**IN THE UNITED STATES BANKRUPTCY COURT**
**FOR THE SOUTHERN DISTRICT OF TEXAS**
**CORPUS CHRISTI DIVISION**

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| **In re:** | § | **Case No. 05-21207** |
| | § | |
| **ASARCO LLC, *et al.*,** | § | **Chapter 11** |
| | § | |
| **Debtors** | § | **Jointly Administered** |
| | § | |
| | § | |
| **ASARCO LLC,** | § | |
| | § | |
| **Plaintiff,** | § | |
| | § | |
| **v.** | § | **Adversary No. 07-02011** |
| | § | |
| **AMERICAS MINING CORPORATION, *et al.*,** | § | |
| | § | |
| | § | |
| **Defendants.** | § | |
| | § | |

**DEBTOR'S PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW IN CONSOLIDATED ADVERSARY PROCEEDING NO. 07-02011**


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# I. INTRODUCTION

1. The Court has considered Administrative Claim No. 18571, as amended by Administrative Claim No. 19214 (collectively, the "Claim"), filed by Americas Mining Corporation ("AMC") and ASARCO Incorporated, a Delaware corporation ("New Asarco," and together with AMC, "Parent"), and all responses, objections, and briefing related to the Claim. In addition, the Court has considered the claim of ASARCO LLC ("Debtor") for a declaratory judgment of Debtor's ownership of a tax refund (the "Refund"), as well as all responses, objections, and briefing related to ownership of the Refund.

2. Through the Claim, Parent seeks to recover $161,718,015 from Debtor's estate. Parent claims that this is the total amount of its post-petition federal and state income tax liability attributable to Debtor's assets and operations for the tax years 2005 through 2008, and that Debtor owes this amount to Parent under a tax sharing agreement. Debtor objects to the allowance, amount, and priority of the Claim.

3. Debtor seeks a declaratory judgment of its ownership of the Refund, which is currently worth more than $60,000,000. The Refund resulted from overpayment of federal income taxes in the late 1980s by ASARCO Incorporated, a New Jersey corporation ("Asarco NJ"), the predecessor of Debtor. Debtor asks the Court to declare that the Refund is property of the bankruptcy estate, with the exception of $51,321 to which CAPCO Pipe Company, Inc. ("CAPCO") is entitled. Parent disputes Debtor's ownership of the Refund. In addition, Enthone, Inc., EI Liquidation, Inc., and OMI International Corporation (collectively, the "Enthone Entities") object to payment of the Refund to either Debtor or Parent before the Refund becomes final.

4. On December 21, 2007, the parties filed motions for summary judgment related to ownership the Refund. The Court heard argument on the summary judgment motions on

January 31, 2008. The parties filed additional, post-hearing briefing related to ownership of the Refund through August 2008.

5. On June 15, 2009, the Court heard argument from Debtor and Parent regarding the bankruptcy and tax law applicable to the Claim. On July 24, 2009, the Court heard opening statements and Debtor's witnesses related to the Claim. On August 4, 2009, the Court heard Parent's witnesses and closing arguments related to the Claim. Debtor, Parent, and all other interested parties attended the hearings and had an opportunity to be heard by the Court.

6. As detailed below, based upon the record before the Court, the Court finds and concludes that:

- Debtor owns the Refund, with the exception of $51,321 to which CAPCO is entitled;
- the Enthone Entities must designate Covington Land Company as substitute agent so that Debtor may receive the Refund from the Internal Revenue Service ("IRS");
- Parent is entitled to no recovery on the Claim;
- New Asarco's claim is disallowed under section 502(b)(1) of the Bankruptcy Code because New Asarco has no right to payment from Debtor;
- AMC's claim is disallowed under section 502(d) of the Bankruptcy Code due to AMC's failure to satisfy the April 15, 2009 Final Judgment of the United States District Court for the Southern District of Texas (the "District Court"), which ordered AMC to return shares of Southern Copper Corporation to Debtor and to pay Debtor money damages of approximately $1.38 billion (the "SCC Final Judgment");
- if AMC satisfies the SCC Final Judgment or the Judgment is reversed on appeal, AMC may move for reconsideration under section 502(j) of the Bankruptcy Code, in accordance with the findings of fact and conclusions of law set forth in this opinion;
- even if the Claim were not disallowed, the allowable amount of the Claim would be, at most, $9,221,731;

- even if the Claim were not disallowed, it would be a general unsecured claim, not an administrative claim; and
- even if the Claim were not disallowed, Debtor would be entitled to set off AMC's claim against the monetary portion of the SCC Final Judgment, subject to the Court's reconsideration if the Judgment were reversed on appeal.

## II. FINDINGS OF FACT

### A. Ownership of the Refund

#### 1. Asarco NJ Consolidated Group Prior to Acquisition by Grupo Mexico

7. Asarco NJ was the common parent of an affiliated group of corporations consisting of Asarco NJ and its subsidiaries (the "Asarco NJ Consolidated Group") that filed consolidated federal income tax returns on a calendar year basis for the taxable years 1987, 1988, 1989, 1994, 1995, 1998, and 1999.[1]

8. Each of CAPCO; Cement Asbestos Product Company; Lac d'Amiante du Quebec Ltee; Lake Asbestos of Quebec, Ltd.; LAQ Canada, Ltd.; Enthone, Inc.; EI Liquidation, Inc.; and OMI International Corporation (collectively, the "Subsidiary Defendants") was a member of the Asarco NJ Consolidated Group for at least one of the taxable years 1987, 1988, or 1989.[2]

9. Asarco NJ paid all federal income taxes reported on the consolidated federal income tax returns filed by the Asarco NJ Consolidated Group for the taxable years 1987 through 1989.[3]

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[1] Plaintiff ASARCO LLC's Motion for Summary Judgment ("Debtor's MSJ") (Dkt. No. 67), Ex. A1 at 349 (1987 Tax Return); Debtor's MSJ, Ex. A2 at 682 (1988 Tax Return); Debtor's MSJ, Ex. A3 at 978 (1989 Tax Return); Debtor's MSJ, Ex. A4 at 125 and 129 (1987 Amended Tax Return); Debtor's MSJ, Ex. A5 at 185 (1988 Amended Tax Return); Debtor's MSJ, Ex. A6 at 268 (1989 Amended Tax Return).

[2] Debtor's MSJ, Ex. A1 at 369 (1987 Tax Return); Debtor's MSJ, Ex. A2 at 700–01 (1988 Tax Return); Debtor's MSJ, Ex. A3 at 998 (1989 Tax Return).

[3] Debtor's MSJ, Ex. A1 at 570 (1987 Tax Return); Debtor's MSJ, Ex. A2 at 964 (1988 Tax Return); Debtor's MSJ, Ex. A3 at 993 (1989 Tax Return).

**2. Grupo Mexico Acquisition of Asarco NJ and Formation of the AMC Consolidated Group**

10. In November 1999, Grupo Mexico S.A. de C.V., a Mexican corporation ("Grupo Mexico"), acquired all of the outstanding common stock of Asarco NJ.[4]

11. In November 2000, Grupo Mexico formed AMC as a wholly owned subsidiary of Grupo Mexico.[5]

12. At that time, Grupo Mexico transferred all of the outstanding common stock of Asarco NJ to AMC.[6]

13. Since November 2000, AMC has filed consolidated federal income tax returns on behalf of the affiliated group of corporations consisting of AMC and its subsidiaries (the "AMC Consolidated Group").[7]

**3. Refund Claim and Partial Allowance**

14. In May 2003, Asarco NJ, acting as agent on behalf of the Asarco NJ Consolidated Group, filed a claim for refund (the "Refund Claim") with the IRS based on the carryback of specified liability losses from the taxable years 1994 and 1995 to the taxable year 1987, from the taxable year 1998 to the taxable year 1988, and from the taxable year 1999 to the taxable year 1989.[8]

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[4] Debtor's MSJ, Ex. B ¶ 3 (Declaration of Douglas E. McAllister); *ASARCO LLC v. Americas Mining Corp.*, 396 B.R. 278, 300–01 (S.D. Tex. 2008).

[5] Debtor's MSJ, Ex. B ¶ 3 (Declaration of Douglas E. McAllister).

[6] Debtor's MSJ, Ex. B ¶ 3 (Declaration of Douglas E. McAllister).

[7] *See, e.g.*, Parent's Exhibit ("PX") 3 (AMC-TAX-5923–6122) (2003 Federal Income Tax Return of AMC and Consolidated Subsidiaries) (Dkt. No. 241).

[8] Debtor's MSJ, Ex. A4 at 119–23 (1987 Amended Tax Return); Debtor's MSJ, Ex. A5 at 181–83 (1988 Amended Tax Return); Debtor's MSJ, Ex. A6 at 264–66 (1989 Amended Tax Return).

15. All of the carryback years relating to the Refund Claim, and all of the years in which the specified liability losses that are the subject of the Refund Claim were incurred, pre-date AMC's acquisition of Asarco NJ.[9]

16. Parent paid no portion of the federal income taxes, and incurred none of the specified liability losses, that formed the basis of the Refund Claim.[10]

17. On January 27, 2006, the IRS issued a Notice of Partial Allowance and Partial Disallowance of the Refund Claim. The amounts of the Refund Claim allowed by the IRS are $1,750,684 for the taxable year 1987, $21,336,162 for the taxable year 1988, and $17,392,575 for the taxable year 1989, for a total amount of $40,479,421, plus statutory interest thereon.[11]

**B. Parent's Claim for Reimbursement**

**1. Fraudulent Transfer and the Deferred Intercompany Gain**

18. As early as March 14, 2003, Grupo Mexico and AMC began considering the possibility of a bankruptcy filing by Asarco NJ.[12]

19. On March 31, 2003, AMC caused Southern Peru Holdings Corporation ("SPHC"), a wholly owned subsidiary of Asarco NJ, to sell its shares of Southern Peru Copper Corporation (the "SPCC Shares") to AMC.[13]

20. SPHC realized a taxable gain of approximately $600 million (the "Deferred Intercompany Gain," or "DIG") on the sale.[14]

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[9] Debtor's MSJ, Ex. B ¶ 3 (Declaration of Douglas E. McAllister).

[10] As noted, AMC and New Asarco did not exist either at the time the tax payments were made or at the time the losses were incurred.

[11] Debtor's MSJ, Ex. A7 (Partial Allowance).

[12] Debtor's Exhibit ("DX") 9 (DT-AA 003667–3671) (memorandum regarding "ASARCO–U.S. Tax Issues") (Dkt. No. 240).

[13] 8/4 Tr. (Smith) at 14:16 – 15:7; Valdes Dep. at 11:22 – 12:12; *ASARCO*, 396 B.R. at 313.

[14] DX28 (DT 022053–22072) (memorandum regarding "Possible Restructuring of Asarco"); 8/4 Tr. (Smith) at 15:8–10; Valdes Dep. at 12:13–17, 13:1–5, 14:24 – 15:3.

21. Because Asarco NJ and its subsidiaries were members of the AMC Consolidated Group, the DIG was a deferred intercompany gain under applicable Treasury Regulations.[15]

22. For federal income tax purposes, the DIG was not includable in the AMC Consolidated Group's taxable income unless and until (1) the SPCC Shares were sold to an entity outside the AMC Consolidated Group, (2) Asarco NJ or SPHC ceased to be a member of the AMC Consolidated Group, or (3) the AMC Consolidated Group terminated.[16] In short, AMC successfully removed the SPCC Shares from Asarco NJ without having to pay any taxes on the transaction, unless one of the foregoing events were to occur.

**2. Execution of the Original Tax Sharing Agreement**

23. Effective January 22, 2004, AMC and Asarco NJ entered into a tax sharing agreement (the "Original TSA").[17]

**3. Planning and Execution of the 2005 Restructuring**

24. By early 2005, it appeared that a bankruptcy filing for Asarco NJ was inevitable.[18]

25. AMC realized that the AMC Consolidated Group would have to include the DIG in its taxable income if AMC ceased to own 80% or more of Asarco NJ during a bankruptcy proceeding.[19]

26. AMC also understood that, as a member of the AMC Consolidated Group, it would be severally liable for tax on the DIG, and, given that AMC was the parent of the AMC

[15] Treas. Reg. § 1.1502-13; DX28; 8/4 Tr. (Smith) at 15:15 – 17:3; Valdes Dep. at 15:4–16.

[16] DX28; Smith Dep. at 51:7–20.

[17] DX17 (ASA00015544–15550) (Tax Sharing Agreement by and between Americas Mining Corporation and ASARCO Incorporated).

[18] Keegan Proffer ¶ 2.

[19] DX28; DX9; 8/4 Tr. (Smith) at 17:8–12; Valdes Dep. at 16:6–10, 17:1 – 18:1, 27:16 – 29:4.

Consolidated Group and Asarco NJ was strapped for cash, AMC most likely would be required to pay such tax.[20]

27. To avoid having to include the DIG in the AMC Consolidated Group's taxable income in the event that AMC ceased to own 80% or more of Asarco NJ during a bankruptcy proceeding, AMC caused a three-step restructuring of Asarco NJ in early 2005.[21]

28. On February 4, 2005, AMC formed New Asarco as a wholly owned subsidiary.[22] New Asarco, in turn, formed Debtor, a single-member limited liability company.[23] Debtor is disregarded as a separate taxable entity for federal income tax purposes.[24]

29. On February 17, 2005, AMC caused Asarco NJ to merge with and into Debtor, with Debtor as the surviving entity.[25]

30. Finally, on March 3, 2005, AMC caused Debtor to form Southern Peru Holdings, LLC ("SPH LLC") and to merge SPHC into SPH LLC, with SPH LLC as the surviving entity.[26]

**4. Execution of the First Amendment to Tax Sharing Agreement**

31. Shortly before the filing of Debtor's bankruptcy petition, AMC, New Asarco, and Debtor entered into the First Amendment to Tax Sharing Agreement (the "First Amendment,"

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[20] DX9; 8/4 Tr. (Smith) at 17:13 – 18:12, 19:13 – 20:5; 8/4 Tr. (Kayle) at 67:2 – 11; Valdes Dep. at 18:2–17, 19:9–17, 20:7–14, 20:21–25, 23:24 – 24:8, 24:17 – 25:6.

[21] DX28 ("The purpose of the transaction would be to give Asarco greater flexibility than it currently has to deliver to creditors in a so-called 'Section 524(g) proceeding' equity interests in Asarco or in certain of Asarco's assets without triggering a particular 'deferred intercompany transaction' described further below."); DX22 (ASARCO TAX 07/07 002351) (Stan Keegan email) ("The intent of establishing the LLC was solely for this purpose, to maintain the gain deferral and provide flexibility with the asbestos plaintiffs."); 7/24 Tr. (Parker) at 44:24 – 45:3, 45:25 – 46:2, 46:7–15, 65:13–14; 8/4 Tr. (Smith) at 20:18 – 21:3; 8/4 Tr. (Kayle) 64:12–23; Valdes Dep. at 34:16 – 35:21, 38:17 – 39:20.

[22] Smith Dep. at 90:15–18.

[23] Valdes Dep. at 33:25 – 34:8; Smith Dep. at 90:19–23.

[24] Treas. Reg. § 301.7701-3(b)(1)(ii); 7/24 Tr. (Parker) at 42:18–24, 63:13–19; Smith Dep. at 106:18 – 107:5.

[25] DX53 (ASARCO TAX 04/07 000014–19) (Agreement and Plan of Merger Between New Asarco and Debtor); Valdes Dep. at 34:9–11; Smith Dep. at 90:24 – 91:7.

[26] PX 20 (Merger Agreement Between SPH LLC and SPHC).

which together with the Original TSA, is hereinafter referred to as the "TSA").[27] The First Amendment had an effective date of February 17, 2005.[28]

32. Notwithstanding that Debtor's income and loss are reported on the consolidated federal income tax returns filed by the AMC Consolidated Group, the TSA required Debtor to make payments to AMC equal to the tax that would have resulted if Debtor and its subsidiaries filed their own separate consolidated federal income tax return for each of the taxable years covered by the TSA.[29]

**5. Commencement of Debtor's Chapter 11 Case**

33. On August 9, 2005, Debtor filed for protection under Chapter 11 of the Bankruptcy Code.[30]

**6. Planning and Execution of the 2007 Deconsolidation**

34. Unlike most companies in bankruptcy, Debtor has been profitable while it has been in bankruptcy.[31] In an effort to isolate itself from the tax liability attributable to Debtor's assets and operations in 2007 and later years, Parent carried out a three-step restructuring in late 2006 and early 2007.[32]

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[27] DX63 (AMC_0107228–107229) (email dated July 13, 2005, showing on-going negotiations of agreement).

[28] DX52 (ASA00015551–15556) (First Amendment to Tax Sharing Agreement by and between AMC, New Asarco, and Debtor).

[29] DX52.

[30] Main Dkt. No. 1.

[31] *See, e.g.*, PX12 (AMC-TAX-000593–762) (2006 Proforma Federal Income Tax Return of New Asarco and Combined Subsidiaries).

[32] Valdes Dep. at 50:11 – 51:21, 53:5 – 54:19; Glickman Dep. at 59:22 – 60:10, 63:5 – 66:14.

35. First, on December 6, 2006, New Asarco formed ASARCO USA Incorporated, a Delaware corporation ("Asarco USA").[33] That same day, New Asarco also formed ASARCO Cayman, Ltd., a Cayman Islands corporation ("Asarco Cayman").[34]

36. Second, on December 15, 2006, New Asarco transferred to Asarco USA all of the member interests in Debtor in exchange for all of Asarco USA's common stock, which consists of 79 Class A and 21 Class B shares.[35]

37. Finally, on January 1, 2007, New Asarco contributed 21 Class B shares of Asarco USA to Asarco Cayman.[36]

38. Parent's goal in effecting the 2007 stock transfer was to cause the income of Debtor and the tax liability associated with that income to be reported on a separate federal income tax return filed by Asarco USA, an entity that had no assets other than its membership interest in Debtor, rather than on the return of the AMC Consolidated Group filed by AMC, which had other profitable assets.[37]

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[33] PX21 (AMC-TAX-002515–2538) (Certificate of Incorporation of Asarco USA, Asarco USA Instrument of Organization, and Bylaws of Asarco USA); Valdes Dep. at 48:12–17; Smith Dep. at 115:21 – 116:12.

[34] PX21 (AMC-TAX-002539–2568) (Memorandum and Articles of Association of Asarco Cayman); Valdes Dep. at 48:18–20; Smith Dep. at 116:13 – 116:22.

[35] DX73 (AMC-TAX-002569–2572) (Transfer Agreement by and between New Asarco and Asarco USA); PX21 (AMC-TAX-002573–2578) (Asarco USA written consent in lieu of first meeting of the board of directors); DX75 (AMC-TAX-002579–2582) (Contribution Agreement by and between New Asarco and Asarco USA); DX77 (AMC-TAX-002583–2585) (Certification of stock ownership by New Asarco); 8/4 Tr. (Smith) at 26:19 – 27:3; Valdes Dep. at 48:21 – 49:2.

[36] DX78 (AMC-TAX-002597–2600) (Contribution Agreement by and between New Asarco and Asarco Cayman); DX79 (AMC-TAX-002601–2603) (Certification of stock ownership by Asarco Cayman); Valdes Dep. at 50:8–10; Smith Dep. at 118:10–18.

[37] Valdes Dep. at 50:5 – 51:3, 53:5 – 54:19; Glickman Dep. at 59:22 – 60:10, 63:5 – 66:2, 66:3–14; Smith Dep. at 133:13–23, 134:18 – 136:24.

**7. Planning and Execution of the 2007 Rescission**

39. On December 31, 2007, Parent rescinded, for federal income tax purposes, New Asarco's transfer of 21 Class B shares of Asarco USA to Asarco Cayman.[38]

40. Parent rescinded the transfer so that Asarco USA would remain part of the AMC Consolidated Group in 2007 and later years, which would enable Parent to carry back and use losses generated by resolution of Debtor's bankruptcy to claim a refund of taxes paid by Parent in previous years (or to reduce unpaid taxes still owed).[39]

41. None of AMC, New Asarco, or Asarco USA obtained the consent of Debtor to the rescission or to any undoing of the termination of the TSA.[40]

**8. Fraudulent Transfer Judgment**

42. In 2007, Debtor filed suit to avoid the SPCC sale as a fraudulent transfer under 11 U.S.C. § 544. On August 30, 2008, the District Court issued a Memorandum Opinion and Order holding AMC liable for (i) actual-intent fraudulent transfer under Delaware's version of the Uniform Fraudulent Transfer Act,[41] (ii) aiding and abetting a breach of fiduciary duty under New Jersey law,[42] and (iii) civil conspiracy under Arizona law.[43]

43. On April 14, 2009, the District Court issued a Memorandum Opinion and Order requiring AMC to return the SPCC Shares to Debtor and to pay Debtor money damages of approximately $1.38 billion.[44]

44. The District Court entered the SCC Final Judgment on April 15, 2009.[45]

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[38] 7/24 Tr. (Parker) at 40:7–11; 8/4 Tr. (Smith) at 27:4–8

[39] Valdes Dep. at 56:11 – 57:6, 57:16–23, 58:12 – 59:7, 62:14 – 64:14; Glickman Dep. at 66:15 – 67:9.

[40] PX 22 (AMC-TAX-2486–2509) (ASARCO Re-Consolidation Closing Documents).

[41] *ASARCO*, 396 B.R. at 394.

[42] *Id.* at 413–414.

[43] *Id.* at 418–21.

[44] *ASARCO LLC v. Americas Mining Corp.*, 404 B.R. 150, 181 (S.D. Tex. 2009).

### 9. Taxes Owed by the AMC Consolidated Group Prior to Carryback of the 2009 Net Operating Losses

45. No amounts are owed by Debtor to AMC under the TSA for the taxable year 2004.[46]

46. The AMC Consolidated Group's federal income tax liability for the taxable year 2005 was $2,451,185.[47]

47. AMC paid $2,451,185 in federal income taxes for the taxable year 2005.[48]

48. The AMC Consolidated Group's federal income tax liability for the taxable year 2006 was $99,971,057.[49]

49. AMC paid $99,971,057 in federal income taxes for the taxable year 2006.[50]

50. The net amount owed by Debtor to AMC under the TSA, in respect of U.S. federal income taxes for the taxable years 2005 and 2006, is $0.[51]

51. No amount is owed by Debtor to AMC under the TSA on account of state income taxes for the taxable year 2005.[52]

52. The total amount of state income taxes incurred on account of Debtor's assets and operations for 2006 was $9,221,173.[53] Parent offered no evidence showing the amount of state income taxes actually paid by AMC on Debtor's behalf for 2006.

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[45] Dist. Dkt. No. 508.

[46] PX1 (Amended Proof of Administrative Claim).

[47] PX5 (AMC-TAX-6397–6696) (2005 Federal Income Tax Return of AMC and Consolidated Subsidiaries).

[48] PX14 (AMC-TAX-3747–3765) (2005 AMC Federal Tax Payments).

[49] PX6 (AMC-TAX-6697–6974) (2006 Federal Income Tax Return of AMC and Consolidated Subsidiaries).

[50] PX15 (AMC-TAX-3766–3784) (2006 AMC Federal Tax Payments).

[51] PX1.

[52] *Id.*

[53] *Id.*

53. The AMC Consolidated Group's federal income tax liability for the taxable year 2007 was $158,172,831.[54]

54. AMC paid $97,127,000 in federal income taxes for the taxable year 2007.[55]

55. The amount of the AMC Consolidated Group's federal income tax liability for 2007 that is attributable to Debtor's assets and operations is $71,186,562.[56]

56. The total amount of state income taxes incurred on account of Debtor's assets and operations for 2007 was $11,498,951.[57] Parent offered no evidence showing the amount of state income taxes actually paid by AMC on Debtor's behalf for 2007.

