

# Environmental Obligations in Bankruptcy: Reconciling the Conflicting Goals of Bankruptcy and Environmental Laws

Pre- vs. Post-Petition Claims, Enforcement Actions, Statutory Super Liens, Asset Sales, Abandonment

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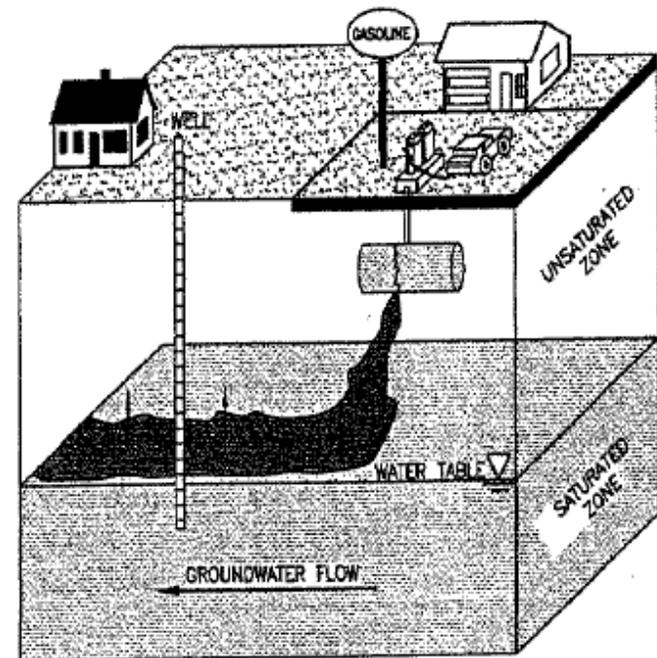
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# SUBSURFACE CONTAMINATION

- ❑ Where does it come from?
- ❑ State and federal Superfund sites



# Environmental Liability

Comprehensive Environmental Response, Compensation, and Liability Act of 1980, as amended (“CERCLA”). CERCLA is a federal statute.

- Scope of Liability
  - (1) Hazardous substances were disposed at a facility
  - (2) There has been a release or threatened release
  - (3) Response costs have been incurred
  - (4) The defendant is included within one of four classes of responsible parties (commonly referred to as “PRPs”). One such class is a current owner of the property regardless of whether they caused the contamination
- A PRP is strictly liable for: (a) the response costs incurred by the government or private parties, and (b) any resulting natural resource damages.

# Who Are CERCLA PRPs?

The following Parties are PRPs:

- The current owner or operator of the facility;
- The party that owned or operated the facility at the time of disposal of the hazardous substances;
- The party that arranged for disposal, treatment or transportation of the hazardous substances;
- Any person who accepted hazardous substances for transport, disposal or treatment.

# CERCLA LIABILITY SCHEME

- PRPs are jointly and severally liable to reimburse the government for remediation costs.
- PRPs may seek contribution from one another possibly resulting in a percentage allocation of responsibility among the parties.
- A PRP's corporate form may not provide a shield to the individuals exercising management authority or sufficient control over the hazardous substance as those individuals have been considered operators.

# Bona Fide Prospective Purchaser Defense to CERCLA Liability

- A prospective purchaser may buy the property knowing and having reason to know of contamination on the property and still be afforded the benefits of this defense.
- The defense provides a complete shield to a prospective purchaser from CERCLA liability (but likely not tort liability).
- Fact intensive defense. Generally not relied upon by buyer at purchase without government declaration that the defense applies.
  - The prospective purchaser must exercise appropriate care with respect to hazardous substances found at the facility by taking reasonable steps to (a) stop any continuing release, (b) prevent future release, and (c) prevent or limit environmental exposure to any previously released hazardous substances.

# Bankruptcy Process

- Debtor files a petition that commences the bankruptcy case. The Debtor's assets become property of the "debtor's estate".
- Automatic Stay.
- Creditors are notified of the bankruptcy filing.
- Creditors file claims against the Debtor
  - Claims arising pre-petition are unsecured claims – likely paid pennies on the dollar
  - Claims arising post-petition are administrative claims- often paid 100%
- In chapter 7, trustee is appointed to liquidate assets and make distributions to creditors in accordance with the Bankruptcy Code.
- In chapter 11, debtor often remains "in possession" to liquidate assets and make distributions to creditors in accordance with the Bankruptcy Code and the chapter 11 plan. The chapter 11 plan is a heavily negotiated document among all constituents and subject to confirmation by the bankruptcy court.
- Upon conclusion of the bankruptcy, either the pre-petition claims are discharged (chapter 7) or the debtor emerges with little or no liability pursuant to a chapter 11 plan.

