Order, it had to have known that a remand was possible. As a result, it cannot be heard to argue that it never contemplated the possibility that its motion to dissolve would be decided by the state court.

In its Motion, the IRS significantly mischaracterizes the nature of the Rehabilitation Proceeding. In particular, the IRS describes the state court Injunction Order as “absolving members of a consolidated tax group from their several liability,” and “asserting exclusive state jurisdiction over these federal tax issues.” IRS Br. at 5. In fact, the liability of the consolidated tax group will be determined, not in state court, but in an adversary proceeding filed by Ambac’s parent company in the United States Bankruptcy Court for the Southern District of New York (the “Bankruptcy Court”). The Rehabilitation Proceeding will neither decide nor eliminate Ambac’s tax liability. As this Court explained in its Remand Order:

The Commissioner is not arguing that the United States cannot collect taxes from insurance companies in general or from Ambac in particular or that it can never pursue return of the refund if it determines it was improper; he argues only that under the McCarran-Ferguson Act, the United States must conform its efforts to the restrictions necessary to the effectiveness of the state’s rehabilitation proceedings.

Remand Order at 11. The IRS is simply wrong in contending otherwise.

Importantly, as of the filing of this memorandum, the IRS had not yet made a formal determination as to whether Ambac was entitled to the full amount of the tax refund it received for 2007 and 2008. Declaration of Lawrence M. Hill, dated February 14, 2011 (“Hill Decl.”) ¶ 8. That is the issue before the Bankruptcy Court. Ambac’s parent company has attempted to expedite that adversary proceeding in order to obtain a prompt decision on this issue, but the IRS is seeking a more leisurely schedule. Hill Decl. ¶ 9.

ARGUMENT

I. There Is No Federal Subject Matter Jurisdiction Because It Is Reverse-Preempted Under McCarran-Ferguson

The instant action is *déjà vu* all over again. In order to grant the relief requested by the IRS, this Court must have subject matter jurisdiction. But subject matter jurisdiction is lacking for the very same reason it was absent when the IRS removed the Rehabilitation Proceeding from state court: the McCarran-Ferguson Act reverse-preempts the exercise of federal jurisdiction to enjoin the Rehabilitation Court from performing its work. As this Court explained in its Remand Order:

In this case, Wis. Stat. ch. 645 vests jurisdiction in the state rehabilitation court over matters related to the rehabilitation of an insurer. Wis. Stat. § 645.04. The state court has authority to enjoin any action that may interfere with the proceedings or “lessen the value of the insurer’s assets or prejudice the rights of policyholders, creditors or shareholders, or the administration of the proceeding.” Wis. Stat. § 645.05. These sections of chapter 645 relate specifically to regulating the business of insurance. Application of the federal removal statutes would impair the operation of chapter 645 by depriving the state rehabilitation court of jurisdiction, disrupting the goal of a comprehensive rehabilitation structure and *interfering with the orders issued by the state court for the purpose of protecting assets payable to claimants*. In sum, the federal removal statutes would “invalidate[], impair[], or supersede[] the state laws at issue in this case.”

Remand Order at 12 (citations omitted) (emphasis added).

There is no reason to entertain the same argument, or reach a different conclusion, here, just because the IRS has filed a separate lawsuit to accomplish the same result it sought unsuccessfully through removal. Here, the IRS cites as the basis for federal subject matter jurisdiction 26 U.S.C. §7402 (authorizing injunctions) and 28 U.S.C. §§1331 (federal question), 1340 (federal tax issues) and 1345 (U.S. as plaintiff). *See* IRS Amended Complaint Feb. 11, 2011 at 3. These are all statutes of general application, however. None of them specifically relates to the business of insurance. Thus, each of

these statutes is subject to reverse-preemption under the McCarran-Ferguson Act, 15 U.S.C. §1012(b), for the exact same reasons this Court entered the Remand Order.⁵

The Wisconsin statutes authorizing the Rehabilitation Court to enter its Injunction Order were undeniably enacted for the purpose of regulating the business of insurance within the meaning of the McCarran-Ferguson Act. *See* Snyder Decl. Ex. 8 (Ambac Remand Br.), at 14-17; Snyder Decl. Ex. 4 (Commissioner Remand Br.), 29-30; Snyder Decl. Ex. 5 (Ambac Mot. to Dissolve Opp.), at 12-16; Snyder Decl. Ex. 6 (Commissioner Mot. to Dissolve Opp.), at 11-13. This Court so held in its Remand Order, and the IRS offers no reason to reach a different conclusion here. Remand Order at 12.

