IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ALABAMA
SOUTHERN DIVISION

In Re:	)	
	)	
JEFFERSON COUNTY, ALABAMA,	)	
a political subdivision of the State of Alabama,	)	Case No. 11-05736-TBB
	)	
Debtor	)	Chapter 9
	)	

REPLY MEMORANDUM IN SUPPORT OF MOTION REQUESTING ALLOWANCE OF ADMINISTRATIVE CLAIMS OF NORFOLK SOUTHERN RAILWAY COMPANY

COMES NOW Norfolk Southern Railway Company, an administrative creditor and party in interest (hereinafter "Norfolk Southern"), and, in support of its Motion Requesting Allowance Of Administrative Claims (Doc. No. 2343) ("Motion") and in reply to the Response of Jefferson County (Doc. No. 2873) ("Response") respectfully shows to the Court as follows:

The County in its Response argues only that Norfolk Southern has not "sustained its burden of proof that its purported claim against the County arose postpetition" and that the decision in *Reading Company v. Brown* should not be applied in Chapter 9 cases. By negative implication, Jefferson County concedes that if the Norfolk Southern claims for refund of taxes paid postpetition are postpetition claims and if *Reading Company v. Brown* does apply in Chapter 9, the claims of Norfolk Southern are administrative expense claims.

I. **The refund claims of Norfolk Southern are postpetition claims.**

To deal with the County's argument that refund claims for taxes collected by the County postpetition on postpetition sales and use transactions are somehow prepetition claims, a considerable running start is required. The starting point is the recognition that the transactions involved here do not begin with contract breaches or torts or undiscovered product defects but with direct involuntary extractions of private property by taxing fiat of a subdivision of the sovereign, the State of Alabama, occurring postpetition. Inherent in that involuntary taxing fiat is the sovereign's self-limitation in the form of the Alabama Taxpayers' Bill of Rights, which recognizes the taxpayer's entitlement to a refund for "any overpayment of tax or other amount erroneously paid." Ala. Code § 40-2A-7 (1975). At the risk of stating the obvious, there is no entitlement to a refund unless and until an overpayment of tax is made, and the characterization of the payment as excessive or in error cannot be made until the time of payment.

The County attempts to rely on the *Piper* test applied in products liability cases: "[A]n individual has a § 101(5) claim against a debtor manufacturer if (i) events occurring before confirmation create a relationship, such as contact, exposure, impact, or privity, between the claimant and the debtor's product; and (ii) the basis for liability is the debtor's prepetition conduct in designing, manufacturing and selling the allegedly defective or dangerous product." *Epstein v. Official Comm. of Unsecured Creditors of Estate of Piper Aircraft Corp., 5*8 F.3d 1573, 1577 (11th Cir. 1995). Norfolk Southern has no disagreement with that principle as applied in *Piper* and its products liability case progeny. The point of distinction is that this is not a products liability case and that the "basis for liability" here is the acceptance of tax payments postpetition. The County has no refund liability until it accepts the tax payments, which is the governmental act giving rise to governmental refund liability rather than the "accrual of damages" from a prepetition tort.

The County's theory is in part that the issue of the legality of the collection of the *type* of taxes at issue here was variously raised elsewhere prepetition by others, with others,[1] and that the County's postpetition collection of sales and use taxes to which it is not entitled should be considered postpetition damages accruing as a result of the County's prepetition misconduct in enacting an illegal tax measure. It is certainly the case that based on the Eleventh Circuit's last ruling, each act of tax collection by the County in reliance on the basis of an invalid state statute was wrongful and gave rise to an entitlement to refund under Alabama law, and the County, in its Response, "assumes that the Claimant is entitled to a tax refund pursuant to state and federal law." The

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[1] The history of the dispute over the collection by the State itself of the type of taxes at issue here is long and meandering. In 2008, Norfolk Southern sued the State of Alabama, seeking to enjoin it from imposing sales and use tax on diesel fuel used by the railroad as a discriminatory violation of the Railroad Revitalization and Regulatory Reform Act of 1976 (the "4–R Act"). The Eleventh Circuit ultimately held that Norfolk Southern could not succeed on its claims because "[*Dep't of Revenue v. ACF Indus., Inc.*, 510 U.S. 332, 335, 114 S.Ct. 843, 127 L.Ed.2d 165 (1994)] controls our analysis, and dictates that the Alabama tax statute at issue, with its exemptions for motor and water carriers, does not offend the 4–R Act so long as the tax is generally applicable and does not target railroads within Alabama." *Norfolk Southern Ry. Co. v. Alabama Department of Revenue*, 550 F. 3d 1306, 1314 (11th Cir. 2008). A subsequent action against the State on essentially the same theory was brought by CSX Transportation, and was summarily rejected by the District and Appeals Courts based on the *Norfolk Southern* opinion. The Supreme Court, however, granted certiorari in the CSX case, abrogated the *Norfolk Southern* result as based on a misinterpretation of the *ACF Industries* decision, and remanded the CSX case for further proceedings on the merits. *CSX Transp., Inc. v. Alabama Dept. of Revenue*, 131 S.Ct. 1101 (February 22, 2011). After the District Court on remand ruled that the tax was not discriminatory in violation of the 4-R Act, the Eleventh Circuit reversed that ruling in a July 1, 2013 decision, holding that the tax was discriminatory in violation of the 4-R Act, and the Supreme Court has granted certiorari to review that opinion. At no time has Norfolk Southern (or, so far as is known, any other railroad) been engaged in litigation with Jefferson County over its separate levy and enforcement of parallel county taxes under Jefferson County Ordinance No. 1769 and Ala. Act No. 405 (1967).

