

# **EXHIBIT 7**

UNITED STATES DISTRICT COURT  
FOR THE WESTERN DISTRICT OF WISCONSIN

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IN THE MATTER OF THE REHABILITATION  
OF SEGREGATED ACCOUNT OF  
AMBAC ASSURANCE CORPORATION

THEODORE K. NICKEL,  
COMMISSIONER OF INSURANCE  
OF THE STATE OF WISCONSIN

Petitioner,  
-vs-

Case No. 10-CV-778-BBC

UNITED STATES OF AMERICA,

Madison, Wisconsin

January 12, 2011

Respondent.

2:30 p.m.

\* \* \* \* \*

STENOGRAPHIC TRANSCRIPT OF MOTION HEARING  
HELD BEFORE DISTRICT JUDGE BARBARA B. CRABB,

APPEARANCES:

For the Petitioner: Foley & Lardner  
BY: ATTORNEYS MICHAEL VAN SICKLEN  
and NAIKANG TSAO  
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Madison, Wisconsin 53703

For Ambac Assurance Corporation: Dewey & LeBoeuf  
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Lynette Swenson, RMR, CRR, CBC  
Federal Court Reporter  
U.S. District Court 120 N. Henry St., Rm. 520  
Madison, WI 53703 (608) 255-3821

1 Appearances continued:

2 For the Respondent: Department of Justice, Tax Division  
3 BY: ATTORNEYS ROBERT KOVACEV  
4 and HILARIE SNYDER  
5 P.O. Box 7238  
6 Washington, DC 20044

7  
8 Also present: Roger Peterson - Deputy Adm. of OCI

9 \* \* \* \* \*

10 (Call to order)

11 THE CLERK: Case Number 10-CV-778-BBC. Sean  
12 *Dilweg versus United States of America, et al.* Court is  
13 called for a motion hearing. May we have the  
14 appearances, please.

15 MR. VAN SICKLEN: Michael Van Sicklen and  
16 Naikang Tsao seated to my left of Foley & Lardner appear  
17 on behalf of the Wisconsin Commissioner of Insurance as  
18 the state-appointed rehabilitator. Also present in the  
19 first row is Roger Peterson from OCI. He is the Deputy  
20 Administrator in charge of the Division of Regulation  
21 and Enforcement.

22 I would also note one other point, Your Honor, and  
23 that is as a result of the recent election, the  
24 Commissioner has changed very recently and we will be  
25 noting that in further filings in the rehabilitation  
proceeding.

1 THE COURT: And that's Mr. Nickel?

2 MR. VAN SICKLEN: Yes, it is, Your Honor.

3 MR. RICARDO: Good afternoon, Your Honor.

4 Henry Ricardo of Dewey & LeBoeuf for Ambac Assurance  
5 Corporation. With me is Dan Stolper of Stafford  
6 Rosenbaum, also for Ambac Assurance Corporation.

7 THE COURT: Thank you.

8 MR. KOVACEV: Good afternoon, Your Honor.  
9 Robert Kovacev for the United States, and Hilarie  
10 Snyder.

11 THE COURT: Thank you. And that's fine that  
12 you stood up then, but I have to keep you sitting down  
13 and speaking into the microphone, unless you'd like to  
14 use the lectern and use the microphone on the lectern.

15 MR. KOVACEV: That's quite all right, Your  
16 Honor.

17 THE COURT: All right. Thank you. Seems to me  
18 that the major issue, and certainly the threshold issue,  
19 is the question whether this case was properly removed,  
20 and I would like to spend most of the two hours allotted  
21 to the argument today to that issue. I certainly will  
22 consider other things as well.

23 It also seems to me that because the United States  
24 bears the burden of showing that removal was proper,  
25 that perhaps it would be just as well to let the United

1 States go first and try to justify the removal. Any  
2 objection to that?

3 MR. VAN SICKLEN: That would be fine, Your  
4 Honor.

5 THE COURT: Okay.

6 MR. KOVACEV: And I may remain sitting, Your  
7 Honor?

8 THE COURT: You may, and please do.

9 MR. KOVACEV: In this case, the Dane County  
10 Circuit Court issued an injunction restraining the  
11 United States from assessing or collecting a potential  
12 tax liability of 700 million dollars. This injunction  
13 was issued in the rehabilitation proceeding of what's  
14 called the Segregated Account, which is a small part of  
15 a larger corporation, insurance company called Ambac  
16 Assurance and affiliated subsidiaries.

17 This injunction, while it was issued in the  
18 Segregated Account, applies to all -- collection against  
19 all of Ambac and any of its affiliates.

20 THE COURT: And isn't that absolutely necessary  
21 if there's going to be a rehabilitation proceeding?  
22 It's an odd duck in this instance because you've got  
23 this Segregated Account with all the liabilities and the  
24 problem debts in this one box A, but then you have these  
25 significant loans and insurers who are out there who, if

1 something happens to them and their ability to insure or  
2 to make good on their commitments to the Segregated  
3 Account and to the whole rehabilitation proceeding, will  
4 result in the failure of the rehabilitation proceeding,  
5 right?

6 MR. KOVACEV: Well, that's the Commissioner's  
7 statement on that. We haven't had discovery. I have no  
8 basis right now to agree or disagree with that.

9 THE COURT: But I think it's so important,  
10 because clearly you're not objecting to having to be  
11 constrained as it relates to the Segregated Account. Of  
12 course that probably goes without saying. Nobody wants  
13 what's in the Segregated Account, frankly. But you  
14 certainly are upset about having to be restrained from  
15 doing anything in connection with investigating whether  
16 this 708 million dollars of refund was a proper refund  
17 or not a proper refund, in which case you're entitled to  
18 get it back. The Commissioner has said that it will --  
19 it doesn't really want to restrain you from doing  
20 anything except actually levying and collecting. How  
21 does that affect your situation?

22 MR. KOVACEV: Well, to begin with, Your Honor,  
23 it's not absolutely clear to me from reading the  
24 Commissioner's pleadings exactly where he's drawing that  
25 line. The injunction itself is very broad --

1 THE COURT: Right.

2 MR. KOVACEV: -- and could be read to prevent  
3 us from doing anything, even conducting an audit. In  
4 his opposition brief to the motion to dissolve, the  
5 Commissioner seemed to indicate and what I took from  
6 that was any actual seizure of assets, which would be  
7 effectively a levy of assets, an administrative levy,  
8 but not assessing the tax or the perfecting a tax lien  
9 or conducting an investigation. Now it seemed to me,  
10 reading the reply, that he walked back from that a  
11 little bit. So I would be interested to hear from the  
12 Commissioner exactly where he would draw the line.

13 In any event though, Your Honor, the  
14 Anti-Injunction Act would still prevent any restraint as  
15 to what we're calling the General Account, the rest of  
16 Ambac, except for the Segregated Account, even as to  
17 levying because --

18 THE COURT: So you think you can remove because  
19 this is a civil action against the United States, the  
20 IRS. And why do you characterize it as a civil action?  
21 And why do you characterize it as being against the  
22 United States?

23 MR. KOVACEV: Because, Your Honor, we were --  
24 the IRS was singled out by name in an injunction  
25 enjoining them from conducting their constitutional

1 duties to lay and collect taxes against Ambac. And any  
2 time when there's an action, however it's labeled, that  
3 puts a state agency or state officer in jeopardy for  
4 conducting his official duties, that has been  
5 interpreted under Sec. 1442(a) as sufficient as a civil  
6 action to justify a removal. There have been cases in  
7 this circuit and other cases --

8 THE COURT: But mostly in situations in which  
9 the underlying case is a civil action or criminal  
10 proceeding, right? I'm not aware of any rehabilitation  
11 proceeding, any proceeding involving a race -- an *in rem*  
12 proceeding in which there's been any case arising out of  
13 it in which somebody sought to present -- prevent being  
14 restrained by the nature of the proceeding.

15 MR. KOVACEV: Well, I would point Your Honor to  
16 the *Granite Resources* case, I believe, from Nebraska.

17 THE COURT: But that case involved the Federal  
18 Crop Insurance Corporation, so --

19 MR. KOVACEV: That's true.

20 THE COURT: -- that was another insurance case.  
21 That gets us into the preemption aspect of this whole  
22 argument. But in other cases by that same judge --

23 MR. KOVACEV: But none of --

24 THE COURT: -- he hadn't agreed to have any  
25 kind of federal action. But it's just here where there

1 was the special crop insurance issue, I think that  
2 really stands by itself.

3 MR. KOVACEV: Well, however none of the cases  
4 that the Commissioner cites involve a federal agency  
5 engaging in its federal duties and then being denied the  
6 right to remand, certainly none since the change in 1996  
7 to 1442(a) to make it explicit that its the United  
8 States and its agencies and not just the officers that  
9 have the right to remove.

10 THE COURT: But in the fourteen years since  
11 that change was made, there must have been a number of  
12 rehabilitation proceedings going on around the United  
13 States.

14 MR. KOVACEV: It may be a reflection of the  
15 hootspa, for lack of a better word, of Ambac and the  
16 Commissioner for taking this step that it hasn't  
17 happened before. I am not aware of a rehabilitation  
18 proceeding where any injunction against the IRS was  
19 sought. I haven't -- the Commissioner and Ambac have  
20 not relayed any of that, any suggestions of that in  
21 their brief. So it's entirely possible that this is  
22 sui-generis.

23 THE COURT: But you're a major creditor in this  
24 proceeding --

25 MR. KOVACEV: Potential.

1 THE COURT: -- and the second level of  
2 priority. If you jump the line, how is the rest of the  
3 proceeding going to succeed?

4 MR. KOVACEV: If I may break that down, Your  
5 Honor. To begin with, we're a potential creditor as to  
6 this tax liability.

