IN THE 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 OF INSURANCE OF THE STATE OF WISCONSIN, as Rehabilitator of the Segregated Account of Ambac Assurance Corporation; and AMBAC ASSURANCE CORPORATION Defendants.	)	Case No. 11-cv-99

MEMORANDUM OF LAW IN SUPPORT OF UNITED STATES' MOTION FOR PRELIMINARY INJUNCTION AND FOR EXPEDITED RULING BY FEBRUARY 17, 2011

INTRODUCTION

The Dane County Circuit Court (the "State Court") has issued orders restraining the United States from collecting (and possibly even simply assessing) federal taxes against Ambac Assurance Corporation or its affiliates. Those orders also purported to allocate any federal tax liability to a segregated account that may be insufficient, to absolve members of Ambac's consolidated tax group from their several liability for the taxes of the entire group, and to assert exclusive state jurisdiction over these federal tax issues. The State Court has neither the jurisdiction nor the power to do so. The State Court's orders violate the sovereign immunity of the United States from suit. Only Congress can waive that immunity, by "unambiguous" statutory language, and it has not done so. Those orders also violate the Anti-Injunction Act, 26

U.S.C. § 7421(a), which prohibits the entry by any court of any injunction interfering with the assessment or collection of federal taxes.

The United States has filed a complaint seeking to enjoin permanently the enforcement of the injunction order or, alternatively, at least seeks a determination that the State Court injunction is void and unenforceable so that the United States is not at risk of a contempt citation if it violates the terms of the order. In the meantime, this motion seeks a preliminary injunction to restrain the State Court, Ambac, and the Commissioner from enforcing the injunction against the United States Internal Revenue Service. The proposed preliminary injunction would also bar any further state court proceedings with respect to these federal tax issues. The requested preliminary injunction would also restrain the State Court from ruling on a motion to dissolve its injunction that the United States filed *in this Court* after it tried to remove the State Court action and before this Court held that removal invalid and remanded. The preliminary injunction would remain in place until this Court is able to reach a final determination of the complaint and, if it dismisses the complaint, then pending an appeal to the Seventh Circuit.

In that regard, the facts and the United States' arguments on the merits are familiar to this Court, as they are largely the same arguments presented in the briefs filed in *In re Rehabilitation of the Segregated Account of Ambac Assurance Corporation*, Case No. 10-cv-778-bbc. Rather than burden the Court with a retelling of those arguments, the United States attaches herewith the briefs filed by both sides in that action so that they may become part of the record in this action. While the merits issues are largely the same, this motion obviously no longer involves the procedural issue regarding removal, as the instant action does not invoke this Court's jurisdiction under 28 U.S.C. § 1441 or § 1442 but instead under § 7402(a) of the Internal Revenue Code.

Further, the briefing in the prior case did not need to address whether the United States can collaterally attack the State Court injunction so that issue is addressed in this memorandum.

The United States recognizes that this Court expressed the view, in the order remanding the prior action, that McCarran-Ferguson authorizes the reverse-preemption of the tax Anti-Injunction Act. The Court did not directly address sovereign immunity in its remand order, so the United States will briefly amplify its argument as to sovereign immunity below. The United States believes that sovereign immunity makes the issue presented in this motion readily distinguishable from the removal issue that the court addressed in its prior order, and that the Court may reach a different conclusion as to McCarran -Ferguson reverse-preemption with respect to the State injunction order. Should the Court not be persuaded, however, the United States respectfully requests in the interests of judicial economy that the Court summarily deny this motion without the necessity of a hearing or further briefing, in order to permit any appeal from that denial to proceed without delay, and to be consolidated with the pending appeal from the remand order, assuming that order is not held to be unappealable.

