IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re: EXIDE TECHNOLOGIES, Reorganized Debtor.[1]	**Chapter 11** **Case No. 13-11482 (KJC)** **Hrg./Status Conf. Date: February 2, 2016 at 10:00 a.m. Eastern Standard Time** **Reply Due: December 18, 2015** **Related Docket No.: 4507, 4528, 4558**

THE SOUTH COAST AIR QUALITY MANAGEMENT DISTRICT'S OPPOSITION TO THE REORGANIZED DEBTOR'S (SUBSTANTIVE) OBJECTION PURSUANT TO BANKRUPTCY CODE SECTION 503(b) AND BANKRUPTCY RULE 3007 TO PROOF OF ADMINISTRATIVE EXPENSE CLAIM FILED BY THE SOUTH COAST AIR QUALITY MANAGEMENT DISTRICT (CLAIM NO. 4123)

Pursuant to and in accordance with that certain *Order Granting Parties' Agreed Schedule* [Docket No. 4528], the South Coast Air Quality Management District (the "District") hereby opposes the *Reorganized Debtor's (Substantive) Objection … to Proof of Administrative Expense Claim Filed by the … District (Claim No. 4123)* [Docket No. 4507] (the "Administrative Claim Objection"), filed by Exide Technologies ("Exide" or the "Reorganized Debtor").[2]

[1] The last four digits of the Reorganized Debtor's taxpayer identification number are 2730. The Reorganized Debtor's corporate headquarters are located at 13000 Deerfield Parkway, Building 200, Milton, Georgia 30004.

[2] The Administrative Claim Objection, together with *The South Coast Air Quality Management District's Motion for Entry of an Order Concerning the Timeliness of Its General Unsecured Claims Against Exide* [Docket No. 4503] (the "GUC Claims Motion"), and *The South Coast Air Quality Management District's Motion for a Determination That It has Alleged a Prima Facie Case for Application of the 11 U.S.C. § 1141(d)(6) Exception to Discharge* [Docket No. 4505] (the "Excepted-from-Discharge Motion"), are intended to more precisely frame the issues originally raised in *The Reorganized Debtor's Motion [to Enforce]* [Docket No. 4023] (the "Motion to Enforce"). Certain pertinent documents are attached to the *Declaration of Robert J. Pfister [Etc.]* [Docket No. 4247-1] (the "Pfister Declaration"), the entirety of which is incorporated by reference as if fully set out herein. Capitalized terms not otherwise defined

(footnote continued)

PRELIMINARY STATEMENT

1. Exide manufactures lead-acid batteries. One of its key costs is lead. For years – including during much of its bankruptcy case – Exide kept its costs low by sourcing lead from its own battery recycling facility in Vernon, California. *See Debtor's Motion for an Order … Authorizing the Debtor to Close the Vernon Facility* [Docket No. 3262] (the "Vernon Closure Motion") at 1. Indeed, Exide itself has estimated that it saves about $15 to $38 million a year by running its own lead recycling facility, instead of buying lead from third parties. *Id.* at 2.

2. Exide's choice to increase its own profits by running a lead recycling facility has imposed serious costs on the surrounding communities. Lead is a poison that, if inhaled or swallowed, harms almost every organ in the body. Vernon is just five miles south of downtown Los Angeles, in the heart of a large basin (the "South Coast Air Basin") between the Pacific Ocean and the San Gabriel Mountains. Exide's Vernon facility single-handedly took the South Coast Air Basin out of compliance with federal air quality standards for lead. *See infra* ¶ 12. It also emitted excessive levels of arsenic (which is used to strengthen alloys of lead). As a result, the South Coast Air Basin has some of the most contaminated air in the country.

3. Exide could have avoided its excessive emissions of lead and arsenic either by investing in better technology or shuttering the Vernon facility and buying its lead from someone else. But either option would have cost more, so Exide chose to keep its own costs down by continuing to operate the Vernon facility during the pendency of the chapter 11 case. The beneficiaries of that choice were Exide's prepetition creditors, who reaped the benefit of the company's increased profitability. It is the residents of the surrounding communities who suffered the environmental harm.

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herein have the meanings ascribed in the Pfister Declaration. Citations to the "RJN" are to the request for judicial notice filed concurrently herewith.

4. Civil fines stemming from Exide's choice to save money by operating the Vernon facility in violation of applicable law are entitled to administrative expense priority. Under the Bankruptcy Code, the phrase "administrative expenses" is defined in part as "the actual, necessary costs and expenses of preserving the estate." 11 U.S.C. § 503(b)(1)(A). The Supreme Court has construed that definition expansively, reasoning that it "include[s] costs ordinarily incident to operation of a business," and is not "limited to costs without which rehabilitation would be impossible." *Reading Co. v. Brown*, 391 U.S. 471, 483, 88 S. Ct. 1759, 1766 (1968). In *Reading*, the Supreme Court construed the substantively identical language of section 503(b)'s predecessor (section 64a(1) of the former Bankruptcy Act) in holding that a debtor's postpetition tort liability qualifies as an administrative expense. That is, tort liability is a "cost[] ordinarily incident to operation of a business," and therefore the party injured by the debtor's postpetition negligence enjoys administrative priority. *Id*. Judge Posner has lucidly explained the rationale of *Reading*: "Tort liability is an expense of doing business, like labor or material costs, and should be treated the same way." *In re Res. Tech. Corp.*, 662 F.3d 472, 476 (7th Cir. 2011). If businesses operating in bankruptcy were excused from tort liability, they "would have an inefficient competitive advantage over their solvent competitors" and "deficient incentives to use due care in the operation" of their businesses. *Id*.

5. The rationale of *Reading* applies with even greater force here. Exide could have invested in better technology to avoid environmental harm, and that investment would undoubtedly have qualified as an administrative expense. Or Exide could have purchased lead from third parties, which would also have been an administrative expense. Instead, Exide operated its Vernon facility in violation of environmental regulations in order to increase its profits and benefit its stakeholders. The regulatory liability flowing from Exide's choice is, no

less than tort liability, "an expense of doing business." *Id*. If Exide were immune from civil fines while operating in bankruptcy, it would have an "inefficient competitive advantage" over solvent competitors and "deficient incentives" to comply with environmental regulations. *Id*. In short, the company could violate the law with impunity.

6. That last point is important because the Bankruptcy Code provides explicitly that a "debtor in possession" such as Exide must "manage and operate the property in [its] possession … ***according to the requirements of the valid laws of the State*** in which such property is situated …." 28 U.S.C. § 959(b) (emphasis added); *see also Ohio v. Kovacs*, 469 U.S. 274, 285, 105 S. Ct. 705, 711 (1985) (a debtor in possession "must comply with the environmental laws of the State"). That principle would be toothless if a governmental agency trying to protect public health and welfare through postpetition enforcement of applicable law had to go to the back of the line with all the other unsecured creditors. It would not cost the debtor (or the prepetition creditors) anything to ignore the law.

7. In light of all this, it should come as no surprise that every court of appeals to squarely face the question has held that a postpetition civil fine for violation of an environmental regulation is an administrative expense. *See, e.g.*, *Cumberland Farms, Inc. v. Fla. Dep't of Envtl. Prot.*, 116 F.3d 16, 21 (1st Cir. 1997); *Ala. Surface Mining Comm'n v. N.P. Mining Co. (In re N.P. Mining Co.)*, 963 F.2d 1449, 1458 (11th Cir. 1992); *Dep't of Interior v. Elliott (In re Elkins Energy Corp.)*, 761 F.2d 168, 172 (4th Cir. 1985) (Bankruptcy Act). There is thus no dispute that, if this bankruptcy case had been filed in one of those other circuits, the District's claim would be entitled to administrative priority.

8. Exide argues that this Court should depart from that unanimous authority based on a 1999 Third Circuit case called *Pennsylvania Department of Environmental Resources v.*

Tri-State Clinical Laboratories, Inc., 178 F.3d 685 (3d Cir. 1999). But *Tri-State* is readily distinguishable. *Tri-State* held only that a ***criminal fine*** imposed on a medical lab for the isolated misconduct of two rogue employees was not a "cost[] ordinarily incident to operation of a business," *Reading*, 391 U.S. at 483, 88 S. Ct. at 1766, and thus not an administrative expense. That is far removed from the situation here – a business determining that it will increase its profits by keeping a polluting facility in operation. The core of the *Tri-State* panel's reasoning was its "refus[al] to adopt an analysis of administrative expenses that is based upon the assumption that legitimate businesses engage in a 'cost-benefit' analysis to determine if they will comply with criminal laws …." 178 F.3d at 692–93. As the First Circuit has recognized, however, "the considerations driving *Tri-State* plainly are not present" in the case of a civil fine for violation of an environmental regulation. *Munce's Superior Petroleum Prods., Inc. v. N.H. Dep't of Envtl. Servs. (In re Munce's Superior Petroleum Prods., Inc.)*, 736 F.3d 567, 573 (1st Cir. 2013). Indeed, *Tri-State* itself recognized that the outcome might be different "for a civil fine on a business in a heavily regulated industry[,]" a fitting description of the lead-acid battery recycling business. 178 F.3d at 698. Exide operated its business the way it did because it was more lucrative to do so, and *Tri-State* does not permit the prepetition creditors – that is, those "for whose benefit the business is carried on," in *Reading*'s words, 391 U.S. at 482, 88 S. Ct. at 1765 – to profit from Exide's misbehavior.