7 THE COURT: Which adds different complications.

8 MR. KOVACEV: It does. It does. But second,  
9 when you say *this proceeding*, that's the rehabilitation  
10 of the Segregated Account. All of the rest of Ambac is  
11 outside of that proceeding, and the Commissioner, Ambac,  
12 the state rehabilitation court all indicated as  
13 explicitly as possible that the rest of Ambac is not  
14 within the custody of the rehabilitation court, is not  
15 in rehabilitation, and therefore could not be subject to  
16 the insolvency priorities game. Nor, would I add, would  
17 it be subject to the federal insolvency priority  
18 statute, assuming that the rest of Ambac is solvent at  
19 this time. So any kind of priority fight really doesn't  
20 enter into it as to the rest of Ambac because there is  
21 no rehabilitation. The Wisconsin -- there is no  
22 Wisconsin priority statute that applies. It would just  
23 be whatever the priorities of a federal tax lien would  
24 be against any other claimants, just as if there were no  
25 rehabilitation proceeding.

1           Now as to the Segregated Account, there where  
2 there -- we have a disagreement about priority, and I'm  
3 happy to discuss, you know, the reasons why we disagree  
4 if Your Honor thinks that's important. But as far as --  
5 but as far as whether we can assess taxes, whether we  
6 can collect against the rest of Ambac, the General  
7 Account, whether we can perfect a lien, all of those  
8 issues are issues that have nothing to do with a fight  
9 over priority over whatever assets may be in the  
10 Segregated Account. We may have that fight if and when  
11 we either intervene or file a proof of claim in the  
12 Segregated Account as to the Segregated Account, but  
13 that's not ripe now.

14           THE COURT: You're not ready to levy and you're  
15 not ready to collect because you haven't even done the  
16 investigation that you need to do to find out whether  
17 that money was refunded improperly or not.

18           MR. KOVACEV: Right. And just to clarify, this  
19 all began because of the operation of the Internal  
20 Revenue Code. Section 6411 permits a tentative refund  
21 in certain instances, including for net operating losses  
22 in this case. Ambac, the consolidated group, requested  
23 refunds to the tentative refunds to the order of about  
24 700 million dollars. Under the statute, the IRS had 90  
25 days to conduct a very limited review. At the end of

1 that time, they had to refund the money unless they  
2 could show some good cause, as laid out in the statute.  
3 The IRS retains the right, however, under this scheme to  
4 reexamine it at length after the 90 days and then  
5 recapture the funds, and that's the Congressional scheme  
6 for permitting these tentative refunds, so the taxpayers  
7 can have the benefit of getting money for operating  
8 purposes or cash flow purposes. But on the flip side,  
9 the IRS has the opportunity to recapture it if they  
10 later determine that they can -- that the refund was  
11 erroneous.

12 Here the IRS issued what's called an *information*  
13 *document request*, which is -- it's not even a summons or  
14 subpoena, it's just a request for information. And it  
15 was some -- I believe it had some accounting issues  
16 involving Ambac that related to the refunds. Within  
17 days, the Ambac holding company was in bankruptcy and  
18 they filed an adversary proceeding declaring that the  
19 IRS had driven them to bankruptcy and demanding some --  
20 that the bankruptcy court determine the tax. At that  
21 same time, the Commissioner asked for and got this  
22 ex-parte injunction against the IRS, again not just as  
23 to the Segregated Account, but as to all of Ambac.

24 So that was on November, I believe, 7th and 8th.  
25 So since that time, I understand that the IRS has

1 received some informal discovery from Ambac and they are  
2 considering the issue and --

3 THE COURT: Ambac is. Is that what you're  
4 saying?

5 MR. KOVACEV: Ambac has produced some  
6 documents. Technically I believe it's the holding  
7 company that's produced them to the IRS, but some  
8 documents have been produced. The IRS is conducting an  
9 examination and will come to a determination. But the  
10 point is under the Anti-Injunction Act, under the  
11 Anti-Injunction Act you can't enjoin even a potential  
12 tax liability, especially a potential tax liability,  
13 because the Internal Revenue Code says if there's an  
14 assessment, if there's a lien or if there's a levy,  
15 there are remedies for that under the Code. And the  
16 Commissioner pointed out that there's a possibility of a  
17 quiet title action. This isn't it quite yet, but there  
18 could be a quiet title action on the assets regarding  
19 whether the lien was valid, the federal tax lien. If  
20 there's a levy, there are ways to contest the levy. But  
21 those were all actions in federal court taken after the  
22 fact. And that's how Congress intended the system to  
23 work. Congress did not intend any sort of *ab initio*,  
24 you know, some sort of injunction before the IRS had  
25 even reached a conclusion as to a tax liability. That's

1 not what the Anti-Injunction Act says, it says just the  
2 opposite.

3 THE COURT: If the rehabilitation proceeding  
4 was what apparently the Commissioner calls a full  
5 proceeding so that everybody, all the Ambac entities  
6 were part of it, and the same thing happened, would you  
7 have any right to go to federal court?

8 MR. KOVACEV: Well, in that case -- in that  
9 case, Your Honor, to begin with, assuming that all the  
10 Ambac entities in the consolidated that were insurance  
11 companies were in rehabilitation, then under IRS  
12 regulations there would be no levy against the assets in  
13 the custody of the state court. So that would apply to  
14 everything in rehabilitation at that time.

15 THE COURT: So your objection is that the  
16 Commissioner has made this partial rehabilitation  
17 proceeding for reasons that he thinks are best or at  
18 least that his predecessor thought were best and that  
19 the presiding judge has approved, but it leaves these  
20 entities with the money and the resources kind of out  
21 beyond the protection of this Segregated Account. And  
22 you think that you should have the right to go after  
23 them for recovery of the refund if you find that you're  
24 entitled to it --

25 MR. KOVACEV: Well --

1 THE COURT: -- regardless of the effect that  
2 will have on the rehabilitation proceeding.

3 MR. KOVACEV: Well, it's not that we think so,  
4 it's that Congress has said so in terms of -- there's a  
5 consolidated tax group, which is what Ambac and its  
6 affiliates and AFGI, the holding company, were. The  
7 deal there, the scheme is that they get to take  
8 advantage of pooling their taxes, their income, losses,  
9 whatever, and Ambac has indicated that's a considerable  
10 tax benefit to them. The flip side to that as part of  
11 the scheme that Congress has enacted is any member of  
12 the consolidated tax group is severally liable for the  
13 liability of the entire group. That is what Congress  
14 and the Treasury through regulations has determined.

15 Ambac wants to have it both ways. They want to  
16 take advantage even now of the consolidated tax rules,  
17 but they want to forget that part about the Ambac and  
18 its subsidiaries not in rehabilitation being severally  
19 liable, and no state court and no state law can do that.

20 I do want to say one more thing, Your Honor. We do  
21 not take issue with the Commissioner undertaking a  
22 partial rehabilitation. We do not take issue with the  
23 establishment of a Segregated Account. And we know that  
24 the Commissioner and the people working in his office  
25 are dedicated public servants. They're trying to do

1 their best to fulfill their duties as insurance  
2 regulators. We understand that. We have no desire to  
3 interfere with any of that, except that Congress has  
4 given us the responsibility to collect federal taxes and  
5 so making an allocation of federal tax liability for  
6 internal accounting purposes to the Segregated Account  
7 would not trouble the United States. Attempting to bind  
8 the United States in that sort of agreement, that  
9 violates the Anti-Injunction Act.

10 I hope I've made myself clear, that we don't take  
11 issue with the way that the rehabilitation proceeding,  
12 except as it pertains to --

13 THE COURT: I assumed that. I guess what I  
14 want to know is more about your -- and I'll be asking  
15 the other side this as well, but isn't it true that  
16 these other entities have pledged money to the  
17 rehabilitation proceeding?

18 MR. KOVACEV: Well, this pledge apparently is  
19 in the form of a note. It's a demand note, and we have  
20 attached it to one of our pleadings. I think it's our  
21 reply brief. And as to the assets of the General  
22 Account, it appears that it's an unsecured note. There  
23 is a security offered as to certain premiums from --  
24 with respect of policies in the Segregated Account, not  
25 the General Account. So this pledge, they're unsecured

1 creditors. The Segregated Account is at best an  
2 unsecured creditor of the General Account as to most, if  
3 not all, the General Account's assets. And certainly  
4 merely being an unsecured creditor cannot create the  
5 custody of the rehabilitation court that would be  
6 required to oust this court of jurisdiction or to affect  
7 the ability of the IRS to levy.

8 And I do believe there is also a reinsurance  
9 agreement, but again, it's a contractual agreement and  
10 as far as I'm aware does not carry any security  
11 interest. Even a security interest would not suffice to  
12 overcome the Anti-Injunction Act, but I don't think even  
13 that exists here.

14 THE COURT: So this whole thing really rises or  
15 falls in your mind on whether there is a proceeding that  
16 encompasses more than the Segregated Account, because  
17 you take the position that you're free to do anything  
18 you want to do, and I don't mean that you want to do,  
19 but that you're required to do by law against any entity  
20 other than the Segregated Account without interfering  
21 with the rehabilitation proceeding. And that's the  
22 basis on which you say that you're entitled to remand,  
23 because to the extent that you're being enjoined, that's  
24 an action taken against the United States that allows  
25 you to remove.

1 MR. KOVACEV: I -- I'm sorry, Your Honor.

2 THE COURT: Go ahead.

3 MR. KOVACEV: I think it is fair to say that  
4 what has aggrieved us at this point is the injunction.  
5 We do think that we -- it may well be that there will be  
6 a tax liability assessed in the near future and at that  
7 time there may be -- will be some sort of collection  
8 proceeding that the IRS will take against the General  
9 Account. At that time, should Ambac or the Commissioner  
10 wish to contest it, they can, and there are statutory  
11 mechanisms in the Internal Revenue Code that let them do  
12 that. They all lead to this court. But in terms of the  
13 removal, that was predicated by the injunction against  
14 the IRS.