Request for Expedited Ruling by February 17, 2011

Recent actions by the Commissioner as Rehabilitator force the United States to request expedited resolution of this motion. The Commissioner has unilaterally asked the State Court to rule on the United States' motion to dissolve the injunction, even though the United States has not appeared before the State Court, is not pressing that motion in that forum, and has appealed this Court's remand order with its refusal to dissolve the injunction based on non-removability. (*See* Ex. 1, Commissioner's Notice to the State Court.) The Commissioner did so in the guise of seeking to "clarify" the injunction against the IRS even though the State Court had already specifically applied the injunction to the IRS and reiterated that application in a more recent

(post-remand) order approving the plan of rehabilitation. Because the Commissioner made this request only after the United States indicated, in pleadings before the Seventh Circuit, that it intended to file an original action in this Court challenging the State Court injunction (*i.e.*, the instant action), 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 United States' arguments either in this Court or in the pending appeal before the Seventh Circuit.[1] Stated simply, the Commissioner is trying desperately to keep important questions of federal law and sovereign immunity from being decided by federal courts.

Counsel for the United States yesterday discovered, after reviewing the electronic docket of the State Court proceeding, 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 United States' motion to dissolve, which hearing is not sought by the movant United States. Neither the State Court nor the Commissioner have given any notice, formal or informal, of this hearing to the United States. The 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

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[1] The United States does not concede that such a decision by the State Court, which has no jurisdiction at all to decide the issue, would have any preclusive effect against the United States because that decision would be null and void. *See, e.g., Kalb v. Feuerstein*, 308 U.S. 433, 439-440, 444 (1940) (Wisconsin state court foreclosure judgment subject to collateral attack in federal court based on federal statute affirmatively divesting state court of jurisdiction despite state court's prior rejection of jurisdictional argument). It must be acknowledged, however, that this result is uncertain, so we seek a preliminary injunction now, barring the state court from acting on our motion to dissolve, in order to preserve, without question, this Court's ability to grant relief if either this Court or the Seventh Circuit were to rule that the United States in fact has the right to litigate these important federal-law issues in the federal courts, whether by its removal or by this original action under Section 7402(a).

before the State Court. The Commissioner obviously intends to argue the opposite, and which view will ultimately prevail is not without uncertainty. Moreover, even if the motion to dissolve filed in this Court is properly before the State Court as a result of the remand, the United States maintains it is entitled to have the uniquely federal issues of sovereign immunity and whether the McCarran-Ferguson Act reverse preempts the Internal Revenue Code, including the tax Anti-Injunction Act, determined in the federal courts rather than in Wisconsin courts.

The United States therefore moves this Court to address this motion on an expedited basis and either issue the requested preliminary injunction or deny this motion by Thursday, February 17, 2011. The United States regrets the imposition on the Court's time, but respectfully suggests that a ruling would prevent the State Court from conducting a needless hearing (should the United States ultimately prevail) or allow the United States at least some realistic opportunity to seek emergency relief from the Seventh Circuit in advance of that hearing (should it not prevail).

STATEMENT OF FACTS

The United States incorporates by reference the statement of facts contained in its Motion to Dissolve, at pages 3 - 8. The Commissioner's statement of facts is contained in his Motion for Remand at pages 6 - 16. The factual basis for the requested relief is as follows:

1. The State Court has issued orders that restrain the IRS from collecting (and possibly even assessing) federal taxes against Ambac Assurance Corporation or its affiliates, allocating any federal tax liability to a segregated account that may be insufficient, absolving members of a consolidated tax group from their several liability for the taxes of the entire group, and asserting exclusive state jurisdiction over these federal tax issues. (*See* Ex. 2, November 8 Injunction; Ex. 12, January 21 Order.)

2. The Commissioner has unilaterally asked the State Court to rule on the United States' motion to dissolve the injunction, even though the United States has not appeared before the State Court, is not pressing that motion in that forum, and has appealed this Court's remand order with its refusal to dissolve the injunction to the Seventh Circuit. (*See* Ex. 1, Commissioner's Notice to the State Court; *see also Nickel v. United States*, No. 11-1158 (7th Cir.))

3. The State Court has scheduled a hearing for February 23, 2011, at 1:00 p.m. (*See* Ex. 11, Dare County Case No. 2010CV001576 Court Record Events, relevant entries.)

