UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF WISCONSIN

UNITED STATES OF AMERICA,

Plaintiff,

v. Case No. 11-cv-99

WISCONSIN STATE CIRCUIT COURT FOR DANE COUNTY; THEODORE K. NICKEL, COMMISSIONER OF INSURANCE OF THE STATE OF WISCONSIN, as Rehabilitator of the Segregated Account of Ambac Assurance Corporation; and AMBAC ASSURANCE CORPORATION,

Defendants.

WISCONSIN COMMISSIONER OF INSURANCE'S OPPOSITION TO UNITED STATES' MOTION FOR PRELIMINARY INJUNCTION

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The Wisconsin Commissioner of Insurance ("the Commissioner"), as court-appointed Rehabilitator of the Segregated Account ("the Segregated Account") of Ambac Assurance Corporation ("Ambac"), files this opposition to the United States' motion for a preliminary injunction.

PRELIMINARY STATEMENT

At the outset, the Commissioner notes that there is no need to decide the United States' motion on an expedited basis. According to the United States,

> the relief that [it]. . . urgently seeks no later than February 17, 2011, is that specified in item (3) above [*i.e.*, "enjoining the State Court from asserting jurisdiction over and purporting to decide the United States' motion to dissolve the November 8 injunction"], in order to avoid the potential confusion that may be caused if the State Court reaches the merits in the meantime [at a February 23, 2011 hearing].

(U.S. Mem. of Law in Support of Mot. for Preliminary Inj. & for Expedited Ruling (dkt. 7) ("P.I. Mem.") at 7; *see also id.* at 4-5.) To avoid any needless time pressures caused by the United States' motion, the Commissioner asked the State Rehabilitation Court on February 11, 2011 to adjourn the scheduled February 23 hearing, and the State Rehabilitation Court did so. Thus, the United States' stated reason for requesting an expedited ruling is now moot.

Nevertheless, the United States filed a "Notice" yesterday, which asserted that this Court should still consider its motion for an injunction "on an expedited basis" because "the State Court is not foreclosed from issuing a decision regarding the motion to dissolve without a hearing" and "the State Court's injunction remains in place." (Dkt. 24 ("Notice"), at 2.) However, the United States' claim of exigency is contradicted by its own actions.

- The United States waited the full thirty days after the November 8, 2010 Supplemental Injunction was entered by the State Rehabilitation Court to remove the rehabilitation proceeding to federal court, which shows that it did not believe that exigent circumstances existed. (*See* Second Declaration of Michael B. Van Sicklen ("Second Van Sicklen Decl.") Ex. 5.)

- In its December 15, 2010 motion to dissolve the Supplemental Injunction, the United States did not seek "emergency" or "expedited" relief, and agreed to an orderly briefing schedule. (Dkt. 11, 11.1)

- In its pending appeal of this Court's January 14, 2011 Opinion and Order remanding the entire rehabilitation proceeding to the State Rehabilitation Court ("Remand Order") (Second Van Sicklen Decl. Ex. 6, the United States has not sought a stay or "emergency" or "expedited" relief. (*Id.* Ex. 8 (Notice of Appeal).)

- Although this Court effectuated the remand of the rehabilitation proceeding by returning the original record and the Remand Order to the State Rehabilitation Court on January 19, 2011 (*see* Second Van Sicklen Decl. Ex. 9), the United States waited almost three weeks (until February 9) before filing this action.

- As discussed below, *infra*, at Facts § C, on November 9, 2010, the United States stipulated on the record in the New York Bankruptcy Court proceeding that the federal government would take no action in violation of the Supplemental Injunction without providing advance notice, and never sought to be relieved of its court-approved stipulation in the three months since. (*See* Second Van Sicklen Decl., Ex. 3 at 4:1-10, 11:6-12:1; and Declaration of Lawrence M. Hill ("Hill Decl.") at ¶¶ 2-5.)

None of these actions by the United States are consistent with its request for expedited relief in its February 14 Notice.

The Commissioner further submits that this Court should defer ruling on the United States' motion for a preliminary injunction pending the Seventh Circuit's decision on whether it has jurisdiction to decide the United States' appeal of this Court's Remand Order.[1] First, as the United States admits, the issues raised in Case No. 10-cv-778-bbc (now on appeal)

[1] On January 20, 2011, the Seventh Circuit issued an Order in Case No. 11-1158, requiring the United States to file a Jurisdictional Memorandum (Second Van Sicklen Decl., Ex. 11), stating why the appeal should not be dismissed for lack of jurisdiction. The briefing related to the jurisdictional issue is now complete, and is pending decision.

and this action "are largely the same arguments" and "the merits issues are largely the same." (P.I. Mem. at 2.) Therefore, having taken an appeal of this Court's Remand Order, the United States should not be permitted to pursue a collateral attack on that Remand Order at the same time it presses its appeal.

Second, one reason the United States continues to seek "expedited review" of its motion for injunctive relief is because it appears to be trying to manipulate this Court's and the Seventh Circuit's jurisdiction—*i.e.*, *not* "protect the jurisdiction of this Court and the Seventh Circuit" (Notice, at 1)—by "consolidat[ing] [any adverse ruling by this Court on its motion for preliminary injunction] with the pending appeal from the remand order[.]" (P.I. Mem. at 3.) By seeking expedited review of its motion for preliminary injunction, the United States may be in a position to seek consolidation *before* the Seventh Circuit decides the pending issue of whether the Remand Order is appealable. In other words, because remand orders based on a lack of subject matter jurisdiction are not reviewable under 28 U.S.C. § 1447(d),[2] the United States may seek to manufacture appellate jurisdiction to review the otherwise unreviewable Remand Order by consolidating it with the United States' appeal of any adverse ruling on its pending motion for preliminary injunction. Thus, this Court should defer ruling on the United States' motion until after the Seventh Circuit decides whether the Remand Order is reviewable.[3]

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[2] *See Kircher v. Putnam Funds Trust*, 547 U.S. 633, 640 (2006) (We have "relentlessly repeated that 'any remand order issued on the grounds specified in § 1447(c) [is immunized from all forms of appellate review], whether or not that order might be deemed erroneous by an appellate court.'") (alteration in original); Jan. 20, 2011 Order in *Nickel v. United States*, Case No. 11-1158 (7th Cir.) ("This court has consistently reminded litigants that an order remanding a case to state court based on a lack of subject matter jurisdiction or a defect in the removal procedure is *not* reviewable on appeal, whether or not the decision is correct.") (citations omitted).

[3] If that order *is* reviewable, then the present proceeding is barred by *res judicata*. *See Health Cost Controls of Ill., Inc. v. Washington*, 187 F.3d 703, 708 (7th Cir. 1999) (cited in Juris. Mem. at 9.)

SUMMARY OF ARGUMENT

Barely two months ago, the IRS effected a temporary injunction of the rehabilitation proceeding by removing "all issues and/or claims in this rehabilitation action that are []related to the Internal Revenue Service" to this Court (Notice of Removal, ¶ 3), an action that by law required "the State Court [to] proceed no further unless and until the case is remanded." 28 U.S.C. § 1446(d). *See also Application of Rosenthal-Block China Corp.*, 278 F.2d 713, 714 (2d Cir. 1960) ("[T]he removal statute, 28 U.S.C. § 1441, itself in substance creates an exception to the proscription of § 2283 of the Judicial Code against federal court injunctions of state court actions[.]").

One month ago, this Court remanded the case in its entirety to the State Rehabilitation Court. (*See generally* Remand Order.) As a result, the Commissioner and the State Rehabilitation Court "thereupon proceed[ed] with [the remanded] case." 28 U.S.C. § 1447(c). With prescience, this Court made clear that the United States should not file a new proceeding to challenge the Rehabilitation injunction:

> As in bankruptcy, the efficacy of a rehabilitation proceeding is dependent upon the court's ability to stay actions by creditors that will interfere with the court's ability to manage the proceeding. When a claimant is affected by the stay, the claimant challenges the effect in the bankruptcy court and if the result is unfavorable, it appeals. The claimant does not file a separate proceeding in a separate court to determine whether the stay should apply, as the United States has done in this case.

(Remand Order at 20.)

In the present action, the United States ignores this Court's above-quoted holding and seeks to enjoin the effect of this Court's prior Remand Order. This type of direct collateral attack on a court's remand order is unprecedented. Disgruntled litigants have moved to reconsider remand orders, which is impermissible. *See FDIC v. Santiago Plaza*, 598 F.2d 634,

636 (1st Cir. 1979) (per curiam) ("[O]nce a district court has decided to remand a case and has so notified the state court, the district judge is without power to take any further action.") (cited with approval in *Midlock v. Apple Vacations W., Inc.*, 406 F.3d 453, 457 (7th Cir. 2005)). They also have moved to stay remand orders, which is impermissible. *See Rosenthal-Block China Corp.*, 278 F.2d at 714 ("Grant of stay of an order of remand, whether itself within the prohibition of § 1447(d) or not, is squarely in conflict with the policy of this section."). But the Commissioner has found no precedent—and the United States points to none—where a litigant subject to a remand order has attempted to enjoin the effect of that remand through a new action. The United States' motion is functionally the same as: (1) an untimely effort to stay this Court's Remand Order pending appeal; or (2) an effort to obtain a ruling that the final sentence of 28 U.S.C. § 1447(c)—upon remand, "[t]he State court may thereupon proceed with such case"—is somehow inapplicable to this Court's Remand Order.

