UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF WISCONSIN

IN THE MATTER OF THE REHABILITATION OF THE SEGREGATED ACCOUNT OF AMBAC ASSURANCE CORPORATION	Case No. 10-cv-778 (Removed From Dane Court Circuit Court – No. 10 CV 1576)

BRIEF IN SUPPORT OF MOTION TO REMAND BY THE WISCONSIN COMMISSIONER OF INSURANCE, AS COURT-APPOINTED REHABILITATOR OF THE SEGREGATED ACCOUNT OF AMBAC ASSURANCE CORPORATION

FOLEY & LARDNER LLP

Michael B. Van Sicklen, SBN 1017827
Naikang Tsao, SBN 1036747
Matthew R. Lynch, SBN 1066370

150 East Gilman Street
Madison, WI 53703
(608) 257-5035 (phone)
(608) 258-4258 (fax)

Attorneys for the Wisconsin Commissioner of Insurance, as Court-Appointed Rehabilitator of the Segregated Account of Ambac Assurance Corporation

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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"), files this brief in support of his motion to remand this action back to the Dane County Circuit Court ("the State Rehabilitation Court"), which has been overseeing this insurer rehabilitation case since the Commissioner commenced it on March 24, 2010.

INTRODUCTION

A. The Insurance Rehabilitation Proceeding

The rehabilitation of the Segregated Account (the "Rehabilitation Proceeding") is the largest insurance delinquency proceeding in Wisconsin history.[1] The Commissioner initiated it by Verified Petition on March 24, 2010 pursuant to Chapter 645 of the Wisconsin Statutes.

The State Rehabilitation Court already has addressed and decided many issues.[2] It also completed a week-long evidentiary hearing and another day of closing arguments in November on the Commissioner's proposed Plan of Rehabilitation. At the hearing, the Commissioner and other witnesses gave testimony and were cross-examined at length by counsel

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[1] At the time Ambac exercised its option to split its affairs under Wis. Stat. § 611.24(2) into a Segregated Account and a General Account, and the Commissioner placed the Segregated Account into rehabilitation pursuant to Wis. Stat. §§ 611.24(3)(e) and 645.31 *et seq.*, Ambac had approximately 15,000 policies—most with numerous bond, note or other beneficial holders—insuring over $370 billion in obligations (net par then outstanding). Pursuant to the Commissioner's approved restructuring, about 1,000 of those policies (insuring approximately $68 billion of exposures) were allocated to the Segregated Account, together with certain other liabilities, and placed into rehabilitation. (Declaration of Michael B. Van Sicklen ("Van Sicklen Decl.") Ex. G ("Findings & Conclusions") at 14.)

[2] To date, there have been more than 650 docket entries in the Rehabilitation Proceeding. The substantive court filings and orders are publicly available at http://ambacpolicyholders.com/court-filings. In addition, voluminous information regarding the plan of rehabilitation, confirmation of which is pending, is available at http://ambacpolicyholders.com/overview.

for some of the largest financial institutions in the world, including Wells Fargo Bank, U.S. Bank, Deutsche Bank, and Bank of America, as well as the Federal Home Loan Mortgage Corporation ("Freddie Mac") and Federal National Mortgage Association ("Fannie Mae").[3] Several interlocutory appeals arising from the Rehabilitation Proceeding also are pending and in various stages of briefing before the Wisconsin Court of Appeals. Those appeals present issues under state insurance law, including the scope of Wis. Stat. § 611.24(2) and the State Rehabilitation Court's injunctive powers under Wis. Stat. § 645.05.

At the conclusion of the Plan confirmation hearing on November 30, 2010, the State Rehabilitation Court noted that it would issue an order regarding the Commissioner's motion to confirm the Plan of Rehabilitation within "several days . . . it will be coming as quick as I can get it" out.[4] (Van Sicklen Decl. Ex. Z ("11/30/10 Hearing Tr.") at 223:9-15.) The December 8, 2010 notice of removal by the United States Internal Revenue Service ("IRS") was filed on the eve of the State Rehabilitation Court's ruling regarding Plan confirmation, and has halted the Rehabilitation Proceeding in its tracks.

B. The November 8 Supplemental Injunction

The basis for the IRS's removal notice is its objection to a November 8, 2010 supplemental injunction issued by the State Rehabilitation Court (the "Supplemental

[3] Freddie Mac and Fannie Mae are federal government-sponsored enterprises, *see* 104 Stat. 1388-607 and 2 U.S.C. § 622(8), which are under federal conservatorship by the Federal Housing Finance Agency.

[4] The proposed Confirmation Order submitted by the Commissioner is 61 pages long with 152 paragraphs of findings of fact annotated to the written and oral evidence submitted in conjunction with the week-long confirmation hearing. (Van Sicklen Decl. Ex. Y ("Proposed Order Confirming Plan").)

Injunction"). It is important to understand the highly conditional nature of the alleged dispute that the IRS seeks to pursue in federal court. Here are the facts:

- In September 2009 and February 2010, the IRS made two tax refund payments totaling $708 million to Ambac's parent company, Ambac Financial Group, Inc. ("AFGI"), which AFGI immediately transferred to Ambac in accordance with their longstanding inter-company Tax Sharing Agreement. (Van Sicklen Decl. Ex. P ("11/8/10 Aff.") ¶¶ 3-7.)

- On October 28, 2010, the IRS sent AFGI an "Information Document Request," which indicated that the agency was investigating whether it might have erred in issuing the tax refund payments. (*Id*. ¶ 9 & Ex. B.)

- Based in part on a concern that the IRS might attach or levy on $708 million of assets before the IRS's investigation was completed and before a judgment on the merits of the dispute, AFGI sought Chapter 11 protection in the Southern District of New York, and has filed a motion in the bankruptcy court seeking an injunction to prevent the IRS from taking such actions. (Van Sicklen Decl. Ex. S ("Wallis Aff.") ¶¶ 35, 37, 39, 44; Ex. T ("Bankruptcy Hearing Tr.") at 1-12.)

- Because the Commissioner's proposed Plan of Rehabilitation contemplates that the claims of policyholders whose policies have been allocated to the Segregated Account will be paid from Ambac's General Account, which ultimately received the tax refund proceeds, the Commissioner was concerned that the IRS might attach or levy on $708 million of General Account assets, and then argue that the pre-judgment levy elevated the IRS's claim to that of a secured creditor (*i.e*., above the claims of policyholders), in direct violation of Wisconsin state law priority rules that provide that federal government claims have lower payment priority than policyholder claims. *See* Wis. Stat. § 645.68(3), (3c).

- In order to prevent the IRS from subverting Wisconsin state insurance law regarding priority and from disrupting the orderly administration of the rehabilitation, Ambac allocated the disputed $708 million tax refund liability to the Segregated Account, and the Commissioner sought and obtained the Supplemental Injunction in the Rehabilitation Proceeding which prevents the IRS from attaching or levying on General Account assets needed to fund the Rehabilitation Plan.

- The Supplemental Injunction is conceptually the same as the original injunction that was entered at the commencement of the Rehabilitation Proceeding in March (the "First-Day Injunction"). The First-Day Injunction prevented *any third party* (governmental or otherwise) with an interest in the Segregated Account from taking steps that would impair the claims paying assets available to fund a rehabilitation of the Segregated Account. (*See* Van Sicklen Decl. Ex. D ("First-Day Injunction") ¶¶ 1, 3-8.) The Supplemental Injunction is intended to have the same effect, and is specific to the IRS (and AFGI's unsecured creditors) only

> because those potential liabilities became known and were allocated to the Segregated Account subsequent to the First-Day Injunction. (11/8/10 Aff. ¶¶ 8-11.)

Against this factual backdrop, there are a number of key points. Although the IRS frames the issue in its removal petition as a state court's attack on the IRS's discretion (through the issuance of the Supplemental Injunction), the injunction constrains the IRS's discretion in a *very narrow* and *targeted* respect: it only prevents the IRS from pursuing attachment or levy to collect on a presently disputed tax liability, which would violate state insurance law by permitting the IRS to leap-frog policyholders (who are senior claimants under the priority scheme laid out in Wis. Stat. § 645.68). The IRS position regarding collection also would violate the McCarran-Ferguson Act, which reverse-preempts federal law in the area of insurance regulation. *See generally U.S. Dep't of Treasury v. Fabe*, 508 U.S. 491 (1993) (holding that state insurance law supersedes federal law to the extent it prioritizes policyholder and administrative claims ahead of federal claims).

Of note, the Supplemental Injunction: (a) *does not* constrain the IRS from collecting taxes on a going forward basis; (b) *does not* constrain the IRS from conducting its investigation and determining whether to change its decision to issue the tax refund in the first place; (c) *does not* constrain the IRS from litigating *the merits* of the disputed tax liability to judgment in a federal forum (*e.g.*, the AFGI bankruptcy court); and (d) *does not* constrain the IRS from submitting a claim in the AFGI Chapter 11 proceeding, or a claim in the Rehabilitation Proceeding to be treated under a Rehabilitation Plan consistent with the Wisconsin statutory priority rules.

