IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	:	Chapter 11
EXIDE TECHNOLOGIES,	:	Case No. 13-11482 (KJC)
Reorganized Debtor.[1]	:	**Related Docket Nos.: 4023, 4029, 4245, 4247, 4291, 4299, 4412, 4414, 4505, 4561, 4606, 4626, 4627, 4902, 4913**

REORGANIZED DEBTOR'S RESPONSE TO SOUTH COAST AIR QUALITY MANAGEMENT DISTRICT'S SUPPLEMENTAL AUTHORITIES REGARDING 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

Exide Technologies ("Exide"), the reorganized debtor, submits this response in opposition to the South Coast Air Quality Management District's (the "District") supplemental authorities (Docket No. 4913) (the "District's Statement") regarding its motion for a determination that it has alleged a prima facie case for application of the exception to discharge under 11 U.S.C. § 1141(d)(6) (Docket No. 4505) (the "Motion").

RESPONSE

The District's Statement continues its effort to squeeze a square peg into a round hole as it seeks to deny Exide and its stakeholders their fresh start.[2] This time the District's alleged

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

[2] The Court referred to the opportunistic effort to capitalize on admissions in Exide's non-prosecution agreement with the federal authorities – in the District's Third Amended Complaint filed a month after Exide emerged from bankruptcy – as an "aha" moment. July 7, 2015 Hrg. Transcript, Docket 4389 at p. 20 ("[let['s] go after [Exide] even harder").

"gotcha" is the Supreme Court's recent decision in Husky Int'l Elecs., Inc. v. Ritz, 136 S. Ct. 1581 (2016).

Husky simply held that a fraudulent conveyance scheme resulting in direct harm to a creditor can satisfy the actual fraud element of Bankruptcy Code section 523(a)(2)(A) even absent a misrepresentation – nothing more. That holding is not relevant here. To the contrary, the ruling in Husky, as well as the other decisions cited by the District, support Exide's position on the causation and damage issues that are fatal to the District's prima facie discharge claim.

The District's Statement advances two primary arguments. First, the District wrongly asserts that Husky expanded the discharge exception in a way that somehow weakened the causation and damage elements of the statute. Expanding what constitutes actual fraud under the statute does not change the fact that, here, the District cannot show a causal link between its alleged debt and any alleged fraudulent acquisition of money by Exide. In particular, the District's debt arises, if at all, from Exide's alleged failure to maintain "good operating practices" at the Vernon facility, and **not** from fraud. Because the District suffered no fraud-based harm, Husky provides no support for its effort to force its non-compensatory debt into a discharge exception meant to compensate victims who have been harmed by fraud.

Second, the District claims that by recognizing that other fraud-like exceptions to discharge in section 523 might apply, in Husky, the Supreme Court rejected Exide's argument that section 523(a)(7), dealing with non-compensatory governmental penalties, is the only arguable exception to discharge applicable to the District's claims. The District is wrong. The common element in section 523(a)(2)(A) cases is that a creditor suffered a compensatory loss as a direct result of fraud. Not so here, where the District has not shown any harm, yet attempts to recover admittedly non-compensatory penalties under a discharge exception intended to

compensate victims of fraud. Therefore, regardless of whether certain portions of section 523(a) may overlap in instances of fraud committed on a creditor, the Supreme Court did not throw out traditional canons of statutory interpretation and common sense. Indeed, section 523(a)(7) specifically addresses the types of non-compensatory penalties sought by the District, and Congress rejected including that exception to discharge in the chapter 11 context. Moreover, nothing in Husky supports the District's non-sequitur that a debt can arise from fraud (and, thus, be compensatory) and also be non-compensatory at the same time. By definition, the two are incompatible. Husky does not change that.

The District's Statement, and the supplemental authorities offered therein, do nothing to bolster its attempt to vitiate Exide's fresh start. Accordingly, the District's Motion for a determination that it has alleged a prima facie case for application of the exception to discharge under Bankruptcy Code section 1141(d)(6) should be denied as a matter of law.