# Environmental Claims in Bankruptcy

- Pre-petition monetary environmental claims will likely be discharged in bankruptcy. Applicable government agencies, aggrieved property owners, and other PRPs must be notified of the bankruptcy filing.
- But is an environmental claim pre-petition? Date of release?
- If a party incurs cleanup costs after the petition date for a pre-petition release, are the costs considered pre-petition unsecured claims?
- Discharge may not be available where the environmental obligation relates to the obligation to clean up the property under a government consent order – as opposed to monetary satisfaction of a claim.
- The case law is muddy.

# Discharge of Responsibility Through Abandonment

- Not a slam dunk.
- Cannot abandon hazardous properties in a bankruptcy case in contravention of a statute designed to protect public health or safety. See Midatlantic Nat. Bank v. New Jersey DEP, 474 U.S. 494 (1986)).
- Courts have applied Midatlantic narrowly, allowing abandonment if it does not pose an imminent or immediate identifiable threat to public health or safety.
- If no asset chapter 7 case, abandonment will be permitted.

# Sales Through Bankruptcy

- Section 363(b) of the Bankruptcy Code authorizes a trustee or debtor-in-possession to sell a debtor's interest in property.
- Court approval is required.
- A sale of property may also be completed through a Chapter 11 plan.
- Pursuant to section 363(f) a trustee or debtor-in-possession may sell a property to a buyer free and clear of all liens, claims, encumbrances, and interests attached to the property.
- Upon the sale, the liens, claims, encumbrances and interests will then attach to the proceeds of sale in the same form and priority as they attached to the property.

# Environmental Liabilities and Section 363(f)

- Notwithstanding section 363(f), environmental liabilities generally run with the land because of current owner strict liability under CERCLA.
- A 363(f) sale will likely not shield the purchaser of real property from environmental liabilities typically causing the purchaser to pay a significantly reduced purchase price.

# How to Sell Free and Clear of CERLCA Liabilities

- Use the holdings in a section 363 order or order confirming the Chapter 11 plan as a shield to prospective purchaser liability.
- Incorporate factual findings of applicable CERLCA and state statutory defenses shielding the purchaser from liability.
  - CERLCA: Bona Fide Prospective Purchaser Defense
- Have the Court expressly hold that the defense applies, which will shield the purchaser from the applicable liability so long as they comply with the order and statute.

# Case Study- Contaminated Real Property Sale in Bankruptcy

- From 1945 to 1978 – a well-known entity caused massive contamination.
- The contamination migrated off-site and contaminated the public drinking water supply wells operated by three water districts.
- Water districts sued for their treatment costs (tens of millions).
- More than 6 years prior to bankruptcy filing, the entity spun off its assets. The resulting entity became the property owner holding the property as its sole asset.
- The resulting entity filed for chapter 7 bankruptcy.
- Trustee tried to sell the property, but liability was enormous. No buyer was interested.
- We developed a plan to minimize buyer liability and brought a potential buyer to the table.
- Negotiations between buyer, government, debtor, and water districts resulting in an agreement between the parties to minimize liability.
- But what about other third parties with potential CERCLA claims?
  - BFPP finding in the 363 order.
- Buyer paid fair market value for the property because it was protected.

# Hypothetical– No Viable Defendant

- Same facts as case study, but assume property is worthless even with BFPP protection.
- No PRP to sue because no viable assets.  
Where to turn?
- General liability insurance policies have pollution exclusions.
- Get your hands on pre-1970 policies.

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# **ENVIRONMENTAL OBLIGATIONS IN BANKRUPTCY**

**Administrative Priority, Claim Estimation and Case  
Studies**

**William F. Tarantino**

April 13, 2021

# Administrative Priority Treatment

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- What claims qualify?
  - Claims arising post-petition.
  - Actual, necessary costs & expenses of preserving the estate - §503(b)(1)(A).
  - Allowed when supplied to and beneficial to the estate or debtor in possession; see *Amalgamated Ins. Fund v. McFarlin's, Inc.*, 789 F.2d 98, 101 (2d Cir. 1986).
  - Includes costs of complying with environmental laws; 28 U.S.C. § 959(b).
- *In re Munce's Superior Petroleum Prod., Inc.*, 736 F.3d 567 (1st Cir. 2013) (post-petition penalties arising from pre-petition environmental violations).
- *In re N.P. Mining Co., Inc.*, 963 F.2d 1449 (11th Cir. 1992) (penalties for post-petition mining operations).
- *In re Jones Transfer Co.*, 1996 WL 33674288, \*2 (E.D. Mich. June 18, 1996) (costs incurred to clean up property owned by debtor's estate).