As discussed below, the United States' motion for preliminary injunction should be denied. *First*, the United States has no likelihood of success on the merits. Pursuant to the McCarran-Ferguson Act, the statutes the United States invokes are reverse-preempted by state insurance law or are inapplicable for other reasons. In addition, the United States' arguments based on sovereign immunity should be rejected. Neither the First-Day Injunction nor the Supplemental Injunction initiated a civil action (or "suit") against the United States. Like the thousands of other entities that have an interest in the rehabilitation proceeding, the United States is a potential claimant, not a party that is being sued. As the Supreme Court has held, the United States does not become a "defendant" in a state regulatory proceeding merely because it is required to submit its claims, if it has any, in that proceeding. *United States v. Bank of N.Y. & Trust Co.*, 296 U.S. 463, 478-81 (1936).

Second, the United States is subject to no risk of irreparable harm. The United States has not even taken a position on whether Ambac Financial Group (and the entities that comprise its consolidated tax group, including Ambac) owe additional taxes for 2007 and 2008, or whether the tax refunds were properly made. Even if the IRS decides that additional taxes are owed, it already has a federal forum (the New York Bankruptcy Court) to litigate the merits of that issue. And, given the Commissioner's control over the pool of assets designated to fund the rehabilitation, there is no risk that assets may be improperly dissipated outside the terms of the confirmed Plan. Finally, the United States' claim that it is being irreparably harmed each day by the mere existence of the Rehabilitation injunction is belied by the fact that it stipulated in open court on November 9, 2010 to comply with the injunction and never sought relief from its stipulation before filing its new lawsuit three months later. In light of these facts, the United States does not come close to showing irreparable harm.

Moreover, the alleged basis for the United States' urgency is the fact that the State Rehabilitation Court, upon re-assuming jurisdiction over the rehabilitation proceeding post-remand, scheduled a (now-adjourned) hearing related to the United States' motion to dissolve the Injunction. Without explanation, "[t]he United States maintains that its motion to dissolve filed *in this Court* assumed proper removal, and because the removal was held to be preempted and thus not available in the first place, the United States maintains that its motion to dissolve is not properly before the State Court." (P.I. Mem. at 4-5.) Regardless of what position the United States maintains, 28 U.S.C. § 1447(c) specifies that, upon remand, "[t]he State court may thereupon proceed with such case." If the United States did not want its motion to dissolve to be part of "such case," then the remedy was simple: it should have withdrawn that motion. Having failed to do that, the United States cannot complain that the Commissioner and the State

Rehabilitation Court are causing it irreparable harm by moving forward on remand. (*See* Remand Order at 19-20.)

Third, with respect to harm to others, if the Supplemental Injunction were enjoined, the IRS has made clear that, even though it does not yet have a claim (nor has it even decided whether it will pursue trying to establish one), it intends to immediately use its tax collection powers to "jump the line" and seize or place a lien on the amount of the disputed tax refund, in violation of state and federal law and to the detriment of thousands of policyholders, beneficiaries and trustees. A preliminary injunction would destroy (rather than preserve) the status quo by (1) establishing the United States as the *only* entity (or person) in the world with a known, potentially material claim against the claims-paying resources that is *not* subject to the Segregated Account rehabilitation process, and (2) obstructing the claims-paying process of the rehabilitation through the assertion of a lien or levy against the common well of resources designated by the Commissioner to fund the rehabilitation.

Fourth, the public interest would not be served by an injunction. Although the United States contends that the exercise of the IRS's tax collection powers serves the public interest, this is not a tax case; it is an insurer rehabilitation proceeding, and the dispute at issue relates to the administration and equitable distribution of claims-paying resources of a financially distressed insurer to competing claimants. As this Court previously recognized, this is not a disagreement over whether the IRS has the authority to investigate and make tax claims against an insurer, but rather a contest over *how* any IRS claim against the insurer will be administered—through the State's comprehensive framework for insurer delinquency proceedings, or through the IRS's generalized tax collection powers. Consistent with the McCarran-Ferguson Act and the Supreme Court's decision in *U.S. Dep't of the Treasury v. Fabe*,

508 U.S. 491 (1993), the public interest is best served by permitting the Commissioner and the State Rehabilitation Court to continue to oversee the rehabilitation proceeding, unencumbered by repetitive collateral attacks by the IRS.

Finally, in the alternative, based on the same reasoning set forth in the Remand Order, this Court should abstain from interfering with the specialized, ongoing state insurance regulatory scheme and stay this action pursuant to *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943), and *Colorado River Water Conservation District v. United States*, 424 U.S. 800, 814 (1976).

FACTUAL BACKGROUND

The background facts regarding the rehabilitation and the Supplemental Injunction are set out at pages 1-19 of the Commissioner's brief in support of motion to remand (Dkt. 12.1)), and at pages 2-7 and 13-14 of the Remand Order, and are incorporated by reference. This section corrects a number of the misstatements and erroneous assumptions in the United States' Memorandum, and discusses the posture of the present dispute.

A. The Supplemental Injunction

As the Commissioner previously noted, the Supplemental Injunction has the same effect and was entered for the same purpose as the generally applicable first-day injunction protecting the assets necessary to fund the rehabilitation; the Supplemental Injunction merely continues the first-day injunction and supplements it to clarify its applicability to the subsequently allocated liabilities (including the potential IRS claim). (Dkt. 12.20 ¶¶ 1-2.)

Among other mischaracterizations this Court and the State Rehabilitation Court already have rejected,[4] the United States contends that the Supplemental Injunction prevents it

[4] For example, the IRS claims that the Supplemental Injunction "also purported to allocate any federal tax liability to a segregated account that may be insufficient, [and] to absolve

(footnote continued on following page)

from "possibly even assessing" a liability as to the tax refunds. (*See, e.g.*, Am. Compl. at pages 1 (paragraph (1)) and 14 (paragraph (a)) and ¶¶ 20, 32; P.I. Mem. at 1, 5, 6.) Through these statements, the IRS is again implying that a formal assessment is nothing more than an internal determination of the amount owed, without legal consequence. However, in response to this Court's questions at the January 12, 2011 hearing regarding the IRS's first attempted removal, the same counsel of record for the United States admitted that an IRS assessment would create a lien against the assets needed to fund the rehabilitation. (*See* Second Van Sicklen Decl., Ex. 7 at 55:14-56:18; *see also id.* at 20:3-4.) As this Court noted at the hearing, "that's the point at which [the Commissioner] is really concerned, is when a lien attaches, because then any payment has to be subject to a lien" and would require the Commissioner to delay payments to claimants indefinitely while he pursues needless, direct legal action against the IRS to remove the lien on the resources from which those payments are made. (*Id.* at 56:15-17.)

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members of Ambac's consolidated tax group from their several liability for the taxes of the entire group[.]" (P.I. Mem. at 1.)

This is erroneous on several levels. First, as the State Rehabilitation Court and this Court have already held, the claims-paying resources for the Segregated Account are the same as those of Ambac, as Ambac is obligated (through the secured note and reinsurance agreement) to make cash payments and redeem notes issued by the Segregated Account; Segregated Account resources are no more "insufficient" than Ambac resources. (Remand Order at 4-5; Dkt. 20 at 29-30, ¶¶ 70-75, 52-54, ¶¶ 139-42.)

Second, the allocation does not "absolve" any tax liability. It merely defines how a claimant may access the common well of claims-paying resources for the Segregated Account as well as the General Account and its subsidiaries, and it treats the IRS no differently than *every* other actual material claimant and *all* known potential material claimants to those resources. (Remand Order at 4; Dkt. 20 at 31-33, ¶¶ 80-84.) The United States will have its opportunity to determine whether there is any tax liability and litigate the merits of that liability in the New York Bankruptcy Court. The injunction merely ensures that, if and when the liability is determined and reduced to judgment, the United States follows the same rules as every other material claimant in seeking payment from the claims-paying resources protected by the Commissioner and the State Rehabilitation Court. (Remand Order at 11.)

B. The United States' Objections Related To The Rehabilitation Proceeding

As the State Rehabilitation Court had previously indicated it would (*see* dkt. 14.1), it issued its order on confirmation of the Plan of Rehabilitation following its receipt of a certified copy of the Remand Order. The Plan confirmation order, entered January 24, 2011, confirmed the Commissioner's Plan, based on the briefs and evidence of record and the testimony of witnesses during hearings on the merits of the plan. (*See generally* dkt. 20.)

The United States contends that it "was not notified of and did not participate in the December state court hearings on the Commissioner's motion to confirm his plan." (Am. Compl. ¶ 30.) In fact, there were no December hearings in the State Rehabilitation Court; the IRS removed the rehabilitation proceeding to federal court on December 8, 2010.