15 THE COURT: And what connection does the  
16 bankruptcy proceeding play in this? That determination,  
17 wouldn't that be where the determination is going to be  
18 played out?

19 MR. KOVACEV: Well, right now there is an  
20 action pending in the bankruptcy court to determine the  
21 tax liability, actually to litigate and resolve the  
22 substantive tax issue whether -- which I think boils  
23 down to whether the accounting methods that were used  
24 for certain credit default swaps clearly reflected  
25 income, and that's an issue that's currently being

1 litigated in the Southern District of New York and  
2 presumably will stay litigated in the Southern District  
3 of New York.

4 But our concern is with the injunction, which  
5 prevents us from accomplishing the recapture which we're  
6 allowed to do under the Code of this refund should we  
7 conclude it's erroneous. So that has nothing to do with  
8 actually contesting the merits of the tax because of a  
9 levy or recapture, those are provisional remedies that  
10 the IRS may take.

11 THE COURT: So you're saying that at some point  
12 sooner, then the Southern District of New York will make  
13 its decision about the legality of this refund and you  
14 will make a tentative decision that will give you the  
15 authority to levy on assets of Ambac --

16 MR. KOVACEV: Just so --

17 THE COURT: -- setting aside the existence of  
18 the rehabilitation proceeding?

19 MR. KOVACEV: Just so I'm clear, the IRS's  
20 decision would not be tentative. I meant the tentative  
21 refund, but that's where the term tentative came in.  
22 But the IRS would make a determination that that refund  
23 was erroneous, and then is entitled, among other things,  
24 to recapture that erroneous refund.

25 THE COURT: Even though that's still being

1 decided in the bankruptcy court.

2 MR. KOVACEV: Yes, Your Honor, because it's a  
3 provisional remedy and the Treasury would -- if the  
4 issue is ultimately decided against the Government, the  
5 Treasury will happily return the funds. But it's not  
6 the place of any court, not even the rehabilitation  
7 court, to tell us that we can't take that provisional  
8 remedy when Congress has instructed us that we have --  
9 that we can.

10 THE COURT: But this is going to take you some  
11 period of time to decide.

12 MR. KOVACEV: Yes. And I hesitate to predict,  
13 and I certainly wouldn't want to bind the IRS as to a  
14 timetable. My personal suspicion is that it would be in  
15 weeks rather than months that they would come to a  
16 conclusion about that, but I'm not intending to bind  
17 anyone by that, so just to be clear with the Court.

18 THE COURT: And you would not be satisfied with  
19 standing in line with the other creditors of Ambac in  
20 the rehabilitation proceeding.

21 MR. KOVACEV: Well again, Your Honor, right now  
22 there is just the Segregated Account that is in  
23 rehabilitation. So any *standing in line* only applies to  
24 the Segregated Account. There is no line and -- to jump  
25 as to the rest of Ambac. I think in, Your Honor, your

1 hypothetical, you said what would happen if it was all  
2 in rehabilitation. Well, at that point we would assess,  
3 the IRS would assess the taxes owed and would take the  
4 steps it needed to perfect the lien. It could not levy  
5 because Treasury regulations foreclose that on any  
6 assets that are actually within the custody of the  
7 rehabilitation court, and what the next step would be,  
8 whether it would be to file a proof of claim in the  
9 rehabilitation proceeding or to move to intervene and  
10 bring it back here, I can't say. But those are both  
11 potential options. And in that case, whatever decision  
12 about priority, whether it's the Wisconsin priority  
13 statute or the Internal Revenue Code priority statute,  
14 which is something entirely different from 3713, which  
15 has never been litigated as far as I'm aware, those  
16 issues would be ripe then. But they're not ripe now.

17 THE COURT: Let me turn to the other side, at  
18 least for awhile. Mr. Van Sicklen.

19 MR. VAN SICKLEN: Yes. Thank you, Your Honor.  
20 And thank you very much for having this hearing  
21 opportunity. Our perspective is that this is a  
22 comprehensive state rehabilitation proceeding in which  
23 the IRS is one of many, you know, actual or potential  
24 claimants.

25 THE COURT: But doesn't -- isn't there a

1 problem when you've got this particular form of  
2 rehabilitation proceeding, which may have a lot of  
3 merit, and I realize that you and the Commissioner  
4 believe that it has a lot of merit because it has in  
5 your view the greatest chance of preserving assets, but  
6 you have this strange situation in which the only  
7 protected part of the proceeding is this Segregated  
8 Account, which is the toxic part of the whole business?

9 MR. VAN SICKLEN: Well, Your Honor, I guess I  
10 would say several things, and that is that I think  
11 counsel's argument misapprehends the nature and  
12 relationship between the Segregated Account and the  
13 claims-paying resources in this case, and I would like  
14 to explore that. I think it also misapprehends this  
15 kind of in the legal custody argument that he makes.  
16 There's a much narrower test than McCarran-Ferguson,  
17 where the issue is whether the threatened action by the  
18 federal claimant would interfere with the rehabilitation  
19 proceeding and the best interest of the policyholders  
20 who have preference under Wisconsin law, as in all  
21 states, over the federal claimants. And because the  
22 McCarran test is broader than simply who has legal  
23 control or custody of the assets being protected, I  
24 think it's a meaningful distinction.

25 I'd also note that the statute that was used here

1 in aid of the rehabilitation is typically always a  
2 first-day injunction order, very much like a bankruptcy  
3 automatic stay, and we did issue that at the outset. It  
4 wasn't until nine months into the proceeding that the  
5 IRS issued its document request and we discovered that  
6 there might be a concern about retention of these tax  
7 refunds, and at that point, we issued the supplemental  
8 injunction.

9 But under 645.05, which is the injunction statute  
10 which aids rehabilitation, it allows the Commissioner to  
11 enjoin any kind of threatened action under (k) which  
12 would have the potential effect of either impairing the  
13 assets used for the liquidation or here rehabilitation  
14 or interfere with the actual proceeding in the interest  
15 of policyholders. And we think in that regard --

16 THE COURT: Well, that's --

17 THE WITNESS: -- this relationship is like your  
18 decision in *Metropolitan*. There is a --

19 THE COURT: It's a great test, but the  
20 McCarran-Ferguson Act gives the state authority, in many  
21 cases, to override federal statutes, so far as the  
22 federal statutes are trying to relate to insurance, the  
23 business of insurance in the state. But just because  
24 the state statute says that the test should be this  
25 other one, how does that override the Federal

1 Government's interests in protecting its legitimate  
2 claims to assets that are due and owing to it?

3 MR. VAN SICKLEN: Well, the state insurance  
4 priority scheme does expressly address any kind of claim  
5 that any federal player would have and its subordinate  
6 to policyholders. And the issue here is there is a very  
7 unique and special relationship between the one entity,  
8 Ambac, and these two accounts. And these are not  
9 stranger accounts here. They are tied together. And  
10 this issue has been tested in prior litigation in the  
11 underlying state court proceedings. There is a plan of  
12 operation which ties the two together, links them.  
13 There is, as part of that, a management services  
14 agreement, a cooperation agreement, a secured note for  
15 two billion dollars, and the excess of loss reinsurance  
16 agreement that basically subjects -- makes this pool of  
17 claims-paying resources a common well for both the  
18 General Account and the Segregated Account claimants.  
19 The difference being is that the Commissioner, for the  
20 best interest of all of the claimants, including here  
21 the IRS, tried to derisk the General Account by moving  
22 the liabilities into that account and treating them  
23 pursuant to this comprehensive plan.

24 I would submit again that the test under McCarran  
25 is about whether or not the threatened action here would

1 interfere with the ability to fund claims out of that  
2 common well. It is very much like the situation you  
3 addressed in the *Metropolitan Life* case, where there was  
4 a liquidation estate with a certain pool of assets that  
5 were under the direct access, if you will, of the State  
6 Commissioner as liquidator, and there was a separate  
7 pool, in that case called the Segregated Account, which  
8 this Court found would be -- was a proper source of the  
9 Commissioner's interest in protecting from the  
10 claimants; and that if the claimant was permitted to  
11 interfere with that separate source of funding for his  
12 liquidation proceeding, it would disservice the  
13 interests of the policyholders and other claimants and  
14 it would lead to the unfortunate result of having split  
15 jurisdictions and potentially incongruous and  
16 inconsistent decisions.

17 That's what you would have here, Your Honor. We  
18 have no problem with the IRS going into the state court  
19 and litigating the scope of the injunction or any issue  
20 it has about the Segregated Account or the like. But  
21 they should not be proceeding on two fronts. And I  
22 would come back to your first question which is whether  
23 or not the removal itself was defective, and we think it  
24 is. I think it reflects the very different perspectives  
25 that these two parties have.

1           The IRS views this primarily as a tax dispute. We  
2 view it again as a comprehensive insurance  
3 rehabilitation proceeding. We didn't sue the  
4 Commissioner -- I'm sorry, the IRS. They're not a  
5 party. We didn't take any action against them that was  
6 any different than any other claimant or potential  
7 claimant affected by this rehabilitation. And under the  
8 injunction powers of the rehabilitator, we need to issue  
9 protection in aid of the rehabilitation, and I submit  
10 that on its face the statute allows us to protect assets  
11 in the General Account. But those assets are within the  
12 control or the law of the rehabilitator in meaningful  
13 respects.

14           We cited in our briefing the testimony at the week  
15 long confirmation trial which established the very  
16 strong controls that the rehabilitator has over those  
17 funds under the cooperation agreement, which is an  
18 exhibit to one of the IRS declarations. They are not --  
19 they have to provide budgets to the rehabilitator.  
20 They're not allowed to expend any funds in excess of  
21 five million dollars without the rehabilitator's  
22 consent.