Finally, it is beyond debate that suing the Rehabilitation Court in order to enjoin it from enforcing its own Injunction Order would “invalidate, impair or supersede” the state statutes authorizing the Rehabilitation Court to act. Thus, the test for reverse-preemption is met. *See U.S. Dep’t of Treasury v. Fabe*, 508 U.S. 491, 501 (1993); *Munich Am. Reins. Co. v. Crawford*, 141 F.3d 585, 595 (5th Cir. 1998).

The IRS does not seriously contest these conclusions, nor could it in good faith. Its Motion for a preliminary injunction should consequently be denied for lack of subject matter jurisdiction, and its amended complaint should be dismissed, *sua sponte*.⁶

⁵ In the interest of avoiding repetition of the voluminous briefing conducted in this Court little over a month ago, Ambac incorporates by reference the arguments made in the Snyder Decl. Ex. 4 (Commissioner Remand Br.), at 26-36; Snyder Decl. Ex. 8 (Ambac Remand Br.), at 12-19; Snyder Decl. Ex. 9 (Commissioner Remand Reply Br.), at 11-15.

⁶ This Court may on its own dismiss the case for lack of jurisdiction. *See* Fed. R. Civ. P. 12(h)(3) (“If the court determines at any time that it lacks subject-matter jurisdiction, the court must dismiss the action.”); *Buchel-Ruegsegger v. Buchel*, 576 F.3d 451, 453 (7th Cir. 2009) (courts are required to evaluate their own jurisdiction and dismiss *sua sponte* if jurisdiction is lacking). To the extent the Court believes a motion to dismiss is necessary before the Court may dismiss this action, it may consider this brief such a motion under Rule 12(b)(1) of the Federal Rules of Civil Procedure.

II. In the Alternative, this Court Should Abstain from Exercising Jurisdiction

Even assuming, *arguendo*, that there is federal subject matter jurisdiction to grant an injunction, this Court should abstain from exercising it based on the equitable abstention doctrines set forth in *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943) and *Colorado River Water Conservation District v. United States*, 424 U.S. 800 (1976).⁷

Ambac incorporates by reference the prior briefing on abstention.⁸ In short, *Burford* abstention is appropriate where federal adjudication “would be disruptive of state efforts to establish a coherent policy with respect to a matter of substantial public concern.” *Int’l College of Surgeons v. City of Chicago*, 153 F.3d 356, 362 (7th Cir. 1998) (internal quotations omitted). As this Court correctly concluded in its Remand Order:

Wisconsin has a great interest in maintaining a uniform insurance rehabilitation process that provides strong protection to policyholders. To accomplish this, the state has assumed primary responsibility for regulating the insurance industry. The Wisconsin statutes contemplate that rehabilitation proceedings should be conducted almost exclusively in the state rehabilitation court, which has the authority both to enjoin actions that threaten the success of the rehabilitation and to address challenges to the structure of the rehabilitation. The statutes allow the rehabilitator to

⁷ Although the IRS does not explicitly contend in its amended complaint or Motion that Wis. Stat. §645.05 (which expressly authorized the Rehabilitation Court to issue the Injunction Order) is unconstitutional as applied to the IRS under the Supremacy Clause of the U.S. Constitution, to the extent it intends indirectly to advance such an argument by citing *In re Lewis*, 512 F. Supp. 1146 (S.D.N.Y. 1981) (*see* IRS Br. at 12), a third abstention doctrine, the so-called “*Younger*” doctrine (*see Younger v. Harris*, 401 U.S. 37 (1971)), may also be applicable. *Younger* abstention requires dismissal where, as here, there is an ongoing state court proceeding, implicating important state interests, that also provides an adequate forum in which to raise a federal constitutional challenge. *See Aims Enters. v. Muir*, 609 F. Supp. 257, 263-64 (M.D. Pa. 1985) (abstaining under *Younger* from federal court constitutional challenge of state statute at issue in ongoing state insurance insolvency proceeding); *Pennzoil Co. v. Texaco*, 481 U.S. 1, 18 (1987) (abstaining under *Younger* and explaining “proper respect for the ability of state courts to resolve federal questions presented in state-court litigation mandates that the federal court stay its hand”).