Thus, if the IRS has no intention of attaching or levying against Ambac's assets—thereby elevating its claim priority over policyholder claims—then the Supplemental Injunction issued by the State Rehabilitation Court does not constrain the IRS in any way. Or stated

conversely, the only reason the IRS has to challenge the injunction is to reserve the right to take collection action (through its attachment or levy collection powers), even though such action would violate Wisconsin insurance law, and even though the IRS *has yet to make up its own mind* whether the dispute regarding the tax refund is a real one.

Aside from being a federal usurpation of state law in an area that Congress expressly reserved for the states under the McCarran-Ferguson Act, the IRS's removal of the entire Rehabilitation Proceeding to federal court—based on its *initial* and *conditional* view about what it *might* want to do with respect to collection tactics regarding the disputed tax refund issue—causes considerable disruption to thousands of policyholders, policy beneficiaries, trustees, creditors and others. Under the First-Day Injunction, policyholders are presently suffering under a moratorium on payments of claims that total more than $900 million since the commencement of the Rehabilitation Proceeding on March 24, and those unpaid claims are growing (*without* interest accruing) by $120 million to $150 million per month. (Van Sicklen Decl. Ex. V ("11/16/10 Hearing Tr.") at 192:3-194:3.) The delay in the Plan confirmation process, and the delay in the resumption of claims payments under a confirmed Plan, prejudices all policyholders. In addition, the Commissioner has a number of time-sensitive requests for court approval related to the Rehabilitation Proceeding that need to be filed, which are being held in abeyance until it is determined which court has jurisdiction over the Rehabilitation Proceeding. (Van Sicklen Decl. ¶ 3.)

C. The Reasons For Remand

For the reasons more fully explained below, this action should be remanded to the State Rehabilitation Court. As a non-party to the Rehabilitation Proceeding, the IRS cannot remove the Rehabilitation Proceeding to federal court under either of the cited removal statutes. Moreover, even if the IRS were deemed to have party status, this action should be remanded

because the McCarran-Ferguson Act reverse-preempts federal law to the extent it interferes with or impairs laws "enacted by any state for the purpose of regulating the business of insurance," 15 U.S.C. § 1012(b), and because the *Burford* doctrine requires abstention in this case.

BACKGROUND

I. THE STATE REHABILITATION COURT PROCEEDING

A. Ambac And Its Deterioration

Ambac Assurance Corporation ("Ambac") is a Wisconsin-domiciled insurer that is headquartered in New York and was, for most of the past 30 years, one of the two largest monoline[5] insurers in the world. (*See generally* Van Sicklen Decl. Ex. A ("Verified Petition").) Ambac offered financial guaranty insurance on investment-grade municipal financial 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. (Findings & Conclusions at 2, 9.)

Beginning in late 2007, Ambac's financial condition—like that of all other financial guaranty monolines—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. (Findings & Conclusions at 2-3.) As actual and estimated future losses continued to grow over the next two years, Ambac's credit ratings suffered, it ceased writing new policies, and it began a functional run-off of its policies in force. (*Id*.)

Starting in late 2007, the Wisconsin Office of the Commissioner of Insurance ("OCI") engaged in increasingly extensive oversight of Ambac and retained independent

[5] Ambac is a "monoline" because it offers only one line of insurance: financial guaranty insurance.

financial advisors and legal counsel with expertise regarding the specialized, complex financial transactions insured by Ambac. (Findings & Conclusions at 3.) By early 2010, Ambac's mounting claims payments and projected loss impairments made it clear to OCI that formal regulatory action under Chapter 645 of the Wisconsin Statutes was necessary to alleviate the growing risk that Ambac would become insolvent before its policy obligations were satisfied. (Findings & Conclusions at 8.)

B. OCI's Determination To Rehabilitate The Segregated Account Of Ambac Rather Than Ambac As A Whole

In terms of regulatory options, the simplest approach for the Commissioner would have been the commencement of the rehabilitation of Ambac as a whole, followed by the run-off of its approximately 15,000 in-force policies pursuant to a global plan of rehabilitation. Unfortunately, because Ambac's policies are not "off the shelf" contracts but rather complex, individually negotiated transactions that generally include a number of embedded covenants and default triggers tied to the avoidance of formal delinquency proceedings, the "full rehabilitation" option carried significant and unnecessary risks of harm to policyholders. (Findings & Conclusions at 9.) The full rehabilitation approach raised two main concerns.

First, full rehabilitation could cause massive unnecessary and avoidable losses. The vast majority of Ambac's 15,000 policies (more than 90 percent) insured problem-free transactions that were performing, with little or no projected future losses *unless* they were subjected to a rehabilitation. (Findings & Conclusions at 9-10.) By way of example, Ambac insured notes issued by large corporations such as Sonic Corporation (the franchisor of the Sonic drive-in restaurant chain) and the Hertz Corporation (the owner of Hertz rental car and equipment businesses), among others. A rehabilitation of Ambac could have permitted these corporate issuers' lenders the right to withhold financing for the payment of the notes, and

permitted counterparties on the notes the right to accelerate and declare defaults—actions that OCI concluded it might not be able to effectively enjoin. (Findings & Conclusions at 9; 11/16/10 Hearing Tr. at 71:15-21, 117:21-118:1, 153:25-156:15.) The projected shortfalls in the corporate issuers' ability to make such accelerated damages payments would fall on Ambac as the insurer, thus creating additional, otherwise avoidable policy losses estimated to be in excess of $1 billion on Commercial ABS transactions alone, which were otherwise projected to have few or no policy loss claims. (Findings & Conclusions at 9.)

Other segments of Ambac's business would have faced similar adverse consequences, including the acceleration of obligations of Ambac affiliates that issued interest rate and currency swaps and guaranteed investment contracts, all of which were insured by Ambac (Findings & Conclusions at 10), and the assertion of more than $10 billion in otherwise avoidable mark-to-market damages relating to credit default swaps and collateralized loan obligations. (11/16/10 Hearing Tr. at 153:25-156:15; Van Sicklen Decl. Ex. U ("11/15/10 Hearing Tr.") at 146:23-148:2.)

Second, a full rehabilitation carried larger risks to the domestic economy. OCI received comments from economic leaders and government entities—including the United States Treasury Department and the New York Federal Reserve—expressing concern that a full rehabilitation of Ambac posed systemic risks of market disruption and unpredictable downstream consequences for the economy. (Findings & Conclusions at 10; 11/15/10 Hearing Tr. at 143:9-145:15.) "In broad terms, the discussions [OCI] had with the New York Fed and others affirmed [its] perception that systemic risks related to Ambac could exist and that they were worth considering in [the] overall plan[] development." (11/16/10 Hearing Tr. at 33:8-12.)

OCI therefore opted for a surgical approach that addressed the need for rehabilitation but avoided the disastrous adverse consequences of a full rehabilitation. To accomplish this purpose, it utilized Wis. Stat. § 611.24(2), a statute that is unique to Wisconsin insurance law. Section 611.24(2) permits an insurer (with the Commissioner's approval) to establish a segregated account for any part of its business, and it previously has been employed by OCI in the context of insurance delinquency proceedings. (11/16/10 Hearing Tr. at 157:19-159:18.) Ensuring that this structure would meet the purposes of "protecting the interests of insureds, creditors, and the public generally" and foster the "equitable allocation of any unavoidable loss," Wis. Stat. § 645.01(4), without making massive but avoidable losses unavoidable, required substantial care by OCI.

Specifically, OCI engaged in an extensive book-by-book and sometimes policy-by-policy assessment of Ambac's diverse business to determine the triggers and expected losses associated with Ambac's policies. (11/16/10 Hearing Tr. at 177:17-181:23.) It then allocated approximately 1,000 policies with material projected losses, structural problems with the transactions, and/or contractual triggers that could not be avoided without injunctive relief to the segregated account of Ambac (the "Segregated Account"), while keeping the remaining 14,000 problem-free policies in the "General Account" of Ambac. (Van Sicklen Decl. Ex. W ("11/17/10 Hearing Tr.") at 157:19-160:7; Findings & Conclusions at 12-13.) In creating this structure, it was imperative that Ambac's claims-paying resources remain in the General Account. Many of Ambac's performing policies with no anticipated losses—namely its massive book of municipal bond policies—were subject to acceleration, early termination and other triggers if Ambac transferred assets to affiliates or other entities. (11/16/10 Hearing Tr. at 156:16-157:14.) Therefore, claims on the Segregated Account will be funded under the

Commissioner's pending Rehabilitation Plan through a secured note and excess-of-loss reinsurance agreement from the General Account. This arrangement gives the Segregated Account on-demand access to essentially all General Account resources to satisfy Segregated Account liabilities, but does not trigger the asset-transfer restrictions inherent in General Account policies. (11/16/10 Hearing Tr. at 159:4-18, 195:21-196:21, 197:19-199:23.)