To the extent the United States is referring to the five days of hearings (November 15 through 19) and one day of oral argument (November 30) that the State Rehabilitation Court held on the merits of the Plan, the United States *was* provided notice of those hearings. First, the IRS was served with advance written notice of the confirmation hearings on November 10, 2010, three days after the allocation of its potential claim to the Segregated Account, and two days after issuance of the Supplemental Injunction. (Second Van Sicklen Decl. ¶¶ 2-3 & Ex. 1.) Second, counsel for the IRS participated in a hearing in the Bankruptcy Court on November 9, 2010, at which the debtor's counsel noted the upcoming confirmation hearings. (Second Van Sicklen Decl., Ex. 3 at 6:19-21.) Third, the notice of the Supplemental Injunction that was hand-served on the IRS included a cover letter from the Commissioner inviting the recipient to call for more information regarding "this complex matter" and stating that the official court-approved Web site for the proceedings contained extensive information regarding the proceedings, including all substantive court filings and a schedule for all hearings. *(Id.* ¶ 4 & Ex. 2; Dkt. 10 at 1-2.) Counsel for the IRS did not appear at the hearings in person or telephonically, and made no

objection, procedural or substantive, to the Plan at any time prior to its confirmation on January 24, 2011.

Moreover, even after the State Rehabilitation Court on December 16, 2010 informed all parties-in-interest that it was prepared to rule on the Plan upon remand from this Court—a letter that was immediately posted on the court-approved Web site and attached as an exhibit in the first proceedings in this Court (dkt. 14.1)—the IRS expressed no concerns regarding that intent to the State Rehabilitation Court, either before or after remand. The IRS does not appear to have considered the confirmation of the Plan to create an "emergency" until it filed this action. To the extent it has objections to the Plan confirmation, it waived them by consistently refusing to avail itself of the State Rehabilitation Court's invitation to be heard.

As to the United States' objections to the Supplemental Injunction, the Commissioner requested that the State Rehabilitation Court set the United States' motion to dissolve the injunction for a hearing in light of the fact that the United States had raised those challenges in the rehabilitation proceeding it had removed to this Court. (Dkt. 11.) That motion was not ruled upon by this Court. In spite of the United States' insistence that this Court previously "refus[ed] to dissolve the injunction" (P.I. Mem. at 6), a mischaracterization it also has pressed in the Seventh Circuit,[5] the Remand Order was clear: this Court remanded the case for lack of subject-matter jurisdiction, and it expressly and repeatedly stated that the Remand Order did not reach the motion to dissolve the Supplemental Injunction. (Remand Order at 2, 8, 21.) Because that motion was not resolved and remained a part of the case on remand, the Commissioner asked the State Rehabilitation Court to schedule a hearing on it. The fact that the

[5] (*See* Second Van Sicklen Decl. Ex. 10 (IRS's 7th Circuit Docketing Statement) at 5 ("Section 1292(a)(1) gives this Court jurisdiction over the District Court's interlocutory order *refusing to dissolve or modify the state court's injunction*.") (emphasis added).)

United States was "not pressing the issue in that forum" (P.I. Mem. at 6) only underscores the need for the Commissioner's request; a litigant cannot raise a legal challenge of this magnitude to a proceeding affecting thousands, then demand that its motion linger over the case until the litigant sees fit to "press the issue." If the United States did not want the State Rehabilitation Court to "proceed with" its motion upon remand, 28 U.S.C. § 1447(c), it should have withdrawn the motion.

As this Court noted, the generally applicable injunctive relief in the rehabilitation proceeding (including the Supplemental Injunction) is "the linchpin that secures the entire enterprise" of the rehabilitation. (Remand Order at 14.) Challenges to that injunctive relief need to be decided by the only court with jurisdiction over them, so that a rehabilitation involving billions of dollars and thousands of claimants can move forward in an orderly fashion without needless uncertainty. Rather than seeking to prevent "any review of the merits of the United States' arguments" (P.I. Mem. at 4), the Commissioner's request for a hearing sought to ensure the IRS an opportunity to "argue its position on the merits and if the result is unsatisfactory, appeal to the Wisconsin Court of Appeals," just "[a]s other claimants have done." (Remand Order at 19-20.)

Any alleged "emergency" arising from this request is artificial and it was and remains reparable. The United States initiated this action on February 9, 2011 after noticing a day earlier on the Wisconsin state courts' unofficial electronic docketing system that "the State Court has set a hearing for February 23, 2011, at 1:00 p.m., *presumably* to address the Commissioner's request to have the State Court rule on the IRS's motion to dissolve" and asserts that "[n]either the State Court nor the Commissioner have given any notice, formal or informal, of this hearing to the IRS." (P.I. Mem. at 4 (emphasis added).) In fact, the State Rehabilitation

Court had not yet issued any Notice of Hearing. The Notice of Hearing was mailed to counsel on February 9, was received by the Commissioner on February 10, and was immediately scanned and emailed to counsel for all entities that have appeared in the rehabilitation proceeding, including the United States. (Second Van Sicklen Decl. ¶ 7.) Based on the written notice from the State Rehabilitation Court, it is the Commissioner's understanding that the hearing for February 23 was to be nothing more than a scheduling/status conference on the Commissioner's request to have the State Rehabilitation Court set a date to hear the United States' motion to dissolve the Supplemental Injunction. (Second Van Sicklen Decl., Ex. 4.)

To the extent this prospect caused concern for the United States, it could have responded in a number of less drastic ways than suing the Commissioner, Ambac and the State Rehabilitation Court in direct contravention of the State Court's injunction (which specifically prohibits suits against Ambac and the Commissioner).

- The United States' counsel could have attended that conference and stated its objection to having the State Rehabilitation Court schedule its motion for a decision on the merits.
- The United States could have written the State Rehabilitation Court asking to delay or adjourn the hearing.
- Upon seeing the notice of hearing on the electronic docket, it could have called the court clerk and inquired of the nature of the scheduled hearing.
- It could have called counsel for the Commissioner, either after receiving the hearing request or after seeing the hearing docketed, and asked whether the United States' timing concerns could be resolved by simply adjourning the hearing (which would have solved the problem, as demonstrated subsequently by the Commissioner).
- Most simply, if the United States did not want its motion heard by the State Rehabilitation Court following remand, it could have withdrawn it from the rehabilitation proceeding.

Counsel for the United States took none of these practical, common-sense steps. Instead, its counsel's first correspondence to the State Rehabilitation Court presiding over its

remanded motion came in the form of a preemptive federal lawsuit against it.[6] Given the United States' counsel's apparent unwillingness to take these less intrusive measures, the Commissioner stepped forward to eliminate any perceived "emergency" by asking the State Rehabilitation Court to adjourn the hearing, so as to eliminate the United States' artificial deadlines for a decision from this Court. (Second Van Sicklen Decl. ¶ 7 & Ex. 4.)

C. The Bankruptcy Court Stipulation

As noted before, the Supplemental Injunction does not prevent the IRS from conducting an investigation to determine whether it believes there is a liability and litigating the extent of any liability in a federal forum. Indeed, that litigation is presently underway in the New York Bankruptcy Court.

Of note, despite its claims of exigency here, the United States has rebuffed attempts to expedite the Bankruptcy Court litigation to *determine whether it even has a claim.* In fact, the United States recently filed an objection to the debtor's proposed case schedule (which had a dispositive motion deadline of July) and asked the court to postpone it by months. (*See generally* Hill Decl. ¶¶ 7-9.)

In addition, at the November 9, 2010 hearing before the Bankruptcy Court, counsel for the United States stipulated that the federal government would not violate the Wisconsin Supplemental Injunction without prior notice:

> [Counsel for the debtor]: So as not to hold any suspense, we do think we're very fortunate in having a stipulation with the Internal Revenue Service which would obviate a dispute in that regard in connection with the papers we filed this morning [moving for a preliminary injunction against the IRS]. Because it happened only recently, it will be oral. We will ask the Court to so order it.

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[6] Unlike the removal action, the United States Attorney for the Western District of Wisconsin has not appeared as counsel of record in this action.

> The Court: Okay.
>
> [Counsel for the debtor]: But I think we're in agreement and the United States Attorney will definitely correct me if I get anything wrong. . . .
>
> . . . What we've agreed to is that any action that violates the state court injunction, whether or not it's in effect—
>
> The Court: Okay.
>
> [Counsel for the debtor]: —requires five business days' notice to us in advance.
>
> The Court: All right. But is that—I guess my question is is that broad enough to encompass—the state court injunction broad enough by its terms to encompass any action that the IRS would take against a non-debtor subsidiary with respect to the tax refunds.
>
> [Counsel for the debtor]: Yes, Your Honor.
>
> The Court: I just want to make sure it's fully protected.
>
> [Counsel for the debtor]: Yes, Your Honor.
>
> The Court: All right.
>
> [Counsel for the United States]: *Then that's fine with the government, Your Honor.*
>
> The Court: All right?
>
> [Counsel for the debtor]: Yes, your Honor.
>
> The Court: All right. Then I will so order the record in that regard.