⁸ *See* Snyder Decl. Ex. 8 (Ambac Remand Br.), at 23-26; Snyder Decl. Ex. 4 (Commissioner Remand Br.), at 36-44.

segregate accounts in order to achieve greater protection for policyholders. Ultimately, claims against the segregated account will be collected in the rehabilitation court and paid according to Wisconsin's priority statute.

Federal court review of the United States' claims would be disruptive of the state's rehabilitation goals and procedures.

Remand Order at 17-18 (citations omitted).

Additionally, to the extent the IRS challenges the segregated account structure of the rehabilitation, this would require a federal court to decide "difficult questions of state law bearing on policy problems of substantial import," which is a separate basis for *Burford* abstention. *Int'l College of Surgeons*, 153 F.3d at 362 (internal quotations omitted).

Here, the state Rehabilitation Court offers a forum in which the IRS' application to dissolve the Injunction Order can be litigated. Indeed, the Rehabilitation Court was taking preliminary steps to do so by scheduling a hearing, which apparently induced the IRS to file the instant Motion. As this Court found:

The state rehabilitation court has allowed entities with an interest in the rehabilitation an ongoing right to be heard and apply for relief. In fact, the state court has heard challenges to the lawfulness of the account allocation and structure and the first-day injunction. As other claimants have done, the United States may present its challenges to the state court, argue its position on the merits, and if the result is unsatisfactory, appeal to the Wisconsin Court of Appeals.

Remand Order at 19-20.⁹ This Court also found that the Rehabilitation Court is "uniquely qualified" to hear such claims because it has "the most familiarity with the rehabilitation proceeding and the applicable state statutes." *Id.* at 20. That determination was also plainly correct.

⁹ Ambac incorporates by reference the Snyder Decl. Ex. 4 (Commissioner Remand Br.), at 21.

Now that the Rehabilitation Proceeding has been remanded to state court, there is reason to apply *Colorado River* abstention in addition to *Burford* abstention because this case presents exceptional circumstances where there are now parallel state and federal proceedings deciding substantially the same issue between the same parties.¹⁰ *See Clark v. Lacy*, 376 F.3d 682 (7th Cir. 2004). As this Court found in *Metropolitan Life Insurance Co. v. Board of Directors*, 572 F. Supp. 460 (W.D. Wis. 1983):

Whether plaintiffs' suit is essentially against the segregated account (because the obvious result of a ruling in plaintiffs' favor will be to reduce the amounts in the segregated account available for use for the payment of disability insurance claims), and thus an *in rem* proceeding, or whether the suit is viewed as an *in personam* action which interferes with the state court's *in rem* liquidation proceedings, the result is the same: this court must defer to the state court proceedings to avoid the "unseemly and disastrous conflicts" that would arise if this court were to issue rulings that reduced the funding in the account and thereby defeated that part of the state's liquidation efforts which involves the provision of continuing coverage to holders of Reliable disability insurance policies.

Id. at 471. As in *Metropolitan Life*, the "orderly administration of justice and the prevention of unseemly conflicts between courts require this court to defer to the state courts." *Id.* at 472. In short, whether viewed in terms of subject matter jurisdiction or abstention, the same result is warranted -- dismissal.