As OCI officials have testified, and as the State Rehabilitation Court has ruled, the rehabilitation of the Segregated Account carried substantial benefits for Ambac's policyholders, creditors, and the public and avoided potentially catastrophic harms that could have resulted from a full rehabilitation of Ambac. (Findings & Conclusions at 14; 11/15/10 Hearing Tr. at 151:12-21, 152:25-153:6, 155:4-11; 11/16/10 Hearing Tr. at 71:15-21, 117:21-118:1, 152:2-12, 161:2-162:18, 168:10-14.) Accomplishing the rehabilitation of Ambac without placing all of Ambac into rehabilitation carried certain risks of its own, however—primarily the risk that the policyholders and creditors with actual or potential material claims placed in the Segregated Account would attempt to collect against the General Account directly, rather than submitting claims to the Segregated Account for orderly payment consistent with Wisconsin's priority structure for delinquent insurers, Wis. Stat. § 645.68.

OCI addressed those concerns by allocating all policies with material anticipated losses and all other known, potentially material non-policy liabilities of the General Account to the Segregated Account, including the General Account's obligations under certain reinsurance contracts and disputed contingent liabilities related to two office leases.

Then, the Commissioner commenced the rehabilitation of the Segregated Account—establishing the State Rehabilitation Court as the forum for all such claims related to Segregated Account liabilities—and, pursuant to Wis. Stat. § 645.05, obtained first-day

injunctive relief barring all persons and entities from commencing or prosecuting any actions against the General Account *in respect of the Segregated Account or policies, contracts or liabilities allocated to the Segregated Account.* (First-Day Injunction ¶ 1.) OCI obtained the injunction *ex parte* because advance notice would likely have prompted those with an interest in the Segregated Account to immediately exercise contractual trigger and acceleration provisions prior to the issuance of the injunction, thus preemptively causing the harm that the injunction sought to prevent. (11/16/10 Hearing Tr. at 165:4-12.) The First-Day Injunction, like the Supplemental Injunction the IRS seeks to challenge, expressly permitted all affected persons or entities the opportunity to challenge it in the State Rehabilitation Court. (First-Day Injunction ¶ 12.)

OCI immediately provided court-approved notice to the world of the rehabilitation and First-Day Injunction, in three ways: by mail to all known policyholders and other creditors of the Segregated Account; by publication of notices in the *Wall Street Journal* and *USA Today*; and by posting all substantive filings and other information on the court-approved Web site for the rehabilitation, http://ambacpolicyholders.com.[6]

In this Segregated Account rehabilitation, all material risks to the claims-paying resources of Ambac are controlled and treated no differently than they would be in a full rehabilitation of Ambac, *see* Wis. Stat. §§ 645.01(4), 645.32(1), 645.33, 645.68, but the strains

[6] Additionally, the Rehabilitation Proceeding was well-publicized from the outset. *See, e.g.*, Andrew Frye and Christine Richard, *Ambac Regulator Takes Over to Avoid Asset "Scramble,"* BLOOMBERG BUSINESS WEEK (Mar. 26, 2010), available at http://www.businessweek.com/news/2010-03-26/ambac-regulator-takes-over-to-avoid-asset-scramble-update1-.html; Aparajita Saha-Bubna, *State Regulator Takes Over Ambac's Troubled Contracts*, WALL ST. J. (Mar. 25, 2010), available at http://online.wsj.com/article/SB10001424052748703312504575142441871801742.html; Rolfe Winkler and Una Galani, *An A.I.G. Lesson from Wisconsin*, N.Y. TIMES (Mar. 25, 2010), available at http://www.nytimes.com/2010/03/26/business/26views.html.

on Ambac's claims-paying resources are substantially reduced by avoidance of trigger-related claims for loss, which increases the amount of the likely recovery for all claimants with policies, contracts, or liabilities allocated to the Segregated Account. No entity is worse off than it would be in a full-fledged rehabilitation or liquidation of Ambac as a whole, and virtually all have substantially better and more timely prospects for recovery of their claims due to the avoidance of protracted litigation and additional contract-related losses that a full rehabilitation or liquidation would cause. (Findings & Conclusions at 14; 11/15/10 Hearing Tr. at 151:12-21; 11/16/10 Hearing Tr. at 161:2-162:18, 167:21-173:2; *see generally* Van Sicklen Decl. Ex. L ("10/26/10 Order").)

By utilizing the Segregated Account in this manner, the Commissioner was able to accomplish the functional rehabilitation of Ambac as a whole while avoiding the dangerous contractual pitfalls of a formal, full rehabilitation. Avoiding any actual unfairness through this structure, however, requires constant vigilance. (11/17/10 Hearing Tr. at 142:7-143:9.) The primary threat to the fairness of proceeding in this manner is the subsequent development of material liabilities that are not allocated to the Segregated Account—a situation that could give rise to adverse collection and other actions detrimental to the claims-paying resources of the Segregated Account outside the confines of the rehabilitation of the Segregated Account and its adherence to Wisconsin's priority structure. If, for example, economic conditions shifted such that certain policies in the General Account suffered material losses, it would be unfair to pay those policyholders for loss claims in the normal course while holders of policies in the Segregated Account receive deferred payments on loss claims under the Plan of Rehabilitation. (*Id.* at 127:16-23.) Of greater concern, if a person or entity making a claim that would be subordinate to policyholder claims under Wis. Stat. § 645.68, such as shareholders, judgment

creditors, or the federal government, took action to collect on those types of subordinate claims outside the Plan, that person or entity would effectively subvert the priority structure and tie up claims-paying resources necessary to fund the rehabilitation. (*See generally* Van Sicklen Decl. Ex. O ("Nov. 8 Motion").) In addition, if a government agency or other claimant were to assert formal legal control over a material portion of assets in the General Account, it could potentially trip the default triggers of numerous General Account policies, thus causing the massive unnecessary harm that prompted OCI to pursue this narrow form of rehabilitation in the first place. (11/16/10 Hearing Tr. at 152:2-12, 156:16-157:14.)

Therefore, OCI has maintained careful oversight over potential risks to the General Account. Thus far, its initial allocations to the Segregated Account have accomplished these purposes:

- As of the November Plan confirmation hearing, there were approximately *$900 million* in pending loss claims (that had accrued since March) awaiting payment under a plan of rehabilitation on the approximately *800* remaining policies allocated to the Segregated Account.
- By contrast, only *$13 million* in claims had been presented on the *14,000* General Account policies during the same time frame.

(11/16/10 Hearing Tr. at 193:22-194:3.) OCI also has required Ambac to make further allocations as necessary to protect the fairness and equitable treatment of all with a material interest in the assets currently held in the General Account. (11/15/10 Hearing Tr. at 169:3-170:21; 11/16/10 Hearing Tr. at 180:3-24.)

C. The State Rehabilitation Court Has Rejected All Challenges To Date Regarding OCI's Decision To Rehabilitate The Segregated Account

The State Rehabilitation Court has rejected numerous challenges to the Segregated Account, with almost all of them consisting of one entity or another seeking either to gain better treatment at the expense of others, or asking the State Rehabilitation Court to ignore

the realities of Ambac's financial condition and the rationale for structuring the rehabilitation in the way the Commissioner determined was in the best interest of all policyholders, as well as creditors and the public. In its first substantive decision in May, the State Rehabilitation Court found:

> 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.

(Findings & Conclusions at 14.) The State Rehabilitation Court reiterated this Finding at the conclusion of week-long evidentiary hearings on the merits of the Commissioner's proposed Plan of Rehabilitation for the Segregated Account:

> This is an extremely complex and difficult situation. I have watched the testimony of the Commissioner and especially Mr. Peterson over the two days . . . he was on the stand. It was as grilling a series of questionings as I've ever seen any witness undergo in all my years on the bench. There were questions asked by very bright, intelligent counsel, and the answers given, the evaluation shown to be made, the fact[s] gathered, the procedures followed as testified to by Mr. Peterson leads me to believe, as they consistently pointed out, that they were acting in what would be the best interest of policyholders, doing what is fair for them.
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> * * *
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> [The relationship between the General Account and Segregated Account] was fair, it was equitable. It was an extremely well thought-out, well-based decision.

(Van Sicklen Decl. Ex. X ("11/19/10 Hearing Tr.") at 50:1-51:4.)

