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Hearing Date: June 25, 2013
Hearing Time: 10:00 a.m.

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re:	:	
	:	
SOUND SHORE MEDICAL CENTER OF WESTCHESTER, *et al.*,	:	Chapter 11
	:	
	:	Case No. 13-22840 (RDD)
Debtors.	:	
	:	

LIMITED OBJECTION OF THE UNITED STATES OF AMERICA TO DEBTORS' MOTION FOR ENTRY OF INTERIM AND FINAL ORDERS (I) AUTHORIZING DEBTORS (A) TO OBTAIN POST-PETITION SECURED, SUPERPRIORITY FINANCING PURSUANT TO 11 U.S.C. §§ 105, 361, 362, 363, AND 364 AND (B) TO UTILIZE CASH COLLATERAL PURSUANT TO 11 U.S.C. § 363; (II) GRANTING ADEQUATE PROTECTION TO PRE-PETITION SECURED CREDITORS PURSUANT TO 11 U.S.C. §§ 361, 362, 363 AND 364; AND (III) SCHEDULING A FINAL HEARING PURSUANT TO BANKRUPTY RULES 4001(B) AND 4001(C)

The United States of America (the "Government"), by its attorney Preet Bharara, United States Attorney for the Southern District of New York, hereby objects to the Debtors' Motion for Entry of Interim and Final Orders (I) Authorizing Debtors (A) to Obtain Post-Petition Secured, Superpriority Financing Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, and 364 and (B) to Utilize Cash Collateral Pursuant to 11 U.S.C. § 363; (II) Granting Adequate Protection to Pre-Petition Secured Creditors Pursuant to 11 U.S.C. §§ 361, 362, 363 and 364; and (III) Scheduling a Final Hearing Pursuant to Bankruptcy Rules 4001(B) and 4001(C) (the "DIP Motion") [Dkt. No. 16].

The Government objects principally to Paragraph 32 of the Debtors' proposed Final DIP

Order, attached as Exhibit D to the DIP Motion [Dkt. No. 16-3], and endorsed by the Court on May 31, 2013 [Dkt. No. 39], because it improperly declares that the DIP Agent and the DIP Lender, as defined in the Interim DIP Order, have "no liability to any third party" and are not "deemed to be in control of the operation of Debtors or to be acting as a 'controlling person,' 'responsible person,' or 'owner or operator' with respect to the operation or management of the Debtors (as such term, or any similar terms, are used in the Internal Revenue Code, the United States Comprehensive Environmental Response, Compensation and Liability Act as amended, or any similar federal or state statute) . . . ." Interim DIP Order, ¶ 32. This language is overbroad and impermissible as a matter of public policy because it seeks, by bankruptcy order, to immunize the DIP Agent and the DIP Lender from liabilities they may incur under a host of federal and state laws, including the Internal Revenue Code and the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 ("CERCLA"), 42 U.S.C. §§ 9601-9675. Because actions that the DIP Agent and DIP Lender may take in the future under the Final DIP Order and the DIP Documents are presently unknown, it is impossible for the Court or anyone else to determine whether such future acts would create lender liability under applicable non-bankruptcy law.

The Government also objects to Paragraph 44(a) of the Interim DIP Order, because it acknowledges the Government's valid rights of setoff or recoupment only with respect to Debtors' Medicare provider agreements, notwithstanding the Government's right to interagency setoff. *See* Interim DIP Order, ¶ 44(a).

ARGUMENT

1. Paragraph 32 of the Interim DIP Order provides as follows:

> *No Deemed Control.* In making decisions to advance any extensions of credit under the DIP Financing, or in taking any other actions related to this Interim Order or the DIP Documents (including, without limitation, the exercise of its approval rights with respect to any budget), the DIP Agent and DIP Lender shall have no liability to any third party and shall not be deemed to be in control of the operations of Debtors or to be acting as a "controlling person," "responsible person," or "owner or operator" with respect to the operation or management of the Debtors (as such term, or any similar terms, are used in the Internal Revenue Code, the United States Comprehensive Environmental Response, Compensation and Liability Act as amended, or any similar federal or state statute), and the DIP Agent's relationship with the Debtors shall not constitute or be deemed to constitute a joint venture or partnership of any kind.

Interim DIP Order, ¶ 32. The Government objects to this language because it improperly attempts to circumvent the Government's regulatory and police powers by shielding the acts of the DIP Lender and the DIP Agent from future liabilities.

