**IN THE UNITED STATES BANKRUPTCY COURT**
**FOR THE DISTRICT OF DELAWARE**

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| In re: | : | Chapter 11 |
| ADVANTA CORP., *et al.* | : | Case No. 09-13931 (KJC) |
| Debtors.[*] | : | (Jointly Administered) |
| ADVANTA BANK CORP. | : | Adversary Proceeding No.: 10-50795 (KJC) |
| Plaintiff, | : | **RE: D.I. 8, 9** |
| -against- | : | **Hearing Date: May 10, 2010 at 1:30 p.m.** **Reply Deadline: May 6, 2010 at 5:00 p.m.** |
| ADVANTA CORP. | : | |
| Defendant. | : | |

**OBJECTION TO MOTION OF PLAINTIFF ADVANTA BANK CORP. FOR DECLARATORY AND INJUNCTIVE RELIEF IN CONNECTION WITH ITS AMENDED COMPLAINT**

[*] The Debtors in these jointly administered chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number, are Advanta Corp. (2070), Advanta Investment Corp. (5627), Advanta Business Services Holding Corp. (4047), Advanta Business Services Corp. (3786), Advanta Shared Services Corp. (7074), Advanta Service Corp. (5625), Advanta Advertising Inc. (0186), Advantennis Corp. (2355), Advanta Mortgage Holding Company (5221), Advanta Auto Finance Corporation (6077), Advanta Mortgage Corp. USA (2654), Advanta Finance Corp. (8991), Advanta Ventures Inc. (5127), BizEquity Corp. (8960), Ideablob Corp. (0726), Advanta Credit Card Receivables Corp. (7955), Great Expectations International Inc. (0440), Great Expectations Franchise Corp. (3326), and Great Expectations Management Corp. (3328). Information regarding the Debtors' businesses and the background relating to events leading up to these chapter 11 cases can be found in (i) the Declaration of William A. Rosoff in Support of the Debtors' Chapter 11 Petitions and First-Day Motions, filed on November 8, 2009 (the "***Rosoff Declaration***"), the date the majority of Debtors filed their petitions under chapter 11 of title 11 of the United States Code (the "***Bankruptcy Code***"), and (ii) that certain supplement thereto, filed on November 20, 2009, the date Advanta Ventures Inc., BizEquity Corp., Ideablob Corp. and Advanta Credit Card Receivables Corp. filed their chapter 11 cases. The Debtors are authorized to continue to operate their businesses and manage their properties as debtors and debtors in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code. Further, in accordance with an order of this Court, the Debtors' cases are being jointly administered pursuant to Rule 1015(b) of the Federal Rules of Bankruptcy Procedure (the "***Bankruptcy Rules***").

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Advanta Corp. ("***Advanta***"), as debtor and debtor in possession in the above-referenced jointly administered chapter 11 cases, submits this objection (the "***Objection***") to the emergency motion, dated March 19, 2010 (the "***Motion***"), of Advanta Bank Corp. ("***ABC***")[1] (i) seeking a judgment declaring that (a) Advanta's election in the consolidated group's 2009 federal income tax return filed on March 14, 2010 (the "***Tax Return***") to waive the carryback of any portion of the consolidated group's net operating loss ("***NOL***") for the 2009 taxable year (the "***2009 Carryback***") and (b) Advanta's separate election (together with the election referred to in clause (a), the "***Tax Elections***") to carry back the consolidated group's 2008 NOL five years (the "***2008 Five-Year Carryback***") were outside the ordinary course of Advanta's business and, thus, void *ab initio* under section 363(b) of the Bankruptcy Code, and (ii) seeking mandatory injunctive relief compelling Advanta to elect to carry back the consolidated group's NOL for the 2009 taxable year five years, and respectfully represents as follows:

## Preliminary Statement

1. ABC purports to file the Motion as a creditor concerned about the best interests of Advanta's estate. But this is disingenuous at best. ABC is not a creditor – it is actually a net obligor to the Debtors.[2] The relief requested in the Motion would not benefit Advanta's estate. To the contrary, it could give rise to a large claim by ABC against Advanta. Tellingly, Advanta's statutory creditors' committee (the "***Creditors' Committee***") – the representative of Advanta's unsecured creditors – participated in and fully supported Advanta's decision to make the Tax Elections.

[1] On March 19, 2010, the Federal Deposit Insurance Corporation (the "***FDIC***") was appointed receiver for ABC. It is the Debtors' understanding that the FDIC, as receiver for ABC, intends to prosecute the Motion. All references herein to ABC after March 19, 2010, apply to the FDIC, as receiver for ABC.

[2] The Debtors believe that on a net aggregate basis they are owed approximately $18 million from ABC. The Debtors will be filing claims in ABC's receivership.

2. This Adversary Proceeding and the Motion boil down to two issues: (i) whether ABC has any legal grounds to try to force Advanta to "unwind" the Tax Elections and (ii) whether such an unwind is even possible. By making the Tax Elections, Advanta chose to forgo a tax refund of approximately $54 million (the "***Refund***") (which ABC claims either wholly or partially belongs to it,[3] *see* Mot. ¶ 43) in order to avoid the creation of a potential unsecured claim by ABC against Advanta of up to approximately $170 million pursuant to the tax sharing agreement between the parties[4] – a result that inures to the benefit of the estate and its true creditors. Amazingly, nowhere in the Motion does ABC disclose the likely assertion of such claim were the Court to grant the relief sought. With this fact brought to light, it is inescapable that the relief ABC seeks places its interests ahead of the interests of all true creditors of Advanta. Therefore, ABC tries to avoid the issue by arguing that the making or waiver of certain standard elections attendant to the annual filing of tax returns are outside a debtor's ordinary course of business.

3. The Court should deny the Motion as wholly without merit. First, the filings whereby Advanta made the Tax Elections were routine business decisions, and pursuant to section 363(c) of the Bankruptcy Code, could be effected in the ordinary course of Advanta's business. Second, even if the Tax Elections were not in the ordinary course of Advanta's business, cause exists for the Court to ratify the Tax Elections because (i) they were based on Advanta's sound business judgment and are within the scope of Advanta's authority under the

[3] If Advanta were to have elected the 2009 Carryback, Advanta submits that ABC would not have had any direct ownership interest in any portion of the Refund. At most, ABC would have a general unsecured claim under the tax sharing agreement.