relevant point, however, is that each illegal act of collection is a separate postpetition act giving rise to liability. Trying to analogize a defective law to a defective product and to argue that every postpetition enforcement of an invalid prepetition law is merely a matter of damages and not a separate act of postpetition misconduct simply does not work, even invoking *Epstein*. Under the *Epstein/Piper* formula for identification of a prepetition claim, there must be a pre-confirmation relationship between the claimant "and the debtor's product" and a basis of liability founded on "debtor's *prepetition conduct*" in "designing, manufacturing, *and* selling" the product. *Epstein/Piper* requires that the debtor's culpable conduct must have been entirely prepetition for the claim to be treated as prepetition. The culpable conduct by the County at issue here was postpetition.

> "Under [*Epstein v. Official Committee of Unsecured Creditors (In re Piper Aircraft Corp.)*, 58 F.3d 1573, 1576–1577 (11th Cir.1995)], *a contingent claim arises upon occurrence of the conduct giving rise to the claim*, even if the injury itself occurs later. *Id.*, citing *Grady v. A.H. Robins Co., Inc.*, 839 F.2d 198, 200–201 (4th Cir.1988)."

In re CD Realty Partners, 205 B.R. 651, 656 (Bankr. D. Mass. 1997)(emphasis supplied).

The "*Piper* test" cases described by the County at pages 4-5 of the Response are all prepetition tortious misconduct or vested prepetition contract right cases, with the exception of *In re Krause, Inc.*, 2005 WL 6487214 (Bankr. N.D. Ga. 2005), which the County inaccurately summarizes with "creditor had prepetition claim against debtor arising from prepetition and postpetition purchase of defective ladders even if damages may have been incurred postpetition." In actuality *Krause* is expressly a dictum discussion of various possible setoff and recoupment issues that accompanies a denial of summary judgment required by the failure of the parties to establish the actual facts as to prepetition and postpetition transactions.

> Krause contends in its brief that there is no dispute that the ladders giving rise to Home Depot's claims were manufactured and sold by Krause to Home Depot prepetition. *Plaintiff's Response to Defendant's Motion for Summary Judgment*, p. 24 ("[A]ny claims that the Defendant has for breach of an implied warranty of merchantability arise solely prepetition."). Home Depot's brief neither disputes nor admits this contention. At oral argument, Krause's counsel again asserted that the ladders involved in injuries were sold to Home Depot prepetition. Home Depot's counsel asserted that it purchased allegedly defective ladders postpetition as well as prepetition.
> . . . [N]either party has shown that there is no dispute as to when allegedly defective ladders were sold to Home Depot. For this reason alone, the motion must be denied. The Court will nonetheless discuss the legal issues presented with some factual assumptions in the hope that this discussion may facilitate the resolution of this dispute.

Consistent with *Epstein*, the *Krause* Court theorized that, assuming a course of dealing that began prepetition and ended postpetition, the rights of Home Depot as purchaser of defective ladders would vary based on the date of sale of each ladder:

> [Home Depot] and Krause had a relationship prior to Krause's bankruptcy during which it purchased from Krause defective ladders manufactured by Krause. To the extent that damages suffered by Home Depot are attributable to such ladders, even if those damages were incurred after Krause filed bankruptcy, the *Piper* test is met.
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> . . . .
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> [I]n its answer to the amended complaint, Home Depot asserts it has postpetition claims for breach of the implied warranty of merchantability, a statutory state law cause of action, *citing* Ga.Code Ann. § 11–2–314. *McDonald v. Mazda Motors of Americas, Inc.*, 269 Ga.App. 67, 68, 603 S.E.2d 456 (Ga.App.2001). Any claim that Home Depot holds for breach of an implied warranty of merchantability arose at the time of sale. *McDonald v. Mazda Motors of Americas, Inc.*, 269 Ga.App. 67, 68, 603 S.E.2d 456 (Ga.App.2001). The same analysis set forth above with respect to state law indemnity rights applies to any claim that Home Depot has for breach of an implied warranty of merchantability imposed by state law. Because there is no evidence in the record to show when the ladders giving rise to Home

> Depot's breach of warranty claims were shipped, summary judgment on this breach of implied warranty has to be denied.