D. There Are Pending Interlocutory Appeals Of Non-Final State Rehabilitation Court Orders In The Wisconsin Court of Appeals

Several appeals of non-final orders of the State Rehabilitation Court are pending in the Wisconsin Court of Appeals. Certain entities have appealed the following non-final orders:

(1) MAY 27, 2010 ORDER, which denied motions to enjoin a settlement between Ambac and a group of financial institutions, rejected certain arguments regarding the creation of the Segregated Account and denied motions of certain hedge funds, bondholders, and Freddie Mac to intervene;

(2) JULY 16, 2010 ORDER, which rejected the objections raised by Wells Fargo and certain holders of Las Vegas Monorail ("LVM") bonds relating to the allocation of the LVM policy to the Segregated Account, and denied the objectors' renewed motion to intervene; and

(3) OCTOBER 26, 2010 ORDER, which ruled on legal challenges to the establishment of the Segregated Account, denied various requests for injunctive relief, and refused to allow several entities to intervene.[7]

Thus, in addition to interfering with the State Rehabilitation Court's oversight of the Rehabilitation Proceeding, including an imminent ruling on the Commissioner's motion to confirm the Plan of Rehabilitation, the IRS's removal of the Rehabilitation Proceeding to this

[7] *See* Van Sicklen Decl. Exs. H, J & M (notices of appeal). With the exception of one appeal that was dismissed by stipulation, the numerous appeals of non-final orders of the State Rehabilitation Court remain pending in the Wisconsin Court of Appeals. Over the Commissioner's objection, the Wisconsin Court of Appeals previously ruled that entities that were denied the right to intervene were entitled to immediately appeal the denial of intervention (as well as merits issues decided in the same order). (*See* 6/18/10 Ct. App. Order in Case No. 2010AP1291.) Therefore, prior to the IRS's removal, a number of appeals were moving forward on a parallel track with the State Rehabilitation Court's ongoing oversight of the Rehabilitation Proceeding.

Court on December 8, 2010 creates the prospect of inconsistent state and federal rulings at both the trial court level and with respect to the pending appeals in the Wisconsin Court of Appeals.

E. The Rehabilitation Proceeding Is Now At The Plan Confirmation Stage

The First-Day Injunction issued at the outset of the rehabilitation imposed a claims payment moratorium on all policies and liabilities of the Segregated Account until such time as the State Rehabilitation Court approved a Plan of Rehabilitation. (First-Day Injunction ¶ 8.) While the claims payment moratorium was necessary while a Plan was formulated, it was also a reason the Commissioner felt urgency and committed to the State Rehabilitation Court at the outset that it would endeavor to develop and submit for court approval a proposed Rehabilitation Plan within six months, so that claims payments could resume. (Verified Petition ¶ 12(a), (b).)

The Commissioner followed this timetable, finalizing and filing the Plan of Rehabilitation for the Segregated Account on October 8, 2010. The State Rehabilitation Court heard a week of testimony regarding the merits of the Plan from November 15 to 19, 2010, and a full day of oral argument regarding it on November 30, 2010. At the conclusion of that oral argument, the State Rehabilitation Court noted that it would issue a ruling approving, rejecting or modifying the Plan within "several days." (11/30/10 Hearing Tr. at 223:9.)

Commencement of the Plan, including making initial payments on the approximately $900 million (and growing) in outstanding claims that have accrued since March (under the First-Day Injunction's claims payment moratorium), will begin promptly after Plan approval.

II. THE IRS REMOVAL OF THE REHABILITATION PROCEEDING TO THIS COURT

In early November of this year, the Commissioner learned of two groups claiming that they might have an interest in certain tax refunds totaling $708 million that Ambac previously received in connection with its pre-rehabilitation business: (1) the IRS, which sent a request for information to AFGI concerning the accounting related to the refunds; and (2) unsecured creditors of AFGI, who claimed that AFGI's payment of the tax refunds to its subsidiary, Ambac, might be a preference. (*See generally* 11/8/10 Aff.)

The Commissioner was particularly concerned about the potential threat to the rehabilitation posed by the IRS because of its right, absent an injunction, to pursue an immediate pre-judgment jeopardy levy or attachment as to some or all of the $708 million of refunds previously paid to Ambac. Were that to occur, the IRS would be in a position to obtain payment in full of its contingent future tax claim even though policyholder claims are entitled to higher priority than federal government claims under Wisconsin's statutory scheme for handling claims against insurers in rehabilitation or liquidation. *Compare* claims priorities in Wis. Stat. § 645.68(3) for policyholders *with* § 645.68(3)(c) for "claims of the federal government."

To avoid that subversion of state insurance law, the General Account—with the Commissioner's approval—allocated the contingent IRS liability to the Segregated Account, and the Commissioner moved the State Rehabilitation Court *ex parte* (again, to prevent precipitating the very harm the injunction sought to prevent) to apply the same injunctive relief applicable to all others with an interest in previously allocated Segregated Account policies, contracts and liabilities to the newly allocated, disputed contingent liabilities relating to the past tax refunds.[8]

[8] The same concern about potential IRS collection actions was a reason Ambac's non-insurer parent company, AFGI, sought Chapter 11 protection. (Wallis Aff. ¶¶ 35, 37, 39, 44.)
(footnote continued on following page)

(*See* Van Sicklen Decl. Ex. Q ("11/8/10 Hearing Tr.") at 4:1-5:4 (rationale for seeking *ex parte* relief).)

To be clear, the IRS does not presently assert that the tax refunds it paid were improper, and it has not commenced any formal legal action to recover them. It has merely sent a request for information regarding the refunds to AFGI. (11/8/10 Aff., Ex. B.) Based on the information requested and meetings with AFGI and its tax advisors, the IRS may conclude that the tax refunds were in fact proper, in which case this entire action (and the massive disruption to the Rehabilitation Proceeding) would have served no purpose. Of note, the injunction does not prevent the IRS from collecting taxes going forward, from continuing to investigate and gather information relating to the past refunds, from litigating its entitlement to those refunds should it determine that such litigation is warranted, or from ultimately making a claim for those refunds, either in the AFGI bankruptcy or in the Rehabilitation Proceeding (subject to a Plan and the state law priority structure).[9] The injunction merely requires the IRS to avoid taking any action to assert control over such assets that would prioritize its claim over claims of policyholders while its investigation of the refund issue is pending and, *if* the IRS concludes that the refunds were

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The IRS has made no challenge to the effectiveness or validity of the stay provision as to AFGI in the bankruptcy court; the IRS apparently contends only that *state* law cannot impose identical relief in the context of the congressionally recognized bankruptcy equivalent for a financially hazardous insurer: a state delinquency proceeding. *See Munich Am. Reinsurance 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).

[9] To the extent the injunction as drafted arguably reaches activities beyond this intended scope, the Rehabilitator may and hereby does consent to the IRS conducting such activities in the normal course. (*See* Supplemental Injunction ¶ 1 (incorporating terms of First-Day Injunction); First-Day Injunction ¶ 15 ("The Rehabilitator may consent to actions or failure[s] to act which would otherwise be enjoined or restrained by this Order.").)

improper and *if* it prevails on that issue in an enforcement action, to submit its claim through the process established under a Plan of Rehabilitation like all other holders of claims relating to the Segregated Account, rather than taking action to collect those refunds through other means.

Moreover, given the size and complexity of the Rehabilitation Proceeding, there is no unified federal interest in this case. By challenging the Supplemental Injunction, the IRS is seeking the right to immediately levy on the amount of disputed tax refund, the effect of which would be to *jump ahead of* policyholders who would be paid pursuant to a Plan of Rehabilitation. Freddie Mac and Fannie Mae, which are government-sponsored enterprises under federal conservatorship, are two such policyholders. These entities own $2 billion and $1.25 billion respectively in bond obligations insured by Segregated Account policies—claims that will not be paid until the approval of a plan, and then only to the extent claims-paying resources are available. An IRS levy on the disputed tax liability would freeze a substantial portion of those resources and, if awarded to the IRS outside the Plan of Rehabilitation, would prioritize the claim of a federal agency *as a federal agency* ahead of the claims of federally-sponsored entities *as policyholders*. (*See* 11/30/10 Hearing Tr. at 100:10-18 (argument of counsel for Freddie Mac that "ultimately every dollar that Freddie receives, including under the plan of rehabilitation, benefits taxpayers," and the diversion of money to subordinate claimants works "to the detriment of taxpayers").)

On December 8, 2010, the IRS filed a notice, removing the Rehabilitation Proceeding to this Court. As a result, the State Rehabilitation Court has transmitted the record to this Court, no orders have issued since that time, and the moratorium on payments to policyholders remains in place.

ARGUMENT

I. THE IRS'S REMOVAL IS DEFECTIVE

The IRS fails to meet the requirements for removal of this dispute under 28 U.S.C. §§ 1441 and 1442(a)(1). *See Boyd v. Phoenix Funding Corp.*, 366 F.3d 524, 529 (7th Cir. 2004) (party seeking to invoke federal jurisdiction bears burden of demonstrating that removal is proper). Those statutes permit removal (1) of a "civil action" commenced in a state court, (2) that is brought against the party seeking removal. Those requirements are not satisfied given the comprehensive, remedial, and *in rem* nature of state insurance delinquency proceedings.

