UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

THEODORE NICKEL,
Plaintiff-Appellee,
v.
No. 11-1158
UNITED STATES OF AMERICA,
Defendant-Appellant.

UNITED STATES OF AMERICA,
Plaintiff-Appellant,
v.
No. 11-1419
WISCONSIN STATE CIRCUIT COURT FOR
DANE COUNTY; THEODORE NICKEL,
Commissioner of Insurance of the State of Wisconsin,
As Rehabilitator of the Segregated Account of
Ambac Assurance Corporation;
AMBAC ASSURANCE CORPORATION,
Defendants-Appellees.

RESPONSE BRIEF OF WISCONSIN COMMISSIONER OF INSURANCE AND AMBAC ASSURANCE CORPORATION

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CIRCUIT RULE 26.1 DISCLOSURE STATEMENT

Appellate Court No: 11-1158; 11-1419

Short Caption: Theodore Nickel v. United States; United States v. Wisconsin State Circuit Court for Dane County

To enable the judges to determine whether recusal is necessary or appropriate, an attorney for a non-governmental party or amicus curiae, or a private attorney representing a government party, must furnish a disclosure statement providing the following information in compliance with Circuit Rule 26.1 and Fed. R. App. P. 26.1.

The Court prefers that the disclosure statement be filed immediately following docketing; but, the disclosure statement must be filed within 21 days of docketing or upon the filing of a motion, response, petition, or answer in this court, whichever occurs first. Attorneys are required to file an amended statement to reflect any material changes in the required information. The text of the statement must also be included in front of the table of contents of the party's main brief. Counsel is required to complete the entire statement and to use N/A for any information that is not applicable if this form is used.

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(1) The full name of every party that the attorney represents in the case (if the party is a corporation, you must provide the corporate disclosure information required by Fed. R. App. P 26.1 by completing item #3):

Theodore K. Nickel, Wisconsin Commissioner of Insurance, as Court-Appointed Rehabilitator of the Segregated Account of Ambac Assurance Corporation

(2) The names of all law firms whose partners or associates have appeared for the party in the case (including proceedings in the district court or before an administrative agency) or are expected to appear for the party in this court:

Foley & Lardner LLP

(3) If the party or amicus is a corporation:

i) Identify all its parent corporations, if any; and

N/A

ii) list any publicly held company that owns 10% or more of the party's or amicus' stock:

N/A

Attorney's Signature: /s/ Michael B. Van Sicklen Date: December 15, 2011

Attorney's Printed Name: Michael B. Van Sicklen

Please indicate if you are Counsel of Record for the above listed parties pursuant to Circuit Rule 3(d). Yes X No

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(1) The full name of every party that the attorney represents in the case (if the party is a corporation, you must provide the corporate disclosure information required by Fed. R. App. P. 26.1 by completing the item #3):
Ambac Assurance Corporation ("AAC")

(2) The names of all law firms whose partners or associates have appeared for the party in the case (including proceedings in the district court or before an administrative agency) or are expected to appear for the party in this court:

Dewey & LeBoeuf LLP, Stafford Rosenbaum LLP

(3) If the party or amicus is a corporation:

i) Identify all its parent corporations, if any; and
AAC is a wholly-owned subsidiary of Ambac Financial Group, Inc.

ii) list any publicly held company that owns 10% or more of the party's or amicus' stock:
AAC is a wholly-owned subsidiary of Ambac Financial Group, Inc., which is a publicly-owned corporation.

Attorney's Signature: s/Henry J. Ricardo Date: 12/14/2011

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CIRCUIT RULE 26.1 DISCLOSURE STATEMENT

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(2) The names of all law firms whose partners or associates have appeared for the party in the case (including proceedings in the district court or before an administrative agency) or are expected to appear for the party in this court:

Stafford Rosenbaum LLP, Dewey & LeBoeuf LLP

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i) Identify all its parent corporations, if any; and
AAC is a wholly-owned subsidiary of Ambac Financial Group, Inc.

ii) list any publicly held company that owns 10% or more of the party's or amicus' stock:
AAC is a wholly-owned subsidiary of Ambac Financial Group, Inc., which is a publicly-owned corporation.

Attorney's Signature: s/Daniel Stolper Date: 12/14/2011

Attorney's Printed Name: Daniel W. Stolper (Wis. State Bar No. 1016462)

Please indicate if you are *Counsel of Record* for the above listed parties pursuant to Circuit Rule 3(d). Yes ___ No _X_.

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The Wisconsin Commissioner of Insurance ("the Commissioner"), as court-appointed rehabilitator of the segregated account ("the segregated account") of Ambac Assurance Corporation ("Ambac"), submits this response brief. Ambac joins it.[1]

JURISDICTIONAL STATEMENT

I. APPEAL NO. 11-1158

As to Appeal No. 11-1158, the United States' jurisdictional statement is not complete or correct due to legislation enacted subsequent to the filing of its opening brief. In its January 14, 2011 order, the district court held that it lacked subject matter jurisdiction over the action removed by the United States, and remanded the action to state court. (A-App. 21.[2]) The United States timely appealed on January 18, 2011. (A-App. 178-79.)

On November 9, 2011, the Removal Clarification Act of 2011, Pub L. No. 112-51, was enacted. Among other things, 28 U.S.C. § 1447(d) was amended to permit appellate review of orders remanding cases removed pursuant to "section

[1] The Commissioner and Ambac normally would have submitted separate briefs reflecting their different perspectives in the rehabilitation, but are proceeding here with Ambac adopting the Commissioner's positions to comply with this Court's August 22, 2011 Order.

[2] Citations are to the United States' Appendix ("A-App.") and to the Commissioner's Supplemental Appendix ("S-App.").

1442[.]" Because § 1442 was a basis for removal by the United States (A-App. 175 (¶ 4)), the amendment to § 1447(d) confers jurisdiction over this appeal.

II. APPEAL NO. 11-1419

As to Appeal No. 11-1419, the United States' jurisdictional statement is complete and correct. (*See* Blue Br. at 4.)

INTRODUCTION

This case arises out of the largest insurer delinquency proceeding in Wisconsin history, venued in the Dane County, Wisconsin Circuit Court ("rehabilitation court"). As part of its litigation strategy, the United States chose not to participate in the rehabilitation court.[3] Instead, it first tried to remove the entire proceeding to federal court, and then, after the district court rejected that approach, it directly sued the rehabilitation court, the Commissioner and Ambac in federal court, seeking to collaterally attack the rehabilitation court's orders.

[3] As discussed below, the United States is pursuing parallel appellate relief in the Wisconsin state court system in regard to the same orders of the rehabilitation court that it is challenging in these consolidated federal appeals. At the December 2, 2011 oral argument before the Wisconsin Supreme Court, in response to a question from the Court, counsel for the United States (the same counsel appearing in these appeals) admitted that its decision not to participate in the rehabilitation court despite ample opportunity was a "conscious[] deci[sion]." Oral Argument at 1:09:24-41, *Nickel v. United States*, No. 2011AP987 (Wis. filed June 1, 2011), *available at* mms://sc-media.wicourts.gov/sc-media/11AP0987.wma.

The United States asked the district court to dissolve the rehabilitation court's injunction and enjoin the Commissioner's Rehabilitation Plan so it could seize tax refunds of $708 million it had paid Ambac, even though those funds are a material portion of the claims-paying resources needed to fund the rehabilitation, and even though Wisconsin and federal law expressly prohibit the United States from getting paid before policyholders. The district court, the Honorable Barbara B. Crabb, presiding, held that it lacked subject matter jurisdiction in both of the actions, without reaching the merits of the United States' motion to dissolve the injunction, and these appeals (now consolidated) ensued.

The district court's remand and dismissal orders should be affirmed for the following reasons.

First, the district court correctly held that, based on the McCarran-Ferguson Act, the federal jurisdictional statutes invoked by the United States were reverse-preempted by the state insurance laws that establish the exclusive jurisdiction for insurer rehabilitation proceedings, and authorize the issuance of injunctions—akin to the automatic stay in bankruptcy proceedings—to protect the proceeding and the assets available to fund the rehabilitation.

Second, the district court correctly held that, under the *Burford* doctrine, it should abstain from exercising jurisdiction because the rehabilitation court was a specialized forum for processing claims and resolving objections related to the administration of the rehabilitation. The present dispute raises state law, as well as federal law, issues, and the United States offers no reason why it cannot pursue its objections in state court.

Finally, the United States' request that this Court address the merits of the issues pertaining to the rehabilitation court's Supplemental Injunction should be rejected. Doing so would be improper procedurally and unfair to appellees, given that the district court did not address those issues and this appeal raises purely jurisdictional issues. And, even if this Court were inclined to reach the merits in this appeal, neither sovereign immunity nor the tax Anti-Injunction Act support the relief the United States seeks here.

STATEMENT OF ISSUES

1. Was the district court correct in holding that, under the McCarran-Ferguson Act, it lacked subject matter jurisdiction over the United States' challenges to the state court insurer rehabilitation proceeding being administered by the Commissioner?

2. Even if *arguendo* it had subject matter jurisdiction, was the district court correct in abstaining under the *Burford* doctrine from exercising jurisdiction over the United States' challenges to the rehabilitation proceeding?

3. If this Court were to reverse the district court's remand or dismissal orders, should it then reach the merits of the underlying issues about the state court injunction, when the district court did not address those issues, and these appeals raise purely jurisdictional issues?

STATEMENT OF THE CASE

I. STATEMENT OF FACTS

A. The Insurer Rehabilitation Proceeding

1. Ambac and its deterioration

Ambac is a Wisconsin-domiciled insurer that was one of the two largest financial guaranty insurers in the world. (A-App. 2.) When the rehabilitation commenced in March 2010, Ambac insured over $367 billion in bond exposures (net par outstanding). (R.14-6 (¶ 10) (Appeal No. 11-1158).)

Ambac offered financial guaranty insurance on large public municipal projects and private structured debt obligations such as residential mortgage-backed securities ("RMBS"), credit default swaps ("CDS"), commercial asset-backed securities ("Commercial ABS"), and other substantial financial transactions involving "some of the most complicated financial instruments ever created."

(A-App. 2; S-App. 21 (¶ 50).) Ambac's obligations included a mix of "short-tail" policy obligations (typically relating to RMBS) of only a few years' duration and "long-tail" obligations (typically relating to municipal bonds) of up to 40 years in duration, across approximately 20 distinct exposure categories. (S-App. 21 (¶ 49), 22-23 (¶ 54), 68 (¶ 6).)