57. The amount of the AMC Consolidated Group's federal income tax liability for 2008 that is attributable to Debtor's assets and operations is estimated to be $59,998,809.[58]

58. AMC has not paid any federal income taxes for the taxable year 2008.[59]

59. The total amount of state income taxes incurred on account of Debtor's assets and operations for 2008 is estimated to be $9,812,520.[60] Parent offered no evidence showing the amount of state income taxes actually paid by AMC on Debtor's behalf for 2008.

60. New Asarco has not paid any federal or state income taxes for the taxable years 2005, 2006, 2007, or 2008.[61]

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[54] PX7 (AMC-TAX-6975–7187) (2007 Federal Income Tax Return of AMC and Consolidated Subsidiaries).

[55] PX16 (AMC-TAX-3785–3795) (2007 AMC Federal Tax Payments); Valdes Dep. at 66:10–25.

[56] PX1.

[57] *Id.*

[58] *Id.*

[59] Valdes Dep. at 68:19–22, 69:19 – 70:1; Glickman Dep. at 67:24 – 68:7; Smith Dep. at 150:4–7, 152:10 – 153:8.

[60] PX1.

[61] Valdes Dep. at 70:16–18.

### 10. 2009 Net Operating Loss Carrybacks and Carryforwards

61. Payments to certain creditors upon confirmation of either Debtor's or Parent's plan of reorganization will result in very large net operating losses for the taxable year 2009 that will be carried back and applied against the taxable income of the AMC Consolidated Group for prior years.[62] Debtor's assets and operations generated the cash to be used under either plan of reorganization to pay creditor claims, which payment creates the 2009 net operating losses. Carryback of the 2009 net operating losses will substantially reduce the federal income tax liabilities for which Parent seeks reimbursement.[63] Excess net operating losses may be carried forward to reduce the federal income tax liability of the AMC Consolidated Group for future years.

## III. CONCLUSIONS OF LAW

### A. Legal Consequences of Parent's Restructurings of the AMC Consolidated Group

### 1. The 2005 Restructuring

62. As a disregarded entity, Debtor is not liable for federal income tax attributable to its income, but rather is treated as a branch or division of its owner, which must report the income and loss from Debtor's assets and operations.[64]

63. Under Delaware law and the plan of merger of Asarco NJ and Debtor, Debtor succeeded to all of the assets, liabilities, and operations of Asarco NJ, including the Refund.[65]

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[62] 8/4 Tr. (Smith) at 32:3–12, 33:3–7, 34:17 – 36:3, 46:17 – 47:13.

[63] 8/4 Tr. (Smith) at 36:4 –38:14, 43:17 – 44:2, 48:3 – 49:2, 49:25 – 50:8, 51:3–12.

[64] Treas. Reg. § 301.7701-2(a); 7/24 Tr. (Parker) at 42:18–24, 63:13–19; Smith Dep. at 104:5–16, 104:24 – 105:14.

[65] *See infra* ¶¶ 68–76; DX53; DX28 (memorandum written by Parent's attorneys) ("Although current law may entitle New Asarco to any proceeds of Asarco's pending tax carryback refund claim, under certain proposed Treasury Regulations [that have since been implemented], it is likely that Asarco LLC, rather than New Asarco would be the entity that is legally entitled to those claims. Proposed Treasury Regulation section 301.7701-2(c)(2)(iii)(A)(3))").

64. Because both Debtor and SPH LLC are disregarded entities, all of the tax attributes of Asarco NJ and SPHC, including the DIG, passed to New Asarco for federal income tax purposes as a result of the 2005 restructuring.[66]

65. AMC benefited from the 2005 restructuring by (1) obtaining almost complete control of whether and when inclusion of the DIG in taxable income would be triggered, and (2) maintaining its ability to use any losses generated by Debtor's assets and operations to offset taxable income from its other subsidiaries.[67]

**2. The 2007 Deconsolidation**

66. By reducing AMC's ownership of Asarco USA to below 80%, the 2007 stock transfer caused a "Deconsolidation Event" as to Debtor under the TSA, resulting in termination of the agreement by its terms.[68]

**3. The 2007 Rescission**

67. Parent effectively rescinded the 2007 Deconsolidation for federal income tax purposes.[69] However, as discussed below, the 2007 Rescission was ineffective to reinstate the TSA for state law purposes. *See infra* ¶¶ 131–37.

**B. The Refund**

**1. Federal Tax Liability and Any Overpayment of That Liability Are Determined Under Federal Law**

68. The federal tax liability of a taxpayer, or in this case, the consolidated federal income tax liability of an affiliated group, is determined by reference to federal tax law. If tax payments made by the taxpayer exceed the federal income tax liability as determined under

[66] I.R.C. § 368(a)(1)(F); Treas. Reg. § 301.7701-3(g)(1)(iii); 8/4 Tr. (Glickman) at 101:5–10; Glickman Proffer, Ex. 1, Ex. A., ¶ 27.2 (SPHC); Glickman Proffer, Ex. 1, Ex. B., ¶¶ 20–29 (Asarco NJ).

[67] DX28; Valdes Dep. at 35:22 – 36:2, 36:10–18; Smith Dep. at 93:21 – 94:4.

[68] DX52.

[69] *See Penn v. Robertson*, 115 F.2d 167 (4th Cir. 1940); Rev. Rul. 80-58, 1980-1 C.B. 181.

federal tax law, an overpayment results and the taxpayer is entitled to a refund. I.R.C. § 6402(a). These determinations—the amount of the tax liability and any overpayment of that liability—are made by application of the Code and applicable tax law.

**2. Ownership of a Tax Refund is Determined Under State Law**

69. The Refund has been allowed by the IRS and is not in dispute. At issue in this case is the question of *ownership* of the Refund. Entitlement to a federal tax refund is a property right, and in order to determine ownership, federal courts apply state law. Under state law, the Refund is Debtor's property.

**a. State Law Determines Property Rights**

70. It is a bedrock principle that the nature and extent of a taxpayer's rights in and to its property are determined under state law; how those property rights and interests created by state law are to be taxed is determined by federal law. As the Supreme Court held long ago, "state law creates legal interests and rights. The federal revenue acts designate what interests or rights, so created, shall be taxed." *Morgan v. Comm'r*, 309 U.S. 78, 80 (1940). Thus, "in the application of a federal revenue act, state law controls in determining the nature of the legal interest which the taxpayer had in the property." *Id.* at 82. The Supreme Court has reaffirmed this principle over the years: "In the determination of [property] ownership, state law controls." *United States v. Mitchell*, 403 U.S. 190, 197 (1971); *accord Bouterie v. Comm'r*, 36 F.3d 1361, 1369 (5th Cir. 1994). Put another way, the Code "creates no property rights." *United States v. Bess*, 357, U.S. 51, 55 (1958); *accord In re Orr*, 180 F.3d 656, 660 (5th Cir. 1999). Instead, federal tax law attaches federally defined consequences to rights and property interests created under state law. *Id.*

71. Ownership of a federal income tax refund, or the claim to a federal income tax refund, is a property right of the owner. *In re Luongo*, 259 F.3d 323, 335 (5th Cir. 2001) (citing

*Mueller v. Comm'r*, 496 F.2d 899, 903 (5th Cir. 1974) ("A Debtor's claim to a tax refund is property of the Estate.")); *see also Hutchins v. IRS*, 67 F.3d 40 (3d Cir. 1995). The right to receive a federal tax refund is a "general intangible" property right of the owner, and a security interest can be created in the right to a refund. *In re TMCI Electronics,* 279 B.R. 552, 555 (Bankr. N.D. Cal. 1999); *In re Palmetto Pump & Irrigation,* 81 B.R. 109, 111 (Bankr. M.D. Fla. 1987). Therefore, "[t]o determine the nature and extent of a debtor's interest in specific property, in this case tax refunds, the [Bankruptcy] Court looks to state law." *In re Martell,* 349 B.R. 233, 235–36 (Bankr. D. Idaho 2005) (citing *In re Gendreau,* 191 B.R. 798, 804 (9th Cir. 1995), and *Butner v. United States,* 440 U.S. 48, 54 (1979)).

**b. Asarco NJ Owned the Refund Claim Until February 2005**

72. Debtor and Parent agree that Asarco NJ owned the Refund Claim before the merger of Asarco NJ into Debtor. Parent has admitted that "[p]rior to the [2005] Merger, ASARCO NJ had an ownership interest in the Refund Claim and/or Refund."[70] This admission is consistent with well-established law. For example, in the case of a corporate debtor that is entitled to a tax refund attributable to the carryback of losses, the debtor's "inchoate right to receive the tax refund resulting from a loss-carryback constituted property of the debtor prior to the date the [bankruptcy] petition was filed, because the debtor's right accrued as a result of prepetition losses sustained by it for [a prepetition] tax year." *In re Mammoth Spring Distributing Co.*, 139 B.R. 205, 207 (Bankr. W.D. Ark. 1992).

73. Parent claims that it obtained ownership of the Refund Claim in 2005 as a result of the merger of Asarco NJ into Debtor. Parent argues that (i) because Debtor is a "disregarded entity" for federal tax purposes, Asarco NJ is deemed to have merged into New Asarco, and (ii)

[70] Debtor's MSJ, Ex. C (Americas Mining Corporation's and ASARCO Incorporated's Supplement to Their Objection and Responses to ASARCO LLC's First Request for Admissions and Interrogatories ("Parent's Supplemental Discovery Responses")) at 8.

because the merger constituted a so-called F reorganization under federal tax law, Asarco NJ and New Asarco are treated as one and the same entity. As a result, the argument continues, the merger resulted in "all of [Asarco NJ's] assets, including tax refunds, liabilities and tax attributes [being] transferred to [New Asarco] for all federal tax purposes . . . . Therefore, [New Asarco] should recover the Refund."[71] Parent's argument, which is based solely upon federal tax law, ignores Debtor's existence and ownership of the Refund under state law.[72]

### 3. Ownership of the Refund Claim Was Transferred to Debtor

#### a. Ownership of the Refund Claim Vested in Debtor Under Delaware Law

74. When AMC caused Asarco NJ to merge with and into Debtor pursuant to the Merger Agreement, with Debtor as the surviving entity, ownership of the Refund Claim vested in Debtor under Delaware law. The merger was effected pursuant to the Delaware Limited Liability Company Act. DEL. CODE ANN. tit. 6, §§ 18-101-18-1109. Section 18-209(b) of that act authorizes mergers between Delaware limited liability companies and other business entities formed under the laws of any other state in which the Delaware limited liability company may be the surviving entity. When such a merger is effected, property owned by each of the merged entities, and all debts due to both companies, are vested in and become the property of the surviving company under Delaware law:

> When any merger or consolidation shall have become effective under this section, for all purposes of the laws of the State of Delaware, all of the rights, privileges and powers of each of the . . . companies . . . that have merged and consolidated, and all property, real, personal and mixed, and all debts due to any of said

[71] Parent's Supplemental Discovery Responses, at 15.

[72] The fact that Debtor is classified as a disregarded entity for federal tax purposes does not mean that New Asarco acquired an ownership interest in Asarco NJ's or Debtor's assets. The Treasury Department made this clear in promulgating regulations under section 7701 of the Internal Revenue Code concerning disregarded entities: "Whether an organization is treated as an entity for federal tax purposes is a matter of federal tax law, and does not affect the rights and obligations of its owners under local law." T.D. 8697, 1997-1 C.B. 215., 61 Fed. Reg. 66,585 (Dec. 18, 1996).

> domestic limited liability companies and other business entities, as well as all other things and causes of action belonging to each of such . . . companies . . . shall be vested in the surviving or resulting domestic limited liability company . . . and shall thereafter be the property of the surviving or resulting domestic limited liability company . . . .

Section 18-209(g). Therefore, under Delaware statutory law, all property owned by, and debts owed to, Asarco NJ became the property of Debtor as a result of the merger. This included Asarco NJ's "ownership interest in the Refund Claim and/or Refund."[73]

**b. Ownership of the Refund Claim Vested in Debtor Pursuant to the Merger Agreement**

75. The Merger Agreement provides that it is to be governed by Delaware law, and the Delaware Limited Liability Company Act is referenced throughout the Merger Agreement. As a result of the merger, Debtor acquired all assets and all property of Asarco NJ, including property interests of any kind or character, with no exceptions. Specifically, the Merger Agreement provides as follows:

> [Debtor] shall . . . possess all the rights, privileges, immunities, powers and franchises, of a public as well as of a private nature, of [both Asarco NJ and Debtor], and *all property*, real, personal and mixed, all debts due on whatever account, including subscriptions to ownership interests and all other choses in action, *and all and every other interest of, or belonging to, [Asarco NJ and Debtor] shall be taken and deemed to be transferred to and vested in [Debtor]* without further act or deed . . . .[74]

Therefore, all of Asarco NJ's property was "transferred to and vested in" Debtor without any further action being required. All of Asarco NJ's property—including the Refund Claim—vested in Debtor pursuant to the express terms of the Merger Agreement, as admitted by the Parent: "The state law effect of the merger was that all of the assets and liabilities of Asarco NJ

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[73] Parent's Supplemental Discovery Responses, at 15.

[74] DX53 § 2.1(d) (emphasis added).

were transferred to [Debtor] for state law purposes . . . ."[75] Accordingly, there is no dispute that under Delaware law, the Merger Agreement transferred all of Asarco NJ's property rights to Debtor.

**c. The Refund Claim Became Property of the Estate**

76. As discussed above, ownership of the Refund is determined under state law. Debtor became the owner of Asarco NJ's interest in the Refund Claim under Delaware law. And, of course, because the Refund Claim was owned by Debtor at the time of its bankruptcy filing, it became property of Debtor's estate at the time of the filing. 11 U.S.C. § 541(a)(1).[76] Accordingly, Debtor owns the Refund at issue here.

**4. Parent Cannot Meet Its Burden on Its Affirmative Defenses Related to the Refund**

77. Parent asserts three affirmative defenses to Debtor's ownership claim: estoppel, waiver, and recoupment.

**a. Estoppel and Waiver**

78. Parent's Amended Answer contains no allegations regarding its estoppel and waiver defenses beyond vaguely asserting that "[a]ll or part of the claims asserted by [Debtor] against Parent are barred by" waiver and estoppel.[77] The only other description of these affirmative defenses is in response to Debtor's interrogatory requesting the legal and factual basis for the affirmative defenses. Other than boilerplate objections, that response is as follows: "[Debtor] has been operating under [the TSA][78] which was heavily negotiated with each party

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[75] Parent's Supplemental Discovery Responses, at 15.

[76] *See also* DX28 (memorandum written by Parent's attorneys) ("Although current law may entitle New Asarco to any proceeds of Asarco's pending tax carryback refund claim, under certain proposed Treasury Regulations [that have since been implemented], it is likely that Asarco LLC, rather than New Asarco would be the entity that is legally entitled to those claims. Proposed Treasury Regulation section 301.7701-2(c)(2)(iii)(A)(3).").

[77] Parent's Amended Answer ¶¶ 43–44 (Dkt. No. 46).

[78] The TSA is not relevant, as Debtor's ownership of the Refund is independent of the TSA.

thereto having consulted with independent and competent counsel. [Debtor] is now barred from attempting to circumvent the express provisions of the [TSA] under the doctrines of estoppel and waiver."[79]

**(1) Estoppel**

79. "Estoppel is an affirmative defense requiring the party asserting it to establish: (1) a false representation or concealment of material facts; (2) made with knowledge, actual or constructive, of those facts; (3) to a party without knowledge, or the means of knowledge, of those facts; (4) with the intention that it should be acted on; and (5) the party to whom it was made must have relied or acted on it to his prejudice." *In re A.L.G.*, 229 S.W.3d 783, 786 (Tex. App.–San Antonio 2007, no pet.). There is no evidence supporting any or all of these elements against Debtor. Accordingly, Parent's affirmative defense of estoppel fails.

**(2) Waiver**

80. "The affirmative defense of waiver can be asserted against a party who intentionally relinquishes a known right or engages in intentional conduct inconsistent with claiming that right." *Tenneco, Inc. v. Enterprise Prods. Co.*, 925 S.W.2d 640, 643 (Tex. 1996). There is no evidence that Debtor intentionally relinquished its right to the Refund or engaged in intentional conduct inconsistent with claiming its right to the Refund. Accordingly, Parent's affirmative defense of waiver also fails.

**b. Recoupment**

81. Parent provides even less detail regarding its affirmative defense of recoupment. According to Parent's Amended Answer, "[a]ll or part of the Refund amount sought by [Debtor] is reduced or eliminated because of Parent's right of recoupment against the Refund."[80]

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[79] Parent's Supplemental Discovery Responses, at 14.

[80] Parent's Amended Answer ¶ 45.

82. Recoupment allows a defendant "to reduce the amount of a plaintiff's claim by asserting a claim against the plaintiff which arose out of the same transaction to arrive at a just and proper liability on the plaintiff's claim." *Holford v. Powers*, 896 F.2d 176, 178 (5th Cir. 1990) (emphasis omitted). The obligations must arise out of a single integrated transaction so that it would be inequitable for the debtor to enjoy the benefits of the transaction without also meeting its obligations. 5 COLLIER ON BANKRUPTCY ¶ 553.10 (15th ed. rev. 2007). Here, the "same transaction" requirement cannot be met; Debtor is seeking a declaration of ownership, not entitlement to a money judgment. *See Sommers v. Concepcion*, 20 S.W.3d 27, 34 (Tex. App.–Houston [14th Dist.] 2000, pet. denied) (recoupment "allows a defendant to reduce the amount of a plaintiff's claims by asserting a counterclaim which arose out of the same transaction"); *In re McMahon*, 129 F.3d 93, 96 (2d Cir. 1997) ("[r]ecoupment means a deduction from a *money claim* through a process whereby cross demands arising out of the same transaction are allowed to compensate one another and the balance only to be recovered") (emphasis added). Because there is no evidence to support the "same transaction" requirement, Parent's recoupment affirmative defense also fails.

**5. No Subsidiary Defendant Other Than CAPCO Is Entitled to Any Portion of the Refund**

83. Each of the Subsidiary Defendants was a member of the Asarco NJ Consolidated Group for one or more of the taxable years 1987, 1988, and 1989. *See supra* ¶ 8. The evidence shows that, of the Subsidiary Defendants, only CAPCO is entitled to any portion of the Refund. In fact, Lac d'Amiante du Quebec Ltee; Cement Asbestos Product Company; Lake Asbestos of Quebec, Ltd.; and LAQ Canada, Ltd. stipulate that they have no right to the Refund, while CAPCO stipulates that it is entitled only to $51,321, plus a pro rata portion of the accrued

interest on the Refund.[81] Accordingly, Count I of Debtor's suit for declaratory judgment, which seeks a declaration that the Refund belongs to Debtor's bankruptcy estate, has been dismissed with respect to all of the Subsidiary Defendants except for the Enthone Entities.[82]

**a. A Subsidiary Is Entitled to a Refund Only to the Extent It Could Have Generated a Refund Had It Filed Its Own Tax Return**

84. Just as state law determines whether Debtor or Parent is entitled to the Refund, the question of which "entity is entitled to ultimately receive the benefit of a consolidated tax refund is a matter which is not addressed in the Internal Revenue Code." *Jump v. Manchester Life & Cas. Mgmt. Corp.*, 579 F.2d 449, 452 (8th Cir. 1978). Numerous courts, however, have considered how a tax refund involving members of an affiliated tax group should be allocated.

85. In the seminal case *In re Bob Richards Chrysler-Plymouth Corp., Inc.*, 473 F.2d 262 (9th Cir. 1973), Western Dealer Management, Inc. ("WDM") filed a consolidated federal income tax return on behalf of itself, its wholly owned subsidiary, Bob Richards Chrysler-Plymouth ("BRCP"), and another wholly owned subsidiary of WDM. The trustee of bankrupt BRCP sought an order directing WDM to turn over a tax refund obtained by WDM in its capacity as the common parent of the affiliated group. *Id.* at 263. The entirety of the tax refund was due to BRCP's income and losses. *Id.* According to the court, "a tax refund resulting solely from offsetting the losses of one member of a consolidated filing group against the income of that same member in a prior or subsequent year should inure to the benefit of that member." *Id.* at 265. Thus, the trustee was entitled to the tax refund. *Id.*

86. Other federal appellate courts have followed and refined the holding of *In re Bob Richards*. In *Jump v. Manchester Life & Cas. Mgmt. Corp.*, 438 F. Supp. 185 (E.D. Mo. 1977),

[81] Dkt. No. 132.

[82] *Id.*

*aff'd*, 579 F.2d 449, 452 (8th Cir. 1978), a subsidiary sought to recover a tax refund paid to the affiliated group. The tax refund resulted from losses incurred by the subsidiary and carried back against prior year taxable income of several members of the affiliated group, including the subsidiary. *Id.* at 187. The subsidiary maintained that because its losses had been the only losses carried back to generate the tax refund, it was entitled to all of the proceeds of the tax refund, even though that amount would exceed the amount the subsidiary had paid in taxes in the years to which its losses were carried back. *Id.* The court disagreed and held that the subsidiary's right to recover the income tax refund was "limited to the recovery which the subsidiary would have had if it had filed individual returns throughout, so that [the subsidiary's] recovery here is limited to the amount previously paid in taxes." *Id.* at 189.

87. Similarly, in *Capital Bancshares v. Federal Deposit Ins. Corp.*, 957 F.2d 203 (5th Cir. 1992), a parent corporation sought to recover the proceeds from a tax refund arising from losses attributable solely to a subsidiary. The subsidiary had reported taxable income in all taxable years to which the losses were carried back. *Id.* at 208. Because the subsidiary had income and losses in the relevant years, and thus "could have generated the refund on its own had it filed income taxes separately from the group," it was entitled to the tax refund. *Id.*; *see also United States v. Revco D.S., Inc.,* 111 B.R. 631 (Bankr. N.D. Ohio 1990) (holding that subsidiary incurring the losses that gave rise to the tax refund was entitled to a portion of the tax refund to the extent it had reimbursed its parent for the taxes paid on the income generated by the subsidiary); *Florida Park Banks, Inc. v. Fed. Deposit Ins. Co.*, 110 B.R. 986, 987 (Bankr. M.D. Fla. 1990) (awarding tax refund to a subsidiary in a case where both parent and subsidiary had losses that were carried back, but only the subsidiary had paid taxes in the years to which the losses were carried back).

**b. CAPCO Is the Only Subsidiary Defendant that Could Have Generated a Refund Had It Filed on Its Own**

88. The Refund Claim was based on the carryback of specified liability losses (i) from the taxable years 1994 and 1995 to the taxable year 1987; (ii) from the taxable year 1998 to the taxable year 1988; and (iii) from the taxable year 1999 to the taxable year 1989. *See supra* ¶ 14. Of the Subsidiary Defendants, only CAPCO recognized taxable income and incurred specified liability losses during the relevant taxable years.[83] CAPCO incurred specified liability losses in 1994 and 1995 and had taxable income for the 1987 taxable year to which such losses were carried back.[84] Likewise, of the Subsidiary Defendants, only CAPCO incurred specified liability losses in 1998 and had taxable income in 1988.[85] Finally, no Subsidiary Defendant incurred specified liability losses in 1999 and had taxable income in 1989.[86] Accordingly, CAPCO is the only Subsidiary Defendant entitled to any portion of the Refund, and CAPCO is entitled only to a portion of the Refund for the taxable years 1987 and 1988. No other Subsidiary Defendant is entitled to any portion of the Refund.