[4] The amount of up to approximately $170 million is based on the hypothetical tax refund ABC would have been entitled to if it had filed separate returns and an election to carry back the 2009 tax loss for five years was in effect. Nothing in this Objection is an admission by Advanta that ABC has or would under any circumstances have any valid claims against Advanta under the tax sharing agreement.

Bankruptcy Code and the Internal Revenue Code (the "***IRC***"), and (ii) they were supported by the Creditors' Committee, which acts as a fiduciary for all unsecured creditors in this case. Third, the mandatory injunctive relief ABC seeks constitutes extraordinary relief that is contrary to applicable tax law and devoid of support in case law. Accordingly, Advanta respectfully requests that the Court deny the Motion in its entirety.

4. Moreover, should the Court not deny the Motion in its present posture, the Court should require ABC to join the United States government, which acts here through the Internal Revenue Service (collectively, the "***IRS***"), as a required party to this action before ruling on the Motion.

## Background[5]

5. As acknowledged in the Motion, Advanta is the common parent of an affiliated group of corporations, including ABC, that files consolidated returns for federal income tax purposes. Consistent with applicable tax law, Advanta and ABC entered into that certain Fourth Amended and Restated Tax Sharing Agreement, dated as of May 1, 1995, by and between Advanta and its wholly-owned direct and indirect subsidiaries (the "***TSA***"). A copy of the TSA is attached as ***Exhibit A*** to the Motion.

6. ABC does not dispute that Advanta, as the common parent corporation of the consolidated group, has sole authority to act on behalf of the group in matters relating to the tax liability for the consolidated return years. (Mot. ¶ 15.) *See* 26 C.F.R. § 1.1502-77(a)(1)(i) (stating that, subject to exceptions not relevant here, "the common parent . . . for a consolidated return year is the sole agent (agent for the group) that is authorized to act in its own name with

[5] The *Declaration of Phillip M. Browne in Support of Advanta's Objection to Motion of Plaintiff Advanta Bank Corp. for Declaratory and Injunctive Relief in Connection with its Amended Complaint*, which sets forth the facts referred to herein, will be filed with the Court subsequent to the filing of this Objection.

respect to all matters relating to the tax liability for that consolidated return year, for – (A) Each member in the group . . . .").

7. In the exercise of such authority, on March 14, 2010, one day before the IRS deadline to file the Tax Return, Advanta filed the Tax Return for the consolidated group and made the Tax Elections. Because of the need to avoid the risk of technical errors in transmitting the Tax Return electronically to the IRS (Advanta is required to file the Tax Return electronically), March 14 was the last day to prudently file the Tax Return. Indeed, Advanta's consistent practice has been to avoid waiting to file its tax returns on the actual IRS deadline. If Advanta did not timely file the Tax Return, the default result would have been that the generally applicable two-year carryback would not have been waived (absent obtaining an extension of time to file the Tax Return, which Advanta determined was not in the estate's best interests), as 26 U.S.C. § 172(b)(3) requires an election waiving the carryback of a NOL to be made on a timely-filed tax return for the year in which the NOL arises. Accordingly, the Debtors determined that it was not in the best interests of Advanta's estate to wait until after March 14, 2010 to file the Tax Return.

8. Notwithstanding that ABC was aware of the March 15, 2010, filing deadline and the NOL carryback issues for months, ABC waited until March 10, 2010 to send Advanta a letter (*see* Mot. Ex. B) in which it requested *that Advanta file as soon as possible* its Tax Return and elect to carry back the 2009 NOL five years. There was no suggestion in the letter that such a filing and election would require Court approval. Then, on Friday, March 12, 2010, at 4:00 p.m., ABC filed its *Emergency Motion of Advanta Bank Corp. for Entry of an Order Compelling Debtor Advanta Corp. to (I) Timely File a Request for an Extension of Time to File 2009 Consolidated Federal Income Tax Return; Or, in the Alternative (II) Elect to Carry*

*Back 2009 Consolidated Net Operating Losses Five Years* (the "***Tax Motion***") (D.I. 323) in Advanta's chapter 11 case. The Tax Motion sought entry of an order compelling Advanta to timely request an extension of time to file the Tax Return or, in the alternative, elect the 2009 Carryback for five years. ABC did not seek a temporary restraining order concurrently with the Tax Motion in order to prevent Advanta from filing the Tax Return by March 15, 2010, and did not even seek the relief in the Tax Motion by adversary proceeding, as required by the Bankruptcy Rules.[6] *See* Fed. R. Bankr. P. 7001(7), 7003 (requiring that a proceeding to obtain an injunction or other equitable relief be commenced by filing a complaint to initiate an adversary proceeding). On March 15, 2010, Advanta filed an objection to the Tax Motion (the "***Tax Objection***") (D.I. 332), asserting that the Tax Motion was procedurally flawed, partially moot, and lacking in authorities to substantiate the extraordinary relief requested. The same day, the Creditors' Committee filed a joinder to the Tax Objection (D.I. 333), in which it set forth its support for Advanta's sound business decision to make the Tax Elections.

9. On March 14, 2010, ABC initiated this Adversary Proceeding, effectively admitting that its eleventh hour filing of the Tax Motion on an emergency basis was procedurally improper (Adv. Proc. D.I. 1). On March 19, 2010, ABC filed an Amended Complaint (Adv. Proc. D.I. 8) and the Motion (Adv. Proc. D.I. 9), whereby ABC changed its legal theory to assert that pursuant to section 363(b) of the Bankruptcy Code, the Tax Elections required notice to creditors and a hearing, and this Court's prior approval, and are void *ab initio*. Notably, neither the March 10, 2010 letter nor the Tax Motion asserted that the filing of the Tax Return or the elections made therein constituted an action requiring notice and a hearing under section 363(b)

[6] Instead, ABC waited to file its *Emergency Motion of Plaintiff Advanta Bank Corp. for Temporary Restraining Order and Preliminary Injunctive Relief Against Defendant Advanta Corp.* in the above-captioned adversary proceeding on March 14, 2010 (D.I. 3). This motion was subsequently withdrawn pursuant to the *Order Approving Stipulation*, which this Court signed on April 6, 2010 (D.I. 15).

of the Bankruptcy Code. To the contrary, ABC expressly urged Advanta to promptly file the Tax Return and to make a five-year carryback election for 2009 in the March 10 letter, and then sought to have the Court compel such election via the Tax Motion. It was only after ABC learned that Advanta filed the Tax Return and made the Tax Elections that ABC adopted the view that the Tax Elections were outside the ordinary course of business.