9. Exide muddies its Administrative Claim Objection by including pages of irrelevant factual arguments that obfuscate the clear legal issue now facing this Court – whether civil fines for postpetition violations of environmental laws are entitled to administrative priority. This Court should decline Exide's invitation to enter a factual morass not amenable to resolution by this Court at this time. The key point for present purposes is that the District's Third

Amended Complaint alleges violations that are unquestionably postpetition in both cause and effect. *See infra* ¶¶ 23–24. This Court should thus decide the legal issue briefed by the parties. It can then determine the ***amount*** of the District's administrative claim at the conclusion of proceedings in the California State Court – the forum where the factual issues raised by Exide should be adjudicated in the first instance.

FACTUAL BACKGROUND

10. The District is a domestic governmental unit responsible for implementing the air quality mandates established under the federal Clean Air Act in the South Coast Air Basin, which includes the urban portions of Los Angeles, Riverside, and San Bernardino Counties and all of Orange County. This area of 10,743 square miles (slightly larger than Massachusetts) is home to over 16.8 million people (about half the population of California), making it the second most populated urban area in the United States. Approximately 28,400 businesses in the South Coast Air Basin operate under District permits.

11. The District primarily regulates stationary sources of air pollution, which run the gamut from large power plants and refineries to corner gas stations and dry cleaners. The District develops and adopts an Air Quality Management Plan, which serves as the blueprint to bring the South Coast Air Basin into compliance with federal and state standards. The District adopts rules to regulate emissions from various sources, including specific types of equipment and industrial processes, and issues permits to ensure compliance with those rules. The District staff measures compliance through periodic inspections of permittees and continuous air quality monitoring at 38 locations throughout the District.

12. Exide's Vernon facility has single-handedly taken the District out of compliance with federal lead emissions standards. For example, in 2007–09, the EPA determined that Los

Angeles County was out of compliance with federal lead standards on the basis of data from two source-specific monitors – one in Vernon and the other in City of Industry. *See* RJN Ex. A at 2-10 (South Coast Air Quality Management District's Final 2012 Air Quality Management Plan) (the "2012 Report"). For the 2009–11 data period, only Vernon still exceeded the lead standard. *Id*. The District's report observed:

> Lead concentrations in 2011 were well below the … federal standard at all ambient monitoring sites not located near lead sources. However, the source specific monitoring site immediately downwind of a stationary lead source in the City of Vernon recorded a maximum 3-month rolling average of 0.46 µg/m3 ….

Id. at 2–12. This was approximately three times the standard. The referenced "stationary lead source in the City of Vernon," *id.*, is Exide. *See* RJN Ex. B (2012 Report App'x II) at Table A-18 (listing Exide as the only such source in the City of Vernon, and reflecting ambient lead monitoring results around Exide that were more than five times higher than any other measured source in the South Coast Air Basin).

13. Exide's Administrative Claim Objection glosses over the history of the District's efforts to regulate Exide's lead emissions by presenting what is essentially a caricature of decades of interactions between Exide and the District via the declaration of an executive who has been with Exide for less than a year and a half. *See Declaration of Thomas H. Strang [Etc.]* [Docket No. 4508] (the "Strang Declaration") ¶ 2 (employed by Exide since May 2014). The Strang Declaration purports to summarize thirty-five years in a single, cursory paragraph that Exide relies on to support its assertion that the District is seeking administrative priority for "the postpetition continuation of an alleged prepetition regulatory violation[,]" Admin. Claim Obj. ¶ 3:

> The District first permitted the two smelting furnaces used at the Vernon Facility in 1980.[3] For more than 30 years thereafter, through most of 2013: (i) the Vernon Facility operated the furnaces without any requirement that negative pressure had to be maintained within the chambers of the furnaces; (ii) the District modified the Debtor's permits multiple times, and no modification or regulation ever required that negative pressure had to be maintained in the furnaces; (iii) the District issued multiple individual permits to construct and operate the Vernon Facility without requiring the Debtor to maintain negative pressure in the furnaces; and (iv) despite annual facility and equipment inspections, the District never issued a notice of violation for failure to maintain negative pressure until December 4, 2013, or even required the Debtor to measure pressure within either furnace.

Strang Decl. ¶ 4.[4] The Strang Declaration is the only evidence offered in support of Exide's Administrative Claim Objection.

14. The actual facts are far more complex than the Strang Declaration would suggest. Solely to illustrate this complexity (that is, without tendering any issues for the Court's determination), the District has attached three public records from 2009: (i) the *Findings and Decision* entered July 1, 2009 (the "Stipulated 2009 Order") (RJN Ex. C); (ii) the *Declaration of Kenneth Copeland [Etc.]* dated June 9, 2009 (the "Stipulated 2009 Declaration") (RJN Ex. D); and (iii) a settlement agreement dated June 15, 2009 (the "Stipulated 2009 Settlement Agreement"; and with the Stipulated 2009 Order and the Stipulated 2009 Declaration, the "Stipulated 2009 Documents") (RJN Ex. E).

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[3] Contrary to the implication of this statement, Exide only acquired the Vernon facility in September 2000. *See* Vernon Closure Motion ¶ 10 n.4.

[4] The "negative pressure" referenced in the Strang Declaration refers to a contamination containment technique that creates areas of low pressure (within a room used for dust-generating activities, for example) to regulate the movement of air. Air naturally flows from higher pressure areas to lower pressure areas, so opening the door to a negatively pressurized dusty room causes air to flow from the outside of the room in, like a vacuum, thereby inhibiting the escape of any contaminants in the affected area.

15. The Stipulated 2009 Documents arose out of the District's contention in the summer of 2009 that Exide was "discharging emissions into the atmosphere which result in ambient concentrations of lead exceeding [the applicable limits] averaged over 30 days beyond the property line of the facility so as to violate District Rule 1420(d)." Stipulated 2009 Order Finding ¶ 18. The District's allegations were consensually resolved in the Stipulated 2009 Settlement Agreement, in which Exide did not admit the District's allegations but did agree to pay a non-compensatory civil penalty and to make technological updates to the facility. *See, e.g.*, *id*. Ordering ¶ 2 (requiring installation of "at least three (3) separate pressure differential monitoring systems … so as to measure the negative pressure differential between the internal building atmosphere and the external atmosphere at all times").

16. The technology and processes involved in Exide's operations are inconsistent with Exide's argument that "the allegations do not allege postpetition acts by the Debtor," Admin. Claim Obj. ¶ 31 – as though the excess lead and arsenic released into the air during the bankruptcy case are the slow-moving result of exclusively prepetition activities, rather than the consequence of Exide's daily decision to reduce costs during the bankruptcy case by continuing to smelt and source lead cheaply from an out-of-compliance facility. Tellingly, Exide's Administrative Claim Objection contains a lengthy reservation of rights that itself shows how the Third Amended Complaint includes allegations of postpetition violations that caused postpetition consequences (insofar as Exide blames others for its conduct). For example, in response to the District's allegations of lead exceedances in September and October 2013, *see* TAC ¶ 190, Exide responds that "offsite work by a third party caused such exceedance[,]" Admin. Claim Obj. ¶ 44(d), and in response to the District's allegations of exceedances in December 2013 and January 2014, *see* TAC ¶¶ 186–187, Exide blames "a neighboring property owner[,]" Admin.

Claim Obj. ¶ 44(c). Exide can argue in the alternative if it so chooses, but there is an inherent contradiction in saying that all misconduct took place years ago (before the June 2013 bankruptcy filing) while at the same time saying that the neighbors did it.

17. Parsing Exide's claim that the Vernon facility was only "operating" for eight months postpetition (from July 2, 2013 through March 14, 2014), *see* Admin. Claim Obj. ¶ 4, is also a technically complex, fact-laden undertaking. Commercial operations were briefly suspended from April 24, 2013 until July 2, 2013 (a period that straddles the June 10, 2013 petition date) as a result of a shutdown order issued by a different regulator (the California Department of Toxic Substances Control, or "DTSC"), but Exide sought and secured a court order allowing it to reopen on July 2, 2013. Strang Decl. ¶ 6. Commercial operations continued until Exide temporarily suspended them on March 14, 2014, *id*. ¶ 10, yet even then Exide deemed it "prudent to continue to allocate money and resources to preserve optionality of someday resuming operations," Vernon Closure Mot. at 3, and continued to perform maintenance and upgrade activities that themselves caused the release of lead, *see, e.g.*, TAC ¶¶ 197–199 (alleging the escape of fugitive lead dust during improperly conducted pipe repair work on March 21–22, 2014).

18. It was not until March 12, 2015, with the filing of the Vernon Closure Motion, that Exide sought authorization to permanently close the facility as part of a plea agreement with the U.S. Attorney's Office. *See* Vernon Closure Mot. ¶ 13 ("[C]losing the Vernon Facility is a condition to Exide's entry into a non-prosecution agreement with the [U.S. Attorney's Office] that will resolve the [U.S. Attorney's Office's] ongoing criminal investigation."). The *Order … Authorizing the Debtor to Close the Vernon Facility* [Docket No. 3418] (the "Vernon Closure Order") authorized Exide "to close the Vernon Facility and take such actions as are necessary to

terminate its recycling operations in California" (¶ 2), and directed that all of Exide's actions in doing so must comply with, *inter alia*, "District Abatement Orders issued against the Debtor in District Hearing Board Case Number 3151-29 and District Hearing Board Case Number 3151-32 (including the Dust Mitigation Plan), as applicable" (¶ 3) – which are stipulated abatement orders (similar to the Stipulated 2009 Documents) that Exide agreed to when it was preparing to reopen the Vernon facility.