(Second Van Sicklen Decl., Ex. 3 at 4:1-10, 11:6-12:1 (emphasis added).) The filing of the subject lawsuit against the Commissioner, Ambac, and the State Rehabilitation Court is a direct violation of the Supplemental Injunction, yet the United States failed to give the promised notice or otherwise seek leave of the Bankruptcy Court to initiate this action. (*See* Hill Decl. ¶¶ 2-5.)

The debtor, Ambac's parent holding company, has filed a motion to enforce the stipulation in the Bankruptcy Court. (*Id.* ¶ 5.)

ARGUMENT[7]

The United States offers no persuasive reason why its motion should be granted. By suing the State Rehabilitation Court and violating the express terms of its orders and state insurance law, and by ignoring the effect of this Court's prior Remand Order while still seeking appellate review of that decision before the Seventh Circuit, the United States' present motion essentially disregards the orders or procedures of the courts that have heard, or are in the process of hearing, its grievances. Specifically, the United States' motion:

(1) disregards and asks this Court to *enjoin* the statutory effect of its Remand Order;

(2) disregards the fact that the United States already has an appeal of the Remand Order pending in the Seventh Circuit (Case No. 11-1158), in which it has raised the same arguments it now seeks to re-argue here (*see* Second Van Sicklen Decl. Ex. 11 ("Juris. Mem.") at 17-21);

(3) violates the State Rehabilitation Court injunction which prohibits suits against Ambac or the Commissioner and/or efforts to lien or levy against Ambac's assets, entered pursuant to Wis. Stat. § 645.05;

(4) disregards state insurance law prohibiting civil actions against the state or the Commissioner relating to their duties pursuant to Chapter 645, *see* Wis. Stat. § 645.08(2);

(5) disregards the fact that the United States already is litigating the merits of the disputed tax liability in the Bankruptcy Court;

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[7] In its memorandum, the United States notes that it is attaching all of the briefs filed in Case No. 3:10-cv-778-bbc "so that they may become part of the record in this action." (P.I. Mem. at 2 (Dkt. 7).) As a result, the Commissioner incorporates by reference the arguments made in his briefs filed in the prior case, and responds here to the specific arguments made in the IRS's preliminary injunction memorandum.

(6) disregards the stipulated TRO order it agreed to in the New York Bankruptcy Court on November 9, 2010 (*see* Hill Decl. at ¶¶ 2-5 and Second Van Sicklen Decl., Ex. 3 at 11-12); and

(7) disregards this Court's Remand Order and all notions of comity and federalism by continuing to challenge the State Rehabilitation Court's jurisdiction over the rehabilitation proceeding *post-remand*, including naming the State Rehabilitation Court as a party "defendant" in this action.

The United States' only asserted justification for its approach is its admitted strategy to obtain a ruling from this Court that it can appeal in the federal court system, because the Remand Order it already has appealed may be unreviewable. (*See* P.I. Mem. at 3.) Given the fact that the United States is still arguing to the Seventh Circuit that the original Remand Order *is* reviewable, the United States has no reason to flout these orders now on an "emergency" basis. (*Id.* at 5.)

Further, the alleged "emergency" is nothing more than the natural, statutory consequence of this Court's Remand Order—namely, that upon remand, the state court "proceed[s] with such case." 28 U.S.C. § 1447(c). The United States' motion to dissolve the Supplemental Injunction was raised in, but not reached by, this Court, which instead remanded the entire case to the State Rehabilitation Court and noted that, "[a]s 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 20.) The United States has not withdrawn that motion from the State Rehabilitation Court. The United States cannot expect the rehabilitation to proceed while the $708 million cloud of its motion to dissolve remains pending indefinitely. The allegation that the Commissioner's necessary request to proceed was some sort of "guise" or "desperate" attempt to "keep important questions of federal law and sovereign immunity from being decided by federal courts" (P.I. Mem. at 3-4) is baseless: the Commissioner and the State Rehabilitation Court were following

federal law governing remand, following the mandate of this Court, and meeting the practical necessity for finality on the motion the United States chose to file in the rehabilitation proceeding.

I. THE UNITED STATES' MOTION FOR A PRELIMINARY INJUNCTION SHOULD BE DENIED

As discussed below, the United States fails to satisfy *any* of the equitable requirements for injunctive relief. In its memorandum, the United States argues that injunctions pursuant to 26 U.S.C. § 7402(a) "need not comply with the traditional standards for a preliminary injunction." (P.I. Mem. at 10.) However, the only Seventh Circuit case the United States cites for this proposition says the opposite: "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." *Bedrossian v. Nw. Mem. Hosp.*, 409 F.3d 840, 843 (7th Cir. 2005).

Section 7402(a) has no such mandate; it is merely a statutory grant of jurisdiction to issue orders "as *may* be necessary or appropriate for the enforcement of the internal revenue laws," without any guidance as to what "particular set of circumstances" might render injunctive relief "necessary or appropriate." Therefore, the traditional equitable factors apply. *See United States v. Ernst & Whinney*, 735 F.2d 1296, 1301 (11th Cir. 1984) ("[T]he 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. Hollar*, 885 F. Supp. 822, 824-25 (M.D.N.C. 1995) (weighing equitable factors on request for Section 7402 injunction because "[i]njunctive relief in the federal courts, absent an express Congressional mandate to the contrary, requires irreparable injury and the inadequacy of legal remedies"). *See also Weinberger v. Romero-Barcelo*, 456

U.S. 305, 312 (1982) ("The court has repeatedly held that the basis for injunctive relief in the federal courts has always been irreparable injury and the inadequacy of legal remedies.").[8]

A. THE UNITED STATES HAS NO LIKELIHOOD OF SUCCESS ON THE MERITS

1. Pursuant To The McCarran-Ferguson Act, 26 U.S.C. § 7402 Is Reverse-Preempted By State Insurance Law

The United States bases its request for injunctive relief on 26 U.S.C. § 7402(a), which authorizes federal jurisdiction over motions of the United States seeking injunctions or other relief "as may be necessary and appropriate for the enforcement of internal revenue laws." (*See* P.I. Mem. at 2, 6.)

Under the McCarran-Ferguson Act,

> a federal statute is reverse-preempted by a state statute or law if: (1) the federal statute does not specifically relate to the business of insurance; (2) the state statute was enacted for the purpose of regulating the business of insurance; and (3) enforcing the federal statute would "invalidate, impair or supersede" the state statute.

In re Amwest Sur. Ins. Co., 245 F. Supp. 2d 1038, 1043 (D. Neb. 2002) (citing *Fabe*, 508 U.S. at 501, and *Munich Am. Reinsurance Co. v. Crawford*, 141 F.3d 585, 595 (5th Cir. 1998)). All three elements of the McCarran-Ferguson reverse preemption test are met here, and therefore Section 7402(a) is reverse-preempted by state law governing insurer delinquency proceedings.[9]

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[8] Even the two district court cases the United States cites for the proposition that the traditional equity factors need not be met nevertheless applied those factors in determining the propriety of injunctive relief. *See United States v. Colo. Mufflers Unlimited, Inc.*, No. 03-CV-1310, 2007 WL 987459, at *4 (D. Colo. Mar. 30, 2007) (stating that a showing under the equitable factors was not required for an injunction under Section 7402, but nevertheless proceeding to apply the equitable factors);*United States v. Stoll*, No. Civ C05-0262RSM, 2005 WL 1763617, at *8 (W.D. Wash. June 27, 2005) (same).

[9] Based on the McCarran-Ferguson Act, this Court also lacks subject matter jurisdiction under the federal statutes cited in the United States' Amended Complaint. The Commissioner intends to file a dispositive motion on jurisdictional grounds within the time allotted to respond to the Amended Complaint. By limiting this opposition to the specific arguments raised in
(footnote continued on following page)

a. Section 7402 does not specifically relate to the business of insurance

Section 7402 is a statute of general applicability, which provides, in relevant part:

> "The district courts . . . at the instance of the United States shall have such jurisdiction to make and issue in civil actions . . . orders of injunction . . . as may be necessary or appropriate for the enforcement of the internal revenue laws."

26 U.S.C. § 7402. Because this statute does not specifically relate to the business of insurance, the first element of the McCarran-Ferguson test is satisfied. *See Am. Deposit Corp. v. Schacht*, 84 F.3d 834, 843 (7th Cir. 1996).

b. Chapter 645, Wis. Stats., was enacted for the purpose of regulating the business of insurance

Chapter 645 regulates the business of insurance. "The broad category of laws enacted 'for the purpose of regulating the business of insurance' consists of laws that possess the 'end, intention, or aim' of adjusting, managing, or controlling the business of insurance." *Fabe*, 508 U.S. at 505. The Supreme Court in *Fabe* and other courts held that state rehabilitation and liquidation statutes regulate the business of insurance within the meaning of the McCarran-Ferguson Act. *See id.* at 508-10; *Munich Am. Reinsurance Co.*, 141 F.3d at 592-93 ("[T]he specific provisions of the statute at issue here—vesting exclusive original jurisdiction of delinquency proceedings in the Oklahoma state court and authorizing the court to enjoin any action interfering with the delinquency proceedings—are laws enacted clearly for the purpose of regulating the business of insurance."); *Amwest*, 245 F. Supp. 2d at 1044-45; *In re Advanced Cellular Systems*, 235 B.R. 713, 720-25 (Bankr. D.P.R. 1999) (law establishing exclusive forum for insurer delinquency proceedings regulates business of insurance and is therefore exempt from

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conjunction with the United States' motion for preliminary injunction, the Commissioner reserves all other jurisdictional defenses.

preemption under federal law); *Boozell v. United States*, 979 F. Supp. 670, 678 (N.D. Ill. 1997); *U.S. Fin. Corp v. Warfield*, 839 F. Supp. 684, 688-89 (D. Ariz. 1993). *See also Eden Fin. Group, Inc. v. Fid. Bankers Life Ins. Co.*, 778 F. Supp. 278, 282 (E.D. Va. 1991) (pre-*Fabe* case noting that "rehabilitation proceedings necessarily are the business of insurance" because "[a] rehabilitation proceeding modifies and monitors the operation of an insurer consistent with the interests of policyholders"); *Corcoran v. Universal Reinsurance Corp.*, 713 F. Supp. 77, 80-82 (S.D.N.Y. 1989).