# Administrative Priority Treatment

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- While administrative priority claims may not be paid in a chapter 7 liquidation if estate assets are insufficient to satisfy them, a chapter 11 plan must generally provide for payment of administrative priority claims in full, in cash.
- § 1129(a)(9)(A) requires administrative creditors to be paid in full, in cash unless they agree to a different treatment of their claims.
- Most environmental claims will not qualify, but it's worth a shot.

# Categorization of Claims

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- **Category A: Sites currently owned and operated by debtor.**
  - *United States v. LTV Steel Co. (In re Chateaugay)*, 944 F.2d 997, 1008 (2d Cir. 1991)(cleanup order nondischargeable)
- **Category B: Sites currently owned by debtor, but inactive.**
- **Category C: Sites formerly owned/operated by debtor.**
  - *Ohio v. Kovacs*, 469 U.S. 274 (1985) (cleanup order is dischargeable where a receiver had taken over the debtor's property to conduct the cleanup, which effectively converted the injunctive order into a cost reimbursement claim).
  - *But see In re Torwico*, 8 F.3d 146 (3d Cir. 1993) (injunctive order relating to property formerly leased by the debtor is not dischargeable if the debtor still had access to property because the debtor's obligations "run with the waste")
- **Category D: Third party off-site waste disposal sites**
  - *In re Crystal Oil*, 158 F.3d 291, 295 (5th Cir. 1998) (state cleanup claims at formerly owned hazardous waste site were deemed to be discharged).
  - *In re FV Steel & Wire Co.*, 324 B.R. 701 (Bankr. E.D. Wis. 2005) (EPA enforcement of CERCLA consent decree at waste site is equivalent to seeking money judgment and, therefore, is barred by automatic stay).

# Valuing Contingent + Unliquidated Claims

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- Environmental claims are often contingent or unliquidated.
- Determining the amount of some environmental liabilities can be a complex and protracted process
  - Hundreds of PRPs involved in a single action.
  - Years to remediate a site
  - Estimation requires the work of experts.
- The Bankruptcy Code provides certain tools to assist in valuing environmental claims, mitigating the cost and delay of claims resolution:
  - A claim may be estimated (for voting or distribution purposes) if liquidating the claim is likely to unduly delay administration of the case (Bankruptcy Code, § 502(c)).
  - Contingent claims of third-parties for reimbursement or contribution will be disallowed when the debtor is co-liable with the claimant to a state or federal environmental agency (Bankruptcy Code, § 502(e)(1)(B)).

# Case Study: Maxus Energy Corporation

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- **1986:** Maxus sells its chemical business to Occidental Chemical Company. In connection with the sale, Maxus agrees to indemnify Occidental for claims under CERCLA or RCRA with respect to any release, storage or disposal of polluting substances.
- **1995:** YPF S.A. acquires Maxus in a leveraged buyout. YPF allegedly “loots” Maxus’s assets for its own benefit.
- **2005:** NJ Department of Environmental Protection sues Occidental and Maxus for environmental contamination of New Jersey’s Passaic River. YPF later added as a defendant under “alter ego” theory.
- **2011:** New Jersey State Court holds Occidental liable under the New Jersey Spill Act for any “cleanup and removal costs” later shown to be associated with the Passaic River discharges.
- **2013:** YPF, Maxus, and others settle with NJDEP for \$130 mm.

# Case Study: Maxus Energy Corp. (Cont'd)

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- **2014:** Occidental settles with NJDEP for \$190 mm and then submits an indemnity claim to Maxus to recover the payment. Maxus disputes the claim.
- **June 2016:**
  - Trial scheduled to begin regarding Occidental's indemnification claim against Maxus and alter ego claim against YPF.
  - Maxus files for chapter 11 bankruptcy, which stays the trial.
  - YPF provides Maxus with \$63.1 mm of DIP financing.
- **August 2016:** Maxus seeks bankruptcy court approval for \$130 mm settlement with YPF regarding "alter ego" claims. Occidental and other creditors object.
- **December 2016:** Maxus files initial chapter 11 plan premised on settlement with YPF.

# Case Study: Maxus Energy Corp. (Cont'd)

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- **March 2017:**
  - Maxus withdraws initial chapter 11 plan.
  - Maxus files new creditor-supported chapter 11 plan, which is premised on contribution of Maxus's alter ego claim against YPF to liquidating trust.
  - Maxus seeks approval of “take out” \$17.5 mm DIP financing from Occidental to refinance original YPF loan.
- **May 2017:** Maxus and UCC obtain bankruptcy court approval for amended chapter 11 plan.
- **June 2018:** Maxus liquidating trust files complaint against YPF seeking \$14 billion in damages.

