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UNITED STATES COURT OF APPEALS  
FOR THE SEVENTH CIRCUIT

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THEODORE NICKEL,  
Plaintiff-Appellee

v.

UNITED STATES OF AMERICA,  
Defendant-Appellant

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UNITED STATES OF AMERICA,  
Plaintiff-Appellant

v.

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

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APPEALS FROM THE ORDER (No. 3:10-cv-778-bbc)  
AND THE JUDGMENT (No. 3:11-cv-99-bbc) OF THE  
UNITED STATES DISTRICT COURT FOR THE WESTERN  
DISTRICT OF WISCONSIN (Judge Barbara B. Crabb)

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REPLY BRIEF OF THE APPELLANT, UNITED STATES

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## GLOSSARY

<b>Note:</b>	Numerical references in brief and appendix citations are to page numbers.
<b>A.:</b>	Record appendix (portion separately bound and submitted with the United States' opening brief (A. 34–212))
<b>A.Br:</b>	Answering brief of the appellees
<b>Ambac:</b>	Ambac Assurance Corporation (an appellee herein)
<b>App.:</b>	Record appendix (portion bound with the United States' opening brief (App. 1–34))
<b>Appellees:</b>	Wisconsin Insurance Commissioner and Ambac Assurance Corporation, collectively
<b>District Court:</b>	United States District Court for the Western District of Wisconsin
<b>I.R.C. or the Code:</b>	Internal Revenue Code of 1986 (26 U.S.C.)
<b>IRS:</b>	Internal Revenue Service
<b>OBr:</b>	Opening brief of the United States
<b>Supp. A.:</b>	Supplemental record appendix (separately bound and submitted with appellees' answering brief)
<b>Treas. Reg.:</b>	Treasury Regulations (26 C.F.R.)
<b>Wisconsin Court:</b>	Wisconsin Circuit Court for Dane County

## ARGUMENT

This brief addresses those contentions in the combined answering brief of the Wisconsin Insurance Commissioner and Ambac Assurance Corporation (collectively, “appellees”) that warrant a response. We otherwise rely upon our opening brief.

### I

#### **The newly enacted Removal Clarification Act of 2011 removes any doubt regarding this Court’s jurisdiction over appeal no. 11-1158**

We addressed in our opening brief the issue whether this Court had appellate jurisdiction over appeal no. 11-1158<sup>1</sup> despite seemingly adverse language in 28 U.S.C. § 1447(d). Subsequently, Congress passed (on October 31, 2011), and the President signed (on November 9, 2011), the Removal Clarification Act of 2011, Pub. L. No. 112-51, 125

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<sup>1</sup> The Wisconsin Court overseeing this insurance rehabilitation issued an injunction barring the United States from collecting any liability Ambac might owe as a result of having received approximately \$708 million in tentative federal tax refunds. (OBr:6–16.) Appeal no. 11-1158 deals with the District Court’s remand to the Wisconsin Court of the United States’ removal action that sought dissolution of that injunction. (OBr:16–17.) Appeal no. 11-1419 deals with the District Court’s dismissal of the United States’ separate action seeking (1) a declaration that the Wisconsin Court’s injunction is void and (2) a federal injunction against its enforcement. (OBr:20–21.)



Stat. 545. *See also* H.R. Rep. No. 112-17 (2011). That Act amended 28 U.S.C. § 1447(d) to read as follows (new text italicized):

An order remanding a case to the State court from which it was removed is not reviewable on appeal or otherwise, except that an order remanding a case to the State court from which it was removed pursuant to section *1442 or* 1443 of this title shall be reviewable by appeal or otherwise.

The United States agrees with appellees (ABr:1–2) that the amended § 1447(d) gives this Court jurisdiction over appeal no. 11-1158. The United States invoked 28 U.S.C. § 1442 as a basis for its removal. (A. 175.) The District Court issued an order remanding the case to the Wisconsin Court from which it was removed. (App. 21.) Section 1447(d) states that a remand of a removal pursuant to § 1442 “shall be reviewable by appeal or otherwise,” thereby giving this Court jurisdiction to review the remand order from which the United States appealed in appeal no. 11-1158.

It does not matter that Congress amended § 1447(d) during the pendency of this appeal. “[A] court is to apply the law in effect at the time it renders its decision, unless doing so would result in manifest injustice or there is statutory direction or legislative history to the contrary.” *Bradley v. School Bd. of Richmond*, 416 U.S. 696, 711 (1974). The Supreme Court has “regularly applied intervening statutes

conferring or ousting jurisdiction, whether or not jurisdiction lay when the underlying conduct occurred or when the suit was filed” (*Landgraf v. USI Film Prods.*, 511 U.S. 244, 274 (1994)), particularly when such statutes merely address “*which* court shall have jurisdiction to entertain a particular cause of action” and “affect only *where* a suit may be brought, not *whether* it may be brought at all” (*Hughes Aircraft Co. v. United States ex rel. Schumer*, 520 U.S. 939, 951 (1997) (emphasis in original)).

Since this Court now has jurisdiction to review the District Court’s remand order being challenged in appeal no. 11-1158, there is no longer any impediment to this Court’s addressing the merits of the two appeals.