Wholly apart from trying to paste a prepetition label on the refund claim, the County chooses to ignore that it is a subdivision of the State, has only the taxing authority granted it by the State, and is subject to the taxation power limitations imposed on it by the State, including the obligation to make refunds of taxes not owed. As the District Court has observed in this case, "'[t]he bankruptcy of a public entity,' such as the County, 'is different from that of a private person or concern. Unlike any other chapter of the Bankruptcy Code, Chapter 9 places federal law in juxtaposition to the rights of states to create and govern their own subdivisions.'" Memorandum Opinion, *Bennett, et.al v. Jefferson County*, 2:14-CV-0213-SLB (09/30/14) at 38. No Chapter 9 plan can absolve the County of its obligations under state law to refund taxes wrongfully collected under state law because in Chapter 9 a political subdivision of a State cannot escape the requirements of the state law which governs that subdivision in the exercise of the governmental power of taxation. "This chapter [9] does not limit or impair the power of a State to control, by legislation or otherwise, a municipality of or in such State in the exercise of the political or governmental powers of such municipality, including expenditures for such exercise . . ." 11 U.S.C. § 903.

> Counties, being political subdivisions of the state, have no inherent power of taxation but have only such taxing power as the Legislature delegates to them. " '[U]pon them, in the absence of special constitutional restriction, the general assembly may confer the taxing power in such measure as it deems expedient,--"in other words, with such limitations as it sees fit as to the rate of taxation, the public purposes for which it is authorized, and the objects (the persons and property) which shall be subjected to taxation." ' " Frazier v. State Tax Comm'n, 234 Ala. 353, 355, 175 So. 402, 403 (1937)

> (quoting earlier authorities). Although Frazier addressed a municipality's power to tax, the principles stated in Frazier are equally applicable to a county.

Jefferson County v. Richards, 805 So.2d 690, 706 (Ala. 2001). The Alabama Taxpayers' Bill of Rights governs all counties in Alabama that levy a county sales or use tax. *General Motors Acceptance Corporation v. City of Red Bay,* 894 So. 2d 650, 653 (2004). ("[T]he Local Tax Simplification Act of 1998, Act No. 98-192, Ala. Acts 1988 ('the LTSA'), made the TBOR equally applicable to tax assessments and tax-collection procedures by local taxing authorities such as the City and the County."). If the County contends that the intervention of a confirmed Chapter 9 plan in this case would free it from strict compliance with the tax refund obligations imposed on it by the State of Alabama in the Alabama Taxpayers' Bill of Rights, it is contending that the Chapter 9 plan both violates §903 and exceeds the constitutional power of the federal courts under the Tenth Amendment. The only way to avoid that outcome here is for the County to concede that any claim for the refund of taxes paid postpetition is to be accorded the status of an administrative expense claim to be paid in full as allowed as provided by the Alabama Taxpayers' Bill of Rights.

> Section 903 of the Bankruptcy Code is the 'constitutional mooring' for municipal debt readjustment and makes clear that nothing in chapter 9 should be interpreted to limit a State's power to control its municipalities. Section 903 also indicates that with regards to debt readjustment of municipal entities, chapter 9 preempts any coordinate state law. 6 Collier on Bankruptcy ¶ 903.01. As nothing in chapter 9 may be interpreted to interfere with the power of a State to control its municipalities, it necessarily follows that debtors under chapter 9 must follow state laws, at least those that are not preempted by federal law.

In re New York City Off-Track Betting Corp., 434 B.R. 131, 144 (Bankr. S.D.N.Y. 2010).

II. ***Reading Company v. Brown*** **and general administrative expense principles apply in Chapter 9.**

The County does not question the validity of the proposition that the Bankruptcy Act case of *Reading Company v. Brown* survived the adoption of the Bankruptcy Code and governs the interpretation of §503 with respect to the meaning of a "nonlisted administrative expense under 503(b) in general." The County's contention is that the principles of *Reading Company* for some reason do not apply in a Chapter 9 case. The County first offers the sweeping conclusion that no "administrative claim may be allowed for anything other than the 'actual necessary costs and expenses of preserving the estate' or in a case where there is no estate." (Response at 8.) It then retreats to the wholly inconsistent and unsupported conclusion that "administrative expenses under Section 503 in chapter 9 are limited to expenses incurred in connection with the chapter 9 case itself, such as professional fees and expenses and creditor costs otherwise allowable under section 503(b)(1)(A)." (*Id*.) There is no estate in a Chapter 9 case, so that the County cannot intelligently explain how any creditor costs in a Chapter 9 case would be allowable under §503(b)(1)(A) which is expressly limited to the cost of "preserving the estate." The truly mysterious concept is the County's unexplained phrase "incurred in connection with the chapter 9 itself."