Beginning in late 2007, Ambac's financial condition began to deteriorate as many transactions it insured (particularly those with RMBS exposure) began to suffer significant insured losses, with dramatically increased estimates of future losses. (S-App. 66-67 (¶ 3).) Through his analysis, the Commissioner found that the bulk of Ambac's business was sound: around 14,000 of Ambac's roughly 15,000 policies insured problem-free transactions with little risk of material loss, primarily in Ambac's municipal bond portfolio. (S-App. 15 (¶ 30), 21-22 (¶ 51), 73 (¶ 21).) But the remaining policies—primarily those insuring short-tail RMBS transactions—threatened to drain Ambac's claims-paying resources well before its long-tail policy obligations expired. (A-App. 3; S-App. 19 (¶ 42), 21 (¶ 49), 72-73 (¶¶ 19-20).)

By early 2010, the Commissioner determined that regulatory action under Wisconsin's Insurers Rehabilitation and Liquidation Act, WIS. STAT. CH. 645, was necessary to alleviate the growing risk that Ambac would become insolvent before its policy obligations were satisfied. (A-App. 3.)

2. The Commissioner's regulatory choices

Similar to federal bankruptcy protection, which is not available to insurers,[4] state insurer delinquency proceedings[5] provide a legal mechanism for the Commissioner to preserve assets and promote the orderly and "[e]quitable apportionment of any unavoidable loss." WIS. STAT. §§ 645.01(4)(d), 645.05.

In terms of regulatory options, the Commissioner could have commenced a rehabilitation of Ambac as a whole under WIS. STAT. §§ 645.31 or 645.41. (S-App. 22-23 (¶¶ 54-56), 73 (¶¶ 20-21).) However, the complexity of Ambac's business presented unique challenges to the Commissioner in fulfilling his statutory duty to protect policyholders. (A-App. 3; S-App. 21-23 (¶¶ 51-54); WIS. STAT. § 645.01(4).) Ambac's policies are not "off-the-shelf" documents; many were individually negotiated and contain different covenants and "triggers" that would be "pulled" if the policies were subject to a delinquency proceeding. (S-App. 21-22 (¶¶ 51-52).) The Commissioner concluded that it may not have been possible to enjoin the exercise of many of these policy triggers if the policies were subject to a rehabilitation. (*Id.*)

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[4] *See* 11 U.S.C. § 109(b)(2) and WIS. STAT. § 645.035; *see also Munich Am. Reins. Co. v. Crawford*, 141 F.3d 585, 593 (5th Cir. 1998) ("Insurance companies are ineligible for the protections afforded by the federal Bankruptcy Code; such protections instead are provided by state laws, which are shielded from federal interference by the McCarran-Ferguson Act.") (internal citation omitted).

[5] WIS. STAT. ANN. CH. 645, introductory cmt. to subch. III (grounds for rehabilitation and liquidation are "interchangeable").

These triggers had the potential to create massive, unnecessary claims to the detriment of all of Ambac's policyholders and creditors. (A-App. 3-4; S-App. 19 (¶ 43), 21-23 (¶¶ 51-54), 25 (¶ 60), 28 (¶ 70), 39 (¶ 109), 73-74 (¶¶ 21-22).) The Commissioner determined that such a result would be destructive to the many large corporate employers like Hertz, Sonic and Dunkin' Donuts that depended on Ambac's policies to protect their financings. (S-App. 22 (¶¶ 52-53), 73 (¶ 21).) The Commissioner estimated that these policy triggers would cause additional, otherwise avoidable policy losses estimated to be in excess of $1 billion just on the Commercial ABS line of transactions alone, which were otherwise projected to have few or no policy loss claims. (S-App. 73 (¶ 21).)

The same kind of domino effects existed with other categories of Ambac's policies, which had the potential to cause billions of dollars in additional loss claims for Ambac. (*See, e.g.*, S-App. 21-22 (¶¶ 51-53), 39 (¶ 109), 68-69 (¶ 8), 73-74 (¶ 22).)

The adverse consequences of a full rehabilitation of Ambac were not limited to Ambac's policyholders. The Commissioner and his staff met several times with the United States Department of Treasury and the New York Federal Reserve. (S-App. 17 (¶ 36).) These agencies warned the Commissioner of a "systemic risk that placing all of Ambac's policies in rehabilitation could result in market disruption

such that trading and refinancing of these obligations could be significantly impaired, with unpredictable risks to the broader economy." (S-App. 74 (¶ 23).)

Thus, the Commissioner faced a conundrum: how to find a solution for an insurer that presented a risk of non-payment to policyholders and creditors *absent* rehabilitation, when the vast majority of its policies insured problem-free transactions that were performing, with little or no projected future losses *unless* they were subjected to a rehabilitation. (S-App. 21-25 (¶¶ 50-60), 39 (¶ 109), 73-74 (¶¶ 21-23).)

3. The segregated account solution

In the face of the dilemma caused by the nature of Ambac's business, the Commissioner sought a surgical approach that would address the need for rehabilitation but avoid the disastrous adverse consequences of a full rehabilitation to Ambac's policyholders and to the broader economy. (S-App. 22-23 (¶¶ 54-55), 73-74 (¶¶ 21-25).) He found that approach through WIS. STAT. § 611.24. Section 611.24 permits an insurer with the Commissioner's approval to establish a segregated account for any portions of its business, and permits the Commissioner to rehabilitate that segregated account without necessarily subjecting the remainder of the insurer to rehabilitation. WIS. STAT. § 611.24(2), (3)(e). The segregated account is not a separate corporation from the insurer that creates it—the part of Ambac's business that is in the segregated account is still Ambac, just like the part

of its business that is not in the segregated account (commonly referred to as Ambac's "general account")—but the segregated account is "deemed" a separate insurer for the purpose of delinquency proceedings such as rehabilitation. (A-App. 13; WIS. STAT. § 611.24(3)(e).)

The Commissioner recognized that, as long as the segregated account included every Ambac policy with anticipated material losses (*i.e.*, not the healthy policies with adverse triggers), and every other known, material liability to other potential claimants, then Ambac as a whole could be effectively rehabilitated without causing the unnecessary losses that would accompany a full rehabilitation. (A-App. 13-14; S-App. 23 (¶ 55), 25 (¶ 63), 39 (¶¶ 108-109), 50 (¶ 136), 74 (¶ 25), 78 (¶ 36).) In economic terms, the segregated account statute presented an opportunity for a "Pareto-superior"[6] outcome as compared to a full rehabilitation. As the rehabilitation court determined, the segregated account rehabilitation leaves all policyholders and other claimants better off than they would have been in a full rehabilitation of Ambac as a whole. (S-App. 23-24 (¶¶ 55-57), 25 (¶¶ 60, 63), 38-39 (¶¶ 105-109), 50-51 (¶ 136), 78 (¶ 36).)

[6] *See Cavel Int'l, Inc. v. Madigan*, 500 F.3d 544, 550 (7th Cir. 2007) (Easterbrook, C.J., dissenting) ("Pareto-superior" means "no one loses in the process, and at least some people gain").

The available claims-paying resources could not be transferred outright to the segregated account because many of Ambac's performing policies with no anticipated losses—*e.g.*, public municipal bond policies—were subject to acceleration, early termination and other triggers if Ambac allocated material portions of its claims-paying resources to an affiliate. (S-App. 28 (¶ 70).) Therefore, the Commissioner determined that claims against Ambac's segregated account—which, as noted above, would include every anticipated material claim—should be paid from Ambac's general account. (S-App. 28 (¶ 71).)

With rehabilitation court approval, the Commissioner imposed tight controls over those claims-paying resources. They are subject to a $2 billion Secured Note and a Reinsurance Agreement in favor of the segregated account. (A-App. 4-5; S-App. 28-29 (¶¶ 71-75), 51-52 (¶¶ 139-141).) The rehabilitation court also approved a Cooperation Agreement, which significantly constrains the general account from using the resources for any purpose other than paying policyholder claims without the Commissioner's authorization. (S-App. 104 (§ 1.02).) These arrangements provide on-demand access to essentially all resources to satisfy segregated account liabilities, without triggering the asset-transfer restrictions in many policies. (S-App. 28-29 (¶¶ 71-75), 51-52 (¶¶ 139-141), 90-91.)

The Commissioner implemented the segregated account approach in March 2010. (A-App. 4-5.) After months of investigation, the Commissioner identified

and caused Ambac to allocate all known, material and anticipated claims to a newly formed segregated account with access to the same pool of claims-paying resources as Ambac's general account. (*Id.*; S-App. 26-29 (¶¶ 64-75).) He then petitioned for rehabilitation of the segregated account in the rehabilitation court, the Honorable William D. Johnston, presiding. (A-App. 5, 50.) The rehabilitation contemplated that deferred payments on claims would be made over time, so that claims-paying resources would be preserved throughout the life of Ambac's policies in force, and any shortfalls in those resources would fall equally upon all policyholders, short-tail as well as long-tail. (A-App. 58-59 (¶ 12); S-App. 35-38 (¶¶ 96-104).)

The rehabilitation court endorsed the segregated account solution as providing the best possible outcome for policyholders and others, noting:

> The formation of the Segregated Account, the allocation of less than 1,000 of Ambac's almost 15,000 policies thereto, and the commencement of this rehabilitation of the Segregated Account was a fair and reasonable response to Ambac's financial condition. It addresses the serious financial hazards the allocated policies presented to Ambac and all of its policyholders (including those allocated to the Segregated Account), maximizes claims-paying resources, and avoids the unpredictable and potentially substantial collateral damage to Ambac, its policyholders, and the public that would accompany a full rehabilitation of Ambac.

(S-App. 78 (¶ 36).) Likewise, at the conclusion of week-long evidentiary hearings regarding the Commissioner's Rehabilitation Plan, the rehabilitation court

reiterated that the decision to proceed with a segregated account rehabilitation "was fair, it was equitable. It was an extremely well thought-out, well-based decision." (S-App. 12-13 (¶ 22).)

4. Protecting the segregated account approach from unfairness

To protect the claims-paying resources needed to fund the rehabilitation, the Commissioner sought and obtained a standard first-day Injunction pursuant to WIS. STAT. § 645.05, which broadly barred all persons and entities from commencing or prosecuting any actions against Ambac's general account (where the claims-paying resources reside) "in respect of the segregated account or policies, contracts or liabilities allocated to the segregated account." (A-App. 5, 91 (¶ 1).) The Injunction expressly permitted all affected persons the opportunity to challenge it in the rehabilitation court. (A-App. 102 (¶ 12).)