First, no "civil action" was commenced against the IRS in the State Rehabilitation Court. To the extent the IRS contends that the commencement of the Rehabilitation Proceeding constituted a "civil action" against it, that argument fails, because the petition for rehabilitation was not "against" the IRS within the meaning of 28 U.S.C. §§ 1441 and 1442(a)(1). Indeed, other than perhaps the insurer, the petition for rehabilitation was not "against" any person or entity; it instead initiated a formal remedial procedure to "rehabilitate the business of a domestic insurer," Wis. Stat. § 645.32(1), and to facilitate the "[e]quitable distribution an any unavoidable loss," Wis. Stat. § 645.01(4)(d). There are no formal "defendants" or "parties" to the rehabilitation. As a result, the State Rehabilitation Court has denied multiple motions to intervene as inappropriate and unnecessary, because all interested persons and entities have an ongoing right to be heard in the proceeding. (*See* Van Sicklen Decl. Ex. I ("7/16/10 Order") at 6-7.) The Commissioner's Verified Petition for Rehabilitation seeks no judgment against a defendant and requires no answers or other pleadings from third parties. The Rehabilitation Proceeding will conclude only when the Commissioner petitions the State Rehabilitation Court to either terminate the Proceeding or to transform it into a liquidation proceeding. Wis. Stat. § 645.35. As the State Rehabilitation Court has noted, it is not an adversarial proceeding; it is a

structure for management of the operation of the insurer while financially hazardous conditions exist. (7/16/10 Order at 6-7.)

The Commissioner has not located any precedent for a federal court accepting removal of an underlying state insurance delinquency proceeding or finding that an insurance rehabilitation or liquidation petition constituted a "civil action" against all potential claimants of the insurer. Indeed, the Commissioner has not found an instance where the federal government or any other person or entity has even attempted to effect such a removal.

In instances where the federal government is merely one of a large number of potential claimants against the limited assets of an insurer, it has participated in the state proceedings, argued any objections in state court, and received its distribution under a plan of rehabilitation, no differently than all other claimants in the rehabilitation proceeding. *See Grode v. Mut. Fire, Marine & Inland Ins. Co.*, 572 A.2d 798, 801 n.2, 807-08 (Pa. Commw. 1990) (pre-*Fabe* case in which United States contested priority of contingent claims under rehabilitation plan in state court, and was subject to consequences of injunction against disposing assets of insurer), *aff'd in all relevant respects, Foster v. Mut. Fire, Marine & Inland Ins. Co.*, 614 A.2d 1086, 1100-01 (Pa. 1992).

There may be individual, ancillary adversarial disputes litigated within that larger state-court management framework, and that litigation may occur in courts other than the State Rehabilitation Court. For example, the Commissioner is presently a co-plaintiff in ongoing litigation seeking equitable and legal remedies against certain companies that aggregated mortgages into pools collateralizing RMBS, in order to maximize claims-paying assets. *See, e.g., Ambac Assurance Corp. v. DLJ Mortgage Capital, Inc.*, Index No. 600070/2010 (N.Y. Sup. Ct., N.Y. County, filed Jan. 12, 2010). In such situations, wherein the Commissioner is not

engaged in protecting and distributing the *res* of the insurer for all claimants but is rather "on offense" by filing complaints for damages on their behalf, the "cause of action" for removal purposes is clear—the Commissioner's new complaints are separate causes of action, seeking *in personam* relief against named defendants with the Commissioner as a named plaintiff. *See Grode v. Mut. Fire, Marine & Inland Ins. Co.*, 8 F.3d 953, 960 (3d Cir. 1993) (distinguishing between rehabilitation actions related to "a large number of similarly situated plaintiffs competing for a limited amount of money," wherein it is necessary for a single forum "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); *In re Matter of All-Star Ins. Corp.*, 484 F. Supp. 623, 624 (E.D. Wis. 1980) ("[A]n action by the liquidator to add to the res by collection of a debt owing to the insured is an in personam action and need not be brought in the court wherein the liquidation proceeding is pending.").

The rehabilitation itself, however, is not an adversarial "civil action" within the meaning of the removal statutes merely because the IRS is one of the hundreds or thousands of entities with a potential interest in the assets of the insurer. The rehabilitation is nothing more than an "in rem type of proceeding in which the court is made the custodian of moneys and determines adverse claims thereto[,]" *Fountain Park Coop., Inc. v. Bank of Am. Nat'l Trust & Sav. Ass'n*, 289 F. Supp. 150, 154 (C.D. Cal. 1968), as opposed to the types of adverse proceedings against federal agencies envisioned by the removal statutes. As the Seventh Circuit has noted:

> The appointment of a receiver and institution of liquidation proceedings in the Illinois court against [the insurer] constitutes an action *in rem*. The fact that the Illinois court does not have actual physical possession of all of [the insurer's] assets is of no

> consequence. The constructive possession by [the insurer's] liquidator is sufficient; his possession is the court's possession. *In rem* jurisdiction attached when the liquidation proceedings were commenced against [the insurer].

Blackhawk Heating & Plumbing Co. v. Geeslin, 530 F.2d 154, 158 (7th Cir. 1976) (internal citations omitted). Therefore, such statutes do not grant authority to treat the rehabilitation proceeding as a civil action against the IRS subject to removal to federal court. *See Sheda v. U.S. Dep't of the Treasury*, 196 F. Supp. 2d 743, 745 (N.D. Ill. 2002) (finding that removal under 28 U.S.C. § 1442(a) was improper in contested probate proceedings in which the federal government had an interest, even though—unlike here—a federal agency was a named defendant);[10] *In re 73rd Precinct Station House*, 329 F. Supp. 1175, 1178-79 (E.D.N.Y. 1971) (removal by United States in state condemnation action not permitted under 28 U.S.C. §§ 1441 and 1442 even though United States was owner of one of several parcels subject to condemnation).

To the extent the IRS argues that the "Notice, Motion and Order filed on November 8, 2010" constitute a separate civil action, that contention fails as well. First, the "Notice" was a notice of amendment to the Plan of Operation for the Segregated Account that merely noted the allocation of the contingent liability relating to past tax refunds to the Segregated Account pursuant to Wis. Stat. § 611.24(2) (*See* Van Sicklen Decl. Ex. N.) The notice itself had no legal effect and required no judicial approval; it was merely filing a copy of an amendment to a document executed by and between the Segregated Account and the General Account and approved by the Commissioner as regulator of the General Account. Section

[10] *Cf. In re Matter of All-Star Ins. Corp.*, 484 F. Supp. at 625 ("[L]ike probate matters, the area of liquidation of domestic insurance companies is an area of particular state concern[.]")

611.24(2) requires no judicial approval of the establishment of segregated accounts or allocations thereto; instead, it requires the Commissioner to approve such actions of the insurer so long as the Commissioner believes they are not contrary to law or the interests of any class of policyholders. Providing notice of an action taken under a law that requires no judicial approval is not the commencement of a "civil action."

Second, the November 8 Motion and Supplemental Injunction also did not constitute a civil action against the IRS. As the Supplemental Injunction makes clear, it merely continues the First-Day Injunction and supplements that order to ensure its applicability to the newly allocated contingent liabilities. (Van Sicklen Decl. Ex. R ("Supplemental Injunction") ¶¶ 1-2.) Had the potential IRS liability been known and allocated to the Segregated Account at the time the Rehabilitation Proceeding commenced, the First-Day Injunction would have had the same effect on the IRS as the Supplemental Injunction. Indeed, the First-Day Injunction *did* enjoin the IRS, at least to the extent that it had any interest in the policies, contracts, and liabilities allocated to the Segregated Account at that time. That a later-discovered potential liability was subsequently allocated to the Segregated Account without the requirement for judicial involvement does not transform an existing injunction that is clarified to apply to this recent allocation into a new "civil action."[11]

In short, the Supplemental Injunction cannot constitute a distinct civil action against the IRS any more than the First-Day Injunction constituted the commencement of civil

[11] In light of the First-Day Injunction, the Supplemental Injunction may well have been unnecessary. As noted in the Motion, the Commissioner sought it "to ensure" that the terms of the First-Day Injunction applied to the newly allocated contingent liabilities, noting that it was "intended to supplement, rather than replace" that First-Day Injunction. The Commissioner named the AFGI bondholders and the IRS specifically to allow those entities an opportunity to challenge the injunctive relief as applied to them.

actions against "all persons and entities," or the filing of the Rehabilitation Plan constituted the commencement of civil actions against all present and future Segregated Account claimants, known and unknown. Both are merely generalized, prophylactic injunctions to protect against "threatened or contemplated action that might lessen the value of the insurer's assets or prejudice the rights of policyholders, creditors or shareholders, or the administration of the proceeding." Wis. Stat. § 645.05(k).