10. The Court should see through and reject ABC's renewed attempt to (i) supplant Advanta's sound business judgment, which Advanta exercised in the ordinary course of its business and within the scope of its authority under the Bankruptcy Code and the IRC, and (ii) compel Advanta to take affirmative action that harms its estate for ABC's benefit.

## Objection

### I. The Tax Elections Were in the Ordinary Course of Advanta's Business

11. Contrary to ABC's contention, the Tax Elections were within the ordinary course of Advanta's business and did not require prior notice to creditors or prior Court approval. Section 363(c)(1) of the Bankruptcy Code provides that, unless the court orders otherwise, a debtor authorized to operate under section 1108 of the Bankruptcy Code "may enter into transactions, including the sale or lease of property of the estate, in the ordinary course of business, without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing." 11 U.S.C. § 363(c)(1). "[S]ection 363 is designed to allow a trustee (or debtor-in-possession) the flexibility to engage in ordinary transactions without unnecessary creditor and bankruptcy court oversight, while protecting creditors by giving them an opportunity to be heard when transactions are not ordinary." *In re Roth Am., Inc.*, 975 F.2d 949, 952 (3d Cir. 1992).

12. The Third Circuit has enunciated a two-part test for determining whether a transaction is in the ordinary course of a debtor's business. *Id.* at 952-53. The " horizontal test"

compares the transaction to those made in the debtor's industry to determine whether the debtor's transaction is similar to those commonly entered into by others in the industry. *Id.* at 953 (citation omitted). The "vertical test" views the transaction from a hypothetical creditor's perspective and inquires whether the transaction is within the "reasonable expectations of what transactions the debtor in possession is likely to enter in the course of its business." *Id.* (internal quotation marks and citation omitted). If a court determines that a transaction is in the ordinary course of a debtor's business, a court "will not entertain an objection to the transaction, provided that the conduct involves a business judgment made in good faith upon a reasonable basis and within the scope of authority under the Bankruptcy Code." *In re Nellson Nutraceutical, Inc.*, 369 B.R. 787, 797 (Bankr. D. Del. 2007) (citation omitted).

13. As established below, the Tax Elections satisfy both the horizontal and vertical tests, and, thus, are within the ordinary course of Advanta's business.

### A. The Tax Elections Are Routine Actions in Advanta's Industry for the Parent of a Consolidated Tax Group

14. ABC does not argue or cite any authority that stands for the proposition that the filing of a tax return or the making of an election on such tax return by the parent of a consolidated tax group on behalf of individual members of the group is not an ordinary course action. Nor could it. In this case, satisfaction of the horizontal test is readily apparent.

15. First, it is within the ordinary course of business for the common parent of a consolidated tax group – in Advanta's industry or any industry – to file a consolidated return; indeed, it is mandated by applicable federal law. (*See* Reply, *supra*, ¶ 5.) *See also* 11 U.S.C. § 521 (requiring that a debtor file a tax return that becomes due after the commencement of the case); 26 U.S.C. § 6012(b)(3) ("([S]uch receiver, trustee, or assignee shall make the return of

income for such corporation in the same manner and form as corporations are required to make such returns."). ABC does not appear to allege, nor has it cited any cases alleging, otherwise.

16. Second, the ordinary consequence of filing a consolidated group's federal income tax return is that the common parent makes a choice with respect to the carryback or carryforward of consolidated NOLs for the group. Indeed, the IRC contains a default provision providing that if a loss is sustained for a particular taxable year and a taxpayer makes no election with respect to such loss, the loss would be carried back and applied to each of the two taxable years preceding the year of the loss, with any loss remaining at the end of the two-year carryback period then carried forward and applied against the taxpayer's income for each of the next 20 taxable years following the year of loss. *See* 26 U.S.C. § 172(b)(1)(A). Thus, a common parent of an affiliated group has no choice but to make elections with respect to NOLs – either affirmatively or by default – whenever it files a consolidated tax return.

17. Third, on every corporate income tax return, there are almost always significant choices and elections to be made. Most often, such choices must balance some present benefit or liability against a future one. Indeed, if every time a corporate debtor had to make such a choice on its tax return it was required to seek prior bankruptcy court approval, then the result would be to place bankruptcy courts in the tax preparer business.[7] This result would be contrary to the flexibility that section 363 is designed to provide to a debtor in possession. *In re Roth Am.*, 975 F.2d at 952; *see In re Nellson Nutraceutical*, 369 B.R. at 796 ("[T]he discretion [for a debtor in possession] to act with regard to *ordinary* business matters without prior court approval has been said to be at the heart of the powers of a . . . debtor in possession, and courts

[7] Advanta notes that the Court would not normally review a tax return unless there is a dispute between the debtor and the tax authority. If ABC's position is sustained, courts would be called upon to weigh competing tax return positions, each of which may be lawful, in advance of filing a return and under the constraints of a filing deadline.

have shown a reluctance to interfere in the making of routine, day-to-day business decisions." (internal quotation marks and citation omitted)); *cf. Vision Metals, Inc. v. SMS Demag, Inc. (In re Vision Metals, Inc.)*, 325 B.R. 138, 144 (Bankr. D. Del. 2005) (rejecting argument that maintenance and repair agreement, which included settlement and offset of mutual claims, was not ordinary course because "[t]he resolution of such issues . . is an ordinary course of business transaction . . . [that] occur[s] every day in every industry").