ARGUMENT

I. THIS COURT HAS THE STATUTORY AUTHORITY TO ENJOIN THE STATE COURT'S ORDERS

The United States, pursuant to 26 U.S.C. § 7402, has moved for a preliminary injunction order, effective at least until this Court can finally determine the United States' complaint for a permanent injunction or at least a determination that the State Court injunction is void and therefore unenforceable:

(1) enjoining the Wisconsin State Circuit Court of Dane County (Hon. William D. Johnston, presiding) from enforcing the injunction it issued on November 8, 2010, in *In the Matter of the Rehabilitation of Segregated Account of Ambac Assurance Corporation*, Case Number 2010CV001576 ("the state rehabilitation action"), purporting to restrain and enjoin Internal Revenue Service ("IRS") from, *inter alia*, collecting (and possibly even simply assessing) a $700 million potential federal tax liability owed by Ambac Assurance Corporation and other members of its consolidated tax group;

(2) enjoining the State Court from enforcing the decision and order of January 21, 2011, confirming the rehabilitation plan for the Segregated Account, insofar as it purports to make the November 8 Injunction permanent, asserts exclusive state jurisdiction over certain federal tax liabilities of Ambac, and otherwise purports to bind the United States;

(3) enjoining the State Court from asserting jurisdiction over and purporting to decide the United States' motion to dissolve the November 8 Injunction; and

(4) otherwise enjoining the State Court from conducting proceedings directed at further violating the Anti-Injunction Act (26 U.S.C. § 7421) and the sovereign immunity of the United States.

If this Court needs additional time to consider whether to grant items (1), (2), and (4), the relief that the United States more urgently seeks no later than February 17, 2011, is that specified in item (3) above, in order to avoid the potential confusion that may be caused if the State Court reaches the merits in the meantime. In short, we are asking this Court at the very least to assure that its ability to consider fuller relief is not impaired by hasty and unnecessary action by the Commissioner and the State Court. Although we would argue that even a State Court ruling on the merits would not prevent this Court from granting a permanent injunction and determining that the State Court's orders cannot bind the United States, it is clear from the Commissioner's request for a State Court hearing, made as soon as the Commissioner learned the United States would be filing this action, that the Commissioner will argue just the opposite. Assuming *arguendo* that the Commissioner is correct, this Court should then even more clearly protect its own jurisdiction by at least temporarily enjoining the State Court from proceeding to address the merits.

Section 7402(a) provides:

> The "district courts of the United States at the instance of the United States shall have 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. The remedies hereby provided are in addition to an not exclusive of any an all other remedies of the United States in such courts or otherwise to enforce such laws.

26 U. S.C. § 7402(a). "The United States has standing to seek relief from actual or threatened interference with the performance of its proper governmental functions" as to tax administration, and may seek an injunction under Section 7402(a) to prevent or stop such interference. *United States v. Ekblad*, 732 F.2d 562, 563 (7th Cir. 1984) (citing *Island Airlines, Inc. v. CAB*, 352 F.2d 735, 744 (9th Cir.1965). "[T]here need not be a showing that a party has violated a particular Internal Revenue Code section in order for an injunction to issue. The language of § 7402(a) encompasses a broad range of powers necessary to compel compliance with the tax laws." *United States v. Ernst & Whinney*, 735 F.2d 1296, 1300 (11th Cir. 1984). 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, and without defining the person against whom the injunction may issue. As stated by the First Circuit in *Brody v. United States*, "[i]t would be difficult to find language more clearly manifesting a congressional intention to provide the district courts with a full arsenal of powers to compel compliance with the internal revenue laws." 243 F.2d 378, 384 (1st Cir.), *cert. den.*, 354 U.S. 923 (1957); *see also United States v. Edwards*, 2008 WL 1925243, at *3 (E.D. Cal. 2008); *United States v. Hempfling*, 2008 WL 703809, at *14 (E.D. Cal. 2008); *Ernst & Whinney*, 735 F.2d at 1301 n.12 (quoting legislative history as recognizing "the great latitude inherent in" § 7402(a), authorizing courts to "enjoin

any action to impede proper administration of the tax laws"); *United States v. First Nat'l City Bank*, 568 F.2d 853, 855 (2d Cir. 1977) (calling Section 7402(a)'s language "broad and clear").