In proceedings such as this one, "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 make the suit one "against" the United States and 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 has explained:

> The adverse claimants are parties to the respective proceedings in the state court and from every point of view the principles governing the convenient and orderly administration of justice require that the jurisdiction of the state court should be respected.
>
> 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 an 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"); *In re Amwest Sur. Ins. Co.*, 245 F. Supp. 2d at 1046-47 ("[T]he court first assuming jurisdiction over property may exercise that jurisdiction to the exclusion of other courts.") (quotation omitted).

In sum, the removal statutes do not encompass the removal of all or part of a comprehensive *in rem* proceeding for the orderly administration and distribution of property, or the removal of specific motions or orders that clarify and further those purposes. The fact that the United States *may* have an interest in the assets at issue—depending on the outcome of its (at this juncture) preliminary inquiry regarding the tax refund issue—is neither unusual nor cause for exception to this principle. The United States can identify no basis for asserting that its interests will be less protected in state court than the interests of any of the countless other persons and entities with a stake in the process and outcome of the Rehabilitation Proceeding.

II. THIS ACTION SHOULD BE REMANDED TO THE STATE REHABILITATION COURT.

A. The McCarran-Ferguson Act Deprives This Court Of Jurisdiction Over The Rehabilitation Proceeding.

Even if the statutory criteria for removal were met, this Court nevertheless lacks subject matter jurisdiction over this insurance rehabilitation proceeding. In the McCarran-Ferguson Act, Congress reverse-preempted any non-insurance federal statutes to the extent they interfere with state regulation of the business of insurance:

> (a) State regulation – The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

> (b) Federal regulation – 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, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance[.]

15 U.S.C. § 1012.

The Wisconsin legislature appears to have enacted Chapter 645 with the McCarran-Ferguson Act, 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"). *Cf. In re Liquidation of All-Star Ins. Corp.*, 110 Wis. 2d 72, 81, 327 N.W.2d 648, 652 (Ct. App. 1983) ("Ch. 645 was enacted in 1967 as the product of a comprehensive study and revision of the insurance laws and redesigned all aspects of insurance delinquency proceedings. It sets up a comprehensive framework for the complete, orderly and efficient liquidation of insolvent Wisconsin insurance companies in order to fairly distribute the unavoidable burden of delinquency.") (internal footnote omitted); Wis. Stat. Ann.

ch. 645, introductory cmt. to subch. III (noting that the grounds for rehabilitation and liquidation are "interchangeable").[12]

Here, Chapter 645 establishes the exclusive jurisdiction of the State Rehabilitation Court over matters directly pertaining to or incidental 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 state 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," "the 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, creditors or shareholders, or the administration of the proceeding." Wis. Stat. § 645.05.

In sum, Wisconsin law contemplates the exclusive jurisdiction of the State Rehabilitation Court in matters directly relating to the rehabilitation and the relief incidental to it, including injunctive relief to protect against "preferences, judgments, attachments, garnishments, or liens against the insurer or its assets," and the prosecution of actions in other fora to accomplish those ends. The only question is whether the statutes that might otherwise grant this Court subject matter jurisdiction over any disputes relating to the far-flung entities with an

[12] To the extent the IRS seeks to challenge the allocation of the contingent tax refund liability to the Segregated Account under Wis. Stat. § 611.24(2), that statute too concerns the business of insurance. Chapter 611 to is part of a "complete, self-contained procedure for the formation of insurance corporations," Wis. Stat. § 611.02(2), to "strengthen the protection accorded insureds in particular and the public in general," Wis. Stat. Ann. ch. 611 introductory cmt. Moreover, Section 611.24(3)(e) expressly provides for rehabilitating segregated accounts.

interest in this rehabilitation, 28 U.S.C. §§ 1331, 1332, 1340, & 1346, are reverse preempted such that this Court lacks subject-matter jurisdiction—a question that multiple district courts have answered in the affirmative. *See Hudson v. Supreme Enters., Inc.*, No. 2:06-cv-795, 2007 WL 2323380, at *6-*7 (S.D. Ohio Aug. 9, 2007); *In re Amwest Surety Ins. Co.*, 245 F. Supp. 2d 1038, 1044-45 (D. Neb. 2002); *Covington v. Sun Life of Canada (U.S.) Holdings, Inc.*, No. C-2-00-069, 2000 WL 33964592, at *9-*10 (S.D. Ohio May 17, 2000); *U.S. Fin. Corp. v. Warfield*, 839 F. Supp. 684, 688-90 (D. Ariz. 1993); *Corcoran v. Universal Reinsurance Corp.*, 713 F. Supp. 77, 81 (S.D.N.Y. 1989).

1. The Criteria For Reverse-Preemption Under The McCarran-Ferguson Act Are Satisfied Here

Under McCarran-Ferguson,

> a federal statute is reverse-preempted by a state statute or law 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) enforcing the federal statute would "invalidate, impair or supersede" the state statute.

In re Amwest, 245 F. Supp. 2d at 1043 (citing *Fabe*, 508 U.S. at 501, and *Munich Am. Reinsurance Co.*, 141 F.3d at 595). All three conditions exist here.

First, the federal subject-matter jurisdiction statutes "undoubtedly" do not specifically relate to the business of insurance, but rather apply to a broad range of claims. *Amwest*, 245 F. Supp. 2d at 1044. *See also Hudson*, 2007 WL 2323380, at *4.

Second, Chapter 645 plainly regulates the business of insurance. "The broad category of laws enacted 'for the purpose of regulating the business of insurance' consists of laws that possess the 'end, intention, or aim' of adjusting, managing, or controlling the business of insurance." *Fabe*, 508 U.S. at 505. Since *Fabe*, courts have consistently held that state rehabilitation and liquidation statutes regulate the business of insurance within the meaning of

the McCarran-Ferguson Act. *See id.* at 508-10; *Munich Am. Reinsurance Co.*, 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."); *Amwest*, 245 F. Supp. 2d at 1044-45; *Boozell v. United States*, 979 F. Supp. 670, 678 (N.D. Ill. 1997); *Warfield*, 839 F. Supp. at 688-89. *See also Eden Fin. Group, Inc. v. Fid. Bankers Life Ins. Co.*, 778 F. Supp. 278, 282 (E.D. Va. 1991) (pre-*Fabe* case noting that "rehabilitation proceedings necessarily are the business of insurance" because "[a] rehabilitation proceeding modifies and monitors the operation of an insurer consistent with the interests of policyholders"); *Corcoran*, 713 F. Supp. at 80-82.

Third, application of the federal statutes granting jurisdiction and removal here would impair and supersede the state statutes concerning rehabilitation and orders issued pursuant to those statutes. As noted above, Wisconsin delinquency proceedings are intended to be comprehensive, akin to bankruptcy proceedings (which insurers are expressly prohibited from filing under both federal, 11 U.S.C. § 109, and state law, Wis. Stat. § 645.035) for other entities, with the rehabilitator as trustee. *See* Wis. Stat. § 645.04(3), (4) (exclusive jurisdiction and venue of the rehabilitation court); Wis. Stat. § 645.32 ("An order to rehabilitate the business of a domestic insurer . . . shall appoint the commissioner and his or her successors in office rehabilitator and shall direct the rehabilitator to take possession of the assets of the insurer and to administer them under the orders of the court."); Wis. Stat. § 645.34(1) (establishing automatic stay of pending litigation involving delinquent insurer within the state and requiring the rehabilitator to seek stays of all litigation outside the state "whenever necessary to protect the estate of the insurer"); Wis. Stat. § 645.68 (establishing priorities for the equitable distribution of

assets). *See also Munich Am. Reinsurance Co.*, 141 F.3d at 593 ("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).

The need to preserve a single comprehensive proceeding here is vital. More than 20 entities have appeared and challenged one or more aspects of this proceeding, often on overlapping legal grounds and hundreds or thousands more have an interest in the Rehabilitation Proceeding. It would create chaos and eviscerate Chapter 645 to permit all objecting parties-in-interest who might otherwise have a basis for removal to run into federal court whenever they have a claim or issue that would otherwise be removable under federal statutes. This is not to say that discrete disputes that do not materially impact the rehabilitation as a whole will not arise between the Commissioner and one or more potential claimants, or that such disputes would automatically be inappropriate for resolution in another forum. Indeed, the Commissioner acknowledges that if the IRS review of the tax refunds leads to a conclusion by the IRS that those refunds were improper, the merits of that federal tax dispute should be litigated in a federal forum.