**c. CAPCO is Entitled to No More Than $51,321 of the Refund**

89. In 1994 and 1995, CAPCO incurred allowable specified liability losses of $4,053,267.[87] Those losses were carried back to offset CAPCO's 1987 taxable income of $2,395,650.[88] The IRS allowed total specified liability losses for 1994 and 1995 in the amount of $177,437,623.[89] The tax refund allowed for 1987 was $1,750,684.[90] By dividing CAPCO's

[83] Debtor's MSJ, Ex. D, ¶¶ 13–15 (Affidavit of Stanley W. Jozefiak).

[84] *Id.* ¶ 13.

[85] *Id.* ¶ 14.

[86] *Id.* ¶ 15.

[87] *Id.* ¶ 16.

[88] *Id.*

[89] *Id.*

allowed losses[91] by the total allowed losses and multiplying the total tax refund for 1987 by the resulting percentage, CAPCO's portion of the Refund for 1987 is calculated to be $23,637.[92]

90. In 1998, CAPCO had allowable specified liability losses of $82,439.[93] Those losses were carried back to offset CAPCO's 1988 taxable income of $6,312,076.[94] The IRS allowed total specified liability losses for 1998 in the amount of $63,534,958.[95] The Refund allowed for 1988 was $21,336,162.[96] CAPCO's portion of the Refund for 1988 is $27,685.[97] Accordingly, the principal amount of the Refund to which CAPCO is entitled is an amount not to exceed $51,321, plus a pro rata portion of the accrued interest on the Refund.

### 6. The Enthone Entities Must Designate Covington Land Company as Substitute Agent for the Asarco NJ Consolidated Group

91. Under 28 U.S.C. § 2202, the Court has authority to enter any "necessary or proper relief based on a declaratory judgment." Section 105(a) of the Bankruptcy Code further authorizes and empowers the Court to issue any orders that will advance the purposes and goals of the Bankruptcy Code, assist in the orderly and effective administration of Debtor's bankruptcy case, aid in the preservation of Debtor's assets, and aid in the promulgation and confirmation of a chapter 11 plan that will maximize recovery to all creditors. 11 U.S.C. § 105(a).

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[90] *Id.*

[91] For purposes of this calculation, CAPCO's allowed losses for 1987 are capped at its income for 1987. *Id.*

[92] *Id.*

[93] *Id.* ¶ 17.

[94] *Id.*

[95] *Id.*

[96] *Id.*

[97] *Id.*

92. The IRS will pay the Refund only to a designated agent. *See* Treas. Reg. 1.1502-77A(a).[98] As explained in paragraphs 68–76, the Refund is Debtor's property as a matter of law. Debtor has received letters of consent designating Covington Land Company as the substitute tax agent from all of the Subsidiary Defendants except for the Enthone Entities, which designation the Court has approved.[99] By ordering the Enthone Entities to designate Covington Land Company as the substitute agent for the Asarco NJ Consolidated Group, any impediment to the IRS's payment of the Refund will be removed.

93. Accordingly, the Court (i) directs the Enthone Entities to designate, in accordance with Treasury Regulation § 1.1502-77A(d), Covington Land Company, a former member of the Asarco NJ Consolidated Group, as the substitute tax agent of the group for the taxable years 1987, 1988, and 1989 for purposes of receiving the Refund, and (ii) enjoins the Enthone Entities from changing the designated agent without the Court's approval.

**7. The Relief Sought by the Enthone Entities is Not Merited**

94. The Enthone Entities have requested that this Court either (i) enter an order directing Parent to seek a closing agreement under section 7121 of the Code concerning the Refund, or (ii) enter an order directing any member of the Asarco NJ Consolidated Group that receives payment of the Refund to place the proceeds in escrow until the later of (a) the expiration of the statute of limitations under section 6532(b) of the Code applicable to the

[98] Treas. Reg. § 1.1502-77A is applicable for consolidated return years prior to June 28, 2002. *See also* Rev. Proc. 2002-43 (June 28, 2002). Treas. Reg. § 1.1502-77A(a) provides that the common parent of a consolidated group shall be the sole agent of the group (subject to certain exceptions that are inapplicable here). The agent must file refund claims and "any refund will be made directly to and in the name of the common parent and will discharge any liability of the Government in respect thereof to any such subsidiary." *Id.* Treas. Reg. § 1.1502-77A(d) sets forth the procedure for designation of a substitute agent to act on behalf of the group when the common parent goes out of existence. Because Asarco NJ did not designate a substitute agent before going out of existence, section 1.1502-77A(d) states that the remaining members of the group must select another member of the group to act as the substitute agent. Covington Land Company, as a member of the Asarco NJ Consolidated Group during 1987, 1988, and 1989, meets this criteria.

[99] Dkt. No. 81.

recovery of an erroneous tax refund, or (b) entry of final judgment with respect to any suit brought by the IRS pursuant to section 7405(b) of the Code to recover all or any portion of the Refund.[100] The Enthone Entities are not entitled to this relief.

**a. The Enthone Entities' Liability for Return of the Refund Is So Remote That Further Delay In Payment of the Refund Is Not Merited**

95. The Enthone Entities state that their "only concern is to be protected from potential future liability under the Internal Revenue Code . . . related to the payment of the [Refund]" because they "are jointly and severally liable under the [Code] and Treasury Regulations for any amounts that may be determined to be erroneously refunded regardless of whether they actually received any portion of the tax refund."[101]

96. As noted previously, the IRS fully examined the amended consolidated federal income tax returns filed by Asarco NJ on behalf of the Asarco NJ Consolidated Group and determined that there was an overpayment in tax of approximately $40.5 million.[102] Section 6405 of the Code provides that no refund of income tax in excess of $2,000,000 shall be made until after the expiration of thirty days from the date upon which a report containing the taxpayer's name, the amount of the refund, and a summary of the facts and the decision of the [IRS] is submitted to the Joint Committee on Taxation.[103] While the IRS views section 6405 as granting the Joint Committee on Taxation "with oversight (as opposed to approval) authority of refunds," if the Joint Committee on Taxation "disagrees with or questions the position taken" in

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[100] Defendants Enthone Inc., EI Liquidation, Inc., and OMI International Corporation's Response to Plaintiff ASARCO LLC's Motion for Summary Judgment ("Enthone Entities' Response") (Dkt. No. 89).

[101] *Id.* at 2, ¶ 2; 5, ¶ 10.

[102] *See* Form 4549-A, Income Tax Examination Changes, included in Exhibit A7 attached to Debtor's MSJ, at 25 (Dkt. No. 67).

[103] Pursuant to section 8002(a) of the Code, the Joint Committee on Taxation is composed of five members of the Committee on Finance of the Senate and five members of the Committee on Ways and Means of the House of Representatives.

an examiner's report, "the refund is, generally, as a matter of agency policy, not processed pending the resolution of the dispute." Internal Revenue Manual 4.36.1.1 (08-15-2004), 4.36.1.2 (08-15-2004). Here, the Joint Committee on Taxation reviewed and approved the Refund.

97. The fact that the Refund Claim was audited by the IRS and approved by the Joint Committee on Taxation in accordance with section 6405(a) of the Code demonstrates that the IRS is extremely unlikely to assert that the allowance of the Refund Claim was erroneous. Consequently, the "only concern" expressed by the Enthone Entities is unfounded, so the relief requested by the Enthone Entities must be denied.

#### b. Parent Lacks the Requisite Authority to Seek or Enter Into a Closing Agreement

98. The Enthone Entities state that "[a] closing agreement executed with the IRS would protect them from joint and several liability for the Refund."[104] The Enthone Entities further argue that "[t]he Enthone Defendants cannot request a closing agreement themselves because they are neither the taxpayer which filed the tax refund claim nor the parent company of the consolidated tax group."[105] Instead, the Enthone Entities request that the Court order Parent to enter into a closing agreement with the IRS.[106] Parent lacks the requisite authority, however, to enter into a closing agreement related to the Refund.

99. Section 7121(a) of the Code provides that the Commissioner may enter into a written closing agreement "with any person relating to the *liability of such person* (or of the person or estate for whom he acts) in respect to any internal revenue tax for any taxable period." In the case of an affiliated group of corporations, Treasury Regulation section 1.1502-77A(a) provides as follows:

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[104] Enthone Entities' Response, at 6, ¶ 11.

[105] *Id.* at 7, ¶ 12.

[106] *Id.* at 7, ¶ 13.

> The common parent, for all purposes . . . shall be the sole agent for each subsidiary in the group, duly authorized to act in its own name in all matters relating to the tax liability for the consolidated return year. . . . [T]he common parent in its name will give waivers, give bonds, and execute closing agreements, offers in compromise, and all other documents, and any waiver or bond so given, or agreement, offer in compromise, or any other document so executed, shall be considered as having also been given or executed by each such subsidiary.

100. Neither AMC nor New Asarco is the common parent of the Asarco NJ Consolidated Group.[107] Moreover, while the status of Asarco NJ as the common parent of the Asarco NJ Consolidated Group terminated when it merged with and into Debtor in 2005, neither AMC nor New Asarco is eligible to be designated as the substitute agent for the Asarco NJ Consolidated Group. Instead, Treasury Regulation § 1.1502-77A sets forth the exclusive rules for designating a substitute agent when the common parent of an affiliated group goes out of existence. Those rules require that another member of the Asarco NJ Consolidated Group be appointed by consent of all remaining members of the group. Because neither AMC nor New Asarco was ever a member of the Asarco NJ Consolidated Group, neither is eligible to be appointed as its substitute agent.[108] Accordingly, Parent lacks the requisite authority to seek or enter into the closing agreement requested by the Enthone Entities.

#### c. The Enthone Entities Can Seek a Closing Agreement

101. As discussed above, section 7121(a) of the Code provides that the Commissioner may enter into a closing agreement with any person relating to the *liability of such person* in respect to any internal revenue tax for any taxable period ending prior or subsequent to the

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[107] Asarco NJ was the common parent of the Asarco NJ Consolidated Group. *See supra* ¶ 7.

[108] Section 8.13.1.2.5.1 of the Internal Revenue Manual also indicates that a successor corporation in a merger is not the proper party to execute a closing agreement on behalf of a consolidated group: "[t]he alternative agent provision of Treas. Reg. 1.1502-77A is not applicable to determining who is the proper party to sign a closing agreement for a consolidated group." An "alternative agent" for these purposes includes "[a] successor to the former common parent in a transaction to which section 381(a) [of the Code] applies." Treas. Reg. § 1.1502-77A(e)(4)(ii). New Asarco is the successor to the former common parent of the Asarco NJ Consolidated Group for purposes of the alternative agent provision because Asarco NJ merged into Debtor in a reorganization described in section 368(a)(1)(F), a transaction described in section 381(a) of the Code. As quoted above, however, the Internal Revenue Manual provides that an alternative agent lacks authority to execute a closing agreement on behalf of a consolidated group.

agreement. A closing agreement may relate to the total tax liability of the taxpayer or to one or more separate items affecting the tax liability of the taxpayer. Treas. Reg. § 301.7121-1(b)(2). It is undisputed that the Enthone Entities were members of the Asarco NJ Consolidated Group for the taxable years to which the Refund relates. As such, each of the Enthone Entities is jointly and severally liable for the tax reported on the consolidated federal income tax returns filed by the Asarco NJ Consolidated Group for the taxable years to which the Refund relates. *See* Treas. Reg. § 1.1502-6(a). Therefore, under section 7121(a) of the Code, the Enthone Entities can seek a closing agreement with the IRS regarding the allowance of the Refund.

## C. Parent's Claim for Reimbursement

### 1. Parent's Claim is Disallowed

#### a. AMC's Claim is Disallowed Under 11 U.S.C. § 502(d)

102. AMC's claim is disallowed under section 502(d) of the Bankruptcy Code unless and until AMC satisfies the SCC Final Judgment or the Judgment is reversed on appeal. Section 502(d) provides:

> [T]he court *shall* disallow any claim of any entity . . . that is a transferee of a transfer avoidable under section . . . 544 . . . of this title, unless such entity or transferee has paid the amount, or turned over any such property, for which such entity or transferee is liable under . . . this title.

11 U.S.C. § 502(d) (emphasis added). A court must disallow the claim of any party that is the recipient of a fraudulent transfer unless the party has returned the property in question. *See In re Consol. Indus. Corp.*, No. 98-40533, 2006 WL 2136037, at *1 (Bankr. N.D. Ind. June 19, 2006) (trustee was entitled to judgment as a matter of law on its objections to creditor's claims because bankruptcy court and district court had determined that creditor was recipient of avoidable transfers and creditor had not returned transfers to debtor's estate); *In re Red Dot Scenic,*

*Inc.*, 313 B.R. 181, 185 (Bankr. S.D.N.Y. 2004) (creditor's failure to pay trustee amount of judgment in avoidance action required disallowance of creditor's claim).

103. It is undisputed that (1) the District Court held that AMC is the transferee of a fraudulent transfer;[109] (2) the District Court ordered AMC to return the SPCC Shares to Debtor and to pay Debtor money damages of approximately $1.38 billion;[110] and (3) AMC has not satisfied the SCC Final Judgment. Thus, the Court must disallow AMC's claim unless and until AMC satisfies the SCC Final Judgment or the Judgment is reversed on appeal. This would be true even if the Court determined that the Claim is an administrative claim, and even though AMC has appealed the SCC Final Judgment.

**(1) Section 502(d) Applies to Administrative Claims**

104. Parent argues that § 502(d) does not apply because the Claim is an administrative claim under § 503.[111] Parent is incorrect, even assuming for the sake of argument that the Claim is an administrative claim.

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[109] *ASARCO*, 396 B.R. at 394; Dist. Dkt. No. 508. Issue preclusion bars AMC from relitigating whether it is the transferee of an avoidable transfer. Issue preclusion bars the relitigation of an issue of ultimate fact by the party against whom the issue has been determined by a valid and final judgment. *Weiner v. United States*, 255 F. Supp. 2d 624, 640 (S.D. Tex. 2002). Issue preclusion traditionally applies when three conditions are met: (1) the issue under consideration is identical to that litigated in the prior action; (2) the issue was fully and vigorously litigated in the prior action; and (3) the issue was necessary to support the judgment in the prior action. *Id.* The Fifth Circuit has recognized a fourth requirement for offensive use of issue preclusion: lack of any special circumstances that would make it unfair to apply the doctrine. *Winters v. Diamond Shamrock Chem. Co.*, 149 F.3d 387, 391 (5th Cir. 1998). All four requirements for offensive use of issue preclusion are met. The first three requirements are met because the issue of whether AMC is the transferee of a transfer avoidable under § 544 was litigated and was necessary to the District Court's Final Judgment. Debtor asserted fraudulent transfer claims against AMC under § 544(b), and the District Court found that "AMC had actual intent to hinder or delay [Debtor's] creditors and is liable for actual fraudulent transfer under 6 Del. C. § 1304(a)(1)," which is incorporated by § 544(b). *ASARCO*, 396 B.R. at 315, 394. The fourth requirement is met because no special circumstance exists that would make it unfair to apply the doctrine of issue preclusion. To the contrary, it would be unfair to Debtor and its creditors to allow AMC to relitigate whether it is the transferee of a fraudulent transfer. Debtor spent millions of dollars, and the District Court used a great deal of resources, trying that issue. Finally, the District Court's Final Judgment is sufficiently final for purposes of issue preclusion, even though AMC may appeal. It is well established that a judgment is final for preclusive purposes even if it is on appeal. *Prager v. El Paso Nat'l Bank*, 417 F.2d 1111, 1112 (5th Cir. 1969).

[110] *ASARCO*, 404 B.R. at 181.

[111] Response of Americas Mining Corporation and ASARCO Incorporated to Debtors' Objection to Administrative Claim No. 18571 of Americas Mining Corporation and ASARCO Incorporated ("Parent's Response") at 25–27 (Dkt. No. 162).

105. There is a split in the case law on whether an administrative claim is subject to the requirements of § 502(d). However, the plain language of § 502(d), judicial precedent predating enactment of the section, the section's legislative history, and the policy underlying the section, all demonstrate that § 502(d) applies to both general unsecured claims and administrative claims. *See MicroAge, Inc. v. Viewsonic Corp. (In re MicroAge, Inc.)*, 291 B.R. 503, 508–12 (B.A.P. 9th Cir. 2002) (relying on these factors in concluding that § 502(d) may be raised in response to allowance of an administrative claim).[112]

**(a) The Plain Language of 11 U.S.C. § 502(d) Supports Applying the Section to Administrative Claims**

106. The plain language of § 502(d) is not limited to disallowance of general unsecured claims. "Section 502(d) by its terms applies to 'any claim' of an entity that received an avoidable transfer, and the definition of a 'claim' in § 101(5) is sufficiently broad to include requests for payment of expenses of administration." *In re MicroAge*, 291 B.R. at 508. Section 101(5)(A) provides that the term "claim" means any "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." 11 U.S.C. § 101(5)(A).

107. Other sections of the Bankruptcy Code support the conclusion that Congress intended the term "claim" in § 502(d) to encompass administrative claims. *In re MicroAge*, 291 B.R. at 508. First, many sections of the Bankruptcy Code refer to "claims" allowable or allowed

[112] *See also Movitz v. Baker (In re Triple Star Welding, Inc.)*, 324 B.R. 778, 796 (B.A.P. 9th Cir. 2005) (under § 502(d), creditor's administrative claim could not be paid until creditor returned any avoidable preference to debtor's estate), *abrogated on other grounds by Dye v. Brown (In re AFI Holding, Inc.)*, 530 F.3d 832 (9th Cir. 2008); *In re Bob Grissett Golf Shoppes, Inc.*, 50 B.R. 598, 607 (Bankr. E.D. Va. 1985) (§ 502(d) required disallowance of any claim for administrative rent, unless and until landlord disgorged avoidable post-petition transfers); *In re Ga. Steel, Inc.*, 38 B.R. 829, 839–40 (Bankr. M.D. Ga. 1984) (fact that claim is for administrative expense has no bearing on whether § 502(d) requires disallowance of claim).

under § 503(b). For example, § 348(d) refers to "a *claim* specified in section 503(b)." 11 U.S.C. § 348(d) (emphasis added); *see also* §§ 726(b), 726(c), 1226(a)(1), & 1326(a)(2). These sections indicate that Congress viewed administrative claims as merely one type of "claim." *In re MicroAge*, 291 B.R. at 508.

108. Second, several sections of the Bankruptcy Code explicitly exclude administrative claims from their reach. For example, § 348(d) excepts "a claim specified in section 503(b)" from its scope. 11 U.S.C. § 348(d). "The fact that Congress chose not to include similar language in § 502(d) suggests that Congress did not mean to exclude administrative claims from the application of this section." *In re MicroAge*, 291 B.R. at 508.

**(b) Judicial Precedent Predating the Bankruptcy Code and the Legislative History of 11 U.S.C. § 502(d) Support Applying the Section to Administrative Claims**

109. Judicial precedent predating the Bankruptcy Code and the legislative history of § 502(d) further support the conclusion that the section applies to administrative claims. *Microage*, 291 B.R. at 509. Courts interpreting section 57g of the Bankruptcy Act, which was the predecessor of § 502(d), held that section 57g applied to administrative claims. *See, e.g.*, *Weber v. Mickelson (In re Colonial Servs. Co.)*, 480 F.2d 747, 749 (8th Cir. 1973); *Hudson Feather & Down Prod., Inc. v. B&B Assocs., Inc. (In re Hudson Feather & Down Prods., Inc.)*, 22 B.R. 247 (Bankr. E.D.N.Y. 1982). The legislative history accompanying § 502(d) states that the section was "derived from present law," which indicates that Congress did not intend to depart from these holdings when it adopted § 502(d). S. Rep. No. 95-989, at 65 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5787, 5851.

110. The fact that Congress wrote § 502(d) to apply to any claim of any "entity," rather than any claim of any "creditor," also shows that Congress intended the section to apply to administrative claims. *In re Microage*, 291 B.R. at 509. Section 57g provided: "The claims of

*creditors* who have received or acquired preferences, liens, conveyances, transfers, assignments or encumbrances, void or voidable under this title, shall not be allowed unless such *creditors* shall surrender such preferences, liens, conveyances, transfers, assignments or encumbrances." Law of July 1, 1898, ch. 541, § 57g, 30 Stat. 560 as amended (repealed 1979). Although the term "creditor" was defined in the Bankruptcy Act to include administrative claimants, the same is not true under the Bankruptcy Code. Under the Bankruptcy Code, the term "creditor" excludes administrative claimants. *See* 11 U.S.C. § 101(10). Congress preserved the breadth of § 502(d) by making the section applicable not to any claim of any "creditor," but to any claim of any "entity." *In re MicroAge*, 291 B.R. at 509.

111. In support of its argument that § 502(d) does not apply to administrative claims, Parent relies on cases that looked to the structure of the Bankruptcy Code for evidence of Congress's intent.[113] However, any evidence of congressional intent provided by the structure of the Bankruptcy Code is ambiguous at best and is insufficient to overcome the presumption that Congress intended to leave existing law regarding § 502(d) unchanged. *In re MicroAge*, 291 B.R. at 511. "The normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific." *Midlantic Nat'l Bank v. N.J. Dep't of Envtl. Prot.*, 474 U.S. 494, 501 (1986). That rule is followed "with particular care in construing the scope of bankruptcy codifications." *Id.*[114] As Congress expressed no intent to change existing law when it enacted § 502(d), courts must apply § 502(d), like its predecessor section 57g, to administrative claims.

[113] Parent's Response at 26.

[114] *See also United States v. Whiting Pools, Inc.*, 462 U.S. 198, 208 (1983) (construing provision of Bankruptcy Code to be "consistent with judicial precedent predating the Bankruptcy Code" because "[n]othing in the legislative history evince[d] a congressional intent to depart from" pre-Code practice); *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs. (In re Timbers of Inwood Forest Assocs., Ltd.)*, 793 F.2d 1380, 1390, 1401 (5th Cir. 1986) (if Congress had intended to change pre-Code rules regarding adequate protection and post-petition interest, "the intention would have been clearly expressed").

**(c) The Policy Underlying 11 U.S.C. § 502(d) Supports Applying the Section to Administrative Claims**

112. The policy behind § 502(d) also supports application of the section to administrative claims. Section 502(d) is designed to coerce compliance with judicial orders and to assure an equality of distribution of the assets of the bankruptcy estate. *Campbell v. United States (In re Davis)*, 889 F.2d 658, 661–62 (5th Cir. 1989). As the *MicroAge* court explained:

> Why should a transferee [like AMC] who is obligated to return an avoidable transfer to the estate be permitted to further deplete the estate's resources by receiving payment of a claim of any kind without first being required to return the avoidable transfer? If the objective behind § 502(d) is to encourage transferees to return avoidable transfers to the estate, that objective would be best served by applying § 502(d) to transferees of both administrative and prepetition claims.

*In re MicroAge*, 291 B.R. at 512.

113. To uphold the goal of § 502(d), AMC's claim, regardless of its nature, must be disallowed unless and until AMC satisfies the SCC Final Judgment or the Judgment is reversed on appeal. Otherwise, the Court would allow AMC to further deplete the bankruptcy estate without first returning the estate's most valuable asset, which, according to the District Court, AMC took from Debtor "knowing that the transaction as contemplated would constitute a transfer in fraud of [Debtor's] creditors." *ASARCO*, 396 B.R. at 420.

