STATE OF WISCONSIN COURT OF APPEALS DIST. IV

In the Matter of the Rehabilitation of:

SEGREGATED ACCOUNT OF
AMBAC ASSURANCE CORPORATION

Appeal of the United States of America:
Appeal No. 2011AP516

UNITED STATES' MOTION TO HOLD THE INSTANT APPEAL IN ABEYANCE UNTIL THE RESOLUTION OF THE UNITED STATES' PENDING APPEALS IN THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The United States, the appellant in the above-captioned appeal, through its counsel Richard Humphrey and Anthony T. Sheehan, moves to hold the above-captioned appeal in abeyance. Holding this appeal in abeyance will reduce the burden on this Court and conserve judicial resources by avoiding the duplication of judicial effort by the United States Court of Appeals for the Seventh Circuit and by this Court.

1. The United States has filed a protective notice of appeal from the Dane County Circuit Court's final order in this case. Authorization of the Solicitor General of the United States is

required for the United States to take an appeal. The Department of Justice's procedures require that the decision whether to authorize the prosecution of an appeal be made by the Solicitor General of the United States, after review of recommendations prepared by the Department's Tax Division and the Chief Counsel of the Internal Revenue Service. Those recommendations have been completed and are before the Acting Solicitor General. His office is currently considering whether to authorize prosecution of the appeal in this case. If the Acting Solicitor General authorizes appeal, the proceedings should continue to be held in abeyance for the reasons discussed below.

2. As the United States stated in its notice of appeal and in its docketing statement, the United States is the appellant in two pending appeals in the Seventh Circuit arising out of the Ambac rehabilitation. Those appeals are *Nickel v. United States* (7th Cir. – No. 11-1158) and *United States v. Wisconsin State Circuit Court for Dane County; et al.* (7th Cir. – No. 11-1419).

3. The United States also has consistently asserted: (1) that it does not admit that the Wisconsin state courts have properly asserted jurisdiction over the United States; (2) that the federal courts, not Wisconsin state courts, properly have jurisdiction over the issues raised by the United States; and (3) that it was appealing to this Court only to preserve its Wisconsin appellate rights should the Seventh Circuit hold that the United States had to pursue its rights in the Wisconsin courts. The United States further stated its intention to file this motion to hold this appeal in abeyance pending the outcome of the Seventh Circuit appeals.

4. The parent company of Ambac Assurance Corporation (Ambac) received tentative federal income tax refunds of approximately $700 million pursuant to the special procedure in 26 U.S.C. § 6411.[*] Ambac's parent, in turn, transferred the $700

[*] Section 6411 of the Internal Revenue Code provides a special procedure under which a taxpayer with a net operating loss can circumvent the audit procedures that are usually applied when a taxpayer files a claim for refund. The special procedure allows a taxpayer to make an "application for a tentative

million to Ambac, relying on a tax sharing agreement. Ambac and its parent are members of a consolidated group for federal income tax purposes. All members of a consolidated group are severally liable for the federal tax liabilities of the group, notwithstanding any private arrangement among the group members to allocate the tax liability. Treas. Reg. (26 C.F.R.) §§ 1.1502-6; 1.1502-78(b)(2).

On November 8, 2010, the last day for objections to the plan of rehabilitation, the insurance commissioner filed a "Notice" in the Dane County Circuit Court of a purported allocation of only Ambac's potential liability for the $700 million to the segregated account being rehabilitated, leaving the money itself in Ambac to be used for the payments to other creditors. (Order of Oct. 18,

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carryback adjustment" (26 U.S.C. § 6411(a)) which is subject only to "limited examination" to discover errors of computation or omissions (26 U.S.C. § 6411(b)). The IRS is required to act on the application within 90 days. *Ibid.* It is only after the expedited refund is paid that the IRS makes a full examination of the relevant return under its regular auditing procedures. M. Saltzman, *IRS Practice and Procedure*, ¶ 11.03 (Rev. 2d ed. 2005).

2010 at 2; Notice of Nov. 8, 2010; Affidavit dated Nov. 7, 2010 at 1–3.) The court immediately imposed an *ex parte* injunction that expressly enjoined the "United States Internal Revenue Service, and all other federal . . . entities" from taking steps with respect to the "allocated" tax liabilities, thereby raising issues involving the sovereign immunity of the United States. (Order of Nov. 8, 2010 at 2–3.) The filing of a notice of the tax "allocation" in court on November 8 did not inform the United States of the purported tax allocation in time for it to make an objection to the plan of rehabilitation before the November 8 deadline for filing such objections had expired.

5. In its docketing statement in its appeal to this Court, and in light of the above-summarized facts, the United States noted five potential issues:

- Whether the injunctions issued by the Dane County Circuit Court violated the sovereign immunity of the United States, which cannot be waived except by a statute enacted by Congress.

- Whether certain injunctions are barred by the federal Tax Anti-Injunction Act, 26 U.S.C. § 7421(a), which states that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed."
- Whether the circuit court exceeded its jurisdiction when it asserted exclusive state court jurisdiction over a potential federal tax liability of Ambac not yet asserted by the IRS and where Ambac itself is not in rehabilitation or receivership. *See* 26 U.S.C. § 6871.
- Whether the circuit court erred in concluding that "the rest of the disputed tax allocations, which total approximately $700 million, are subject to the jurisdiction of this Court and the priority structure adopted by the Plan due to the timely, pre-bankruptcy allocation of those disputed liabilities by the Rehabilitator and OCI to the Segregated Account." (Final Order of Jan. 24, 2011 at 30.)