Section 7402 grants this Court the authority to enjoin the proceedings of the State Court. The United States observes that 28 U.S.C. § 2283, which generally bars injunctions against state court proceedings, does not bar the injunction sought here. In *Leiter Minerals, Inc. v. United States*, 352 U.S. 220 (1957), the Supreme Court held that § 2283 does not apply where the United States seeks the injunction, despite the absence of any pertinent legislative history or any express exception in the statute itself. The Supreme Court found that the statutory limitation was premised upon comity considerations and that these have more force in private litigation than when the Government invokes a "national interest." *Id*. at 225-26. In addition, § 2283 carves out express exceptions so that a district court *may* enjoin a state court proceeding where "necessary in aid of its jurisdiction." *Leiter Minerals* also affirmed the correctness of the district court's having proceeded with a quiet title action brought by the United States notwithstanding the pendency of an action in accounting and for a declaration of ownership with respect to the same property in the state court.

The State Court has made no final judgment (including the exhaustion of appeals) specifically addressing the Anti-Injunction Act and sovereign immunity issues raised herein. Thus, a federal court injunction against the State Court's orders is proper under well-established Supreme Court precedent. *See, e.g., United States v. United States Fidelity & Guaranty Co.*, 309 U.S. 506 (1940) (holding that order in 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); *Kalb*, 308 U.S. at 439-440, 444 (permitting federal collateral attack on judgment by state court that lacked subject matter jurisdiction); *see also Travelers Indemnity v.*

Bailey, 129 S.Ct. 2195, 2206 n. 6 (2009) (citing *US F&G* and *Kalb* as permitting "a collateral attack on subject-matter jurisdiction . . . 'where the issue is the waiver of [sovereign] immunity'" and where a "federal statute affirmatively divested other courts of jurisdiction," respectively); *cf. State ex rel. R.G. v. W.M.B.*, 465 N.W.2d 221, 223 (Wis. App. 1990) ("A judgment is void if the court rendering it lacked subject matter jurisdiction. Also, a void judgment is subject to collateral attack.")

II. THE UNITED STATES HAS SATISFIED THE REQUIREMENTS FOR A PRELIMINARY INJUNCTION

When a party seeks injunctive relief pursuant to a specific statute, it need not comply with the traditional standards for a preliminary injunction. For example, "generally when the party seeks a statutory injunction, we have dispensed with the requirement of showing irreparable harm, and instead employ a presumption of irreparable harm based on a statutory violation." *City of New York v. Golden Feather Smoke Shop, Inc.*, 597 F.3d 115, 120 (2d Cir. 2010); *see also United States v. Microsoft Corp.*, 147 F.3d 935, 943 (D.C. Cir.1998)("if a statute confers a right to an injunction once a certain showing is made, no plaintiff ... need show more than the statute specifies."); *Bedrossian v. Northwestern Memorial Hosp.*, 409 F.3d 840, 842-43 & n.1 (7th Cir. 2005) (if "statute clearly mandates injunctive relief for a particular set of circumstances," traditional equitable considerations do not apply). The United States contends that Section 7402(a) is a specific statute mandating relief when "necessary or appropriate for the enforcement of the internal revenue laws," and that the only showing the United States must make is that the state court injunction purports to restrain the assessment and collection of federal taxes and otherwise interferes with the administration of the federal tax system in violation of the Internal Revenue Code. *See United States v. Stoll*, 2005 WL 1763617 * 8 (W.D. Wash. 2005) ("Because I.R.C. §§ 7402(a) and 7408 set forth the criteria for injunctive relief, the

United States need only meet those criteria, without reference to the traditional equitable factors."); *United States v. Colorado Mufflers Unlimited, Inc*., 2007 WL 987459 (D. Colo. 2007) (citing *Stoll*). Some courts have nonetheless applied the traditional factors in § 7402(a) cases. *See United States v. Ernst & Whinney*, 735 F.2d 1296, 1301 (11th Cir. 1984).