**(2) Section 502(d) Applies to Claims on Appeal**

114. That AMC has appealed the SCC Final Judgment does not affect the § 502(d) analysis. The plain language of § 502(d), case law, and the policy underlying the section show that a bankruptcy court must disallow a creditor's claim under § 502(d) if a court has found that the creditor is the transferee of an avoidable transfer, regardless of whether the court's findings are on appeal. *See In re Consol. Indus. Corp.*, 2006 WL 2136037, at *1 (disallowing claims on basis of judgments "subject to pending appeals").

**(a) The Plain Language of 11 U.S.C. § 502(d) Requires Immediate Disallowance Even of Claims on Appeal**

115. The plain language of § 502(d) makes clear that, once a debtor has shown an "avoidable" transfer, a bankruptcy court must disallow any claim by the transferee unless the transferee has returned the avoidable transfer to the debtor's estate. Because the section refers to "avoidable" transfers rather than avoided transfers, a debtor is not required to obtain a final judgment in an underlying avoidance action—much less an affirmance of that judgment by an appellate court—prior to obtaining disallowance of a claim. *See In re Octagon Roofing*, 156 B.R. 214, 219 (Bankr. N.D. Ill. 1993) ("the plain language of § 502(d)" refutes the argument "that § 502(d) only acts to disallow claims that are subject to judgments under § 550").[115]

116. Relying on the plain language of § 502(d), one court within the Fifth Circuit has even suggested that the section requires disallowance of a creditor's claims when an avoidance action is pending against the creditor, even when no judicial determination has been made in that action. *In re Heritage Org., L.L.C.*, 375 B.R. 230, 288 (Bankr. N.D. Tex. 2007). When the trustee in *Heritage Organization* objected to certain claims by a creditor, an avoidance proceeding was pending against the creditor but had not been concluded. The court stated that because an avoidance action was pending, "§ 502(d) appears to require the disallowance of [the creditor's] claims as a matter of law." *Id.* at 288–89.

117. Focusing on the last clause of § 502(d), Parent argues that the Court may not disallow the Claim unless and until AMC refuses to comply with the SCC Final Judgment within

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[115] *See also In re Consol. Capital Equities Corp.*, 143 B.R. 80, 84 (Bankr. N.D. Tex. 1992) (§ 502(d) "does not require that the transfer be avoided, only that it be 'avoidable'"); *In re Chase & Sanborn Corp.*, 124 B.R. 368, 370 (Bankr. S.D. Fla. 1991) ("Nothing on the face of the statute or any case requires the entry of a judgment as a prerequisite to the disallowance under § 502(d) of a preferred creditor's claims."); *In re Coral Petroleum, Inc.*, 60 B.R. 377, 382 (Bankr. S.D. Tex. 1986) ("The requirement suggested by the [defendants] that judgment first be rendered before section 502(d) becomes operative ignores the plain language . . . of the Code section."); 4 COLLIER ON BANKRUPTCY ¶ 502.05[2][a] (15th ed. rev. 2008) ("The wording of section 502(d) refers to transfers 'avoidable' under various sections and not to claims that have been avoided.").

a reasonable amount of time.[116] This argument misconstrues § 502(d). Congress's use of the word "unless" in the last clause of § 502(d) indicates that the clause does not set forth an additional requirement for disallowance of a claim, but rather creates an exception to the general rule that a claim of a creditor who has received an avoidable transfer must be disallowed. *El Paso v. Am. W. Airlines, Inc. (In re Am. W. Airlines, Inc.)*, 217 F.3d 1161, 1165–66 (9th Cir. 2000). This exception to the general rule of disallowance exists because, if a creditor has already relinquished an avoidable transfer, there is no need to disallow the creditor's claim. *Id.*[117]

**(b) Case Law Supports Immediate Disallowance of AMC's Claim**

118. Most courts that have addressed the issue have held that a final judgment in an underlying avoidance action is not a prerequisite to disallowance of a claim under § 502(d). *See, e.g.*, *In re Heritage Org.*, 375 B.R. at 288.[118] In fact, many courts have held that § 502(d)

[116] Parent's Response at 29.

[117] *See also Smith v. Am. Founders Fin., Corp.*, 365 B.R. 647, 659 (S.D. Tex. 2007) ("Section 502(d) disallows the claims of creditors who have received avoidable transfers, unless the creditor relinquishes the transfer." (citing *Am. W. Airlines*, 217 F.3d at 1163–64)); *Red Dot Scenic*, 313 B.R. at 186 ("[S]ection 502(d) of the Bankruptcy Code does not even necessarily require the entry of a judgment, let alone the failure to enforce one, for a claim to be disallowed.").

[118] *See also In re Lambert Oil Co., Inc.*, 347 B.R. 508, 522 n.6 (W.D. Va. 2006); *In re Integrated Health Servs., Inc.*, 344 B.R. 262, 280 (Bankr. D. Del. 2006); *In re Consol. Indus. Corp.*, 2006 WL 2136037 at *1; *In re Red Dot Scenic*, 313 B.R. at 186; *In re Consol. Indus. Corp.*, No. 98-40533, slip op. at 3–4 (Bankr. N.D. Ind. July 2, 2003) (attached as Attachment A); *In re Octagon Roofing*, 156 B.R. at 219; *In re Chase & Sanborn Corp.*, 124 B.R. at 370; *In re Coral Petroleum*, 60 B.R. at 382–83; *In re Moriarty*, 22 B.R. 689, 690 (Bankr. D. Neb. 1982).

*Consolidated Industries* is particularly instructive. In that case, Enodis Corporation filed a number of objections to claims filed in Consolidated Industries' bankruptcy case. *In re Consol. Indus. Corp.*, No. 98-40533, slip op. at 1. The trustee objected to the filings, arguing that Enodis was not a party in interest because a district court had determined that Enodis was the recipient of avoidable transfers and Enodis had not paid the amount of those transfers to the estate. *Id.* Enodis opposed the trustee's objection, contending that the district court's decision that Enodis had received avoidable transfers had not been memorialized in a final judgment. *Id.* The bankruptcy court found Enodis's argument unpersuasive and disallowed its claim, stating: "That the district court has determined Enodis received avoidable transfers in excess of seven million dollars is not and cannot be disputed. Neither is there any dispute that Enodis has failed to pay the amount of those transfers to the estate. These undisputed facts lead to the conclusion that Enodis's claim must be disallowed pursuant to § 502(d), as surely as night follows day." *Id.* at 3–4 (citations omitted). In deciding that Enodis received avoidable transfers, the bankruptcy court looked to the

operates to disallow the claim of any creditor who does not surrender an avoidable transfer, even if the underlying avoidance action would be barred by the statute of limitations. *See, e.g.*, *In re Am. W. Airlines, Inc.*, 217 F.3d at 1167–68.[119]

119. These holdings refute any argument that the Court cannot disallow the Claim because AMC has appealed the SCC Final Judgment. If a court can disallow a claim under § 502(d) based on an avoidance action in which no final judgment has been entered, then, *a fortiori*, a court can (and must) disallow a claim based on an avoidance action in which a final judgment has been entered. Similarly, if a time-barred avoidance action (on which a final judgment is forever foreclosed) can form a proper basis for disallowance of a claim under § 502(d), then, *a fortiori*, so can an avoidance action in which a final judgment has been entered.

120. A debtor need only obtain some judicial determination of a creditor's liability in order to entitle it to disallowance of the creditor's claim under § 502(d). As noted by *Collier*:

> To assure the effectuation of the purpose of [§ 502(d)], a claim may be disallowed at least temporarily and for certain purposes, subject to reconsideration, simply upon the allegation of an avoidable transfer. But to prevent abuse of this section this initial disallowance should be made by judicial determination, whether it be obtained in a claim objection or by some form of a declaratory judgment action.

4 COLLIER ON BANKRUPTCY ¶ 502.05[2][a] (15th ed. rev. 2008). Debtor obtained a Final Judgment holding AMC liable for actual fraudulent transfer. That is more than enough to meet the requirements of § 502(d).

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district court's decision in the underlying avoidance action, which the bankruptcy court held was "sufficiently firm to be accorded conclusive effect." *Id.* at 4–5.

[119] *See also Smith*, 365 B.R. at 673 n.6; *In re McLean Indus., Inc.*, 196 B.R. 670, 675–77 (S.D.N.Y. 1996); *In re Eye Contact, Inc.*, 97 B.R. 990, 992 & n.3 (Bankr. W.D. Wis. 1989); *In re Mid Atl. Funds, Inc.*, 60 B.R. 604, 609–11 (Bankr. S.D.N.Y. 1986); 4 COLLIER ON BANKRUPTCY ¶ 502.05[2][a] (15th ed. rev. 2008) ("Most courts find that there is no prohibition against the trustee's asserting section 502(d) as an affirmative defense to a claim of a creditor even if the trustee's claim is time-barred or otherwise nonrecoverable.").

**(c) The Policy Underlying 11 U.S.C. § 502(d) Supports Immediate Disallowance of Claims on Appeal**

121. The policy behind § 502(d) also supports disallowance of the Claim with respect to AMC. As explained above, § 502(d) is designed to coerce compliance with judicial orders and to assure an equality of distribution of the assets of the bankruptcy estate. *In re Davis*, 889 F.2d at 661–62; *In re Chase & Sanborn Corp.*, 124 B.R at 371. A creditor that has been found to have received an avoidable transfer should not share in the distribution of the assets of the estate, whether or not the creditor has appealed the judgment against it. AMC, which the District Court has found to be the perpetrator of an actual fraudulent transfer, is not permitted to further deplete the bankruptcy estate by receiving payment of the Claim without first being required to return the fraudulent transfer.

122. The Court's holding does not forever disallow the Claim. It merely disallows the Claim unless and until AMC satisfies the SCC Final Judgment or the Judgment is reversed on appeal, at which time AMC may move for reconsideration under 11 U.S.C. § 502(j) in accordance with the findings of fact and conclusions of law set forth in this opinion. This relief assures equality in distribution of the assets of the bankruptcy estate, but does not penalize AMC for appealing the SCC Final Judgment.

**b. New Asarco's Claim is Disallowed Under 11 U.S.C. § 502(b)(1)**

123. New Asarco's claim is disallowed under section 502(b)(1) of the Bankruptcy Code because Debtor owes nothing to New Asarco.

124. Section 502(b)(1) provides that a court must allow a claim, unless "such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law for a reason other than because such claim is contingent or unmatured." 11 U.S.C. § 502(b)(1). Courts routinely disallow claims on the ground that the claimant does not have an

enforceable right to payment from the debtor. *See, e.g.*, *In re BFP Invs., Ltd.*, 149 Fed. App'x 828, 830 (11th Cir. 2005) (bankruptcy court properly disallowed claim because claimant had right to payment from debtor's general partner, not from debtor itself).[120]

125. There is no evidence establishing New Asarco's right to payment from Debtor based on the TSA or otherwise. The TSA does not obligate Debtor to pay New Asarco anything.[121] Instead, the TSA provides that Debtor "agrees to pay to *AMC*, for each taxable year to which this Agreement is applicable, the portion of the Group's consolidated federal income tax liability attributable to the Asarco Subgroup."[122] Moreover, New Asarco has never paid any taxes attributable to Debtor's assets and operations. *See supra* ¶ 60.

**2. If Parent Had an Allowed Claim, Parent's Damages Would Be Substantially Less Than the Amount of the Claim**

126. Two questions must be addressed in order to determine the amount of the Claim, in the event Parent's claim is ever allowed. First, the Court must address Debtor's argument that the TSA terminated on January 1, 2007, as Parent's claim arises under the TSA and encompasses taxable years 2007 and 2008. Second, the Court must address Debtor's arguments (i) that Parent has not paid the taxes it seeks for 2007 and 2008, and (ii) that any tax losses arising as a result of payment of Debtor's creditors will reduce the amount Parent ever has to pay. As described below, even if the Claim is not disallowed, the amount of the Claim is significantly overstated.

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[120] *See also In re Gatzke*, 365 B.R. 138, 185 (Bankr. D. Mont. 2007) (disallowing claim because claimant offered no evidence establishing right to payment from debtor based on written agreement or otherwise); *In re Enron*, No. 01-16034 (AJG), 2006 WL 2864972, at *1 (Bankr. S.D.N.Y. Sept. 29, 2006) (disallowing claim because claimant offered no evidence of enforceable contractual relationship giving claimant right to payment from debtor); *In re Official Comm. of Unsecured Creditors for Dornier Aviation (N. Am.), Inc.*, 453 F.3d 225, 232 (4th Cir. 2006) (disallowance of claim under § 502(b) is appropriate when claimant has no rights vis-à-vis bankrupt, *i.e.*, when there is no basis in fact or law for any recovery from debtor).

[121] DX52.

[122] *Id.*

### a. The Termination of the TSA in 2007 Substantially Decreases the Amount of the Claim

127. As a disregarded entity, Debtor is not liable for federal income tax on its income. *See supra* ¶ 62. Therefore, Debtor's liability to Parent, if any, arises solely from the TSA. While Parent's claim is for reimbursement of taxes allegedly paid on Debtor's behalf for 2005 through 2008, Parent terminated the TSA on January 1, 2007. Consequently, Parent has no claim under the TSA for 2007 and 2008. As a result, the maximum amount of Parent's damages under the TSA is $9,221,173—the amount allegedly owed by Debtor under the TSA for the taxable years 2005 and 2006.[123]

#### (1) New York Law Determines Whether the TSA Is Still in Effect

128. To determine whether the TSA is still in effect, the Court applies New York law. Section 12 of the First Amendment specifies that the agreement shall be governed by, and construed in accordance with, the law of the State of New York.[124] While the TSA incorporates certain federal income tax concepts into its terms, the TSA is simply an agreement between private parties that is governed by state contract law. Other courts faced with the task of interpreting tax sharing agreements that define certain contractual obligations by reference to federal income tax concepts have held that state contract law governed the agreements. *See, e.g.*, *Summit Nat'l Life Ins. Co. v. Cargill, Inc.*, 807 F. Supp. 363, 368 (E.D. Pa. 1992); *McReynolds v. Cherokee Ins. Co.*, 896 S.W.2d 777, 779–80 (Tenn. Ct. App. 1994). Whether the TSA still exists depends upon whether the rescission effected on December 31, 2007 *for federal income tax purposes* is also effective to unilaterally reinstate the TSA *under New York law*.

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[123] As noted above, Parent has failed to submit any evidence of payment of state income tax liabilities. *See supra* ¶¶ 52, 56, 59.

[124] *Id.*

**(2) Parent Terminated the TSA on January 1, 2007**

129. Parent terminated the TSA according to its terms on January 1, 2007 when New Asarco transferred 21 Class B shares of Asarco USA to Asarco Cayman.[125] Section 9 of the amendment to the TSA provides: "Notwithstanding anything in the Original Agreement to the contrary, this Agreement shall terminate upon the occurrence of a Deconsolidation Event."[126] Section 6 of the amendment to the TSA, in turn, states that a "Deconsolidation Event" occurs if Debtor "no longer meets the requirements of Code section 1504(a) for inclusion in the [AMC Consolidated Group] (assuming, for these purposes, that [Debtor] is and continues to be a corporation for federal income tax purposes)."[127]

130. New Asarco's transfer of 21 Class B shares of Asarco USA to Asarco Cayman, which is a foreign corporation, caused Asarco USA to no longer meet the requirements of section 1504(a) of the Code for inclusion in the AMC Consolidated Group because, immediately after this transfer, neither New Asarco nor any other *domestic* corporation that was part of the AMC Consolidated Group owned at least 80% of the stock of Asarco USA. This transfer also caused Debtor to no longer meet the requirements of section 1504(a) of the Code for inclusion in the AMC Consolidated Group (assuming, as the TSA requires, that Debtor was a corporation for federal income tax purposes) because Debtor is wholly owned by Asarco USA. *See* I.R.C. §§ 1504(a)(2), 1504(b). Accordingly, New Asarco's transfer of 21 Class B shares of Asarco USA to Asarco Cayman caused a Deconsolidation Event to occur, and the TSA to terminate, on January 1, 2007.

[125] DX78; DX79; Valdes Dep. at 50:8–10; Smith Dep. at 118:10–18.

[126] DX52.

[127] *Id.*

**(3) Parent's Rescission of the 2007 Stock Transfer Did Not Reinstate the TSA**

131. New Asarco transferred 21 Class B shares of Asarco USA to Asarco Cayman on January 1, 2007 because Parent wanted to isolate itself from the tax liability attributable to Debtor's assets and operations in 2007 and later years. *See supra* ¶¶ 37–38. Later in 2007, Parent decided that it would be in its best interests if Asarco USA remained a member of the AMC Consolidated Group. In particular, Parent wanted to be able to carry back and use any losses generated by resolution of Debtor's bankruptcy to claim a refund of taxes paid by the AMC Consolidated Group in previous years (or to reduce unpaid taxes still owed). *See supra* ¶ 40.

132. To include Asarco USA in the AMC Consolidated Group in 2007 and later years, on December 31, 2007, Parent rescinded, for federal income tax purposes, New Asarco's transfer of 21 Class B shares of Asarco USA to Asarco Cayman on January 1, 2007. *See supra* ¶ 39. The rescission was effective for federal income tax purposes: Asarco USA was included as a member of the AMC Consolidated Group in 2007 and later years.[128] The rescission did not, however, reinstate the TSA because Debtor never assented to revival of the agreement.

**(a) Under New York Law, a Terminated Contract Cannot Be Revived Without the Assent of All Parties to the Contract**

133. Under New York law, upon the satisfaction of a condition that triggers a contract's termination, there is no contract remaining for the parties to enforce. At that point, the terminated contract can be revived only with the mutual assent of all parties to the contract. *See Moller v. Tuska*, 87 N.Y. 166, 170 (N.Y. 1881) (once "contract was at an end, . . . no act on the part of the plaintiffs alone could revive it"); *Wilderhomes, LLC v. Zautner*, 34 A.D.3d 1062,

[128] PX7.

1064 (N.Y. App. Div. 2006) (no contract existed on which to premise plaintiff's breach-of-contract action because the parties' contract was nullified and the parties never executed a new contract); *Bessette v. Niles*, 23 A.D.3d 996, 997 (N.Y. App. Div. 2006) (agreement terminated by its own terms after one year, and parties' conduct did not evidence their mutual assent to a new agreement); *Dauber v. Reznik*, 200 A.D. 650, 652 (N.Y. App. Div. 1922) (plaintiffs had no contract to enforce because the parties' contract terminated and the defendant refused to revive the contract); *Cornerstone Realty Group, LLC v. County of Greene*, 859 N.Y.S.2d 893, 2005 WL 6075236, at *4 (N.Y. Sup. Ct. June 6, 2005) (terminated contract was not revived because parties never came to an agreement on a new contract).[129] Because Debtor never agreed to revival of the TSA, the TSA has not existed since Parent terminated it on January 1, 2007.

134. The Second Circuit faced a situation similar to the present case in which one party to a contract sought to rescind an act that triggered the contract's termination after the contract had terminated. *See Roleco Serv. Stations, Inc. v. Getty Ref. and Mktg. Co.*, 839 F.2d 88 (2d Cir. 1988). Roleco entered into a set of franchise agreements with Getty. *Id.* at 89. One agreement provided that, at the end of either the initial franchise term of five years or any subsequent year, either party could terminate the agreement upon thirty days prior written notice. *Id.* at 90. On March 18, 1983, Roleco sent Getty a letter giving notice of its intent to terminate the agreement, effective at the close of business on May 10, 1983, the last day of the initial five-year franchise term. *Id.* On May 11, 1983, Roleco sent Getty a letter attempting to revoke its

[129] Contract treatises confirm that New York law is consistent with the law of most states on this point. *See* 17B C.J.S. *Contracts* § 432 (2009) ("After a contract has been rescinded, it can be revived only by mutual assent. Revival may be effected by express agreement or by acts evidencing such an intention."); *id.* § 448 ("When a contract is terminated, even wrongfully, there is no longer a contract, hence no duty to perform and no right to demand performance . . . ."); 13 CORBIN ON CONTRACTS § 67.8 (rev'd ed. 2003) ("After a mutual rescission of a contract, it can be 'revived' only by mutual expressions to that effect by both parties."); 17A AM. JUR. 2D *Contracts* § 585 (2009) ("After a contract has been rescinded, it can be revived only by mutual assent or by a decree in equity.").

notice of termination that read: "This will advise that any and all terminations, specifically including a certain letter dated March 18, 1983, by Roleco to Getty, are hereby rescinded . . . ." *Id.* Getty maintained that the attempted rescission was ineffective because the franchise agreement had already terminated. *Id.* The Second Circuit agreed, holding that the contract terminated on May 10, 1983, and that Roleco's purported rescission of its notice of termination was ineffective to revive the terminated contract. *Id.* at 92.

135. Like Roleco, Parent attempted to revive the TSA by rescinding the act that triggered its termination. It cannot do this without Debtor's assent. Once a contract has been terminated, each party is powerless to revive it without the assent of all other parties to the contract.

**(b) The Tax Sharing Agreement Does Not Allow For Its Revival Upon the Unilateral Acts of One Party**

136. Section 9 of the amendment to the TSA provides that "*[u]pon* the occurrence of a Deconsolidation Event or any other termination of this Agreement, none of the parties hereto shall have any further rights or obligations hereunder," except with respect to certain enumerated items that survive termination of the agreement.[130] A right to unilaterally revive the TSA by rescinding the act that terminated the agreement is not one of the enumerated items.[131]

137. It is a fundamental principle of New York law that "if the language [of a contract] is clear and unambiguous, that is to control." *Clark v. New York Life Ins. & Trust Co.,* 64 N.Y. 33, 38 (1876). Contract provisions governing termination of the agreement are no exception to this rule. *J. Petrocelli Constr., Inc. v. Realm Elec. Contractors, Inc.*, 790 N.Y.S.2d 197, 199 (N.Y. App. Div. 2005) ("Generally, where parties agree on a termination procedure, the

[130] DX52.

[131] *Id.*

clause must be enforced as written."). Section 9 of the amendment to the TSA clearly and unambiguously states that the agreement terminates upon the occurrence of a Deconsolidation Event, and that the agreement continues to apply only to certain enumerated items following its termination. None of the enumerated items allows Parent to retroactively and unilaterally reinstate the TSA by rescinding the act that resulted in a Deconsolidation Event. Absent a specific contract provision authorizing Parent to unilaterally revive the TSA following its termination, Parent has no ability to do so. Even if the Claim were not disallowed, Parent would be entitled, at most, to a claim for $9,221,173—the amount allegedly owed by Debtor under the TSA for the taxable years 2005 and 2006—because Parent's rescission of the 2007 stock transfer did not revive the TSA.[132]

**(4) Parent Has No Equitable Claim For Taxes Incurred After January 1, 2007**

138. Parent cannot rely upon principles of equity to support the amount of the Claim. As explained below, in response to equitable arguments made by shareholders or other owners of pass-through entities, courts frequently place the blame back on the shareholders or other owners because they chose to structure the debtor as a pass-through entity and to accept the benefits and burdens of that structure. *See infra* ¶¶ 174–76. Between 2003 and today, Parent made a number of purposeful decisions, including forming Debtor as a disregarded entity for federal income tax purposes, in an effort to reduce its tax liability. Having benefited from those decisions, Parent cannot now ask the Court to act as if they were never made. Parent is not entitled to anything from Debtor under principles of equity.