Under standard state insurance law, codified in Wisconsin at WIS. STAT. § 645.68, policyholder claims are guaranteed a higher claim priority than governmental claims, contract and judgment claims and equity claims. To protect the policyholders in the segregated account from lower-priority claimants getting paid ahead of them outside of the rehabilitation claim priority structure, the Commissioner allocated all potentially material non-policy liabilities to the segregated account, thus subjecting those claimants to the Injunction and requiring them to make their claims through the rehabilitation process. (S-App. 31-32

(¶¶ 82-84), 33 (¶ 88).) When the rehabilitation was filed in March 2010, two main types of material, potential lower-priority claims were known to the Commissioner: (1) Ambac's obligations under reinsurance contracts with third-parties, which do not constitute "policies" under Wisconsin law (S-App. 35 (¶ 94)); and (2) contractual lease liabilities (S-App. 26 (¶ 66)). Those potential claims were allocated to the segregated account, and those allocations were affirmed by the rehabilitation court. (*Id.*; *see generally* S-App. 82-102 (denying objections by lessor).) The Commissioner pledged to continue to closely monitor Ambac's financial condition and to take further action if other material, lower-priority claims arose. (S-App. 31-33 (¶¶ 83-85, 88).)

5. The possibility of a material tax claim

On November 3, 2010, the Commissioner learned that the IRS had notified Ambac's parent company, Ambac Financial Group, Inc. ("AFGI"), that it might challenge the basis on which the IRS had paid $708 million in tax refunds to AFGI in 2009 and 2010. (A-App. 130-131 (¶¶ 5-6, 9).) AFGI files consolidated tax returns on behalf of itself and its subsidiaries and, upon receipt of the tax refunds at issue, AFGI paid them to Ambac because the refunds were attributable to Ambac's operations. (A-App. 130 (¶¶ 4, 7).)

The prospect of the IRS going after AFGI for the refunds was of little consequence for the rehabilitation; AFGI is not an insurer, and the Commissioner

does not regulate it. (S-App. 32 (¶ 84).) But because the IRS claimed the power to recover tax payments from any member of the consolidated tax group, on a joint and several basis (*see* Blue Br. at 7), the Commissioner was concerned that the IRS might make a pre-judgment jeopardy assessment to try to get paid outside the rehabilitation in violation of the Wisconsin claim priority statute. (A-App. 131 (¶ 9).)

To protect policyholders against that risk, the Commissioner on November 7, 2010 allocated the contingent tax-refund claim to the segregated account, with Ambac's other material anticipated claims. (A-App. 163-164.)

The Commissioner notified the rehabilitation court of the allocation and moved to expand the Injunction to encompass the newly allocated tax liability. (A-App. 122-128.) The rehabilitation court granted that relief (the "Supplemental Injunction") while expressly allowing the United States 45 days to challenge it. (A-App. 149 (¶ 5).) The Commissioner immediately notified the local United States Attorney's Office, the United States Attorney General's Office, and the IRS office having oversight over Ambac. (A-App. 164-170.) The Commissioner also informed them of the scheduled Plan confirmation hearings, suggested they contact his counsel with any questions, and directed them to the court-approved Web site

for the proceedings, http://ambacpolicyholders.com, to access court filings and other information about the rehabilitation. (A-App. 168-173.)[7]

The Supplemental Injunction does not differ from the first-day Injunction in any relevant respect. (*Compare* A-App. 90-92 (¶¶ 1-4) *with* A-App. 146-148 (¶¶ 1-4).) It merely expands the Injunction to apply to the contingent tax-refund liability and other liabilities pertaining to AFGI that were allocated to the segregated account at that time. The Supplemental Injunction ensured that the newly allocated potential claims—like the claims allocated to the segregated account from the outset—receive the same treatment than they would have received in a full rehabilitation. (A-App. 13-14, 126-127 (¶¶ 14-16).)

Nothing in the Supplemental Injunction or any other order purported to extinguish Ambac's present or future liabilities to any creditor or potential creditor, including the United States. (*See* A-App. 11; S-App. 96-97.) The United States, like all other creditors, was entitled to submit any claim to recover the refunds to the Commissioner, to have that claim paid in accordance with Wisconsin's claim priority statute and the Rehabilitation Plan, and, if there was some dispute over the

[7] AFGI sought Chapter 11 protection and sued the United States in an adversary proceeding for a declaratory judgment to confirm that the tax refunds were proper. That federal action is proceeding. (A-App. 161-162 (¶¶ 35, 37, 39).) The United States has made no challenge to the effectiveness or validity of the stay provision entered in the bankruptcy proceeding. *See generally In re Ambac Fin. Group, Inc.*, No. 10-15973 (Bankr. S.D.N.Y. filed Nov. 8, 2010).

treatment of that claim, to raise that dispute in the rehabilitation court. (A-App. 18-20.)

As the district court noted, the Supplemental Injunction does not say "that the United States cannot collect taxes from insurance companies in general or from Ambac in particular or that it can never pursue return of the refund if it determines it was improper." (A-App. 11.) The Supplemental Injunction merely requires "the United States [to] conform its efforts to the restrictions necessary to the effectiveness of the state's rehabilitation proceedings." (*Id.*)

6. The Plan confirmation hearings

Dozens of policyholders and other parties-in-interest appeared at the evidentiary hearings on the Commissioner's Rehabilitation Plan and raised various objections to certain actions or parts of the Plan. (S-App. 10 (¶ 14).) The rehabilitation court heard five days of testimony (from November 15 through 19, 2010) and heard oral argument on November 30, 2010. (S-App. 7 (¶ 10).) Although it was served with notice about the confirmation hearings and the 45-day period to challenge the Supplemental Injunction, the United States chose for strategic reasons not to appear in the rehabilitation court.[8]

[8] *See* footnote 3, *supra*. The United States contends that the filing of a written objection was "a prerequisite for participation in the plan-confirmation hearing" (Blue Br. at 15), but the Commissioner informed the government that
(footnote continued on following page)

II. PROCEDURAL HISTORY

A. The Removal And Remand Of The Rehabilitation Proceeding

On December 8, 2010, the United States removed the entire rehabilitation proceeding to federal court, contending that the Supplemental Injunction made the United States a *de facto* defendant in the rehabilitation. (A-App. 175 (¶¶ 2-4).) The United States' removal stopped the rehabilitation proceeding in its tracks: the rehabilitation court could not rule on the Commissioner's Rehabilitation Plan or decide various pending motions. (A-App. 18.)

The United States then filed a motion to dissolve the rehabilitation court's Supplemental Injunction. (A-App. 1-2.) The Commissioner moved to remand the case to the rehabilitation court.

On January 14, 2011, the district court granted the Commissioner's motion to remand the proceedings, holding that: (a) it lacked subject matter jurisdiction because, applying the McCarran-Ferguson analysis, the federal removal statutes invoked by the United States were reverse-preempted by the state insurance statutes relating to jurisdiction and injunctive relief in rehabilitation proceedings (A-App. 9-15); and (b) even if subject matter jurisdiction existed, it would abstain under the *Burford* doctrine to prevent federal interference with the rehabilitation

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"[t]he hearings on confirmation shall be conducted in open court and are open to the public and to all parties-in-interest." (A-App. 172.)

proceeding (A-App. 16-21). The district court did not reach the United States' motion to dissolve the Supplemental Injunction, advising the government to raise its challenges in the rehabilitation court. (A-App. 19-20.)

The United States appealed the remand order to this Court, but did not seek a stay of the remand order pending appeal.

B. The United States' State Court Appeal And Its Federal Suit Against The Rehabilitation Court, The Commissioner And Ambac

Upon remand, the rehabilitation court entered a final order confirming the Rehabilitation Plan on January 24, 2011. (S-App. 1-64.) The United States took two steps in reaction to the rehabilitation court proceeding after the remand.

First, even though it had never appeared in the rehabilitation court, the United States appealed that court's Supplemental Injunction and Plan Confirmation Order in state court. The Wisconsin Court of Appeals dismissed the United States' appeal on procedural grounds, and the appeal of that ruling is pending in the Wisconsin Supreme Court. (Blue Br. at 19-20.)

Second, the United States sued the rehabilitation court, the Commissioner and Ambac in federal court, seeking to enjoin the rehabilitation court from enforcing the Supplemental Injunction and Plan Confirmation Order against the United States. (A-App. 22.)

The district court dismissed the United States' lawsuit for the same reasons underlying its remand order: lack of subject matter jurisdiction under the McCarran-Ferguson Act; and abstention under the *Burford* doctrine. (A-App. 26, 29-31.) The district court noted the disruption caused by the United States' actions:

> Despite the court's substantial discussion regarding abstention in the remand order, the United States does not explain why the court's analysis of the doctrine would be any different in this case. . . . By filing a collateral attack against orders issued in the state rehabilitation proceeding, the United States has once again disrupted the proceeding and deprived the state court of the opportunity to address issues that are similar to those raised by other creditors and have the potential to impair the rehabilitation plan.

(A-App. 30-31.)

C. The Present Status Of The Rehabilitation And The Disputed Tax Claim

The United States has never submitted a claim as to the tax refunds in the rehabilitation proceeding. Indeed, it is unclear whether the United States will ever have a claim; the merits of the potential $708 million claim are presently being litigated in AFGI's bankruptcy proceeding. (A-App. 25.) If the United States establishes a claim in the bankruptcy court, it may submit that claim to the Commissioner for payment through the rehabilitation process. (A-App. 29.)

If it fails to establish a claim in the bankruptcy court, the issues raised by the United States in this appeal will be moot.

SUMMARY OF ARGUMENT

The Introduction above fully sets forth the Commissioner's summary of argument.

ARGUMENT

As a threshold matter, the United States' arguments are premised on its inaccurate characterization of the nature and structure of the segregated account rehabilitation. The reality of the rehabilitation is what the district court and the rehabilitation court found it to be: a necessary, practical solution to Ambac's financial situation that successfully "control[s] the material risks to the claims-paying resources of Ambac and [] treat[s] them in the same way it would treat those risks in a full rehabilitation." (A-App. 13; S-App. 25 (¶ 63), 39 (¶ 109), 50-51 (¶ 136), 59 (¶ 13), 78 (¶ 36).) It functions as a full rehabilitation of Ambac without the adverse consequences a full, formal rehabilitation would cause in this circumstance. (*Id.*)

The United States admits that federal law would bar it from imposing a levy on the claims-paying resources if the Commissioner were pursuing a "full" rehabilitation of Ambac or the assets were in the formal "custody" of the

rehabilitation court. (Blue Br. at 10-11, 88-89 n.26.)[9] For that reason, the United States insists on characterizing the segregated account rehabilitation in a narrow sense, claiming that the Supplemental Injunction improperly "enjoin[ed] collection from an entity that was not in receivership." (Blue Br. at 76.)