A. This Court Lacks Subject Matter Jurisdiction to Enter Declaratory Judgment or Injunctive Relief With Respect to the DIP Agent's and DIP Lender's Obligations Under Federal Tax Laws

2. The Government objects to Paragraph 32 of the Interim DIP Order because it states that the DIP Agent and the DIP Lender will not deemed to be acting as "controlling persons," "responsible persons," or "owners or operators" within the meaning of the Internal Revenue Code, which can be read as a waiver of potential federal tax liability. *See* Interim DIP Order, ¶ 32. The Declaratory Judgment Act, 28 U.S.C. § 2201, and the Anti-Injunction Act, 26 U.S.C. § 7421(a), affirmatively bar injunctive or declaratory relief with respect to federal taxes. *See SEC v. Credit Bancorp, Ltd.*, 297 F.3d 127, 138 (2d Cir. 2002); *see also Alcan Aluminum Ltd. v. Dep't of Revenue*, 724 F.2d 1294, 1298 n.8 (7th Cir. 1984) ("[T]here is a strong policy against allowing declaratory or injunctive relief against the assessment or collection of federal taxes.") (citing 28 U.S.C. § 2201 and 26 U.S.C. § 7421(a)). Specifically, the Declaratory

Judgment Act waives the Government's sovereign immunity by authorizing courts to declare "the rights and other legal relations of an interested party seeking such declaration, whether or not further relief is or could be sought," but expressly excludes matters "with respect to Federal taxes." 28 U.S.C. § 2201(a). Likewise, the Anti-Injunction Act separately provides that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person." 26 U.S.C. § 7421(a). Separately, section 505(a) of the Bankruptcy Code, which gives this Court the authority to "determine the amount or legality of any tax," does not give this Court jurisdiction "to adjudicate the tax liability of non-debtors." *In re Prudential Lines Inc.*, 928 F.2d 565, 574-75 (2d Cir. 1991) (citing cases); *see also Brandt-Airflex Corp. v. Long Island Trust Co.*, 843 F.2d 90, 96 (2d Cir. 1988) (holding that 11 U.S.C. § 505 does not apply to the tax liability of secured lender).

3. Accordingly, this Court lacks jurisdiction to enter an order which purports to grant declaratory and injunctive relief with respect to any liabilities that the DIP Agent and the DIP Lender may have under the Internal Revenue Code. *See, e.g., In re Bradlees Stores, Inc.*, No. 95 Civ. 5494, 1995 WL 510005, at *1 (S.D.N.Y. Aug. 28, 1995) (vacating bankruptcy court order which provided that DIP lender "shall not be deemed to be (i) an owner or operator, (ii) in control, or (iii), a responsible person, with respect to the operations of the Debtors within the meaning of federal tax or CERCLA statutes," because bankruptcy court lacked jurisdiction to issue a declaratory judgment concerning federal taxes).

B. Nothing in the DIP Order Should Shield the DIP Agent and the DIP Lender From Liability Under the Federal Environmental Laws

4. There is no question that the Government is charged with the police and regulatory responsibility of protecting public health and safety pursuant to several statutes, including but not limited to, the Clean Air Act, 42 U.S.C. §§ 7401-7671q; the Clean Water Act, 33 U.S.C. §§ 1251-1387; and CERCLA.

5. CERCLA imposes strict liability for the cleanup costs of an environmental hazard, even if the person did not contribute to the contamination, on four categories of potentially responsible parties ("PRPs"), including the current owners and operators of a vessel or facility, and the former owners or operators of a facility at the time of the disposal of any hazardous substance. 42 U.S.C. § 9607(a)(1)-(4). Although CERCLA lists various categories of persons who may be considered "owners or operators" of a contaminated property for purposes of imposing liability, *see generally* 42 U.S.C. § 9601(20), CERCLA excludes from "owner or operator" liability a secured creditor who holds "indicia of ownership" primarily to protect its security interest but does not "participat[e] in management of a vessel or facility." *Id.* § 9601(20)(A). "Participation in management," in turn, is defined as "actually participating in the management or operational affairs of a vessel or facility." *Id.* § 9601(20)(F).

6. CERCLA further provides that a lender who holds an "indicia of ownership primarily to protect a security interest in a vessel or facility" can be deemed to "participate in management" if that lender "exercises decisionmaking control over the environmental compliance related to the vessel or facility, such that the person has undertaken responsibility for the hazardous substance handling or disposal practices related to the vessel or facility." *Id.* § 9601(2)(F)(ii). The lender may also be deemed to have "participate[d] in management" if it "exercises control at a level comparable to that of manager of the vessel or facility," where the lender has "assumed or manifested responsibility" for the vessel or facility's overall management. *Id.*