18. Fourth, the common parent of a consolidated tax group is the sole authority, for federal income tax purposes, for all decisions relating to the group's tax liability for the consolidated return year, as historically recognized by ABC in the TSA. "With respect to any consolidated return year for which it is the common parent—(i) [t]he common parent makes any election (or similar choice of a permissible option) that is available to a subsidiary in the computation of its separate taxable income…" 26 C.F.R. § 1.1502-77(a)(2). Moreover, "[a] group may make an irrevocable election… with respect to a [consolidated net operating loss] for any consolidated return year. Except [for an exception not relevant here], the election may not be made separately for any member…" *Id.* § 1.1502-21(b)(3)(i). Thus, elections for a consolidated return year are routinely made by the common parent of a consolidated tax group on behalf of, and without interference by, individual subsidiary members. For these reasons, Advanta submits that the first prong of the Third Circuit's two-part test is satisfied.

### B. The Tax Elections Are Within A Hypothetical Creditor's Reasonable Expectations

19. ABC argues that Advanta's decision to forego the Refund, thereby mitigating its exposure to assertion by ABC of up to an approximately $170 million general unsecured claim, was an extraordinary transaction that falls outside the reasonable expectations of creditors. ABC's argument is unpersuasive.

20. Even if the Refund were to inure to the benefit of Advanta's estate, which ABC disputes, an increase of assets of only approximately $54 million would not compensate general unsecured creditors for the dilution of their recovery pool by as much as approximately $170 million, given current expectations of potential recoveries to unsecured claimants. Therefore, an election in favor of the 2009 Carryback would have had an adverse impact on Advanta's estate.[8] As a result, Advanta, with the concurrence of the Creditors' Committee, determined that the Refund was worth forgoing to avoid creating additional claims against the estate and to maximize creditor recovery.

21. This is sufficient to satisfy the vertical dimensions test because a hypothetical creditor would reasonably expect that Advanta would file tax returns postpetition, and in doing so, would make elections that would preserve value for the estate and maximize creditor recoveries. Indeed, a chapter 11 debtor owes a fiduciary duty to maximize the value of the estate for all creditors. *See Martin v. Meyers (In re Martin)*, 91 F.3d 389, 394 (3d Cir. 1996) (finding "a trustee has a fiduciary relationship with *all* creditors of the estate" and a "duty to maximize the value of the estate"); *In re Jasmine, Ltd.*, 258 B.R. 119, 128 (D.N.J. 1999) ( "The trustee has a fiduciary duty towards all creditors of the estate, not just the limited class of creditors comprising the objectors herein."). Certainly, a hypothetical creditor would not expect Advanta to undertake a transaction or other action that would create an additional claim against the estate, to the detriment of all other creditors in the case, without a commensurate or greater offsetting benefit. *See In re UAL Corp.*, 412 F.3d 775, 778 (7th Cir. 2005) ("[B]ankruptcy is not supposed to appropriate some investors' wealth for distribution to others."). Advanta arguably

[8] In addition, arguments raised in the Amended Complaint that the 2009 Carryback is needed to enhance ABC's liquidity position, stave off regulatory action to terminate ABC's charter, and ultimately protect Advanta's *de minimis* equity position in ABC (*see* Am. Compl. ¶¶ 24-26) are rendered moot by the FDIC's appointment as receiver of ABC.

would have breached the fiduciary duty it owes to all creditors of its estate by electing a five-year carryback of the 2009 NOL and triggering ABC's alleged general unsecured claim of up to approximately $170 million. *See, e.g., In re Pinnacle Brands, Inc.*, 259 B.R. 46, 54 (Bankr. D. Del. 2001) ("A debtor's fiduciary duty is to maximize the value of the estate for distribution to creditors, not to minimize the exposure of an individual creditor while increasing the liability of the estate."); *Pacificorp Ky. Energy Corp. v. Big Rivers Elec. Corp. (In re Big Rivers Elec. Corp.)*, 233 B.R. 739, 752 (W.D. Ky. 1998) ("[The] duty to maximize the estate [for all creditors] often trumps other duties the debtor may owe to individual creditors or third parties." (citing *In re Wintex*, 158 B.R. 540, 543 (D. Mass. 1992) (holding duty of debtor to act in good faith and fair dealing in furthering contract was limited by debtor's obligation to maximize value for its creditors))); *Carter v. Schott (In re Carter Paper Co.)*, 220 B.R. 276, 301 (Bankr. M.D. La. 1998) (finding that debtor's obligation to maximize value of debtor's assets "includes a fiduciary duty to the estate to rid the estate of any property that operates as a net reduction in the value of the res"). Therefore, the Tax Elections fall within the reasonable expectations of a hypothetical creditor because the filing of the Tax Return is to be expected, as is the making of elections designed to limit Advanta's exposure to claims that would dilute creditor recovery.

22. Moreover, ABC argues, without support, that the Debtors' lengthy consultation with its advisors, and the Creditors' Committee and its advisors, is evidence that the Tax Elections were outside of the ordinary course. The difficulty, or sensitivity, of a decision is not part of the test. In fact, the focus of the vertical analysis is a debtor's prepetition business practices and conduct. *In re Roth Am.*, 975 F.2d at 953. It strains credulity to imagine that it was not Advanta's prepetition business practice to carefully weigh the costs and benefits of making tax elections on its consolidated returns, and to consult with its advisors as appropriate regarding

the consequences of such elections. To the contrary, Advanta submits that its well-reasoned decision to elect the Tax Elections is entirely consistent with its prepetition business practices, and within the ordinary course of its business.

23. Finally, the fact that Advanta did not seek an extension of time to file the Tax Return, even if its prepetition practice was to request one, is of no moment. First, the argument relates to when to file, not what to file or elect, and thus is irrelevant. Second, although the "primary focus" is on "the debtor's pre-petition business practices and conduct, . . . a court must also 'consider the changing circumstances inherent in the hypothetical creditor's expectations.'" *Id.* (quoted reference omitted). Here, there was no reason to delay the filing, and Advanta believed that any delay would simply increase the likelihood that ABC and/or the FDIC would take actions to the detriment of Advanta's estate and its creditors' interests. As there was no prudent business reason to delay the filing, it was within a hypothetical creditor's reasonable expectations that Advanta would forgo an extension of time to file the Tax Return. In this regard, ABC's March 10th letter urging a prompt filing of the Tax Return (albeit it to a different end), without suggestion that Advanta file an extension of time or seek this Court's approval, belies ABC's contention that the timely filing of the Tax Return was inconsistent with its expectations. Advanta submits that the Tax Elections, therefore, satisfy the second prong of the Third Circuit's two-part test.