¹⁰ In *Lumen Constr., Inc. v. Brant Constr. Co.*, 780 F.2d 691, 694-95 (7th Cir. 1985), the Seventh Circuit set forth ten factors for a district court to consider when evaluating whether to abstain under *Colorado River*. *See also La Duke v. Burlington Northern R.R. Co.*, 879 F.2d 1556, 1559 (7th Cir. 1989). At least seven of those factors weigh in favor of abstention: (i) the state court has jurisdiction over certain assets; (ii) avoiding piecemeal adjudication is particularly important in this insolvency proceeding; (iii) jurisdiction was first obtained by the state court; (iv) the state court is an adequate and appropriate forum; (v) the rehabilitation proceeding has been pending for nearly eleven months, while the instant case was filed last week; (vi) this Court lacks subject matter jurisdiction, while the Rehabilitation Court plainly has jurisdiction; and (vii) the IRS' filing of this action is "vexatious or contrived" because this Court has already ruled that it lacks subject matter jurisdiction.

III. The IRS Is Not Entitled to Injunctive Relief

If the Court finds that it lacks subject matter jurisdiction, or, alternatively, that it should abstain from exercising subject matter jurisdiction, there will be no need for the Court to consider the IRS' Motion for a preliminary injunction. But, if for any reason the Court decides to consider the merits of the IRS' Motion -- despite the lack of jurisdiction and clear grounds for abstention -- the requested relief should be denied. As demonstrated below, the IRS has not come close to meeting its burden with regard to the extraordinary relief it seeks.

A. The IRS Cannot Avoid the Customary Requirements for Preliminary Injunctive Relief

The IRS denies any obligation to satisfy the traditional requirements for obtaining a preliminary injunction -- a likelihood of success on the merits, irreparable harm, balance of the harms to both parties and the public interest -- on the theory that its Motion is made "pursuant to a specific statute," namely, 26 U.S.C. §7402(a). *See* IRS Br. at 10.

The IRS' reliance on section 7402(a) is misplaced. As the Seventh Circuit explained in *Bedrossian v. Northwestern Memorial Hospital*, 409 F.3d 840, 842-43 (7th Cir. 2005), a case the IRS cites, *see* IRS Br. at 10, "unless a statute clearly mandates injunctive relief for *a particular set of circumstances*, the courts are to employ traditional equitable considerations (including irreparable harm) in deciding whether to grant such relief." *Id.* at 843 (emphasis added). Further, "countless decisions . . . have required a showing of irreparable harm under statutes that specifically provide for injunctive relief." *Id.* at 843 n.1.

Section 7402(a) *authorizes, but does not require*, injunctive relief. It provides no specific test which, if met, would require injunctive relief. To the contrary, the statute is jurisdictional in nature, granting:

such jurisdiction to make and issue in civil actions, writs and orders of injunction, and of *ne exeat republica*, orders appointing receivers, and such other orders and processes, and to render such judgments and decrees as may be necessary or appropriate for the enforcement of the internal revenue laws.

26 U.S.C. 7402(a). The statute contemplates a wide range of potential remedies, none of which is mandated.¹¹ The Seventh Circuit apparently recognized this in *United States v. Shaheen*, 445 F.2d 6, 7-10 (7th Cir. 1971) (Stevens, J.) -- a case the IRS fails to cite -- in which the court applied traditional equitable principles when reviewing an IRS request for injunctive relief under section 7402(a).¹²

Nor is the preliminary injunction the IRS seeks “necessary or appropriate for the enforcement of the internal revenue laws.” That is plainly not the case here. The IRS remains free to conduct an audit, to determine Ambac’s tax liability, and to litigate the existence and extent of any tax liability. To date, the IRS has yet to take a position on whether any additional tax is owed by Ambac and its consolidated tax group for 2007 and 2008, nor has it committed to a deadline by which it will make such a determination. *See*

¹¹ Indeed, the IRS admits as much, noting that “Section 7402 authorizes the fashioning of any appropriate remedy without enumerating the ways in which the revenue laws may be violated or their intent thwarted” *See* IRS Br. at 8.

¹² Other courts have done the same. *See, e.g., United States v. Ernst & Whinney*, 735 F.2d 1296, 1301 (11th Cir. 1984) (“In addition to factual disputes that must be resolved, the decision to issue an injunction under §7402(a) is governed by the traditional factors shaping the district court’s use of the equitable remedy.”); *United States v. Zerjav*, No. 4:08CV00207 ERW, 2009 WL 912821, at *32 (E.D. Mo. Mar. 31, 2009) (denying preliminary injunction under Section 7402); *see also United States v. Cruz*, 611 F.3d 880, 887 (11th Cir. 2010) (squarely rejecting the government’s argument that “if the statutory requirements [of 26 U.S.C. §7407] are met then a court should issue an injunction without applying traditional equitable factors” and denying government’s request for a broader injunction).