23           All -- any claim from the rehabilitation can draw  
24 upon all of the funds pursuant to the secured note and  
25 the reinsurance agreement. These are not separate

1 corporations. And again, we cited in our reply brief  
2 the legislative history about the Segregated Account  
3 statutes; how they're a corporation within a  
4 corporation. It's a different beast, and I would  
5 respectfully submit that the nexus between the two and  
6 the control that can and is being exercised by the  
7 Commissioner through the rehabilitation proceeding on  
8 the claims-paying resources is stronger than what was at  
9 issue in the *Metropolitan* decision.

10 I would submit that there are three independent  
11 ways here, reasons why this Court should remand the  
12 entire proceeding back to the state court, and that is  
13 again that the IRS didn't have the right to remove this  
14 proceeding as a nonparty. It's a claimant. They  
15 haven't intervened and they're not being sued. We're  
16 simply protecting against our collection rights. They  
17 repeatedly in their briefs talk about well, there's a  
18 tax issue or an injunction is too broad. Let there be  
19 no doubt, when you look at the injunction, it's solely  
20 with respect to claims they would make with respect to  
21 what to allocate, and that's just their pre-petition  
22 claim as to those tax refunds. The merits is being  
23 litigated in federal court. They concede that here.  
24 Any kind of current tax --

25 THE COURT: Could you say that again? You're

1 saying their claim is limited to?

2 MR. VAN SICKLEN: Is a collection issue. It's  
3 how their claim, if they ever prove it up, should be  
4 treated in the rehabilitation. That's the only issue  
5 that we think is relevant here. And in that respect,  
6 they're not being sued. So we don't think removal is  
7 appropriate. We think we clearly satisfied the three  
8 tests for application of McCarran here. Their statutes  
9 are of general interest. The removal statutes that they  
10 look at for being a federal defendant would be the same  
11 issue for diversity or parties in the rehabilitation  
12 trying to remove on a federal constitutional issue. If  
13 we allowed removal in all those instances, it would  
14 eviscerate the ability to have a comprehensive state  
15 insurance rehabilitation proceeding.

16 THE COURT: So do you think it all hinges on  
17 the showing that the whole thing is one package? You've  
18 got the segregated finding of a Segregated Account, the  
19 General Account, and these other entities, and to the  
20 extent that they all play a part in this rehabilitative  
21 proceeding, that affects the IRS's right to remove?  
22 Generally in a regular case, if a judge like the one  
23 that the IRS has cited involving the state court that  
24 ordered the United States Attorney to turn over grand  
25 jury records and the Court of Appeals for the Seventh

1 Circuit said oh, that's a case we have to hear, that has  
2 to be in federal court because state courts can't be  
3 allowing -- can't be ordering federal officials to do  
4 things. Now in that case, there was no -- it was  
5 clearly an *in personam* action. There wasn't anything  
6 that was involved. It was a criminal proceeding.

7 It seems to me the argument is really -- really  
8 hinges on this whole question of the amount of control  
9 and connection and relationship of all of the different  
10 entities in the rehabilitation proceeding being part of  
11 a thing, whatever that thing would be called.  
12 Otherwise, if it doesn't matter to the rehabilitation  
13 proceeding what Ambac is doing or other entities, then I  
14 don't see any reason to say that the IRS can't remove  
15 the case to be heard on the particular claim against  
16 that particular entity.

17 MR. VAN SICKLEN: I guess I --

18 THE COURT: If that makes any sense.

19 MR. VAN SICKLEN: It's complicated, Your Honor,  
20 I admit.

21 THE COURT: Yes, it is complicated.

22 MR. VAN SICKLEN: I don't think that they --  
23 they concede that they would not be able -- they  
24 wouldn't be here if we were in a full rehab essentially,  
25 and --

1 THE COURT: Right.

2 MR. VAN SICKLEN: -- the irony of that, of  
3 course, is that from all of the evidence which has been  
4 produced in the underlying state court proceeding, the  
5 result of a full rehabilitation would be a major  
6 increase potentially in claims, which would lessen the  
7 likelihood of resources being available to pay a  
8 subordinate creditor like the IRS.

9 But taking that, putting that to the side, I submit  
10 that under McCarran, that we don't have to establish  
11 that we have full and complete custody of these claim  
12 paying resources; that all we need to show is that the  
13 state law permits us to shield those assets from  
14 collection here and require the collection to take place  
15 to the rehabilitation proceeding.

16 This isn't a stranger corporation. We are  
17 restructuring Ambac Assurance Corporation in different  
18 pieces. We did so through the bank settlement, which is  
19 referenced in the materials. We've done so through the  
20 allocation of the types of policies and exposures  
21 between the two accounts. But the Segregated Account is  
22 part of Ambac. It's a corporation within a corporation.  
23 And we've linked that in a way that's unusual. You're  
24 not going to find case law in other states because  
25 Wisconsin is alone in having this type of a Segregated

1 Account proceeding. It requires, when you look at the  
2 actual language of 611.24, which is the provision that  
3 governs setting up an optional Segregated Account, if  
4 you set it up as was done here, once the corporation is  
5 already in existence, we need to assure the Commissioner  
6 that the way it was done does not disserve the interest  
7 of policyholders. We made specific findings of fact to  
8 that fact, which are set forth in the May state court  
9 decision.

10 We also need to assure that there's adequate  
11 capital, and the way -- and that's an issue that's been  
12 litigated in the state court, and there's, you know,  
13 appeals from parties pending in the Court of Appeals  
14 regarding it. But the state court agreed with the  
15 Commissioner who made specific findings of fact, as did  
16 the state court, that there is adequate capital for the  
17 Segregated Account and it takes the form of these links  
18 that I've outlined through the plan of operation.  
19 Through the contractual legal controls that we have over  
20 those claims-paying resources, Ambac is not free to  
21 spend it without us having some control. They must  
22 submit budgets. There's a cooperation agreement. They  
23 can't spend more than five million. And every single  
24 claim in the Segregated Account can draw in full against  
25 those resources. That's a different situation than

1 you'd have in unrelated corporations, which is what the  
2 IRS posits. We're not trying to protect the holding  
3 company, which isn't an insurance company. The  
4 injunction doesn't reach that. It only pertains to  
5 these claims-paying resources.

6 THE COURT: Would you say that again? It  
7 doesn't apply to Ambac Financial?

8 MR. VAN SICKLEN: Ambac Financial. We are  
9 not --

10 THE COURT: None of this applies to them.

11 MR. VAN SICKLEN: Correct. It's not an  
12 insurance company. We're not trying to enjoin any  
13 action. It's one of the reasons the holding company  
14 filed bankruptcy. They needed a different type of  
15 protection, which we weren't in a position to afford.  
16 It also has assets, Your Honor, but they're not assets  
17 of the insurer. Our duty here is to regulate Ambac and  
18 we've done it through this restructuring. We've done it  
19 in a way that does two things: It maximizes the  
20 claims-paying resources for everyone by avoiding these  
21 contractual triggers that we've left unimpaired in the  
22 General Account. All of the testimony has shown that  
23 that's a benefit to policyholders. And we've also done  
24 it through the injunction to protect the claims-paying  
25 resources; again, for the benefit of all the

1 policyholders. And it is within the custody of the law  
2 in a sense that we have these contractual and legal  
3 controls in a state court who's been dealing with it for  
4 nine months.

5       So I do think that we do satisfy even the IRS test  
6 in that regard, and I think we certainly satisfy Your  
7 Honor's test. When you look at your language in  
8 *Metropolitan*, it's a very similar situation. There was  
9 the liquidation account that was, you know, without  
10 doubt within the jurisdiction of the liquidation state  
11 court proceeding and then you had this other Segregated  
12 Account that wasn't strictly within the control of the  
13 liquidator. And you made very clear in your decision  
14 that if you permitted the plaintiff there to access this  
15 other account, it would disserve the interest of the  
16 liquidation proceeding. And your quote is "the result"  
17 -- I'm sorry. "This court must defer to the state court  
18 proceeding to avoid the unseemly and disastrous  
19 conflicts that would arise if this court were to issue  
20 rulings that reduced the funding in the account and  
21 thereby defeated that part of the state's liquidation  
22 efforts which involves the provision of continuing  
23 coverage to holders of the disability policies."

24       Here we're trying to afford continuing coverage to  
25 the policyholders in both the Segregated Account and the

1 larger group in the General Account. If we have to  
2 throw them all into rehabilitation, there are  
3 substantial potential drawbacks, which have been laid  
4 out in our briefing and I won't go through it. But  
5 again, going back to McCarran, I don't think McCarran is  
6 limited to situations where the insurance -- you know,  
7 court has direct possession or custody of the funds  
8 being looked to to fund the rehabilitation. The test is  
9 interference. Impairment. And it's a very broad test.

10 The Seventh Circuit -- well, the U.S. Supreme Court  
11 in the *Humana* case looked at the question of what is  
12 this -- what does this word *impair* mean as used in  
13 McCarran. And it said "any act by the federal statute  
14 that would weaken, make worse or otherwise affect in an  
15 injurious manner the state goal." Elsewhere in the  
16 decision the Supreme Court says that "impairment would  
17 be where the federal action would frustrate the goal of  
18 rehabilitation."

19 What the IRS says they want to do here is to levy  
20 and then litigate and pursue collection later. But that  
21 would very much frustrate our efforts to rehabilitate.  
22 What happens when they assess pre-litigation,  
23 pre-federal court determination on the merits is they've  
24 dropped a footnote about this. It arguably puts a lien  
25 on all these assets. So we wouldn't even be able to

1 start sending out checks to claimants under the plan  
2 because they would have a lien on all of the  
3 claims-paying resources and it would render futile,  
4 until we got to the bottom eventually of whether they  
5 even had a claim, the rehabilitation process. That  
6 would be disastrous.

7 We addressed it a bit in the briefs, but the  
8 passage of time does pose very practical problems. The  
9 claims accruing right now are building up at the rate of  
10 approximately of 150 million dollars a month, and since  
11 this proceeding started in March of last year, the  
12 testimony is that we're almost up to a billion dollars  
13 in claims during that period of time to now. Under  
14 Wisconsin law, there's no interest in those claims.