- Whether the circuit court otherwise erred in confirming the rehabiliation plan as it relates to the United States and its agencies.

6. The first four issues also are inherently federal and unique to the United States. They involve the sovereignty and sovereign immunity of the United States, and the interpretation of the McCarran-Ferguson Act (15 U.S.C. § 1011–1015) as it relates to the Internal Revenue Code (26 U.S.C.) and the Treasury Regulations governing the tax liability of consolidated groups. Because the issues are inherently federal and involve the United States as sovereign, the United States should be able, in the first instance, to have its issues addressed by the federal courts.

7. There is considerable overlap between the issues that the United States is raising in the Seventh Circuit and the issues that it raised in its notice of appeal and its docketing statement in the instant appeal. At a minimum, the Seventh Circuit will need to rule on the interaction between the McCarran-Ferguson

Act and the federal statutes granting the United States district courts original and removal jurisdiction. *See* 26 U.S.C. § 7402(a); 28 U.S.C. §§ 1331, 1340, 1345, 1442. Moreover, another issue in the Seventh Circuit is whether the United States District Court for the Western District of Wisconsin erred, in part, by refusing to enjoin (on jurisdictional grounds) the Dane County Circuit Court from proceeding with respect to Ambac's potential federal tax liability. The ruling of the Seventh Circuit should resolve the United States' jurisdictional objections to litigating in the Wisconsin courts, thereby sparing this Court from having to consider this appeal with those objections pending.

Further, the Seventh Circuit appeals involve the above-listed issues concerning sovereign immunity, the McCarran-Ferguson Act, and the Internal Revenue Code as they pertain to the allocation of the tax liability to the segregated account and the imposition of an injunction against the United States. Compelling the United States' appeal to proceed immediately would result in both this Court and the Seventh Circuit

considering the same issues simultaneously — a wasteful duplication of judicial effort. Holding the United States' appeal in abeyance would both eliminate that duplication and could reduce the number and complexity of the issues that this Court might ultimately need to decide.

8. The order that is being appealed here notes that "[t]he Plan anticipates claims arising in three classes designated by Wis. Stat. § 645.68: administrative claims (Class 1); policy claims (Class 3); and general creditor claims (Class 5)." (Order of Jan. 24, 2011 at 31.) The order then goes on to point out that "[o]ther claims that fall into other classes are possible" and gives "a federal government claim for taxes" as an example. (*Ibid.*)

The insurance commissioner has taken the position that "the merits of the disputed [federal] tax liability" will be "resolved in a . . . federal forum (*e.g.*, the pending bankruptcy of Ambac Financial Group, Inc. ("AFGI"), Ambac's parent company)." (In the Matter of the Rehabilitation of the Segregated Account of Ambac Assurance Corporation, No. 10-cv-778 (W.D. Wis.), Doc. 21

at 12.) He has also represented to the Dane County Circuit Court that he "will take necessary steps to ensure the appropriate treatment of [a federal government] claim[ ] [for tax liabilities] under Wis. Stat. § 645.68 if and when such liabilities become less speculative." (Order of Jan. 24, 2011 at 31.) Thus, the insurance commissioner has represented that the federal tax claims are to be resolved at a later time through appropriate treatment under Wis. Stat. § 645.68. Accordingly, he cannot represent that this appeal needs to proceed expeditiously so that the federal tax claims can be finally resolved.

9. Holding the United States' appeal in abeyance will not prejudice any of the other creditor-appellants, whose appeals will go forward in this Court. There is also little chance of this Court will issue conflicting rulings, inasmuch as the Court will be able to consider its prior opinions, in later deciding an appeal of the United States.

For the foregoing reasons, the instant appeal of the United States (No. 2011AP561) should be held in abeyance pending the outcome of the United States' appeals to the Seventh Circuit.

Respectfully submitted,

/s/ Richard D. Humphrey

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Dated this 21st day of March, 2011. March 22, 2011

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DECLARATION

Anthony T. Sheehan, of the Department of Justice, Washington, D.C., states as follows:

1. I am an attorney employed in the Appellate Section, Tax Division, United States Department of Justice.

2. The facts recited in the foregoing motion are true and correct to the best of my knowledge and belief.

I declare under penalty of perjury, pursuant to 28 U.S.C. § 1746, that the foregoing is true and correct. Executed this 22d day of March, 2011, in Washington, D.C.

/s/ Anthony T. Sheehan

ANTHONY T. SHEEHAN
Attorney

CERTIFICATE OF SERVICE

I hereby certify that, on this 22d day of March, 2011, that a true and correct copy of the foregoing document has been served upon counsel for the Wisconsin insurance commissioner via First Class Mail, with postage prepaid, in an envelope properly addressed as follows:

Matthew R. Lynch, Esquire
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I further certify that a true and correct copy of the foregoing document (except for replacing handwritten dates and signatures with typed versions of the same) has been served on all counsel of record using the e-mail distribution list established by the Circuit Court for Dane County for that purpose, as listed below:

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