

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF INDIANA
HAMMOND DIVISION

IN RE:)
)
CONTINENTAL ENGINEERING &) CASE NO. 03-62669 JPK
CONSULTANTS, INC. and) Chapter 11
CONTINENTAL MACHINE &)
ENGINEERING CO., INC.)
Debtor.)

CONTINENTAL ENGINEERING &)
CONSULTANTS, INC., et al.,)
Plaintiffs,)
v.) ADVERSARY NO. 04-6068
LAKE COUNTY ASSESSOR, et al.,)
Defendants.)

ORDER DENYING AFFIRMATIVE DEFENSE

This adversary proceeding was initiated by complaint filed on April 13, 2004 by Continental Engineering & Consultants, Inc. and Continental Machine & Engineering Co., Inc. (collectively "Continental"). The original defendants were designated as Tax Assessor of Lake County, IN ("Assessor") and Lake County, IN ("Lake County"). On May 25, 2004, both defendants filed a joint Motion to Join Indispensable Parties. This motion was granted by order entered on June 16, 2004: the mechanism for joinder of the two additional parties – Indiana Department of Local Government Finance ("Department") and Cole-Layer-Trumble Company ("Cole-Layer-Trumble") – was agreed by the parties to be an amended complaint to be filed by Continental. By order entered on August 12, 2004, Continental was granted leave to file an amended complaint, and the amended complaint filed on July 16, 2004 by Continental became the complaint for the purposes of this action.

The Department filed its answer on October 4, 2004; under the designation of "First Affirmative Defense", the Department asserted that the complaint "fails to state a claim upon which relief can be granted". The Assessor and Lake County filed their answer to the amended complaint on December 15, 2004. Cole-Layer-Trumble has yet to appear in the action.

By its order entered on December 2, 2004, the Court stated the manner in which the Department's affirmative defense would be presented to the Court for determination, as follows:

Deputy Attorney General Whelan states that it is the position of the Indiana Department of Local Government Finance that the United States Bankruptcy Court may not grant the relief sought by the plaintiff. The Court deems this issue to have been raised as an affirmative defense in the answer of the Indiana Department of Local Government Finance filed on October 4, 2004, and that as so raised, the defendant's asserted defense falls within the provisions of B.R. 7012(b)/Rule 12(b)(6) of the Federal Rules of Civil Procedure. Because it does not appear that matters outside the pleadings will be presented by the parties with respect to this defense, matters relating to this defense will not be converted to a summary judgment proceeding as provided in B.R. 7056/Rule 56 of the Federal Rules of Civil Procedure. The plaintiff and the defendant Indiana Department of Local Government Finance concur that the Rule 12(b)(6) defense will be presented to the Court by means of concurrent briefs filed by each of those parties, without further response.

In response to this order, Continental filed a legal memorandum on February 7, 2005; the Department filed its memorandum on the same date.

The Court has jurisdiction over this adversary proceeding pursuant to 28 U.S.C. § 1334(b), 28 U.S.C. § 157, and N.D.Ind.L.R. 200.1(a) of the Rules of the United States District Court for the Northern District of Indiana. As will be addressed, the Court determines that this adversary proceeding constitutes a "core proceeding" within the meaning of 28 U.S.C. § 157(b)(2)(O).

I. Issue Before the Court

The issue before the Court is simply framed as follows: does Continental's amended complaint state a claim upon which relief may be granted?

II. The Record Before the Court

Continental Engineering & Consultants, Inc. is the debtor-in-possession in a Chapter 11 case initiated by voluntary petition filed on June 4, 2003, docketed as case number 03-62669 in the United States Bankruptcy Court for the Northern District of Indiana. Continental Machine &

Engineering Co., Inc. is the debtor-in-possession in a case initiated by voluntary petition on June 4, 2003, docketed as case number 03-62671 in the United States Bankruptcy Court for the Northern District of Indiana. By order entered on June 9, 2003, the foregoing two cases were consolidated for administrative purposes only under the primary case number 03-62669.

Continental's amended complaint states that "the Debtors have ceased conducting business and are in the process of locating a buyer for their assets and real estate"; (Amended Complaint, ¶ 5). The amended complaint asserts that the "Debtors are the fee holders of certain real property and improvements located at 4949 Huish Drive in East Chicago, Indiana"; (Amended Complaint, ¶ 6). Paragraph 7 of the amended complaint states that as the fee owners of the subject property, "the Debtors are liable to Lake County, Indiana for *ad valorem* taxes"; paragraph 8 asserts that for the 2003 tax year, the subject real property was assessed at a value of \$3,258,200.00, and that the *ad valorem* taxes asserted with respect to the property were based upon that Assessed Value. Paragraph 9 states that the "Assessed Value does not reflect the fair value of the Real Property for tax purposes". The focus of this action, which the Department has challenged by its affirmative defense, is stated as follows in paragraphs 14, 15 and 16 of the amended complaint:

14. This Court, pursuant to section 505 of the Bankruptcy Code, has the power and authority to determine the amount or legality of any tax so long as that tax has not been determined by a competent tribunal before the commencement of the case.