[132] As noted above, Parent has failed to submit any evidence of payment of state income tax liabilities. *See supra* ¶¶ 52, 56, 59.

**b. Even if the Tax Sharing Agreement Remained in Effect Today, Parent's Damages Would Be Substantially Less Than the Amount of the Claim**

139. Parent seeks roughly $161 million from the bankruptcy estate for taxes allegedly attributable to Debtor's assets and operations between 2005 and 2008. But Parent has not paid $161 million in taxes attributable to Debtor's assets and operations in those years. Additionally, the TSA provides that the amounts owed by Debtor to Parent under the TSA are determined for a particular tax year by giving effect to any losses generated by Debtor that can be carried back to that year. The Claim, however, does not take into account the tax losses that will be generated by payment of certain of Debtor's creditors upon resolution of its bankruptcy, as required by the TSA. Consequently, even if the Claim were not disallowed and the TSA remained in effect today, Parent's damages under the TSA would be substantially less than the amount of the Claim.

**(1) Under New York law, Parent Must Come Forward With Specific Evidence to Establish Damages**

140. State law determines the amount of the Claim. *See Menchise v. Akerman Senterfitt*, 532 F.3d 1146, 1151 (11th Cir. 2008).[133] Because the TSA contains a choice-of-law provision providing that the agreement shall be governed by, and construed in accordance with, the law of the State of New York, the Court applies New York law to determine the amount of the Claim.[134]

141. To establish a breach-of-contract claim under New York law, a plaintiff must show that it has suffered damages. *Coastal Aviation, Inc. v. Commander Aircraft Co.*, 937 F. Supp. 1051, 1060 (S.D.N.Y. 1996). It is not enough for the plaintiff to allege damage; it must

[133] *See also Highland Superstores, Inc. v. Strobeck Real Estate, Inc. (In re Highland Superstores, Inc.)*, 154 F.3d 573, 578 (6th Cir. 1998); *Canal Corp. v. Finnman (In re Johnson)*, 960 F.2d 396, 404 (4th Cir. 1992); *Calton Crescent, Inc. v. Becker*, 173 F.2d 944, 946 (2d. Cir. 1949).

[134] DX52.

come forward with specific evidence to establish the existence of damages flowing from the alleged breach. *Stanford Square, L.L.C. v. Nomura Asset Capital Corp.*, 229 F. Supp. 2d 199, 206 (S.D.N.Y. 2002); *Lexington 360 Assocs. v. First Union Nat'l Bank of N.C.*, 234 A.D.2d 187, 189–90 (N.Y. App. Div. 1996). Parent has not met this burden.

**(2) Parent Cannot Recover Taxes It Has Not Paid**

142. Parent cannot show that it has incurred $161 million in damages due to Debtor's alleged breach of the TSA. If anything, Parent has incurred only a fraction of the damages it claims for the taxable years 2007 and 2008. Parent has paid only about $14 million of the $71 million of federal income tax liability allegedly attributable to Debtor's assets and operations for 2007, and Parent has not paid any of the $60 million of federal income tax liability allegedly attributable to Debtor's assets and operations for 2008. *See supra* ¶¶ 55–58. Further, Parent has failed to offer any evidence establishing its payment of state taxes for which it claims reimbursement. Parent can only recover from Debtor, if at all, for taxes Parent has actually paid on account of Debtor's assets and operations.

**(3) Parent Cannot Recover Taxes That It Never Will Pay**

**(a) Resolution of Debtor's Bankruptcy Will Produce Substantial Tax Deductions for Parent**

143. Parent estimates that the resolution of Debtor's bankruptcy will result in regular federal tax deductions of approximately $2.15 billion for 2009.[135] The deductions arise from payments to Debtor's creditors,[136] which payments will occur under either Debtor's or Parent's

[135] DX112 (ASARCO LLC and Subsidiaries Rough Estimate of Hypothetical Net Operating Loss Carryforwards); 8/4 Tr. (Smith) at 33:3–7.

[136] All or substantially all of the amounts paid by Debtor in settlement of environmental claims, asbestos claims, and toxic tort claims will be deductible and will generate losses. *See Coltec Indus., Inc. v. United States*, 62 Fed. Cl. 716, 744 (Fed. Cl. 2004) (liabilities for asbestos claims are deductible as ordinary and necessary business expenses under section 162 of the Internal Revenue Code); *Kerr-McGee Corp. v. United States*, 77 Fed. Cl. 309, 317 (2007) ("Expenditures incurred by a taxpayer in carrying on its trade or business to remediate property that it contaminated and that do not increase the value or change the use of the property may be classified by that taxpayer as ordinary

plan of reorganization. The AMC Consolidated Group's taxable income for 2009 will be decreased by approximately $1 billion[137] to $2 billion[138] on account of Debtor's assets and operations.[139]

**(b) Debtor Is Entitled to the Benefit of the 2009 Net Operating Losses Under the TSA**

144. As just outlined, the parties agree that payments to creditors upon the resolution of Debtor's bankruptcy will result in at least $1 to $2 billion of net operating losses for 2009.[140] Section 172(b) of the Code permits losses to be carried back two years or, in the case of certain specified losses such as deductions for remediation of environmental contamination, to be carried back ten years. Thus, the net operating losses generated upon resolution of Debtor's bankruptcy will reduce Parent's federal income tax liability for prior years, including its liability for taxes attributable to Debtor's assets and operations for which it seeks reimbursement.

145. Because the Claim does not take these losses into account, it significantly overstates the amount, if any, due under the TSA. Under the TSA, Debtor is entitled to receive the benefits of any net operating losses attributable to its operations. Section 5 of the First Amendment provides that Debtor's payment obligations to Parent under the TSA shall be determined for a particular year by "giving effect to any net operating loss, tax credit, or other

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and necessary business expenses . . . ."); Treas. Reg. § 1.162-21(b)(2) ("Compensatory damages . . . paid to a government do not constitute a [nondeductible] fine or penalty."); 8/4 Tr. (Smith) at 33:3–7; 8/4 Tr. (Kayle) at 82:6–23; Parker Proffer ¶ 48.

[137] Hitter Proffer ¶ 5; 8/4 Tr. (Smith) at 47:14 – 48:2.

[138] DX112; 8/4 Tr. (Smith) at 33:3–7, 34:20 – 35:3.

[139] Debtor's assets and operations produce a smaller net operating loss for the AMC Consolidated Group under Debtor's plan because Debtor's plan involves a sale of assets to Sterlite that will produce taxable gain. This gain would partially offset the roughly $2.15 billion of tax deductions arising from payments to certain creditors. Hitter Proffer ¶ 5; 8/4 Tr. (Smith) at 47:14 – 48:2.

[140] These figures are based on the plans of reorganization on file on August 4, 2009. The final plans of reorganization proposed by Debtor and Parent would result in greater payments to creditors and, thus, greater net operating losses.

tax benefit or attribute that may carried forward or back to such year."[141] In addition, Section 7(b) of the First Amendment states:

> To the extent that the Asarco LLC Subgroup incurs a net operating loss or loss in any year that would be utilized by the Asarco LLC Subgroup to cause the Asarco LLC Subgroup to receive a refund with respect to a taxable year had it filed a separate federal income tax return, AMC shall pay Asarco the amount of the refund that the Asarco LLC Subgroup would have enjoyed if it had filed such separate returns . . . .[142]

146. Parent argues that Section 8 of the First Amendment entitles Parent to the benefit of the 2009 net operating losses attributable to Debtor's assets and operations. Section 8 provides in relevant part:

> The parties hereto also agree that any deduction arising directly or indirectly from or attributable in whole or in part to the transactions or other circumstances giving rise to or otherwise resulting in the Deconsolidation Event, shall be treated for all purposes of this Agreement and the Original Agreement as an item of deduction of the AMC Subgroup and not the Asarco LLC Subgroup.

Contrary to Parent's argument, the transactions giving rise to the deductions are not the same transactions that will cause a Deconsolidation Event under Debtor's plan (assuming for the sake of argument that the TSA still exists). As stated above, the deductions arise from the payment of certain of Debtor's creditors under either Debtor's or Parent's plan of reorganization. *See supra* ¶ 143. If Debtor's plan is confirmed, and assuming the TSA is still in effect, a Deconsolidation Event would occur upon the cancellation of Parent's member interests in Debtor, not upon the payments to creditors. That the transactions giving rise to the deductions are independent of the transactions that would cause a Deconsolidation Event is illustrated by the fact that, under Parent's plan, the deductions would arise even though no Deconsolidation Event would occur because Parent would retain its member interests in Debtor.

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[141] DX52 § 7(b).

[142] *Id.*

147. Parent will not only benefit from the 2009 net operating losses generated by Debtor's assets and operations by decreasing Parent's federal income tax liability for prior years through carryback of the losses; Parent will also benefit by sheltering future income from taxation by carrying forward the remaining net operating losses. Parent estimates that, accounting for Debtor's assets and operations on a stand–alone basis as if Debtor were a separate filer for federal income tax purposes, Debtor's assets and operations will produce a net operating loss carryforward of $1.5 billion after carrying back the 2009 net operating losses generated by Debtor's assets and operations against income produced by Debtor in previous years.[143]

148. Parent will be able to use the 2009 net operating losses attributable to Debtor's assets and operations to reduce its federal income tax liability for prior years. If Debtor's contractual liability, if any, to AMC is not reduced due to those same losses as the terms of the TSA require, Parent will receive a double recovery. In addition, Parent will be able to carry forward the remaining net operating losses attributable to Debtor's assets and operations to shelter its own future income. This is an unreasonable and unfair interpretation of the TSA.

149. Under New York law, it is a canon of contract construction that a court should not interpret a contract in a way that leads to unfair or absurd results. *Metro. Life Ins. Co. v. Noble Lowndes Int'l, Inc.*, 643 N.E.2d 504, 508 (N.Y. 1994) ("A court will endeavor to give the [contract] construction most equitable to both parties instead of the construction which will give one of them an unfair and unreasonable advantage over the other." (citing *Fleischman v. Furgueson*, 119 N.E. 400, 402 (N.Y. 1918)); *Farrell Lines, Inc. v. City of N.Y.*, 281 N.E.2d 162, 165 (N.Y. 1972) ("[R]ules of construction of contracts require, whenever possible, that an agreement should be given a 'fair and reasonable interpretation' . . . ."); *Lipper Holdings, LLC v.*

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[143] DX112; 8/4 Tr. (Smith) at 43:17 – 44:7.

*Trident Holdings, LLC*, 766 N.Y.S.2d 561, 562 (N.Y. App. Div. 2003) ("A contract should not be interpreted to produce a result that is absurd, commercially unreasonable or contrary to the reasonable expectations of the parties.") (citations omitted). Thus, even if the Claim were not disallowed and the TSA were still in existence, Debtor would be entitled to carry back the 2009 net operating losses attributable to its assets and operations in determining its liability to Parent, if any, under the TSA.

**(c) Parent Cannot Recover More Than It Is Entitled to Recover Under the TSA**

150. The Claim must be reduced to reflect what Parent bargained for under the TSA. The theory underlying an award of damages in a breach-of-contract action brought under New York law is to make good or replace the loss caused by the breach. *Brushton-Moira Cent. School Dist. v. Fred H. Thomas Assocs., P.C.*, 91 N.Y.2d 256, 261 (N.Y. 1998). Breach-of-contract damages are intended to return the parties to the point at which the breach arose and to place the non-breaching party in as good a position as it would have been had the contract been performed. *Brushton-Moira*, 91 N.Y.2d at 261.[144] So far as possible, New York law attempts to secure to the non-breaching party the benefit of its bargain, subject to the limitations that the injury was foreseeable and that the amount of damages claimed are measurable with a reasonable degree of certainty and adequately proven. *Freund v. Washington Square Press, Inc.*, 34 N.Y.2d 379, 382 (N.Y. 1974); *Heary Bros. Lightning Prot. Co. v. Intertek Testing Servs., N.A.*, 9 A.D.3d 870, 873 (N.Y. App. Div. 2004).

151. Under New York law, a non-breaching party cannot recover more from a breach of contract than it would have gained had the contract been performed fully. *Freund*, 34 N.Y.2d

[144] *See also Goodstein Constr. Corp. v. City of New York*, 80 N.Y.2d 366, 373 (N.Y. 1992); *Freund v. Washington Square Press, Inc.*, 34 N.Y.2d 379, 382 (N.Y. 1974); *Siegel v. Laric Entm't Corp.*, 307 A.D.2d 861, 863–64 (N.Y. App. Div. 2003); 11 CORBIN ON CONTRACTS § 55.3 (rev'd ed. 2003); RESTATEMENT (SECOND) OF CONTRACTS §§ 344 & 347 (1982).

at 382.[145] Rather, a non-breaching party's recovery is limited to the loss it actually suffered by reason of the breach. *Inchaustegui v. 666 5th Ave. Ltd. P'ship*, 96 N.Y.2d 111, 116 (N.Y. 2001). This rule is not unique to New York law. "[I]t is a basic tenet of contract law that the aggrieved party will not be placed in a better position than it would have occupied had the contract been fully performed." 11 CORBIN ON CONTRACTS § 55.3 (rev'd ed. 2003).[146]

152. Courts frequently apply this basic tenet of contract law in bankruptcy cases. In deciding what damages to award a non-debtor for a debtor's breach of a contract, courts have consistently held that the non-debtor should not receive more than what it bargained for. *See, e.g.*, *Montgomery Ward Holding Corp. v. Meridian Leasing*, 326 F.3d 383, 388–89 (3d Cir. 2003) (liquidated damages clause in contract was an unenforceable penalty because it would have put the plaintiff in a better position than the plaintiff would have been in had the contract been performed fully), *aff'g Montgomery Ward & Co. v. Meridian Leasing Co. (In re Montgomery Ward Holding Corp.)*, 269 B.R. 1, 7–9, 12 (D. Del. 2001) (same).[147]

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[145] *See also Baker v. Drake*, 53 N.Y. 211, 217 (N.Y. 1873); *Heary Bros.*, 9 A.D.3d at 873; *Bogdan & Faist, P.C. v. CAI Wireless Sys., Inc.*, 295 A.D.2d 849, 853–54 (N.Y. App. Div. 2002); *see also Hinds v. Brescia*, No. 2002-1452, 2003 WL 22462383, at *1 (N.Y. App. Term Sept. 30, 2003) (unpublished opinion) (court improperly awarded plaintiff partial damages for her mortgage and maintenance costs because such award placed plaintiff, who had an independent obligation to pay these expenses, in a better position than she would have been upon performance of the breached contract); *Interfilm, Inc. v. Advanced Exhibition Corp.*, 249 A.D.2d 242, 242 (N.Y. App. Div. 1998) (court properly precluded evidence of plaintiffs' reliance damages because such damages would have placed plaintiffs in a better position than if the breached contract had been performed); *Odysseys Unlimited, Inc. v. Astral Travel Serv.*, 77 Misc.2d 502, 505 (N.Y. Sup. Ct. 1974) ("Damages in the usual breach of contract action should . . . leave [the non-breaching party] in no worse, *but put him in no better*, position than he would have been had the breach not occurred.") (emphasis added); *Nu Dimensions Figure Salons v. Becerra*, 73 Misc.2d 140, 143 (N.Y. Civ. Ct. 1973) (refusing to enforce penalty clause in breached contract because doing so would have placed plaintiff in a better position after the breach than he would have been if the contract had not been breached).

[146] *See also* 22 AM. JUR. 2D *Damages* § 46 (1982) ("[T]he injured party should not be put in a better position than had the contract been performed, or be provided with a windfall recovery."); 3 DAN B. DOBBS, DOBBS ON REMEDIES § 12.2(1) at 22–23 (1993) ("Subject to the limitations on damages that the parties themselves provide or assume, the contract idea of money compensation has been to award a sum that will put the plaintiff as a nonbreaching party in as good a position as he would have been in had the contract been performed, *and no better*.") (emphasis added).

[147] *Sterling Vision, Inc. v. Sterling Optical Corp. (In re Sterling Optical Corp.)*, 371 B.R. 680, 692–93 (Bankr. S.D.N.Y. 2007) (non-breaching party to letter agreement was entitled to a claim for damages to make it whole, but was not entitled to be put in a better position than if the agreement was actually performed); *In re Health Am. Med. Group, Inc.*, 293 B.R. 799, 804–05 (Bankr. M.D. Fla. 2003) (if lessor had re-leased the property in question for more

153. The situation facing the Court is similar to the one in *In re Enron Corp.*, 349 B.R. 96 (Bankr. S.D.N.Y. 2006). The debtor in *Enron* rejected three interrelated agreements that made up one single contract. *Id.* at 97, 104. One of the agreements was valuable to the debtor because it was in-the-money to the debtor. *Id.* at 97. The other two agreements were valuable to the non-debtor because they were in-the-money to the non-debtor. *Id.* The court held that to determine the allowable amount of the non-debtor's claim for breach of contract, the debtor's in-the-money position under one agreement should be set off against the non-debtor's in-the-money positions under the other two agreements. *Id.* at 104. The court noted that, under contract law, damages are intended to give the benefit of the bargain to non-breaching parties by awarding a sum of money that will put them in as good a position as they would have been in had the contract been performed. *Id.* at 106. The court concluded that the debtor's in-the-money position should be taken into consideration when computing the non-debtor's breach-of-contract damages because, if the non-debtor received damages based only on its in-the-money positions, the non-debtor would receive more than what it bargained for. *Id.*

154. The net operating losses that will result from resolution of Debtor's bankruptcy are similar to the debtor's in-the-money position in *Enron*. If Parent receives damages based only on its current tax liability for 2005 through 2008, Parent would receive more than it bargained for. Indeed, Parent would obtain a double recovery. Parent would receive a claim against the bankruptcy estate for taxes attributable to Debtor's assets and operations, and later Parent would collect a refund from the IRS for any payment of such taxes. As explained above, under the TSA the Debtor is entitled to the benefit of any net operating loss carrybacks

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and for the same length or a longer period of time than it was leased under the rejected lease agreement, lessor would not have been entitled to any damages, which would have been "an unacceptable windfall" to the lessor); *In re Greenville Auto Mall, Inc.*, 278 B.R. 414, 425 (Bankr. N.D. Miss. 2001) (plaintiff's rejection damages had to be reduced by the amount that the plaintiff would have expended in performing its obligations under the rejected contract because the plaintiff's fulfillment of its responsibilities under the contract was not free of charge).

attributable to Debtor's assets and operations. *See supra* ¶ 145. Taking into account the net operating losses that will result from resolution of Debtor's bankruptcy puts Parent in as good a position as it would have been in had the TSA been performed, and no better.

**(d) Parent Has Presented No Evidence On the Amount of Its Total Federal Income Tax Liability After Carryback of the 2009 Net Operating Losses**

155. Parent's corporate representative, Miguel Valdes, testified that, after taking into account the net operating loss carrybacks that will arise under either Debtor's or Parent's plan of reorganization, Parent's unpaid federal income tax liabilities for 2007 and 2008 will be completely eliminated.[148] In fact, Parent expects to receive tax refunds of up to $160 million, depending on which plan is confirmed.[149] Even if the Claim were not disallowed and the TSA were still in effect, the Court would limit the amount of the Claim to the taxes Parent testified it would actually owe on account of Debtor's assets and operations after carryback of the 2009 net operating losses.

156. Parent, however, has not presented any evidence to substantiate this testimony. Instead, Parent seeks to rely on the testimony of Joseph Hitter, one of Debtor's witnesses, to support the amount of the Claim after carryback of the 2009 net operating losses.[150] Indeed, Parent refused to produce any calculations showing its estimate of its total federal income tax liability for 2005 through 2008 after carryback of the 2009 net operating losses, asserting that such documents are privileged.[151] As Debtor has explained, however, Mr. Hitter's estimate of

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[148] Valdes Dep. at 74:5–16, 75:7 – 76:10, 77:5 – 79:23, 80:13 – 80:19.

[149] *Id.* This amount is likely even higher now because the final plans of reorganization proposed by Debtor and Parent would result in greater payments to creditors (and thus greater net operating losses) than the plans on file on August 4, 2009.

[150] 8/4 Tr. (Smith) at 56:13–18; 8/4 Tr. at 161:15–23, 169:11 – 170:1, 170:20 – 171:1; 7/24 Tr. (Hitter) at 72:19–23, 73:15 – 74:2.

[151] 8/4 Tr. at 119:7 – 120:12.

this amount is merely an extrapolation based on the testimony of Mr. Valdes.[152] Mr. Hitter simply determined the amount of Parent's federal income tax liability after carryback of the 2009 net operating losses *assuming for these purposes* that Mr. Valdes's testimony accurately reflects Parent's federal income tax liability for the years in question. Mr. Hitter's testimony was offered to demonstrate nothing more than the fact that, *using the (probably now outdated) estimates of Parent's own corporate representative*, Parent's ultimate federal income tax liability on account of Debtor's assets and operations will be substantially less than the amount of the Claim. Mr. Hitter did not, as Parent appears to contend, perform calculations of his own that Parent can rely upon to meet *Parent's* burden to prove the amount of the Claim. Therefore, even if the Claim were not disallowed and the TSA were still in effect, Parent would be entitled to recover nothing under the TSA for federal income taxes incurred on account of Debtor's assets and operations for tax years 2007 and 2008 because Parent has failed to meet its burden of proof with respect to its alleged damages.

### 3. If Parent Had an Allowed Claim, It Would Be a General Unsecured Claim

#### a. Parent is Not Entitled to an Administrative Claim Under 11 U.S.C. § 503(b)(1)(A)

157. Parent first argues that it is entitled to an administrative claim under 11 U.S.C. § 503(b)(1)(A).[153] This section does not apply to the Claim. Section 503(b)(1)(A) provides that an administrative claim will be allowed against the estate for the "actual, necessary costs and expenses of preserving the estate." 11 U.S.C. § 503(b)(1)(A). An administrative claimant bears the burden of proving that its claim meets the requirements for administrative treatment under § 503(b)(1)(A). *In re TransAmerican Natural Gas Corp.*, 978 F.2d 1409, 1416 (5th

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[152] 7/24 Tr. at 84:11–16; 8/4 Tr. at 181:15 – 19.

[153] Parent's Response at 17–24.

Cir. 1992).[154] Courts have narrowly construed this section in order to hold administrative expenses to a minimum amount and thus preserve the estate assets for the benefit of all creditors. *In re Eagle Bus Mfg., Inc.*, 158 B.R. 421, 435 (S.D. Tex. 1993); *In re Canton Jubilee, Inc.*, 253 B.R. 770, 775 (Bankr. E.D. Tex. 2000); *In re Buttes Gas & Oil Co.*, 112 B.R. at 196. Under § 503(b)(1)(A), an administrative claimant has the burden of establishing (1) that it has conferred a benefit on the bankruptcy estate, and (2) that its right to payment arises from a post-petition transaction with the bankruptcy estate, rather than from a pre-petition transaction with the debtor. *In re Phones for All, Inc.*, 288 F.3d 730, 732 (5th Cir. 2002); *Cramer v. Mammoth Mart, Inc. (In re Mammoth Mart, Inc.)*, 536 F.2d 950, 954 (1st Cir. 1976).

158. Parent cannot meet either prong of this test. First, Parent's payment of taxes in 2005 and 2006 for which it was liable, and for which the bankruptcy estate was not liable, conferred no benefit on the bankruptcy estate. Likewise, by failing to pay its own tax liability in 2007 and 2008, and incurring penalties for its failure to pay, Parent conferred no benefit on the bankruptcy estate. Second, Parent's alleged right to reimbursement from Debtor for payment of taxes arises from the TSA, a pre-petition agreement between Parent and Debtor, not from any post-petition transaction with the bankruptcy estate.