15 THE COURT: I understand that from your brief.

16 MR. VAN SICKLEN: Yeah.

17 THE COURT: What protection does the IRS have,  
18 assuming that some period of time it decides that the  
19 refunds were improperly made, that it can get in line  
20 for return of that 708 million dollars?

21 MR. VAN SICKLEN: That is our statutory duty is  
22 to make sure that our plan of rehabilitation does the  
23 best it can with a corporation and the situation of  
24 Ambac to address all claims of policyholders and  
25 creditors in their lawful priority under state law. In

1 the week long evidentiary confirmation proceeding we  
2 held in December in Darlington, there was an interesting  
3 dichotomy between the group of policyholders who were  
4 called RMBS, the real estate mortgage-backed security  
5 holder group, who had very short-tail claims. They  
6 wanted to see a lot of cash go out quickly under our  
7 plan. Then you had other creditors, claimants who had  
8 long-tail claims, and they wanted to be sure that the  
9 Commissioner was cautious and prudent to make sure that  
10 the funds were used in a manner where there would --  
11 they would have received the fair equal amount of  
12 payments over time, even if their claim took 40 years to  
13 develop.

14 And we spent an enormous effort in developing the  
15 plan of confirmation with hundreds of pages of  
16 disclosure statements and projections and financial  
17 scenarios to address this tension between trying to  
18 maximize payment to creditors and their lawful priority  
19 as quickly as possible without imperilling the  
20 longer-tail positions. And the IRS position here would  
21 be a longer-tail position because it's subordinate under  
22 Wisconsin law to policyholders.

23 And one of the features of our plan is that it can  
24 be adjusted every year in light of any kind of change in  
25 circumstances. The initial split in each payment will

1 be 25 cents cash and 75 cents in a surplus note that  
2 bears interest. Each year in June, the plan provides  
3 that Mr. Peterson and others at OCI will look at claims  
4 development and the financial position of the company  
5 and make any adjustment appropriate. But the guiding  
6 principle of the plan was to be as cautious as possible  
7 at the outset so that people at the end of the line  
8 would have the best possible chance of payment.

9 THE COURT: And that would include people whose  
10 claims hadn't even ripened.

11 MR. VAN SICKLEN: Right. The business is a  
12 very long-tail business for some of these policies,  
13 literally decades on some of the municipal exposures.  
14 And again, the IRS, as a subordinate creditor, like  
15 other subordinate creditors, would be receiving  
16 subordinate notes. So they'll always come ahead of Mr.  
17 Ricardo's client, ultimately the shareholders, and our  
18 plan assures that protection. In the meantime, there  
19 are no dividends going out and we're overseeing the  
20 protection of the claims-paying resources being used to  
21 fund the plan. They're invested and the like. They're  
22 under active management and protection.

23 And so we're not saying that if ultimately the IRS  
24 proves up a 700 million dollar refund claim, that  
25 they're going to receive a check in full. We are

1 guaranteeing that we're going to do the best we can to  
2 maximize the likelihood of their payment, given the  
3 limited nature of assets that we have in their priority.

4 In their brief, they basically, in their reply  
5 brief, take the position that they want Your Honor to  
6 address the state court priorities and wish to challenge  
7 what the United States Supreme Court directed in *Fabe*.  
8 I submit that that's not appropriate. That's an issue  
9 that they should pursue in the state court proceeding,  
10 and at the present time *Fabe* remains good law and their  
11 claim is ahead of everyone except policyholders and  
12 administrative expenses.

13 Wisconsin law, when you look at the legislative  
14 history we attached to our briefs, was immediately  
15 modified on these priorities, in light of *Fabe*, to make  
16 sure that the federal claimants came immediately after  
17 policyholders. And that's how we would treat them if  
18 and when they ever prove up a claim.

19 That's all this process is about. It's a claims  
20 management process. And you know, for them to levy or  
21 assess or place liens on all of our assets now for  
22 months, I submit, is inappropriate under the fact that  
23 the removal isn't appropriate under McCarran and under  
24 *Burford*. I think the Seventh Circuit test in *Hartford*  
25 is very strong on *Burford*. I think Your Honor's

1 decision in *Teed* and *Metropolitan* are strong in that  
2 regard; that their issues should be addressed in the  
3 state court, and to do otherwise will split this  
4 proceeding and lead to other claimants trying to do the  
5 same. It would be impossible for the Commissioner to  
6 protect the interests of policyholders if we're  
7 litigating on multiple fronts.

8 THE COURT: Thank you. Mr. Kovacev.

9 MR. KOVACEV: Thank you, Your Honor. If I may  
10 just respond to a couple of points to begin with. As to  
11 the rest of Ambac that is not in rehabilitation, right  
12 now the policyholders of accounts in that General  
13 Account don't have to wait in line. They don't have to  
14 wait for IOUs that are due 20, 30 years from now. They  
15 are being paid, if they make a claim, now because  
16 they're not -- because the General Account is not  
17 subject to any rehabilitation proceeding. And as we  
18 pointed out in our reply brief, there was a settlement  
19 agreement between Ambac and various banks which involved  
20 policies or instruments that were not in the Segregated  
21 Account that were in the General Account. People in the  
22 Segregated Account complained about that and filed --  
23 pursued an action in or attempted to in the  
24 rehabilitation court, and the Commissioner and Ambac  
25 argued that because this was in the General Account, the

1 rehabilitation court had no jurisdiction, had no  
2 custody, the insolvency rules for Wisconsin Insurance  
3 Code did not apply, and they ultimately prevailed. For  
4 them now to say well, these agreements, which are  
5 contractual agreements that do not have force of law and  
6 certainly do not bind the IRS, for the Commissioner and  
7 Ambac to say that as to the General Account  
8 policyholders and everyone else well, that has nothing  
9 to do with rehabilitation, it's business as usual. But  
10 when the IRS comes calling, suddenly you're in the  
11 custody of the court, and all this, I guess, penumbra  
12 emerging from the rehabilitation, you can't be a little  
13 bit in the custody of the court. Either the  
14 policyholders in the General Account are subject to the  
15 rehabilitation proceedings and the insolvency statutes  
16 and have to stand in line or not.

17 Similarly, either the IRS is able to collect  
18 against the General Account or not. And the position is  
19 the same. Now the only thing that's different is  
20 that --

21 THE COURT: And why do you think you could not,  
22 assuming that you get to the point where you prove that  
23 you're entitled to the return of the money?

24 MR. KOVACEV: Well, as it stands right now, the  
25 General Account we could do, you know, save the

1 injunction, we would be able to lien or levy, take  
2 advantage of any of the administrative collection --

3 THE COURT: Well, let's just assume that you go  
4 ahead and you do your investigation and you find out  
5 that you have a legitimate claim to the return of the  
6 money and then you put it in the form of a claim and  
7 file it.

8 MR. KOVACEV: In the Segregated Account you  
9 mean?

10 THE COURT: In the proceeding.

11 MR. KOVACEV: Well, we don't have to file any  
12 claim as to the rest of Ambac because there is no  
13 proceeding. We would simply issue a notice of levy.

14 THE COURT: How did the other claimants gets  
15 money from the General Account?

16 MR. KOVACEV: Well, let's be clear. There are  
17 policies in the General Account. There are policies in  
18 the Segregated Account. And my understanding is the  
19 policyholders in the General Account --

20 THE COURT: I see.

21 MR. KOVACEV: -- if they have a claim, it's  
22 paid. It's paid in the normal course because that's  
23 separate.

24 THE COURT: That's the healthy side of the  
25 business.

1           MR. KOVACEV: Right. Now if the policies that  
2 have been relegated to the Segregated Account, they do  
3 have to wait in line is my understanding, and at some  
4 point in some fashion, money can be made available  
5 through that -- through the note that was referred to  
6 earlier; that money from the General Account may be  
7 transferred over to pay those claims. But they cannot  
8 go after the rest of Ambac. Whereas a policyholder of a  
9 policy that's in the General Account can, and I don't  
10 understand the Commissioner to contest that.

11           Just one other point as far as the breadth of the  
12 injunction. From what I understood Mr. Van Sicklen to  
13 say, the rehabilitation court could conclude that the  
14 rest of Ambac shouldn't pay any federal taxes at all,  
15 including employment taxes or any other taxes because  
16 somehow that would reduce the amount of money that would  
17 be available to the Segregated Account and that just --  
18 that cannot be the rule.

19           With respect to the tax liability itself, the tax  
20 liability cannot be allocated in a way that binds the  
21 IRS. This actually happens a fair amount in probate and  
22 family law contexts. For instance in a divorce, you  
23 will have two spouses that are jointly and severally  
24 liable for federal tax. There may be a separation  
25 agreement where one spouse agrees to pay the tax for the

1 other spouse. That's well and good, but it does not  
2 bind the IRS. There's a Seventh Circuit case that we  
3 cite involving a trust that was made and turned out to  
4 be defective and the IRS assessed a tax liability  
5 against them because it didn't meet the statutory  
6 requirements. They, after the fact, tried to reform the  
7 trust, and the Seventh Circuit said no, you can't do  
8 that, not even if a state court says you can reform the  
9 trust the way you say. That is not binding on the IRS.  
10 It would be revolutionary to allow an insurance company  
11 to delegate away a federal tax liability in that way.

12 THE COURT: Mr. Van Sicklen, just on the facts  
13 that Mr. Kovacev was talking about, was he right that --  
14 it seems to me the point of putting some of the toxic  
15 assets in the Segregated Account and leaving the  
16 majority in the General Account was so those could just  
17 be -- the ones in the General Account could just be  
18 handled as they would have been had there been no  
19 rehabilitation proceeding.