## II

### **Appellees have not refuted our argument that the District Court erred in declining to exercise jurisdiction**

#### **A. The McCarran-Ferguson Act did not deprive the District Court of jurisdiction**

Section 1012(b) of 15 U.S.C., part of the McCarran-Ferguson Act, allows a state statute to reverse preempt a federal statute if three requirements are satisfied: (1) the federal statute must not “specifically relate[ ] to the business of insurance”; (2) the state statute

must have been “enacted . . . for the purpose of regulating the business of insurance”; and (3) the application of the federal statute must “invalidate, impair or supersede” the state statute.

In our opening brief, we maintained that the second and third McCarran-Ferguson requirements are not satisfied with respect to the federal jurisdictional statutes invoked by the United States.

(OBr:49–68.) In the alternative, we argued that, if the term “business of insurance” is broad enough that applying state statutes to eliminate federal-question jurisdiction is “regulating the business of insurance,” then I.R.C. § 7402 “specifically relates to the business of insurance.”

(OBr:68–72.) In that event, the first McCarran-Ferguson requirement would *not* be satisfied with respect to I.R.C. § 7402, and that statute would provide jurisdiction for the separate suit (appeal no. 11-1419) the United States brought challenging the Wisconsin Court’s injunction.

**1. Blocking federal courts from answering federal questions raised by the United States is not regulating the business of insurance**

a. In our opening brief, we argued that the United States’ invocation of the District Court’s federal-question jurisdiction only remotely affected the performance of insurance contracts (if at all), and that blocking such attenuated effects is insufficient to qualify as

regulating the business of insurance. (OBr:54–57.) Overall, appellees erroneously conflate jurisdiction and the merits, as illustrated by their accusations that the United States resorted to the District Court in order to jump ahead in line.<sup>2</sup> (ABr:26, 35, 38, 45.) Although jurisdiction and the merits each require a reverse-preemption analysis, the merits are separate from the primary issue presented on appeal, *viz.*, the District Court’s jurisdiction over the federal questions posed by the United States.

b. Appellees misinterpret *United States Dep’t of Treas. v. Fabe*, 508 U.S. 491 (1993). (ABr:31–34.) The observation in *Fabe* regarding the “broad category” of laws enacted for the purpose of regulating the business on insurance (508 U.S. at 505) is only the beginning of the proper analysis. A state statute must fit within that “broad category” to be entitled to further consideration under McCarran-Ferguson. Once under McCarran-Ferguson, however, “a state statute regulating the liquidation of insolvent insurance companies need not be treated as a package which stands or falls in its entirety.” *Id.* at 509 n.8. Instead, such a statute can displace federal law only “to the extent that” it, in a

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<sup>2</sup> The merits involve whether McCarran-Ferguson reverse preemption permits (1) Ambac to “allocate” its federal tax liabilities to a segregated account and (2) the Wisconsin Court to enforce that allocation through an injunction against the United States.

non-attenuated way, regulates policyholders and protects their ability to be paid on their claims. *Id.* at 506, 508–09; *Autry v. Northwest Premium Servs., Inc.*, 144 F.3d 1037, 1042 n.3 (7th Cir. 1998). *Fabe* did not uphold the entire Ohio priority statute at issue there, even though it fell into the broad category of insurance rehabilitation statutes. Instead, the Court parsed the statute. It held that the statute regulated the business of insurance to the extent that it gave priority to administrative expenses and policyholders, but held that the “preferences conferred upon employees and other general creditors . . . do not escape [federal] pre-emption because their connection to the ultimate aim of insurance is too tenuous.” 508 U.S. at 508–09.

c. Appellees’ erroneous conflation of jurisdiction and the merits, and their misinterpretation of *Fabe*, are reflected in their analysis of Chapter 645 of the Wisconsin Statutes. (ABr:26–27, 31–32, 35, 38.) That Chapter 645 addresses insurance rehabilitations and liquidations merely puts it into the broad category where a McCarran-Ferguson analysis is appropriate. As we argued (OBr:56–57), invoking federal-question jurisdiction to allow the District Court (as opposed to the Wisconsin Court) to adjudicate the federal, reverse-preemption questions presented by the merits does not predetermine any answers

to those questions. Thus, blocking federal-question jurisdiction does not affect policyholder regulation or remedies. The Wisconsin statutes, therefore, cannot prevail to the extent that they purport to reverse preempt the federal statutes granting federal-question jurisdiction to the federal courts.

Appellees specifically invoke Wis. Stat. §§ 645.04 (jurisdiction) and 645.05 (injunctions) to argue that centralizing rehabilitations in one court protects policyholders by preserving assets and ensuring an orderly rehabilitation consistent with Wis. Stat. § 645.68 (claims priority). (ABr:31–32, 38.) The United States’ reverse-preemption issues, however, are legal (not factual), will not change with venue, and must be resolved somewhere. The cost of litigating them in the District Court will be similar to the cost of litigating them in the Wisconsin Court. *See Garcia v. Island Program Designer, Inc.*, 4 F.3d 57, 62 (1st Cir. 1993) (increased administrative difficulty insufficient for reverse preemption so long as “liquidation would still prove manageable”).