24. The cases cited in the Motion do not alter this result because they are inapplicable to the present litigation in several ways. First, ABC cites cases where debtors "release[d] a claim, deplete[d] estate funds, or divert[ed] proceeds away from the estate" outside the ordinary course of business and without notice and a hearing. (Mot. ¶ 42.) Here, however, the situation is quite the opposite – Advanta concluded in its sound business judgment that it was

to the benefit of its estate and creditors to waive the 2009 Carryback and forgo the right to the Refund in order to mitigate the possibility of incurring an unsecured claim of up to approximately $170 million, and the representatives of Advanta's creditors agreed.

25. Furthermore, ABC makes Advanta's case by, in fact, citing authority that supports the proposition that a hypothetical creditor would not expect a debtor to open itself up to greater liability, as Advanta determined it would if it elected the 2009 Carryback. *See Johnston v. First Street Cos. (In re Waterfront Cos., Inc.)*, 56 B.R. 31, 35 (Bankr. D. Minn. 1985) (finding that indemnity agreement was void as to the debtor because "open-ended exposure to unlimited liability is simply not the type of transaction which creditors expect a debtor will enter into without notice to creditors and other interested parties"). ABC's insistence that Advanta's estate and creditors expose themselves to a potential claim that would dilute their recovery demonstrates that ABC is merely acting in its own self-interest to the detriment of other creditors.

26. In addition, several of the cases ABC cites involve situations where the debtor attempted to enter into agreements that do not occur with enough frequency to fall within a hypothetical creditor's reasonable expectations, such as a settlement, *Peltz v. Gulfcoast Workstation Group (In re Bridge Info. Sys., Inc.)*, 293 B.R. 479 (Bankr. E.D. Mo. 2003), stipulation and assignment of causes of action, *Parkway Plaza Investors v. Bacigalupi (In re Bacigalupi, Inc.)*, 60 B.R. 442 (B.A.P. 9th Cir. 1986), or amendment of an option contract, *In re Koneta*, 357 B.R. 540 (D. Ariz. 2006). In contrast, the filing of a tax return, and the consequence of making either an affirmative or default election, are transactions that occur with enough regularity that they are within a hypothetical creditor's reasonable expectations.

27. Finally, the only case cited in the Motion that concerns a debtor's tax election, *Streetman v. United States (In re Russell)*, 187 B.R. 287 (W.D. Ark. 1995), is not on point here. *Streetman* involved an *individual* debtor who irrevocably elected to forgo the carryback of his NOLs, which presents a very different tax situation. When an individual debtor files a case under chapter 7 or 11 of the Bankruptcy Code, the bankruptcy estate becomes a new taxable entity. 26 U.S.C. § 1398(a), (c). Applicable tax law provides that the individual debtor's NOLs pass to the estate. *Id.* § 1398(g)(1). However, to the extent that the NOLs are not used during the case, they inure to the benefit of the debtor and not the debtor's creditors. *Id.* § 1398(i). Thus, the debtor's election to forgo the carryback of his NOLs would have deprived the individual debtor's creditors of the ability to obtain a refund with no offsetting benefit. Instead, the debtor would likely receive any value inherent in the NOLs at the conclusion of the case. *See Gibson v. United States*, 927 F.2d 413, 416 (8th Cir. 1991). In contrast, a corporation's bankruptcy does not create a new taxable entity; the corporation's tax life continues uninterrupted. 26 U.S.C. § 1399. Moreover, unlike in an individual debtor's case, creditors of a corporation often become the owners of the corporation, and benefit from any NOLs that are carried forward after the conclusion of the case. Therefore, one way or another, creditors of a corporate debtor enjoy the value inherent in the NOLs. There is no conflict between the corporate debtor and its creditors in this respect.

28. *Streetman* is also distinguishable in that the district court's decision is specific to the facts of that case. The *Streetman* court reversed its prior ruling,[9] which had

[9] The bankruptcy court initially found that creditors of a debtor would reasonably expect a debtor to make an applicable election in connection with the filing of his or her tax returns, and thus, a debtor's act of exercising a tax election is in the ordinary course of business. *Streetman v. United States (In re Russell)*, 154 B.R. 723, 726-28 (Bankr. W.D. Ark. 1993). The district court initially affirmed this finding. *Streetman v. United States (In re Russell)*, No. 93-1118, 1994 WL 850527 (W.D. Ark. Apr. 22, 1994).

affirmed the bankruptcy court's determination that the debtor's postpetition election to carry forward a NOL was made in the ordinary course of business, because the district court was unable to reconcile the bankruptcy court's conclusions that the debtor's prepetition election to carry forward a NOL was constructively fraudulent,[10] but the same election postpetition was not. 187 B.R. at 293. The discussion in *Streetman* includes almost no analysis of either the horizontal or vertical dimensions tests. As such, the case is not helpful for this Court's analysis of the Tax Elections. At best, the case stands for no more than the proposition that an election in which an individual debtor deprives his creditors of value in order to retain such value for his own future benefit is not in the ordinary course.

29. For the foregoing reasons, Advanta submits that the Third Circuit's two-part test is satisfied. Because the Tax Elections were in the ordinary course of Advanta's business, the Court should deny the Motion if it finds that Advanta reasonably exercised its business judgment within the scope of its authority under the Bankruptcy Code. *In re Nellson Nutraceutical*, 369 B.R. at 797.