I. HUSKY SUPPORTS THE DEBTOR'S, NOT THE DISTRICT'S, POSITION.

A. Husky's Holding That False Representations Are Not Required To Prove Actual Fraud Has No Application Here.

1. The thrust of the District's Statement is that Husky expanded what constitutes fraud for purposes of the narrow discharge exception. However, that is irrelevant, because the expansion has nothing to do with the issues here.

2. Husky simply held that to prove "actual fraud" for purposes of section 523(a)(2)(A), a creditor is not required to demonstrate that there was a false representation between the debtor and the creditor. 136 S. Ct. at 1593. There, the debtor siphoned off a company's assets as part of a fraudulent conveyance scheme that directly resulted in harm to the creditor who was prevented from collecting its debt. The District's Motion does not allege any fraudulent conveyances like those in Husky, but, rather, fraudulent representations. Therefore, Husky is

inapplicable here even as to the fraud element. See, e.g., In re Nunnelee, 560 B.R. 277, 285 (Bankr. N.D. Miss. 2016).[3]

3. Moreover, regardless of whether the District is asserting false pretenses, false representations or actual fraud,[4] it still must prove causation and damages, which was reaffirmed by Husky. The District has failed to do so. There simply is no nexus between the District's alleged debt and any alleged fraudulent acquisition of money by Exide, nor was there any harm to the District.

4. The District attempts to divert the Court's attention from these fatal flaws and avoid its heavy burden of demonstrating non-dischargeability by recasting the narrow discharge exception as a limitless catch-all untethered to any traceability or damages requirements.[5] For example, the District claims that in Husky "[t]he District Court and Fifth Circuit Court of Appeals each held that a debt was not excepted from discharge because the debt did not arise as a direct consequence of a misrepresentation by Ritz to Husky . . . ."[6] (District's Statement ¶ 2). In

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[3] In Nunnelee, the court found: "[T]he Plaintiff here has not alleged a fraudulent conveyance scheme, such as the one at issue in [Husky]. Instead, the Plaintiff alleges that the Defendant's statements about the Lawsuit and the Building amounted to 'actual fraud' under § 523(a)(2)(A). Because she relies on these two misrepresentations and does not allege a fraudulent conveyance scheme or some other fraudulent transaction, the [Husky] opinion has limited applicability." Id. at 285.

[4] The fact is that even now, after voluminous briefing, it is still unclear which of the three prongs of section 523(a)(2)(A) the District is proceeding under. Therefore, because fraud must be pled with particularity, see Fed. R. Civ. P. 9(b), as incorporated in Fed. R. Bankr. P. 7009, the District has not adequately pled a prima facie case for non-dischargeability.

[5] Exceptions to discharge are construed strictly against creditors and in favor of debtors. In re Sabban, 384 B.R. 1, 5 (9th Cir. BAP 2008), aff'd in part, 600 F.3d 1219 (9th Cir. 2010). Accordingly, the burden is on the District to prove each element of its nondischargeability claim by a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 291 (1991).

[6] This statement by the District is wrong, because neither lower court made any such ruling. Instead, both lower court opinions focused on whether a misrepresentation was required at all to demonstrate actual fraud for purposes of the discharge exception statute, not whether a debt had to be a direct consequence of the misrepresentation. Indeed, the Fifth Circuit expressly declined to address the issue. See 787 F.3d 316, fn. 4. Husky stands for the narrow proposition that a misrepresentation by a debtor is not required to support a claim of actual fraud, overruling cases to the contrary.

reversing, the Supreme Court did nothing more than hold that a misrepresentation was not required to show actual fraud for purposes of the discharge exception statute. It did **not** change the requirements that (i) the debt must directly arise from the fraud, and (ii) the creditor must suffer a loss. To the extent that the District suggests that the broadening of one element (i.e., what constitutes "actual fraud") had any effect on the causation and damages elements of the statute, it is wrong.