But the IRS's objections to the Supplemental Injunction are not among such independent disputes. The Commissioner assumes that the only substantive grounds that the IRS may raise in opposition to the Supplemental Injunction concern the propriety of allocation of contingent liabilities under Wis. Stat. § 611.24(2) and the propriety of enjoining otherwise lawful collection actions against the assets of the General Account. The State Rehabilitation Court has already rejected legal challenges regarding OCI's application of the Segregated Account statute, including a challenge to the allocation of a disputed contingent liability. (*See generally* Findings

& Conclusions; 7/16/10 Order; 10/26/10 Order.) It has also rejected legal challenges to injunctive relief that protects General Account assets from seizure or impairment on account of Segregated Account liabilities. (Findings & Conclusions at 14-17; 7/16/10 Order at 4-6; 10/26/10 Order at 7-19.) Such challenges are now on appeal. (Van Sicklen Decl. Exs. H, J & M.) A ruling from this Court (or the Seventh Circuit) regarding application of the same statutes and same relief while the appeals process in state court remains pending would only foster uncertainty and inefficiency, two outcomes that state delinquency proceedings seek to avoid. *See Davister Corp. v. United Republic Life Ins. Co.*, 152 F.3d 1277, 1281 (10th Cir. 1998) ("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."); *Hartford Cas. Ins. Co. v. Borg-Warner Corp.*, 913 F.2d 419, 426 (7th Cir. 1990) (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).

In addition, the only reasons for the injunction are to prevent actions that would interfere with the administration of the rehabilitation, cause avoidable harm to the assets available to pay claimants, and circumvent the priority structure of Wis. Stat. § 645.68. All of these reasons are expressly contemplated as grounds for injunctive relief under Wis. Stat. § 645.05. To grant the IRS relief from the injunction under *federal* law would necessarily impair

state statutes expressly authorizing the injunctive relief entered by the State Rehabilitation Court, with the resulting subversion of Wisconsin's priority statute by permitting the IRS to levy or otherwise claim against the $708 million in tax refunds outside the confines of a plan of 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. To grant the IRS relief from the injunction under *state* law, meanwhile, would implicate state legal issues of first impression relating to insurance statutes that have previously been decided by the State Rehabilitation Court in connection with challenges of other parties-in-interest and are presently winding their way through the state appellate system. Therefore, in this instance, the ultimate purpose of the IRS's removal and availment of federal jurisdictional statutes can be none other than to seek a result that would impair Wisconsin insurance law as construed and applied by the State Rehabilitation Court.

2. Precedent Supports The Reverse-Preemption of Removal Statutes Under These Circumstances

Numerous district courts have held that the McCarran-Ferguson Act reverse preempts removal of claims from state insurance delinquency proceedings. *See Hudson*, 2007 WL 2323380, at *7 ("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."); *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 invalids, 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").

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. The only arguable difference between the present removal and the removals at issue in the above-cited cases is that the removal here was attempted by a government agency rather than a private person or entity. This is a distinction without difference in the McCarran-Ferguson context, however. McCarran-Ferguson creates no special exceptions or exemptions whenever federal interests are implicated. Indeed, as proven by the Supreme Court's holding in *Fabe*, 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.[13] Neither McCarran-Ferguson nor Chapter 645 offer any reasonable justification for distinguishing between a removal by the IRS here and a future removal by any of the other non-resident or federally created entities with an interest in the rehabilitation. *Cf. Munich Am. Reinsurance Co.*, 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); *Boozell*, 979 F. Supp. at 678 (noting that the Seventh Circuit gives *Fabe* "a broad, rather than narrow reading, in applying the McCarran-Ferguson Act") (citing *Am. Deposit Corp. v. Schacht*, 84 F.3d 834, 837-44 (7th Cir. 1996)).

Finally, as the Seventh Circuit held in another case involving a Wisconsin state proceeding pertaining to the control of assets in which the federal government claimed an interest, the IRS "is in no position to claim that its interests . . . could not be preserved by a Wisconsin court." *$79,123.49 in U.S. Cash and Currency*, 830 F.2d at 99. *See also Davister Corp.*, 152 F.3d at 1282 (noting that the same remedies were available to a claimant in the state court overseeing delinquency proceedings, that the state court was capable of resolving any objections, and that a "federal court need not interfere in the process"). The State Rehabilitation Court has consistently maintained that all entities with an interest in the rehabilitation have an

[13] The priority issue in *Fabe* was litigated in federal court, but only because the Ohio Commissioner of Insurance brought a declaratory action there to resolve the issue. *Fabe*, 508 U.S. at 495-96. As subsequent Ohio cases show, the federal court likely would have found jurisdiction lacking and remanded the case to state court had the Commissioner initially brought it in state court as part of the delinquency proceeding. *See Hudson*, 2007 WL 2323380, at *7; *Covington*, 2000 WL 33964592, at *9-*10.

ongoing right to be heard on those interests and to apply for relief. If the IRS contends that the allocation or injunction are unlawful or unwarranted under the law, it has every right to follow the course that numerous other parties-in-interest have chosen: to file motions with the State Rehabilitation Court (which has the greatest familiarity with and control over this rehabilitation), to argue its position on the merits, and, if the result is unsatisfactory to the IRS, to appeal. The IRS does not and cannot contend that a Wisconsin court is ill-suited to construe Wisconsin state law pertaining to the allocation of this liability and the related injunction.

B. This Action Should Be Remanded Based On *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 itself 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.

> 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) (internal quotations omitted). 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.*

Teed v. JT Packard & Assocs., Inc., Case Nos. 08-cv-303-bbc, 09-cv-313-bbc, 2010 WL 446468, at *1 (W.D. Wis. Feb. 2, 2010); *see also New Orleans Pub. Ser., Inc. v. Council of City of New Orleans*, 491 U.S. 350, 361 (1989) (noting *Burford* factors); *Colo. River Water Conservation Dist. v. United States*, 424 U.S. 800, 814 (1976) (same).

Although abstention "remains the exception, not the rule," *Property & Casualty Insurance Ltd. v. Central National Insurance Co. of Omaha*, 936 F.2d 319, 321 (7th Cir. 1991) (internal quotations omitted), numerous federal courts have applied *Burford* abstention to the state regulation of insurance, including insurance company delinquency proceedings.

As this Court noted earlier this year,

> The Court of Appeals for the Seventh Circuit has applied the second type of *Burford* abstention in cases involving state insurance rehabilitation proceedings, noting that states have assumed primary responsibility for regulating the insurance industry. *E.g. Hartford* [*Casualty Insurance Co. v. Borg-Warner Corp.*], 913 F.3d [419,] 425-27 [7th Cir. 1990)] (finding *Burford* abstention appropriate where Illinois had implemented state-court rehabilitation proceeding that would resolve plaintiff's claims); *see also Mountain Funding, Inc. v. Frontier Insurance Co.*, 329 F. Supp. 2d 994, 999 (N.D. Ill. 2004) (abstention appropriate where insurance liquidation proceeding was adjudicating all claims against defendant in detailed and uniform manner).

Teed, 2010 WL 446468, at *1; see also *Feige v. Sechrest*, 90 F.3d 846, 847-51 (3d Cir. 1996); *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); *Sebelius v. Universe Life Ins. Co.*, No. 98-4114-RDR, 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).

Likewise, in *Metropolitan Life Insurance Co. v. Board of Directors of Wisconsin Insurance Security Fund*, 572 F. Supp. 460 (W.D. Wis. 1983), this Court 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 Wis. Stats. Chapters 645 and 646. *Id*. at 462, 469-73. In doing so, this Court noted:

> a decision by this court of the state claims could impede efforts to implement the state policy expressed in Wis. Stats. § 646.01(2)(a) and *the 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).[14]

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

In the Seventh Circuit, there are two essential elements of *Burford* abstention:

(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 & Casualty Insurance Ltd., 936 F.2d at 323; *Teed*, 2010 WL 446468, at *2.[15]

[14] These same considerations apply to Chapter 645 rehabilitation proceedings. *See* Wis. Stat. § 645.01(4) ("The purpose of this chapter is the protection of the interests of insureds, creditors, and the public generally . . . .").

Here, both 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. *See* Wis. Stat. § 645.05(3) (exclusiveness of proceedings); Wis. Stat. § 645.32(1) (requiring appointment of Commissioner as rehabilitator and ordering rehabilitator to take position of assets of the insurer and administer them under orders of the rehabilitation court); Wis. Stat. § 645.33(2) ("Subject to court approval, the rehabilitator [here, OCI] may take the action he or she deems necessary or expedient to reform or revitalize the insurer."). *See also* Wis. Stat. § 601.01(4) (Wisconsin insurance statutes enacted in part "[t]o provide for an office [OCI] that is expert in the field of insurance, and able to enforce chs. 600 to 655"). As evidenced by the over 650 filings by policyholders, trustees, policy beneficiaries and others, the state court rehabilitation proceeding is the forum in which claims related to the rehabilitation (*i.e.*, claims objecting to the scope of the rehabilitation court's injunctions; claims objecting to the allocation of specific policies to the

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[15] Some courts applying the *Burford* doctrine also have considered additional factors: whether the suit is based on a cause of action that is "exclusively" federal; and whether there are difficult or unusual state laws at issue. *See, e.g.*, *Hartford*, 913 F.2d at 425. Here, setting aside the fact that there is no "suit" against the IRS, the Commissioner's positions in the Rehabilitation Proceeding are based on state law. As courts have explained, *Burford* abstention turns "on whether the plaintiff's claim may be 'in any way entangled in a skein of state law that must be untangled before the federal case can proceed.'" *Sierra Club v. City of San Antonio*, 112 F.3d 789, 795 (5th Cir. 1997) (quoting *Quackenbush v. Allstate Ins. Co.*, 517 U.S. 706, 727 (1996), quoting *McNeese v. Bd. of Educ. For Cmty. Unit Sch. Dist.*, 373 U.S. 668, 674 (1963)). Moreover, as explained above, the Rehabilitation Proceeding raises a number of state law issues of first impression, some of which already are on appeal. Thus, these additional factors also support abstention.