# Maxus Energy: Key Agreements

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- **Transition Services Agreement:** Established framework for Maxus to transition ongoing remediation projects and services to Occidental in orderly fashion.
- **Site Transition Agreement:** Established framework for Maxus transfer technical files and assign service agreements to Occidental, among other things.
- **Real Property APA:** Maxus sold owned real property to Occidental “free and clear” of all preexisting liabilities for \$17 mm purchase price and assumption of key environmental liabilities.
- **Chapter 11 Plan:** Provided for the creation of three trusts:
  - **Liquidating trust** to pursue alter ego claims against YPF;
  - **Remediation trust** to fund environmental remediation activities; and
  - **Property trust** to hold any unsold real properties.

# Exide Bankruptcy & Abandonment

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- Section 554(a) allows trustee to abandon estate's property that is burdensome or of inconsequential value and benefit to the estate.
- A court need only find the trustee or debtor made:
  - (1) a business judgment on abandonment;
  - (2) in good faith;
  - (3) upon some reasonable basis, and
  - (4) within the trustee's or debtor's scope of authority
- *Midland National Bank* framework: Is there an imminent and identifiable harm and where the debtor's attempt to abandon contravenes state or local laws or regulations to protect the public?
- Exide's Vernon site – Judge Sontchi allows abandonment. Significant contamination but “[t]he entire property is not sort of a seething, glowing, toxic lead situation.”

# 363 Sales to Conservation Entities

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Virginia Conservation Legacy Fund (VCLF) purchased Patriot Coal's troubled mining assets, including more than 150 mining permits in six states in a section 363 sale.

- Assets encumbered by environmental reclamation obligations and miner healthcare liabilities.
- VCLF acquired the mining assets under the following multi-faceted approach:
  - The mines would be operated to generate revenue to meet reclamation and remediation obligations.
  - The mined land would be reforested allowing VCLF to take advantage of clean energy offsets.
- In a separate transaction, Patriot Coal sold its profitable assets to an entity formed by a lender group



Prepetition secured lenders purchased Walter Energy's core mining assets in its chapter 11 cases.

- VCLF purchased the remaining coal and coke assets with extensive reclamation obligations for \$1 and assumed \$38 million in liabilities.
- The bankruptcy court's approval of the sale was affirmed on appeal by the district court.

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# Environmental Obligations in Bankruptcy:

## A Case Study

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# Elements of a Deal

## Identify Environmental Liabilities

- Vary greatly in available information
- May require additional testing or modeling

## Identify Available Tools

- Tools from the bankruptcy code
- Tools from environmental law
- Practical Solutions

## Identify Constituents

- Bankruptcy good forum to identify constituents and force resolution of issues
- Litigation forum can restrict outcomes

# Identifying Environmental Liabilities

## Well Defined

- Site well characterized
- Ongoing remediation
- Costs well known

## Moderately Well Defined

- Some liabilities well defined
- Some issues identified but not characterized
- Some site areas not investigated or issues not identified