### C. The Tax Elections Constitute A Valid Exercise of Advanta's Business Judgment

30. There is no evidence that Advanta's decisions with respect to the filing of the Tax Return and the making of the Tax Elections are anything other than "a business judgment made in good faith upon a reasonable basis." *Id.* Courts generally accord a debtor's reasonable business judgment a high level of deference. *See, e.g.*, *In re Dura Auto. Sys.*, No. 06-11202 (KJC), 2007 Bankr. LEXIS 2764, at *259-60 (Bankr. D. Del. Aug. 15, 2007) ("[O]nce 'the debtor articulates a reasonable basis for its business decisions . . . courts will generally not

[10] The bankruptcy court held an evidentiary hearing and determined the evidence indicated the debtor did not receive reasonably equivalent value for his prepetition election to carry forward a NOL. *Id.* at 290.

entertain objections to the debtor's conduct.'" (quoting *Committee of Asbestos-Related Litigants and/or Creditors v. Johns-Manville Corp. (In re Johns-Manville Corp.)*, 60 B.R. 612, 616 (Bankr. S.D.N.Y. 1986))). Under the business judgment standard, the debtor does not even need to show that it is making the best or even a good business decision. *See In re Trans World Airlines, Inc.*, 261 B.R. 103, 121-22 (Bankr. D. Del. 2001) (citing *Wheeling-Pittsburgh Steel Corp. v. W. Penn. Power Co. (In re Wheeling-Pittsburgh Steel Corp.)*, 72 B.R. 845, 849 (Bankr. W.D. Pa. 1987) ("[W]hether the debtor is making the best or even a good business decision is not a material issue of fact under the business judgment test.")); *In re Old Carco LLC*, 406 B.R. 180, 193 (Bankr. S.D.N.Y. 2009) (same). There is a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company. *Kaplan v. Centex Corp.*, 284 A.2d 119, 124 (Del. Ch. 1971) (citations omitted); *accord Johns-Manville*, 60 B.R. at 616 ("[A] presumption of reasonableness attaches to a debtor's management decisions." (citations omitted)). In particular, debtors enjoy significant latitude when undertaking transactions in the ordinary course of their business. *See Johns-Manville*, 60 B.R. at 616 (noting that a debtor in possession's authority to use estate property in the ordinary course without a prior hearing "necessarily includes the concomitant discretion to exercise reasonable judgment in ordinary business matters"). The burden is on the party challenging the decision to establish facts rebutting the presumption. *See Kaplan*, 284 A.2d at 124. "[I]f a debtor's actions satisfy the business judgment rule, then the transaction in question should be approved . . . ." *Dura*, 2007 Bankr. LEXIS 2764, at *260 (finding debtors' decision to sell assets and reject leases were proper exercises of the debtors' business judgment).

31. It is also long-established that a parent's decision regarding allocation of tax savings among affiliated group members should be reviewed under the deferential business judgment rule. *See Meyerson v. El Paso Natural Gas Co.*, 246 A.2d 789 (Del. Ch. 1967); *Case v. N.Y. Cent. R.R. Co.*, 204 N.E.2d 643 (N.Y. 1965); *W. Pac. R.R. Corp. v. W. Pac. R.R. Co.*, 197 F.2d 994 (9th Cir. 1951), *vacated on procedural grounds*, 345 U.S. 247 (1953). As a result of cases such as *Meyerson*, *Western Pacific*, and *Case*, a *per se* rule has evolved that a parent's decisions concerning the allocation of tax savings among consolidated group members (including a parent's entitlement to retain or take all tax savings for itself) is a business judgment with which courts generally will not interfere. *See Marvel Entm't Group, Inc. v. Mafco Holdings, Inc. (In re Marvel Entm't Group, Inc.)*, 273 B.R. 58, 78-79 (D. Del. 2002) (applying business judgment rule to analysis of breach of fiduciary duty claims in connection with subsidiary's entry into consolidated group tax sharing agreement).

32. As discussed in *Marvel*, "the question of which standard to apply in parent/subsidiary tax sharing situations was settled in *Meyerson* and confirmed again in *Wolfensohn v. Madison Fund, Inc.*, 253 A.2d 72 (Del. 1969)." *Id.* In *Meyerson*, the plaintiff, a minority stockholder of the parent corporation's 80%-owned subsidiary, alleged the parent had breached its fiduciary duties by including the subsidiary in its consolidated tax group without implementing a "fair" tax sharing agreement. 246 A.2d at 790. The plaintiff alleged that the parent's use of NOLs generated by the subsidiary in calculating the tax liability of the consolidated group was unfair because the parent received tax benefits without sharing any of the corresponding tax benefits with the subsidiary. The plaintiff sought payment for the NOLs generated by the subsidiary and a "fair allocation" of future tax benefits. The court granted summary judgment to the parent corporation, holding that the allocation of tax benefits between

the parent and subsidiary in a tax sharing agreement is governed by the parent's business judgment. *Id.* at 794. The Delaware Supreme Court subsequently approved the *Meyerson* holding in *Wolfensohn*. 253 A.2d at 76; *see also Getty Oil Co. v. Skelly Oil Co.*, 267 A.2d 883, 888 (Del. 1970) (applying business judgment rule to parent-subsidiary allocation agreement and finding that subsidiary failed to demonstrate "gross and palpable overreaching").

33. The Tax Elections were the product of a careful, comprehensive analysis. As indicated in the Motion, had Advanta elected to carry back the 2009 NOL five years, the group would have been entitled to the Refund. However, by making such election, Advanta would have exposed itself to an assertion by ABC under the TSA of a general unsecured claim of up to approximately $170 million. (*See* TSA §§ 1, 3(b).) The Motion fails to mention this critical fact, or the fact that the existence of such claim is significantly dependent on Advanta electing the 2009 Carryback. Yet, the dilutive effect of this potential claim of up to approximately $170 million on general unsecured creditors' recoveries was a key consideration in Advanta's decision to waive the 2009 Carryback. Moreover, although Advanta believes that the Refund would be property of its estate, ABC would assert that all or a portion of the Refund should go directly to ABC. (*See* Mot. ¶ 17 ("ABC believes that it may be entitled to a significant portion of the Anticipated Refund pursuant to and in accordance with the [TSA].").)

34. In addition, Advanta determined that the consolidated group's waiver of the 2009 Carryback allows the 2009 NOL to be carried forward, *see* 26 U.S.C. § 172(b)(1)(A)(ii), and thereby preserves Advanta's tax basis in the stock of ABC, *see* 26 C.F.R. §§ 1.1502-32(b)(2), (3)(i) (providing that utilization of subsidiary's tax loss results in a corresponding decrease in the parent's tax basis in its stock in the subsidiary). That stock basis may ultimately make available to Advanta a worthless stock loss (in lieu of the portion of the

consolidated group's net operating losses incurred by ABC). *See* 26 U.S.C. § 165(g). The use of the worthless stock loss, unlike the use of any NOLs incurred by ABC, would not result in a claim under the TSA. This stock loss could offset in whole or in part any gains triggered during Advanta's chapter 11 case, pursuant to the terms of its chapter 11 plan or, potentially, after consummation of the chapter 11 plan.