Hill Decl. ¶ 8. Finally, the liability of the consolidated tax group will be determined, not in state court, but in an adversary proceeding filed by Ambac's parent company in the Bankruptcy Court.¹³ Under these circumstances, it is difficult to understand why an "expedited" preliminary injunction is "necessary or appropriate" to a determination the Rehabilitation Court has not been asked to make, and will not be making (and is already before another federal court). As this Court explained in its Remand Order (at 11):

The Commissioner is not arguing that the United States cannot collect taxes from insurance companies in general or from Ambac in particular or that it can never pursue return of the refund if it determines it was improper; he argues only that under the McCarran-Ferguson Act, the United States must conform its efforts to the restrictions necessary to the effectiveness of the state's rehabilitation proceedings.

Under these circumstances, the IRS cannot establish that a preliminary injunction is "necessary or appropriate for the enforcement of the internal revenue laws."

B. The United States Has Not Met the Requirements for Injunctive Relief

Injunctive relief should be denied because the IRS cannot meet the four-part test applied in, *inter alia*, *Dorel Juvenile Group, Inc. v. DiMartinis*, 495 F.3d 500, 502-03 (7th Cir. 2007): a party must demonstrate a likelihood of success on the merits and "a substantial threat of immediate irreparable harm if injunctive relief [is] not granted." *Id.* at 502. If those two elements are met, a court must then weigh the balance of harms to both parties and consider the public interest. *Id.*¹⁴

¹³ The IRS has acknowledged that because Ambac and its parent (Ambac Financial Group, Inc.) are part of a consolidated tax group, an adjudication of the parent's tax liability will effectively determine Ambac's tax liability. *See Snyder Decl. Ex. 3 at 8, n.28.*

¹⁴ The Seventh Circuit has also characterized this as a five-part test, requiring a threshold showing of a likelihood of success on the merits, lack of an adequate remedy at law, and irreparable harm absent an injunction, after which a court should consider the balance of harms
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1. **The IRS Is Unlikely to Succeed on the Merits**

Stripped of its rhetoric, the IRS is asking this Court to clear the way for it to impose liens and levies on Ambac's assets, without which the Rehabilitation Plan cannot succeed. The IRS is a *potential* unsecured creditor, ranking junior to Ambac's policyholders under Wisconsin's priority statute. *See* Wis. Stat. §645.68. It is plainly attempting to improve its standing by using its array of enforcement tools to seize Ambac's assets, thereby obtaining payment ahead of policyholder. In other words, the IRS seeks to "jump the line" ahead of Ambac's other creditors, to the tune of some \$700 million, which would cause enormous disruption to the Rehabilitation Proceeding.

The Supreme Court squarely rejected a similar attempt by the Department of the Treasury, which, like the IRS here, sought to obtain payment first in violation of a state insurance priority statute. *U.S. Dep't of Treasury v. Fabe*, 508 U.S. 491 (1993). Because the Motion's very objective is prohibited by the *Fabe* decision, the IRS has no likelihood of success on the merits. Moreover, the IRS has not even determined whether any tax is owed, and thus whether the IRS even has a claim at all.

Without mentioning *Fabe*, the IRS Brief presents two primary arguments concerning its likelihood of success on the merits of this suit: (1) the Injunction Order offends its sovereign immunity (*see* IRS Br. at 11-12); and (2) the Injunction Order

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and the public interest. *See, e.g., Storck USA, L.P. v. Farley Candy Co.*, 14 F.3d 311, 313-14 (7th Cir. 1994) (denying preliminary injunctive relief). Under either formulation, the result is the same.