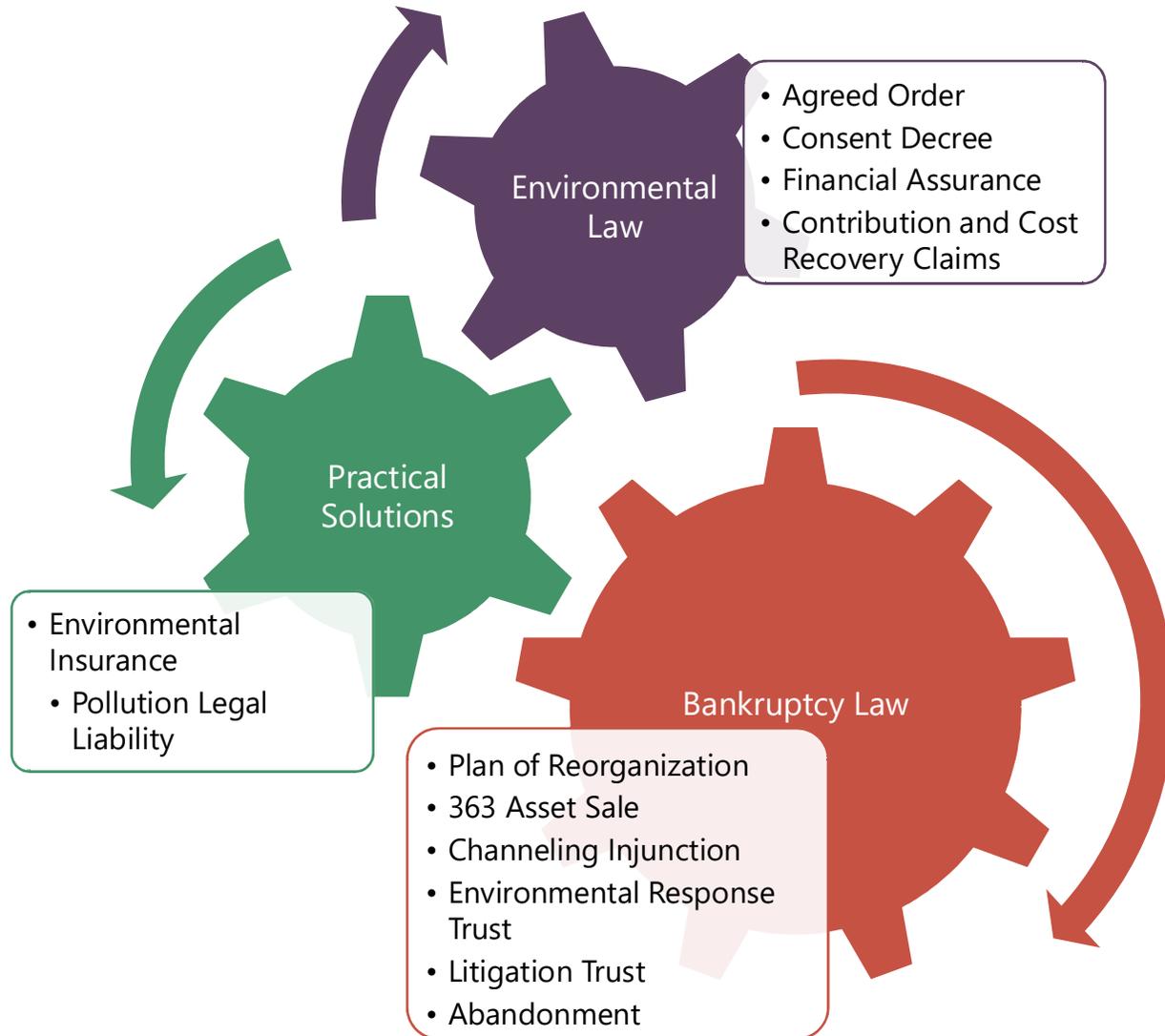
## Undefined or poorly defined

- Environmental liabilities not yet identified
- Site not yet characterized
- Material potential costs unknown
- May require estimation techniques