35. Accordingly, the decision by members of Advanta's board of directors to authorize the Tax Elections serves a rational purpose and constitutes a valid exercise of Advanta's business judgment. Advanta's decision is consistent with its fiduciary obligation to maximize the value of the estates for all creditors. Thus, the Court should not substitute ABC's judgment regarding the proper allocation of tax benefits among the consolidated group for Advanta's. *See Marvel*, 273 B.R. at 80. Advanta's exercise of sound business judgment in making the Tax Elections should be respected and affirmed.

### D. Advanta's Business Judgment Is Within the Scope of Authority Under the Bankruptcy Code and Tax Code

36. In addition to being an ordinary course action, the filing of the Tax Return – and the accompanying determination of which elections are most beneficial to Advanta's estate – were postpetition obligations of Advanta, as debtor in possession. The Bankruptcy Code requires that a debtor file a tax return that becomes due after the commencement of the case. *See* 11 U.S.C. § 521. Likewise, the IRC provides that the filing of a bankruptcy case does not alter a corporate debtor's responsibility for filing tax returns. *See* 26 U.S.C. § 6012(b)(3).

37. As mentioned above, it is undisputed that Advanta, as common parent of the consolidated tax group, has sole authority to make a NOL election for a consolidated return year. (*See* Mot. ¶ 15.) Thus, Advanta has exclusive authority to decide whether or not to elect

any portion of the 2009 Carryback or to otherwise waive the 2009 Carryback for the consolidated group. This is similarly true with respect to the 2008 Five-Year Carryback. As a result, Advanta was required under the Bankruptcy Code and the IRC to timely file the Tax Return and was authorized under applicable tax law to effectuate the Tax Elections.

### E. Alternatively, Even If the Tax Elections Were Not Made in The Ordinary Course, the Court Should Ratify the Tax Elections

38. Even if the Court finds that the Tax Elections were not made in the ordinary course of business, the Debtors request that the Court approve them retroactively under sections 105(a) and 363(b) of the Bankruptcy Code. Pursuant to section 105(a) of the Bankruptcy Code, the "[C]ourt may 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). In addition, section 363(b)(1) provides, in relevant part, that "[t]he trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate." 11 U.S.C. § 363(b).[11]

39. First, as described above, sound business reasons exist for the Tax Elections. Failure to ratify the Tax Elections may increase claims against Advanta's estate to the sole benefit of ABC, and may significantly dilute recoveries of general unsecured creditors to the detriment of all other stakeholders.

40. Second, the purpose of requiring notice and a hearing if a transaction is other than in the ordinary course is so that creditors, who have a vital interest in maximizing

[11] ABC readily admits that it has known for months that Advanta could waive the 2009 Carryback in connection with the filing of the Tax Return (Mot. ¶ 21), and urged Advanta to carry back the 2009 NOL five years (*id.* ¶ 20, Ex. B). Advanta also consulted extensively with the Creditors' Committee prior to making the Tax Elections. In addition, pleadings related to this issue have been on the Court's docket for months. Advanta submits that all creditors had notice of the Tax Elections and are adequately represented in connection with this hearing. Accordingly, Advanta requests that, if the Court finds the Tax Elections were not made in the ordinary course of business, the Court waive the notice requirements of Bankruptcy Rule 2002 in connection with Advanta's request to ratify the Tax Elections at this time pursuant to sections 105(a) and 363(b) of the Bankruptcy Code.

recovery of assets of the estate, "have the opportunity to review the terms of the proposed transaction and to object if they deem the terms and conditions are not in their best interest." *In re Crystal Apparel, Inc.*, 220 B.R. 816 (S.D.N.Y. 1998) (citation omitted). Here, the Creditors' Committee, which acts as fiduciary of all unsecured creditors in this case, evaluated the appropriateness of the Tax Elections and supported Advanta's exercise of its business judgment.

41. Advanta and its advisors expended significant time over the past several months weighing the costs and benefits of any election made in connection with the filing of the Tax Return, including the options of a two-year carryback or five-year carryback for 2008 or 2009, and waiver of the 2009 Carryback. Moreover, Advanta engaged in discussions with the Creditors' Committee and its advisors regarding the potential impact of the Tax Elections on Advanta's estate. Advanta's decision – which was made by its fully-informed board of directors – to waive the 2009 Carryback, forego the Refund, and prevent a potential claim of up to approximately $170 million by ABC under the TSA was a reasonable exercise of its business judgment, and is supported by the Creditors' Committee. Accordingly, if the Court determines that the Tax Elections were not in the ordinary course of business, Advanta submits that such actions were nonetheless in the best interests of creditors, as evidenced by the Creditors' Committee's joinder to this Objection and the Tax Objection, and should be ratified at this time.

## II. The Mandatory Injunctive Relief Sought Is Extraordinary

42. In addition to declaring the Tax Return void *ab initio*, ABC also moves for an injunction compelling Advanta to make an election carrying back the 2009 NOL five years. (Mot. ¶ 6.) Advanta submits that the mandatory injunctive relief that ABC seeks is truly extraordinary, and lacking support in statute or case law. Advanta's research has not uncovered any instance where a court compelled a debtor to affirmatively make a particular election on a corporate tax return. This can be contrasted with cases where courts may have ordered non-

debtors to take positions or refrain from taking positions that would harm the debtor. *Cf. In re Prudential Lines, Inc.*, 982 F.2d 565 (2d Cir. 1990) (permanently enjoining nonbankrupt parent corporation from claiming a worthless stock deduction where such deduction would have limited debtor subsidiary's use of its NOLs). However, no court has supplanted a debtors' business judgment with its own or a creditor's and compelled the debtor to make a tax election that the debtor deemed not beneficial to its estate. This consideration is particularly salient here, where not only does ABC seek to compel the Debtors to take a particular tax position, but it is a position that would harm the estate, and benefit only ABC.