**(1) Parent's Payment of Taxes For Which Parent is Liable Conferred No Benefit on Debtor's Estate**

159. The Fifth Circuit has made clear that a claimant may receive administrative priority for a claim under § 503(b)(1)(A) only if the claimant has conferred a benefit on the bankruptcy estate. *Phones for All*, 288 F.3d at 732.[155] To support its argument that it is entitled

[154] After the claimant has established a *prima facie* case, the burden of producing evidence shifts to the objector. But the burden of persuasion, by preponderance of the evidence, remains with the claimant. *In re TransAmerican Natural Gas*, 978 F.2d at 1416; *In re Buttes Gas & Oil Co.*, 112 B.R. 191, 193 (Bankr. S.D. Tex. 1989).

[155] *See also NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 531–32 (1984), *superseded on other grounds by*, 11 U.S.C. § 1113; *Herod v. Sw. Gas Corp. (In re Gasmark Ltd.)*, 193 F.3d 371, 373–74 (5th Cir. 1999); *In re Transamerican*

to an administrative claim under § 503(b)(1)(A), Parent contends that the bankruptcy estate has received three benefits from Parent's post-petition performance under the TSA.[156] First, Parent argues that the bankruptcy estate has benefited *from the TSA* by "not having to pay [Debtor's] taxes and yet enjoying the substantial income on which those taxes are assessed."[157] Second, Parent argues that the bankruptcy estate has benefited from the provision in the TSA entitling Debtor to receive the Refund.[158] Third, Parent argues that the bankruptcy estate has benefited from the provision of the TSA relieving Debtor of the liability for income taxes that may be paid on account of the DIG.[159] Each of these arguments will be addressed in turn.

**(a) Debtor's Status as a Disregarded Entity Relieves Debtor of the Obligation to Pay Federal Income Taxes, Not the Tax Sharing Agreement**

160. Parent's request for administrative priority is based on the premise that Parent has paid, on behalf of the bankruptcy estate and pursuant to the TSA, certain taxes for which the estate is liable. That premise is false. Debtor has no liability for the federal income taxes that are the subject of the Claim.

161. Before Debtor filed for bankruptcy, Parent deliberately undertook a corporate restructuring in 2005 in which Debtor became a limited liability company. *See supra* ¶¶ 24–30. Because Debtor did not elect to be treated as an association taxable as a corporation, Debtor is a disregarded entity for federal income tax purposes. Treas. Reg. § 301.7701-3(b)(1)(ii). As a disregarded entity, Debtor is not liable to the IRS for tax on its taxable income. Instead, it is

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*Natural Gas*, 978 F.2d at 1416; *NL Indus., Inc. v. GHR Energy Corp.*, 940 F.2d 957, 966 (5th Cir. 1991); *Memphis-Shelby County Airport Auth. v. Braniff Airways, Inc. (In re Braniff Airways, Inc.)*, 783 F.2d 1283, 1286 (5th Cir. 1986), *superseded on other grounds by*, 11 U.S.C. § 365(d)(3).

[156] Parent's Response at 20–21.

[157] *Id.* at 20.

[158] *Id.* at 21.

[159] *Id.* at 29.

treated as a branch or division of its owner, which must report the items of income and loss from Debtor's assets and operations. Treas. Reg. § 301.7701-2(a). Because Debtor's owner (New Asarco until December 15, 2006, and Asarco USA thereafter) joins in the filing of consolidated federal income tax returns with the AMC Consolidated Group, all items of income and loss attributable to Debtor's assets and operations are reported on the consolidated federal income tax returns filed by the AMC Consolidated Group.[160]

162. Parent, as well as each other corporation that is a member of the AMC Consolidated Group, is severally liable for all income taxes attributable to income and gain reportable on the consolidated federal income tax returns filed by the AMC Consolidated Group, regardless of whether such income or gain arose from Debtor's assets and operations or a separate source. Treas. Reg. § 1.1502-6(a).[161] If Parent fails to pay such tax liability (regardless of whether it arose from Debtor's assets and operations or a separate source), the IRS can initiate collection procedures against Parent, but *not* against Debtor or its assets. *See* I.R.S. Chief Couns. Adv. 200235023 (June 28, 2002). Specifically, the IRS can attach a lien upon and levy against Parent's assets, including its membership interest in Debtor, and use the proceeds of the levy, including the proceeds of the liquidation of Debtor, to offset the tax liability, commensurate with its priority against the owner's other creditors. *Id.* However, absent fraud or some other overreaching theory (none of which is present here), the IRS has no right to go directly against the assets of Debtor. *Id.*; *see also* I.R.S. Chief Couns. Adv. 199930013 (July 30, 1999).

163. In short, Debtor is not, and never will be, liable to the IRS for the taxes that are the subject of the Claim because of its status as a disregarded entity. Rather, Parent is liable to the IRS for those taxes. Contrary to Parent's characterization, the TSA does not benefit Debtor's

[160] PX5; PX6; PX7.

[161] This is true notwithstanding the presence or terms of the TSA. Treas. Reg. § 1.1502-6(c).

estate. Rather, it *harms* the estate by requiring it to make payments to AMC in respect of AMC's liability for federal income taxes. Because Parent, not Debtor, is liable for the taxes at issue, Parent is not entitled to an administrative claim under § 503(b)(1)(A). This is especially true with respect to any taxes due for the 2007 and 2008 taxable years, which Parent has not even paid.

**(b) Debtor's Entitlement to the Refund Under the TSA Conferred No Benefit on the Estate Because Debtor was Already Entitled to the Refund**

164. The bankruptcy estate also has not benefited from the provision in the TSA entitling Debtor to receive the Refund.[162] That provision is mere surplusage. As explained above, Debtor's ownership of the Refund is established by operation of Delaware merger law and the Merger Agreement by which Asarco NJ merged with and into Debtor. *See supra* ¶¶ 68–76.

**(c) Parent's Obligation Under the Tax Sharing Agreement to Pay Any Taxes on the Deferred Intercompany Gain that May Arise Conferred No Benefit on the Estate Because the Deferred Intercompany Gain Already Resided with Parent**

165. Finally, the bankruptcy estate has not benefited from the provision of the TSA relieving Debtor of liability for income taxes that may be paid at some indefinite time in the future on account of the DIG.[163] The bankruptcy estate has not benefited from that provision because Debtor is not liable for income taxes that may be owed at a later date on account of the DIG.[164] The DIG was inherited by New Asarco under section 381 of the Code and Treasury

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[162] Parent's Response at 21.

[163] Parent's Response at 29.

[164] Treasury Regulation § 1.1502-6(a) provides that, with one exception that is not relevant in the present case, "the common parent corporation and each subsidiary which was a member of the [consolidated] group during any part of the consolidated return year shall be severally liable for the tax for such year." Treas. Reg. § 1.1502-6(a). Treasury Regulation § 1.1502-6(c) provides that "[n]o agreement entered into by one or more members of the [consolidated]

Regulation § 1.1502-13(j) upon the merger of Asarco NJ into Debtor in February 2005. Indeed, causing New Asarco to inherit the DIG was the *purpose* of the 2005 restructuring. *See supra* ¶¶ 24–30.

166. Absent the 2005 restructuring, if Debtor were deconsolidated from the AMC Consolidated Group, the AMC Consolidated Group would have been required to include the DIG in its taxable income at that time. AMC understood that, given that it was the common parent of the AMC Consolidated Group and Asarco NJ was strapped for cash, AMC most likely would be required to pay such tax. *See supra* ¶ 26. AMC carried out the 2005 restructuring in which Debtor became a disregarded entity to avoid this result. Consequently, however, Debtor, as a disregarded entity, is not liable for federal income tax on its income. If AMC transfers the SPCC Shares to an entity outside the AMC Consolidated Group, or if New Asarco ceases to be a member of the AMC Consolidated Group, then the AMC Consolidated Group, not Debtor, will be liable to the IRS for any tax on the DIG. Treas. Reg. § 1.1502-13(c)–(d). Furthermore, even if Debtor were liable for income taxes that may be owed at a later date on account of the DIG, the bankruptcy estate has not benefited from this provision of the TSA during the post-petition period because the DIG is still a deferred intercompany gain. Indeed, Parent's expert admitted that the DIG might *never* be included in the AMC Consolidated Group's taxable income.[165]

**(d) Denying the Claim Administrative Priority is Consistent With Precedent**

167. The Second Circuit considered a situation similar to the one at hand in *Frito-Lay, Inc. v. LTV Steel Co., Inc. (In re Chateaugay Corp.)*, 10 F.3d 944 (2d Cir. 1993). In that case, the debtor and Frito Lay were parties to a number of pre-petition "safe-harbor leases," also

group with any other member of such group or with any other person shall in any case have the effect of reducing the liability prescribed in this section." Treas. Reg. § 1.1502-6(c).

[165] 8/4 Tr. (Glickman) at 95:21–23.

known as "tax benefit transfer agreements." *Id.* at 948. Under the agreements, Frito-Lay nominally purchased tens of millions of dollars in depreciable assets used by the debtor, and at the same time nominally leased the assets back to the debtor. *Id.* In this way, Frito-Lay purchased tax benefits that the debtor, as an unprofitable company, could not use. *Id.* After filing for bankruptcy, the debtor retired many of the assets subject to the Frito-Lay agreements. *Id.* Under governing tax law, those retirements reduced the federal tax liability of the bankruptcy estate and triggered adverse federal tax consequences for Frito-Lay. *Id.* Frito Lay filed an administrative claim based on provisions in the pre-petition agreements that obligated the debtor to indemnify Frito-Lay for the adverse tax consequences triggered by the disposition of assets subject to the agreements. *Id.* The Second Circuit held that Frito Lay could not assert an administrative claim for payment of the post-petition taxes because the debtor received no post-petition benefit *under the pre-petition agreements*. The Second Circuit stated:

> [The debtor] had full power to dispose of its assets before it signed the leases, and the leases simply acknowledge [the debtor's] retention of that pre-existing power. . . . Unquestionably, [the debtor] visited a postpetition loss on Frito-Lay, but that is not the same thing as saying that Frito-Lay thereby conferred a contractual benefit on [the debtor] or that a benefit was otherwise conferred on [the debtor] under the leases. Frito-Lay was [the debtor's] victim, but that status is not enough to support an administrative claim.

*Id*. at 955. The Second Circuit concluded that, by reason of the debtor's decision to retire the assets, Frito-Lay became entitled to an indemnification award to be paid as a general unsecured claim, not as an administrative claim. *Id.* at 955–56.

168. The situation Parent faces is one of its own making, and is no different than that faced by Frito-Lay in the *Chateaugay* case. Parent imposed a pre-petition restructuring on Debtor, and Parent has enjoyed, and continues to enjoy, the benefits of that restructuring. First, as a result of the 2005 restructuring, Parent controls if and when the DIG will be included in the

taxable income of the AMC Consolidated Group.[166] Second, any losses suffered by Debtor pass through Debtor and may be used by Parent to offset taxable income from its other subsidiaries.[167] The restructuring, however, came at a cost to Parent. By electing to treat Debtor as a disregarded entity for federal income tax purposes, Parent became liable to the IRS for tax on Debtor's taxable income. The TSA *itself* does not relieve Debtor of liability for paying federal income taxes generated by its operations. Rather, tax law provides that Debtor is not liable for federal income taxes, and the TSA "simply acknowledge[s]" that Parent was and is responsible to the IRS for those taxes. *Chateaugay*, 10 F.3d at 955. Parent therefore cannot rely on the TSA to elevate the Claim to administrative status. At best, Parent can assert a general unsecured breach-of-contract claim under the TSA.

**(2) The Claim Is Based on a Pre-Petition Agreement**

169. The Claim is not an administrative claim under § 503(b)(1)(A) for a separate, but related, reason: Parent's alleged right to payment from Debtor arises from the pre-petition TSA, not from a post-petition transaction with the bankruptcy estate.

170. With respect to an award of administrative priority under § 503(b)(1)(A), it is "an absolute requirement" that the liability at issue arose post-petition. *Interstate Gas Supply, Inc. v. Wheeling Pittsburgh Steel Corp. (In re Pittsburgh-Canfield Corp.)*, 283 B.R. 231, 239 (Bankr. N.D. Ohio 2002). "It is only when the debtor-in-possession's actions themselves—that is, considered apart from any obligation of the debtor—give rise to a legal liability that the claimant is entitled to the priority of a cost and expense of administration." *In re Mammoth Mart*, 536 F.2d at 955. The proper standard for determining a claim's priority focuses on when the acts giving rise to the liability took place, not when they accrued. *In re G-I Holdings, Inc.*, 308 B.R.

[166] DX28.

[167] *Id.*

196, 209 (Bankr. D. N.J. 2004). Moreover, the fact that a pre-petition obligation may be dependent upon the occurrence of a post-petition event does not make the obligation an administrative claim. *Id.* "A debt is not entitled to administrative priority simply because the right to payment arises after the debtor in possession has begun managing the estate." *Bachman v. Commercial Fin. Servs., Inc. (In re Commercial Fin. Servs., Inc.)*, 246 F.3d 1291, 1294 (10th Cir. 2001).

171. Courts frequently deny requests for administrative priority on the ground that the claimant's right to payment arose from a pre-petition agreement with the debtor, rather than a post-petition transaction with the debtor-in-possession. *See, e.g.*, *In re Commercial Fin. Servs.*, 246 F.3d at 1294–95 (payments promised to debtor's employees under pre-petition contracts with debtor were not entitled to administrative priority).[168] In a leading case from the Seventh Circuit, the debtor had contracted pre-petition with the claimants to place ads in Yellow Page directories. *In re Jartran, Inc.*, 732 F.2d 584, 585 (7th Cir. 1984). Although the debtor was irrevocably committed to pay for the advertising several months before the ads were to appear, payment for those ads was not due until after each ad was published. *Id.* Prior to publication of the ads, the debtor filed for bankruptcy. *Id.* at 585–86. Later, the ads were published, and the claimants sought to require the debtor to pay the amount due under the contract as an administrative expense. *Id.* The Seventh Circuit held that the claimants were not entitled to payment under the contract as an administrative expense, notwithstanding the fact that the bankruptcy estate received the benefit of the ads, because it was the pre-petition debtor that had

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[168] *Employee Transfer Corp. v. Grigsby (In re White Motor Corp.)*, 831 F.2d 106, 110–11 (6th Cir. 1987) (post-petition expenses incurred by claimant were not entitled to administrative priority because debtor-in-possession did not induce claimant to incur them), *superseded on other grounds by*, 11 U.S.C. § 365(d)(10); *In re G-I Holdings, Inc.*, 308 B.R. at 210 (debtor's portion of post-petition remediation costs were not entitled to administrative priority because debtor's liability for indemnification or contribution arose when contract was executed, almost six years before debtor's bankruptcy filing).

induced the claimants to place the ads. *Id.* at 587–88. The Seventh Circuit stressed that the "key fact" was that "the irrevocable commitment by [the claimants] to place the ads was made before the filing of the petition in bankruptcy." *Id.* at 586. The court concluded that "because the liability for the costs of the ads was irrevocably incurred before the petition was filed," "no inducement by the debtor-in-possession was required." *Id.* at 588.

172. Like the claimants in *Jartran*, Parent fails to satisfy the second prong of the § 503(b)(1)(A) test because it cannot demonstrate a *post-petition* transaction with Debtor. Debtor, in its capacity as debtor-in-possession, did not induce Parent to pay any of the taxes that are the subject of the Claim. No inducement was required because Parent became obligated to pay those taxes when it restructured Debtor in February 2005. Debtor's liability to Parent, if any, arose at the time the TSA was executed, before Debtor filed for bankruptcy.[169] Because the Claim arises solely out of commitments made before the debtor-in-possession came into existence, if Parent had an allowable claim, it would be a general unsecured claim, not an administrative claim. *See id.* at 588; *In re G-I Holdings*, 308 B.R. at 210.

173. Parent argues that Debtor's liability arose post-petition because Debtor's payment obligations under the TSA did not become fixed until the end of each taxable year, beginning with the end of the 2005 taxable year.[170] However, "the fact that the payments became due after [Debtor's] bankruptcy filing does not alter the conclusion that the payments are pre-petition obligations." *Stewart Foods, Inc. v. Broecker (In re Stewart Foods, Inc.)*, 64 F.3d 141, 146 (4th Cir. 1995). "A claim is not rendered a postpetition claim simply by the fact that the time for

[169] DX52.

[170] Parent's Response at 18–20.

payment is triggered by an event that happens after the filing of the petition." *Chiasson v. J. Louis Matherne & Assocs. (In re Oxford Mgmt., Inc.)*, 4 F.3d 1329, 1335 n.7 (5th Cir. 1993).[171]

**(3) Courts Uniformly Hold That It Is Fair to Uphold the Tax Status of Disregarded Entities Post-Bankruptcy**

174. That Parent has not received any of Debtor's post-bankruptcy income that generated the taxes that are the subject of the Claim is irrelevant to the Court's analysis under § 503(b)(1)(A). Courts have uniformly held that a shareholder is not permitted to shift to creditors its own tax obligation arising from a tax structure it purposefully created pre-bankruptcy, even though the shareholder may not have controlled the debtor post-bankruptcy and may not have received any of the post-bankruptcy income that generated the tax. Limited liability companies, as well as other forms of pass-through business entities, retain the same tax status in bankruptcy as these entities had outside bankruptcy. *See, e.g.*, *Mourad v. Comm'r*, 387 F.3d 27, 30 (1st Cir. 2004) ("[A] Chapter 11 bankruptcy filing does not change the tax relationship between a debtor corporation and its shareholders.").[172]

175. In fact, courts consistently preserve a debtor's pre-bankruptcy status and character for tax purposes, even when the consequences of doing so may appear inequitable at first glance. For example, the debtor in *Ram Restaurants* was a Subchapter S corporation and, thus, a pass-through entity for federal income tax purposes. *In re Ram Rests., Inc.*, 2008 WL 2561890, at *2.

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[171] *See also Braniff Airways, Inc. v. Exxon Co., U.S.A.*, 814 F.2d 1030, 1036 (5th Cir. 1987) ("The character of a claim is not transformed from pre-petition to postpetition simply because it is contingent, unliquidated, or unmatured when the debtor's petition is filed." (quotations omitted)); *United States v. Gerth*, 991 F.2d 1428, 1433–34 (8th Cir. 1993) ("[D]ependency on a postpetition event does not prevent a debt from arising prepetition. . . . A debt can be absolutely owing prepetition even though that debt would never have come into existence except for postpetition events."); *In re G-I Holdings*, 308 B.R. at 210 ("The fact that the Debtor's obligation to indemnify the [claimant] continues to accrue post-petition does not transform the obligation into an administrative expense.").

[172] *See also Gilliam v. Speier (In re KRSM Prop., LLC)*, 318 B.R. 712, 719 (B.A.P. 9th Cir. 2004) ("[T]he filing of a bankruptcy case, does not operate, without more, to effect a change in the status of income tax elections regarding an LLC."); *In re Ram Rests.*, No. 03-BK-18991, 2008 WL 2561890, at *2 (Bankr. D. Ariz. June 24, 2008) ("Since the Debtor has been a Subchapter S corporation since its formation and that status has not been revoked, the filing of the bankruptcy petition did not terminate that status and did not create a separate tax entity.").

During bankruptcy, the debtor sold substantially all of its assets, generating approximately $200,000 in tax liability to its sole shareholder. *Id.* The shareholder asked the bankruptcy trustee to use the net sale proceeds to pay this tax liability. *Id.* The trustee refused, arguing that because the shareholder had enjoyed the benefits of the debtor's status as a pass-through entity, he should also suffer the burdens, including paying any tax liability that might accrue from the sale of the debtor's assets. *Id.* The bankruptcy court agreed with the trustee. *Id.* at *3–4. As a result, the shareholder was not entitled to reimbursement from the estate for the $200,000 in tax from the sale of the debtor's assets, even though all of the sale proceeds were distributed to creditors. *Id.*[173]

176. In response to complaints for fairness advanced by shareholders or other owners of pass-through entities, courts routinely place the blame back on the shareholders or other owners, reminding them that they chose to structure the debtor as a pass-through entity and to accept the benefits and burdens of that structure. For example, in *KRSM Properties*, the sole owners of the debtor, a California LLC, caused the debtor to use its own funds to pay estimated income taxes owed by the owners on income generated by the debtor. *In re KRSM Props.*, 318 B.R. at 714. After the debtor filed for bankruptcy, the trustee of the debtor demanded that the tax collectors return the funds to the debtor's estate. *Id.* The Bankruptcy Appellate Panel of the Ninth Circuit affirmed orders requiring the tax collectors to return the funds to the debtor's estate over the objections of the debtor's owners. *Id.* The panel stated: "The owners elected to have the LLC ignored as a separately-taxed entity so that they could enjoy limited liability while avoiding double corporate and individual taxation. That choice comes with benefits and, as this appeal demonstrates, burdens." *Id.* at 720.

[173] Other courts have reached similar conclusions. *See, e.g.*, *Mourad*, 387 F.3d at 30–31 (shareholder remained liable for tax liability resulting from sale of debtor's assets, even though shareholder received no sale proceeds); *In re KRSM Props.*, 318 B.R. at 717–20 (forcing return of pre-petition taxes paid by LLC on behalf of its sole owners).

177. Parent attempts to distinguish this line of cases by arguing that none of the cases involved a contractual right to recover taxes owed by a disregarded entity to its sole shareholder.[174] This is a distinction without a difference. The bankruptcy estate has received no benefit as a result of the TSA. *See supra* ¶¶ 159–166. If Parent had an allowable claim under the TSA, it would be a general unsecured claim, not an administrative claim.

178. Parent also asserts that *In re Forman Enterprises, Inc.*, 281 B.R. 600 (W.D. Penn. 2002), contradicts Debtor's position that the owners of a disregarded entity in bankruptcy remain liable for any federal income taxes on the disregarded entity's income notwithstanding the fact that the disregarded entity's creditors, not the owners, enjoy the benefit of that income.[175] *Forman Enterprises* does not support Parent's position.

179. In that case, the shareholders of an S corporation, a pass-through entity, paid federal income tax on behalf of the corporation for 1997 and 1998. *Id.* at 605. In 1999, the corporation generated a large net operating loss that, when carried back against 1997 and 1998, produced refunds for the taxes paid in those years. *Id.* The corporation filed a voluntary bankruptcy petition on January 26, 2000. *Id.* The question facing the court was whether it would be inequitable for the shareholders to keep the refunds based on the 1999 net operating losses. *Id.* at 606. The court held this was not an inequitable result and allowed the shareholders to retain the refunds. *Id.* at 608–13. In other words, the owners of the debtor continued to be responsible for the tax consequences of the debtor's assets and operations. Thus, *Forman Enterprises* is consistent with the cases cited above, which stand for the proposition that the tax status of an entity that does not pay taxes on its income does not change simply because the entity filed for bankruptcy.

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[174] Parent's Response at 22–23.

[175] 7/24 Tr. at 24:20 – 26:1.

180. Parent has enjoyed at least two significant benefits by electing to treat Debtor as a disregarded entity rather than as an association taxable as a corporation: control over triggering of the DIG, and the ability to benefit from net operating losses generated by Debtor's assets and operations even if Parent loses control over Debtor. The evidence shows that Parent purposefully sought these benefits when it carried out the 2005 restructuring. *See supra* ¶¶ 24–30. Having purposefully sought the benefits of disregarded-entity treatment, it is equitable for Parent to incur the burden of paying taxes attributable to Debtor's assets and operations.