19. Exide's broad-brush complaints about "intense political and public pressure[,]" Admin. Claim Obj. ¶ 20 n.10 (relying solely on hearsay from a two-year-old local news broadcast and newspaper article), and its intimations of unfairness in the District's rulemaking process, *e.g.*, *id*. ¶ 19 (asserting that a particular petition for order of abatement was "[i]ncredibl[e]" because it allegedly sought penalties for violations of a rule that Exide says did not apply), are not germane to whether postpetition penalties are entitled to administrative priority.[5] Rather, they are arguments for why penalties should not be imposed in the first instance, or for imposing penalties in a reduced amount – which are matters for the California State Court to resolve.[6]

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[5] The District disputes Exide's characterizations. It is also notable that the crux of Exide's complaint (the "incredible" petition for order of abatement) was, by Exide's own telling, "settled … with the District in July of 2014[,]" Strang Decl. ¶ 11, and that another lead recycling facility in the South Coast Air Basin made the capital investment necessary to adopt the technology that Exide rejected as too costly.

[6] *Cf*. 11 U.S.C. § 362(b)(4) (excepting from the automatic stay "the commencement or continuation by a governmental unit … to enforce such governmental unit's … police and regulatory power[,]" and thus allowing such actions to proceed in a state forum); 28 U.S.C. § 1452(a) (barring bankruptcy-jurisdiction-based removal to federal court of "a civil action by a governmental unit to enforce such governmental unit's police or regulatory power ….''); Remand Order (Pfister Decl. Ex. 10) at 3 (remanding the California State Action to California State Court on the ground that California "has a strong sovereign interest in … protect[ing] its citizens' ambient air quality from emissions that know no borders" – a consideration "clearly paramount to any other interest that may be gleaned from the nature of the claims").

PROCEDURAL HISTORY

20. On December 9, 2013, the District timely filed its Original Proof of Claim (Pfister Decl. Ex. 7), asserting a claim for civil penalties on account of prepetition lead and arsenic emissions that exceeded what is allowed by the District's Rules and Exide's permit.

21. On January 16, 2014, consistent with 11 U.S.C. § 362(b)(4), the District filed its Original Complaint (Pfister Decl. Ex. 8) in California State Court, thereby creating a forum in which the District's Original Proof of Claim would be liquidated. Exide tried to remove the California State Action to federal court, but the case was remanded. *See* Remand Order (Pfister Decl. Ex. 10).

22. On March 6, 2014, this Court entered the March 2014 Stipulation (Pfister Decl. Ex. 6), which confirms that the District can prosecute the California State Action to final judgment, including any appeals therefrom, with the proviso that the District will return to this Court before seeking to enforce a money judgment, as required by 11 U.S.C. § 362(b)(4).

23. Subsequent to the March 2014 Stipulation, the District amended its operative pleading in the California State Action three times, culminating in the Third Amended Complaint (Pfister Decl. Ex. 21) filed May 28, 2015. The Third Amended Complaint alleges both pre- and postpetition violations. Certain of the counts involve conduct spanning the pre- and postpetition periods, *see, e.g.*, TAC ¶¶ 140–156 (fifth cause of action), whereas others are completely prepetition, *see, e.g.*, *id*. ¶¶ 173–176 (ninth cause of action, concerning the failure to file a report that was due in February 2012 but was not filed until October 2012), and still others are completely postpetition, *see, e.g.*, *id*. ¶¶ 180–181 (eleventh cause of action, concerning events that took place on July 8 and July 9, 2013). The chart attached hereto as **Exhibit A** specifies which portions of the Third Amended Complaint concern postpetition conduct.

24. Exhibit A shows that the majority of the causes of action in the Third Amended Complaint either could involve postpetition conduct or consist entirely of postpetition conduct. For example, three causes of action are for Exide's failure to submit semi-annual monitoring reports that became due on, respectively, August 31, 2013, February 28, 2014, and March 1, 2014. *See id.* ¶¶ 192 (fourteenth cause of action), 194 (fifteenth cause of action) & 196 (sixteenth cause of action). A number of the causes of action involve Exide's submission in April 2014 of a false Report for Annual Compliance Certification stating that Exide met the requirements of its permit (when it did not). *See id.* ¶¶ 131 (third cause of action), 138 (fourth cause of action), 147 (fifth cause of action), 155 (sixth cause of action), 164 (seventh cause of action) & 172 (eighth cause of action). The Third Amended Complaint also addresses Exide's use in July 2013 of equipment connected to air pollution control equipment that was not properly in full use, *see id.* ¶ 181 (eleventh cause of action), and storm drain repairs that Exide improperly conducted in September 2013, *id.* ¶ 156 (sixth cause of action). The pleading also alleges that Exide contributed to unlawful ambient air concentrations of lead in September 2013, December 2013, and January 2014, including by using a tent that had holes in it to control lead dust emissions, *see id.* ¶¶ 185–187 (twelfth cause of action), and alleges Exide's violation of its approved Compliance Plan by failing on numerous occasions in September and October 2013 to reduce the amount charged to its reverbatory furnace, despite receiving sampling data showing that it had exceeded the permitted ambient air concentrations of lead, *see id.* ¶ 190 (thirteenth cause of action). It also addresses maintenance work on Exide's reverb furnace that was conducted on March 21 and 22, 2014 without using proper air containment enclosure to prevent fugitive lead emissions, *see id.* ¶ 199 (seventeenth cause of action), and the discharge of lead in March and April 2014, *see id.* ¶ 201 (eighteenth cause of action).

25. On May 30, 2015, the District timely filed its Administrative Claim (Pfister Decl. Ex. 22), with the Third Amended Complaint attached as an exhibit. Although Exide disputes that the Third Amended Complaint sets out the metes and bounds of the District's ***prepetition*** general unsecured claim (because Exide says that the allegations do not relate back to the Original Complaint – a matter to be resolved via the GUC Claims Motion), there is no dispute that the District's Administrative Claim is timely and encompasses all postpetition conduct alleged in the Third Amended Complaint.[7] The issues raised in the GUC Claims Motion and the Excepted-from-Discharge Motion are not implicated by the District's Administrative Claim.

26. The Court confirmed Exide's plan on March 27, 2015. The Confirmation Order provides that "[n]otwithstanding any otherwise applicable injunction in the Plan or in the confirmation order, the [District] shall be permitted to prosecute [the California State Action] subject to, and in accordance with the terms of, [the March 2014 Stipulation]." *See* Pfister Decl. ¶ 38 (quoting Paragraph 31 of the Confirmation Order); *see also id*. ¶¶ 29–37 (detailing the origins of the language that became Paragraph 31 of the Confirmation Order).

[7] Exide complains that the District's Administrative Claim is on "a preprinted claim form" and is supposedly too cursory because it does not expressly delineate "which of the allegations contained in the Third Amended Complaint relate to postpetition conduct …." Admin. Claim Obj. ¶ 16. The objection is not well-taken. The District used the preprinted form required by Exide's noticing agent, and explained in the detailed attachment that it "asserts this Administrative Claim Request in respect of penalties for the Debtor's conduct between June 10, 2013 and April 30, 2015[,]" with the Third Amended Complaint attached and incorporated by reference. It is true that the Third Amended Complaint ***also*** alleges prepetition conduct, but the District seeks administrative priority only for those portions of the Third Amended Complaint that concern postpetition conduct. Especially with Exide having stipulated to the amendment of the District's pleadings in the California State Action (rather than demurring on the ground that they failed to state a cause of action – the California State Court equivalent of a Rule 12(b)(6) motion), the District's Administrative Claim is more than sufficient. *Cf. In re Nortel Networks, Inc.*, 469 B.R. 478, 497 (Bankr. D. Del. 2012) (collecting cases in which courts "apply the federal pleading standards to proofs of claim," yet noting that the Rule 12(b)(6) standard may be too stringent in light of the Third Circuit's decision in *In re Allegheny International, Inc.*, 954 F.2d 167, 173 (3d Cir. 1992), which says only that "the claimant must allege facts sufficient to support the claim").

27. Regardless of the outcome of the Administrative Claim Objection, the GUC Claims Motion, or the Excepted-from-Discharge Motion, the California State Action will proceed in California State Court for, at a minimum, the purpose of liquidating the District's indisputably timely Original Proof of Claim. *See The Reorganized Debtor's Reply in Support of Its Motion [to Enforce]* [Docket No. 4291] at 7 n.9 ("The District can prosecute the Third Amended Complaint in the California State Court, but not the New Claims contained therein.").

28. Given the existence of another forum (the California State Court) in which complex questions of fact may be determined, the only question properly before the Court at this juncture is whether the District's Administrative Claim "alleges facts sufficient to support a legal liability." *Allegheny International*, 954 F.2d at 173. *See also Nortel Networks*, 469 B.R. at 497 ("[I]t is clear that in the Third Circuit, the *Allegheny* standard is the rule …."). It does. The Administrative Claim, as further explicated herein, properly and adequately alleges a factual basis for liability under section 503(b), and this brief demonstrates the legal basis for according administrative priority to civil fines and penalties arising from Exide's postpetition operations at its Vernon facility. Resolution of contested factual issues is not appropriate until the California State Court discovery and fact-finding processes are completed. *Cf. Order Resolving the Reorganized Debtor's [Motion to Enforce]* [Docket No. 4414] ¶ 7 (reserving all parties' rights with regard to discovery).