20 MR. VAN SICKLEN: Right.

21 THE COURT: Is that correct?

22 MR. VAN SICKLEN: There's one point of  
23 clarification. We've never made any claim here that  
24 current taxes were allocated or any kind of close  
25 rehabilitation tax obligations. There's no reason to

1 allocate those because they're administrative expenses.  
2 They're owed in full. So I think counsel misstates that  
3 concern.

4 As to your other point, as found by the state court  
5 here, Wisconsin state insurance law allows a company  
6 with a Commissioner's involvement and consent to use  
7 Segregated Accounts for this type of purpose. We went  
8 through an elaborate extensive process, which is  
9 mentioned in the briefing, of trying to make sure that  
10 there weren't material draws of any policy against a  
11 General Account. All of the portions of the business,  
12 particular policies and these outstanding outlier  
13 pre-rehabilitation material size claims like the IRS  
14 claim, the landlord of the parent company has a  
15 contingent claim against the insurance company. Those  
16 types of liabilities were also allocated.

17 THE COURT: To the Segregated Account.

18 MR. VAN SICKLEN: To the Segregated Account so  
19 they could all be treated in accordance with the  
20 Wisconsin priorities. The ones that were left are not  
21 drawing on the claims-paying resources because they're  
22 the obligations that there aren't claims being made on  
23 them. We used our best judgment to strike that balance,  
24 and state law allows us to do that.

25 Counsel's analogy to probate or other types of

1 business I don't think is apt because McCarran allows  
2 the state insurance law that type of latitude. This  
3 goes to the heart of the regulation of the insurance  
4 business here in Wisconsin. There are other  
5 proceedings, even one pending now using a Segregated  
6 Account and a General Account for purposes of  
7 rehabilitation, and they can challenge the allocation of  
8 their contingent liability or other aspects of this, but  
9 it should be done in the state court before the court  
10 that's been handling these matters, that has the  
11 expertise and experience in dealing with them, and so  
12 there's a consistent outcome in the treatment.

13 If they're allowed to jump the line and levy or  
14 lien up this common well of claims-paying resources,  
15 others will argue they have the same right under some,  
16 you know, federal constitutional claim here and it will  
17 essentially eliminate the ability of the Commissioner to  
18 use this important tool of the Segregated Accounts in  
19 this type of a situation.

20 The banks that he points to, their situation was  
21 they were not allocated for an important reason. Again,  
22 we're getting into something that was the subject of  
23 elaborate -- an equally complex, litigated dispute. But  
24 they had the type of a policy that had an acceleration  
25 rate, and so that if they had been allocated instead of

1 being owed a relatively small amount of claims on a  
2 pay-as-you-go basis, we would have had enormous market  
3 claims that would have been punitive and would have  
4 swamped any effort to rehabilitate this company.

5 So we struck that balance, again with the  
6 Commissioner's expertise, using his best efforts to  
7 strike that balance in a way that carried out his  
8 statutory goal which is to protect policyholders as a  
9 whole.

10 And that's what we've done here. We're not trying  
11 to penalize the IRS. They will be paid essentially,  
12 whether it's in a full rehab or in this type of a rehab.  
13 If they forced us into a full rehab, there would just be  
14 less claims-paying resources to pay them. And we can't  
15 be in a position where certain selected creditors are  
16 able to eat up material portions of these resources out  
17 of line. That's all we're trying to accomplish here.

18 I respectfully submit that it should -- their  
19 issues should be taken up with, if and when they ever  
20 have a tax claim, with the state court. The irony of  
21 this, Your Honor, is that the underlying tax dispute, we  
22 don't think that -- we think there's a high likelihood  
23 they may never even actually have a claim or even want  
24 to litigate it. They're looking at a position that's  
25 never been supported in any reported tax decision, and

1 so it would be in our view terribly unfortunate if we  
2 derail this entire proceeding or delay it for years with  
3 claims accruing and would result in chaos to wait for  
4 two years or whatever the outcome is going to be of the  
5 IRS actually proving it has a claim. That's a very  
6 disruptive path.

7 And if we're forced in the meantime, because they  
8 want to levy first and litigate later, to essentially  
9 blow up the present rehabilitation, it could yield to  
10 enormous disruption and much higher claims. And not  
11 only claims, Your Honor.

12 One of the things that you would see if you had  
13 time to look into the underlying testimony and briefing  
14 in the state court, all of which is available online, is  
15 there are a number of major corporations in the United  
16 States whose financings are guaranteed by Ambac policies  
17 left in the General Account. We had affidavits in the  
18 state court from Sonic and Hertz and the like about had  
19 we gone into a full rehab, it would be potentially  
20 disastrous for some of those underlying corporations and  
21 their thousands of American employees, if, in fact, we  
22 were unsuccessful in our injunctive powers to protect  
23 them. And part of our decision who got allocated and  
24 who didn't was based upon our sense of how safe we would  
25 be in terms of exercising injunction powers, in terms of

1 how far in privity some of these people were that we'd  
2 have to enjoin.

3         So again, it was drawing lines, but it was done for  
4 a proper purpose here. I submit that the IRS should be  
5 treated like other claimants here. And it is very much  
6 like your decision in *Metropolitan*. We're trying to do  
7 the right thing. We have a pool of claims-paying  
8 resources that they have full access to under our plan.  
9 We're not shielding it from them. It's not in some  
10 unrelated corporation. It's not outside our legal  
11 control. And so I submit that this is an appropriate  
12 vehicle for accomplishing that remedial goal. Thank  
13 you.

14                 THE COURT: Thank you. Mr. Kovacev.

15                 MR. KOVACEV: With respect to *Metropolitan*  
16 *Life*, this a completely different from that case. In  
17 that case, there were insurers who were -- who raised  
18 claims against the state law that assessed state fees  
19 with respect to the state insurance law. Here we have  
20 the IRS with an indisputably federal case, indisputably  
21 about federal law, and entitled to federal jurisdiction,  
22 and we have an injunction which violates the  
23 Anti-Injunction Act and no court, not the state court  
24 and with respect not this Court, has the jurisdiction  
25 either to issue or to maintain that injunction.

1 With respect to McCarran-Ferguson, this was briefed  
2 at length, I'd be happy to answer any questions for you,  
3 but I would just point out that following the Seventh  
4 Circuit *Modern Life* decision which held that the  
5 Internal Revenue Code is not -- is beyond the reach of  
6 McCarran-Ferguson --

7 THE COURT: But that only affected the  
8 classification for taxation of the particular entity  
9 that was before the court. I think that's a very  
10 different situation. I don't think there's ever been --  
11 you know, the whole group of cases you cited all say  
12 that the United States can always decide what  
13 classification a particular entity should be in for  
14 federal tax purposes. I don't think that really helps  
15 us much here.

16 MR. KOVACEV: Actually, Your Honor, the  
17 cases -- the *Modern Life* and the other related cases are  
18 really quite extraordinary because in that case, there  
19 was a state statute that defined the very essence of  
20 insurance regulation. What is an insurance company.  
21 What is a mutual insurance company. That is, if there  
22 is a core of -- that would be protected by the  
23 McCarran-Ferguson Act, that would be it. Nevertheless,  
24 the Seventh Circuit and every other circuit has held  
25 that the Internal Revenue Code trumps that.

1           And I'll just point out that the courts have held  
2 that provisions of the Internal Revenue Code that don't  
3 specifically mention insurance apply to insurance  
4 companies. I cited the First Circuit case, the *UNUM*  
5 case, and certainly by its own terms the Internal  
6 Revenue Code defines insurance companies specifically as  
7 incorporated in the term corporation and by extension as  
8 person and taxpayer, which those three terms occurred  
9 all the provisions that are at issue. Clearly when  
10 Congress defined corporation in the Tax Code to include  
11 specifically insurance companies, they clearly intended  
12 that insurance companies would be included and it would  
13 be a disservice to Congress's choice to then suggest  
14 that somehow they didn't intend the Internal Revenue  
15 Code as a nationwide scheme which should have uniform  
16 application across all taxpayers to apply to insurance  
17 companies.

18           With respect to the final point, I do understand  
19 the Commissioner's position on the potential financial  
20 harm to Ambac and so forth. The Supreme Court in  
21 *Williams Packing* has a very explicit test. The Supreme  
22 Court has said that even the ruination of a business is  
23 not enough to overcome the Anti-Injunction Act unless  
24 you can prove two things: Number one, that on the  
25 merits of the underlying tax liability there is no

1 conceivable way the IRS could prevail; and number two,  
2 there was irreparable harm that no legal remedy could  
3 remedy. That is what the Supreme Court has said. And  
4 there is nothing that Ambac or the Commissioner have  
5 presented that meets that high a threshold.

6 The Anti-Injunction Act is clear. No court may  
7 issue an injunction against the collection of tax, and  
8 the Supreme Court has repeatedly affirmed that. Cases  
9 are removed. We cited a case from the Third Circuit  
10 that if an action, which is an injunction action or  
11 sounds as an injunction action against the IRS is placed  
12 in state court, it is proper to remove it to federal  
13 court and the federal court then must dismiss it for  
14 lack of subject matter jurisdiction. A court should  
15 sua sponte dismiss a case that is outside its  
16 jurisdiction, and the Anti-Injunction Act would be one  
17 example of that.

18 At bottom, Your Honor, the Internal Revenue Code is  
19 really designed, as the Seventh Circuit said, for  
20 uniform application to taxpayers, and unfortunate as it  
21 is, the IRS issues taxes to people, individuals who are  
22 in dire financial straits and have had their homes  
23 foreclosed and have had their assets taken away and  
24 subjected to financial harm. It is unfortunate, but  
25 that is the law. And it would be extraordinary for an

1 insurance company to claim it's above that law.

2 THE COURT: Well, I think -- I'm not sure  
3 that's the best way to state it. I think this is a  
4 situation in which the Insurance Commissioner believes  
5 that he's acting in the best interests of not just the  
6 insurance companies, more in the interests of the  
7 policyholders who all stand to lose if the  
8 rehabilitation does not take place.