5. To the contrary, Husky re-affirms the traceability requirement: "§ 523(a)(2)(A) is a **tailored remedy for behavior connected to specific debts**." 136 S.Ct. at 1589 (emphasis added). "Husky recognized the statutory requirement that only a debt 'obtained by' actual fraud is non-dischargeable under § 523(a)(2)(A)." Walker v. Vanwinkle (In re Vanwinkle), 562 B.R. 671, 677-78 (Bankr. E.D. Ky. 2016) (citing Husky, 136 S.Ct. at 1589 n.3) (recognizing that the statute "takes an existing debt and excepts it from discharge upon a showing that it was **obtained by actual fraud**") (emphasis added).

B. Post-Husky Cases Reinforce Exide's Arguments Regarding Causation And Harm.

6. Despite the District's selective recitations to opinions in the wake of Husky, courts have held that the Supreme Court's decision should not be read to turn a dischargeable debt into a non-dischargeable debt merely because the creditor alleges that the debtor has committed some type of fraud. See, e.g., In re Vanwinkle, 562 B.R. at 678; In re Melo, 558 B.R. 521, 561 (Bankr. D. Mass. 2016) ("this Court construes Husky narrowly and concludes that its finding is limited to a determination that 'actual fraud' does not require a misrepresentation."). Instead, the debt must directly result from the fraud.

7. For example, in Vanwinkle, the court held that judgment creditors failed to state a claim for non-dischargeability of an underlying judgment debt for money allegedly owed to a limited liability company for unpaid financial obligations where the debtor's alleged fraudulent

scheme had nothing to do with creation of the underlying debt. See In re Vanwinkle, 562 B.R. at 677 ("Nothing in the State Court Judgment sounds in fraud, and the Plaintiffs have not alleged a cause of action that might create separate liability on the part of the Defendant."). So too here. Since the District latched onto the non-dischargeability exception, it has yet to articulate a fraud cause of action against Exide that creates separate, compensatory liability. Thus, the fact remains, that the District is still missing a critical element, and no amount of supplemental briefing will change that. At bottom, the District is urging this Court to expand the discharge exception to encompass non-compensatory fines that have no link to any fraud-based compensatory damages. This Court, like the court in Vanwinkle, should reject the District's attempt at this unprecedented expansion of the narrow discharge exception.

8. Indeed, in Husky, the creditor's lawsuit sought to hold the debtor personally liable for the underlying corporate debt under a fraud-based veil-piercing statute. The debt arose directly from fraud, because but for the debtor's fraudulent transfers that drained assets from the company, the creditor would have collected on its claims against the company and, therefore, would not have been harmed. Here, the alleged fraud did nothing to hinder the District's ability to collect on its alleged debt,[7] nor did the debt in any way directly result from the alleged fraud.

9. Because the District's potential judgment debt does not arise from any alleged fraud, its reliance on Hatfield v. Thompson (In re Thompson), 555 B.R. 1 (B.A.P. 10th Cir. 2016), is equally unavailing.[8] (See District's Statement ¶¶ 10-15) Moreover, Thompson, like Husky,

[7] If anything, taking the District's allegations as true, Exide's ability to continue to operate the Vernon facility (i) made it more likely that all of its debts, including any owed to the District, would be collectible and (ii) did not hinder payment on such debts.

[8] Importantly, the Thompson court expressly stated: "What is required to satisfy the required causal link is not at issue in this appeal. As such, we decline to address it." 555 B.R. at 13, n. 69. By contrast, the required causal link is a critical issue here.

supports the Debtor's position.[9] The debt that the plaintiff in Thompson sought to except from discharge was his "**fraud-based corporate veil piercing claim** [against the individual debtor accused of fraud], not [the company's] debt based on providing substandard [nursing home] care." Id. at 20 (emphasis added). Thus, the debt sought to be excepted from discharge in Thompson potentially arose from the fraud. See id. at 28 (thus, the "fraud-based corporate veil piercing claim under Oklahoma law . . . may arise from actual fraud under §523(a)(2)(A))."

10. These decisions underscore the critical nature of the causal link between the fraudulent conduct and the debt sought to be excepted from the discharge. In each of Husky and Thompson, the debt excepted from discharge was compensation for losses to the creditor directly caused by the debtor's fraud. Here, in contrast to the fraud-based and veil-piercing debts, the underlying debt is for non-compensatory environmental penalties that accrued as a result of Exide's alleged noncompliance with the District's environmental regulations, which is completely unrelated to any alleged fraudulent conduct by Exide. Nor did the District suffer any losses for which it seeks compensation.