As this Court noted in the Remand Order,

> 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.

(Remand Order at 12 (citations omitted).)

Given that the prioritization of administrative and policyholder loss claims ahead of federal government claims constitutes the business of insurance under *Fabe*, the state injunction statute designed to protect policyholders under that very same statutory priority structure (as well as the administration of the delinquency proceeding) also constitutes the business of insurance. *See Munich Am. Reinsurance Co.*, 141 F.3d at 593 (Injunctions in insurance delinquency proceedings "eliminate[] the risk of conflicting rulings, piecemeal litigation of claims, and *unequal treatment of claimants*, all of which are of particular interest to insurance companies and policyholders, who are often relying on policies with the same or similar provisions.") (emphasis added); *Warfield*, 839 F. Supp. at 689 (statute authorizing

injunctive relief in insurance delinquency proceeding "regulat[es] business of insurance within the meaning of the McCarran-Ferguson Act").

c. Enforcing Section 7402 would impair or supersede Chapter 645

Application of the federal statutes pertaining to the IRS collection remedies would impair or supersede the state statutes concerning rehabilitation and orders issued pursuant to those statutes. As the Supreme Court has explained, only "[w]hen federal law does not directly conflict with state regulation, *and* when application of the federal law would not frustrate any declared state policy or interfere with a State's administrative regime, [does] the McCarran-Ferguson Act . . . not preclude its application." *Humana Inc. v. Forsyth*, 525 U.S. 299, 310 (1999) (emphasis added); *Doe v. Mut. of Omaha Ins. Co.*, 179 F.3d 557, 563 (7th Cir. 1999) (McCarran-Ferguson prohibition triggered if interpretation of federal law "would interfere with a State's administrative regime"; a "[d]irect conflict with state law" is not required).

As this Court found in the Remand Order:

> 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.) Likewise, the fact that the United States asserts that Section 7402 provides a vehicle for it to enjoin the State Rehabilitation Court from enforcing the Supplemental Injunction and the Order confirming the rehabilitation plan (to the extent it implicates tax issues or the IRS) shows that the statute impairs or supersedes the state laws at issue in the case.

Because the three elements of the McCarran-Ferguson test are met in this case, the statutory basis for the United States' motion for injunctive relief, Section 7402, is reverse-preempted by the state insurance laws. (*See* Remand Order at 9-15.)

2. The Tax Anti-Injunction Act Is Inapplicable Here

The United States also cites to the tax Anti-Injunction Act ("AIA"), 26 U.S.C. § 7421, but that statute is inapplicable for a number of reasons.

At the outset, the AIA does not apply on its face. As noted in the Commissioner's brief in support of his motion to remand the proceedings (Dkt. 12.1), neither this rehabilitation proceeding nor the injunctive relief applied to the IRS (and all other potential claimants) to protect the equitable allocation of assets and the administration of the proceeding constitute a "suit" against the IRS, let alone a "suit for the purpose of restraining the assessment or collection of any tax." 26 U.S.C. § 7421(a). Further, the AIA "applies to injunctions which would be grounded on disputes over the right to tax or the amount to be assessed or collected." *Rodriguez v. United States*, 629 F. Supp. 333, 341 (N.D. Ill. 1986). As noted above, the Supplemental Injunction makes no challenge to the merits of the IRS evaluation of the tax issues, or the amount (if any) that the IRS may determine in the New York federal case to be owing. It merely addresses the *manner* of collection, so as to protect the proper priorities and the administration of the rehabilitation proceeding.[10]

[10] In addition, the AIA does not apply to the Commissioner acting in his official capacity in this non-adversarial insurance delinquency proceeding. The AIA operates to bar "any person" from bringing a "suit for the purpose of restraining the assessment or collection" of taxes. 26 U.S.C. § 7421(a). The Commissioner here is acting in his official capacity on behalf of the State of Wisconsin, and there is "a longstanding interpretive presumption that 'person' does not include the sovereign" absent "some affirmative showing of statutory intent to the contrary." *Vt. Agency of Natural Res. v. United States ex rel. Stevens*, 529 U.S. 765, 781 (2000); *Virginia ex rel. Cuccinelli v. Sebelius*, 702 F. Supp. 2d 598, 604 (E.D. Va. 2010). Given that the AIA
(footnote continued on following page)

Even if the AIA were otherwise applicable to this action, it is reverse-preempted by Wisconsin law regulating the business of insurance—namely, Wis. Stat. § 645.05, which authorizes injunctive relief to protect policyholders and the administration of the delinquency proceeding.

The three elements of the McCarran-Ferguson analysis are met. *First*, the AIA is a law of general application; it broadly bars any "suit for the purpose of restraining the assessment or collection of any tax . . . in any court by any person." 26 U.S.C. 7421(a). No part of the statute specifically relates to insurance.

Second, as noted above, Section 645.05 regulates the business of insurance within the meaning of McCarran-Ferguson.

Third, there is a direct conflict between the AIA and Section 645.05. The latter expressly permits the State Rehabilitation Court to enjoin *any* threatened or contemplated action that might prejudice policyholders or the administration of the proceeding; the AIA would supersede that statute to the extent it protected policyholders or the proceeding from threatened or contemplated actions by the United States, including threatened or contemplated action that would on its face violate the priority structure of Wisconsin insurance law—and thereby violate the McCarran-Ferguson Act as interpreted in *Fabe*. (*See* Remand Order at 10 ("[I]t does not follow that federal law in the form of the McCarran-Ferguson Act cannot override this [AIA] statute and any others insofar as they threaten to impede or impair the state's regulation of the business of insurance.").

"apparently has no recorded legislative history," *Bob Jones Univ. v. Simon*, 416 U.S. 725, 736 (1974), the IRS cannot overcome this presumption here.

Finally, even in situations where the AIA applies on its face and is not reverse-preempted by state insurance law, the Supreme Court has imposed a judicial exception to the application of the AIA when IRS action threatens irreparable injury and "it is clear that under no circumstances could the Government ultimately prevail" in the issue in dispute—here, its entitlement to avoid the state priority statute by collecting and retaining any amounts it may find to be due and owing without submitting a claim in the rehabilitation process. *Enochs v. Williams Packing & Nav. Co.*, 370 U.S. 1, 7 (1962).

For the reasons the Commissioner previously noted (*see generally* dkt. 14 at 18-19), both circumstances exist here. First, the mere threat of a prolonged deprivation of substantial claims-paying resources of a financially distressed insurer would cause irreparable injury to the rehabilitation. Second, there is no circumstance under which the IRS will ultimately prevail on the priority issue before or after a levy, in light of *Fabe* and the Wisconsin priority statute's preference of policyholder loss claims over federal government claims. The IRS's own regulations bar levies on assets subject to the control of a receivership court.[11] Simply put, there is no conceivable ground on which the IRS could seize and permanently retain claims-paying resources outside the rehabilitation proceeding without running afoul of McCarran-Ferguson and Wisconsin law governing insurer delinquency proceedings, and there is no reason why any futile, yet irreparably harmful, attempts at such unlawful action should not remain enjoined.

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[11] *See Fla. ex rel Lewis v. United States*, No. 89-6143-CIV-HOEVELER, 1989 WL 91135, at *3-*4 (S.D. Fla. June 28, 1989) (abating levy against assets under control of state receiver and subject to a plan of distribution because the IRS's levy operated to "prevent the funds in the constructive trust from being disbursed to those for whose benefit it was established" in violation of 26 C.F.R. § 301.6331-1).