However, Ambac and the segregated account are not separate corporations; the segregated account is simply "deemed" a separate insurer for the purpose of enabling its rehabilitation without forcing a rehabilitation of Ambac as a whole. WIS. STAT. § 611.24(3)(e). The segregated account has full access to the shared resources. (S-App. 28-29 (¶¶ 70-75), 52 (¶¶ 140-141).) As a practical matter, the segregated account is the only portion of Ambac that can draw upon those assets to any material degree. At the request of the Commissioner, the rehabilitation court approved strict controls over the claims-paying resources (*see* discussion regarding

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[9] The IRS regulation provides:

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

26 C.F.R. § 301.6331-1(a)(3) (emphasis added).

the Secured Note, Reinsurance Agreement and Cooperation Agreement, *supra*) to ensure their availability to fund the rehabilitation. The claims-paying resources are further protected for the benefit of the rehabilitation by the rehabilitation court's first-day and Supplemental Injunctions, which ensure that no material claims can be paid by Ambac outside the context of the rehabilitation. (A-App. 5; S-App. 30-32 (¶¶ 80-84), 104 (§ 1.02).)

The United States' potential claim has not been eliminated; it will be treated like all other material claims against Ambac, in accordance with the Commissioner's Rehabilitation Plan and Wisconsin's claim-priority statute. (A-App. 13-14.) As the district court explained:

> [T]he United States takes a narrow view of the rehabilitation proceeding, focusing on the fact that the only *res* technically subject to the rehabilitation court's jurisdiction is the segregated account . . . . It overlooks the lengths to which the Commissioner has gone to control the material risks to the claims-paying resources of Ambac and to treat them in the same way it would treat those risks in a full rehabilitation.
>
> Technically, the rehabilitation proceeding extends only to the segregated account to which certain of [] Ambac's liabilities are allocated. In reality, it extends to the general account and to Ambac's affiliates and subsidiaries to the extent that these entities are lenders or insurers of the segregated account. Although the segregated account is deemed to be a separate insurer for [the] purpose of rehabilitation, it is not actually a separate corporation from Ambac. Indeed, the whole point of the rehabilitation is to rehabilitate Ambac Assurance Corporation. The Commissioner and the presiding judge

> have made the decision that treating the assets and liabilities as they have is best calculated to lead to a successful rehabilitation. The judge held a five-day hearing on the scope and nature of the proceeding and determined that the relationship between the general account and segregated account is fair and equitable. Thus, the plan to rehabilitate the segregated account depends in large part on the assets of the general account being protected by the first-day and supplemental injunctions. Allowing the United States to proceed against Ambac or any of the affiliates and subsidiaries would amount to pulling out the linchpin that secures the entire enterprise.

(A-App. 13-14.)

Viewing the rehabilitation in its proper form highlights the extent to which the United States' actions have impaired and interfered with the Commissioner's rehabilitation efforts and Wisconsin's comprehensive Chapter 645 regulatory framework for troubled insurers.

I. THE DISTRICT COURT CORRECTLY HELD THAT IT LACKED SUBJECT MATTER JURISDICTION OVER THE UNITED STATES' CHALLENGES TO THE STATE COURT REHABILITATION PROCEEDING

A. The McCarran-Ferguson Act

"[T]he starting point in a case involving construction of the McCarran-Ferguson Act, like the starting point in any case involving the meaning of a statute, is the language of the statute itself." *U.S. Dep't of Treasury v. Fabe*, 508 U.S. 491, 500 (1993) (quoting *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 210 (1979)).

Section 2(b) of the McCarran-Ferguson Act provides, in relevant part:

> *No Act of Congress* shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, . . . unless such Act specifically relates to the business of insurance[.]

15 U.S.C. § 1012(b) (emphasis added).

On its face, the Act states that *every* federal statute is subject to reverse-preemption, as long as the remaining requirements of the Act are satisfied. *See Am. Deposit Corp. v. Schacht*, 84 F.3d 834, 844 (7th Cir. 1996) (noting that "any" federal law is "within the reach of the McCarran-Ferguson Act"). Thus, the Act does not exempt federal jurisdictional statutes from its scope, nor does it draw distinctions based on whether the federal statute at issue relates to jurisdiction or authorizes a specific remedy or form of affirmative relief, as the United States suggests. (Blue Br. at 57-62.) The only exemption from the Act is for federal statutes that "specifically relate[] to the business of insurance." *See Autry v. Nw. Premium Servs., Inc.*, 144 F.3d 1037, 1040 (7th Cir. 1998) ("Congress intended the McCarran Act to allow the states to regulate the business of insurance 'free from inadvertent preemption by federal statutes of general applicability.'") (citation omitted).

B. Wisconsin Law Governing Insurer Delinquency Proceedings

"Pursuant to the McCarran-Ferguson Act, the states have assumed primary responsibility for regulating the insurance industry. Under this regulatory power, most states have adopted statutes to govern the rehabilitation and liquidation of insolvent insurers." *Hartford Cas. Ins. Co. v. Borg-Warner Corp.*, 913 F.2d 419, 426 (7th Cir. 1990) (internal citation omitted).

Chapter 645, WIS. STATS., was enacted with McCarran-Ferguson, and the circumstance of a claimant attempting to use federal law to circumvent the priority structure, in mind:

> [T]his chapter is perceived by the legislature as, and in fact is, part of the regulatory structure. It is a part of the regulatory system because this chapter will have considerable effect on the way the insurance business is conducted by the reinsurers, agents, premium financers, and others. If the courts see clearly that the chapter is a part of the regulatory system, it should be possible *to overcome what would otherwise be a limiting interpretation of federal statutes. This problem is of special importance in s. 645.68, on priorities*[.]

WIS. STAT. ANN. § 645.01 cmt (emphasis added). *See also* WIS. STAT. § 645.01(4)(f) (noting purpose of Chapter 645 is the "protection of the interests of insureds" through "[r]egulation of the insurance business by the impact of the law relating to delinquency procedures and substantive rules on the entire insurance business").

Chapter 645 establishes the exclusive jurisdiction of the rehabilitation court over matters pertaining to the rehabilitation of an insurer. *See* WIS. STAT. § 645.04(3). Whether to permit a change of forum for any such issues is a matter of discretion for the state court presiding over the delinquency proceeding. WIS. STAT. § 645.04(6). Moreover, the rehabilitation court has the express authority to enjoin "[i]nterference with the receiver or with the proceedings," "[t]he institution or further prosecution of any actions or proceedings," "[t]he obtaining of preferences, judgments, attachments, garnishments, or liens against the insurer or its assets," "[t]he levying of execution against the insurer or its assets," and "[a]ny other threatened or contemplated action that might lessen the value of the insurer's assets or prejudice the rights of policyholders . . . , or the administration of the proceeding." WIS. STAT. § 645.05(1)(c), (f), (g), (h), (k).

C. The Three-Part McCarran-Ferguson Test For Applying Reverse-Preemption Is Satisfied

Under the Act, any federal statute is reverse-preempted by a state statute if:

(1) "the federal statute does not 'specifically relate to the business of insurance'";

(2) "the state statute was 'enacted . . . for the purpose of regulating the business of insurance'"; and

(3) "application of the federal statute would 'invalidate, impair or supersede' the state law."

Autry, 144 F.3d at 1042 (quoting *Fabe*, 508 U.S. at 501). All three of these requirements are met here.

1. The federal jurisdictional statutes at issue do not "specifically relate" to the business of insurance

All of the jurisdictional statutes invoked by the United States—28 U.S.C. §§ 1441 and 1442 in the removal action, and 28 U.S.C. §§ 1331, 1340, 1345, and 26 U.S.C. § 7402 in the original action—are statutes of general application, which do not specifically relate to the business of insurance. (A-App. 11-15, 28.)

The United States concedes that 28 U.S.C. §§ 1441, 1442, 1331, 1340 and 1345 do not specifically relate to the business of insurance. (*See generally* Blue Br. at 48-49, 68-72.)

With respect to 26 U.S.C. § 7402, the United States argues that, if the state insurer delinquency statutes are deemed to regulate the "business of insurance" under the second part of the McCarran-Ferguson test, then the entire "Internal Revenue Code [including § 7402] should be treated as specifically relating to the business of insurance" under the first part of that test. (Blue Br. at 68-69; *see id*. at 70-72.)

The United States' argument is flawed because § 7402, on its face, does not "specifically relate" to the business of insurance, and no other provision of the Internal Revenue Code is incorporated by reference into § 7402 or is otherwise at issue in this jurisdictional appeal. Section 7402 provides general authority regarding the issuance of injunctions relating to "the enforcement of the internal revenue laws," which—like the other jurisdictional statutes at issue—is a statute of

general application that covers a broad range of activities and potential claims. (A-App. 28.)

The United States cites *Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25 (1996), but that authority supports the Commissioner's position. (Blue Br. at 69-70.) In *Barnett*, the Supreme Court held that the federal statute at issue (12 U.S.C. § 92) specifically related to the business of insurance because:

> The statute *explicitly* grants national banks permission to "act as the agent for any fire, life, or other insurance company," to "solici[t] and sel[l] insurance," to "collect premiums," and to "receive for services so rendered . . . fees or commissions," subject to Comptroller regulation. 12 U.S.C. § 92. It also sets forth certain specific rules prohibiting banks from guaranteeing the "payment of any premium on insurance policies issued through its agency . . . . The statute thereby *not only focuses directly upon industry-specific selling practices, but also affects the relation of insured and insurer and the spreading of risk-matters* that this Court, in other contexts, has placed at the core of the McCarran-Ferguson Act's concern.

Barnett, 517 U.S. at 39 (emphasis added, citations omitted). By contrast, § 7402 does not "specifically"—*i.e.*, "explicitly, particularly, [or] definitely," *id*. at 38—relate to the business of insurance, or affect the policy relationship between the insurer and the insured.