ARGUMENT

29. From and after the June 2013 petition date, Exide operated the Vernon facility for the purpose of maximizing the value of its bankruptcy estate for the benefit of its stakeholders. The costs of doing so are entitled to administrative priority. *See* Point I.A. Civil penalties are among the costs eligible for such priority, *see* Point I.B, regardless of whether they are explicitly

compensatory, *see* Point I.C. Exide's legal argument to the contrary is based on a case (*Tri-State*) that does not control here, *see* Point II, and Exide's factual arguments rest on contested, non-dispositive assertions that are not ripe for resolution by this Court at this time, *see* Point III.

I. Civil Penalties Arising From Exide's Postpetition Operations Are Eligible for Administrative Priority

A. Administrative Status Generally – *Reading* and 28 U.S.C. § 959(b)

30. Section 503 of the Bankruptcy Code provides that "[a]fter notice and a hearing, there shall be allowed … administrative expenses, … including – (1)(A) the actual, necessary costs and expenses of preserving the estate…." 11 U.S.C. § 503(b)(1)(A). *See also* 11 U.S.C. § 507(a)(2) (providing that "administrative expenses allowed under section 503(b)" are a second priority expense). Section 503(b) is essentially identical to section 64a(1) of the Bankruptcy Act,[8] and as such the precedents construing section 64a(1) are relevant to the interpretation of section 503(b). *See, e.g.*, *Pa. Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 563, 110 S. Ct. 2126, 2133 (1990); *N.P. Mining*, 963 F.2d at 1456.

31. *Reading* authoritatively construed the key statutory phrase – "actual, necessary costs and expenses of preserving the estate" – to "include the larger objective, common to arrangements, of operating the debtor's business with a view to rehabilitating it." 391 U.S. at 475, 88 S. Ct. at 1762. In *Reading*, a receiver had been appointed to operate the business of Knight Realty, a debtor that leased units in an industrial building. 391 U.S. at 473, 88 S. Ct. at 1761. During the receiver's tenure, the building was destroyed in a fire, which spread to neighboring buildings and ultimately destroyed property of Reading Company. *Id.* For purposes

[8] Section 64a(1) of the Bankruptcy Act provided administrative priority for "the actual and necessary costs and expenses of preserving the estate …." (as quoted in *Reading*, 391 U.S. at 475, 88 S. Ct. at 1762), which is substantively identical to the current priority for "the actual, necessary costs and expenses of preserving the estate[,]" 11 U.S.C. § 503(b)(1).

of deciding the legal issue, the parties stipulated that the damage to Reading's property was caused by the negligence of the receiver and his employee. 391 U.S. at 474, 88 S. Ct. at 1761. Framing the issue as "whether the negligence of a receiver administering an estate … gives rise to an 'actual and necessary' cost of operating the debtor's business[,]" 391 U.S. at 476, 88 S. Ct. at 1762, the Court answered in the affirmative:

> At the moment when an arrangement is sought, the debtor is insolvent. Its existing creditors hope that by partial or complete postponement of their claims they will, through successful rehabilitation, eventually recover from the debtor either in full or in larger proportion than they would in immediate bankruptcy. Hence the present petitioner did not merely suffer injury at the hands of an insolvent business: it had an insolvent business thrust upon it by operation of law.
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>
> [I]t is theoretically sounder, as well as linguistically more comfortable, to treat tort claims arising during an arrangement as actual and necessary expenses of the arrangement rather than debts of the bankrupt. In the first place, in considering whether those injured by the operation of the business during an arrangement should share equally with, or recover ahead of, those for whose benefit the business is carried on, the latter seems more natural and just. Existing creditors are, to be sure, in a dilemma not of their own making, but there is no obvious reason why they should be allowed to attempt to escape that dilemma at the risk of imposing it on others equally innocent.

391 U.S. at 478 & 482–83, 88 S. Ct. at 1763 & 1765. The Court thus held that tort liability is a "cost[] ordinarily incident to operation of a business" and therefore entitled to administrative expense priority. *Id.* at 483–85, 88 S. Ct. at 1766–67.

32. Central to *Reading*'s analysis is the fact that the true stakeholders of a debtor in possession are its prepetition creditors, "for whose benefit the business is carried on …." 391 U.S. at 482, 88 S. Ct. at 1765. *See, e.g.*, *In re Marvel Entm't Grp., Inc.*, 140 F.3d 463, 474 (3d Cir. 1998) ("When the chapter 11 petition was filed in this case, the debtor-in-possession assumed the same fiduciary duties as would an appointed trustee[, including] the duty to protect

and conserve property in its possession for the benefit of creditors." (internal quotation omitted)). Like their non-bankruptcy counterparts (the equityholders of a solvent enterprise), prepetition creditors of a debtor in possession are effectively residual claimants, entitled only to what remains of the enterprise's assets after all legitimate liabilities have been satisfied.

33. In preventing a debtor in possession's ultimate stakeholders from externalizing the costs incurred in attempting to generate a dividend, *Reading* dovetails with the well-settled rule that debtors in bankruptcy must operate their businesses in accordance with state and federal laws. This rule has a long pedigree, *see, e.g.*, *Boteler v. Ingels*, 308 U.S. 57, 60–61, 60 S. Ct. 29, 31–32 (1939) (rejecting a bankruptcy trustee's attempt to evade penalties for personally operating the debtor's unregistered and unlicensed vehicles on California highways during his administration of the debtor's estate), and is explicitly codified in the section of the Judicial Code that requires debtors in possession to "manage and operate the property in [their] possession … according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof." 28 U.S.C. § 959(b). *See also Midlantic Nat'l Bank v. N.J. Dep't of Envtl. Prot.*, 474 U.S. 494, 502, 106 S. Ct. 755, 760 (1986) ("Congress has repeatedly expressed its legislative determination that the trustee is not to have *carte blanche* to ignore nonbankruptcy law.").

B. Civil Penalties as Administrative Claims – *Conroy*

34. Exide summarily dismisses *Reading* as a case about "administrative expense priority of a business's postpetition tort liabilities," Admin. Claim Obj. ¶ 37, and brushes aside section 959(b) of the Judicial Code (requiring debtors in possession to operate in accordance with applicable law) with the assertion that the statute "fails to specify the priority of a claim

arising from the liability it imposes[,]" *id*. ¶ 40.[9] But *Reading*'s authoritative construction of the substantively identical predecessor to section 503(b), together with the mandate of 28 U.S.C. § 959(b), extends beyond the precise fact pattern in *Reading* to include civil fines and penalties arising out of violations of health and safety laws within the ambit of allowable administrative expenses. In *Spunt v. Charlesbank Laundry, Inc. (In re Charlesbank Laundry, Inc.)*, 755 F.2d 200 (1st Cir. 1985), for example, the First Circuit accorded administrative priority status to "a compensatory fine assessed civilly" on account of the postpetition operation of the debtor's dry cleaning operations. *Id*. at 201. After analyzing *Reading*, the First Circuit concluded that there was an even ***stronger*** case for according administrative priority to the civil fine:

> The debtor in this case *deliberately* continued a violation of law month after month presumably because it was more lucrative for the business to operate outside the zoning ordinance than within it. If fairness dictates that a tort claim based on negligence should be paid ahead of pre-reorganization claims, then, *a fortiori*, an intentional act which violates the law and damages others should be so treated.

Id. at 203. If the rule were otherwise (*i.e.*, if debtors in possession could violate health and safety regulations without the estate's creditors facing the economic consequences), "the bankruptcy estate would have an unfair advantage over nonbankrupt competitors" and "could, under the protection of chapter 11, cut costs by ignoring safety and environmental violations." *N.P. Mining*, 963 F.2d at 1458.

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[9] In construing the predecessor to 28 U.S.C. § 959(b) in *Boteler*, the Supreme Court rejected the contention (analogous to that advanced by Exide here) that making the tax laws applicable to receivers does not imply that such a claim is entitled to administrative expense priority. 308 U.S. at 60–61, 60 S. Ct. at 31–32 ("[P]etitioner's contention would exempt a trustee operating a business in bankruptcy from this double tax liability which other delinquents must bear. A State would thus be accorded the theoretical privilege of taxing businesses operated by trustees in bankruptcy on an equal footing with all other businesses, but would be denied the traditional and almost universal method of enforcing prompt payment.").

35. The law in the Third Circuit is in accord. The leading case is then-Judge Alito's opinion in *Pennsylvania Department of Environmental Resources v. Conroy (In re Conroy)*, 24 F.3d 568 (3d Cir. 1994). The debtor in *Conroy* failed to comply with an order from a state regulator to dispose of drums and canisters of hazardous waste, prompting the regulator to hire a contractor to clean the facility and then file an administrative expense claim for the costs incurred. *Id*. at 569. Section 503(b) does not expressly include a regulator's assessment of cleanup costs (essentially a compensatory civil fine) within the ambit of administrative expense priority. Nevertheless, the Third Circuit held that such costs "were properly classified as administrative expenses" because, *inter alia*, had the debtor disposed of the waste himself (as the law required), the costs incurred would indisputably qualify as administrative expenses. *Id*. at 569–70. *Conroy* rests on the well-settled rule that the Bankruptcy Code does not excuse compliance with environmental laws:

> Since the bankruptcy laws were revised in 1978, debtors have argued that state laws prohibiting the abandonment of hazardous substances are preempted by the literal language of Section 554 of the Bankruptcy Code, 11 U.S.C. § 554. However, in [*Midlantic*], the Supreme Court held that Section 554 does not preempt a state law that, in a reasonable effort to promote public health or safety, prohibits the abandonment of property containing hazardous wastes. It appears, therefore, that if [the regulator] had not itself undertaken to clean up the printing company facility, the Conroys could not have escaped their obligation to do so by abandoning the hazardous property in question.