7. The Government objects to the language set forth in Paragraph 32 of the Interim DIP Order because it permits the DIP Lender and the DIP Agent to evade potential liability under CERCLA by declaring that neither are "controlling persons," "responsible persons," or "owners or operators" within the meaning of CERCLA. *See* Interim DIP Order, ¶ 32. In theory,

the DIP Agent and the DIP Lender may, in the course of "taking any . . . actions related to this [Final] Order or the DIP Documents," which include "the exercise of its approval rights with respect to any budget," *id.*, take actions that may deem them as PRPs within the meaning of CERCLA. For instance, if a federal agency were to exercise its police and regulatory powers pursuant to 11 U.S.C. § 362(b)(4) and require Debtors to undertake certain environmental remediation work, and the DIP Lender were to exercise its budgetary approval rights and cause the necessary funds for compliance to be unavailable, the DIP Lender could be liable as a PRP to the extent that a court finds that it "exercise[d] decisionmaking control over the environmental compliance related to the vessel or facility, such that the person has undertaken responsibility for the hazardous substance handling or disposal practices related to the vessel or facility." 42 U.S.C. § 9601(20)(F)(ii)(I). Or, if the DIP Lender became involved in the Debtors' operations and directed the manner in which Debtors could dispose of hazardous waste to meet a budget limitation, such activities could constitute "actions related to this [Final] Order or the DIP Documents," and also give rise to lender liability under the environmental laws. *Id.* However, Paragraph 32 of the Interim DIP Order plainly protects the DIP Agent and the DIP Lender from any such liability.

8. Such a broad release would permit the DIP Agent and the DIP Lender to evade potential liability for failure to comply with environmental laws—a waiver not granted even to Debtors, who, as debtors-in-possession, are subject to the full regulatory force of those laws. *See, e.g., Ohio v. Kovacs*, 469 U.S. 274, 285 (1985) ("We do not question that anyone in possession of the site . . . . must comply with the environmental laws of the State of Ohio"); *Midlantic Nat'l Bank v. N.J. Dep't of Environmental Protection*, 474 U.S. 494, 502 (1986) ("Neither the Court nor Congress has granted a trustee in bankruptcy powers that would lend support to a right to abandon property in contravention of state or local laws designed to protect

public health or safety . . . Congress has repeatedly expressed its legislative determination that the trustee is not to have *carte blanche* to ignore nonbankruptcy law.").

9. Moreover, for the Court to provide the DIP Agent and the DIP Lender with what is essentially an advance ruling as to their liability would violate CERCLA's prohibition on pre-enforcement judicial review of various environmental actions, including orders issued by the United States Environmental Protection Agency to PRPs to clean up contaminated sites. *See* 42 U.S.C. § 9613(h) ("No Federal court shall have jurisdiction under Federal law . . . to review any order issued under section 9606(a) of this title [prior to one of several listed actions."). Here, far from seeking to enforce a clean-up order against the DIP Lender or the DIP Agent or to recover clean-up costs from them, their potential liability under the CERCLA provisions cited above is speculative and any determination would be premature.

C. Nothing In the Bankruptcy Code and Non-Bankruptcy Law Authorizes the Waivers in Paragraph 32 of the Proposed Final DIP Order

10. Finally, there is no legal authority for the Court to enter a Final DIP Order containing the broad releases in Paragraph 32. Nothing in the Bankruptcy Code itself grants the DIP Agent and the DIP Lender *carte blanche* release of statutory liability from their own conduct. While the Bankruptcy Code specifies permissible incentives for DIP lenders, such incentives do not include releases from potential liability. *See, e.g.,* 11 U.S.C. § 364.

11. Moreover, although section 105(a) of the Bankruptcy Code gives this Court equitable power to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title," 11 U.S.C. § 105(a), the Second Circuit has made clear that this Court's equitable powers "must and can only be exercised *within the confines of the Bankruptcy Code*." *In re Dairy Mart Convenience Stores, Inc.*, 351 F.3d 86, 92 (2d Cir. 2002) (quoting *FDIC v. Colonial Realty Co.*, 966 F.2d 57, 59 (2d Cir. 1992)) (emphasis added). Section 105(a) "does not 'authorize the bankruptcy courts to create substantive rights that are

otherwise unavailable under applicable law, or constitute a roving commission to do equity.'" *Id.* (quoting *United States v. Sutton*, 786 F.2d 1305, 1308 (5th Cir. 1986)).

12. Here, nothing in the Bankruptcy Code and non-bankruptcy law provides a waiver of tax, environmental, or other federal statutory liability on DIP lenders or agents. Rather, third-party releases of the kind sought by the DIP Lender and DIP Agent are disfavored in this Circuit. *See In re Metromedia Fiber Network, Inc.*, 416 F.3d 136, 141-42 (2d Cir. 2005) ("a nondebtor release . . . is proper only in rare cases. . . . No case has tolerated nondebtor releases absent the finding of circumstances that may be characterized as unique.").