43. It should also be noted that the relief ABC seeks in the Motion is contrary to applicable tax law. Through the pleadings filed in this adversary proceeding, ABC seeks to have the Tax Elections declared void *ab initio* and to compel Advanta to carry back the 2009 NOL five years. As an initial matter, Advanta's election to waive the 2009 Carryback is irrevocable under applicable tax law. *See* 26 U.S.C. § 172(b)(3); 26 C.F.R. § 1.1502-21(b)(3)(i). However, even assuming, *arguendo*, that the Court declares the Tax Elections void because they were outside the ordinary course and improperly filed without the Court's approval, it is unclear that Advanta could return to the point before the Tax Elections were made such that the Court can still effectively compel Advanta to elect a five-year carryback of the consolidated group's 2009 NOL. If the filing of the Tax Return was declared void by this Court, then the IRS would likely deem untimely any federal income tax return Advanta files now on behalf of the consolidated group with respect to the 2009 taxable year. Pursuant to the IRC, the five-year carryback election for 2009 must be affirmatively elected on a timely-filed tax return. *See* 26 U.S.C. § 172(b)(1)(H)(iii)(II); Rev. Proc. 2009-52, 2009-49 I.R.B. 744. Moreover, an

amendment of the Tax Return to elect any portion of the 2009 Carryback also would not be permitted under the IRC, as such amendment would not be considered timely for this purpose.

44. Accordingly, the mandatory injunctive relief that ABC seeks is extraordinary, beyond any authority granted by the Bankruptcy Code or IRC, and should be denied in all respects.

## III. The IRS May Be a Required Party

45. If the Court finds that the Tax Elections were not made in the ordinary course of business, then the Court should not rule on the Motion until the IRS is a joined as a party to this adversary proceeding.[12] Pursuant to Rule 19 of the Federal Rules of Civil Procedure, made applicable to this adversary proceeding by Bankruptcy Rule 7019, a party is a "Required Party" who "must be joined" (if subject to service of process and whose joinder will not deprive the court of jurisdiction) if: (i) in that person's absence, the Court cannot accord complete relief among existing parties; or (ii) that person claims an interest relating to the subject of the action and is so situated that disposing of the action in the person's absence may (a) as a practical matter impair or impede the person's ability to protect that interest or (b) leave an existing party subject to a substantial risk of incurring double, multiple, or otherwise inconsistent obligations on account of the interest. Fed. R. Civ. P. 19(a)(1).

46. The IRS would clearly be a Required Party here if the Court finds that the Tax Elections were not made in the ordinary course of business and should not be ratified. The relief ABC seeks – compelling Advanta to elect the 2009 Carryback *after* the March 15, 2010 filing deadline – is contrary to applicable tax law. An election to waive a NOL carryback, once

[12] There is no affidavit of service for the Amended Complaint or the Motion on the Court's electronic docket. Thus, Advanta is unable to ascertain whether the IRS received notice of the present litigation. Advanta will serve a copy of this Objection on the IRS.

made, is irrevocable. 26 U.S.C. § 172(b)(3); *see also* 26 U.S.C. § 172(b)(1)(H)(iii)(II) (five-year carryback election is irrevocable). Moreover, the five-year carryback election for 2009 can only be made on a timely-filed tax return. *See* 26 U.S.C. § 172(b)(1)(H)(iii)(II); Rev. Proc. 2009-52. In the absence of a court order compelling it to do so, the IRS likely would not give effect to such revocation, nor would it give effect to the untimely filing of a five-year carryback election for 2009. The IRS is a Required Party in such circumstances because complete relief cannot be granted unless the IRS is joined. *See* Fed. R. Civ. P. 19(a)(1)(A). The IRS would also be a Required Party because, if such a revocation and untimely filing were given effect, Advanta's estate would be entitled to some amount of refund, generating a payment obligation on the part of the IRS. Thus, the United States has an interest in the subject of this action such that granting the Motion in its absence may, as a practical matter, impair or impede its ability to protect that interest. *See id.* 19(a)(1)(B); *cf. Employer Solutions, Inc. v. United States (In re Shared Sav. Contracts, Inc.)*, 288 B.R. 827, 832 (Bankr. E.D. Mo. 2001) (holding that IRS was necessary party to adversary proceeding initiated by party that leased employees to debtor where action sought determination that plaintiff was not the leased employees' employer and therefore not liable to the IRS for such employees' withholding taxes, and where judgment in favor of plaintiff in the adversary proceeding would prejudice the IRS's position with respect to plaintiff's pending claim for a tax refund).

47. Importantly, Advanta's estate also could be harmed if the Motion is granted and the United States is not joined as a party. If the Tax Return and 2008 Five-Year Carryback are declared void *ab initio* and the IRS does not subsequently challenge such judgment, any return now filed would (as indicated above) be untimely. Advanta could not elect a five-year carryback of the 2009 NOL on an untimely return, *even if in the estate's best interest*.

*See* 26 U.S.C. § 172(b)(1)(H)(iii)(II); Rev. Proc. 2009-52.[13] Worse yet, Advanta could lose the benefit of the Tax Elections, and the IRS might refuse to pay any amount of refund. In that instance, ABC would likely assert an unsecured claim against Advanta, with no amount of refund to offset such claim. Accordingly, the facts weigh strongly in favor of finding that the IRS would be a Required Party to this adversary proceeding if the Court is not inclined to find that the Tax Elections were made in the ordinary course of business and is not inclined to ratify them. In that event, the Court should require that the IRS be joined as a party before it rules on the Motion.

**Conclusion**

48. Based upon the foregoing, Advanta submits that the relief requested in the Motion is not warranted by the facts, circumstances, or applicable law and the Motion should be denied.

[13] Even the normal two-year carryback, *id.* § 172(b)(1)(A)(i), would expose the estate to harm. Although Advanta would be entitled to an approximately $27 million refund, Advanta would still be exposed to ABC asserting an unsecured claim of up to approximately $70 million under the terms of the TSA, the net effect of which would be to significantly dilute the expected recoveries to existing creditors.

WHEREFORE, Advanta respectfully requests that the Court deny the Motion in all respects, and grant such other and further relief as it deems just and proper.

Dated: April 30, 2010
Wilmington, Delaware

*/s/ Zachary I. Shapiro*

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