Id. at 569 Thus, the Third Circuit reasoned, "we see no reason why the administrative and legal costs incurred by the [regulator] in arranging for the cleanup cannot qualify as administrative expenses under 11 U.S.C. § 503(b)(1)(A). Such costs may constitute 'actual, necessary costs and expenses of preserving the estate.'" *Id*. at 570–71.

36. Like the debtor in *Charlesbank Laundry*, Exide "deliberately continued a violation of law month after month presumably because it was more lucrative for the business to

operate outside the [law] than within it." 755 F.2d at 203. And as was true in *Conroy*, the costs of complying with applicable law – whether by investing in proper air pollution control technology, or by shuttering the Vernon facility and sourcing lead elsewhere at a higher cost – would have been administrative expenses had such costs been incurred by Exide. *See* 24 F.3d at 569–70. Yet instead of expending the funds necessary to ensure that the Vernon facility did not emit too much lead and arsenic (by operating properly or by not operating at all), Exide chose to operate the Vernon facility in violation of applicable law. Its status as a debtor in possession does not immunize it from the consequences of that choice. Judge Posner's analysis of the interplay between the deterrent effect of potential tort liability and the *Reading* principle is characteristically apt and applies with equal force to civil penalty liability:

> Tort liability is an expense of doing business, like labor or material costs, and should be treated the same way. Businesses operating in bankruptcy that were excused from tort liability would have an inefficient competitive advantage over their solvent competitors – and deficient incentives to use due care in the operation of the business. It could indeed be argued that in the interest of safety, insolvent firms, not being deterrable by threat of tort suits, should not be allowed to operate at all. *Reading* strikes a compromise between the safety interest and the interest in saving bankrupts from premature liquidation: the bankrupt that continues to operate (normally under Chapter 11) must give its tort victims priority access to such assets as the bankrupt estate retains.

Res. Tech. Corp., 662 F.3d at 476. So, too, with Exide's civil penalty liability.

C. Compensatory vs. Non-Compensatory Civil Penalties – *N.P. Mining*

37. Exide attempts to distinguish *Conroy* and similar authorities from other Circuits by arguing that the civil penalties in those cases were compensatory, whereas "the District has not asserted a claim for recovery of cleanup costs it incurred as a result of postpetition conduct" and instead seeks civil penalties that are not necessarily measured by reference to the "actual, pecuniary loss" caused by Exide's violations. Admin. Claim Obj. ¶ 24.

38. Exide's proffered distinction between compensatory and non-compensatory civil penalties, with only the former eligible for administrative status and the latter categorically ineligible, is not an accurate statement of the law.[10] As the Eleventh Circuit has explained:

> Even though these civil penalties are not compensatory, it makes sense that when a trustee or debtor in possession operates a bankruptcy estate, compliance with state law should be considered an administrative expense. Otherwise, the bankruptcy estate would have an unfair advantage over nonbankrupt competitors. A mining operation could, under the protection of chapter 11, cut costs by ignoring safety and environmental violations.

N.P. Mining, 963 F.2d at 1458. Exide ignores this critical point. Moreover, the Supreme Court in *Reading* never asked whether every item of damages awarded was purely recompense for a precisely-calculated loss (and certainly did not suggest that its analysis would change if some portion were non-compensatory or remedial).

39. An impressive array of circuit and lower courts have agreed that for purposes of determining whether a civil penalty is entitled to administrative priority, there is no meaningful distinction between civil penalties that are expressly compensatory versus those that are not. *See, e.g.*, *Munce's*, 736 F.3d at 572 ("[The debtor] argues that while 'compensatory' fines may be given priority, punitive civil fines may not. We do not accept the attempted distinction, and could not do so, under our precedent."); *Cumberland Farms*, 116 F.3d at 20–21 (affirming administrative expense priority status for non-compensatory per diem fine assessed for the debtor's failure to notify Florida Department of Environmental Protection of bankruptcy filing); *Elliott*, 761 F.2d at 169 (finding non-compensatory "postpetition environmental penalty claims" allowable under the Bankruptcy Act "as an administrative expense"); *In re Bill's Coal Co., Inc.*, 124 B.R. 827, 830 (D. Kan. 1991) ("[W]e do not believe the noncompensatory character of the

[10] The Third Circuit in *Tri-State* distinguished compensatory fines from ***criminal*** fines, but it did not hold that there is any relevant distinction between compensatory and non-compensatory civil fines.

civil penalties prevents their treatment as administrative expenses."); *In re Double B Distribs., Inc.*, 176 B.R. 271, 273 (Bankr. M.D. Fla. 1994) (following *N.P. Mining* in finding administrative expense priority appropriate for a fine assessed for two postpetition leaks and a postpetition failure of digester); *In re Motel Invs., Inc.*, 172 B.R. 105, 108 (Bankr. M.D. Fla. 1994) (following *N.P. Mining* in finding administrative expense priority appropriate for penalties incurred for failure to comply with consent order). Exide does not address these authorities.[11]

40. Moreover, the amount of a civil penalties judgment must be set by a judge of the California State Court at the conclusion of a trial at which Exide will be accorded full due process and can argue that penalties should be set by reference to compensatory principles – including the harm caused by the violation. The California State Court is required to "take into consideration all relevant circumstances" when determining the amount of a civil penalty, including but not limited to eight enumerated factors:

(1) The extent of harm caused by the violation.

(2) The nature and persistence of the violation.

(3) The length of time over which the violation occurs.

(4) The frequency of past violations.

(5) The record of maintenance.

(6) The unproven or innovative nature of the control equipment.

[11] Exide's citation of *In re Insilco Technologies, Inc.*, 309 B.R. 111 (Bankr. D. Del. 2004), for the proposition that "'only those costs incurred to cleanup property for which an estate has an interest in or owns may qualify as administrative expenses[,]'" Admin. Claim Obj. ¶ 25 (quoting *Insilco*, 309 B.R. at 114), fails to mention that *Insilco* concerned property that the debtors had sold "almost four years before their bankruptcy filing" and thus "was never part of the 'estate.'" 309 B.R. at 115. The case does not stand for the proposition that only cleanup costs – and not civil fines – are entitled to administrative priority.

(7) Any action taken by the defendant, including the nature, extent, and time of response of the cleanup and construction undertaken, to mitigate the violation.

(8) The financial burden to the defendant.

Cal. Health & Safety Code § 42403(b). These are the same factors that the District is required to consider when entering into settlements with permittees, and they rebut Exide's implication that civil penalties are calculated randomly, formulaically, or without consideration of all relevant factors. *Id.*[12]

41. Finally, Exide is incorrect in its implication that a civil penalties judgment simply supplements the California treasury. State law permits regulators to use the proceeds of fines or penalties for a variety of purposes, including to offset harms caused by out-of-compliance permittees (like Exide) by providing grants and other assistance to help bring other permittees into compliance – thus ameliorating some of the harm caused by exceedances. *See, e.g.*, Cal. Health & Safety Code § 40448.6(c) (funding compliance assistance for small businesses using civil penalties collected by the District); *see also id.* § 40448.5(c) (same, for administration of clean-burning fuels program).

II. *Tri-State* Does Not Dictate a Contrary Result

42. The heart of the Administrative Claim Objection is Exide's reliance on *Tri-State*, 178 F.3d 685. *Tri-State*'s central holding – that "non-compensatory criminal fines imposed on a Chapter 7 debtor or trustee should not be deemed administrative expenses[,]" *id.* at 697 – is obviously inapplicable here. *See* Point II.A. Moreover, *Tri-State* concerned isolated, *sui generis*

[12] The proper, careful application of these factors is illustrated by the Stipulated 2009 Documents, in which civil penalties were set in the modest amount of $150,000 with the proviso that the penalties could increase by up to a factor of ten if Exide reneged on its promises. *See* Stip. 2009 Settlement Agreement ¶¶ 2 & 5 (providing for "an additional stipulated penalty" of up to $1.5 million, net of "[t]he value of the performed tasks").

criminal acts carried out by individual actors (not established operating procedures central to the debtor's profitability). *See* Point II.B.

A. Criminal (*Tri-State*) versus Civil (Exide)

43. The facts of *Tri-State* are important. The case concerned criminal fines imposed for a discrete crime committed 51 days into the debtor's chapter 11 case. *Id*. at 687. After the criminal charges were filed, the case converted to chapter 7, and thereafter a state court convicted the debtor and imposed a $20,000 criminal fine. *Id*. The state filed a proof of claim asserting the $20,000 fine as an administrative expense, which the bankruptcy court rejected. *Id*. The district court affirmed, and on further appeal to the Third Circuit, the court framed the issue as follows: "We are asked to decide if a criminal fine is entitled to priority as an administrative expense under Chapter 7 of the Bankruptcy Code." *Id*. at 686. The court answered that narrow question in the negative: "[W]e hold that punitive criminal fines arising from post-petition behavior are not administrative expenses under 11 U.S.C. § 503(b), and therefore, are not accorded priority status pursuant to § 507(a)(1)." *Id*. at 698.