**b. Parent is Not Entitled to an Administrative Claim Under 11 U.S.C. § 503(b)(1)(B)**

181. Parent next argues that it is entitled to an administrative claim under 11 U.S.C. § 503(b)(1)(B).[176] Section 503(b)(1)(B) allows an administrative claim against the estate for "any tax incurred by the estate." 11 U.S.C. § 503(b)(1)(B). The Claim, however, is for payment of a debt allegedly owed by Debtor to Parent under the TSA, not a tax owed to the federal government. Moreover, because Debtor is a disregarded entity, it does not incur federal income tax liability on its income. *See supra* ¶ 62. As discussed above, the IRS could not initiate collection proceedings against Debtor if Parent failed to pay any taxes attributable to Debtor's income. *See supra* ¶ 162. Under the plain language of § 503(b)(1)(B), therefore, the Claim is not an administrative claim because it is not one for taxes incurred by the estate.

**(1) The Claim Is Not For a Tax**

182. Section 503(b)(1)(B) allows for the payment of any "tax" incurred by the estate as an administrative expense. The Claim is not for a tax. Rather, Parent seeks to enforce Debtor's contractual obligation, if any, under the TSA, not to impose a tax upon Debtor. *See New Jersey v. Anderson*, 203 U.S. 483, 493 (1906) ("Taxes are not debts . . . . Debts are obligations for the

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[176] Parent's Response at 7–15.

payment of money founded upon contract, express or implied. Taxes are imposts levied for the support of the government, or for some special purpose authorized by it." (quotations omitted)).

183. Because the Bankruptcy Code does not define the term "tax," courts have had to fashion their own definitions, typically relying on multi-factor tests. *See Workers' Comp. Trust Fund v. Saunders*, 234 B.R. 555, 559–65 (D. Mass. 1999) (analyzing tests adopted by various courts, including the Supreme Court). For example, the Ninth Circuit has held that the following four elements characterize an exaction of a "tax":

> (1) an involuntary pecuniary burden, regardless of name, laid upon individuals;
>
> (2) imposed by, or under authority of, the legislature;
>
> (3) for public purposes, including the purposes of defraying expenses of government or undertakings authorized by it; and
>
> (4) under the police or taxing power of the state.

*County Sanitation Dist. v. Lorber Indus. of Cal.*, 675 F.2d 1062, 1066–67 (9th Cir. 1982). Debtor's obligation, if any, under the TSA has none of these characteristics of a tax. Because Parent seeks payment of a debt, not a tax, the Claim fails to satisfy the requirements of § 503(b)(1)(B).

**(2) The Claim Is Not For a Tax Incurred by the Bankruptcy Estate**

184. Even if the Claim could be construed as a claim for taxes, the Claim still fails to meet the requirements of § 503(b)(1)(B) because it is not for taxes "incurred by the estate." 11 U.S.C. § 503(b)(1)(B). The few cases that involve a claim for reimbursement of taxes owed by an entity other than the debtor uniformly hold that such claims fail to meet the requirements of § 503(b)(1)(B). *See In re Tri-City Health Centre, Inc.*, 283 B.R. 204, 207–08 (Bankr. N.D. Tex. 2002) (disallowing creditor's claim for reimbursement of its own real estate taxes that accrued while estate owned property); *In re Green*, 182 B.R. 532, 534 (Bankr. C.D. Ill. 1995)

(disallowing partner's claim for reimbursement of income taxes assessed against income earned by debtor-partnership).

185. *Green* is especially instructive. In that case, the debtor was a partnership, and the claimants were its three partners, all seeking reimbursement for taxes they owed for income generated by the debtor. *In re Green*, 182 B.R. at 533. The partners argued that the court should allow, as an administrative priority under § 503(b)(1)(B), an amount equal to the tax they personally owed on the partnership's income. *Id.* The court began its analysis by clarifying that "the partnership is not a tax paying entity, the partners are the tax payers," and that "the bankruptcy filing does not change those statuses." *Id.* The court concluded that the partners, not the partnership estate, incurred the taxes for purposes of § 503(b)(1)(B) and rejected the partners' administrative claim on that basis. *Id.* at 534. It stated: "While certain taxes incurred by the estate are routinely allowed as administrative expenses . . . , paying the income taxes owed by some third party, taxes which the debtor is not even legally obligated to pay, could hardly be considered proper." *Id.* at 537 (quoting *In re Miller-Charlton Farms*, 1990 U.S. Dist. Lexis 10599 (W.D. Mo. 1990) (refusing administrative claim by partner for taxes incurred on income earned by the partnership because "there is simply no legal means by which the personal taxes [of the general partner] can be paid out of the estate assets of the partnership debtor")).

186. The *Green* court was not persuaded by the argument that the partners should not be liable for taxes on income from which they did not receive any direct benefit:

> "It should be noted that the [partners] chose the partnership form of business organization when they formed the . . . [business]. If they had selected the corporate form of ownership, they would not be faced with this dilemma that they are now in. They apparently chose the partnership route in order to obtain the tax benefits of partnership, that is, the flow through of gains and losses. It is precisely this tax attribute that they are now attempting to evade. However, having obtained the benefits they must also live with the burdens."

*Id.* at 536 (quoting *In re Nevin*, 135 B.R. 652, 654 (Bankr. D. Haw. 1991)).

187. Like the partnership in *Green*, Debtor is not the taxpayer. And like the partners in that case, Parent is not entitled to an administrative claim for tax liabilities that it, not Debtor, has incurred.

188. *Tri-City Health Centre* further illustrates that, for purposes of § 503(b)(1)(B), the critical question is whether the debtor is liable to the taxing authority for payment of the tax obligation. In that case, a creditor purchased real property of the debtor at a foreclosure sale subject to an existing tax lien. *In re Tri-City Health Centre*, 283 B.R. at 206. The creditor then sold the property to a third party and, at the second closing, paid over $100,000 of real property taxes that had accrued when the property belonged to the estate. *Id.*

189. In analyzing the creditor's subsequent administrative claim under § 503(b)(1)(B), the court reasoned that once the creditor "removed the property from the bankruptcy estate by purchasing the property at foreclosure, the taxing authority would look to the property and, hence, to [the creditor] for payment of the tax lien." *Id.* at 207–08. Because the creditor paid the taxes to "fulfill[] its non-bankruptcy law obligations," *id.* at 207, the creditor could not "transfer its liability to the bankruptcy estate" via an administrative claim. *Id.* at 208.

190. As a disregarded entity, Debtor incurs no federal income tax liability on its taxable income. *See supra* ¶ 62. Parent's payment of any taxes on that income only satisfies its own tax obligations, not Debtor's, and accordingly Parent is not entitled to an administrative claim under § 503(b)(1)(B).

**(3) Parent May Not Shift Its Own Tax Liability to Debtor**

191. Parent argues that the identity of the taxpayer is irrelevant under § 503(b)(1)(B) and cites a series of cases in which courts have held that a debtor may obtain an administrative

claim for taxes that the debtor, as opposed to the estate, incurred post-petition.[177] Parent ignores, however, the competing line of cases that reject the notion that "incurred by the estate" means anything other than what it plainly says, "a liability accrued against the bankruptcy estate." *In re Whall*, 391 B.R. 1, 5–6 (Bankr. D. Mass. 2008) (citing *In re Brown*, No. 05-41071, 2006 WL 3370867 (Bankr. D. Mass. Nov. 20, 2006)). Contrary to Parent's suggestion, there is no consensus in the courts concerning this issue.

192. In any event, the line of cases Parent cites is inapposite. In each case, the issue was whether the debtor in a Chapter 12 family-farmer bankruptcy was personally liable for taxes incurred from the post-petition sale of farming real property, or whether such taxes could be treated as a liability of the estate and discharged under 11 U.S.C. § 1222(a)(2)(A). *In re Hall*, 393 B.R. at 858–59. In each case, the court was persuaded that Congress's intent in passing § 1222 was to "help family farmers through a Chapter 12 bankruptcy," and that a strict reading of "incurred by the estate" in § 503(b)(1)(B) would frustrate that remedial purpose. *Id.* at 862. The courts therefore held that "incurred by the estate" was meant to distinguish between taxes that "accrued to the postpetition estate" and those that accrued "to the debtor prepetition," such that the farmer-debtor would not incur crippling tax liability upon selling his or her real property after filing for bankruptcy. *Dawes*, 382 B.R. at 517.

193. At most, these cases stand for the proposition that *debtors* may properly seek administrative claims for their own post-petition tax liability. They do not support Parent's position that *third parties* are entitled to reimbursement from the bankruptcy estate for their own tax obligations. Unlike in *Hall* and cases like it, where Congress's express intent to help a particular class of individuals reasonably informed the courts' analyses, here there is no inkling

[177] *See* Parent's Response at 18–19 (citing *In re Hall*, 393 B.R. 857, 860 (D. Ariz. 2008); *In re Knudsen*, 389 B.R. 643, 680 (N.D. Iowa 2008); *In re Dawes*, 382 B.R. 509, 516 (Bankr. D. Kan. 2008); *In re Schilke*, 379 B.R. 899, 902 (Bankr. D. Neb. 2007)).

that Congress intended all members of limited liability companies to be able to shift their own tax burdens to their bankrupt, disregarded tax entities. Parent's reliance on the family-farmer cases is misplaced, and Parent's position is in direct conflict with the cases discussed above involving debtors that are pass-through tax entities. *See supra* ¶¶ 174–76.

#### c. Parent Is Not Entitled to an Administrative Claim Under *Reading*

194. Parent also asserts that the Claim is entitled to administrative priority under *Reading Co. v. Brown*, 391 U.S. 471 (1968).[178] However, the limited exception recognized in that case is inapplicable because (1) the Claim is based on Parent's pre-petition obligations; (2) the Claim is not based on any wrongful conduct of Debtor; and (3) the equity and fairness principles that form the basis of the *Reading* exception do not apply here.

##### (1) *Reading* Creates a Limited Exception to 11 U.S.C. § 503(b)(1)(A)

195. *Reading* addressed the limited issue of whether tort damages resulting from the negligence of a receiver administering an estate should be accorded administrative expense priority. The debtor's only significant asset was an industrial structure. *Reading*, 391 U.S. at 473. After the debtor filed for bankruptcy, the building was destroyed by a fire negligently caused by the bankruptcy receiver in the course of operating the debtor's estate. *Id*. at 473. The claimant owned a neighborhood business also damaged by the negligently caused fire. *Id*.

196. After the fire, the claimant applied for administrative expense priority, and the trustee moved to expunge the claim on the grounds that the claimant's tort damage was not an expense of administration. *Id*. The Supreme Court disagreed with the trustee, but did so on limited grounds. The Court framed the issue as "whether the negligence of a receiver in administering an estate under a Chapter XI arrangement gives rise to an 'actual and necessary'

[178] Parent's Response at 15–17.

cost of operating the debtor's business." *Id.* at 476. Forgoing the general rule that an administrative claim must benefit the estate, the Court concluded that it was more "natural and just" for the claimant, injured during the negligent operation of the debtor's business, to recover ahead of those for whose benefit the business was carried on. *Id.* at 482.

197. The Court was motivated largely by the statutory objective of "fairness to all persons having claims against an insolvent." *Id.* at 477. It showed particular sympathy to the claimant's position because the claimant "did not merely suffer injury at the hands of an insolvent business," but rather had "an insolvent business thrust upon it by operation of law." *Id.* at 478. Under the limited exception created in *Reading*, claims based on the *post-petition, wrongful acts* of a debtor-in-possession, while not benefiting the estate as required under § 503(b)(1)(A), may nevertheless receive administrative expense priority.

**(2) Parent's Claim Is Not Based on Debtor's Post-Petition Acts**

198. While *Reading* offers a limited exception to the benefit-to-the-estate requirement of § 503(b)(1)(A), that exception does not apply if the debtor's liability arises from a pre-petition contract. *Reading*, 391 U.S. at 475. Indeed, the First Circuit once noted that it was "aware of no authority that the *Reading[]* exception encompasses a right to payment originating in a prepetition contract with the debtor." *Woburn Assocs. v. Kahn (In re Hemingway Transp., Inc.)*, 954 F.2d 1, 7 (1st Cir. 1992). Even if Parent had an allowable claim, the *Reading* exception would not apply because Debtor's alleged liability to Parent arises from the pre-petition TSA. *Reading*, 391 U.S. at 475; *In re Heritage Leasing Corp.*, No. CA 96-75946-W, 1998 WL 2016851, at *4 (Bankr. D. S.C. Sept. 17, 1998) ("[T]he fact that the liability being asserted by [the administrative claimant] is grounded upon the breach of a prepetition, unassumed contract of a Chapter 7 debtor distinguishes it from the reasoning of *Reading Co. v. Brown*.").

**(3) Parent's Claim Is Not Based On Any Wrongful Conduct of Debtor**

199. Not only is the Claim based on a pre-petition contract, the Claim is also outside *Reading*'s limited scope because it is not based on any wrongful conduct of Debtor. The *Reading* doctrine initially protected innocent third parties against damage caused by a debtor's tort. In limited instances, lower courts have expanded the doctrine and found an exception to the benefit-to-the-estate requirement of § 503(b)(1)(A) where (1) the debtor intentionally violated an injunction;[179] (2) the debtor violated a state law or regulation;[180] (3) the estate incurred costs related to the abatement of violations of environmental laws or payment of fines from post-petition violation of environmental laws;[181] (4) a third party incurred attorneys' fees in defense of a claim brought by the estate;[182] and (5) the estate owed post-petition employee benefits.[183]

200. The application of *Reading*, however, is not without limit. Outside the categories described above, courts, including the Fifth Circuit, strictly construe *Reading* and actively limit its reach. *See Total Minatome Corp. v. Jack/Wade Drilling, Inc. (In re Jack/Wade Drilling, Inc.)*, 258 F.3d 385, 391 (5th Cir. 2001) ("We recognize that we have strictly construed the *Reading* exception.").[184]

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[179] *See, e.g.*, *Spunt v. Charlesbank Laundry, Inc. (In re Charlesbank Laundry, Inc.)*, 755 F.2d 200, 202–03 (1st Cir. 1985).

[180] *See, e.g.*, *State of Texas v. Lowe (In re H.L.S. Energy Co., Inc.)*, 151 F.3d at 437–38 (5th Cir. 1998); *Al Copeland Enters., Inc. v. State of Texas (In re Al Copeland)*, 991 F.2d 233, 239–40 (5th Cir. 1993).

[181] *See, e.g.*, *Alabama Surface Mining Comm'n v. N.P. Mining Co., Inc. (In re N.P. Mining Co., Inc.)*, 963 F.2d 1449, 1458–59 (8th Cir. 1992).

[182] *See, e.g.*, *In re Met-L-Wood Corp.*, 115 B.R. 133, 136 (N.D. Ill. 1990).

[183] *See, e.g.*, *Rodman v. Rinier (In re W.T. Grant Co.)*, 620 F.2d 319, 321 (2nd Cir. 1980), *cert. denied*, 446 U.S. 983 (1980); *Giordano v. Johnstone (In re Parker Ave. Assocs.)*, 1 B.R. 286, 294–95 (Bankr. E.D. Pa. 1979).

[184] *Weinschneider v. Hoseman (In re Weinschneider)*, No. 03-C-5274, 2004 WL 524872, at *4 (N.D. Ill. March 10, 2004) (narrowing *Reading*'s "reach to debts incurred as a result of a trustee's *wrongful* conduct, including 'tort-like' behavior, willful statutory violations or initiation of frivolous litigation"), *aff'd* 395 F.3d 401 (7th Cir. 2005); *In re Heritage Leasing Corp.*, 1998 WL 2016851, at *3 (denying request for administrative priority because the wrong asserted appeared "at most to be based upon an allegation of a breach of a contract").

201. Parent asks the Court to expand *Reading* to include damages incurred by a debtor-in-possession's breach of a pre-petition contract. The Court declines to do so here. Debtor's breach of the TSA, if any, is fundamentally different than the "tort-like" behavior usually protected by *Reading*. Unlike the fire victim in *Reading*, Parent is not a third party "thrust" into the middle of a bankruptcy arrangement by operation of law. *Reading*, 391 U.S. at 478. While the *Reading* Court stressed the victim's involuntary involvement in the bankruptcy, Parent's relationship with Debtor is one of voluntary agreement. Courts have refused to award priority where the claimant's harm arises from breach of a voluntary arrangement. *See, e.g.*, *Amplex v. Gonzales (In re Furr's Supermarkets, Inc.)*, 359 B.R. 356, 2007 WL 559766, at *4 (B.A.P. 10th Cir. Feb 2, 2007) ("a claim for breach of contract . . . is not entitled to administrative priority"); *In re Weinschneider*, 395 F.3d 401, 403 (7th Cir. 2005) (denying administrative priority of attorneys' fees awarded in defense of contract claim, in part, because *Reading*'s action was in tort and claimant's action was based on contract).

**(4) Fundamental Fairness Cuts Against Parent's Request for Administrative Priority**

202. Parent's reliance on *Reading* is also misplaced because fundamental fairness does not compel payment of the Claim at the expense of Debtor's general unsecured creditors. The "driving force behind the Supreme Court's decision in *Reading* was the great injustice that would result to the claimant if it were denied its right to recover its fire damages." *In re Jack/Wade Drilling Inc.*, 258 F.3d at 390 n.4. Unlike in *Reading*, no "great injustice" would result if Parent were required to wait in line with Debtor's other creditors.

203. Parent's current situation is the result of its own actions. In order to avoid including the DIG in the AMC Consolidated Group's taxable income, Parent caused the 2005 restructuring. *See supra* ¶¶ 24–30. Not only did the 2005 restructuring give Parent control over

triggering of the DIG, it also causes any net operating losses generated by Debtor's assets and operations to reside in Asarco USA, such that Parent will retain the benefit of the net operating loss carryforwards generated upon resolution of Debtor's bankruptcy regardless of whether Asarco USA's member interests in Debtor are cancelled. Unlike the fire losses in *Reading*, which resulted from unilateral post-petition conduct on the part of the operating receiver, any losses sustained by Parent derive from Parent's voluntary, pre-petition restructuring of Debtor.

**4. Parent May Not Shift Ownership of Debtor to Debtor's Creditors for Tax Purposes**

204. Parent next argues that, to the extent its "equity rights are subordinated to the creditors of [Debtor] . . . [the creditors] are deemed to have become owners of [Debtor] . . . for the purposes of paying taxes."[185] To support this argument, Parent cites to the Supreme Court's decision in *Helvering v. Alabama Asphaltic Limestone Co*., 315 U.S. 179 (1942).[186] According to Parent, under *Alabama Asphaltic*, "when creditors assume priority over equity holders during bankruptcy, they effectively become the 'owners' of the company."[187]

205. Parent's interpretation of *Alabama Asphaltic* is overstated. The holding in *Alabama Asphaltic* is a limited interpretation of a specific provision contained in the Code that is not applicable to this case.

**a. *Alabama Asphaltic* Does Not Hold That a Bankrupt Company's Creditors Are Its *De Facto* Owners For All Purposes**

206. *Alabama Asphaltic* does not support Parent's claim that Debtor's creditors are *de facto* owners of Debtor for all purposes, including for purposes of paying taxes. In *Alabama Asphaltic*, a debtor in bankruptcy (Alabama Asphaltic) sold its assets to a new company, which

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[185] Parent's Response at 33.

[186] *Id.* at 32–33.

[187] *Id.* at 33.

in turn issued stock to the creditors of Alabama Asphaltic, pursuant to a bankruptcy plan of reorganization. *Alabama Asphaltic*, 315 U.S. at 181–82. The new company, when computing the depreciation and depletion allowances related to the assets acquired from Alabama Asphaltic, treated the assets as having the same basis that they had in the hands of Alabama Asphaltic. *Id.* at 180. The Tax Commissioner disagreed, arguing that the basis should be determined based on the purchase price paid in the bankruptcy sale. The Supreme Court noted that the answer turned on whether the transfer of assets from Alabama Asphaltic to the new company qualified as a tax-free reorganization under the Code. *Id*. at 181.

207. In order for a reorganization to qualify for tax-free treatment, there must be "continuity of interest," meaning that the holders of proprietary interests in the old company must retain a sufficient ownership interest in the new company after the reorganization. *Id.* at 183. In *Alabama Asphaltic*, the sole stockholder of Alabama Asphaltic did not retain an ownership interest in the new company. Instead, creditors of Alabama Asphaltic acquired ownership. *Id*.

208. The Supreme Court held, however, that once Alabama Asphaltic was forced into involuntary bankruptcy, the creditors of Alabama Asphaltic had effective command over the disposition of its assets, and, thus, when the sale of those assets took place, there was no break in the continuity of interest—the creditors, for practical purposes, "owned" a proprietary interest in the property of Alabama Asphaltic before the sale, and they owned a proprietary interest in that same property after the sale. *Id.* at 183–84. In the words of the Court, the asset sale "'did nothing but recognize officially what had before been true in fact.'" *Id*. at 184 (quoting *Helvering v. New Haven & S.L.R. Co.*, 121 F.2d 985, 987 (2d. Cir. 1941)). Because it found

"continuity of interest," the Supreme Court held that the asset sale qualified as a tax-free reorganization under the Code.

209. The holding in *Alabama Asphaltic* is limited: In certain circumstances, creditors may have the equivalent of a pre-reorganization proprietary interest in a company, which satisfies the post-reorganization continuity of interest requirement and "bring[s] the transaction within the statutory definition of merger or consolidation contained in the revenue acts." *Helvering v. Sw. Consol. Corp.*, 315 U.S. 194, 202 (1942). The holding of *Alabama Asphaltic* has since been incorporated into the regulations governing tax-free reorganizations. *See* Treas. Reg. § 1.368-1(e)(6)(i).[188] *Alabama Asphaltic* does not say that creditors of a company in bankruptcy are *de facto* owners of the company for all purposes, including for the purposes of paying taxes. Indeed, authorities citing *Alabama Asphaltic* confirm that the case's holding is confined to applying a continuity of interest requirement in the context of certain tax-free reorganizations.[189]

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[188] Treasury Regulation § 1.368-1(e)(6)(i) provides:

> A creditor's claim against a target corporation may be a proprietary interest in the target corporation if the target corporation is in a title 11 or similar case . . . . In such cases, if any creditor receives a proprietary interest in the issuing corporation in exchange for its claim, every claim of that class of creditors and every claim of all equal and junior classes of creditors (in addition to the claims of shareholders) is a proprietary interest in the target corporation immediately prior to the potential reorganization.

Treas. Reg. § 1.368-1(e)(6)(i). Notably, this regulation does not state that the creditors of a bankrupt corporation are considered its "owners" for tax purposes. Rather, it defines continuity of interest in terms of the extent to which the "proprietary interests" in the old corporation are preserved in the reorganization, and then states that a creditor's claim may be considered such an interest.

[189] *See, e.g.*, I.R.S. Chief Couns. Adv. 200350016 (Aug. 28, 2003) ("We note that, in a reorganization under section 368(a)(1)(G), the short-term creditors would be treated as former shareholders of Corp A for purposes of the continuity of interest requirement. *See Helvering v. Alabama Asphaltic Limestone Co.*, 315 U.S. 179, 183–84 (1942). However, this treatment has not been extended to determine status as a shareholder or security holder for purposes of sections 354 or 355," which provide non-recognition treatment for other exchanges of stock under certain circumstances.).