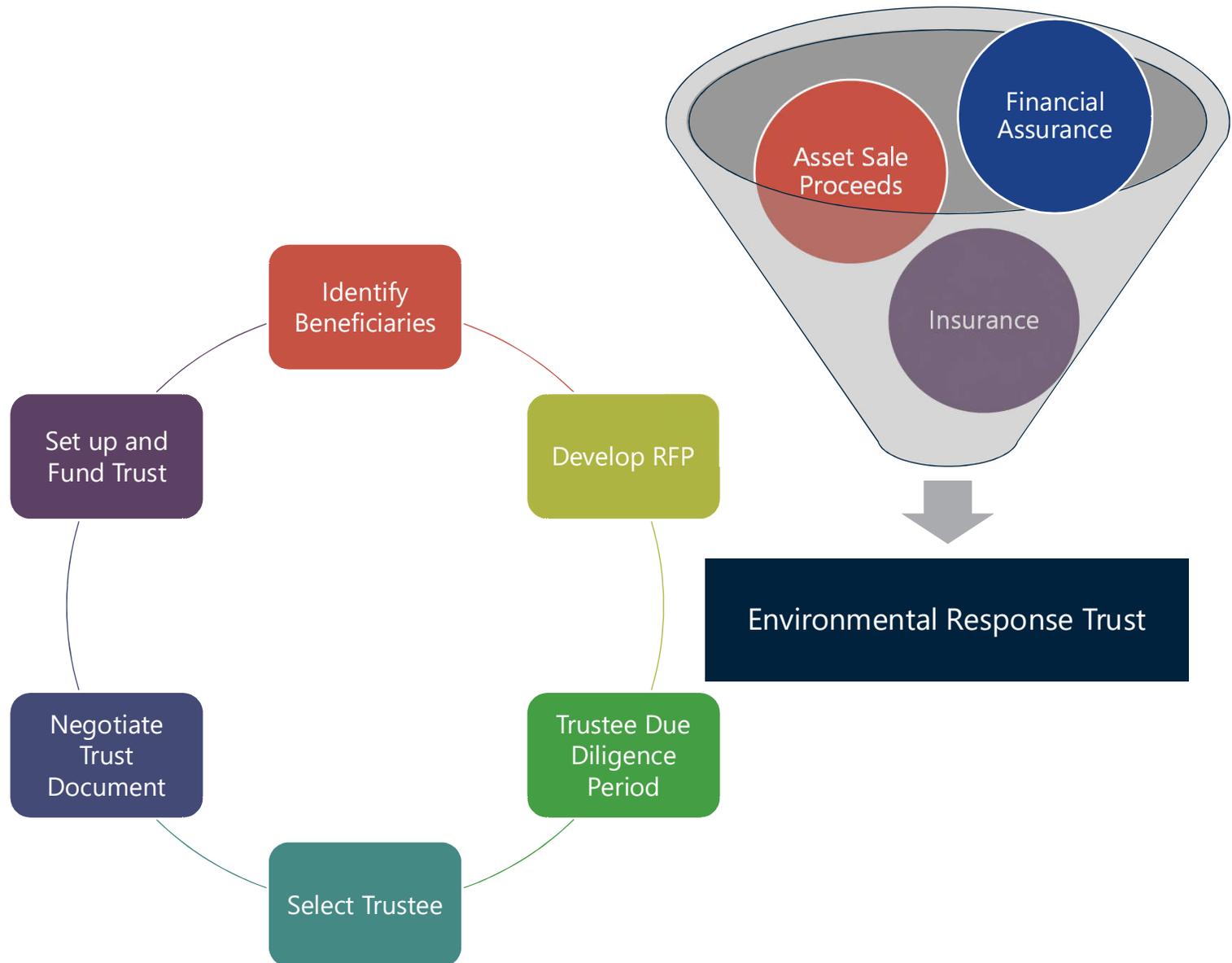
# Deal Constituencies



# Tools



# Environmental Response Trusts



# Case Study - Large Oil Refinery



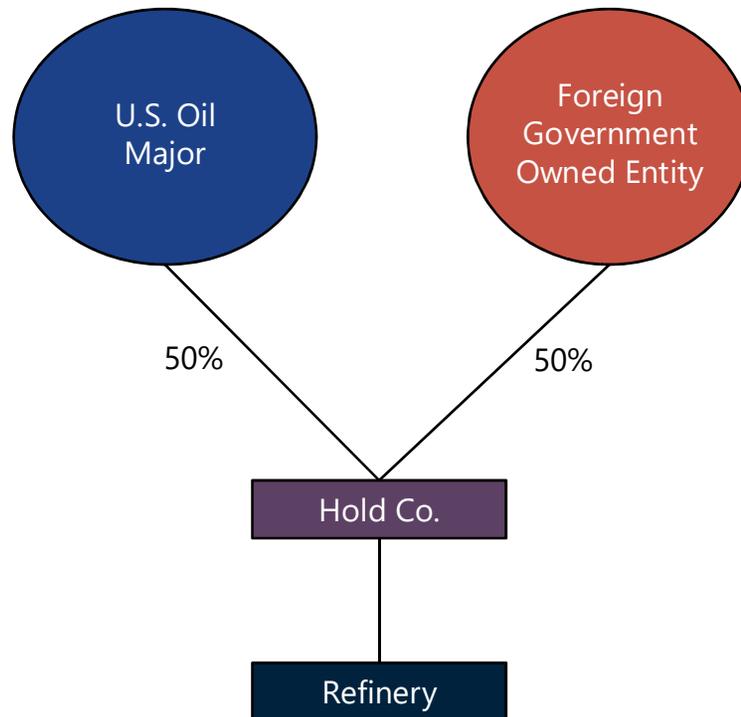
- Located in US Virgin Islands
- Formerly largest refinery in eastern hemisphere (500K per day name plate capacity)
- Constructed in 1966 and operated until 2012

# Environmental Issues



- Site very well characterized
  - Resource Conservation and Recovery Act ("RCRA") corrective action and groundwater contamination issues
- 2011 Petroleum Refinery Initiative ("PRI") Consent Decree under the Clean Air Act
- Natural Resources Damages Litigation
- MTBE Litigation