44. The fact that the fines at issue were criminal – not civil – penalties was critical to the Third Circuit's analysis and holding. The terms "crime" and "criminal" appear at least ***47 times*** in the 13-page *Tri-State* opinion. *See* 178 F.3d at 686 ("criminal fine," "post-petition criminal fine"), 687 ("criminal complaint," "post-petition criminal conduct"), 688 ("criminal fines," "criminal fines," "criminal statutes," "criminal fines and penalties," "criminal fines"), 690 ("criminal fines and penalties"), 692 ("fines for committing crimes," "the criminal," "criminal fine," "criminal laws," "criminal penalties in the form of fines," "criminal law," "criminal fines and the conduct they attempt to punish"), 693 ("criminal laws," "criminal laws," "criminal fines," "criminal fine," "criminal fines and penalties," "criminal penalties," "criminal penalties"),

694 ("criminal fines," "criminal penalties," "criminal judgments," "a crime against society"), 695 ("criminal penalties," "state criminal penalties," "criminal fines and penalties"), 696 ("criminal restitution obligations," "the victim of criminal activity," "criminal statute," "part of the criminal penalty," "criminal sentence," "criminal sentences"), 697 ("non-compensatory criminal fines," "criminal fines and penalties," "character of a criminal fine," "payment of the criminal fines," "criminal fines," "empty pockets of the criminal," "criminal fine"), 698 ("criminal activity," "punitive criminal fines," "punitive criminal fines arising from post-petition behavior").

45. Consistent with this overriding focus on criminality, the trustee in *Tri-State* opposed Supreme Court review on this precise ground, arguing that *Tri-State* did not conflict with decisions of the other circuit courts of appeals because the issue decided by the Third Circuit was the allowability of a criminal fine – not civil penalties. *See* Respondent's Brief in Opposition to Petition for Writ of Certiorari, *Penn. Dep't of Envtl. Prot. v. Nigro*, No. 99-663 (Nov. 17, 1999), *available at* 1999 WL 33632932. The trustee in *Tri-State* distinguished *N.P. Mining*, 963 F.2d 1449, *Cumberland Farms*, 116 F.3d 16, and *Elkins Energy*, 761 F.2d 168 – all of which hold that non-compensatory civil penalties are potentially allowable as administrative expenses – on the ground that they dealt with civil penalties, whereas *Tri-State* concerned criminal penalties. The First Circuit did the same in *Munce's*, observing that *Tri-State* "emphasized the criminal nature of the fine, and reasoned that it is 'neither reasonable nor necessary for a commercial enterprise to violate criminal laws ... to preserve the estate.' The considerations driving *Tri-State* plainly are not present here." 736 F.3d at 573.

46. This distinction is the appropriate one. Criminal fines and civil penalties are different in kind, not merely in degree. The distinction between civil matters and criminal

matters is one of the most fundamental in law, permeating substance and procedure in countless applications. Examples include the distinction between civil and criminal contempt, *see, e.g.*, *United Mine Workers of Am. v. Bagwell*, 512 U.S. 821, 830–31, 114 S. Ct. 2552, 2559 (1994), and the substantial body of case law has developed on the ability of governmental units to seek both civil and criminal penalties for violations of a single statutory scheme depending on the quantum of evidence of wrongdoing and the defendant's state of mind, *see United States v. Kordel*, 397 U.S. 1, 11, 90 S. Ct. 763, 769 (1970). *Cf. Nat'l Fed. of Indep. Bus. v. Sebelius*, 132 S. Ct. 2566, 2600 (2012) (distinguishing between the consequences of "being branded a criminal," which can include "deprivation of otherwise protected civil rights, such as the right to bear arms or vote in elections; loss of employment opportunities; social stigma; and severe disabilities in other controversies, such as custody or immigration disputes" versus the consequences of treating an obligation as a tax, which "leaves an individual with a lawful choice to do or not do a certain act, so long as he is willing to pay a tax levied on that choice").

47. The District has no power to bring criminal charges. The California State Action is pending in a civil department of the California State Court, which will resolve the case by rendering a civil judgment – not a criminal conviction or sentence. A civil penalties judgment will not result in Exide "being branded a criminal," *id*., and allowing administrative priority will convey no message that "a violation of a criminal law intended to protect public safety is necessary or ordinarily incident to operating a business, and therefore, is incurred as an expense of 'preserving the estate.'" *Tri-State*, 178 F.3d at 692. On these facts, *Tri-State* has no application. *See, e.g.*, *Munce's*, 736 F.3d at 573 (distinguishing *Tri-State* on the basis of, *inter alia*, "the criminal nature of the fine").

B. Discrete Crime (*Tri-State*) versus Standard Operating Procedure (Exide)

48. *Tri-State* is also inapplicable because the criminal fine at issue there was on account of a single, isolated, *sui generis* crime committed by individual agents of the debtor. *See* 178 F.3d at 687 (describing the criminal complaint against the debtor in *Tri-State* as seeking to impose criminal liability for an act that occurred "on or about October 4, 1990"). This aspect of the *Tri-State* decision distinguishes it from postpetition civil fines resulting from a debtor's long-standing failure to bring its operations into compliance with environmental laws. *See, e.g.*, *Munce's*, 736 F.3d at 573 (distinguishing *Tri-State* on this basis). Indeed, *Tri-State* recognized the importance of this distinction in its discussion of the Eleventh Circuit's *N.P. Mining* decision. *See Tri-State*, 178 F.3d at 697–98 (observing that the administrative priority allowed in *N.P. Mining* may be "appropriate for a civil fine on a business in a heavily regulated industry"). Smelting lead in a highly congested urban area with some of the worst air pollution in the country is unquestionably "a heavily regulated industry."

49. Exide's conduct here was far more integral to its operations than the isolated crimes of rogue employees at issue in *Tri-State*. The Third Amended Complaint explains that in 2010, Exide lost both a key customer for new batteries and source of used batteries when its partnership with Wal-Mart ended. TAC ¶ 39. In response, Exide closed several of its lead acid battery recycling centers, leaving only Vernon and two others. *Id.* ¶ 40. Any lead that Exide could not extract from these three remaining centers would have to be purchased on the open market, at significantly higher cost. *Id.* Around the same time, Exide performed a Health Risk Assessment to assess the full range of Exide's Vernon emissions and their effect on public health, *id*. ¶ 41, which revealed significant arsenic discharge resulting from Vernon's ordinary operations, *id*. ¶ 42. Yet Exide resisted adopting technology that could reduce these emissions,

complaining in November 2010 that "the cost associated with further technology implementations may be too burdensome for [Exide] to continue operations in California." *Id*. ¶ 46. Exide again resisted technological upgrades in 2011, telling another of its regulators (the DTSC) that it would not be economically feasible to install additional air pollution controls that could reduce Exide's arsenic emissions. Several technologies existed (including one designated by the EPA), but Exide concluded that the "expected $30 million capital cost (and incremental cost of over $6 per ton) renders the available technologies economically infeasible." *Id*. ¶ 57.

50. The background described in the preceding paragraph is part of the District's prepetition claim. But these facts illustrate why Exide's postpetition corporate decision to continue operating in violation of the law – and risk exceeding emissions standards which its antiquated equipment had historically been challenged to meet – is not remotely comparable to a rogue employee's improvident decision to put medical waste in a standard municipal dumpster one particular Thursday in October 1990. Indeed, it is notable that Exide's own framing of its conduct – which it describes as the continuous operation of "two smelting furnaces used at the Vernon Facility [starting] in 1980" and continuing "[f]or more than 30 years thereafter," Strang Decl. ¶ 4 – removes this case from the ambit of *Tri-State*. Although the District disagrees with Exide's broad-brush formulation attributing everything at issue to a unitary, decades-long course of conduct, there is no question that Exide deliberately chose to continue sourcing its lead requirements from the Vernon facility, even after Exide knew that it could be emitting too much lead and arsenic into the air.

51. Finally, it is also relevant that all pertinent parties, including Exide's management and its creditors, have been aware of Exide's regulatory issues since (at least) the outset of this bankruptcy case. *See, e.g.*, *[First Day] Declaration of Phillip A. Damaska [Etc.]* [Docket No. 3]

¶¶ 24–25. As the Fourth Circuit observed in *Elliott*, this is an additional rationale for administrative priority for fines arising from postpetition conduct:

> [Creditors] cannot by their inaction allow the debtor to incur penalties while operating the business, perhaps benefiting the profitability of the business, and yet object to the allowance of postpetition penalty claims. In effect, once the petition is filed the creditors lose their "innocent" status….
>
> Since the creditors' committee can request the bankruptcy court to intervene in the debtor's operation of the business, the creditors cannot shield their eyes from the debtor's unlawful activities, activities that may benefit the creditors by increasing the distribution to which the creditors are entitled. Subjecting the estate to postpetition claims will encourage the creditors to ensure that the debtor is complying with the law while at the same time ensure that violations of law do not go unpunished.