violates 26 U.S.C. §7421(a) (*see* IRS Br. at 12-13). These arguments have been presented before, contribute no genuinely new analysis, and are without merit.¹⁵

a. Sovereign Immunity

First, the IRS contends that the Injunction Order violates the sovereign immunity of the United States. IRS Br. at 11-12. But sovereign immunity is about being sued, and the IRS has not been sued in the Rehabilitation Proceeding, nor is it a party thereto. No one has obtained or is seeking an *in personam* judgment against the IRS, and Ambac's tax liability will not be determined in state court. Ambac incorporates its prior arguments concerning why the IRS was not a "defendant" in the Rehabilitation Proceeding.¹⁶

To the contrary, the purpose of the Injunction Order is to protect from liens and levies assets that are either directly subject to the jurisdiction of the Rehabilitation Court or that are necessary to fund the Rehabilitation Plan. *See* Remand Order at 13-14.¹⁷ The Injunction Order restricts the IRS only to the extent the IRS were to attempt to engage in self-help to improve its priority as a creditor in violation of the Rehabilitation Plan and to the detriment of other (more senior) creditors. Requiring the IRS to play by the same rules as all other creditors does not offend sovereign immunity. *See United States v.*

¹⁵ The United States cites *Storck USA* for the proposition that it "must only show that it has some likelihood of success on the merits." IRS Br. 14. This is misleading. The less likely a movant is to succeed, the greater is its burden to show that the balance of "irreparable" harms points in its favor. *Storck USA*, 14 F.3d at 314. Here, the IRS is *unlikely* to succeed on its claims for the reasons set forth above and its burden to establish the balance of irreparable harms in its favor is thus that much greater.

¹⁶ Ambac incorporates by reference Synder Decl. Ex. 5 (Ambac Mot. to Dissolve Opp.), at 20-22, as well as the Commissioner's argument that, even assuming *arguendo* that sovereign immunity was implicated by the Injunction Order, it has been waived. Wisconsin Commissioner of Insurance's Opposition to, and Request for Hearing Regarding, United States' Motion for Preliminary Injunction, filed February 15, 2011, at 33-35.

¹⁷ As this Court recognized, "[a]llowing the United States to proceed against Ambac or any of its affiliates and subsidiaries would amount to pulling out the linchpin that secures the entire enterprise." Remand Order at 14.

Bank of New York & Trust Co., 296 U.S. 463, 481 (1936) (“We cannot see that there would be impairment of any rights the United States may possess, or any sacrifice of its proper dignity as a sovereign, if it prosecuted its claim in the appropriate forum where the funds are held.”).

Indeed, it is difficult to understand how the IRS can view the Injunction Order as an affront to sovereign immunity when its own regulations impose similar restrictions. The IRS acknowledges, “Treasury Regulations prevent the IRS from levying on assets within the custody of the State Court in [the rehabilitation] proceeding.” IRS Br. at 15; *see also* Snyder Decl. Ex. 6 (Commissioner Mot. to Dissolve Opp.), at 19. While the IRS may dispute the application of this regulation to Ambac’s proceeding because of its unique segregated account structure, the fact that the IRS endures similar restrictions in nearly every other state insurance insolvency proceeding belies its sovereign immunity argument.¹⁸

The IRS cites no authority suggesting that sovereign immunity is infringed by a defensive injunction protecting assets in an insurance rehabilitation proceeding. While *Lewis* involved an insurance insolvency proceeding, that is the end of any similarities to the instant case. In *Lewis*, the state court enjoined a federal official from revoking a health insurer’s federal qualification as a health maintenance organization. The federal

¹⁸ The IRS argues that its regulation is inapplicable here because the Rehabilitation Court has not exercised *in rem* jurisdiction over the General Account. As this Court has already explained, however, “[t]echnically, the rehabilitation proceeding extends only to the segregated account to which certain of Ambac’s liabilities are allocated. In reality, it extends to the general account and to Ambac’s affiliates and subsidiaries to the extent that these entities are lenders or insurers of the segregated account. Although the segregated account is deemed to be a separate insurer for purpose of rehabilitation, it is not actually a separate corporation from Ambac. Indeed, the whole point of the rehabilitation is to rehabilitate Ambac Assurance Corporation.” Remand Order at 13.