3. The United States' Arguments Based On Sovereign Immunity Are Unpersuasive

As a threshold matter, the United States' complaint and motion, like its prior removal action, betray a fundamental misunderstanding of a relatively simple concept: *this is how insurance rehabilitation works*. There is a delinquent insurer. There is an automatic stay and other generally applicable injunctive relief to maintain order, preserve assets, and facilitate the payment of claims. There is a claims-paying process and a priority structure for claimants. There is an opportunity for claimants and other parties-in-interest to obtain legal review in the rehabilitation court. Despite the United States' objections to the contrary, this rehabilitation is no different than any other insurer delinquency proceeding anywhere in the country, and the injunctive relief here is fundamentally no different than the "sweeping injunction" to protect assets in *Bank of New York*, 296 U.S. at 475-79, or the protections imposed in another large insurer rehabilitation, Mutual Fire, in which the United States participated as a claimant and raised challenges in state court. *Foster v. Mut. Fire, Marine & Inland Ins. Co.*, 614 A.2d 1086, 1100-01, 1103 (Pa. 1992) (challenging subordinate priority under plan of rehabilitation, which vested exclusive jurisdiction over the rehabilitation in state court). The United States points to no case (and the Commissioner has found none) in which the federal government has ever sued to enjoin a state rehabilitation proceeding where the United States is one of many potential claimants, or even contended that generally applicable state rehabilitation injunctions are "void and unenforceable" as applied to the IRS. (P.I. Mem. at 2.)[12]

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[12] The United States cites *United States v. U.S. Fid. & Guar. Co.* ("*USF&G*"), 309 U.S. 506 (1940) for the proposition that an "order in [a] rehabilitation proceeding could be collaterally attacked as a violation of sovereign immunity unless that issue was actually raised and finally adjudicated in the first proceeding." (P.I. Mem. at 9.) In fact, *USF&G* did not involve an insurer rehabilitation proceeding protected by the McCarran-Ferguson Act, but rather the receivership of a coal company. 309 U.S. at 510-11. The federal lawsuit did not seek to enjoin that receivership

(footnote continued on following page)

a. The Supplemental Injunction is not a "suit" against the United States

As explained in prior briefing, the Commissioner has not "sued" the United States (or any other claimant) in the rehabilitation proceeding. For the reasons that follow, the government's position would require an expansive view of sovereign immunity that is inconsistent with both precedent and practice.

The commencement of the rehabilitation proceeding was not a suit against the United States, any more than it was against any of the thousands of other potential claimants. Like a voluntary petition for relief under the Bankruptcy Code, the petition for rehabilitation was not "against" any person or entity; it instead initiated a formal remedial procedure to "rehabilitate the business of a domestic insurer," Wis. Stat. § 645.32(1), and to facilitate the "[e]quitable apportionment of any unavoidable loss," *id.* § 645.01(4)(d). As the State Rehabilitation Court has noted, it is not an adversarial proceeding, but rather a structure for management of the operation of the insurer while financially hazardous conditions exist. (Dkt. 12.11 at 7-8.)

The Supplemental Injunction issued in furtherance of the rehabilitation also did not constitute a suit against the United States. In order to effectuate any insurer rehabilitation proceeding, injunctive relief against actions that could interfere with the protection and administration of the distressed insurer's assets is necessary to ensure that the rehabilitation takes place in an orderly fashion and that the state law priority rules (*i.e.*, who gets paid in what order)

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or challenge its ability to issue "defensive" orders protecting the company's assets. Instead, it involved the validity of a judgment issued on a direct cross-claim for damages following the government's assertion of a claim in that proceeding. *Id.* at 512-13. At most, *USF&G* stands for the proposition that under certain conditions the United States may collaterally attack a specific judgment for money damages; it does not authorize the United States to enjoin a supervisory court from issuing equitable, generally applicable prophylactic orders to protect the assets of a distressed state insurer.

are observed. Because insurers are not entitled to protection under federal bankruptcy law, the first-day injunction (and the subsequent Supplemental Injunction) entered in the rehabilitation proceeding are analogous to, and have the same effect as, the automatic stay that is triggered at the outset of a bankruptcy proceeding. (*See* Remand Order at 20.)

If the rehabilitation proceeding and its generally applicable injunctive relief were construed to be a suit against all potential claimants, including the United States, then sovereign immunity would operate to bar *any* state insurer rehabilitation proceeding that implicated the interests of the federal government at any time, at least to the extent that the rehabilitation sought to comprehensively administer assets and make distributions to claimants competing with the federal government. *See United States v. Rural Elec. Convenience Coop. Co.*, 922 F.2d 429, 435 (7th Cir. 1991) (noting the "troubling . . . prospect that the government and private parties aligned with it could deploy sovereign immunity . . . to federalize state proceedings" or to extinguish state rights altogether). There is no precedent to support such a result, which would render the Supreme Court's ruling in *Fabe* essentially meaningless.

Indeed, the IRS's own rules and regulations anticipate the practical necessities of large insolvency proceedings, and recognize that a levy under these circumstances would impede the orderly management of this proceeding:

> During a bankruptcy proceeding or a receivership proceeding in either a Federal or a State court, the assets of the taxpayer are in general under the control of the court in which such proceeding is pending. Taxes cannot be collected by levy upon assets in the custody of a court, whether or not such custody is incident to a bankruptcy or receivership proceeding, except where the proceeding has progressed to such a point that the levy would not interfere with the work of the court or where the court grants permission to levy.

26 C.F.R. § 301.6331-1(a)(3). *See also* Internal Revenue Manual § 5.17.13.7 (Oct. 16, 2007) ("The IRS may file a proof of claim to collect any tax liability from the assets in a judicial

insolvency proceeding. The IRS generally may not levy on assets in the custody of a court."), *available at* http://www.irs.gov/irm/part5/irm_05-017-013.html#d0e342; *id.* (listing alternatives to filing a proof of claim, none of which involve levying or asserting sovereign immunity to avoid or enjoin orders of the receivership court).

The United States' claim of an imposition on sovereign immunity here rests on two form-over-substance contentions. First, the IRS attempts to distinguish its own regulation (and the precedent discussed below) by noting that the claims-paying resources protected by the State Rehabilitation Court are not technically in its custody. This Court already has rejected this "narrow view of the rehabilitation proceeding" in light of its necessary structure and the fact that "the whole point of the rehabilitation is to rehabilitate Ambac Assurance Corporation." (Remand Order at 13-14.)

Second, the United States focuses on the fact that the Supplemental Injunction was directed specifically at a potential IRS claim. This is a matter of the circumstance of when the Commissioner was made aware of this potential claim and its risks to the rehabilitation, not the source of that claim. As the Supplemental Injunction makes clear, it merely continues the injunction applicable to all previously allocated claims and potential claims from the day the rehabilitation commenced (the "First-Day Injunction") and supplements that order to ensure its applicability to the newly allocated contingent liabilities. (Dkt. 12.20 ¶¶ 1-2.) Had the potential IRS liability been known and allocated to the Segregated Account at the time the rehabilitation proceeding commenced, the Supplemental Injunction would have been unnecessary, as the terms of the First-Day Injunction would have had the same effect on the United States as the Supplemental Injunction. Indeed, the First-Day Injunction *did* enjoin the United States, at least

to the extent that it had any interest in the policies, contracts, and liabilities allocated to the Segregated Account at that time.

That a later-discovered potential liability was subsequently allocated to the Segregated Account without judicial involvement does not transform an existing injunction that is clarified to apply to this recent allocation into a new "suit" against the United States specifically. Both the Supplemental Injunction and the First-Day Injunction are merely generalized, prophylactic injunctions to protect against "threatened or contemplated action that might 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(k).

That fact distinguishes the Supplemental Injunction from the injunction at issue in *In re Application of Lewis*, 512 F. Supp. 1146 (S.D.N.Y. 1981), the only case the United States cites to dispute the Commissioner's prior arguments on this point. (*See* P.I. Mem. at 12.) In *Lewis*, the federal court dissolved a state order that was not a generally applicable "defensive" injunction to protect assets and prevent disruption in claims administration, but rather a specific affirmative mandate requiring the Department of Health and Human Services to maintain an insurer's federal HMO qualification intact, regardless of the department's determination as to "whether continued official qualification is appropriate." *Id.* at 1148. The injunction had nothing to do with the protection of the state priority statute against subordinate federal government claims; it had nothing to do with protecting state priorities or the orderly distribution of assets at all. The *Lewis* court was careful to note that distinctive fact in accepting jurisdiction and dissolving the injunction: "Whether 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, is not at issue here." *Id.* at 1149.

Unlike *Lewis*, "where suits are brought to marshal assets, administer trusts, or liquidate estates, and in suits of a similar nature" and the Commissioner is using "a sweeping injunction" in regard to the administration of the assets, the Supreme Court has long held that the mere fact that the United States is one of a number of claimants with a potential interest in the property does not make the suit one against the United States and does not entitle the government to a federal forum for the adjudication of its particular interest. *Bank of N.Y. & Trust Co.*, 296 U.S. at 475-79. As the Supreme Court explained:

> The adverse claimants are parties to the respective proceedings in the state court and from every point of view the principles governing the convenient and orderly administration of justice require that the jurisdiction of the state court should be respected.
>
> There is no merit in the suggestion that the United States, in presenting its claim in the state proceedings, would be compelled to take the position of a defendant—being sued without its consent. In intervening for the presentation of its claim, the United States would be an actor—voluntarily asserting what it deemed to be its rights—and not a defendant. We cannot see that there would be an 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.