15. The Assessed Value on the Real Property has been determined at a level which does not reflect the true value of the Real Property. The Assessed Value exceeds the true value of the Real Property and therefore the taxes are too high.

16. The Assessed Value does not reflect the true value of the Real Property because the assessed value appraisal is not accurate in that it does not reflect the actual verifiable factors used in mass valuation techniques because the assessor has physical information about the Real Property that is incorrect. The assessor, without inspecting the interior of the Real Property, made certain assumptions about the physical characteristics of

the property. Those assumptions are incorrect and lead to an excessive assessed value and therefore an excess tax.

The amended complaint concludes with the following prayers for relief:

WHEREFORE, the Debtors respectfully request that this Court enter a judgment:

- A. Reducing the Assessed Value of the Real Property for the years 2003 and 2004;
- B. Reducing the claims of Lake County, Indiana in accordance with its determination of the Assessed Value of the Real Property;
- C. Reducing the tax obligations on the Real Property;
- D. Awarding such other relief as is equitable and just.

The record before the Court for consideration of the Department's affirmative defense is clouded somewhat by the Department's answer to the amended complaint. By its Answer to the Complaint filed on October 4, 2004, the Department has admitted the allegations in paragraphs 3 and 4 of the amended complaint, which include allegations that the Court "has jurisdiction over this matter pursuant to 28 U.S.C. § 1334"; that the "matter is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A), (K) and (O)"; and that the relief requested by the plaintiff "is sought pursuant to 11 U.S.C. § 505". With respect to paragraphs 13 and 14 of the amended complaint, the answer states:

Defendant admits the allegations contained in rhetorical paragraph's 13 and 14 of Plaintiff's complaint and therefore, denies the same.¹

The issue before the Court and the mechanism for its determination were stated as follows in the Court's order entered on December 2, 2004:

¹It is obvious to the Court – given the Department's asserted affirmative defense and the position which it argued in its legal memorandum submitted in support of that defense – that the Department actually intended to deny paragraphs 13 and 14 of the amended complaint, and the Court thus deems the Department's answer to deny those paragraphs of the amended complaint.

IT IS FURTHER ORDERED that the plaintiff and the defendant Indiana Department of Local Government Finance shall address the affirmative defense stated in that defendant's answer to the plaintiff's amended complaint – i.e., whether or not the United States Bankruptcy Court in the circumstances of this case may determine the assessed valuation of the plaintiff's property for the purposes of the imposition of real property taxes pursuant to 11 U.S.C. § 505 – by means of one brief to be filed by each of those parties by **January 24, 2005**. No response briefs will be filed.

III. Legal Analysis

By the amended complaint, Continental seeks review of the assessed valuation of their real property for the purpose of imposition of Indiana real property taxes by invocation of 11 U.S.C. § 505(a)(1), which states:

Except as provided in paragraph (2) of this subsection, the court may determine the amount or legality of any tax, any fine or penalty relating to a tax, or any addition to tax, whether or not previously assessed, whether or not paid, and whether or not contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction.²

The standard for review of an assertion that a complaint fails to state a claim upon which relief may be granted was succinctly stated as follows in *J.D. Conley v. Gibson*, 355 U.S. 41, 45-6, 78 S.Ct. 99, 102 (1957):

In appraising the sufficiency of the complaint we follow, of course, the accepted rule that a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.

In this context, it is important to note that Continental does not challenge the real property tax structure of the State of Indiana, nor the tax rates imposed by that tax structure. The focus of

²Although the Department has mentioned in its memorandum that Continental has an appeal of the assessment pending before an administrative tribunal in Indiana, there is no concrete evidence of that fact in the record. Moreover, there has been no allegation or evidence that the real property tax issue sought to be addressed by Continental was ever "contested before and adjudicated" by any administrative tribunal, and thus the provisions of 11 U.S.C. § 505(a)(2) do not preclude the relief sought by Continental.

the amended complaint is to seek this Court's determination of the "Assessed Value", as that value is determined under applicable state law, for application of the tax rates imposed by state law to that value to determine Continental's liability for real property taxes for the subject real estate.