Finally, the United States' assertion that § 7402 "should be treated" as specifically relating to the business of insurance is based on an erroneous premise: that the first and second parts of the reverse-preemption test have the same scope

because both parts refer to the "business of insurance." (*See* Blue Br. at 49-51, 68-72.) In fact, the "regulation" of the business of insurance is broader than the "business of insurance" itself. As this Court has explained:

> There will be cases where the regulated activity does not constitute the "business of insurance" as that term is defined in *Pireno*, yet the statute that regulates the activity may have been enacted "for the purpose of regulating the business of insurance." As the *Fabe* Court stated, the "broad category of laws enacted 'for the purpose of regulating the business of insurance' . . . necessarily encompasses more than just the 'business of insurance.'" *Fabe*, 508 U.S. at 505.
>
> Take, for example, the statute at issue in *Fabe*. The state statute at issue regulated creditor priority in a bankruptcy dissolution and gave policyholders a higher preference than they received under the federal statute. If we asked only whether the activity in question, bankruptcy dissolution, was the "business of insurance" as defined in *Pireno*, the answer would be "no." . . . Yet, as the Supreme Court noted, the preferencing of policyholders "serves to ensure that, if possible, policyholders ultimately will receive payment on their claims." *Id.* at 506. "Because the [state] statute is 'aimed at protecting or regulating' the performance of an insurance contract . . . it follows that it is a law 'enacted for the purpose of regulating the business of insurance'. . . .
>
> The Supreme Court did not simply look to the activity being regulated to determine whether it qualified as the "business of insurance." Instead, it dissected the statute and looked to an ultimate effect of the statute: increased probability of enforcement of the insurance contract. *Id.* at 502-05. Thus, a statute that regulates bankruptcy proceedings may still be a statute "enacted . . . for the purpose of regulating the business of insurance" even

> though bankruptcy proceedings themselves are not the "business of insurance."

Autry, 144 F.3d at 1042.

2. The state insurer delinquency statutes were enacted to regulate the business of insurance

Fabe states that "[s]tatutes aimed at protecting *or* regulating th[e] relationship between insurer and [policyholders], *directly or indirectly*, are laws regulating the 'business of insurance,'" and that any laws that "possess the 'end, intention, or aim' of adjusting, managing, or controlling the business of insurance" fall within the "*broad category* of laws enacted 'for the purpose of regulating the business of insurance.'" *Fabe*, 508 U.S. at 503, 505 (citations, internal brackets omitted, emphasis added); *see also Autry*, 144 F.3d at 1044.

The provisions of Chapter 645 satisfy this requirement. Specifically, § 645.04 and § 645.05 regulate the relationship between the insurer and policyholders by: (a) preserving the assets available to fund the rehabilitation, thereby enhancing the ability of the insurer to perform its contractual obligations; and (b) ensuring that the insurer will be rehabilitated in an orderly and predictable manner, consistent with the Wisconsin priority statute, which pays policyholder claims ahead of federal government claims. *See* WIS. STAT. §§ 645.68(3) (policyholder claims), (3)(c) (government claims); *cf. Fabe*, 508 U.S. at 508 ("We

hold that the Ohio priority statute, to the extent that it regulates policyholders, is a law enacted for the purpose of regulating the business of insurance.").

As the district court ruled:

> WIS. STAT. CH. 645 vests jurisdiction in the state rehabilitation court over matters related to the rehabilitation of an insurer. WIS. STAT. § 645.04. The state court has authority to enjoin any action that may interfere with the proceedings or "lessen the value of the insurer's assets or prejudice the rights of policyholders, . . . , or the administration of the proceeding." WIS. STAT. § 645.05. These sections of chapter 645 relate specifically to regulating the business of insurance.

(A-App. 12; *see also* A-App. 27-28.)

Numerous other courts have held that state rehabilitation and liquidation statutes regulate the business of insurance within the meaning of the McCarran-Ferguson Act. *See, e.g.*, *Munich Am.*, 141 F.3d at 592-93 ("[T]he specific provisions of the statute at issue here—vesting exclusive original jurisdiction of delinquency proceedings in the Oklahoma state court and authorizing the court to enjoin any action interfering with the delinquency proceedings—are laws enacted clearly for the purpose of regulating the business of insurance."); *Davister Corp. v. United Republic Life Ins. Co.*, 152 F.3d 1277, 1281 (10th Cir. 1998) ("The stay [against all proceedings against the insolvent insurer] makes clear it is the policy of . . . Utah to consolidate in one forum all matters attendant to the liquidation . . . . That policy guarantees that . . . all decisions . . . affecting the ultimate benefits to

be accorded policyholders . . . are circumscribed in one proceeding. Because the stay prevents conflicting rulings on claims, the unequal treatment of claimants, and the unnecessary and wasteful dissipation of the remaining funds of the insolvent insurer, the stay manifests a purpose of protecting policyholders . . . [and] meets the test of having been enacted for the purpose of regulating the business of insurance."); *Stephens v. Am. Int'l Ins. Co.*, 66 F.3d 41, 45 (2d Cir. 1995) ("The Kentucky Liquidation Act has the 'end, intention, or aim of adjusting, managing or controlling the business of insurance,' in that it regulates the winding up of an insolvent insurance company" and "'protects' policyholders . . . by assuring that an insolvent insurer will be liquidated in an orderly and predictable manner.") (quoting *Fabe*, 508 U.S. at 505). *See also In re Amwest Surety Ins. Co.*, 245 F. Supp. 2d 1038, 1044-45 (D. Neb. 2002); *U.S. Fin. Corp. v. Warfield*, 839 F. Supp. 684, 688-89 (D. Ariz. 1993); *Eden Fin. Group, Inc. v. Fidelity Bankers Life Ins. Co.*, 778 F. Supp. 278, 280-82 (E.D. Va. 1991) (pre-*Fabe* case); *Corcoran v. Universal Reins. Corp.*, 713 F. Supp. 77, 80-81 (S.D.N.Y. 1989) (same).

The United States admits that the Wisconsin statutes relate to "the choice of adjudicative forum,"[10] but contends that the statutes are not "reasonably necessary

[10] The United States argues that regulating the "choice of adjudicative forum" is not the business of insurance, citing *International Insurance Co. v. Duryee*, 96 F.3d 837, 840 (6th Cir. 1996). (Blue Br. at 58.) But *Duryee* did not involve a delinquency proceeding, and instead concerned an Ohio law that required
(footnote continued on following page)

to further the goal of protecting policyholders." (Blue Br. at 54-55, 57-58.) However, this argument is based on an unduly narrow reading of *Fabe* (*see id*. at 52-54, 59), and ignores the numerous cases discussed above. As the First Circuit has explained:

> *Fabe*'s premise was not that priority (over the United States) for policyholders is all right and priority for anyone else is not; *Fabe* itself upheld a priority for administrative expenses of liquidation . . . *because* these reimbursements facilitated payment to policyholders. In other words, priorities that indirectly assure that policyholders get what they were promised can also trigger McCarran-Ferguson protection . . . .

Ruthardt v. United States, 303 F.3d 375, 382 (1st Cir. 2002) (emphasis in original).[11]

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the insurance commissioner to revoke the license of any foreign insurance company that removed an action initiated by a citizen of Ohio to federal court. Because the state statute at issue had no relationship to ensuring that payments were made to policyholders, the Sixth Circuit found that it did not regulate the business of insurance. *Id*. at 840-41.

[11] In *Ruthardt*, two McCarran-Ferguson issues were presented: (1) whether guaranty funds had claim propriety over the United States in a state insurer delinquency proceeding; and (2) whether Massachusetts' one-year deadline for filing claims in the proceeding barred the United States' untimely claims. 303 F.3d at 378-79. As to the first (priority) issue, the First Circuit applied *Fabe* and held that "[t]he priority that Massachusetts affords to guaranty funds is part and parcel of an integrated regime aimed at the protection of policyholders" and reverse-preempted the federal priority statute. *Id*. at 382. As to the second (time bar) issue, the court held that reverse preemption did not apply because "[a]n early bar date for United States claims has only a limited effect on policyholders—*who have priority anyway* . . . ." *Id.* at 385 (emphasis added).

Just as "[a]n insolvency's administrative expenses [in *Fabe*]. . . were reasonably necessary to protect policyholders because a workout could not occur absent payment of those expenses" (Blue Br. at 53), the exclusive jurisdiction and injunction provisions in Chapter 645 ensure the orderly payment of claims to policyholders, and prevent creditors such as the United States from "jumping the line" and seizing assets that would otherwise be available to pay policyholder claims under the Wisconsin priority statute. Similarly, "a workout could not occur" if *any* person or entity with a stake in the rehabilitation were free to engage in self-help and seek relief outside the state court rehabilitation proceeding based on one or more of the *same* federal jurisdictional statutes invoked by the United States, namely 28 U.S.C. §§ 1331 and 1441, or a different one, 28 U.S.C. § 1332. Because the ultimate effect of Wisconsin's insurer delinquency statutes is the "increased probability of enforcement of the insurance contract," *Autry*, 144 F.3d at 1042, the second part of the McCarran-Ferguson test is satisfied.

3. Application of the federal jurisdictional statutes would "impair" the insurer delinquency statutes

The final requirement for reverse-preemption is that the relevant federal statute would operate to "invalidate, impair, or supersede" the state law regulating the business of insurance. *Autry*, 144 F.3d at 1042. "Impair" means to weaken, make worse, lessen in power, diminish, relax, or injure. *Humana, Inc. v. Forsyth*, 525 U.S. 299, 309-10 (1999). "Direct conflict with state law is not required to

trigger this [McCarran-Ferguson] prohibition; it is enough if the interpretation would "interfere with a State's administrative regime." *Doe v. Mutual of Omaha Ins. Co.*, 179 F.3d 557, 563 (7th Cir. 1999) (quoting *Humana*, 525 U.S. at 310).

Here, the federal jurisdictional statutes directly conflict with, and interfere with, the Chapter 645 administrative regime in a number of ways.

First, by removing the entire rehabilitation proceeding—which had "been in state court for roughly ten months and includes . . . policies insuring approximately $60 billion of financial obligations"—to federal court, the United States deprived the rehabilitation court of jurisdiction (under § 645.04) and "stalled confirmation of the rehabilitation plan." (A-App. 12, 18.)

The United States' narrow reading of the McCarran-Ferguson Act would have significant ramifications that extend well beyond the present dispute. In the rehabilitation proceeding, numerous claimants have raised federal constitutional issues, and numerous claimants also would satisfy the criteria for diversity jurisdiction. (*See, e.g.*, S-App. 10 (¶ 14) (listing objectors, all of which appear to have out-of-state citizenship), 58-59 (¶ 11) (rejecting federal constitutional challenges), 79 (¶ 5) (same), 97-100 (same).) Under the United States' position, *any* of those claimants—or any other similarly situated person or entity—could federalize this state insurer delinquency proceeding by removing the proceeding under 28 U.S.C. § 1441.