Id. at 480-81; *see also id.* at 478 (rejecting assertion that claims involving government were *in personam* rather than *in rem* because "the object of the [government's attempted federal claims] is to take the property from the depositaries and from the control of the state court, and to vest the property in the United States to the exclusion of all those whose claims are being adjudicated in the state proceedings"); *United States v. $79,123.49 in U.S. Cash and Currency*, 830 F.2d 94, 97 (7th Cir. 1987) (recognizing *Bank of N.Y. & Trust Co.*'s "modern-day vitality"). *See also Blackhawk Heating & Plumbing Co. v. Geeslin*, 530 F.2d 154, 158 (7th Cir. 1976) ("The appointment of a receiver and institution of liquidation proceedings in the Illinois court against [the insurer] constitutes an action *in rem*. The fact that the Illinois court does not have actual

physical possession of all of [the insurer's] assets is of no consequence. The constructive possession by [the insurer's] liquidator is sufficient; his possession is the court's possession.") (internal citations omitted).

The Commissioner has not located any precedent where a federal court held that an injunction entered in an insurance delinquency proceeding to prevent potential claimants from taking adverse collection actions—similar to the automatic stay imposed in bankruptcy court—constituted a "suit" barred by the sovereign immunity of any potential government claimants, as opposed to being a measure to ensure the orderly rehabilitation of the insurer.[13]

b. Even if sovereign immunity were implicated, the United States has waived that immunity

Even assuming *arguendo* that the Commissioner's actions in the rehabilitation proceeding were deemed to initiate a "suit" against the IRS, sovereign immunity has been waived.

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[13] To the contrary, courts have rejected IRS efforts to deploy sovereign immunity in a manner that would interfere with the order distribution of assets in the analogous bankruptcy context. *See United States v. Whiting Pools, Inc.*, 462 U.S. 198, 208-09, 212 (1983) (pre-bankruptcy seizure of assets by IRS violates automatic stay because the commencement of bankruptcy proceedings "requires the Service to seek protection of its interest according to the congressionally established bankruptcy procedures, rather than by withholding the seized property from the debtor's efforts to reorganize"); *Price v. United States*, 42 F.3d 1068, 1070-72 (7th Cir. 1994) (IRS's notice of an intent to levy on the assets of debtor violates the automatic stay and subjects the IRS to damages, notwithstanding statutes otherwise authorizing the IRS's general use of broad collection powers); *McKenzie v. United States*, 536 F.2d 726, 728-29 (7th Cir. 1976) (noting that "it is axiomatic that the sovereign immunity of the United States can be waived impliedly, as wells as explicitly, by statute[,]" and holding that statute permitting bankruptcy debtor to file an application for the discharge of "any debt" impliedly waived federal sovereign immunity with regard to the determination of tax indebtedness because "we cannot believe that Congress gave the bankruptcy court jurisdiction to determine the dischargeability of tax debts . . . and then intended that such determination should be prohibited" for lack of an express waiver of sovereign immunity regarding tax claims).

Under 28 U.S.C. § 2410(a)(1), "the United States may be named a party in any civil action or suit in any district court, or in any State court having jurisdiction of the subject matter to quiet title to . . . real or personal property on which the United States has or claims a mortgage or other lien."

"The Supreme Court has held that § 2410 is indeed a waiver of sovereign immunity for those situations which it covers." *Rodriguez*, 629 F. Supp. at 338-39 (citing *United States v. John Hancock Mut. Life Ins. Co.*, 364 U.S. 301 (1960)). The "situations which it covers" are wide-ranging, and encompass suits relating to IRS tax claims that are "akin to an action to quiet title brought by a third party," including actions to "clarify or determine the relative rights of the parties in the property, presumably as a matter of the interaction of state and federal priority laws." *Estate of Johnson v. Engel*, 836 F.2d 940, 945, 946 (5th Cir. 1988). *See also Progressive Consumers Fed. Credit Union v. United States*, 79 F.3d 1228, 1232, 1233 (1st Cir. 1996) (Section 2410's quiet title provision receives "a broad construction," extending its waiver of sovereign immunity to all cases in which a plaintiff seeks "a determination of priority between competing liens"); *ContiMortgage Corp. v. United States*, 109 F. Supp. 2d 1038, 1041 (D. Minn. 2000) (noting that "2410(a) has been recognized as a vehicle for determining lien priority" regarding IRS tax claims); *McEndree v. Wilson*, 774 F. Supp. 1292, 1297 (D. Colo. 1991) (claims of priority over federal tax liens are "within the scope of a quiet title action under 28 U.S.C. § 2410(a)(1)"). "Although § 2410(a)(1) speaks expressly only of liens, liens and levies have been treated as essentially interchangeable for purposes of finding an action covered by § 2410," *Jacobson v. Commissioner*, No. 05-C-134-C, 2005 WL 674917, at *2 (W.D. Wis. Mar. 16, 2005) (internal quotation omitted), and levies on cash fall within the scope of Section

2410, *Harrell v. United States,* 13 F.3d 232, 234 (7th Cir. 1993); *Rodriguez*, 629 F. Supp. at 339.

The reasoning of the Fifth Circuit in *Estate of Johnson* is instructive. There, the executor of an estate sought "a determination that the estate's administrative and funeral expenses take priority over the Government's [tax] lien, and a distribution of the assets pursuant to that determination." 836 F.2d at 945. In permitting the challenge, the Fifth Circuit noted:

> While it is true that the executor fails to present the typical section 2410(a) challenge to a federal tax lien by a third party purchaser or mortgagee holding an allegedly superior lien, we see no logical distinction between the instant case and that which the district court termed "the classic § 2410 situation." Both seek relief which would seem to fit within our earlier definition of a section 2410 quiet title action, to wit: "a determination that a tax lien does not exist, has been extinguished, *or is inferior in rank*." Therefore, given that the executor is seeking to clarify or determine the relative rights of the parties in the property, presumably as a matter of the interaction of state and federal priority laws, his suit would seem the proper method for removing the clouds on title cast by the federal tax liens.

Id. at 946 (internal citations omitted, emphasis added). *See In re Matter of All-Star Ins. Corp.*, 484 F. Supp. 623, 625 (E.D. Wis. 1980) (analogizing probate matters and insurance delinquency proceedings and observing that, like probate matters, the Seventh Circuit has noted that insurance rehabilitations and liquidations are "best left to a proceeding which will settle all of its affairs and dispose of all of its property").

Likewise, the First Circuit has observed:

> If, in substance, the relief the plaintiff sought here—a declaration of the priority of Progressive's mortgage over the government's tax lien—is congruent with the relief available in a quiet title suit, it would frustrate congressional intent to block plaintiff's access to relief. Congress, after all, was concerned not with the niceties of common law pleading, but with practical problems facing owners whose property was encumbered by government liens.

Progressive, 79 F.3d at 1231-32*; see also id*. at 1231-33 (discussing types of cases permitted under Section 2410).

B. THE UNITED STATES IS NOT FACING IRREPARABLE HARM

The United States has yet to determine whether there is any actual harm at all. If AFGI convinces the IRS that the tax refunds were proper, then the United States' repeated collateral attacks of the rehabilitation proceeding would have served no purpose at all. On the other hand, if the IRS ends up disputing AFGI's tax treatment, then it has a federal forum (the New York Bankruptcy Court) in which to litigate the merits of that dispute. The United States complains that certain statutory tools for securing and collecting potential tax liabilities are enjoined, but this argument puts the cart before the horse given that the IRS has yet to determine whether any tax liability even exists.

Moreover, the United States has identified no concrete, irreparable harm that would befall it upon denial of a preliminary injunction. It does not (and cannot) assert that Ambac's claims-paying resources will be drained in the near future (or during the pendency of any litigation on the merits of the tax issue). As the Plan confirmation order clearly establishes, the resources are subject to the close oversight of the Commissioner in accordance with a long-term, pay-over-time Plan of Rehabilitation. (*See generally* dkt. 20 at 22-30, ¶¶ 49-75.)

Finally, the United States contends that it is subject to irreparable harm because the State Rehabilitation Court has scheduled a hearing on its motion to dissolve the Supplemental Injunction, and that the State Rehabilitation Court should be enjoined from "proceeding to address the merits" of the IRS's motion. (P.I. Mem. at 7.) However, setting aside the fact that the hearing has been adjourned, the scheduling of a hearing—on a motion the United States itself filed in the rehabilitation proceeding—does not constitute harm.

In its memorandum, the United States' argument goes as follows:

> it is obvious that the Commissioner merely seeks to try to use a State Court decision in his favor on the government's motion to dissolve to attempt to argue that such a decision has preclusive effect and preempts any review of the merits of the IRS's arguments either in this Court or in the pending appeal before the Seventh Circuit. Stated simply, the Commissioner is trying desperately to keep important questions of federal law and sovereign immunity from being decided in federal courts.

(P.I. Mem. at 4.)

The problem with the IRS's argument is that it assumes that the State Rehabilitation Court—the court most familiar with this rehabilitation—will automatically reject the United States' challenge to the Supplemental Injunction. The Commissioner will argue for the denial of those challenges, but it disrespects the integrity of the state court system for the United States to seek to enjoin a state court on the assumption that it will find the United States' arguments unpersuasive.[14]

[14] To the extent the United States' arguments depend on contradicting factual findings regarding the nature and structure of the rehabilitation that the State Rehabilitation Court has previously made, then that only highlights the necessity to keep all proceedings about the rehabilitation in a single comprehensive forum.