As asserted in its memorandum, the Department first essentially contends that the Court does not have subject matter jurisdiction with respect to the relief requested by the amended complaint. Alternatively, the Department argues, if the Court were to find that it has subject matter jurisdiction, it should abstain from exercising that jurisdiction.³

As framed by the pleadings, the precise issue before the Court is whether or not the amended complaint, construed as it must be under the principles of *Conley, supra.*, states a claim which the Court can adjudicate by application of 11 U.S.C. § 505(a)(1) to determine the "Assessed Value" of Continental's real property. The issue presently before the Court does not embrace the manner in which any such determination would be undertaken by the Court, or the standards by which the Assessed Value of the subject real estate is to be determined. This order is limited strictly to the foregoing narrow issue.

The first portion of the Department's brief is devoted to the contention that the § 505(a)(1) determination sought by Continental is not a "core" proceeding. The distinction between "core" and "non-core" proceedings does not in and of itself relate to a bankruptcy court's exercise of jurisdiction over a particular claim; rather, it relates to the bankruptcy court's authority to enter a final judgment as the court of record in a particular proceeding. 28 U.S.C. § 1334 is the jumping-off place with respect to federal courts' jurisdiction over proceedings

³This order does not address the Department's request that the Court abstain from exercising authority under 11 U.S.C. § 505(a)(1) in the event that the Court determines that it has subject matter jurisdiction over the relief requested by the amended complaint. The abstention issue is not before the Court by motion or other affirmative request, and was raised in a brief to which Continental had no opportunity to respond.

which concern matters involved in the administration of a bankruptcy case, stating in pertinent part the following:

§ 1334. Bankruptcy cases and proceedings

(a) Except as provided in subsection (b) of this section, the district courts shall have original and exclusive jurisdiction of all cases under title 11.

(b) Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.

The authority for delegation by United States District Courts to United States Bankruptcy Courts is provided by 28 U.S.C. § 157(a), as follows:

§ 157. Procedures

(a) Each district court may provide that any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district.

28 U.S.C. § 157(b)(1) states the "final judgment" authority of United States Bankruptcy Courts, provided that the types of cases outlined in that section are delegated to the United States Bankruptcy Court by the United States District Court, as follows:

§ 157. Procedures

(b)(1) Bankruptcy judges may hear and determine all cases under title 11 and all core proceedings arising under title 11, or arising in a case under title 11, referred under subsection (a) of this section, and may enter appropriate orders and judgments, subject to review under section 158 of this title.

In the Northern District of Indiana, N.D.Ind.L.R. 200.1 of the Rules of the United States District Court for the Northern District of Indiana have effected delegation of that Court's federal bankruptcy jurisdiction to the United States Bankruptcy Court, to the fullest extent that this delegation is authorized by the foregoing statutes: L.R. 200.1(a)(1).

As outlined above, if the matter before this Court is a "case under title 11", or a "core proceeding arising under title 11, or arising in a case under title 11", then this Court has not only

subject matter jurisdiction over the matter, but has final judgment authority as well. Non-core proceedings related to a case under title 11 are provided for by 28 U.S.C. § 157(b)(3) in terms of the bankruptcy court's determination of its final judgment jurisdiction, as follows:

(3) The bankruptcy judge shall determine, on the judge's own motion or on timely motion of a party, whether a proceeding is a core proceeding under this subsection or is a proceeding that is otherwise related to a case under title 11. A determination that a proceeding is not a core proceeding shall not be made solely on the basis that its resolution may be affected by State law.

If a matter is determined to be related to a case under Title 11, but to not be a "core proceeding", the bankruptcy court's jurisdiction is determined under 28 U.S.C. § 157(c), which states:

(c)(1) A bankruptcy judge may hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11. In such proceeding, the bankruptcy judge shall submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district judge after considering the bankruptcy judge's proposed findings and conclusions and after reviewing de novo those matters to which any party has timely and specifically objected.

(2) Notwithstanding the provisions of paragraph (1) of this subsection, the district court, with the consent of all the parties to the proceeding, may refer a proceeding related to a case under title 11 to a bankruptcy judge to hear and determine and to enter appropriate orders and judgments, subject to review under section 158 of this title.

In the Northern District of Indiana, L.R. 200.1(a)(3) provides the sub-delegation to the United States Bankruptcy Court to hear all non-core proceedings related to a case under Title 11. As authorized by 28 U.S.C. § 157(c), in such matters – absent consent of the parties to the bankruptcy court's exercise of final judgment jurisdiction – the Bankruptcy Court conducts hearings and files proposed findings of fact and conclusions of law, and a proposed order, for review by the United States District Court.