#### b. *Alabama Asphaltic* Embraces Traditional Bankruptcy Principles, But Does Not Expand Them

210. The crux of Parent's argument is the idea that creditors "become 'owners' of a company" when they assume priority over equity holders.[190] As discussed above, the "ownership" is limited to *de facto* ownership for purposes of a "continuity of interest" analysis. As important, however, is that *Alabama Asphaltic*'s idea of "ownership" is rooted in traditional bankruptcy principles. Fundamental to bankruptcy law is the notion that an insolvent corporation is run for the benefit of its creditors. Thus, creditors assume the rights and expectations of the owners of the equity. The *Alabama Asphaltic* decision recognizes this principle. At the time of Alabama Asphaltic's bankruptcy, its creditors "had effective command over the disposition of the [debtor's] property." *Alabama Asphaltic*, 315 U.S. at 183.

211. Contrary to Parent's suggestion, however, bankruptcy principles do not support creditors' assumption of liabilities *owed by the debtor's stockholder*. *Alabama Asphaltic* merely recognizes that creditors "step[] into the shoes of old stockholders" for purposes of receiving benefits from the estate. *Id.* at 184.

212. On-point case law also shows that Parent remains the "owner" of Debtor for tax purposes. Courts consistently hold that bankruptcy "does not change the tax relationship between a debtor corporation and its shareholders." *Mourad*, 387 at 30; *see supra* ¶¶ 174–76. That Parent will not receive Debtor's sale proceeds, if any, does not change the analysis. Parent became liable for Debtor's taxes as a result of its own actions, and case law holds that it cannot unring that bell.

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[190] Parent's Response at 33.

### 5. If AMC Had an Allowed Claim, Debtor Would Be Entitled to Set Off the Claim Against the SCC Final Judgment

213. Even if AMC had an allowed claim, Debtor would be entitled to set off AMC's claim against the monetary portion of the SCC Final Judgment, subject to the Court's reconsideration if the Judgment were reversed on appeal. The debts would be mutual and subject to setoff under section 558 of the Bankruptcy Code and applicable non-bankruptcy law.

#### a. The Bankruptcy Code Allows Setoff

214. Section 553 of the Bankruptcy Code preserves a creditor's right of setoff under other applicable law. It provides:

> Except as otherwise provided in this section and in sections 362 and 363 of this title, this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case, except [in certain circumstances not relevant here].

11 U.S.C. § 553.

215. While § 553 speaks only of a creditor's right of setoff, a debtor's right of setoff is preserved under § 558. Section 558 provides:

> The estate shall have the benefit of any defense available to the debtor as against any entity other than the estate, including statutes of limitation, statutes of frauds, usury, and other personal defenses.

11 U.S.C. § 558. Courts have recognized a debtor's defense of setoff as one of the defenses preserved under § 558. *In re Braniff Airways, Inc.*, 42 B.R. 443, 447–48 (Bankr. N.D. Tex. 1984) ("Although Section 553 does not mention a *debtor's* right of setoff by its terms, the Bankruptcy Code implicitly recognizes the use of offset by a debtor as a 'defense' which the debtor may assert under Section 541(e) of the Code."); *In re Standard Furniture Co.*, 3 B.R. 527,

531 (Bankr. S.D. Cal. 1980) ("The trustee's right of offset is a defense of the Debtor which the trustee may assert under Section 541(e) of the Code.").[191]

216. Under § 558, the Court may set off an allowed claim held by AMC against the SCC Final Judgment, even if AMC's claim is a postpetition claim. Unlike § 553, § 558 provides no independent requirements for asserting a debtor's setoff rights. Rather, it merely preserves for the benefit of the estate any setoff rights available to the debtor under other applicable law. Acknowledging this distinction, courts have held that § 553's requirement that the offsetting claims both arise prepetition does not apply under § 558. *See, e.g.*, *In re Women First Healthcare, Inc.*, 345 B.R. 131, 134 (Bankr. D. Del. 2006); *In re PSA*, 277 B.R. at 53; *Second Pa. Real Estate Corp. v. Papercraft Corp. (In re Papercraft Corp.)*, 127 B.R. 346, 350 (Bankr. W.D. Pa. 1991); *In re M.W. Ettinger Transfer Co.*, No. 4-88-3020, 1988 WL 129334, at *4 (Bankr. D. Minn. Nov. 29, 1988).[192]

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[191] Section 541(e) has since been renumbered as Section 558. 5 COLLIER ON BANKRUPTCY ¶ 558.01[1][a] n.10 (15th ed. rev. 2009) ("The renumbering of section 541(e) as section 558 had no substantive effect upon the defenses of the estate.").

[192] *But see In re Braniff Airways*, 42 B.R. 443, 449 (Bankr. N.D. Tex. 1984) (holding that a *debtor's* prepetition claim may not be offset against a *debtor-in-possession's* postpetition debt because of an absence of mutuality of the parties). The *Braniff* court's rationale has been criticized by courts and commentators. *See, e.g.*, *In re M.W. Ettinger Transfer Co.*, No. 4-88-3020, 1988 WL 129334, at *4 ("While I understand the policy reasons for disallowing a creditor to crossover the petition date, I do not understand the policy reasons underlying the *Braniff Airways* decision to disallow the debtor its full defenses. . . . *Braniff* appears to have reached its conclusion that 'what is fair for a creditor is fair for the debtor' without addressing the intent of then § 541(e), now § 558, of the Bankruptcy Code."); *In re ABC-NACO, Inc.*, 294 B.R. 832, 838 (Bankr. N.D. Ill. 2003) ("[A]lmost all of the reported decisions addressing the issue have held . . . that, specifically, a debtor's counterclaim against a creditor does not require mutuality in the sense of both claims arising prepetition. [*Braniff Airways*] has properly been criticized for failing to address the policy difference between creditor claims to setoff under § 553 and counterclaims by an estate under § 558.") (citations omitted); COLLIER ¶ 553.03[3][g][ii] ("Some courts explain that the reason why the prepetition requirement is a component of mutuality is that the commencement of the case replaces the debtor with a trustee (or debtor-in-possession) and thereby establishes a new 'entity' who acts on behalf of the estate. . . . [T]his theory makes too much of the distinction. As explained by the Supreme Court in a related context: 'For our purposes, it is sensible to view the debtor-in-possession as the same "entity" which existed before the filing of the bankruptcy petition, but empowered by virtue of the Bankruptcy Code to deal with its contracts and property in a manner it could not have employed absent the bankruptcy filing. . . . The better view is to eliminate the prepetition requirement from the concept of 'mutuality.'" (citations omitted)).

**b. Debtor Would Have a Setoff Right Under Applicable Law**

217. Neither § 553 nor § 558 creates a setoff right. *Citizens Bank of Md. v. Strumpf*, 516 U.S. 16, 18–19 (1995). Rather, these sections allow debtors and creditors to assert in a bankruptcy proceeding setoff rights that arise under other bodies of law, subject to any additional requirements imposed by the Bankruptcy Code. *In re PSA, Inc.*, 277 B.R. 51, 54 (Bankr. D. Del. 2002).

218. In determining whether Debtor has an underlying setoff right under state law, the Court must first determine the applicable body of law. The general rule is that "the nature, existence and enforceability of claims sought to be setoff are determined by applying the law of the state where the operative facts occurred." *Williams v. Am. Bank of the Mid-Cities, N.A. (In re Williams*), 61 B.R. 567, 571 (Bankr. N.D. Tex. 1986); *In re WorldCom, Inc.*, 304 B.R. 611, 619 (Bankr. S.D.N.Y. 2004) (same); COLLIER ¶ 553.04[1]. AMC's claim against Debtor under the TSA is governed by New York law, as specified in Section 12 of the amendment to the TSA.[193] On the other hand, Debtor's claims against AMC for fraudulent transfer, aiding and abetting breach of fiduciary duty, and conspiracy are governed by Delaware, New Jersey, and Arizona law, respectively. *ASARCO*, 396 B.R. at 316, 394 n.133, 416. Which state's law applies to Debtor's setoff claim does not matter, however, as each state provides that the Court may set off the claims involved here pending resolution of the appeal of the SCC Final Judgment.

**(1) Debtor Would Be Entitled to Setoff Under New York Law**

219. New York law has long recognized a right of setoff at common law. *See Beecher v. Petier A. Vogt Mfg. Co.*, 125 N.E. 831 (N.Y. 1920); *De Camp v. Thomson*, 54 N.E. 11 (N.Y. 1899); *Scherling v. Hellman Elec. Corp. (In re Westchester*), 181 B.R. 730, 740 (Bankr.

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[193] DX52.

S.D.N.Y. 1995).[194] If the party seeking setoff is the debtor, the offsetting debts do not have to arise prepetition. *In re Westchester*, 181 B.R. at 740. To set off debts under New York law, the debts must be mutual, meaning they are owed between the same parties in the same capacity. *Kemper Reinsurance Co. v. Corcoran (In re Midland Ins. Co.*), 590 N.E.2d 1186, 1192 (N.Y. 1992); *Beecher*, 125 N.E. at 833; *In re Westchester*, 181 B.R. at 740.

220. If AMC had an allowed claim, New York law's mutuality requirement would be satisfied. In that event, the debts would be owed between the same parties—Debtor and AMC. The capacity requirement, on the other hand, concerns the parties' relationship rather than their identities. *In re Midland Ins*., 590 N.E.2d at 1192 ("'Capacity' means legal capacity (e.g., principal, agent, trustee, beneficiary)."); *Beecher*, 125 N.E. at 473. Parties act in the same capacity if each owes the other party an obligation in its own name, rather than as an agent on behalf of another party. *In re Midland Ins*., 590 N.E.2d at 1192. Here, Debtor and AMC are acting in their own names, so the capacity requirement would be satisfied.

221. The New York Court of Appeals has said that, in general, judgments cannot be set off against each other where one of them is subject to a pending appeal because, at that point, the claim is still contingent. *De Camp*, 54 N.E. at 12. However, the *De Camp* court allowed that there could be exceptions, such as in the case of the insolvency of one of the parties. *Id*. This is sensible, as the party holding the contingent claim might be unable to collect on its claim upon the subsequent vindication of its position, whereas it would have been made whole if the court

[194] New York also provides a statutory right of setoff. N.Y. DEBT. & CRED. § 151 (McKinney 2001) ("Every debtor shall have the right upon . . . the filing of a petition under any of the provisions of the federal bankruptcy act or amendments thereto . . . by or against a creditor . . . to set off and apply against any indebtedness, whether matured or unmatured, of such creditor to such debtor, any amount owing from such debtor to such creditor . . . ."). However, because section 151 only speaks of the rights of debtors whose creditors are in bankruptcy, Debtor is unable to avail itself of the statute in the present case. *In re Westchester*, 181 B.R. at 740–41. ("N.Y. Debt. & Cred. Law § 151 only applies to the setoff sought by [Creditor], not by Debtor or Trustee because it allows setoff by one who is owed a debt after the filing of a bankruptcy petition by or against its creditor. In this case, the bankruptcy filing was by Debtor.").

had set off the claims initially and reserved the right to compensate the party with the matured claim later if the contingent claim never became due and payable.

222. In lieu of setting off a contingent claim against a claim that is matured and liquidated, a court applying New York law can simply suspend collection of the matured claim until the contingent claim is resolved. *See McMahon v. Levitt*, 366 N.Y.S.2d 684 (N.Y. App. Div. 1975). In *McMahon*, petitioner, a former civil servant, entered into an agreement with the State that set the amount of back pay owed to him at $2,638.76. *Id*. at 686. The State then sued petitioner to recover damages of $13,300 sustained by the state lottery division in connection with petitioner's forgery of lottery tickets. *Id*. While the State's case was pending, petitioner sued the State to collect on his claim for back pay, which the State refused to pay. *Id*. When the State sought to set off its claim against petitioner's claim for back pay, petitioner argued that the State had no right to set off its unliquidated tort claim against his liquidated claim that was due and payable. *Id*. The court held that the lower court properly dismissed petitioner's collection action until the state's claim was resolved. *Id*. at 687. The court said: "If it is judicially resolved that petitioner owes the State any part of that $13,300, the State Comptroller is entitled to offset the amount concededly owed by the State to petitioner against such amount. It makes little difference whether or not the State's claim against petitioner has been reduced to judgment." *Id*. at 686–87 (citations omitted). Thus, although the State conceded that it owed the amount petitioner claimed for back pay, under New York law it was not required to satisfy that claim until its own claim was resolved.

223. A similar approach is available under § 553 of the Bankruptcy Code. "A [creditor's] claim is not disabled from setoff simply because it is disputed. A court may permit the setoff notwithstanding the dispute, although a court might later undo the setoff to the extent

that the dispute is ultimately resolved in the debtor's favor and the creditor's entitlement is reduced as a result." *See* COLLIER ¶ 553.03[1][e].

224. Under these authorities, if AMC had an allowed claim, the Court would deem it appropriate to set off AMC's claim against the SCC Final Judgment, subject to the Court's reconsideration if the SCC Final Judgment were reversed on appeal. The right of setoff is within the Court's discretion, and the Court may relax the rules when "departure is necessary to 'prevent wrong and injustice.'" *Beecher*, 125 N.E. at 833; *see also In re Westchester*, 181 B.R. at 741 ("[T]he right to setoff is within the court's discretion and it may invoke equity to bend the rules, if required, to avert injustice."). Where, as here, the pending appeal concerns claims for fraudulent transfer, aiding and abetting breach of fiduciary duty, and conspiracy—claims based on AMC's inequitable and wrongful conduct—the argument for relaxing the general rules in the name of equity is particularly strong. It is only fair that AMC should not recover on the Claim unless it prevails in its appeal of the SCC Final Judgment.

**(2) Debtor Would Also Be Entitled to Setoff Under Delaware, New Jersey, and Arizona Law**

225. Delaware law also provides parties with a right of setoff. *See Pettinaro Constr. Co. v. Lindh*, 428 A.2d 1161, 1164 (Del. 1981).[195] Under Delaware law, "a set-off should be allowed only when, in view of all the circumstances, equity and good conscience require it to be made, substantial justice will be promoted thereby, and the rights and interests of third persons will not be infringed." *Pettinaro Constr.*, 428 A.2d at 1164.

226. It is a long-established rule in New Jersey that the right to set off mutual judgments against each other is within a court's discretion. *Atanasio v. Silverman*, 77 A.2d 813,

[195] *See also Di Loreto v. Tiber Holding Corp.*, No. 16564, 2001 WL 221001, at *4 (Del. Ch. Feb. 23, 2001); *Reddy v. Primecare Int'l, Inc.*, No. 18305, 2000 WL 1654834, at *4 (Del. Ch. Oct. 20, 2000); *Esterling v. Bd. of Tr. of the Firemen's Pension Fund*, 1988 WL 77774, at *6 (Del. Super. Ct. July 8, 1988).

814 (N.J. Super. Ct. Law Div. 1950). Courts exercise this right in their sound discretion based on principles of law and equity. *Id*. New Jersey courts look favorably upon the right of setoff. *Id*. at 816 ("[T]he public policy of this State . . . is in favor of granting of a set-off [between] mutually indebted persons."). To be mutual, debts must be due to and from the same persons in the same capacity. *Superintendent of Ins. v. Int'l Equip. Leasing, Inc*., 588 A.2d 883, 887 (N.J. Super. Ct. App. Div. 1991) (citing *Beecher*, 125 N.E. at 833). As explained above, Debtor's and AMC's debts are mutual.

227. Arizona law also recognizes a right of setoff. *Martin v. Wells, Fargo & Co.'s Express*, 28 P. 958, 959 (Ariz. 1892) ("The power of a court of law, in a proper proceeding, to set off one judgment against another, when the demands remain mutual, is undoubted. It does not depend upon any statute, but rests upon the general jurisdiction of a court over its judgments and its suitors when before it.").[196] Debts are mutual when they are due to and from the same persons in the same capacity. *Urias v. PCS Health Sys., Inc*., 118 P.3d 29, 33 (Ariz. Ct. App. 2005) (citing *Beecher*, 125 N.E. at 833). As explained above, Debtor's and AMC's debts are mutual.

228. In all three states, setoff is an equitable remedy exercised at the court's discretion. If AMC had an allowed claim, equity would require setoff of the parties' claims pending resolution of the appeal of the SCC Final Judgment.

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[196] *See also Great Am. Ins. Co. v. Fred J. Gallagher Constr. Co*., 494 P.2d 379, 481 (Ariz. Ct. App. 1972); *Advanced Living Ctr. v. T.J. Bettes Co. of Cal*., 464 P.2d 656, 663 (Ariz. Ct. App. 1970) ("'[N]atural justice and equity require that the demands of parties mutually indebted be set off against each other.").

## D. The Deferred Intercompany Gain

### 1. The Deferred Intercompany Gain Resides With New Asarco Due to the 2005 Restructuring

229. As mentioned above, the primary purpose for the 2005 restructuring was to move the DIG from SPHC to New Asarco. *See supra* ¶¶ 24–30. By doing this, AMC ensured that the DIG would not be triggered in the event that Debtor was deconsolidated from the AMC Consolidated Group in a subsequent bankruptcy proceeding. Both parties agree that the 2005 restructuring accomplished this result.[197] Thus, the DIG resides with New Asarco today, so the members of the AMC Consolidated Group, including Parent, will be solely liable for any tax owed if the DIG is triggered following Debtor's deconsolidation, unless the TSA makes Debtor contractually liable for such an amount.

### 2. The Tax Sharing Agreement Does Not Require Debtor to Reimburse Parent For Any Taxes Owed on the Deferred Intercompany Gain

230. Section 8 of the TSA addresses the parties' liability in the event the DIG is triggered. That section provides:

> The parties hereto hereby agree that in the event the deferred gain from the March 31, 2003 sale of the stock of Southern Peru Copper Corporation is triggered, such gain shall be treated as an item of income realized by the AMC Subgroup and not by the Asarco LLC Subgroup for all purposes of this agreement and the Original Agreement if such deferred gain is triggered (i) after a Deconsolidation Event for any reason that is not in whole or in part attributable to the events or circumstances that resulted in the Deconsolidation Event or (ii) on or prior to a Deconsolidation Event, by reason of any sale or other disposition of stock of Southern Peru Copper Corporation or of SPHC II Incorporated on or after the date hereof.

As explained above, a Deconsolidation Event occurred when Parent deconsolidated Asarco USA, Debtor's parent corporation, from the AMC Consolidated Group. *See supra* ¶¶ 129–30.

[197] 8/4 Tr. (Smith) at 20:6 – 21:3; 8/4 Tr. (Kayle) at 64:2 – 65:2; 8/4 Tr. (Glickman) at 97:1–7, 98:23–24, 100:10–13, 104:1–9; 7/24 Tr. (Parker) at 45:25 – 46:15; Keegan Proffer ¶ 2; Smith Proffer ¶ 6; Kayle Proffer ¶ 4; Parker Proffer ¶¶ 38–39.

Because the potential events that could trigger the DIG—cancellation of Parent's member interests in Debtor, followed by the return of the SPCC Shares to Debtor under the SCC Final Judgment—are not the events that resulted in the Deconsolidation Event, any taxes owed on the DIG are the responsibility of Parent, not Debtor.

231. Even if no Deconsolidation Event under the TSA occurred in 2007 due to the 2007 rescission, Parent would still be obligated to pay any taxes owed on the DIG if it were triggered. If the TSA were still in effect, a Deconsolidation Event would occur upon the cancellation of Asarco USA's member interests in Debtor under Debtor's plan of reorganization. This, however, would not trigger the DIG. Indeed, preventing the triggering of the DIG in these circumstances was the very purpose of the 2005 restructuring. *See supra* ¶¶ 24–30. Rather, the DIG would be triggered, if at all, upon the return of the SPCC Shares to Debtor under the SCC Final Judgment. Because the events that would trigger the DIG are not the same events that would result in a Deconsolidation Event under the TSA, Parent would remain responsible for any taxes owed on the DIG under the TSA.

**3. The Deferred Intercompany Gain Is Not a Liability For Federal Income Tax Purposes**

232. Parent argues that, if the Refund is an asset that passed from Asarco NJ to Debtor, and later to Debtor's estate, then the DIG must be considered a liability that also passed to Debtor as part of the 2005 restructuring.[198] The Refund and the DIG are not equivalent in this respect. As explained above, ownership of a tax refund is a property right under state law. *See*

[198] 8/4 Tr. (Glickman) at 101:13–21, 102:23 – 103:4, 103:14–23, 104:15–18, 105:3–7, 105:12–15; Glickman Proffer ¶¶ 27–28. The Parent has not asserted a claim, in any amount, with respect to the DIG. The Parent's amended claim states: "[D]epending on the resolution of positions asserted in other tax-related matters, the claim may also include taxes resulting from the Debtor's gain from the 2003 sale of shares of Southern Copper Corporation (f/k/a Southern Peru Copper Corporation). The Parent expressly reserves its right to amend its administrative expense claim upon the occurrence of any event that results in an increase or decrease in the amount of taxes attributable to the Debtor." PX1. The Parent never amended its claim.

*supra* ¶¶ 70–71. A deferred gain or loss on an intercompany transaction, on the other hand, is merely a tax attribute that could potentially affect the federal income liability of a member of a consolidated tax group if the deferred gain or loss were triggered at some point. A deferred gain is not a liability for federal income tax purposes.[199] Because the DIG is merely a tax attribute rather than an item of property recognized under state law, it passed to New Asarco as part of the 2005 restructuring, as New Asarco is Asarco NJ's successor for federal income tax purposes since both Debtor and SPH LLC are disregarded entities under federal tax law. *See supra* ¶ 64. The Refund, on the other hand, was an item of property for state law purposes prior to the 2005 restructuring, so it passed to Debtor under Delaware merger law. *See supra* ¶¶ 68–76.

233. In any event, no tax payments were owed on the DIG in 2005, no tax payments are owed on the DIG today, and, as Parent's expert admits, it is possible that no tax payments will *ever* be owed on the DIG. *See supra* ¶ 166.

## IV. CONCLUSION

234. The Court concludes that:

- Debtor owns the Refund, with the exception of $51,321 to which CAPCO is entitled;
- the Enthone Entities must designate Covington Land Company as substitute agent so that Debtor may receive the Refund from the IRS;
- AMC's claim is disallowed under section 502(d) of the Bankruptcy Code, subject to the Court's reconsideration under section 502(j) of the Bankruptcy Code, in accordance with the findings of fact and conclusions of law set forth in this opinion, if AMC satisfies the SCC Final Judgment or the Judgment is reversed on appeal;
- New Asarco's claim is disallowed under section 502(b)(1) of the Bankruptcy Code;
- even if the Claim were not disallowed, the allowable amount of the Claim would be, at most, only $9,221,731;

[199] I.R.C. § 461(h)(4); Parker Proffer ¶¶ 51–59; Parker Report ¶¶ 74–82; 7/24 Tr. (Parker) at 52:4–6, 54:3–8, 55:1–3.

- even if the Claim were not disallowed, it would be a general unsecured claim, not an administrative claim;

- even if AMC's claim were not disallowed, Debtor would be entitled to set off AMC's claim against the monetary portion of the SCC Final Judgment, subject to the Court's reconsideration if the Judgment were reversed on appeal; and

- in the event the DIG is triggered in the future, Parent is responsible for any taxes owed on the DIG at that time.

DATED: _______________, 20__.

_________________________________
RICHARD S. SCHMIDT
United States Bankruptcy Judge

**Dated: August 27, 2009** **Respectfully submitted,**

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**CERTIFICATE OF SERVICE**

I certify that on August 27, 2009, a copy of the foregoing document was served on the counsel listed below by email:

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