d. Appellees argue (ABr:38–39, 41–43) that there is nothing special about the United States, and that only state insurance officials have a choice of forum. Appellees ignore the cases and legislative history we discussed in the removal context (OBr:39–42, 58–59), which

demonstrate that the United States has a virtually absolute right to litigate claims by or against it in a federal forum, particularly cases involving important and complex federal issues such as federal-state conflicts, preemption, federal authority, and sovereign immunity — precisely the matters at issue here. *See Willingham v. Morgan*, 395 U.S. 402, 406–07 (1969); *Matter of Skupniewitz*, 73 F.3d 702, 705 (7th Cir. 1996); *Hudson Sav. Bank v. Austin*, 479 F.3d 102, 106 (1st Cir. 2007). Congress further explained, in conjunction with the Removal Clarification Act of 2011 (Argument I, *supra*), that “it deems the right to remove under these conditions essential to the integrity and preeminence of the Federal Government within its realm of authority.” H.R. Rep. No. 112-17 at 3.

e. There is no basis for appellees’ concern (ABr:35–37) that a United States victory will create a precedent allowing private litigants to disrupt insurance insolvencies by filing suits in multiple forums raising routine, state-law issues. The United States is a unique, sovereign entity with taxing powers. Recognizing the United States’ right to litigate, in the federal courts, federal reverse-preemption issues that only it can raise will not create any precedent for private litigants. Resolving the United States’ issues in federal court (as opposed to the

Wisconsin Court) will not lead to unequal treatment among the members of a creditor class, will not endanger payments to policyholders (ABr:33–34), and will not have anything more than a highly attenuated effect on the regulation of the business of insurance.

f. Contrary to appellees' argument (ABr:18, 36, 43), the United States is not seeking even a partial federal takeover of the actual administration of the instant rehabilitation. As stated in our removal notice, the United States "does not intend to remove (and, to the extent it has removed has no objection to [the District Court] remanding) all issues and/or claims in this rehabilitation action that are unrelated to the Internal Revenue Service, and [the November 8, 2010 actions affecting it]." (A. 175). The United States seeks only to have its federal, reverse-preemption questions answered in federal court, so that the Wisconsin Court can thereafter administer the rehabilitation in accordance with the law as determined. It does not matter that the federal court's answers might (or might not) require adjustments to the rehabilitation. If an aspect of the rehabilitation is contrary to law, then an adjustment must be made to bring it into conformance with the law.

g. The Supreme Court's decision in *Fabe, supra*, aptly illustrates our arguments. By ruling on the interaction between Ohio's claims



priority statute and the federal insolvency statute (31 U.S.C. § 3713), the Supreme Court resolved a federal-state statutory conflict not just once in Ohio, but for all states in all future cases. It did not concern the Supreme Court that its ruling disrupted the Ohio priority structure by moving the United States' priority from fifth to third place. 508 U.S. at 495, 508–10. Even after *McCarran-Ferguson*, general federal statutes preempt conflicting state laws, except to the extent that the state laws were enacted for the purpose of regulating the business of insurance (and, as already explained, applying Wisconsin statutes to block federal-question jurisdiction does not implicate the regulation of the business of insurance). *Id.* at 507. It follows from *Fabe* that, at a minimum, there is no reverse preemption of federal statutes that give the district courts jurisdiction over suits involving federal questions posed by the United States.

h. Appellees' efforts (ABr:33–34, 43–46) at distinguishing our appellate-level cases (OBr:57–62) do not disturb the observation in *Appleton Papers, Inc. v. Home Indem. Co.*, 612 N.W.2d 760, 766–67 (Wis. App. 2000), that the federal courts have consistently exercised jurisdiction to perform a *McCarran-Ferguson*, reverse-preemption

analysis of the requested federal remedy.<sup>3</sup> As that court explained, the federal courts did not immediately dismiss the suits for lack of jurisdiction or because of state-court injunctions, but rather countenanced dismissal only after determining that the reverse preemption of the requested remedy left them without authority to grant relief. *Ibid.* Although *Appleton* was not an insurance insolvency case (see ABr:45 n.16), it relied on *Munich Am. Reinsurance Co. v. Crawford*, 141 F.3d 585, 595–96 (5th Cir. 1998), which was.<sup>4</sup> *Munich*, like *Appleton*, confirms the right of parties to pursue federal remedies in federal courts — despite state-court injunctions — with a federal dismissal coming only after a determination that no relief could be

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<sup>3</sup> Contrary to appellees’ argument (ABr:25, 42, 46), we did not ignore precedent regarding the applicability of McCarran-Ferguson. We subjected the pertinent Wisconsin insurance and federal jurisdictional statutes to a McCarran-Ferguson analysis, and we concluded that the Wisconsin statutes do not regulate the business of insurance to the extent that they are being applied to block the federal jurisdictional statutes.

<sup>4</sup> Appellees’ discussion of *Appleton* (ABr:45 n.16) leaves the inaccurate impression that it allowed injunctions under Wis. Stat. Chapter 645. Instead, *Appleton* concluded “that a state court may not deprive a party from obtaining a determination in federal court of the application of a federal remedy,” and that federal courts honored state-court injunctions out of comity or the lack of an available federal remedy. 612 N.W.2d at 767 & n.11.

granted because the *remedial* statute there at issue (*i.e.*, the Federal Arbitration Act) had been reverse preempted.<sup>5</sup> *Ibid.*

**2. The federal jurisdiction statutes do not invalidate, supersede, or impair the Wisconsin insurance receivership statutes**

