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Environmentally Contaminated Property Issues When Owners Face Insolvency

Complying with Remediation Requirements and Discharging Cleanup Obligations in Bankruptcy

THURSDAY, NOVEMBER 18, 2010

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

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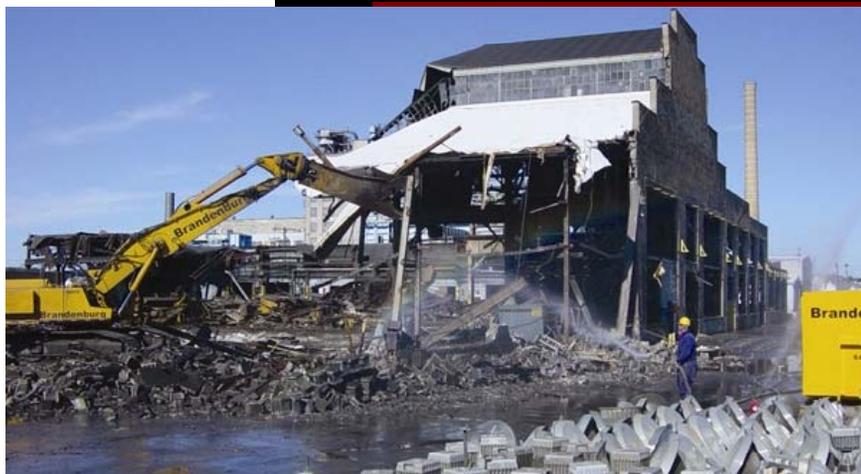
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November 18, 2010



Environmentally Contaminated Property: When Owners Face Insolvency

Section I: Overview of Bankruptcy Law Principles

Presented by:

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Creditors Positions Fixed on Date of Filing

- Secured
- Administrative
- Priority
- Unsecured



Notice of Commencement Case

- Federal Law: The Circuits Differ
- Where is the case filed?
- Deadlines important to creditors
 - Proof of Claim
 - Objection to Discharge
 - Objection to Exemptions
 - Objection to Chapter 13 Plan
- Meeting of Creditors



Who is Secured?

- Recorded Liens
 - County
 - Secretary of State
- Unrecorded Liens



Type of Bankruptcy Cases

- Chapter 7: Liquidation
- Chapter 9: Municipality
- Chapter 11: Reorganization
- Chapter 12: Family Farmers
- Chapter 13: Reorganization for Individuals



Liquidation Chapter 7

Court Appoints Bankruptcy
Panel Trustee

- Liquidates assets
- Looks for avoidance actions
- Distributes assets

Creditors receive prorata
distribution of claims

Debtor

- Gets discharge
- Exempt assets
- Abandoned assets
- Fresh start



Chapter 11

Reorganization

Liquidation of
Ongoing Business

Emergency First Day Motions
Appointment of Creditors' Committee
Defend Motions For Relief of Stay
Obtain Authority to Use Cash Collateral
Assume/Reject Leases
File Disclosure Statement and Plan



Automatic Stay

Actions Against Debtor
Actions Against Property of Estate
Actions by Debtor Not Stayed



Exceptions

- Criminal proceedings
- Family law matters where specified
- Governmental units police and regulatory powers
- Certain tax issues
- Terminated leases



Proofs of Claim

- Filed/Informal
- Pre-petition
 - Secured
 - Priority
 - General Unsecured
- Post-petition
 - Administrative



ENVIRONMENTALLY CONTAMINATED PROPERTY ISSUES WHEN OWNERS FACE INSOLVENCY

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Discharge

- **Discharge:**

- Elimination of liability for debts that arose prior to commencement of bankruptcy case.
- Concept generally available in individual liquidation cases under Chapter 7 of the Bankruptcy Code.
- While discharge is not generally available to a business debtor, similar result achieved through plan of reorganization or plan of liquidation in Chapter 11 case – see 11 U.S.C. § 1141.



Discharge

- **Effect on Co-Obligors:**
 - Discharge generally does not affect liabilities of co-obligors and/or guarantors of an obligation.
 - Third-party releases in plan of reorganization and/or plan of liquidation.