Second, by employing the federal jurisdictional statutes to sue the rehabilitation court and the Commissioner, seeking to enjoin the rehabilitation court "from enforcing the supplemental injunction [issued under § 645.05] and order confirming the rehabilitation plan," and to enjoin the Commissioner from implementing the Plan, the United States again "clearly 'impair[ed]' or 'supersede[d]' the state laws that authorized the state court to issue those orders." (A-App. 28.)

If McCarran-Ferguson does not bar persons or entities from invoking federal jurisdictional statutes (28 U.S.C. §§ 1331, 1332) to collaterally attack unified state insurer delinquency proceedings, or the state law injunctions entered to preserve assets and bring order to those proceedings, then any claimant unhappy with the rehabilitation court's injunction could follow the United States' litigation roadmap and initiate disruptive collateral attacks against the proceeding in the federal courts of their choosing.[12]

[12] *See Davister*, 152 F.3d at 1281 ("Allowing a putative creditor to pluck from the entire liquidation proceeding one discrete issue and force arbitration contrary to the blanket stay entered by the Utah state court would certainly impair the progress of the orderly resolution of all matters involving the insolvent company. Unquestionably, that result would directly impact the policyholders because it deals with a purported asset of the insurance company that could be apportioned to them.")

Third, the purpose of the first-day and Supplemental Injunctions—like the automatic stay in bankruptcy (A-App. 20)—is to prevent actions that would interfere with the administration of the rehabilitation, cause avoidable harm to the assets available to pay claimants, or circumvent the priority structure of § 645.68. All of these reasons are expressly contemplated as grounds for injunctive relief under § 645.05. To grant the United States relief from the injunction under *federal* law would necessarily impair the state insurance statutes that expressly authorize the injunctive relief entered by the rehabilitation court. That result would subvert Wisconsin's insurance priority statute by permitting the IRS to levy against the $708 million in tax refunds outside the confines of the rehabilitation. That action would cause unfairness to all policyholders and impede the implementation of a Rehabilitation Plan that is based on orderly and equitable distributions over time.

Unfazed by the numerous ways in which its actions have interfered with the Chapter 645 rehabilitation scheme, the United States argues that there is no impairment because different provisions of Chapter 645 allow the Commissioner to pursue relief in courts other than the court overseeing the rehabilitation. (Blue Br. at 64-66.) This argument misunderstands the difference between actions that the Commissioner can affirmatively take in response to an insurer's insolvency, and actions that creditors such as the United States can take once the

Commissioner has initiated an exclusive rehabilitation proceeding under § 645.04. As one court has explained:

> Universal also raises the flawed argument that because the Superintendent may bring suit in federal court in other states in order to consolidate the assets of the estate, there cannot be exclusive jurisdiction in a New York state court. . . . If, with the permission of the liquidation court, the liquidator brings suit in state or federal court of a different jurisdiction, no harm is done to the plan of unified liquidation. Needless to say, such action is often necessary to recover assets from debtors not subject to New York jurisdiction. *This type of permissive action by a liquidator does not implicate McCarran-Ferguson, nor does it lend any credence to Universal's attempts to litigate its claims separately from* [*the insurer's*] *other creditors*.

Corcoran, 713 F. Supp. at 82 (emphasis added); *see also Covington v. Sun Life of Can. (U.S.) Holdings, Inc.*, No. C-2-00-069, 2000 WL 33964592, at *8 n.3 (S.D. Ohio May 17, 2000) (rejecting same argument under Ohio law).

The United States' treatment of the caselaw also is flawed. (Blue Br. at 66-67 & n.22.) Numerous courts have held that the McCarran-Ferguson Act reverse-preempts removal of claims from state insurance delinquency proceedings. *See Hudson v. Supreme Enters., Inc.*, No. 06-cv-795, 2007 WL 2323380, at *7 (S.D. Ohio Aug. 9, 2007) ("If this court were to apply the removal statute, it would deprive the state court of its jurisdiction [over the delinquency-related claim at issue]. Thus, this Court holds that the federal removal statute 'invalidates, impairs, or supersedes' the state laws at issue in this case."); *In re Amwest*, 245 F. Supp. 2d

at 1044-45 ("While the Nebraska legislation does not specifically state that the [delinquency] court shall have 'exclusive' jurisdiction over insurer liquidation proceedings, the clear import and purpose of the statutes was to consolidate all insolvency proceedings in one court only . . . . To permit removal of such claims would undermine the purpose of Nebraska's statutory method for regulating and supervising, in one forum, insurance company insolvency proceedings."); *Covington*, 2000 WL 33964592, at *9-*10 ("[T]he Court concludes that the federal statutory authority governing the removal of this action effectively invalidates, impairs, or supersedes [Ohio insurance law] by preventing the consolidation of all liquidation proceedings related to an insolvent insurance company in one forum."); *Warfield*, 839 F. Supp. at 689 (holding that McCarran-Ferguson divested the federal court of jurisdiction over claims relating to an insurer delinquency proceeding because federal jurisdictional statutes conflicted with state interests in "marshaling all the insurance company's assets into one forum where they most efficiently can be monitored, preserved, and eventually distributed," "protecting receivers from having to litigate in multiple forums, which might lead to a depletion of the insurance company's assets, and ensure that questions relevant to Arizona's statutory scheme are resolved by the Arizona courts"); *Corcoran*, 713 F. Supp. at 81 (rejecting attempt to remove a dispute within a state rehabilitation proceeding to federal court because "[t]o permit resort to the removal statute to

extricate this case from state court jurisdiction would 'impair, invalidate or supersede' New York's law requiring a unified proceeding in the state court and would accordingly violate McCarran-Ferguson").

The United States mistakenly argues that these cases are distinguishable because they purportedly "all . . . involved state statutes that limited insurance-insolvency jurisdiction to a single court." (Blue Br. at 66.) In fact, these cases involve the same comprehensive statutory schemes, materially indistinguishable statutes within those schemes, and the same impairments to those schemes caused by removals of specific issues or claims to federal court as exist here. Take, for example, the Ohio Liquidation Act, OHIO REV. CODE CH. 3903, which was at issue in *Covington* and *Hudson*. (Blue Br. at 67.) As the Supreme Court of Ohio recently explained:

> The General Assembly designed the Liquidation Act to be centralized in order to enhance efficiency. R.C. 3903.02(D)(3). The general rule is that all liquidation actions brought pursuant to R.C. 3903.01 to 3903.59 "shall be brought in the court of common pleas of Franklin county" (the "liquidation court"). R.C. 3903.04(E). . . . [E]lsewhere it sets forth limited exceptions under which the liquidator may select a forum other than the liquidation court. . . .
>
> The liquidator's power of forum selection stands in *sharp contrast* to the creditors' *limited right to file suits in the liquidation court only*. R.C. 3903.24(A) (establishing that upon the issuance of a liquidation order, "no civil action shall be commenced against the insurer or liquidator,

> whether in this state or elsewhere, nor shall any such existing action be maintained or further prosecuted"). *In short, when allowed, forum selection belongs to the liquidator, and the liquidator alone.*

Taylor v. Ernst & Young, L.L.P., 2011-Ohio-5262, at ¶¶ 15-16 (emphasis added).[13]

The United States tries to minimize the cited cases on the ground that they involved private parties rather than the "federal sovereign." (Blue Br. at 67.) However, McCarran-Ferguson creates no special exceptions or exemptions when federal interests are implicated. As the Supreme Court's holding in *Fabe* shows, the reverse-preemption mandates of McCarran-Ferguson apply to private and public entities alike, regardless of any federal statutes that would otherwise afford a federal agency different or more favorable rights, so long as those federal statutes do not specifically relate to insurance.[14] Neither McCarran-Ferguson nor Chapter 645 offers any reasonable justification for distinguishing between a collateral attack on the rehabilitation proceeding by the United States (as creditor) and a future collateral attack by any other creditor with an interest in the rehabilitation.

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[13] *See also Grode v. Mut. Fire, Marine & Inland Ins. Co.*, 8 F.3d 953, 960 (3d Cir. 1993) (distinguishing between rehabilitation actions where a single forum is needed "to dispose equitably of the company's limited assets so as to avoid a race to the courthouse," and offensive actions by a rehabilitator to assert causes of action on behalf of the insurer, for which a single forum is unnecessary).

[14] The priority issue in *Fabe* was litigated in federal court only because the Ohio commissioner brought a declaratory action there to resolve the issue. *Fabe*, 508 U.S. at 495-96.

Cf. Munich Am., 141 F.3d at 593 (noting that the reverse-preemption described in *Fabe* was not limited solely to statutes directly affecting policyholders, but also to statutes that *indirectly* protected the relationship between insurers and policyholders).

Finally, the United States cites no authority for the proposition that a creditor can do what it did here: remove an entire rehabilitation proceeding to federal court and collaterally attack an injunction entered in the rehabilitation proceeding in a different court. As the district court noted:

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

(A-App. 20.)

Moreover, the cases the United States does cite are readily distinguishable. (Blue Br. at 59.) Those cases primarily involve actions initiated by a commissioner outside the state court delinquency proceeding, rather than actions

initiated by creditors against the commissioner, which collaterally attack the delinquency proceeding and/or the statutory priority scheme.[15]

For example, in *AmSouth Bank v. Dale*, 386 F.3d 763 (6th Cir. 2004), the receivers attempted to recover money in a common-law-damages suit, and the issue presented was whether various banks' declaratory judgment action as to that same dispute should be permitted to proceed in federal court. *Id.* at 780. As is relevant here, the Sixth Circuit noted:

[15] *See Gross v. Weingarten*, 217 F.3d 208, 220-22 (4th Cir. 2000) (where deputy receiver initiated action in federal court, and defendants would still have to present claims to the Commission in order to recover on any judgment, and any such claims would be subject to rehabilitation plan and state priority statute, there was no impairment to liquidation proceeding in permitting defendants' counterclaims to proceed in federal court) (Blue Br. at 60); *Grimes v. Crown Life Ins. Co.*, 857 F.2d 699, 700, 702, 706, 707 (10th Cir. 1988) (where commissioner obtained permission from receivership court to initiate separate action against defendant seeking a declaration of rights under a reinsurance contract, and state court action was removed, action remanded based on *Burford* abstention) (Blue Br. at 60); *Mich. Ins. Comm'r v. DMB Kyoto Shopping Ctr., L.L.C.*, 42 F. Supp. 2d 726, 729, 733 (W.D. Mich. 1998) (where commissioner initiated action in state court "separate and apart from the liquidation proceedings, [and] the action was given a different case number and assigned by blind draw to a different judge," no reverse preemption of removed action) (Blue Br. at 66); *Costle v. Fremont Indem. Co.*, 839 F. Supp. 265, 267, 274 (D. Vt. 1993) (where commissioner initiated collection action against reinsurer in state court, and where policyholders had already been paid and any recovery would benefit only non-policyholder creditors, order authorizing collection action did not regulate the business of insurance) (Blue Br. at 66).