Section 503(b)(3)(D), (4), and (5) all make specific reference to allowing administrative expenses in a Chapter 9 case, so that the County's argument that there are to be no administrative fees "in a case where there is no estate" is untenable on its face.

Moreover, the County's Plan specifically recognizes the entitlement of a seller of goods to the County in the 20 day prepetition period to administrative expense treatment under §503(b)(9) notwithstanding the absence of any Chapter 9 "estate" that would have been benefitted by the transaction. (Plan §2.2). The critical explanation that the County cannot provide is how parties providing postpetition goods, services, and value in good faith to a Chapter 9 debtor could, in *Reading's* required "fairness," be denied payment characterized as an administrative expense. Consider this hypothetical: an office supply company that had never done business with the County prepetition sells it a crate of pencils on open account after the general claims bar date and before plan confirmation. The County subsequently decides that it has no money in its budget to cover the purchase and simply does not pay. Under the County's proffered analysis, the supply company has no recourse. The County says the seller has no administrative expense claim because it has not helped preserve an estate that does not exist and because it is not the County's lawyer or accountant. The County says that a vendor that sold the County a comparable crate of pencils in the 20 day prepetition period does have an administrative expense claim under §503(b)(9) and gets paid in full but the seller who provides goods to the insolvent County during the pendency of the case is simply out of luck "as a matter of law and policy," *Reading* notwithstanding. The County's "law and policy" analysis would also be the death knell for any homeowner who accidentally overpaid the ad valorem tax on his or her home after the petition date and before the confirmation date and sought a refund, since the inadvertent overpayment would not have helped preserve an estate that does not exist and because the homeowner is not the County's lawyer or accountant.

The County contends that *Reading* does not support administrative expense treatment for "postpetition[2] costs and expenses where no estate exists." The County is wrong. Under *Reading*, people who deal postpetition with an insolvent Chapter 9 debtor are entitled to administrative treatment for their postpetition claims. *Reading* concludes that "costs that form 'an integral and essential element of the continuation of the business' are necessary expenses even though priority is not necessary to the continuation of the business." The cost of refunding taxes improperly collected are such necessary expenses incurred in the continuation of the business of government, just as the cost of paying for the purchase of ordinary goods and services consumed in the course of such continuation are such necessary expenses.

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[2] In a curious elliptical side note, the County suggests that Norfolk Southern "assumes, without any justification or citation, that administrative expense claims in a Chapter 9 case are based on the filing date as opposed to the date of the order for relief. See 11 U.S.C. § 921." The County, apparently in an effort to avoid wasting the Court's time, "does not address further these fact issues." (Response at 6). It may be debatable in the abstract whether a "nonlisted administrative expense under 503(b) in general" in a Chapter 9 case should be defined by the petition filing date, on which the case "is commenced" (§301(a)), or by the date of the order for relief, given the peculiarity that a Chapter 9 petition does not itself constitute an order for relief as do all other voluntary petitions. It is possibly instructive that the only trigger language in the §503(b) illustrative categories is tied to "commencement of the case." (§503(b)(1)(A)(i) and(ii); (B)(ii); (9).) The debate is not required here, however, since the County itself defined administrative expense claims with reference to the petition date in its Plan.

> 9. "Allowed" or "Allowed ______________ Claim" means:
> (a) with respect to a Claim arising prior to the Petition Date (including a 503(b)(9) Claim):
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> (i) either (A) a proof of Claim was timely Filed by the applicable Claims Bar Date, or (B) a proof of Claim is deemed timely Filed either as a result of such Claim being listed on the List of Creditors or by a Final Order; and
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> (ii) either (A) the Claim is not a Contingent Claim, a Disputed Claim, an Unliquidated Claim, or a Disallowed Claim; or (B) the Claim is expressly allowed by a Final Order or under the Plan;
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> (b) with respect to a Claim arising on or after the Petition Date (excluding a 503(b)(9) Claim), a Claim that has been allowed pursuant to Section 2.2(a) of the Plan.

The Norfolk Southern Motion was timely and properly filed as specified in Section 2.2(a) of the Plan, and the allowance of the refund requests would in all respects be a proper allowance of administrative expenses.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have served the above and foregoing motion by means of the Bankruptcy Court's CM/ECF system and by delivery by First Class Mail, postage prepaid to J. Patrick Darby, Jay R. Bender, Jennifer H. Henderson, One Federal Place, 1819 Fifth Avenue North, Birmingham, Alabama 35203, attorneys for the debtor, Jefferson County, Alabama, this 14th day of October, 2014.

/s/ Donald J. Stewart
Of Counsel