In our opening brief, we argued that the federal jurisdictional statutes allowing the District Court to answer federal questions, like reverse preemption, would not invalidate, supersede, or impair the Wisconsin insurance receivership statutes. (OBr:62–68.) Accordingly, the third McCarran-Ferguson requirement was not satisfied.<sup>6</sup>

a. Appellees fail to refute (ABr:27, 35, 37–38) our argument (OBr:64–66) that Chapter 645 of the Wisconsin Statutes does not establish the Wisconsin Court (*i.e.*, the Dane County Circuit Court) as the exclusive forum for all matters related in any way to insurance rehabilitations. *See* Wis. Stat. § 645.31 (providing for rehabilitation

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<sup>5</sup> Appellees cite *Eden Fin. Group, Inc. v. Fidelity Bankers Life Ins. Co.*, 778 F. Supp. 278 (E.D. Va. 1991) (ABr:33), but that case — like *Munich, supra*, *Davister Corp. v. United Republic Life Ins. Co.*, 152 F.3d 1277, 1280–82 (10th Cir. 1998), and *Stephens v. American Int’l Ins. Co.*, 66 F.3d 41, 43–46 (2d Cir. 1995) — is another example of a federal court exercising its federal-question jurisdiction to determine if a federal remedial statute is reverse preempted under McCarran-Ferguson.

<sup>6</sup> Many of appellees’ arguments under their heading for the third McCarran-Ferguson requirement actually pertain to the second McCarran-Ferguson requirement and have already been addressed.

petition in circuit court for county in which principal office of insurer is located or in circuit court for Dane County).<sup>7</sup> The pertinent part of Wis. Stat. § 645.04(3) states only that Wisconsin courts are to conduct insurance insolvency proceedings under the auspices of Chapter 645. Wis. Stat. § 645.04(6) supports our argument by allowing turnover, reinsurance, and officer liability suits to be tried outside of Wisconsin. Likewise, Wis. Stat. § 645.05 permits insolvency-related injunctions to be granted by “any court of general jurisdiction” in Wisconsin, or by “any court outside of” Wisconsin.

b. Appellees argue that the proceedings allowed in other forums are ancillary suits brought by Wisconsin insurance officials in support of the insolvency. (ABr:38–39.) When deciding whether a general federal statute allowing lawsuits conflicts with the operation of a state statute, the inquiry focuses on whether the particular suit at issue would impair the state statute. The federal statute can be applied when doing so would not frustrate declared state policy or interfere

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<sup>7</sup> Appellees reliance on Ohio R.C. § 3903.04(E) is misplaced. (ABr:41–42.) That statute centralizes all liquidation actions under the Ohio supervision, liquidation, and rehabilitation statutes in a *single* court, *viz.*, the court of common pleas of Franklin County. Wisconsin, by contrast, allows any circuit court to entertain a rehabilitation petition filed by the insurance commissioner if the insurer’s principal office is located there. Wis. Stat. § 645.31.

with a state's administrative regime. *Humana, Inc. v. Forsyth*, 525 U.S. 299, 309–10, 313 (1999); *AmSouth Bank v. Dale*, 386 F.3d 763, 781 (6th Cir. 2004).

It bears repeating (*see* p. 9, *supra*) that the United States does not seek a federal takeover of the administration of this rehabilitation. Invoking a federal court's expertise in answering federal questions does not interfere with the administration of an insolvency. Rather, it preserves the resources of the state court and assists it in administering the insolvency in accordance with the law. In *Fabe*, the Ohio insurance superintendent — in the middle of a liquidation — asked a federal district court (not the relevant Ohio court) to resolve a conflict between the federal and Ohio priority statutes. 508 U.S. at 494–95. And in the rehabilitation at issue in the instant case, the Wisconsin Court and the insurance commissioner have recognized, despite assertions of exclusive jurisdiction, that the determination of the propriety and amount of the tentative federal tax refunds should be made in the bankruptcy of AFGI (Ambac's parent) in the United States Bankruptcy Court for the Southern District of New York (no. 1:10-bk-15973-scc). (A. 146, 150). In contrast, the district court cases cited by appellees (A.Br:39–41) all involved private parties asking

federal courts to resolve state-law issues under the courts' diversity-removal or supplemental jurisdiction. Those cases are examples of federal courts not interfering in state-law disputes, where state courts are preeminent.

c. Finally, appellees argue (ABr:27, 37–38) that the United States cannot challenge the Wisconsin Court's injunction orders (A. 146–149, 194) in federal court because doing so would impair Wis. Stat. § 645.05, which allows injunctions in insurance insolvencies. That argument, however, assumes the enforceability of the orders against the United States, which is disputed here. Again, Congress enacted the original-jurisdiction and removal statutes to insure that the United States will have access to a *federal* forum to adjudicate claims by or against it, and the United States has a virtually absolute right to invoke those statutes. Asking the District Court to adjudicate the matter of reverse preemption does not impair the ability of the Wisconsin Court to issue valid injunction orders under § 645.05, properly construed.