> [O]ften when faced with suit in the federal courts, a state commissioner of insurance as receiver or liquidator of an insurance company placed under the state's care will rely on one or both of the[] [McCarran–Ferguson reverse preemption and *Burford* abstention] doctrines to attempt to defeat federal court jurisdiction. Because state liquidation proceedings of insolvent insurers are *exactly the sort of intricate state regulation on behalf of state-resident policyholders that these doctrines are intended to protect, these arguments have some force when angry creditors attempt to sue insolvent insurance companies in federal court to jump ahead in the queue of claims*, but they have less force here, where the insurance companies are themselves the natural plaintiffs, as Receivers vociferously argue. This dispute involves the Receivers' attempt to recover money in an ordinary common-law-damages suit; the Banks *do not here attempt to disrupt a coherent state scheme in favor of enriching their own pockets*.

AmSouth, 386 F.3d at 780 (emphasis added).

By contrast, in the present case, the United States *is* the creditor attempting to sue "in federal court to jump ahead in the queue of claims," and *is* the creditor that has "disrupt[ed] a coherent state scheme" by collaterally attacking the state rehabilitation proceeding and placing the government's interests ahead of those of policyholders, as the district court found. (*See* A-App. 18-19, 30-31.) Thus, the rationale for applying reverse-preemption is squarely presented here.[16]

[16] The United States cites *Appleton Papers, Inc. v. Home Indem. Co.*, 2000 WI App 104, ¶ 29, 235 Wis. 2d 39, 612 N.W.2d 760, for the proposition that federal courts should determine the availability of federal remedies, regardless of

(footnote continued on following page)

II. THE DISTRICT COURT CORRECTLY HELD THAT, EVEN IF SUBJECT MATTER JURISDICTION EXISTED, IT SHOULD ABSTAIN FROM DECIDING THE UNITED STATES' ATTACKS ON THE REHABILITATION PROCEEDING

A. *Burford* Abstention

In *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943), the Supreme Court held that the federal courts should abstain from interfering with specialized, ongoing state regulatory schemes. *Burford* involved a due process challenge in a federal court to a drilling permit issued by the Texas agency charged with responsibility for such regulation. In endorsing abstention, the Court found that the complex state system for regulation of the oil industry, involving administrative decision-making and judicial review, should be allowed to function without continual interference from the federal courts. "Delay, misunderstanding of local law, and needless federal conflict with the state policy" would be "the inevitable product of this double system of review." 319 U.S. at 327.

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whether federal jurisdictional statutes conflict with state law regulating the business of insurance. (Blue Br. at 61-62.) But *Appleton* did not involve a receivership, let alone a situation in which state law contemplated a comprehensive state forum for adjudicating matters pertaining to a delinquent insurer, and it did "not imply that a Wisconsin court may not issue an injunction under WIS. STAT. CH. 645 dealing with rehabilitation and liquidation of insurers." *Id.* ¶ 27 n.11. *Appleton* noted that the efficacy of such an injunction depends upon federal courts honoring it, *id.*, but it does not purport to give federal courts permission to ignore threshold jurisdictional inquiries under McCarran-Ferguson.

Abstention under *Burford* is appropriate in two situations. *First*, federal courts should abstain from deciding difficult questions of state law bearing on policy problems of substantial import. *Int'l College of Surgeons v. City of Chicago*, 153 F.3d 356, 362 (7th Cir. 1998). *Second*, courts "should also abstain from the exercise of federal review that would be disruptive of state efforts to establish a coherent policy with respect to a matter of substantial public concern." *Id*. (internal quotations, citation omitted).

This Court and numerous others have applied *Burford* abstention to the state regulation of insurance, including delinquency proceedings. *See, e.g., Hartford*, 913 F.2d at 425-27; *Feige v. Sechrest*, 90 F.3d 846, 847-51 (3d Cir. 1996); *Grimes*, 857 F.2d at 703-07; *Barnhardt Marine Ins., Inc. v. New Eng. Int'l Sur. of Am., Inc.*, 961 F.2d 529, 531-32 (5th Cir. 1992); *Law Enforcement Ins. Co. v. Corcoran*, 807 F.2d 38, 43-44 (2d Cir. 1986); *Smith v. Metro. Prop. and Liab. Ins. Co.*, 629 F.2d 757 (2d Cir. 1980); *Mountain Funding, Inc. v. Frontier Insurance Co.*, 329 F. Supp. 2d 994, 999 (N.D. Ill. 2004); *Sebelius v. Universe Life Ins. Co.*, No. 98-4114, 1999 WL 118018, at *2-3 (D. Kan. Feb. 9, 1999); *Mathias v. Lennon*, 474 F. Supp. 949 (S.D.N.Y. 1979); *Meicler v. Aetna Cas. & Sur. Co.*, 372 F. Supp. 509 (S.D. Tex. 1974), *aff'd*, 506 F.2d 732 (5th Cir. 1975).

In *Metropolitan Life Insurance Co. v. Board of Directors of Wisconsin Insurance Security Fund*, 572 F. Supp. 460 (W.D. Wis. 1983), the court below

(Crabb, J.) held that it was required under *Burford* (and *Colorado River*) to abstain from addressing constitutional challenges to Wisconsin statutes governing the operation of the Wisconsin Insurance Security Fund in view of the State's ongoing rehabilitation-liquidation proceeding of an insurer under Chapters 645 and 646. *Id*. at 462, 469-73. In doing so, the court noted:

> *[T]he very exercise of federal jurisdiction will interrupt the state's efforts to effect its policy respecting the liquidation and rehabilitation of Wisconsin insurance companies and the concomitant protection of policyholders*. Indeed, the potential for conflict in the results of federal and state court adjudication could *bring to a halt the state's efforts* in this respect. It is a matter of substantial state concern that the process of liquidating an insurance company be carried out in an orderly and efficient manner, so as to protect the interests of the company's owners, policyholders, and creditors, as well as the public.

Metropolitan Life, 572 F. Supp. at 473 (emphasis added).

B. The Elements Of *Burford* Abstention Are Met Here

With respect to the second basis for *Burford* abstention, there are two essential elements:

(1) The state must offer some forum in which claims may be litigated; and

(2) "that forum must be special—it must stand in a special relationship of technical oversight or concentrated review to the evaluation of those claims."

Property & Cas. Ins. Ltd. v. Cent. Nat'l Ins. Co., 936 F.2d 319, 323 (7th Cir. 1991).

Here, both of these elements are met. *First*, OCI initiated a specialized proceeding in March 2010 to rehabilitate the segregated account, a proceeding that is "part of the regulatory structure" for insurance under state law. WIS. STAT. ANN. § 645.01(f) & cmt.[17] The state rehabilitation court is the forum in which claims related to the rehabilitation are being litigated. Thus, unlike the facts in *Property & Casualty Insurance*, 936 F.2d at 323, where abstention was denied because there was no evidence that the state court was providing a forum in which claims could be asserted, there is an ongoing state court rehabilitation proceeding here in which dozens of claimants have availed themselves of the opportunity afforded by the state court to litigate issues pertaining to their respective claims. *See Mountain Funding*, 329 F. Supp. 2d at 997-98 (in view of pending New York rehabilitation proceedings, first element of *Burford* analysis was met).

Second, Wisconsin has a complex administrative and judicial system for regulating and rehabilitating domestic insurance companies. Having regulated Ambac for decades, and having made the determination that significant regulatory action in the form of a rehabilitation of the segregated account was warranted, the

[17] *See also* WIS. STAT. §§ 645.04(3), 645.32(1), 645.33(2).

Commissioner is uniquely qualified to administer this complex rehabilitation involving billions of dollars of claims. *See Property & Cas. Ins. Ltd.*, 936 F.2d at 324 (rehabilitation that involves "specialized claims proceeding . . . for the purpose of centrally and uniformly resolving" all claims against insurer constitutes a "specialized proceeding" for purposes of *Burford*); *Mountain Funding*, 329 F. Supp. 2d at 999 (Where purpose of rehabilitation proceedings was "to facilitate judicial review of all of [insured's] claimants, to expedite the resolution of such claims, to prevent the unnecessary expenditure of assets, and to provide a fair, equitable and unified procedure for all claimants[,]" . . . such a proceeding was "exactly what the Seventh Circuit in *Property & Casualty Insurance Ltd.* found would satisfy the *Burford* requirements").

Furthermore, Wisconsin has provided a particular court to oversee insurer delinquency proceedings, WIS. STAT. § 645.31, and, because of the specialized and complex nature of such proceedings, Wisconsin's Fifth Judicial Administrative District has for the past 20 years assigned all such cases to Judge Johnston by standing order, and he has developed substantive expertise handling such proceedings. (A-App. 66-67 (¶¶ 4-6).) Thus, the rehabilitation court has "a special relationship of cooperation, technical oversight and concentrated review with the [Wisconsin] Commissioner of Insurance[.]" *Grimes*, 857 F.2d at 705. Thus, both elements of the *Burford* analysis are met.

The United States' arguments opposing the application of *Burford* abstention are unpersuasive. Contrary to its assertion, the present dispute involves issues of state—as well as federal—law. (Blue Br. at 78.) Among other things, the United States is challenging the creation of the segregated account (what it terms the "purported" allocation of the disputed tax refunds to the segregated account under WIS. STAT. § 611.24(2)), the scope of the Supplemental Injunction, and aspects of the Commissioner's confirmed Rehabilitation Plan. (Blue Br. at 76.) The rehabilitation court already has addressed legal challenges regarding the Commissioner's application of the segregated account statute, including a challenge to the allocation of a disputed contingent liability. (*See generally* S-App. 78-79, 82-102.) It also has rejected legal challenges to injunctive relief that protects general account assets from seizure or impairment related to segregated account liabilities. (*See, e.g.*, *id*.) Because these challenges are now on appeal in the Wisconsin state court system, the potential for conflicting state and federal rulings supports abstention. *Hartford*, 913 F.2d at 426 (commenting on the risk of inconsistent state and federal rulings and noting that allowing suits pertaining to an insurance delinquency to proceed in federal court "would lead to a system where the states would not control the ultimate distribution to creditors of insolvent insurers," contrary to the McCarran-Ferguson Act).