9 MR. KOVACEV: I think, as I said before, I do  
10 not question the Commissioner and the people that have  
11 worked with him in this for their public service or  
12 their dedication to the insurance regulation. But  
13 federal law is different, and I know Mr. Van Sicklen  
14 said we should -- that we're like other creditors.  
15 Frankly, as a Supreme Court has said, we're not. We are  
16 different. As a federal tax collector, we do have a  
17 constitutional sovereign prerogative to lay and collect  
18 taxes, and that makes a difference.

19 THE COURT: Does that make you so different  
20 from any other aspect of the United States that you  
21 should be treated differently?

22 MR. KOVACEV: Well yes, Your Honor. For  
23 instance -- for instance in the *Rodgers* case, which we  
24 cite, there was a -- there was a property, I believe it  
25 was a home, it was held as joint tenants. I believe it

1 was husband and wife. The husband was liable for unpaid  
2 taxes. The wife was not. Texas law was crystal clear  
3 that no creditor could foreclose on that house because  
4 only one of the two co-tenants was liable. The Supreme  
5 Court held federal taxes are different. The federal tax  
6 collector could foreclose on that house, notwithstanding  
7 any protections in Texas state law, and then give the  
8 proceeds, half of the proceeds back to the nontaxpayer  
9 wife. That's just one example that comes to mind.

10 Another one is just by --

11 THE COURT: But that one didn't involve  
12 insurance.

13 MR. KOVACEV: No, it didn't, but there  
14 shouldn't be any difference. I have yet to find any  
15 statute in the Wisconsin Insurance Code or any  
16 suggestion that they intended to preempt the Internal  
17 Revenue Code. There is, as Mr. Van Sicklen pointed out,  
18 a concern about the federal priority statute, which is  
19 in a separate part of the Code and has nothing in  
20 particular to do with the taxes. And in the *Fabe* case,  
21 it had nothing to do with taxes. That was the U.S. as  
22 the obligee on surety bonds.

23 In that case, the United States really was just any  
24 other creditor. And just so it's crystal clear, we're  
25 not asking anyone to overrule *Fabe*. We do think that we

1 have arguments that were not raised in *Fabe*, because the  
2 federal tax collector wasn't involved in *Fabe* and that  
3 involved statutes other than 3713, but that issue is not  
4 ripe. And frankly Your Honor, a lot of these issues  
5 that we've discussed today are still *what if*. The only  
6 thing that's facing us right now is an injunction and  
7 that injunction is illegal and no court has jurisdiction  
8 to make or sustain it. Everything else, Your Honor, can  
9 be resolved later. That is what is --

10 THE COURT: Are you really resting on the  
11 Anti-injunction statute?

12 MR. KOVACEV: Absolutely, Your Honor. And we  
13 suggested and there was the *Manor Oak* case, which was a  
14 nursing home receiver in state receivership, the court  
15 did retain jurisdiction -- did remand, but retained  
16 jurisdiction over federal tax issues. That might save  
17 time, Your Honor, just because these tax issues are  
18 likely to come up. But the injunction is certainly the  
19 thing --

20 THE COURT: What are you suggesting precisely?

21 MR. KOVACEV: Well, the pursuit was taken in  
22 *Manor Oak* roughly, what we would say here is certainly  
23 without question the injunction should be dissolved.  
24 This Court is now sitting as the rehabilitation court.  
25 Without question Your Honor can do it and we submit must

1 do it.

2 THE COURT: Not if I don't have any  
3 jurisdiction.

4 MR. KOVACEV: Well, if you do not have any --  
5 well, you have the jurisdiction, Your Honor, because you  
6 are the rehabilitation court and right now it's all in  
7 your hands.

8 THE COURT: Only if you properly removed, which  
9 is the issue we're discussing.

10 MR. KOVACEV: And Your Honor, under 1442(a),  
11 the IRS as a federal agency has an absolute right to  
12 remove, and there is no question the injunction, which  
13 particularly named the IRS, put the IRS at risk in the  
14 same way that the U.S. Attorney would have been at risk  
15 had he defied a state subpoena. I'm assuming that  
16 Mr. Van Sicklen is not suggesting that despite the state  
17 injunction, the IRS couldn't go ahead and levy without  
18 sanction. If he's willing to make that -- if he's  
19 willing to make that concession, maybe we could all go  
20 away.

21 THE COURT: I think we can assume he will not.

22 MR. VAN SICKLEN: Correct.

23 MR. KOVACEV: So there is the potential --  
24 there is the potential hazard. And that's precisely why  
25 Congress has said that federal courts should decide

1 cases where the interests of a federal agency are  
2 involved in a federal issue, which this indisputably is.  
3 And therefore this Court is vested with jurisdiction.  
4 The removal was proper. This Court has the obligation,  
5 we submit, to dissolve the injunction, and we further  
6 would recommend to the Court that as to other federal  
7 tax issues, for example, whether a lien attaches or  
8 whether a levy was issued properly or any other issues  
9 of that sort, if Your Honor would reserve jurisdiction  
10 and remand the rest, it would save time because in our  
11 view those issues will come back here anyway. But  
12 certainly the injunction is the one thing which is  
13 before the Court --

14 THE COURT: So I'm not sure what issues you're  
15 saying would be coming back. Whether there was --  
16 whether the refund was correct or not?

17 MR. KOVACEV: Well actually, Your Honor, I was  
18 thinking more in terms of let's assume that the  
19 injunction is dissolved and a month from now --

20 THE COURT: And you, the IRS, can do anything  
21 you want in terms of levying, investigating --

22 MR. KOVACEV: Yes, except of course for levying  
23 those funds that are in the custody of the  
24 rehabilitation court, which is whatever is in the  
25 Segregated Account. But we could do levy or lien or

1 whatever the Internal Revenue Code proposes. A month  
2 from now the IRS determines that the refund was  
3 erroneous and it assesses -- an assessment, just to be  
4 clear, is just the IRS recording on its own books that a  
5 tax is owed.

6 Now after a notice and demand is sent and if a tax  
7 is not paid, then a lien arises against all taxpayers.  
8 So when Mr. Van Sicklen and when the Commissioner asks  
9 that the IRS not assess, they're essentially saying we  
10 can't even record in our own books that a tax is owed,  
11 which is an extremely broad position considering  
12 especially that he's claiming to be scaling back what  
13 the state court said. But I apologize for the  
14 digression. There is a lien.

15 THE COURT: And that's the point at which I  
16 think he's really concerned, is when a lien attaches,  
17 because then any payment has to be subject to a lien.

18 MR. KOVACEV: At that point, a lien attaches.  
19 At that point, assuming that any administrative or  
20 jurisdictional prerequisites are met, there could be a  
21 quiet title action or something in the nature of a quiet  
22 title action under Sec. 2410, which the Commissioner  
23 mentioned in his brief. If that's done, and assuming  
24 it's appropriately done under Sec. 1444 has an absolute  
25 right, the United States, can remove and we would be

1 back here if there is a levy. Should a month from now  
2 the IRS decide to --

3 THE COURT: So the Commissioner brings a quiet  
4 title action against the IRS.

5 MR. KOVACEV: That's correct, Your Honor.

6 THE COURT: And assuming that you have the  
7 right to impose the lien --

8 MR. KOVACEV: Yes.

9 THE COURT: -- what's the issue?

10 MR. KOVACEV: Well, frankly I don't know. That  
11 might be where they would say that they come first,  
12 notwithstanding any priorities in the Segregated  
13 Account. Maybe they could say well policyholders, they  
14 have some sort of lien that trumps the federal tax lien.  
15 I can't think of one, but if they want to assert that,  
16 that's the form to do it. Or a levy, which may be a  
17 better example. The IRS decides to levy on the assets  
18 of the rest of Ambac. Well ordinarily, the IRS would  
19 give notice of the levy and there are procedures that  
20 can be followed. Third parties who are aggrieved  
21 through the levy can file a wrongful levy action under  
22 the Code in federal court. If the taxpayer is served  
23 with a lien, he can pay the money over and file a refund  
24 action in federal court.

25 In the very special unique case of a jeopardy levy,

1 which is kind of the worse case scenario that Ambac and  
2 the Commissioner have mentioned where it is true that on  
3 rare circumstances the IRS can seize first and notice  
4 later, there are statutory requirements that must be met  
5 before that happens. It doesn't happen in every case.  
6 Assuming for the sake of argument that those  
7 requirements are met here and a jeopardy levy is made,  
8 within 30 or so days we would be back in this court  
9 under Sec. 7429 of the Internal Revenue Code and the  
10 legitimacy of that jeopardy levy would be decided. So  
11 there are clear remedies for any of the actions that the  
12 IRS could take. All paths lead back to federal court.

13 THE COURT: Well, not remedies in the sense  
14 that they would aid the rehabilitation proceeding.

15 MR. KOVACEV: Well, these are all assets that  
16 are outside the rehabilitation proceeding. And this is,  
17 I guess, the fundamental disconnect I think between  
18 Mr. Van Sicklen and myself is that -- is the assets that  
19 are not in the rehabilitation proceeding are not in the  
20 rehabilitation proceeding and cannot then therefore --

21 THE COURT: You're saying the assets that are  
22 not part of the Segregated Account are not part of the  
23 rehabilitation proceeding.

24 MR. KOVACEV: Thank you, Your Honor. That's  
25 exactly what I'm trying to say. And so the remedy would

1 be whatever remedy would happen as to the General  
2 Account, the ones -- the remedies I just mentioned. And  
3 those remedies are available, but I will point out again  
4 that, you know, financial hardship is not by itself  
5 enough and the Supreme Court in *Williams Packing* had  
6 said that, to enjoin an IRS action before it happens.