761 F.2d at 171–72.

52. In short, the Court can and should overrule Exide's legal argument that *Tri-State* bars administrative priority here.[13]

III. Exide's Remaining Arguments Are Highly Fact-Intensive, Not Claim-Dispositive, and Not Ripe for Resolution by This Court at This Time

53. In addition to its purely legal *Tri-State* argument, Exide argues that the Administrative Claim should be disallowed "either to the extent it is based upon (i) prepetition conduct that continued postpetition … or (ii) alleged operation violations during time periods

[13] Alternatively, if the Court concludes that *Tri-State* does bar priority, then Exide's Administrative Claim Objection should be sustained on that basis, which will allow the appellate process to unfold while Exide and the District continue to litigate the prepetition claims in California State Court. *Walsh Trucking Co. v. Ins. Co. of N. Am. (In re Walsh Trucking Co.)*, 838 F.2d 698, 701 (3d Cir. 1988) (claim disallowance is a final, appealable order). As set out above, *Tri-State* is distinguishable and is limited to criminal fines resulting from a discrete, *sui generis* crime committed by individual agents of the debtor. But to the extent that this Court disagrees and finds that the *Tri-State* decision applies and bars the District's Administrative Claim, the District reserves the right to argue on appeal that *Tri-State* was wrongly decided and should be overruled. As a lower court within the Third Circuit, this Court is not the proper forum in which to make such an argument, but the District preserves the issue for consideration by the Third Circuit and the Supreme Court.

other than when the Vernon Facility was operating ….” Admin. Claim Obj. ¶ 33. Neither argument is claim-dispositive, because there are portions of the Third Amended Complaint that are unquestionably postpetition even under Exide’s crimped analysis, *see supra* ¶¶ 23–24, and even Exide concedes that the Vernon facility itself was operating commercially and to the financial benefit of the estate as a whole during a meaningful portion of Exide’s chapter 11 case. *See* Strang Decl. ¶¶ 6 & 10 (Vernon facility engaged in “postpetition commercial operations” after July 2, 2013, and “ceased commercial operations on March 14, 2014”).

54. It is unnecessary for this Court to resolve now the intensely factual arguments about when Exide’s conduct “occurred” (including whether a particular postpetition violation is merely a consequence of prepetition conduct) or when, precisely, the Vernon facility was “operating.” These are fact-intensive questions that should be decided only upon a fully-developed record. Contrary to an off-hand remark by Exide’s counsel at the last scheduling conference, *see* Oct. 14, 2015 Tr. at 11:2–3 (“[T]his process may well swallow the whole of the California process ….”), the California State Action will proceed regardless of what happens with the Administrative Claim Objection, the Excepted-from-Discharge Motion, and/or the GUC Claims Motion. The District is undisputedly permitted to proceed with the California State Action in order to liquidate its Original Proof of Claim, and the California State Court is the appropriate venue to make findings concerning the scope and nature of Exide’s activities in the first instance. *See The Reorganized Debtor’s Reply in Support of Its Motion [to Enforce]* [Docket No. 4291] at 7 n.9 (“The District can prosecute the Third Amended Complaint in the California State Court, but not the New Claims contained therein.”).

55. Exide’s reliance on *N.P. Mining* as the legal standard for when a particular act occurs is unavailing. That case held only that the postpetition failure to abate a prepetition

violation would not be accorded an administrative priority. 963 F.2d at 1459. Even assuming *N.P. Mining* were right about that (which the District contests), here the District alleges that Exide's postpetition conduct caused environmental contamination. *See supra* ¶¶ 23–24. Similarly, Exide's reliance on *United States v. Chris-Marine, U.S.A., Inc. (In re Chris-Marine, U.S.A., Inc.)*, 321 B.R. 63 (M.D. Fla. 2004), for the proposition that *per diem* fines for the continuation of prepetition violations are not administrative expenses is similarly unavailing, as the court in that case explicitly distinguished the fines at issue – which were assessed daily for the debtor's inability to pay a judgment – from fines "related to a heavily regulated business under state law …." *Id.* at 66.

56. As the Stipulated 2009 Documents illustrate, the matters in dispute present complex technical issues that require extensive factual development. It is not as simple as tendering a conclusory declaration from a newly-hired executive who opines ("on information and belief, based on the Company's books and records, and the knowledge of its employees, representatives, and advisors," Strang Decl. unnumbered lead-in paragraph) that everything that has happened at the facility since the petition date has been happening exactly that way for the last three decades.

57. In any event, this Court should wait to classify which violations are prepetition and which are postpetition until after the California State Court finds all the relevant facts – which does not prevent this Court from overruling the Administrative Claim Objection now, without prejudice as to arguments that rest on disputed facts that will be developed in the California State Action.

58. So, too, with regard to Exide's claim that it was not "operating" at particular points in time: Exide's arguments rest on disputed factual issues that are far more complex than

the Administrative Claim Objection portrays. For example, Exide glosses over the fact that only a particular segment of the company's operations (the Vernon facility) stopped operating in March 2014 – and even then the only thing that stopped were "commercial operations," not all activity.[14] Exide continued to pursue commercial exploitation of the plant until March 2015, when (as part of a plea agreement with the U.S. Attorney's Office) the company sought and received this Court's authorization to shutter the Vernon facility. And even today deconstruction and demolition projects are being undertaken and are subject to the District's continuing oversight. What matters is that Exide itself never ceased operating; it merely reorganized.

59. Exide's reliance on *N.P. Mining*, 963 F.2d 1449, is again misplaced. *N.P. Mining* held that postpetition fines incurred after a chapter 11 trustee had been appointed and all the debtor's mining activities had ceased would not be accorded administrative expense priority because the trustee was not "operating" within the meaning of 28 U.S.C. § 959(b) (the statute that directs debtors in possession to "manage and operate" "according to the requirements of the valid laws of the State"). 963 F.2d at 1460–61. That aspect of *N.P. Mining* does not apply here,

[14] In fact, in each of the approximately 22 months between the Petition Date and the Effective Date, Exide's filings in this Court recite that the company "continues to operate its business and manage its property as a debtor and a debtor in possession" – even during periods when the Vernon facility was supposedly non-operational. *See* Docket No. 4 ¶ 5 (filed June 10, 2013); Docket No. 223 ¶ 5 (filed June 28, 2013); Docket No. 434 ¶ 5 (filed July 25, 2013); Docket No. 609 ¶ 5 (filed August 27, 2013); Docket No. 766 ¶ 5 (filed September 25, 2013); Docket No. 963 ¶ 5 (filed October 24, 2013); Docket No. 1131 ¶ 5 (filed November 27, 2013); Docket No. 1186 ¶ 5 (filed December 23, 2013); Docket No. 1309 ¶ 5 (filed January 30, 2014); Docket No. 1477 ¶ 5 (filed February 28, 2014); Docket No. 1527 ¶ 5 (filed March 11, 2014); Docket No. 1695 ¶ 5 (filed April 23, 2014); Docket No. 1786 ¶ 5 (filed May 13, 2014); Docket No. 1856 ¶ 5 (filed June 2, 2014); Docket No. 2101 ¶ 10 (filed July 30, 2014); Docket No. 2108 ¶ 5 (filed August 1, 2014); Docket No. 2263 ¶ 5 (filed September 12, 2014); Docket No. 2392 ¶ 5 (filed October 13, 2014); Docket No. 2599 ¶ 5 (filed November 10, 2014); Docket No. 2836 ¶ 5 (filed December 29, 2014); Docket No. 3012 ¶ 9 (filed January 28, 2015); Docket No. 3179 ¶ 5 (filed February 25, 2015); Closure Motion ¶ 5 (filed March 12, 2015); Docket No. 3460 ¶ 8 (filed April 8, 2015).

because Exide never ceased operating its business and, until March 2015, continued to expend resources on the Vernon facility with the prospect of resuming operations there in the future.[15]

60. Nor is it necessary or appropriate to divine a dividing line between commercial operations at the Vernon facility and demolition and deconstruction operations at the Vernon facility. The California State Action is going to proceed regardless of the disposition of the Administrative Claim Objection, the Excepted-from-Discharge Motion, or the GUC Claims Motion. When that proceeding concludes, the parties will return to this Court for final allowance of any postpetition civil penalties as administrative expenses. Any issues with regard to whether a particular penalty or portion thereof is prepetition or postpetition can be resolved on the basis of the record developed in the California State Court. *Cf. In re Marcal Paper Mills, Inc.*, 650 F.3d 311, 319 (3d Cir. 2011) (rejecting the argument that difficulty in calculating the precise portion of a particular cost is insurmountable).

[15] Additionally, the distinction between operating and not operating is irrelevant. *See, e.g.*, *In re Wall Tube & Metal Prods. Co.*, 831 F.2d at 122 ("[W]hether a trustee is liquidating, managing or reorganizing the debtor's estate, his efforts under the Code remain the same – the consolidation and distribution of the estate's assets to the benefit of the creditors. As such, that the trustee in this case is liquidating the estate rather than reorganizing it is inconsequential, especially in the critical context of the public's welfare. In either case, an environmental hazard on the estate's property is within the control of the trustee."); *In re Appalachian Fuels, LLC*, 521 B.R. 779, 804 (Bankr. E.D. Ky. 2014) ("Under the facts and circumstances of these cases, including the application of the Environmental Laws, it is clear that an operator under a permit must comply with permit requirements whether engaging in active mining activities or not. The relevant portions of the Environmental Laws make no distinction between active and inactive mining operations.").