Claims

- Claim:
 - Very broadly defined. Includes:
 - A right to payment (does not have to have already accrued or become cognizable)
 - A right to an equitable remedy (if a breach of that right would give rise to a right to payment)
- Debt:
 - A liability on a claim



Claims

- **General Categories of Claims**
 - Administrative Claims
 - Priority Unsecured Claims
 - General Unsecured Claims
 - Secured Claims
- **Particular Claims of Interest**
 - Reclamation Claims
 - 503(b)(9) Claims
 - Rejection Damage Claims



Administrative Claims (§ 503)

- The cost of administering the bankruptcy case
 - Court costs
 - Attorneys' fees (debtor, trustee, creditors' committee)
 - Other professional fees
 - “The actual, necessary costs and expenses of preserving the estate”



Administrative Claims (§ 503)

- Includes claims for goods and services provided to a bankruptcy estate after the petition date
- The bankruptcy estate has to have received some benefit (e.g., claims for late fees or penalties are generally not allowed as administrative claims)
- Administrative claims are usually paid in full
(Applicable principle: fresh start for the debtor)



Priority Claims (§ 507(a))

- A series of unsecured claims that are paid before all others
 - Domestic support obligations
 - Administrative expenses
 - Employee wages and benefits (capped)
 - Claims of grain farmers and fishermen (capped)
 - Taxes and customs duties
 - Customer deposits



General Unsecured Claims

- Claims that accrued before the petition date
- Paid from the bankruptcy estate after priority claims
- Paid a pro rata share of the available estate assets
- Includes most environmental-related claims



Secured Claims (§ 506)

- A claim secured by a lien on property of the estate
- A claim subject to setoff
- Valuation issues: A claim is secured only to the value of the collateral
- Oversecured Claim (the collateral is worth more than the debt) – interest, fees and costs can be included in the claim
- Undersecured Claim (the collateral is worth less than the debt) – the claimholder is secured only for the value of the collateral, and the remainder is an unsecured claim



Filing a Claim

- Administrative Claims are generally submitted by motion
 - A form for administrative claims is sometimes authorized by the court in larger cases
- Other claims are submitted by filing a “Proof of Claim”
 - A creditor must file a proof of claim in Chapters 7, 12 and 13 unless otherwise directed
 - A creditor must file a proof of claim in Chapters 9 and 11 if the claim is not scheduled, incorrectly scheduled, or scheduled as contingent, disputed, or unliquidated

Bankruptcy Law and Environmental Law:

A Clean Slate vs. A Clean State

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CERCLA (Superfund)

Comprehensive Environmental Response, Compensation, and Liability Act

- Applies to present and former owners & operators of hazardous waste sites and to arrangers, transporters
- Sources of CERCLA obligations
 - EPA suit to recover costs and damages → § 107 Liability
 - Suits by other PRPs → § 113 Contribution
 - EPA orders to protect health → § 106 Abatement Actions
 - Consent Orders → § 122 Settlements

PRP Liability

- A Potentially Responsible Party (PRP) may be liable for:
 - Removal/remediation costs incurred by a government agency
 - Costs incurred pursuant to the National Contingency Plan
 - Damages for injury or destruction of natural resources (including reasonable costs of assessing losses)
 - Costs of health assessments or health effects studies
 - Interest accruing on the above liabilities

Joint and Several Liability...Or So We Thought

- CERCLA liability is joint and several where the harms from contamination are indivisible
- Joint and several liability is not mandatory under CERCLA; courts apply common law principles
- Joint and several liability has been assumed BUT, *Burlington Northern* reversed a joint and several liability ruling in favor of the “reasonable apportionment” calculated by the district court

Successor Liability

- Buyer does not assume liabilities of seller UNLESS:
 - Assumption; De Facto Merger; Mere Continuation; Fraud
 - These are traditional exceptions based on state law; judicially created
 - “Mere continuation” is based on identity of shareholders and officers and directors
 - Substantial Continuity/Continuity of Enterprise
 - Part of federal common law according to many courts
 - Substantial continuity focuses on continuation of the business operation as opposed to continuation of the entity