From the foregoing, it should be apparent that the argument that a determination under

11 U.S.C. § 505(a)(1) is not a "core proceeding" misses the mark. The focus of such an action, including that presented by Continental's amended complaint, is to determine the "amount or legality" of a debtor's tax liability. The amount of a debtor's tax liability is clearly a matter related to the debtor's case under title 11, determining as it will the extent of priority of liens of the taxing authority vis-a-vis other creditors having security interests in the property, the amount of secured claims which must be provided for by a debtor's Chapter 11 plan in order to meet the confirmation criteria of 11 U.S.C. § 1129, the potential distribution required to be made to general unsecured creditors under 11 U.S.C. § 1129(a)(7) to the extent that real property subject to an *ad valorem* tax lien has value in excess of the total of the allowed secured claims which attach to the debtor's interest in that property, and so on, and so on. Thus, even were the Court to determine that Continental's amended complaint did not raise a matter constituting a "core proceeding", the Court has subject matter jurisdiction over the matter presented to it by Continental.

Moreover, as has been routinely determined, proceedings under § 505(a)(1) do in fact constitute core proceedings; *In re Washington Manufacturing Co.*, 120 B.R. 918 (Bankr. N.D.Tenn. 1990); *In re Kreidle*, 143 B.R. 941 (D.Colo. 1992); *In re Lake Worth Generation, LLC*, 318 B.R. 894 (Bankr. S.D.Fla. 2004). To this Court, Continental's § 505(a)(1) request constitutes a core proceeding under 28 U.S.C. § 157(b)(2)(O), a determination which the Department has admitted in its answer to the amended complaint.

The Department next makes a more general argument concerning the Court's ability to adjudicate Continental's claim. This challenge appears to be premised on the distinction between § 505(a)(1)'s authorization to determine the "amount or legality of any tax", as contrasted to the Court's authority to determine the valuation of property upon which the tax computation is based. A corollary of the Department's argument is that Indiana law provides for determination of this valuation by state governmental entities, and thus the assertion is made

that the Bankruptcy Court's substitution of its determination of value for that of those agencies usurps their power. With all due respect, the Supremacy Clause of the United States Constitution itself usurps the power of states in relation to the federal government, and 11 U.S.C. § 505(a)(1) clearly falls within the ambit of this federal Constitutional premise.

As stated by the United States Court of Appeals for the Seventh Circuit in *In re Stoeker*, 179 F.3d 546, 549 (7th Cir. 1999):

The Bankruptcy Code expressly authorizes bankruptcy courts to decide tax issues, 11 U.S.C. § 505(a)(1), and although state taxes are not specified, the courts have interpreted the statute to cover them. *Adams v. Indiana*, 795 F.2d 27, 29 (7th Cir.1986); *City Vending of Muskogee, Inc. v. Oklahoma Tax Comm'n*, 898 F.2d 122, 123-24 (10th Cir.1990) (per curiam). The [Tax Injunction] Act is anyway addressed only to injunctive remedies (or a declaratory judgment viewed as a preliminary to an injunction, *National Private Truck Council, Inc. v. Oklahoma Tax Comm'n*, 515 U.S. 582, 586, 115 S.Ct. 2351, 132 L.Ed.2d 509 (1995)), and no one is seeking an injunction against the state's going after Chandler for the taxes that the state believes Chandler owes it. If federal courts could not determine the debtor's liability for state taxes – if they had to abstain pending a determination of that liability in state court – bankruptcy proceedings would be even more protracted than they are.

As stated by the United States Court of Appeals for the Third Circuit, in a case involving determination of *ad valorem* taxes, in *In re Custom Distribution Services, Inc.*, 224 F.3d 235, 239-240 (3rd Cir. 2000):

We have consistently interpreted § 505(a) as a jurisdictional statute that confers on the bankruptcy court authority to determine certain tax claims. In *Quattrone Accountants, Inc. v. Internal Revenue Service*, 895 F.2d 921, 923 (3d Cir.1990), we stated: "when we review how the language and purpose of Section 505 has evolved, we conclude that Section 505 was intended to clarify the bankruptcy court's jurisdiction over tax claims" See also *H & H Beverage Distributors v. Department of Revenue of Com. of Pa.*, 850 F.2d 165, 166-67 (3d Cir.1998); *In the Matter of Ribs-R-Us, Inc.*, 828 F.2d 199, 202 (3d Cir.1987). (footnote omitted)

It is undisputed by either party that the Bankruptcy Court had jurisdiction, pursuant to § 505(a)(1), to reduce Custom's property

tax assessments for the 1992 through 1997 tax years. The more difficult task lies in defining the precise contours of the jurisdictional grant embodied in § 505 with regard to refunds and offsets of taxes already paid by Custom.