# Ownership Structure



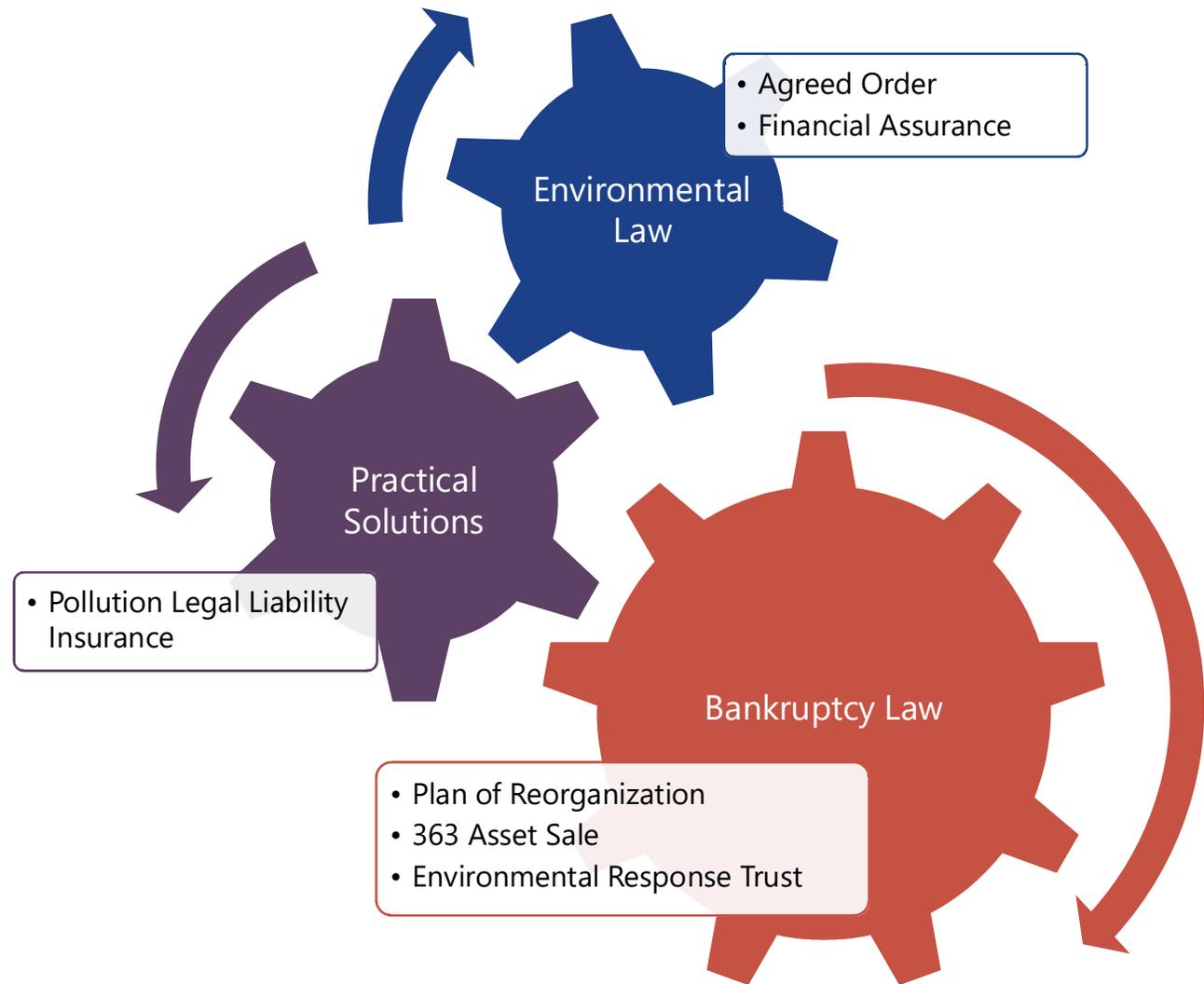
- 50-50 Joint Venture
  - Equal Board representation
  - All Board resolutions required consent of each member
- U.S. Oil major managed refinery under management agreement
  - Had historically operated the refinery
  - Deeper understanding of refinery operations and history

# Constituencies

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- Equity Holders
  - Joint venture parties
  - Included foreign
- Asset purchasers
  - Five bidders
- Creditor Governments
  - Federal
    - DOJ and EPA
    - Unsecured creditors with veto over the plan
  - Government of the Virgin Islands
    - Approval of concession agreement for new buyer and 1.5 billion lawsuit against Debtor
    - Represented by plaintiff's lawyers
  - Two elections during process – VI and Government of Joint Venture Partner

# Tools



# Environmental Law – Agreed Order

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- EPA/DOJ and US VI
  - Different objectives
  - EPA Region 2 priorities
  - US VI and EPA Region 2 relationship
- USED AO to address outstanding compliance issues
- Reluctance to allow RCRA financial assurance resources to be used by Environmental Remediation Trust