PRP Obligations: Injunctive Orders

- CERCLA gives the government a right to issue orders or obtain injunctions from the courts
- Orders are often complex and involve negative injunctions to cease polluting, affirmative injunctions to remediate, and monetary penalties
- Bankruptcy courts have to dissect these orders to determine which parts, if any, are “claims” dischargeable in a bankruptcy proceeding

Successor Liability for Buyers in Bankruptcy

- Courts may not agree on when a buyer of a bankrupt entities' assets has successor liability
 - “Free and clear” purchases as defined in the bankruptcy code may not include CERCLA obligations
 - Courts may require knowledge of CERCLA risks/obligations prior to imposing successor liability
 - If the predecessor still exists and can provide a remedy, there may be no successor liability
 - Buyers of real property may still be liable as current owners even where there is no successor liability
- *Ninth Ave. Remedial Group v. Allis Chalmers Corp.*, 195 B.R. 716 (Bankr. N.D. Ind. 1996)

RCRA

Resource Conservation and Recovery Act

- Regulates hazardous waste, as well as solid waste and some aspects of underground storage tank use
- “Cradle to Grave” concept → applies to generators, transporters, and to treatment, storage, and disposal facilities (TSDFs)

Remedies for RCRA Violations

- Authorizes injunctive relief, civil penalties and criminal penalties, NOT reimbursement of remediation costs
- *Meghrig v. KFC Western* → the Supreme Court found RCRA did not provide for past clean-up costs in the context of citizen suits (§ 7002)

RCRA Obligations & Bankruptcy

- Applying the *Meghrig* reasoning to government actions simplifies bankruptcy decisions under RCRA as compared to those under CERCLA:
 - If neither the government nor private attorneys general can recover past clean-up costs, there is no “right to payment” and RCRA obligations are not claims dischargeable in bankruptcy (*Apex*)

Environmental Bankruptcy Settlements

- Chemtura: \$26 million settlement with U.S. EPA
 - Covers CERCLA, CAA, CWA and EPCRA claims for 17 sites across the U.S.
 - Delineated Chemtura's future obligations at specific sites
 - Expressly excluded liabilities at certain sites still under negotiation with the U.S. EPA
- Former Quebecor: \$838,300 settlement with U.S. EPA
 - Covers CERCLA and CAA claims at 3 sites (Ill., P.A. and M.A.)
 - Established substantial reductions in future payments at PA site

Environmentally Contaminated Property: When Owners Face Insolvency

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Environmental Liabilities as “Claims”

- “Claims” may be discharged in bankruptcy
 - A claim may be monetary obligation or equitable remedy
- Exercise of police powers are not discharged
- An order to remediate may be either a claim or an exercise of police power

What is a Claim Versus Police Power?

- An order requiring cleanup of soil and groundwater pollution?
- An order seeking recovery of cleanup costs?

When Does the Claim Arise?

- Claims can be contingent and unliquidated
- Different courts have used different triggers to determine when a claim arises
 - When hazardous substances released
 - When cleanup required
- If claim when substances released but no cleanup, creditors' claim may be discharged before cleanup costs known or incurred

Claims: Open Issues

- Major open issue in pending bankruptcies is whether cleanup liabilities for property no longer owned by the debtor is a claim and thus discharged
 - Briefings before New York federal courts
 - Lyondell (Settled)
 - Chemtura Corp. (Pending in United States Bankruptcy Court, Southern District of New York)

Creditor Perspective: Pre-Bankruptcy

- Identify potentially liable parties
- Consider whether an administrative order is preferable to voluntary cleanup
- Liquidate claims
- Provide protection in settlement agreements for cleanup costs in event of bankruptcy



What environmental liabilities are bankruptcy claims?