**3. In the alternative, reading the term “business of insurance” broadly means that I.R.C. § 7402 specifically relates to the business of insurance**

In our opening brief (OBr:68–72), we made the alternative argument that if “business of insurance” is read broadly enough to

encompass reverse preempting federal-question jurisdiction, then the first McCarran-Ferguson requirement is not satisfied because I.R.C. § 7402 (a jurisdictional statute in the Internal Revenue Code) would plainly qualify as a federal statute that specifically relates to the business of insurance when read as part of an integrated whole with the Code's subchapter on the federal taxation of insurance companies (I.R.C. §§ 801–848).

a. Appellees quote (ABr:29–31) this Court's decision in *Autry*, 144 F.3d at 1042, for the proposition that regulating the business of insurance is broader than the “business of insurance” itself. The breadth of the phrase “enacted . . . for the purpose of regulating the business of insurance” (15 U.S.C. § 1012(b)) is irrelevant, however, when a federal statute specifically relates to the business of insurance. As this Court explained on the same page that appellees quote (114 F.3d at 1042), all three McCarran-Ferguson requirements must be met before a state statute can reverse preempt a federal statute, and a federal statute that specifically relates to the business of insurance prevails over a state statute that was enacted for the purpose of regulating the business of insurance. Moreover, appellees' quotation from *Autry* does not purport to broaden the term “business of

insurance” itself, but merely reflects the fact that courts should look to the effect of a statute to determine whether it has the purpose of regulating the business of insurance.

b. Appellees cite *Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25, 39 (1996), for their argument (ABr:28–29) that I.R.C. § 7402 does not specifically relate to the business of insurance because § 7402, by itself, does not mention insurance. But their argument, based on § 7402 alone, fails to acknowledge that the Internal Revenue Code has a subchapter, entitled “Insurance Companies” (I.R.C. §§ 801–848), specifically dedicated to the federal taxation of insurance companies. *See Hanover Ins. Co. v. Commissioner*, 598 F.2d 1211, 1218 (1st Cir. 1979) (I.R.C. § 832 specifically relates to the business of insurance). (*See also* OBr:70–72.) That subchapter is not self-contained, but is part of an integrated Code on which it depends for enforcement. *See* Treas. Reg. § 1.831-3(b) (providing that all Code provisions not inconsistent with § 831 “are applicable to the assessment and collection of the tax” that § 831 imposes). *Cf. UNUM Corp. v. United States*, 130 F.3d 501, 508 (1st Cir. 1997) (existence of insurance subchapter does not exempt insurance companies from rest of Code). Section 7402(a) grants jurisdiction to federal district courts to issue



orders “necessary or appropriate for the enforcement of the internal revenue laws.” Without I.R.C. § 7402, and the other tax-enforcement provisions, the payment of the taxes imposed on insurance companies would essentially become voluntary. Thus, if “business of insurance” is read broadly enough to encompass reverse preempting federal-question jurisdiction, then I.R.C. §§ 801–848 specifically relate to the business of insurance, and the states cannot use McCarran-Ferguson reverse preemption to exempt their insurance companies from the federal taxes that those sections impose,<sup>8</sup> or from the enforcement mechanisms needed to ensure payment of such taxes.

In conclusion, the key term is “business of insurance.” If a statute is to have the purpose of regulating the business of insurance, its application in a particular case must have more than an attenuated effect on the business of insurance (*i.e.*, underwriting and policyholder relations). The forum in which the United States’ federal questions are to be answered is so remote from policyholders and underwriting that the Wisconsin statutes do not have the purpose of regulating the business of insurance to the extent that they purport to restrict the

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<sup>8</sup> States cannot exempt insurance companies from federal taxation in any event. *Industrial Life Ins. Co. v. United States*, 481 F.2d 609, 610 (4th Cir. 1973) (McCarran-Ferguson Act did not delegate to the states “the power of the federal government to tax”).

United States' right to have its federal questions answered in federal court. Moreover, resolving the United States' federal issues in federal court cannot be said to impair the Wisconsin statutes, which do not restrict rehabilitation proceedings to a single court. In any event, if "business of insurance" is given such a broad reading that overriding federal-question jurisdiction affects that business enough to constitute its regulation, then the Internal Revenue Code specifically relates to the business of insurance, thereby permitting suits in federal court under I.R.C. § 7402.

**B. *Burford* abstention is not warranted**

In our opening brief, we argued that the District Court erred in its alternative holding that it would decline jurisdiction under *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943). (OBr:72–80.) Under the second type of *Burford* abstention,<sup>9</sup> a federal court can abstain from granting discretionary relief if federal adjudication of that case and of similar cases would disrupt state efforts to establish a coherent policy regarding a matter of substantial public concern. *Quackenbush v. Allstate Ins. Co.*, 517 U.S. 706, 726–27, 730–31 (1996).

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<sup>9</sup> We also argued against the first type of *Burford* abstention (OBr:74), which appellees mention, but do not invoke (ABr:47).

1. Overall, appellees rely heavily on *Burford*, but they ignore *New Orleans Pub. Serv., Inc. v. Council of New Orleans*, 491 U.S. 350 (1989) (*NOPSI*), which we cited extensively and which presents a scenario much closer to this case than the one in *Burford*. (ABr:46–55.) *Burford* allowed abstention regarding Sun Oil’s Fourteenth Amendment, due-process challenge to a decision from Texas’s well-developed administrative and judicial program for regulating the important state issue of oil-drilling permits. *NOPSI* found abstention inappropriate regarding *NOPSI*’s claim that federal law prohibited New Orleans from refusing an electricity rate increase to compensate *NOPSI* for wholesale costs allocated to it by a federal agency. Whereas the constitutional challenge in *Burford* “was of minimal federal importance, involving solely the question whether the [Texas agency] had properly applied Texas’ complex oil and gas conservation regulations,” *NOPSI* involved “[the] sort of pre-emption claim [that] would not disrupt the State’s attempt to ensure uniformity in the treatment of an essentially local problem.” *NOPSI*, 491 U.S. at 360, 362 (internal quotation marks omitted).<sup>10</sup>

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<sup>10</sup> Appellees criticize (ABr:52) the distinction that we drew (OBr:75–76) between general federal issues and specific preemption issues, but, as shown above, that distinction comes directly from the (continued...)