The United States has demonstrated in its arguments on the merits that an injunction against the State Court's orders restraining the IRS from assessing and collecting federal taxes, absolving taxpayers of federal tax liability, and asserting exclusive state court jurisdiction over federal tax matters, is necessary and appropriate for enforcing the federal tax laws.

First, the United States contends that the State Court's orders violate the federal government's sovereign immunity. *See* Motion to Dissolve at 9-10; Reply re Motion to Dissolve at 4, 13. The United States, as sovereign, may not be sued without its consent, and sovereign immunity is waived only when Congress expressly consents to suit by statute. *United States v. Dalm*, 494 U.S. 596, 608 (1990); *Balistrieri v. United States*, 303 F.2d 617, 619 (7th Cir. 1962). Any statute waiving sovereign immunity "is to be strictly construed, in terms of its scope, in favor of the sovereign. Such a waiver must also be 'unequivocally expressed' in the statutory text." *Dep't of Army v. Blue Fox, Inc.*, 525 U.S. 255, 261 (1999) (citations omitted) Absent a waiver, sovereign immunity bars any suit "if 'the judgment sought would expend itself on the public treasury or domain, or interfere with the public administration,' or if the effect of the judgment would be 'to restrain the Government from acting, or to compel it to act.'" *Dugan v. Rank*, 372 U.S. 609, (1963) (citations omitted).

Simply put, there is no federal statute that waives the United States' sovereign immunity from being subject to an injunction against collecting federal taxes. McCarran-Ferguson certainly does not effect such a waiver. To begin with, the "reverse-preemption" provision of

McCarran-Ferguson applies, by its own terms, only to "Act[s] of Congress." 15 U.S.C. § 1012(b). Sovereign immunity is not created by an act of Congress. It is an inherent prerogative of the federal government as the sovereign, and a statute directed at "Acts of Congress" simply cannot be read to breach that prerogative. *See United States v. Thompson*, 98 U.S. 486 (1878) (discussing the ancient origins of sovereign immunity as the prerogative of the Crown at common law that was imparted to the federal government of the United States upon its creation). Further, the statutory text of McCarran-Ferguson does not contain any language expressly waiving the sovereign immunity of the United States, with respect to any suit against it on any particular cause of action and certainly not in respect to federal tax determination or collection, and without such an express Congressional waiver, sovereign immunity *is not waived*. *See In re Application of Lewis*, 512 F. Supp. 1146, 1149-50 (S.D.N.Y. 1981) (dissolving TRO issued by state insurance rehabilitation court against federal agency and holding that McCarran-Ferguson did not waive sovereign immunity). In *Lewis*, as here, the state insurance regulator argued "that this is not an action against the United States, but merely a restraining order ancillary to an in rem action for rehabilitation designed to protect the res from adverse action." The court rejected that characterization: "The federal official has been enjoined from performing his regulatory duty. It is an action against the United States and its officer. No waiver or consent has been identified which overcomes sovereign immunity or permits the suit." *Id.* As the *Lewis* court held, "[t]he Supremacy Clause alone seems sufficient support for the proposition that a federal regulator may not be enjoined from performing his regulatory duties solely by reason of a state rehabilitator's hopes to achieve a successful rehabilitation." *Id.*

Second, the United States contends that the tax Anti-Injunction Act explicitly bars the State Court - or indeed any court - from enjoining the assessment or collection of federal taxes.

Accordingly, the State Court lacked any jurisdiction to issue the November 8 Injunction or those portions of the January 21 Order that address federal tax issues. The McCarran-Ferguson Act, 15 U.S.C. § 1012(b), does not affect this result for several reasons, including: (1) the Seventh Circuit has held the Internal Revenue Code is "in the absence of language evidencing a different purpose, to be interpreted so as to give a uniform application to a nationwide scheme of taxation," and because neither McCarran-Ferguson nor Wisconsin state insurance statutes provide such language, insurance companies cannot therefore claim an exemption from the provisions of the Internal Revenue Code based on state law; (2) neither McCarran-Ferguson nor the Wisconsin state insurance laws contain an express waiver of the sovereign immunity of the United States (and, in any event, no state statute could achieve that purpose without an explicit unambiguous delegation by Congress which the McCarran-Ferguson Act does not do); (3) the state statutes at issue do not regulate the business of insurance in the narrow sense that the Supreme Court has defined that term; (4) the relevant provisions of the Internal Revenue Code relate to the business of insurance; (5) the relevant provisions of the Internal Revenue Code do not impair the state statutes. *See* Motion to Dissolve at 12-21; Opp. Remand at 2-8; Reply re Motion to Dissolve at 3-17 & 21-23.