7 MR. VAN SICKLEN: Your Honor, I think there's a  
8 more significant disconnect, to use counsel's term, is  
9 nowhere in McCarran-Ferguson is there some special  
10 exception for the IRS. It's an act -- all of the  
11 statutes that they're pointing to are general statutes,  
12 which are acts of Congress, and not a single case  
13 supports his position that there's some unique carve out  
14 for the IRS. Yes, federal actors can look to federal  
15 law to prove up their claims. We don't have a problem  
16 with the IRS doing that here. But it turns then to the  
17 collection side of it and how that claim is treated.

18 What counsel wants us to do is drive us through the  
19 federal process here. But it's reverse-preempted.  
20 That's the whole point of McCarran and *Humana* and the  
21 *American Deposit v. Schacht* cases by the Seventh  
22 Circuit. He admits in his reply brief at page 21 that  
23 the Anti-Injunction Act is a federal revenue measure  
24 expressed in terms of general application. And it is.  
25 It's a general application statute, an act of Congress.

1 It is reverse-preempted in our view. We're not suing  
2 the IRS. And nowhere does the IRS ever answer what we  
3 think is separate and apart from whether the removal is  
4 defective on its face. But they never really address  
5 McCarran. And you know, the argument that the entire  
6 Insurance Code is somehow not statutes of general impact  
7 I think is unpersuasive. I mean the Seventh Circuit's  
8 decision in the *American Deposit/Schacht* case talks  
9 about the very same argument that counsel is making was  
10 made there in regard to the National Bank Act. And yes,  
11 there were provisions in the National Bank Act that  
12 touched on insurance, but those weren't the ones at  
13 issue.

14 The Seventh Circuit, I think, addressed his  
15 argument in a lot of meaningful ways at page 843 of the  
16 Seventh Circuit's decision; that you look at really what  
17 is the provision they're relying upon, and here are the  
18 provisions they're relying upon are all of general  
19 import. They admit in their brief several places, page  
20 14 and page 21, that --

21 THE COURT: You're talking about the remand  
22 brief?

23 MR. VAN SICKLEN: Yes. To dissolve the  
24 injunction, their reply.

25 THE COURT: Oh, the reply to dissolve the

1 injunction.

2 MR. VAN SICKLEN: Yeah. January 7th brief.  
3 Page 14, they admit that the Anti-Injunction Act applies  
4 to any person. And all of the collection provisions and  
5 levy provisions, they apply to any provision. And their  
6 argument is that because a provision applies to any  
7 taxpayer, including but not limited to insurance  
8 companies, that therefore it's specific to insurance  
9 companies. I respectfully submit that that stands the  
10 law on its head under *American Deposit* and other cases  
11 which really make clear that the federal statute has to  
12 be specifically directed at the business of insurance.  
13 And these aren't, Your Honor. And so all his arguments,  
14 I think, fall under McCarran. This Court does not have  
15 jurisdiction. It's reverse-preempted.

16 And the Anti-Injunction Act is exactly the same.  
17 It's an act of Congress. First off, it only applies  
18 where they're being sued as a party, and we're not doing  
19 that. But separate and apart, even if it did, we  
20 respectfully submit it's reverse-preempted. And even if  
21 the Court was concerned about holding that a statute --  
22 a procedural statute like removal is reverse-preempted,  
23 we respectfully submit that the abstention doctrine  
24 under *Burford* is a grounds on which the Court can and  
25 should also issue a full remand.

1 Under *Burford*, we haven't really talked about it,  
2 but in your case in *Teed* and *Metropolitan* and the  
3 Seventh Circuit's case in *Hartford*, you really just need  
4 to show two things, and those are both present here in  
5 spades. There is a place where they can litigate their  
6 issues in state court. We have that here. And there's  
7 a process, a specialization to do so, and we have that  
8 in spades with Judge Johnston and this rehabilitation  
9 proceeding. It is specialized, comprehensive and the  
10 like. And it would be, for all the reasons you  
11 articulated in *Metropolitan*, very disruptive to be  
12 having sort of a split rehabilitation proceeding with  
13 potentially inconsistent rulings. That shouldn't be the  
14 case.

15 Congress, whether counsel likes it or not in  
16 McCarran, made a very fundamental decision that whereas  
17 here you have a rehabilitation proceeding or something  
18 that deals specifically with state insurance law, which  
19 this does I submit, they can't supplant it with their  
20 pointing to federal statutes of general import.

21 We cite a number of cases that are very analogous  
22 to this where courts, you know, found reverse-preemption  
23 in this type of removing from a state rehabilitation and  
24 sent it back. His argument about the scope of the  
25 injunction again I think is better directed at Judge

1 Johnston. Others have made that. They've questioned  
2 the adequacy of the capital for the Segregated Account  
3 and the extent of the Commissioner's controls regarding  
4 the common well of these claims-paying resources, but  
5 that can and should be litigated there if the IRS wishes  
6 to at such time as they actually have a claim. But in  
7 the meantime, they shouldn't be issuing liens and levies  
8 and totally derailing our proceeding, I submit. And he  
9 just -- the notion that the Tax Code is above McCarran  
10 just finds no foothold in any of the cases that we were  
11 able to find, Your Honor.

12 So for all those reasons, we would ask you to, you  
13 know, remand the matter in full back. I think it can be  
14 done on all three grounds: That the removal was  
15 technically defective, that it's reverse-preempted, and  
16 that in any event, you would abstain.

17 THE COURT: And why do you think it's  
18 technically defective?

19 MR. VAN SICKLEN: For the reasons I talked  
20 about at the outset is they're not -- they're a  
21 claimant, they're not a defendant.

22 THE COURT: No, but there is this order that's  
23 been issued against them.

24 MR. VAN SICKLEN: It's not issued against them  
25 any more than anyone else. It mirrors exactly the

1 first-day injunction. It just picked them up to avoid  
2 any doubt. It expressly incorporates the terms of the  
3 first-day injunction order. And if every federal  
4 claimant that's enjoined by an order issued under the  
5 rehabilitation statutes in aid of the rehabilitation  
6 gives rise to the federal court challenging it, it would  
7 permit those federal claimants to avoid the state  
8 priorities. That's why we issued it. We didn't want  
9 the IRS to go out and issue an assessment and a levy or  
10 lien and the like.

11 I submit that it was an appropriate, you know,  
12 injunction. It's like the automatic stay. It doesn't  
13 make them a defendant, the fact that all claimants are  
14 enjoined. If they're all defendants and they all have  
15 rights of discovery -- we've litigated this repeatedly  
16 in the state court proceeding. They haven't even sought  
17 to enjoin before they removed this case and sought to  
18 intervene. I'm sorry, I misspoke. It's been a long day  
19 for all of us.

20 But again, I really think he is misapprehending the  
21 unique nature and use of Segregated Accounts in  
22 Wisconsin under our law and the requirements that we, on  
23 behalf of the Commissioner, have to exercise protections  
24 and constraints there, and we've done that here.

25 So for those reasons again, I would ask the Court

1 to remand the matter in full. Thank you.

2 THE COURT: Mr. Kovacev, is there anything you  
3 wish to add?

4 MR. KOVACEV: Briefly, Your Honor. And thank  
5 you. It is a core -- it is a core principle that the  
6 United States may only be sued where it weighs its  
7 immunity as a sovereign to be sued. It is also a core  
8 principle that the Internal Revenue Code as a uniform --  
9 as a uniform nationwide scheme with uniform  
10 applicability cannot be preempted by any law, including  
11 state law, without an express -- without some express  
12 indication of the Code.

13 With respect to McCarran-Ferguson, there is no  
14 waiver of sovereign immunity in McCarran-Ferguson, nor  
15 is there any indication that the Internal Revenue Code  
16 should be affected, which is exactly what the Seventh  
17 Circuit said in *Modern Life*. Nor frankly is there  
18 anything in the Wisconsin state statutes indicating that  
19 they intended to preempt tax laws.

20 At bottom, what the Insurance Commissioner is  
21 asking for is not reverse-preemption of the Tax Code by  
22 state statutes, but reverse-preemption of the Tax Code  
23 by contracts between Ambac and itself, its Segregated  
24 Account. I'm thinking specifically of this allocating  
25 tax liability and making it binding on the IRS, they

1 can't go after other people that are by law, by federal  
2 law, severally liable. Nothing in the Segregated  
3 Account statute says that the Segregated Account may  
4 assume the tax liabilities, federal or state for that  
5 matter, of the insurance company and therefore immunize  
6 the rest of the insurance company from taxation. I'm  
7 not aware of any regulation even from the Insurance  
8 Commissioner that says so. The only basis is this  
9 internal contractual agreement, and Your Honor, we  
10 believe that the state statutes do not preempt the  
11 Internal Revenue Code, and I think we've briefed that  
12 adequately. I'd be happy to go over it again with you  
13 if you'd like.

14 Certainly, certainly internal arrangements of  
15 insurance company, whether or not blessed by a regulator  
16 or a state court judge, cannot reverse-preempt under  
17 McCarran-Ferguson.

18 THE COURT: Anything else by anybody? All  
19 right. I will try to get something out very promptly.

20 MR. VAN SICKLEN: Thank you, Your Honor.

21 MR. KOVACEV: Thank you, Your Honor.

22 (Proceedings concluded at 4:06 p.m.)  
23  
24  
25

1 I, LYNETTE SWENSON, Certified Realtime and Merit  
2 Reporter in and for the State of Wisconsin, certify that  
3 the foregoing is a true and accurate record of the  
4 proceedings held on the 12th day of January 2011 before  
5 the Honorable Barbara B. Crabb, District Judge, District  
6 Judge for the Western District of Wisconsin, in my  
7 presence and reduced to writing in accordance with my  
8 stenographic notes made at said time and place.  
9 Dated this 18th day of January 2011.

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/s/ \_\_\_\_\_

Lynette Swenson, CRR, RMR, CBC  
Federal Court Reporter

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