Unlike Sun Oil in *Burford*, the United States did not create the instant conflict by invoking general constitutional principles in an attempt to shoehorn into federal court a dispute over the application of state law to a state problem. Instead, like New Orleans in *NOPSI*, appellees created the conflict at the heart of this preemption dispute when they acted against the United States by purporting to extinguish federal tax liabilities through an “allocation” of those liabilities to a state-law “segregated account” and an injunction against collection. *Burford* abstention seeks to avoid needless federal friction with, or disruption of, state policies directed at state issues. *See generally Quackenbush*, 517 U.S. at 716–28. It has no application when state officials seek to deprive the United States of its right to have matters concerning the collection of federal taxes decided by federal (and not state) courts.

2. This Court held in *Property & Casualty Ins., Ltd. v. Central Nat’l Ins. Co. of Omaha*, 936 F.2d 319, 323 (7th Cir. 1991), that a prerequisite to the second type of *Burford* abstention is that the state must provide a “forum . . . stand[ing] in a special relationship of technical oversight or concentrated review to the evaluation of” the

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<sup>10</sup> (...continued)  
Supreme Court.

claim being litigated. Relying on *Property & Casualty*, appellees erroneously argue (ABr:48–50) that the Wisconsin Court satisfies that prerequisite. Appellees, however, ignore the later, more-detailed explanation of that prerequisite in *International Coll. of Surgeons v. City of Chicago*, 153 F.3d 356, 363–65 (7th Cir. 1998). In that case, this Court ruled that the prerequisite was not satisfied where no legislative body “deliberately [chose] to concentrate judicial review” in a particular court “as part of an effort to endow that court with the specialized knowledge necessary to deal with cases arising under” a statutory program. *Int’l Coll.*, 153 F.3d at 364. This Court recognized that it was not enough that a court of general jurisdiction coincidentally acquired specialized knowledge because certain disputes regularly came before it. *Id.* at 364–65. Instead, the chosen court should be a “working partner[ ]” in the statutory program, not just a deferential reviewing body. *Ibid.* Although appellees assert that there is a practice of sending insurance rehabilitations in Wisconsin’s Fifth Judicial Administrative District to Judge Johnston (ABr:50), the Wisconsin legislature has not designated a single court to adjudicate, or to acquire specialized knowledge regarding, insurance rehabilitations. Indeed, the statute cited by appellees, Wis. Stat. § 645.31 (ABr:50), allows the

insurance commissioner to file a rehabilitation petition in “the circuit court for Dane County or for the county in which the principal office of the insurer is located” (*see also* Argument II.A.2., *supra*; OBr:64–68).

3. Even if the Wisconsin legislature had designated a specialized court, the second type of *Burford* abstention still would not apply. Appellees argue (ABr:52, 54–55) that these federal proceedings are disrupting the rehabilitation plan. But if their use of tentative federal tax refunds to fund the plan is illegal, then correcting that illegality would not be a disruption as a matter of law. In any event, *Burford* abstention focuses more on the effect of federal litigation on overall state efforts to establish coherent policy, rather than on particular disruptions in particular cases. Otherwise, the Supreme Court would not have said in *NOPSI* that a finding of federal preemption (which necessarily disturbs whatever is being preempted) “would not disrupt the State’s attempt to ensure uniformity” in the treatment of local problems. 491 U.S. at 362.

4. *Mountain Funding, Inc. v. Frontier Ins. Co.*, 329 F. Supp 2d 994 (N.D. Ill. 2004) (cited at ABr:47, 49–50, 53–54), and *Metropolitan Life Ins. Co. v. Board of Dirs. of Wis. Ins. Sec. Fund*, 572 F. Supp. 460 (W.D. Wis. 1983) (cited at ABr:47–48, 54–55), are inapposite because

neither case involved preemption issues affecting the sovereignty of the United States. In *Mountain Funding*, a private party sought payment on a surety bond from an insurance company that later was placed in a New York rehabilitation. In *Metropolitan Life* a group of private insurance companies challenged the manner in which they had been assessed for payments into Wisconsin's insurance security fund, including a due process challenge reminiscent of *Burford*.

5. We addressed *United States v. Bank of New York & Trust Co.*, 296 U.S. 463 (1936), *United States v. \$79,123.49*, 830 F.2d 94 (7th Cir. 1987), and *Blackhawk Heating & Plumbing Co. v. Geeslin*, 530 F.2d 154 (7th Cir. 1976), in the section of our brief discussing the doctrine of prior, exclusive *in rem* jurisdiction. (OBr:80–85.) Appellees do not include a corresponding section in their answering brief, but instead cite those cases in the context of *Burford* abstention. (ABr:52–53.) None of those cases, however, mentions *Burford* or contains an abstention analysis.