The above suffices to show that the requested injunctive relief is "necessary or appropriate for the enforcement of the internal revenue laws," all that is required under Section 7402(a). Nonetheless, the United States will also demonstrate that the proposed injunction satisfies the traditional test for preliminary injunctions.

Normally, in determining whether a litigant is entitled to a preliminary injunction in this circuit, "a party must show that it is reasonably likely to succeed on the merits, it is suffering irreparable harm that outweighs any harm the nonmoving party will suffer if the injunction is

granted, there is no adequate remedy at law, and an injunction would not harm the public interest." *Christian Legal Soc'y v. Walker*, 453 F.3d 853, 859 (7th Cir. 2006) (citations omitted).

First, the United States has demonstrated above that the State Court's orders violate the Anti-Injunction Act and encroach on the United States' sovereign immunity. Accordingly, the United States is highly likely to prevail on the merits of the action. At any rate, the United States "must only show that it has *some* likelihood of success on the merits," which it unquestionably has done. *Storck USA, L.P. v. Farley Candy Co.*, 14 F.3d 311, 314 n.1 (7th Cir. 1994) (emphasis in original).

By definition, court orders that violate federal law and infringe on the sovereign immunity of the United States inflict irreparable harm on the Government and the public that cannot be remedied by a money judgment. Beyond that, Defendants' conduct, unless enjoined, may cause a substantial loss of revenue to the United States Treasury, specifically a potential $700 million federal tax liability that may be rendered effectively uncollectible except from the non-existent assets of the Segregated Account. Defendants' conduct is also likely to encourage the future manipulation of state insurance laws and insolvency proceedings by other corporate taxpayers with insurance company affiliates to artificially shed insurer-taxpayers of consolidated federal tax liabilities by contriving to allocate such liabilities to a separate account or subsidiary, placing that separate entity in rehabilitation, and foreclosing the IRS from collecting those liabilities from the rest of the consolidated group. In contrast, Ambac cannot claim to be unjustly harmed by having to comply with the law and, if the IRS determines that it must, pay back a tentative refund that it was not entitled to in the first place. Nor is the integrity of the rehabilitation proceeding damaged by quashing an injunction that the rehabilitation court lacked

the power to impose in the first place. At any rate, the federal tax issues are a small part of the rehabilitation proceeding, which involves thousands of policies and dozens of potential claimants, and Treasury Regulations prevent the IRS from levying on assets within the custody of the State Court in that proceeding.

Finally, the collection of federal taxes is of crucial public importance, as taxes are the "life blood" of the government, the prompt and certain collection of which is an "imperious need." *Bull v. United States*, 295 U.S. 247, 259 (1935). The uniform application of a nationwide system of tax administration is itself of critical importance to the public interest. In service of that interest, Congress enacted the Anti-Injunction Act to prevent a taxpayer from obtaining by special pleading to a judge an exemption from the tax law requirements with which all other taxpayers must comply. The sovereign immunity of the United States is of equal importance to the integrity of the federal government. Stripped of the rhetoric about states' rights and the sanctity of insurance regulation, at bottom the State Court's orders merely serve to give Ambac a special exemption from paying federal taxes that Congress has never enacted While there is no doubt a general public interest in orderly rehabilitations of insolvent insurance companies, there is no public interest in allowing Ambac to demand and receive a $700 million tentative refund to which it may not be entitled, and then avoid repaying that amount by the artifice of consigning its tax liabilities to a "segregated account."

CONCLUSION

For the reasons described above, the United States respectfully requests that this Court grant the requested preliminary injunction.

Respectfully submitted,

February 9, 2011

UNITED STATES DEPARTMENT OF JUSTICE

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