CONCLUSION

WHEREFORE, the District respectfully requests that the Court: (i) overrule the portion of Exide's Administrative Claim Objection that relies on a blanket application of *Tri-State* with prejudice; (ii) overrule the balance of the Administrative Claim Objection without prejudice (thereby permitting the liquidation of the post-petition fines to take place in the California State Action); and (iii) grant such other or further relief as may be appropriate.

Dated: November 20, 2015

/s/ Jack Shrum

"J" Jackson Shrum, Esq.
WERB & SULLIVAN
300 Delaware Avenue, Suite 1300
Wilmington, Delaware 19801
Telephone: (302) 652-1100
Facsimile: (302) 652-1111

- and -

Thomas E. Patterson (*Pro Hac Vice*)
Robert J. Pfister (*Pro Hac Vice*)
KLEE, TUCHIN, BOGDANOFF & STERN LLP
1999 Avenue of the Stars, Thirty-Ninth Floor
Los Angeles, California 90067

Of Counsel:

Neal Katyal
HOGAN LOVELLS US LLP
Columbia Square
555 Thirteenth Street, NW
Washington, D.C. 20004

-and-

Thomas P. Schmidt
HOGAN LOVELLS US LLP
875 Third Avenue
New York, New York 10022

Attorneys for the South Coast Air Quality Management District

Exhibit A

Causes of Action in Third Amended Complaint for Which Administrative Priority is Sought, In Whole or In Part

Causes of Action in Third Amended Complaint for
Which Administrative Priority is Sought, In Whole or In Part

Cause of Action	Gravamen
1st Cause of Action	Operation of equipment without using good operating practices, including from the Petition Date until March 14, 2014
2nd Cause of Action	Operation of equipment without using good operating practices, including from the Petition Date until March 14, 2014
3rd Cause of Action	Improper storage and transportation of lead-contaminated materials, including from the Petition Date and continuing thereafter; submission of false Report for Annual Compliance Certification on April 1, 2014
4th Cause of Action	Failure to properly enclose materials storage and handling areas, including from the Petition Date and continuing thereafter; submission of false Report for Annual Compliance Certification on April 1, 2014; failure to properly enclose battery breaking area from January 18, 2014 until January 20, 2014
5th Cause of Action	Failure to repair materials storage and handling areas, including from the Petition Date and continuing thereafter; submission of false Report for Annual Compliance Certification on April 1, 2014
6th Cause of Action	Improper storage of lead-contaminated materials, including from the Petition Date and continuing thereafter; submission of false Report for Annual Compliance Certification on April 1, 2014; improper storage of lead-contaminated materials from September 16, 2013 until September 23, 2013
7th Cause of Action	Improper transportation of lead-contaminated materials, including from the Petition Date and continuing thereafter; submission of false Report for Annual Compliance Certification on April 1, 2014
8th Cause of Action	Failure to properly enclose materials storage and handling areas, including from the Petition Date and continuing thereafter; submission of false Report for Annual Compliance Certification on April 1, 2014
11th Cause of Action	Operation of equipment connected to less-than-fully-operational air pollution control equipment, from July 8, 2013 until July 9, 2013
12th Cause of Action	Discharge of lead emissions from September 9, 2013 until September 20, 2013; lead discharges in December 2013; lead discharges from January 2, 2014 until January 9, 2014

Cause of Action	Gravamen
13th Cause of Action	Failure to reduce amount charged to reverberatory furnace on a number of days in September and October 2013
14th Cause of Action	Failure to submit Semi-Annual Monitoring Report from September 1, 2013 until April 1, 2014
15th Cause of Action	Failure to submit Semi-Annual Monitoring Report from March 1, 2014 until April 1, 2014
16th Cause of Action	Failure to submit Annual Compliance Certification Report from March 2, 2014 until April 1, 2014
17th Cause of Action	Failure to properly conduct maintenance activity and enclose area where fugitive lead-dust generation potential exists from March 21, 2014 until March 22, 2014
18th Cause of Action	Discharge of lead emissions from March 21, 2014 until April 19, 2014
19th Cause of Action	Negligent emissions of arsenic, including from the Petition Date and continuing thereafter
20th Cause of Action	Knowing emissions of arsenic, including from the Petition Date and continuing thereafter
21st Cause of Action	Willful emissions of arsenic, including from the Petition Date and continuing thereafter
22nd Cause of Action	Negligent emission of lead from storage and transportation of lead-contaminated plastic chips in leaking van trailers, including from the Petition Date and continuing thereafter
23rd Cause of Action	Knowing emission of lead from storage and transportation of lead-contaminated plastic chips in leaking van trailers, including from the Petition Date and continuing thereafter
24th Cause of Action	Willful emission of lead from storage and transportation of lead-contaminated plastic chips in leaking van trailers, including from the Petition Date and continuing thereafter
25th Cause of Action	Negligent emission of lead in violation of ambient air standard from September 9, 2013 until September 20, 2013; in December 2013; from January 2, 2014 until January 9, 2014; and from March 21, 2014 until April 19, 2014

Cause of Action	Gravamen
26th Cause of Action	Knowing emission of lead in violation of ambient air standard from September 9, 2013 until September 20, 2013; in December 2013; from January 2, 2014 until January 9, 2014; and from March 21, 2014 until April 19, 2014
27th Cause of Action	Willful emission of lead in violation of ambient air standard from September 9, 2013 until September 20, 2013; in December 2013; from January 2, 2014 until January 9, 2014; and from March 21, 2014 until April 19, 2014

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re: EXIDE TECHNOLOGIES, Reorganized Debtor.[1]	**Chapter 11** **Case No. 13-11482 (KJC)**

CERTIFICATE OF SERVICE

The undersigned certifies that on November 20, 2015, I caused a true and correct copy of the foregoing to be served upon all parties via CM/ECF and upon the persons below in the manner indicated.

Date: November 20, 2015

/s/ Jack Shrum
"J" Jackson Shrum (#4757)

[1] The last four digits of the Reorganized Debtor's taxpayer identification number are 2730. The Reorganized Debtor's corporate headquarters are located at 13000 Deerfield Parkway, Building 200, Milton, Georgia 30004.

By Fax:

- **The Debtor, Exide Technologies** Attn: Phillip A. Damaska (fax: 678-566-9188)
- **Office of the U.S. Trustee for the District of Delaware**, Attn: Mark S. Kenney, Esq. (fax: 302-573-6497)

By Email:

- **Counsel to the Reorganized Debtor**, Skadden, Arps, Slate, Meagher & Flom LLP, Attn: Kenneth S. Ziman, Esq., J. Eric Ivester, Esq., Anthony Clark, and James J. Mazza, Jr. (ken.ziman@skadden.com, eric.ivester@skadden.com, anthony.clark@skadden.com, and james.mazza@skadden.com)
- **Counsel to the Agent under the DIP Financing**, Davis, Polk & Wardwell LLP, Attn: Damian S. Schaible, Esq. (damian.schaible@davispolk.com), and Richards, Layton & Finger, P.A., Attn: Mark D. Collins, Esq. (collins@rlf.com)
- **Counsel to the Agent for the Debtor's Prepetition Secured Lenders**, Greenberg Traurig, LLP, Attn: David B. Kurzweil, Esq. and Dennis A. Meloro, Esq. (kurzweild@gtlaw.com and melorod@gtlaw.com)
- **Indenture Trustee for the Debtor's secured bond issuances**, Foley & Lardner LLP, Attn: Mark F. Hebbeln (mhebbeln@foley.com)
- **Indenture Trustee for the Debtor's Unsecured Bond Issuances**, U.S. Bank, N.A., Global Corporate Trust Services, Attn. Cindy Woodward (cindy.woodward@usbank.com), and Arent Fox LLP, Attn: Andrew Silfen, Esq. (andrew.silfen@arentfox.com)
- **Counsel to the Unofficial Committee of Senior Secured Noteholders**, Paul, Weiss, Rifkind, Wharton & Garrison LLP, Attn: Alice Belisle Eaton, Esq. (aeaton@paulweiss.com) and Young Conaway Stargatt & Taylor, LLP, Attn: Pauline K. Morgan, Esq. (pmorgan@ycst.com)
- **Counsel to the Official Committee of Unsecured Creditors**, Lowenstein Sandler LLP, Attn: Kenneth A. Rosen, Esq., Sharon L. Levin, Esq, and Gerald C. Bender, Esq. (krosen@lowenstein.com, slevine@lowenstein.com, gbender@lowenstein.com, and Morris Nichols Arsht & Tunnell LLP, Attn: Robert J. Dehney, Esq. (rdehney@mnat.com)
- **Counsel to the GUC Trust Trustee,** Kelley Drye & Warren LLP, Attn. Dana P. Kane (dkane@kelleydrye.com) and Morris Nichols Arsht & Tunnel, Attn: Erin R. Fay (efay@mnat.com)
- **Fee Examiner,** Robert J. Keach, Esq. (rkeach@bernsteinshur.com)

By Overnight Delivery (FedEx):

- **Indenture Trustee for the Debtor's secured bond issuances**, Wells Fargo Bank, N.A., 150 East 42nd Street, 40th Floor, New York, NY 10017, Attn: James R. Lewis
- **The GUC Trust Trustee,** Peter S. Kravitz, Province, Inc., 9209 Canwood Street, Suite 210, Agoura Hills, CA 91301