In addition, *Quackenbush* limits the application of the *Burford* abstention remedies of remand or dismissal to cases "where the relief being sought is equitable or otherwise discretionary," as opposed to money damages. *Quackenbush*, 517 U.S. at 731. The relief being sought by the United States here is dissolution of the Supplemental Injunction (dkt. 10)—textbook "equitable or otherwise discretionary" relief.

Segregated Account; claims raising objections to OCI's proposed Plan of Rehabilitation; and once a plan is confirmed, plan implementation including the resumption of policy claims payments) are being litigated. Thus, unlike the facts in *Property & Casualty Insurance Ltd.*, 936 F.2d at 323, and *Teed*, 2010 WL 446468, at *2, 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, affecting hundreds of policies and thousands of interested entities, which the IRS's notice of removal has halted in its tracks. *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 closely monitored its decline, and having made the determination that significant regulatory action in the form of a rehabilitation of the Segregated Account was warranted, OCI is uniquely qualified to lead a rehabilitation of the scale and complexity as the one at issue here, which involves the adjustment of thousands of claims by policyholders and those who claim under them. *See Property & Casualty Insurance 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 not only adopted a comprehensive scheme to oversee the rehabilitation of troubled insurers, it has provided a particular court to oversee rehabilitation proceedings. By statute, all Wisconsin delinquency proceedings involving insurance companies must be commenced in Dane County Circuit Court or the circuit court for the county where the insurer is located. Wis. Stat. § 645.31. Because of the specialized and complex nature of such proceedings, the Chief Judge for the Fifth Judicial Administrative District has for the past 20 years assigned all such cases—including this one—to Circuit Judge William D. Johnston, who, as a result, has developed substantial, recognized judicial expertise in the field. (*See generally* Van Sicklen Decl. Ex. B.) Thus, the Circuit Court has "a special relationship of cooperation, technical oversight and concentrated review with the [Wisconsin] Commissioner of Insurance[.]" *Grimes v. Crown Life Ins. Co.*, 857 F.2d 699, 705 (10th Cir. 1988).

In sum, the elements for *Burford* abstention are satisfied.

2. The IRS's Desire To Jump Ahead Of Policyholders In Direct Violation Of The Priority Structure Of Wis. Stat. § 645.68 Supports *Burford* Abstention.

This case involves important federalism and policy considerations that support abstention. As the Seventh Circuit 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, 530 F.2d at 159-60 (emphasis added, internal citations omitted).

Furthermore,

> [a]s noted in *Hartford Casualty Insurance Co. v. Borg-Warner Corp.*, 913 F.2d at 426, the importance of state policies at issue go far beyond the present litigation. [The claimant] *should not be able to jump ahead of* [the insurer's] other creditors because this litigation is outside the New York rehabilitation proceeding and *must not be able to set a precedent for other claimants to do the same*. Additionally, both this Court and the New York rehabilitation proceeding are faced with the same surety bond dispute. The *possibility of inconsistent decisions between this Court and the New York rehabilitation proceeding could lead to confusion*. Furthermore, allowing this case to proceed would lead to a system where the state of New York would not control the ultimate distribution to [the insurer's] creditors. *Id. This type of federal usurpation would be inconsistent with the McCarran-Ferguson Act and general notions of comity*.

Mountain Funding, 329 F. Supp. 2d at 999 (emphasis added).[16]

The same considerations are present here. The IRS is seeking to circumvent Wisconsin state law priority statute—in direct violation of the McCarran-Ferguson Act—by

[16] *See also Davister Corp.*, 152 F.3d at 1281-82; *Munich Am. Reinsurance Co.*, 141 F.3d at 595 ("Congress has evinced a strong federal policy in favor of deferring to state regulation of insolvent insurance companies as reflected in the McCarran-Ferguson Act and the express exclusion of insurance companies from the federal Bankruptcy Code. These laws symbolize the public interest in having the States continue to serve their traditional role as the preeminent regulators of insurance in our federal system and indicates the special status of insurance in the realm of state sovereignty." (citation omitted)); *Eden Fin. Group, Inc.*, 778 F. Supp. at 283 (declining to exercise jurisdiction because "piecemeal litigation" with claimants would undermine "the salutary purposes of state insurance receiverships" by draining management time, potentially creating inconsistent decisions and outcomes, and "jeopardiz[ing] the Receiver's efforts to design and implement a viable rehabilitation plan for [the insurer] in a manner that is in the best interests of all parties concerned"); *Baldwin-United Corp. v. Garner*, 678 S.W.2d 754, 758 (Ark. 1984) ("If any meaning is to be given to the congressional exclusion of insurance companies from the Bankruptcy Act and the mandate of the McCarran-Ferguson Act, it must be that the determination of rights among an insurance company's creditors must be left to state proceedings.").

asserting that it is entitled to "jump ahead of" policyholders, with respect to the IRS's potential, and at this point purely conjectural, claim to the tax refunds at issue.[17]

Furthermore, in *Metropolitan Life*, this Court noted that a consideration in deciding abstention was 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" that led this Court to abstain under *Burford* (and *Colorado River*) in *Metropolitan Life* are present here.

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[17] A number of courts have considered McCarran-Ferguson as a factor weighing in favor of abstention in cases involving insurance delinquency proceedings. *See, e.g.*, *Davister Corp.*, 152 F.3d at 1281-82 (affirming order abstaining on McCarran-Ferguson grounds); *Mountain Funding*, 329 F. Supp. 2d at 999; *In re Med. Care Mgmt. Co.*, 361 B.R. 863, 878-79 (Bankr. M.D. Tenn. 2003) (lift of bankruptcy stay on comity grounds); *Eden Fin. Group, Inc.*, 778 F. Supp. at 283.

[18] Although this statement in *Metropolitan Life* was made in the context of this Court's discussion of *Colorado River* abstention, which is applied in exceptional circumstances where there are parallel federal and state proceedings, *see Metropolitan Life*, 572 F. Supp. at 469-72; *LaDuke v. Burlington N. R. Co.*, 879 F.2d 1556, 1558-62 (7th Cir. 1989) (discussing and applying *Colorado River* abstention), the statement itself is equally applicable to abstention under the *Burford* doctrine.

In sum, Wisconsin has a great interest in maintaining a uniform insurance rehabilitation process and, pursuant to the McCarran-Ferguson Act, has assumed primary responsibility for regulating the insurance industry. *Hartford*, 913 F.2d at 426. Because the Wisconsin rehabilitation process is a "matter of substantial public concern,"[19] and the exercise of federal review would be disruptive of state efforts to establish a coherent policy with respect to that process, the *Burford* doctrine requires abstention in this case. *See Mountain Funding*, 329 F. Supp. 2d at 997-99; *Metropolitan Life*, 572 F. Supp. at 473.

[19] *See Property & Casualty Insurance Ltd.*, 936 F.2d at 322; *All-Star Ins.*, 484 F. Supp. at 626 ("The regulation and liquidation of state domestic insurance companies is a matter of substantial public concern, . . . and Ch. 645, Wis. Stats., is a comprehensive state effort to deal with that area of state concern. . . . Thus, . . . the strong state interest in orderly liquidation dictates the exercise by the court of its discretionary abstention.") (citations omitted).

CONCLUSION

For the reasons stated above, this action should be dismissed for improper removal and lack of subject-matter jurisdiction, or this action should be remanded to the State Rehabilitation Court pursuant to the McCarran-Ferguson Act and/or the *Burford* abstention doctrine.

Dated this 17th day of December, 2010.

FOLEY & LARDNER LLP

/s/ Michael B. Van Sicklen
Michael B. Van Sicklen, SBN 1017827
Naikang Tsao, SBN 1036747
Matthew R. Lynch, SBN 1066370

150 East Gilman Street
Madison, WI 53703
(608) 257-5035 (phone)
(608) 258-4258 (fax)

Attorneys for the Wisconsin Commissioner of Insurance, as Court-Appointed Rehabilitator of the Segregated Account of Ambac Assurance Corporation