As this Court noted in its Remand Order,

> The United States has not argued that its claims cannot be heard in the rehabilitation proceeding. 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 of the merits and if the result is unsatisfactory, appeal to the Wisconsin Court of Appeals. *Cf. Bank of New York & Trust*, 296 U.S. at 481 ("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."); *United States v. $79,123.49 in United States Cash and Currency*, 830 F.2d at 99 ("[T]he United States "is in no position to claim that its interests . . . could not be preserved by a Wisconsin court.").

(Remand Order at 19-20.) Thus, any perceived harm is reparable in the state courts, with a right to petition the United States Supreme Court for certiorari if the United States deems it necessary.

C. AN INJUNCTION WOULD HARM POLICYHOLDERS AND OTHERS

The United States ignores the real, practical impairment of Chapter 645 that results from leaving the IRS's collection powers intact as to the potential claim at issue. An assessment, lien or levy would impede the Commissioner's ability to carry out the Plan of Rehabilitation under Wis. Stat. § 645.33(5), which necessarily calls for the deferred payment of claims over time to ensure equity among long-tail and short-tail claimants and to maximize the value of the insurer's claims-paying resources. That the IRS could invoke its tax collection powers at any time, and retain control over the assets designated to fund the entire rehabilitation for an uncertain duration while the Commissioner wades through "the maze of statutes which govern the assessment and collection of taxes, tax liens, tax levies, refunds and so on," *Rodriguez*, 629 F. Supp. at 336, in order to recover the assets for their equitable distribution under Wisconsin's priority structure, would inject needless uncertainty and instability in a

proceeding that "can only work" if it "prevents the 'run-on-the-bank' psychology." Wis. Stat. Ann. § 645.32 cmt.[15]

Indeed, the grant of even a temporary injunction against the State Rehabilitation Court and the Commissioner would be functionally the same as the grant of a permanent injunction, because it could render the Supplemental Injunction essentially moot. If the Supplemental Injunction were held to be inapplicable to the United States, the IRS could immediately take the very steps (such as creating a lien or levy assets) that the Supplemental Injunction was intended to prevent. As this Court noted, that harm "would amount to pulling out the linchpin that secures the entire enterprise." (Remand Order at 14.)

The severity of this real and substantial harm greatly outweighs any perceived offense to the United States' "sovereign prerogatives," as evidenced by the Commissioner's actions in response to it. Immediately upon learning of the IRS's material potential claim, the Commissioner assessed the threat to policyholders, Wisconsin insurance priorities, and the rehabilitation as a whole, sought immediate injunctive relief to prevent this harm, and moved *ex parte* due to his awareness that prior notice could well precipitate that harm prior to issuance of the injunction. (*See generally* dkt. 12.18, dkt. 20 at 32, ¶ 78.) By contrast, the United States—despite being served with the Supplemental Injunction immediately, and despite stipulating the next day in the New York Bankruptcy Court that it would honor that injunction in recognition of

[15] In addition, the delay and administrative costs of litigating to establish the supremacy of the state priority statute over generalized federal tax laws and obtain recovery of the assets from the IRS would impose additional unnecessary losses on policyholders. *See Amwest*, 245 F. Supp. 2d at 1045 (noting public interest in "conserv[ing] resources" in litigation pertaining to insurance delinquency proceedings in order to "maximize[e] the benefits available to the company's policyholders"); *Warfield*, 839 F. Supp. at 689 (noting that state court's exclusive jurisdiction over matters relating to the insurer delinquency "serve[s] the specific purpose of protecting receivers from having to litigate in multiple forums, which might lead to a depletion of the insurance company's assets").

the potential adverse consequences of a lien or levy on the assets—only now claims that is being irreparably harmed "every day" by an imposition on its "sovereign rights."

D. THE PUBLIC INTEREST WEIGHS HEAVILY AGAINST THE ENTRY OF AN INJUNCTION

The United States does not refute any of the grounds raised by the Commissioner in his motion seeking the Supplemental Injunction in the State Rehabilitation Court, namely: (1) the tax refunds in question "form a material part of the claims-paying resources available to satisfy claims of the Segregated Account"; (2) any IRS claims "are behind policyholder loss claims in priority" under Wisconsin's insurance priority statute, Wis. Stat. § 645.68; and (3) the IRS's seizure of these assets would "circumvent[] the priority scheme for equitable distribution established by Wisconsin insurance law." (Dkt. 12.17, ¶¶ 2, 6, 14-15.) Because the McCarran-Ferguson Act "declares that the continued regulation and taxation by the several states of the business of insurance is in the public interest," 15 U.S.C. § 1011, and Commissioner is required by state insurance law to protect policyholder interests before the interests of the federal government, Wis. Stat. § 645.68, the public interest is served by preventing the United States from circumventing Chapter 645, Wis. Stats.

II. IN THE ALTERNATIVE, THIS COURT SHOULD ABSTAIN FROM EXERCISING JURISDICTION

A. *Burford* Abstention

In the Remand Order, this Court held that "the principles of *Burford* require abstention in this case to permit resolution of the IRS's claims through the available mechanisms in the State Rehabilitation Court." (Remand Order at 21.)

Rather than repeat this Court's reasoning at pages 16-21 of the Remand Order, or the Commissioner's discussion of abstention at pages 36-44 of his brief in support of motion to remand (Dkt. 12.1), the Commissioner incorporates by reference those excerpts here. Because

the elements of *Burford* abstention are met, this Court should abstain from addressing the United States' motion or otherwise exercising jurisdiction over the action.

B. *Colorado River* Abstention

Abstention also is warranted under the *Colorado River* doctrine. Under that doctrine, a federal court may—in "exceptional circumstances"—abstain from hearing a federal suit when there is a concurrent state proceeding and abstention would promote "wise judicial administration." *Colorado River*, 424 U.S. at 818.

In deciding whether abstention is appropriate, a court must consider whether the concurrent federal and state actions are parallel, and whether factors demonstrated the existence of exceptional circumstances. *LaDuke v. Burlington N. R. Co.*, 879 F.2d 1556, 1559-60 (7th Cir. 1989) (trial court did not abuse discretion in declining to exercise jurisdiction over federal action based on *Colorado River* doctrine).

Here, both requirements are met. This action and the state rehabilitation proceeding are proceeding on parallel tracks. *See id.* at 1559. Moreover, in *Colorado River*, the Supreme Court found that the "most important" factor supporting abstention was the existence of a federal statute that evinced a "clear federal policy" of avoiding piecemeal litigation regarding the adjudication of water rights. *Colorado River*, 424 U.S. at 819. Likewise, in this case, the McCarran-Ferguson Act evinces a clear federal policy that the regulation of the insurance industry should be left to the states. Thus, the administrative and judicial scheme erected by Wisconsin to regulate insurance companies, including that part enabling the institution and implementation of rehabilitation proceedings, operates pursuant to an express federal policy of non-interference in insurance matters. (Remand Order at 12-13.) *See generally* factors articulated in *LaDuke,* 879 F.2d at 1559 ("[T]he weight given to any particular factor will vary greatly from case to case, depending on the particular factual setting of the case at hand.)

With respect to the concern over piecemeal litigation and potentially inconsistent rulings, the Seventh Circuit has explained,

> [w]hen a case proceeds on parallel tracks in state and federal court, the threat to efficient adjudication is self-evident. But judicial economy is not the only value that is placed in jeopardy. The legitimacy of the court system in the eyes of the public and fairness to the individual litigants also are endangered by duplicative suits that are the product of gamesmanship or that result in conflicting adjudications.

LaDuke, 879 F.2d at 1560 (quoting *Lumen Constr., Inc. v. Brant Constr. Co.*, 780 F.2d 691, 694 (7th Cir. 1985)).

Furthermore, a federal court may abstain

> where the "exercise of federal review . . . would be disruptive of state efforts to establish a coherent policy with respect to a matter of substantial public concern." *Colorado River Water Conservation District v. United States*, 424 U.S. 800, 814 . . . (1976). The regulation and liquidation of state domestic insurance companies is a matter of substantial public concern, and Ch. 645, Wis. Stats., is a comprehensive state effort to deal with that area of state concern. . . . Thus, . . . the strong state interest in orderly liquidation dictates the exercise by the court of its discretionary abstention.

All-Star Ins., 484 F. Supp. at 626 (citations omitted).

Finally, in *Metropolitan Life*, this Court reasoned:

> 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*.

Metropolitan Life Ins. Co. v. Bd. of Dirs., 572 F. Supp. 460, 471 (W.D. Wis. 1983) (emphasis added). The same types of "unseemly and disastrous conflicts" that led this Court to abstain under *Colorado River* (and *Burford*) in *Metropolitan Life* are present here.

CONCLUSION

For the reasons stated above, the "United States' motion for preliminary injunction and for expedited ruling by February 17, 2011" should be denied.

Dated this 15th day of February, 2011.

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