statutes authorizing this action were viewed as specifically relating to the business of insurance, therefore falling outside of McCarran-Ferguson. *Lewis*, 512 F. Supp. at 1149. Noting that it was not truly an injunction to protect an “asset” of the insurer, the court expressed doubt “[w]hether the same would hold true if the federal official were seeking to perfect a security interest, or to protect rights as a creditor, or as an adverse claimant to some property interest” *Id.* at 1148-49. Yet that is precisely what the IRS seeks to do here. *Id.* at 1149.¹⁹

The IRS also contends that the Rehabilitation Court’s orders may be “collaterally attacked” because “no final judgment (including the exhaustion of appeals) specifically addressing the Anti-Injunction Act and sovereign immunity” has been entered. IRS Br. at 9. Although it is not clear exactly what the IRS is arguing, it appears to be claiming that it is free to attack the Injunction Order in federal court because the state court lacks “in personam” jurisdiction over it. That argument, however, misses the point. As previously explained, the Rehabilitation Court was not seeking to exercise “in personam” jurisdiction over the IRS (or any other creditor) when it entered the Injunction Order. It was simply acting to protect Ambac’s assets for the benefit of policyholders and creditors. The IRS has not cited any case (and Ambac is aware of none) in which a federal court has upheld a similar claim of sovereign immunity or under the Anti-Injunction Act by the IRS (or any other federal agency) in a federal court action seeking (as a creditor) to collaterally attack an insurance company insolvency proceeding. Nor do

¹⁹ The IRS also cites *Dugan v. Rank*, 372 U.S. 609 (1963), but it is inapposite and involved a suit to enjoin federal officials from storing or diverting water in connection with a reclamation project. The Supreme Court concluded that the suit was actually against the United States because it alleged a taking of water rights, sought to inhibit a federal public works project, and would interfere with federal contracts. *Id.* at 620-21. The Supreme Court also held that the takings claim should be brought under the Tucker Act, 28 U.S.C. §1346. *Id.* at 611.

any of the cases cited by the IRS support such a novel proposition. *United States v. United States Fidelity & Guaranty Co.*, 309 U.S. 506, 513 (1940), involved a money judgment entered against the United States *in personam*, as opposed to an injunction entered to protect assets that are the subject of an insolvency proceeding.²⁰

In short, the IRS cites no case establishing the right of the United States to collaterally attack an injunction order that protects assets in an insolvency proceeding.

b. 26 U.S.C. §7421(a)

The IRS presents the very same arguments regarding 26 U.S.C. §7421(a), the tax Anti-Injunction Act, that it made in connection with its removal of the Rehabilitation Proceeding, and the result should be no different. *See* IRS Br. at 12-13. Ambac incorporates the prior briefing of this issue. *See* Snyder Decl. Ex. 6 (Commissioner Motion to Dissolve Opp.), at 17-20; Snyder Decl. Ex. 5 (Ambac Motion to Dissolve Opp.), at 9-20. Section 7421 is a statute of general application that does not specifically relate to the business of insurance. To the extent it would require dissolution of the Injunction Order, it would plainly impair the Wisconsin statutes supporting the Injunction Order. Thus, Section 7421 is reverse-preempted under the McCarran-Ferguson Act.

²⁰ *Kalb v. Feuerstein*, 308 U.S. 433 (1940), invalidated foreclosure and eviction proceedings that were pursued despite a pending bankruptcy proceeding. If anything, this case confirms the need for an exclusive forum to determine claims in insolvency. *Id.* at 443-44. *Travelers Indemnity Co. v. Bailey*, 129 S. Ct. 2195, 2205-06, 2206 n.6 (2009), cited *United States Fidelity & Guaranty* as standing for a rare exception to the rule against collateral attack, finding that an injunction should be attacked *in the court that issued it originally*. Similarly, while *State ex rel. R.G. v. W.M.B.*, 159 Wis. 2d 662, 465 N.W.2d 221 (Ct. App. 1990), contains the language quoted by the IRS, this decision held that the court rendering judgment had jurisdiction to do so.