In preliminarily commenting on the bankruptcy court's jurisdiction under 11 U.S.C. § 505(a)(1) with respect to *ad valorem* taxes, the United States Court of Appeals for the Second Circuit stated as follows in *In re New Haven Projects Ltd. Liability Co.*, 225 F.3d 283, 288-289 (2nd Cir. 2000):

Therefore, based on the plain language of the statute, its legislative history, and relevant case law, we interpret the verb "may" in 11 U.S.C. § 505(a)(1) as vesting the bankruptcy court with discretionary authority to redetermine a debtor's taxes. This authority is not limited solely to instances where uniformity of tax assessments is of significant importance. *See Northbrook Partners, LLP v. Hennepin (In re Northbrook Partners, LLP)*, 245 B.R. 104, 118 n. 26 (Bankr.D.Minn. 2000) . . .

Finally, in the context of the Department's argument that Continental has potentially available state remedies which it should be required to exhaust, the following discussion in *In re Mayfair Mills, Inc.*, 295 B.R. 827, 833 (Bankr. S.C. 2002) [another *ad valorem* tax case] is pertinent:

From the undisputed facts, this Court can consider Plaintiff's Complaint as all of the parties agree that Plaintiff did not contest the amount or the legality of the taxes prepetition. In fact, Defendants emphasize that Plaintiff failed to avail itself to the mechanism provided by state law for challenging property taxes; however, a majority of authorities have held that, despite a debtor's failure to follow state law procedures for contesting the amount of taxes levied or their legality, a debtor is not precluded from moving pursuant to § 505 to determine its taxes. *See New Haven Projects*, 225 F.3d at 286 ("The broad grant of jurisdiction contained in § 505 makes no reference to time periods imposed by state law . . . [A] debtor as representative of the bankruptcy estate is allowed to contest tax debts in the bankruptcy court even though his prior inaction would bar him from contesting them elsewhere.") (citing *Ledgemere Land Corp. v. Ashland (In re Ledgemere Land Corp.)* 135 B.R. 193, 196-97 (Bankr.D.Mass.1991)); *Baltimore County v. Hechinger Inv. Co. of Delaware (In re Hechinger Inv. Co. of Delaware, Inc.)*, 276 B.R. 43, 47 (D.Del. 2002) (finding that there is no requirement of § 505

that a debtor must exhaust state law remedies as a condition for obtaining a bankruptcy ruling on tax liability); *150 N. St. Associates Ltd. P'ship v. City of Pittsfield (In re 150 N. St. Associates Ltd. P'ship)*, 184 B.R. 1, 5 (Bankr.D.Mass.1995) (concluding that the debtor's failure to seek an abatement does not bar it from seeking an adjudication in the bankruptcy court regarding its tax liability); *In the Matter of E. Coast Brokers & Packers, Inc.*, 142 B.R. 499, 501 (Bankr.M.D.Fla.1992) (finding the bankruptcy court still has authority to determine the debtor's objection to claim for ad valorem personal property taxes although the debtor did not timely object to the taxes pursuant to state law); *In re A.H. Robins Co., Inc.*, 126 B.R. 227, 229 (Bankr.E.D.Va.1991) (finding that a debtor's failure to challenge tax assessments does not deprive the bankruptcy court of jurisdiction to decide the validity of tax claims).

Continental's amended complaint seeks the Court's determination of the assessed value of its property under the authority of 11 U.S.C. § 505(a)(1)⁴, in order to apply Indiana's real property tax rates to that valuation to determine Continental's liability for 2003 and 2004 real property taxes. Based upon the foregoing, the Court finds that Continental's amended complaint states a claim upon which relief may be granted, and that therefore the Department's affirmative defense must be overruled/denied.

IT IS ORDERED that the affirmative defense stated in the answer of the defendant Indiana Department of Local Government Finance is overruled/denied.

Dated at Hammond, Indiana on April 21, 2005.

/s/ J. Philip Klingeberger
J. Philip Klingeberger
United States Bankruptcy Court

Distribution:
Attorneys of Record

⁴Of course, the criteria for the determination of that valuation are those provided by state law, and the Court must apply that state law in making any determination sought by the plaintiff.