D. Nothing in the DIP Order Should Prevent the Government From Asserting Its Rights of Setoff and Recoupment

13. The Government also objects to the DIP Order to the extent that Paragraph 44(a) states the Government's right of setoff and recoupment is limited only to funds that the Department of Health and Human Services and its component agency, the Centers for Medicare and Medicaid Services, may owe Debtors under the Debtors' Medicare provider agreements. *See* Interim DIP Order, ¶ 44(a). The Bankruptcy Code, with certain exceptions not applicable here, does not alter a creditor's right to setoff. *See* 11 U.S.C. § 553(a); *see also In re Luongo*, 259 F.3d 323, 333 (5th Cir. 2001) ("It is impossible for us to ignore the clear statement of § 553 that this title [the Bankruptcy Code] does not affect any right of a creditor to offset"). Because the United States is a "unitary creditor" in bankruptcy, it is entitled to offset any mutual debts it has involving multiple federal agencies. *See In re Charter Oak Associates*, 361 F.3d 760, 771 (2d Cir. 2004) (citing 11 U.S.C. § 533(a)). Accordingly, Paragraph 44(a) of the Final DIP Order should acknowledge the Government's rights of setoff and recoupment with respect to tax refunds, any governmental reimbursements, and any payments under governmental contracts other than Debtors' Medicare provider agreements.

14. The Government proposes that these rights be clarified by the inclusion of the following language:

> As to the United States, its agencies, departments, or agents, nothing in this Order or the DIP Documents shall discharge, release, or otherwise preclude any valid right of setoff or recoupment that any such entity may have.

CONCLUSION

15. For the foregoing reasons, the Government respectfully objects to the Debtors' DIP Motion. The DIP Motion should be denied or, in the alternative, the DIP Order should be modified as follows to ensure that its terms do not prejudice the Government's rights.

16. To cure the deficiencies in Paragraph 32 of the DIP Order, the Government proposes the following alternate language:

> In making decisions to advance any extension of credit under the DIP Financing, or in taking any other actions related to this [Final] Order or the DIP Documents (including, without limitation, the exercise of its approval rights with respect to any budget), the DIP Agent and DIP Lender shall not be deemed to be in control of the operations of the Debtors or to be acting as a "responsible person" or "owner or operator" with respect to the operation or management of the Debtors, so long as the DIP Agent's and DIP Lender's actions do not constitute, within the meaning of 42 U.S.C. § 9601(20)(F), actual participation in the management or operational affairs of a vessel or facility owned or operated by a Debtor, or otherwise cause liability to arise to the federal or state government or the status of responsible person or managing agent to exist under applicable law (as such terms, or any similar terms, are used in the United States Comprehensive Environmental Response, Compensation and Liability Act, 42 U.S.C. §§ 9601 *et seq.*, as amended, or any similar federal or state statute).

This Court has included such language, or substantive identical language, in Final DIP Orders. *See, e.g., In re Motors Liquidation Company*, 09-50026 (REG), Dkt. No. 2551 at ¶ 15; *In re Chemtura Corporation*, 09-11233 (REG), Dkt. No. 281 at ¶ 32; *In re Tronox Incorporated*, 09-10156 (ALG), Dkt. No. 148 at ¶ 23; *In re Eastman Kodak Company*, 12-10202 (ALG), Dkt. No. 375, ¶ 25; *In re Residential Capital, LLC*, 12-12020 (MG), Dkt. No. 491, ¶ 37.

17. To cure the deficiencies in Paragraph 44(a) of the DIP Order, the Government proposes the following alternate language:

> As to the United States, its agencies, departments, or agents, nothing in this Order or the DIP Documents shall discharge, release, or otherwise preclude any valid right of setoff or recoupment that any such entity may have.

18. As these objections include citations to the applicable legal authorities, the Government respectfully requests that the Court waive the requirement contained in Rule 9013-1(b) of the Local Bankruptcy Rules for the Southern District of New York that the Government file a separate memorandum of law.

Dated: New York, New York
June 18, 2013

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CERTIFICATE OF SERVICE

I, Tomoko Onozawa, certify that, on June 18, 2013, I caused to be served the Limited Objection of the United States of America to Debtors' Motion for Entry of Interim and Final Orders (I) Authorizing Debtors (A) to Obtain Post-Petition Secured, Superpriority Financing Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, and 364 and (B) to Utilize Cash Collateral Pursuant to 11 U.S.C. § 363; (II) Granting Adequate Protection to Pre-Petition Secured Creditors Pursuant to 11 U.S.C. §§ 361, 362, 363 and 364; and (III) Scheduling a Final Hearing Pursuant to Bankruptcy Rules 4001(B) and 4001, by ECF to all parties, and by electronic mail and overnight mail upon:

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June 18, 2013

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