# Practical Solution – PLL Insurance

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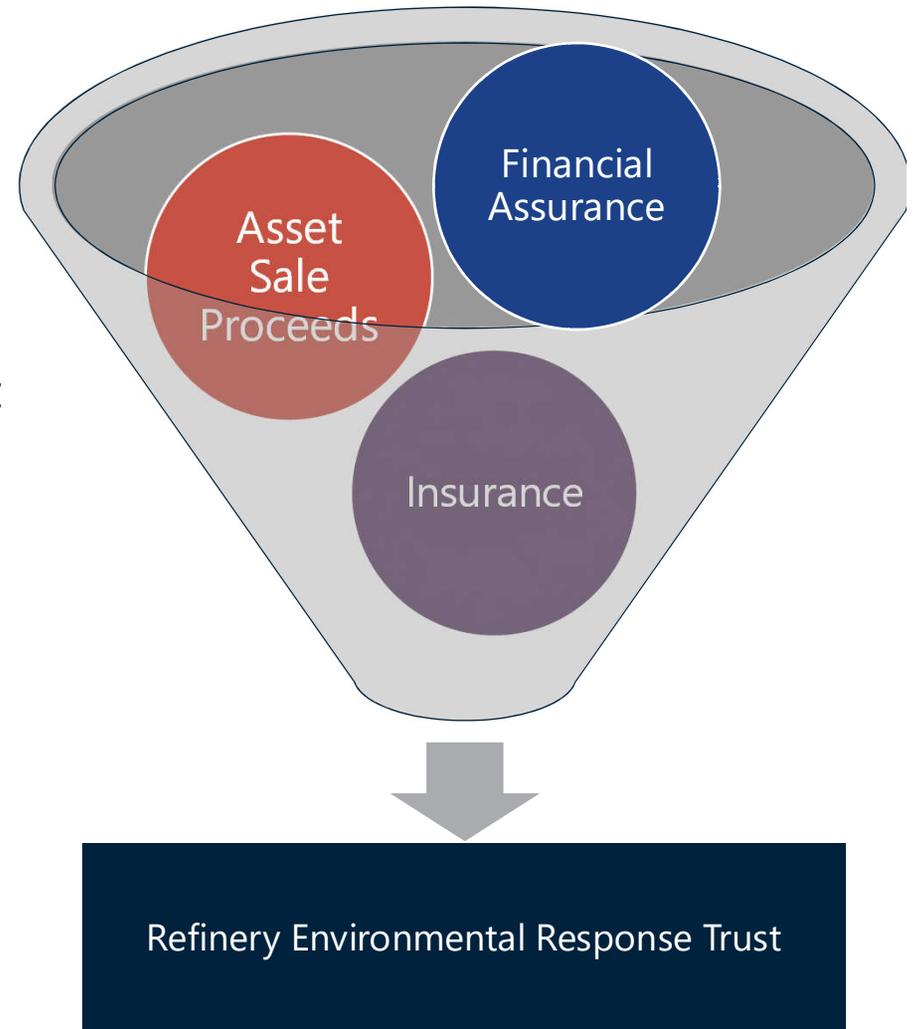
- Acted as backstop in the event of material, unknown liability
  - Although site was well characterized, governments were concerned that ERT have all necessary resources
  - \$75 million/10 years
    - Three carriers
      - One primary at \$25 million
      - Two secondary at \$25 million per
  - Multiple complicating factors in bankruptcy
    - Compressed time frame
    - Multiple parties
    - Defining covered locations when assets moving to other parties

# Bankruptcy Law - Asset Sale

- Different uses of site by purchasers vs governments
  - Purchasers: Best value as terminal
  - V.I. government: More jobs as refinery
  - Need for V.I. government concession gave govt strong negotiating position
  - Original bidder chosen by debtor rejected in VI legislature
- Next best bidder selected
- Key elements of Asset Purchase Agreement related to environment
  - Purchaser contributed \$30 million to wind up costs
  - RCRA liabilities stayed with Seller (poured into environmental remediation trust)
  - Seller provided with access to address RCRA issues
  - If PRI Consent Decree not terminated, to be made applicable to Buyer

# Bankruptcy Law – Environmental Response Trust

- Trustees
  - Proposals from 4 potential trustees
  - Governments had clear preference for trustee
  - Governments played role in negotiating trust agreement
  - Scope of Trust and Powers and Duties of Trustee Key



## Q&A / Conclusion

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- Bankruptcy court can be a useful forum for identifying environmental issues and constituencies, assigning responsibility and establishing mechanisms for addressing issues going forward
- Each resolution different structure depending on mix of environmental issues, constituencies involved (especially government entities) and available tools