The United States tries to draw a distinction between "claims that a state court misapplied its lawful authority or erred under state law" and "federal adjudication of preemption issues [to] establish[] the limits of that lawful authority[,]" but the disruption to the rehabilitation proceeding is the same. (Blue Br. at 75-76.) In insurer insolvency proceedings, "where suits are brought to marshal assets, administer trusts, or liquidate estates, and in suits of a similar nature" and the Commissioner is "protected by a sweeping injunction" in the administration of the assets, the Supreme Court has long held that the mere fact that the United States is one of a number of claimants with a potential interest in the property does not entitle the United States to a federal forum for the adjudication of its particular interest. *United States v. Bank of N.Y. & Trust Co.*, 296 U.S. 463, 475-79 (1936). As the Supreme Court explained:

> There is no merit in the suggestion that the United States, in presenting its claim in the state proceedings, would be compelled to take the position of a defendant—being sued without its consent. In intervening for the presentation of its claim, the United States would be an actor—voluntarily asserting what it deemed to be its rights—and not a defendant. We cannot see that there would be impairment of any rights the United States may possess, or any sacrifice of its proper dignity as a sovereign, if it prosecuted its claim in the appropriate forum where the funds are held.

Id. at 480-81; *see also id.* at 478 (rejecting assertion that claims involving government were *in personam* rather than *in rem* because "the object of the

[government's attempted federal claims] is to take the property from the depositaries and from the control of the state court, and to vest the property in the United States to the exclusion of all those whose claims are being adjudicated in the state proceedings"); *United States v. $79,123.49 in U.S. Cash and Currency*, 830 F.2d 94, 97 (7th Cir. 1987) (recognizing *Bank of New York*'s "modern-day vitality").

This case involves important federalism and policy considerations that support abstention. As this Court has noted:

> The states have a paramount interest in seeing that liquidation proceedings conducted by court-appointed liquidators and overseen by their courts are free from the interference of outside agencies. This interest is of even greater importance when the company undergoing liquidation is a domestic insurance company or other financial institution. The interests of the company's owners, policyholders, and creditors, as well as the public, are best served and protected by an orderly and efficient process of liquidation. The liquidation of [the insurer] is *best left to a proceeding which will settle all of its affairs* and dispose of all of its property. *Federal courts should refrain from deciding select issues confronting another court in pending proceedings.*

Blackhawk Heating & Plumbing Co. v. Geeslin, 530 F.2d 154, 159-60 (7th Cir. 1976) (emphasis added, internal citations omitted). *See also Mountain Funding*, 329 F. Supp. 2d at 999 (holding that, if creditors were permitted to litigate about their claims in federal court outside the state rehabilitation court proceeding, it would set a bad precedent and "[t]he possibility of inconsistent decisions between

this [federal] Court and the New York rehabilitation proceeding could lead to confusion. . . . [T]his type of federal usurpation would be inconsistent with the McCarran-Ferguson Act and general notions of comity.")

The United States is seeking to circumvent Wisconsin's priority statute—in direct violation of McCarran-Ferguson—by asserting that it is entitled to "jump ahead of" policyholders, with respect to the United States' potential, and at this point purely conjectural, claim to the tax refunds at issue. As the district court found:

> The United States admits that [the issues it wants to raise] may include *whether the IRS may assert priority over other claimants to assets that would otherwise be used to pay claims on the segregated account*. Thus, this case has the potential for disrupting any rehabilitation plan developed by the Commissioner and approved by the state court.

(A-App. 19 (emphasis added).)

Moreover, as the court below noted in a different Wisconsin case involving a delinquent insurer, a consideration in deciding abstention is the *effect* of the collateral federal proceeding on the state insurance delinquency proceeding:

> Whether plaintiffs' suit is essentially against the segregated account (because the obvious result of a ruling in plaintiffs' favor will be to reduce the amounts in the segregated account available for use for the payment of disability insurance claims), and thus an *in rem* proceeding, or whether the suit is viewed as an *in personam* action which interferes with the state court's *in rem* liquidation proceedings, the result is the same: *this*

> *court must defer to the state court proceedings to avoid the "unseemly and disastrous conflicts" that would arise if this court were to issue rulings that reduced the funding in the account and thereby defeated that part of the state's liquidation efforts which involves the provision of continuing coverage to holders of Reliable disability insurance policies*.

Metropolitan Life, 572 F. Supp. at 471 (emphasis added).[18] The same types of "unseemly and disastrous conflicts" are at issue here.

III. THE UNITED STATES' REQUEST THAT THIS COURT RESOLVE MERITS ISSUES IN THIS JURISDICTIONAL APPEAL SHOULD BE DENIED

The United States argues that, if the district court's remand and dismissal orders are reversed, then this Court should decide the merits of the United States' motion to enjoin the enforcement of the rehabilitation court's Supplemental Injunction—without remanding the cases to the district court to have it decide that motion in the first instance. (Blue Br. at 85-96.) The United States cites no authority for proceeding in this fashion,[19] but argues that it is appropriate to do so

[18] Although this statement was made in the context of the court's discussion of *Colorado River* abstention, *see Metropolitan Life*, 572 F. Supp. at 469-72, it also is applicable to *Burford* abstention.

[19] *See Jones v. Jones Bros. Constr. Corp*., 888 F.2d 1215, 1216 (7th Cir. 1989) ("District Courts and Courts of Appeals must always work in a spirit of cooperation—in the first instance, to articulate and decide the facts and legal issues so as to allow for meaningful appellate review; in remanding a case, to provide clear instructions and adequate guidance for future cases[.]").

here because its motion—based on sovereign immunity and the tax Anti-Injunction Act—"presents legal issues on undisputed facts." (Blue Br. at 86.)

The United States' argument should be rejected for the following reasons. *First*, this Court has ruled that, even in cases involving the United States' sovereign immunity, there are fact questions that require the district court's consideration in the first instance. *United States v. Rural Elec. Convenience Co-op. Co.*, 922 F.2d 429, 434-36 (7th Cir. 1991) (remanding action to district court for application of sovereign immunity analysis) (hereinafter "*RECC*").

Second, the nature of all motions regarding injunctions, whether they are to issue or dissolve an injunction, is that they involve conclusions of law based on factual determinations—relating to likelihood of success, irreparable harm and the balance of equities[20]—that it is the province of the trial court to make, and this

[20] The United States cites *Bedrossian v. Nw. Mem'l Hosp.*, 409 F.3d 840 (7th Cir. 2005), for the proposition that, under 26 U.S.C. § 7402(a), this Court "does not need to conduct a full-fledged analysis of the traditional equitable principles in considering the United States' request for an injunction . . . ." (Blue Br. at 86-87.) However, *Bedrossian* stands for the opposite proposition: "unless a statute clearly mandates injunctive relief for a particular set of circumstances, the courts are to employ traditional equitable considerations (including irreparable harm) in deciding whether to grant such relief." *Bedrossian*, 409 F.3d at 843. Section 7402(a) has no such mandate; it is merely a statutory grant of jurisdiction to issue orders "as *may* be necessary or appropriate" to enforce tax laws, without any guidance as to what particular set of circumstances might render relief necessary or appropriate. *See United States v. Ernst & Whinney*, 735 F.2d 1296, 1301 (11th Cir. 1984) ("[T]he decision to issue an injunction under § 7402(a) is governed by the traditional factors shaping the district court's use of the equitable remedy.").

Court to review under a highly deferential standard. *See, e.g., Burlington N. & Santa Fe Ry. Co. v. Bhd. of Locomotive Eng'rs*, 367 F.3d 675, 678 (7th Cir. 2004). Presently, there is no record upon which this Court can apply the appropriate standard of review.

Finally, the United States fails to show that it is entitled to the extraordinary relief that it seeks, namely, enjoining the Supplemental Injunction so it can "jump the line" ahead of policyholders in violation of McCarran-Ferguson and *Fabe*.

The sovereign immunity doctrine "bars suits that 'require action by the sovereign or disturb the sovereign's property.'" *RECC*, 922 F.2d at 434 (citation omitted). Here, the Supplemental Injunction is a purely *defensive* injunction, which does not require any action by the United States. Moreover, the disputed tax refunds that are protected by the Supplemental Injunction are not the United States' property; the merits of its disputed claim are currently being litigated in the AFGI bankruptcy, and the United States has never even filed a claim in the rehabilitation. Thus, the United States' sovereign immunity is not implicated.

Furthermore, this Court has warned about the consequences of the United States' aggressive assertion of sovereign immunity:

> Accepting the government's sovereign immunity theory would . . . not only result in the federalization of state law claims, but would vest the government with the power to extinguish them entirely . . . . We find this result more than a little disquieting, and are reluctant to presume that it is required by our sovereign immunity jurisprudence.

RECC, 922 F.2d at 436. Likewise, the United States' overbroad reading of its sovereign immunity would bar any injunction to prevent it from violating the statutory priority scheme, and would render Chapter 645 and the McCarran-Ferguson Act meaningless as to the United States.

Finally, the tax Anti-Injunction Act, 26 U.S.C. § 7421, does not apply here because of the McCarran-Ferguson Act. Section 7421 is a statute of general application that does not specifically relate to the business of insurance. To the extent it would require dissolution of the Supplemental Injunction, it would impair WIS. STAT. § 645.05.

CONCLUSION

For the reasons stated, the district court's January 14, 2011 remand order (Appeal No. 11-1158) and its February 18, 2011 dismissal order (Appeal No. 11-1419) should be affirmed.

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Case Nos. 11-1158 and 11-1419

This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) (as amended by this Court's September 8, 2011 Order granting up to 14,000 words) because this brief contains 13,665 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(56) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word in 14-point Times New Roman.

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CERTIFICATE OF SERVICE

It is hereby certified that, on this 13th day of December, 2011, this brief and separate appendix were filed with the Clerk of the United States Court of Appeals for the Seventh Circuit by using the CM/ECF system and that twenty-five (25) paper copies of the brief and ten (10) paper copies of the appendix were sent to the Clerk by Federal Express. Participants in the case who are registered CM/ECF users will be served by the CM/ECF system.

It is further certified that: (1) all required privacy redactions have been made; and (2) the ECF submission was scanned for viruses with Microsoft Forefront antivirus program (updated daily), and, according to the program, is free of viruses.

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CIRCUIT RULE 30(b) CERTIFICATION

All of the materials required by the Seventh Circuit Rule 30(b) are included in either the appellant United State's appendix or the separately bound supplemental appendix of the appellees filed herewith.

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