11. Put another way, if the underlying environmental claims have merit, Exide would owe the District for these non-compensatory penalties regardless of the alleged fraud. Therefore, these damages do not fall within the fraud exception to discharge. See, e.g., In re Ifeorah, 683 Fed. App'x. 621, 624 (9th Cir. 2017) (damages for unpaid rent, which were owed regardless of debtor's fraud, were not directly caused by the fraud and, therefore, should not have been excepted from discharge).

[9] The Tenth Circuit Bankruptcy Appellate Panel reversed the bankruptcy court's grant of summary judgment to the debtor and remanded for a determination, among other things, of whether the debtor obtained money, property, services, or credit by his alleged fraud, because there were genuine issues of material fact. Thompson, 555 B.R. at 14.

12. Ifeorah, decided earlier this year, is instructive. The Ninth Circuit took a surgical approach in examining specific debts and making particularized determinations as to whether each such debt was non-dischargeable under the Bankruptcy Code. See In re Ifeorah, 683 F.3d App'x. at 625 ("The loss would have been the same if [debtor's] promises were true. Thus, the bankruptcy court clearly erred when it found that [the creditor's loss] was a proximate result of fraud."). In so doing, the Court of Appeals required the judgment creditors to meet their burden of demonstrating the specific debts that arose from the fraudulent conduct. As such, the Ifeorah court found that, even in a case where fraud was demonstrated, a loss of kitchen equipment and certain rental payments was nonetheless dischargeable because it was proximately caused by the debtor's breach of contract, not its fraud. Id.; see also In re Panos, 573 B.R. 723, 734 (Bankr. S.D. Ohio 2017) ("[I]t is only those specific amounts directly traceable to the fraud that are nondischargeable under § 523(a)(2)(A).").

C. The District Has Not Shown Any Actual Harm Traceable To The Alleged Fraud.

13. The District never suffered any specific losses or damages as a proximate result of Exide's allegedly fraudulent acquisition of money, as required by the statute. Instead, the debt the District seeks to liquidate in the state court action is for non-compensatory regulatory penalties arising from Exide's alleged mismanagement of the Vernon facility and the alleged release of lead and arsenic into the air in violation of the District's rules.[10] Indeed, the District has never detailed the amount of the potential state court judgment, if any, that it claims is attributable to (i.e., directly resulted from) Exide's alleged fraud as distinct from its alleged violations of environmental regulations.

[10] The District's Third Amended Complaint (¶ 1) makes this clear: "This action arises from Defendant's knowing and willful release of unsafe levels of lead and arsenic into the air."

14. Tellingly, most of the causes of action for which the District seeks to obtain the judgment debt were first alleged in three earlier iterations of its state court complaint, which made no allegations (or even mention) of fraud.[11] For example, in the second amended complaint (filed two months before the Effective Date of the Plan), the District already was seeking damages from penalties up to $60 million. This shows that the liability the District alleges under its rules in no way arises from, and is not directly traceable to, fraud, as section 523(a)(2)(A) requires.

15. The District claims that the Husky Court rejected the primary arguments advanced by Exide and permitted debts to be excused from discharge even when the fraud post-dates the transaction that gave rise to the debt. See District's Statement ¶ 3. The District is incorrect. Regardless of whether the fraud post-dates the transaction that gives rise to the debt, the creditor must be harmed as a result of the fraud.[12]

16. Fraud victims (whether governmental or private entities) suffer losses. Thus, it is no surprise that statutes meant to remedy fraud, such as section 523(a)(2)(A), are compensatory in

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[11] The original complaint was filed in California state court on January 16, 2014, and two subsequent amended versions were filed on August 7, 2014 and February 18, 2015. On May 28, 2015, two months **after** Exide's Plan was confirmed and nearly a month **after** Exide emerged from chapter 11, the District filed its Third Amended Complaint which raised the fraud allegations for the first time.