2. The IRS Will Not Suffer Irreparable Harm Absent an Injunction

The IRS has also failed to establish that it will suffer irreparable harm without an injunction. Irreparable harm signifies “threatened injury [that is], in some way, peculiar,” and “[m]ere injuries, however substantial, in terms of money, time and energy necessarily expended in the absence of a stay, are not enough.” *Am. Hosp. Ass’n v. Harris*, 625 F.2d 1328, 1331 (7th Cir. 1980) (internal citations and quotation marks omitted). A party seeking injunctive relief bears the burden of establishing “a substantial threat of immediate irreparable harm if injunctive relief [is] not granted.” *DiMartinis*, 495 F.3d at 502.

The IRS complains that the Injunction Order may impact its collection efforts against Ambac, but the IRS has not even determined whether any taxes are owed. Hill Decl. ¶ 8. But even if it had, this would be nothing more than a claim for money damages. The IRS does not (and could not) argue that Ambac will not have enough assets to pay a potential claim, assuming that the IRS both (a) decides that it has a claim and (b) prevails. The recently-confirmed Rehabilitation Plan and the Injunction Order are designed to ensure that Ambac has enough assets to pay claims for decades to come. Finally, the IRS complains that the Injunction Order will encourage gamesmanship, but this argument is entirely speculative.

Additionally, the Rehabilitation Court’s scheduled February 23, 2011 hearing on the motion to dissolve the Injunction Order -- the emergency said to justify the instant Motion -- has been adjourned to avoid any purported timing pressures. *See Van Sicklen Decl. Ex. 4*. For this reason as well, there is no basis to grant the extraordinary remedy of a preliminary injunction.

3. **Ambac Would Suffer Significant Harm from an Injunction**

In addressing the balance of harms between the parties, the IRS does little more than repeat its argument that the Injunction Order was unauthorized. *See* IRS Br. at 14-15. What the IRS fails to mention is that dissolution of the Injunction Order would subvert Wisconsin's priority statute by permitting the IRS to levy against up to \$708 million in derogation of the Rehabilitation Plan, unfairly prejudicing policyholders and disrupting the orderly and efficient administration of the Rehabilitation Plan. Section 645.68 of the Wisconsin Statutes reflects a strong public policy, consistent with *U.S. Department of Treasury v. Fabe* and other states' insurance insolvency statutes, that claims of policyholders should be paid before federal governmental bodies such as the IRS. It would also undermine the strong Wisconsin policy that rehabilitation proceedings are to be comprehensive and to address all issues relevant to the rehabilitation in a single forum. The IRS counters that its regulations prevent it from levying against assets "within the custody of the State Court" (*see* IRS Br. at 15), but the IRS takes the position that *no* assets are subject to the custody of the Rehabilitation Court. Allowing the IRS to pursue a separate collateral attack in federal court would also threaten to delay consummation of the already confirmed plan of rehabilitation,²¹ causing Ambac to incur additional costs in defending such claims and open the door for other creditors to bring collateral attacks against the plan.

²¹ Although the IRS never mentions it, the relief it seeks is designed to empower the IRS to impede AFG's reorganization, as well as Ambac's rehabilitation efforts, notwithstanding that the courts overseeing those efforts will provide for full payment of any tax that is due in the order of priority set forth in the Bankruptcy Code and Wisconsin's Insurance laws.

4. **The Public Interest Weighs Against Granting an Injunction**

Finally, the public interest weighs against granting a preliminary injunction. The requested relief poses a genuine risk of disrupting the orderly administration of the Rehabilitation Plan and prejudicing Ambac's policyholders, as well as violating Wisconsin policy providing for the comprehensive adjudication of rehabilitation proceedings in a single forum.

Public policy also weighs against the IRS because it makes this equitable application with unclean hands. In the adversary proceeding filed by Ambac's parent company in the Bankruptcy Court, the parties stipulated that the IRS would provide five days' notice before taking "any action that violates the state court injunction [in Ambac's rehabilitation proceeding], whether or not it's in effect." The Bankruptcy Court then entered an order to this effect. *See* Hill Decl. ¶ 2. However, the IRS provided no notice that it would file the present action, which violated the Injunction Order. AFG intends to move to enforce this order in the Bankruptcy Court. *Id.* ¶ 5. The IRS should not be rewarded for violating the order of another federal court.

CONCLUSION

For all of the foregoing reasons, the IRS' request for a preliminary injunction and for an expedited ruling should be denied.

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