In any event, none of those opinions speaks to this case, which involves the District Court's jurisdiction to rule on the legality of an attempt to erase a federal tax liability by purportedly allocating it to a state-law segregated account. See *Moran v. Sturges*, 154 U.S. 256, 275

(1894) (exception to prior, exclusive *in rem* jurisdiction for federal courts enforcing “supremacy of the constitution and laws of the United States.”); *Covell v. Heyman*, 111 U.S. 176, 179–80 (1884). *Blackhawk Heating & Plumbing* involved an “ordinary assignee” who had to file a claim in the receivership court and accept its place in line. 530 F.2d at 158–59. Similarly, in *Bank of New York*, the United States was an assignee, having acquired its claim to the American funds of Russian insurance companies from the Russian government, which had dissolved the companies and confiscated their assets. 296 U.S. at 470.<sup>11</sup> Finally, §79,123.49 recognized that “[p]ossession obtained through an invalid seizure neither strips the first court of jurisdiction nor vests it in the second.” 830 F.2d at 98.

6. Appellees contend (ABr:47) that “[t]his Court and numerous others have applied *Burford* abstention to the state regulation of insurance, including delinquency proceedings.” Appellees, however, do not meaningfully address our discussion (OBr:77–78) of this Court’s

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<sup>11</sup> Appellees miss the point of their excerpt from the *Bank of New York* case (ABr:52). Their quote deals only with situations where the funds are held by the court. Here, the Wisconsin court does *not* hold the funds of Ambac. As we noted (OBr:11), consistent with *Bank of New York*, Treas. Reg. § 301.6331-1(a)(3) restrains the IRS from levying on the segregated account, which is under the control of the Wisconsin Court.



decision in *Hartford Cas. Ins. Co. v. Borg-Warner Corp.*, 913 F.2d 419, 425 (7th Cir. 1990) (ABr:47, 51), which recognized that four factors provide useful guidance for the abstention analysis “within the context of the insurance industry.” As we have already explained (*see* OBr:78 n.23), each of the four factors shows that abstention is inappropriate here.

Moreover, appellees do not address our point that the abstention granted in *Hartford* was merely a temporary one. This Court was concerned that the federal district court and the state rehabilitation court would need to make the same rulings regarding reinsurance contracts and dividends (*id.* at 426) and made it plain that once the state court had ruled, Hartford could “come back to federal court with its lawsuit” (*id.* at 427). Here, as we explained (OBr:78), all of the outstanding issues involving the United States are federal, and there is nothing to be decided by the Wisconsin Court that would justify the kind of temporary abstention approved in *Hartford*.

7. Appellees make several arguments (ABr:51) that can be summarily refuted. Although preemption analyses consider state law, the Supreme Court treats preemption as a federal issue for the federal courts. *See Quackenbush*, 517 U.S. at 726; *NOPSI*, 491 U.S. at 361–63.

The United States is not challenging the March 24, 2010 creation of the segregated account, which occurred many months before the November 8, 2010 purported tax allocation and *ex parte* injunction generated this litigation. The Wisconsin Court's May 27 and October 26, 2010 orders, cited by appellees, also predate November 8, 2010. Those orders could not have addressed the United States' supremacy and preemption issues. There is, therefore, little chance of a conflict between state and federal court rulings. The United States' federal issues are unique to it as a sovereign entity with taxation powers, and this federal litigation might be dispositive of the matters that the United States seeks to have resolved, eliminating any need for the United States to pursue relief in the Wisconsin courts. (*See* ABr:2 n.3.) The United States' federal tax issues are also not implicated in the separate Wisconsin state-court appeal by private policyholders whose claims were allocated to the segregated account. Finally, again, the United States' place in line, insofar as priority is concerned, has nothing to do with the District Court's jurisdiction. (ABr:54.)

### III

#### **The United States is entitled to relief from the Wisconsin Court's supplemental injunction**

##### **A. The injunction is invalid**

We argued that the Wisconsin Court's injunction is barred by the lack of a waiver of the United States' sovereign immunity and by the Anti-Injunction Act (I.R.C. § 7421). (OBr:85–96.)

1. Appellees do not address our argument (OBr:91–92) that the McCarran-Ferguson Act cannot override sovereign immunity. Instead, they cite *United States v. Rural Elec. Convenience Co-op. Co.*, 922 F.2d 429 (7th Cir. 1991), to contend that the United States invokes sovereign immunity too freely and that sovereign immunity is inapplicable to the restraints on the United States at issue here. (ABr:57–58.) That case, however, involved a contract dispute affecting a federal security interest in a loan, not actions directly impinging on a sovereign prerogative like taxation. *Id.* at 430–37. More importantly, it confirms the rule that sovereign immunity is implicated if the effect of a judgment would be to restrain the United States. *Id.* at 433.

2. Appellees' cursory argument against the Anti-Injunction Act (ABr:58) fails to address our argument that erasing federal tax debts is not regulating the business of insurance, or, alternatively, even if it is,

that I.R.C. § 7421 specifically relates to the business of insurance as an integral enforcement provision in the Code (OBr:94–95). Indeed, § 7421(a) provides that no suit to enjoin tax collection may be maintained in any court by any “person,” and “insurance companies” are included in the definition of “person.” See I.R.C. § 7701(a)(1), (3). Accordingly, this argument does not assist appellees.

3. The facts surrounding the issuance of the Wisconsin Court’s injunction are undisputed, and, for the reasons stated above and in our opening brief (OBr:89–96), the injunction against the United States is invalid as a matter of law. Contrary to appellees’ argument (ABr:55–57), this Court can resolve the legality of the injunction without remanding. *Shaw v. Autozone, Inc.*, 180 F.3d 806, 813–14 (7th Cir. 1999).