[12] See In re Glunk, 343 B.R. 754, 758 (Bankr. E.D. Pa. 2006) ("before a debt may fall under the exception of § 523(a)(2)(A), the debtor's fraud must result in a loss of property to the creditor.") (internal quotations omitted); 4 ALAN N. RESNICK & HENRY J. SOMMER, COLLIER ON BANKRUPTCY § 523.08 (16th ed. 2017) ("Before the exception applies, the debtor's fraud must result in a loss of property to the creditor."). See also In re Goodwich, 517 B.R. 572, 586 (Bankr. D. Md. 2014) ("[T]he fraud exception . . . still requires that the debtor have obtained something from the creditor for that debt to qualify for the exception."); Richard Levin & Alesia Ranney-Marinelli, The Creeping Repeal of Chapter 11: The Significant Business Provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, 79 Am. Bankr. L.J. 603, 615 (2005) ("An obvious candidate for a governmental unit's claim of nondischargeability is any government-sponsored loan program, such as a small business loan from or guaranteed by the Small Business Administration. A governmental unit may seek to have excepted from the discharge amounts owing under a government contract. . . . Defense and federal government contractors could be particularly affected by this provision. Medicare and Medicaid providers are other obvious targets.").

nature and designed to redress the loss suffered.[13] The District's theory that because of alleged fraud wholly unrelated to the District's underlying debt, it now has a free ticket to compound penalties and jump ahead of other estate creditors, turns that entire harm principle on its head. Notably absent from the District's voluminous pleadings and filings is any allegation that it lost anything as a result of Exide's alleged concealment. Unlike the creditor in Husky, who was blocked from collecting its debt as a direct result of the debtor's fraud, the District was not harmed by Exide's alleged fraud. The District's tortured effort to cram its debt into the narrow discharge exception should be rejected as an opportunistic attempt to generate a gain for itself and thwart the discharge through an upside down contortion of the statute.

17. Simply put, if the District is alleging a fraudulent representation by Exide, then the actual fraud prong, and Husky, are irrelevant. If the District is alleging actual fraud, then Husky merely held that a false representation is not required to prove that element. But the Supreme Court left in place the traceability and damages requirements under the statute, which the District has failed to prove. In either case, Husky and its progeny do not help the District.

II. NON-COMPENSATORY DEBTS ALONE ARE NOT, AND CANNOT BE, DEBTS ARISING FROM FRAUD.

18. The District also claims that Husky "eviscerates" Exide's argument that a debt that is non-dischargeable under Bankruptcy Code section 523(a)(7)[14] cannot also be non-dischargeable

[13] See In re Bandi, 683 F. 3d 671, 674 (5th Cir. 2012) (section 523(a)(2)(A) is "intended to protect victims of fraud"); BBSerCo, Inc. v. Metrix Co., 324 F. 3d 955, 964 (8th Cir. 2003) (defrauded party "was entitled to recover any actual pecuniary loss sustained as a direct result of the wrong") (applying Iowa law)(internal quotations omitted), In re Heritage Org. L.L.C., 375 B.R. 230, 266 (Bankr. N.D. Tex. 2007) ("[a] victim of fraud is entitled to recover the actual amount of loss resulting directly and proximately from the fraud") (applying Texas law).

[14] In section 523(a)(7), Congress provided a separate discharge exception – but only for creditors of individual debtors, not corporate debtors – for debts for fines, penalties or forfeitures payable **to and for the benefit of a governmental unit**, which is **not compensation for actual pecuniary loss**.

under section 523(a)(2)(A). District's Statement ¶ 1. In support, the District relies on the statement in Husky that some overlap appears inevitable in certain of the various discharge exceptions. Id. ¶¶ 4-6. The District misses the point.

19. The Husky Court discussed three discharge exceptions under section 523(a) dealing with fraud or similar bad conduct – subsection (2)(A) (false pretenses, false representations, or actual fraud), subsection (4) (debts for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny), and subsection (6) (debts for willful and malicious injury by the debtor). In so doing, the Court made the offhand statement that some exceptions to discharge may overlap. That unremarkable proposition – that the subsections dealing with fraud may overlap – does not inform the issue here, i.e., whether debts like the District's claims that are specifically covered by a different provision, section 523(a)(7), could also come within the fraud exceptions in section 523(a)(2)(A). Thus, Husky – which never mentions section 523(a)(7), let alone concludes that non-compensatory penalties could ever constitute debts arising from fraud – is irrelevant on the issue.

20. The District avoids this issue, and for good reason. Bankruptcy Code section 1141(d)(6) – which extends a portion of section 523(a), applicable to individual debtors, to corporate debtors – only incorporates subsections (a)(2)(A) and (B), but not subsection (a)(7). The District's alleged debt – for non-compensatory fines/penalties owed to a governmental unit – unquestionably falls under section 523(a)(7). Although non-compensatory debts owed to governmental units could have been excepted from corporate debtors' discharges by including it in section 1141(d)(6), Congress elected not to do so. Congress clearly intended that such debts be dischargeable in a corporate chapter 11 context, which is why the District goes to such lengths to re-cast its debt as something it is not: compensation for loss that it suffered as a result of fraud.

21. Contrary to the District's implication, Exide does not contend that all of the 19 enumerated discharge exceptions in section 523(a) are mutually exclusive. Thus, the simple fact that some sections dealing with fraud and similar bad conduct may overlap is irrelevant to Exide's argument. Rather, Exide contends that the nature of the specific debt here, which the District admits is non-compensatory and not based on any harm it suffered, fits squarely within section 523(a)(7); at the same time, the debt is completely incompatible with section 523(a)(2)(A), which is designed to compensate victims of fraud.

22. Indeed, given the compensatory nature of fraud claims – which compensate victims for losses incurred as a result of such fraud – an assertion of non-compensatory damages on account of fraud makes no sense, no matter what case the District cites. Logic dictates that, even viewing each discharge exception independently, debts that admittedly are non-compensatory penalties because the governmental creditor has not suffered any harm, such as the District's claims here, have nothing to do with any alleged fraud and, therefore, cannot come within the scope of section 523(a)(2)(A), which deals with debts arising from fraud.

23. Here, there is no dispute that (i) the District (a) is a governmental unit, (b) is seeking fines and penalties that are not compensation for any actual pecuniary loss, and (c) did not suffer any losses, and (ii) the fines and penalties were not assessed due to, or directly traceable to, any alleged fraud. Thus, the District's effort to take advantage of the discharge exception designed to compensate fraud victims for their directly resulting losses, in order to recover a non-compensatory penalty where the District suffered no harm, is a legal non-sequitur. The two types of claims, one inherently compensatory and the other inherently noncompensatory, are fundamentally incompatible.

* * * *

24. The purpose of the narrow corporate discharge exception is to identify specific debts for which a reorganized debtor could still be liable, and not to transform the entire universe of otherwise dischargeable claims into non-dischargeable claims simply because a creditor raises the specter of fraud, as the District attempts to do here. Accordingly, the District's assertions that its claims arising from alleged violations of its environmental rules somehow fall within the scope of the exception to discharge under Bankruptcy Code sections 523(a)(2)(A) and 1141(d)(6) are without merit.

CONCLUSION

For all of the foregoing reasons and those set forth in Exide's prior submissions in connection with the Motion, the District fails to state a claim for non-dischargeability for which relief can be granted and, thus, its Motion should be denied.

Dated: Wilmington, Delaware
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SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP
/s/ Anthony W. Clark
Anthony W. Clark (I.D. No. 2051)
One Rodney Square
P.O. Box 636
Wilmington, Delaware 19899-0636
Telephone: (302) 651-3000
Fax: (302) 651-3001

- and -

J. Eric Ivester
Four Times Square
New York, New York 10036-6522
Telephone: (212) 735-3000
Fax: (212) 735-2000

- and -

James J. Mazza, Jr.
155 N. Wacker Dr.
Chicago, Illinois 60606

Counsel for Exide Technologies, the Reorganized Debtor