**B. Appellees’ arguments about the segregated account and priorities are internally inconsistent and unavailing**

Throughout their brief, appellees present the segregated account as a “pareto superior” (ABr:10) solution to Ambac’s financial difficulties.<sup>12</sup> But they are inconsistent regarding the nature of the

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<sup>12</sup> Appellees’ assertion that “all . . . claimants [are] better off than they would have been in a full rehabilitation of Ambac as a whole” (ABr:10) is incorrect. For the reasons discussed, *infra*, and at OBr:13

(continued...)

segregated account. At times, appellees present Ambac and the segregated account as separate entities, with only the segregated account falling under the jurisdiction of the Wisconsin Court, so as to avoid triggering protective provisions in insurance contracts.

(ABr:6–13, 21.) At other times, appellees present Ambac and the segregated account as a single entity, with the segregated account akin to an accounting category on Ambac’s books, so as to argue that efforts by the United States to collect the tentative tax refund money held by Ambac outside of the segregated account would be jumping the line ahead of policy claims in the segregated account, in violation of the priority structure of Wis. Stat. § 645.68.<sup>13</sup> (ABr:13–16, 21–24.)

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<sup>12</sup> (...continued)

n.6, the United States is not better off. Indeed, the special *tax* allocation was designed to separate the tax assets (*i.e.*, the tentative tax refunds that Ambac has received) from the tax liabilities that still may be owed. The assertion that everyone is better off is also belied by the objections to their plan that have been filed by numerous parties in interest. (Supp. A. 10.) *See also* June 17, 2011 opening brief in Wis. Ct. App. Dist. IV (no. 2011AP561) at 1–6 (statement of issues by private-party appellants asserting many ways in which the appellees’ rehabilitation structure did not leave them better off).

<sup>13</sup> The comment to Wisconsin legislation enacted in 1967 that appellees cite (ABr:26) does not support their position. As we have previously discussed, the Supreme Court in *Fabe* rejected the comment’s suggestion that the inclusion of a provision in a chapter that is part of a regulatory system could make it “possible to overcome . . . a limiting interpretation of federal statutes.” Indeed, in *Fabe*, the

(continued...)

But there are flaws in both characterizations when applied to tax debts owed to the United States. Ambac is a member of a consolidated group under its New York parent (AFGI), and the Treasury Regulations expressly provide that each member of a consolidated group is severally liable for the group's tax debts. Treas. Reg. §§ 1.1502-6(a), 1.1502-78(b)(2). If the segregated account is a separate entity carved out of Ambac, then appellees have not explained how Ambac's several liability to repay the tentative federal tax refunds paid to the AFGI consolidated group can be "allocated" to the segregated account. The purported "allocation" of the tax debt is particularly egregious because the tentative tax refunds to which the debt is attributable (*i.e.*, the corresponding assets) continue to be held by members of the AFGI group outside the segregated account. (*See* OBr:6-17, 83-84.) On the other hand, if the segregated account is merely an accounting category on Ambac's books, and all of Ambac is in rehabilitation, appellees have not explained how, under *Fabe*, 508 U.S. at 509, Ambac can make

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<sup>13</sup> (...continued)

Supreme Court held that certain priorities in such a statute did not constitute the regulation of the business insurance and were invalid. Moreover, Wisconsin subsequently had to amend Wis. Stat. § 645.68 — the provision which the comment identifies as the one for which the "problem is of special importance" — so that it complied with *Fabe*. *See* 1999 Wis. Act 30, § 51.

lower-ranking payments (*e.g.*, payments to general creditors and dividends) ahead of what should be the higher-ranking payments to the United States. (ABr:23–24.)

Appellees argue that this litigation is an unwarranted attempt by the United States to jump ahead in line (ABr:57–58), but, in reality, they have tried to create a straitjacket preventing the United States from asserting its federal rights. If the United States were to cease its federal litigation and make a claim to the segregated account, it would stand behind all payments that Ambac might make to lower-priority entities outside the segregated account. But if the United States continues its federal litigation, appellees assert that the United States should still lose on the theory that collecting directly from Ambac (and not just filing a claim against the segregated account) would improperly put the United States ahead of policyholder claims in the segregated account. Appellees apparently see nothing wrong with having their cake and eating it, too.

It is undisputed that Ambac received approximately \$700 million in tentative federal tax refunds under the pay-first-audit-later provisions of I.R.C. § 6411. (OBr:6–7; ABr:14.) Then, when the IRS began an audit, appellees used *ex parte* proceedings in the Wisconsin

Court to purportedly place any liability to repay the tentative refunds in the segregated account, while keeping the refund money in Ambac to fund its rehabilitation. (ABr:14–16.) Appellees argue that United States must lose because the refund money is the linchpin of the rehabilitation (ABr:3, 24), but the United States cannot be made an unwilling partner in a floundering business. *United States v. Kim*, 111 F.3d 1351, 1361 n.11 (7th Cir. 1997).



## CONCLUSION

The Court should reverse the District Court's remand in appeal no. 11-1158 and its dismissal in appeal no. 11-1419. It should then either dissolve, under 28 U.S.C. § 1292(a), the Wisconsin Court's injunction against the collection from Ambac of its tax liabilities, or remand with instructions that the District Court declare the Wisconsin Court's injunction against the collection from Ambac of its tax liabilities void, and enjoin any attempt to enforce such injunctive relief.

Respectfully submitted,

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January 2012

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