- Orders for clean-up activities that the government could perform and seek reimbursement are claims that may be discharged in bankruptcy
 - Does not include orders to stop continued pollution because the debtor must necessarily participate
 - Includes clean-up where the government has a right to recover costs



Ohio v. Kovacs (Supreme Court 1985)

- Kovacs failed to perform clean-up at an industrial and hazardous waste disposal site; Ohio gave a state receiver control over his assets to clean-up the site
- Kovacs filed Ch. 11 but changed to Ch. 7
- Ohio sought a declaratory ruling that Kovacs obligation under the order was not a “claim” and so not dischargeable in bankruptcy
- Because a receiver was appointed to execute the clean-up, no action by the debtor was necessary; the order was dischargeable because it was effectively an order for payment of cleanup costs



In re Chateaugay Corp v. LTV Corp. (2d Cir. 1991)

- LTV and its subsidiaries generated hazardous industrial wastes → PRPs under CERCLA
- Voluntary Ch.11 re-organization petition
- EPA filed \$32 million proof of claim for pre-petition response costs
- U.S. and N.Y. sought declaratory rulings that:
 - Response costs occurring after bankruptcy petition are not dischargeable
 - Environmental injunctive orders are not dischargeable
- Environmental liabilities are dischargeable where the government has a right to recover costs



In re Jensen (9th Cir 1993)

Where the environmental release occurs prior to the bankruptcy case and the creditor knows about the bankruptcy case, the claim will be discharged. In *Jensen*, the Court found that the knowledge by California Water Board about the contamination and the bankruptcy case would be imputed to another California agency, the California DHS. California DHS cleaned up the debtor's contaminated property and then sought reimbursement from the debtors after their Bankruptcy case was closed. Although the California DHS is a different California agency from the California Water Board, the Court found the claim dischargeable since the California Water Board had sufficient knowledge of the contamination and the bankruptcy case, and that knowledge could be imputed to California DHS, another agency of the State of California.



What environmental liabilities are not bankruptcy claims?

- Injunctions to cease ongoing and continuing hazards
 - Does not include injunctions where payment to the government may be made in lieu of performance
 - Includes injunctions obtained solely through the state's regulatory and police powers to protect public health and safety



U.S. v. Apex Oil (7th Cir. 2009)

- RCRA order to clean-up millions of gallons of oil causing an underground plume contaminating groundwater and emitting fumes
- Question was whether order was discharged in Ch. 11 bankruptcy proceeding
- RCRA § 7003 did not have a cash alternative or authorize any monetary relief
- Order did not give rise to payment; it was not a claim under 101(5)(b) so it was not discharged



Torwico Electronics v. N.J. Dept. of Env'r. Protection (3d Cir. 1993)

- Torwico manufacturing site had a hidden illegal seepage pit with hazardous wastes
- Filed Ch. 11 listing state environmental agency as a creditor, but agency never filed proof of claims
- Post-petition, the agency ordered clean-up of ongoing pollution; Torwico argued its obligation was discharged in bankruptcy
- Order was not discharged; it involved an ongoing and existing threat and did not give rise to a right to payment



Contribution Claims

- Contribution claims under CERCLA allow PRP to seek participation in environmental liabilities from other responsible parties.
- The filing of a bankruptcy case potentially compromises contribution claims:
 - *Cooper Industries v. Aviall Services, Inc.*
 - Contingent claims.



Contribution Claims

- *Cooper Industries v. Aviall Services Inc.*, 125 S.Ct. 577 (2004).
 - PRP may not pursue contribution action against other responsible parties under Section 113(f) of CERCLA until the PRP has been sued.
 - Creditor Issue – inability to file proof of claim against debtor for contribution.
 - Debtor Issue – automatic stay prevents action against debtor triggering contribution claim.
 - *U.S. v. Atlantic Research Corp.*, 551 U.S. 128 (2007).



Contribution Claims

- Contingent claims problem:
 - Section 502(e) of the Bankruptcy Code provides, in part, that claims for contribution or reimbursement should be disallowed if they are contingent at the time of allowance/disallowance.
 - Future claims for contribution are contingent
 - *In re APCO Liquidating Trust*, 370 B.R. 635 (Bankr. D. Del. 2007).



Trustee Liability

- *Midlantic Nat'l Bank v. New Jersey Dep't of Environmental Protection*, 474 U.S. 494 (1985)
 - Chapter 7 Bankruptcy Trustee sought to abandon two parcels of contaminated property, thereby relieving the bankruptcy estate of the burden of the cleanup liability.
 - Supreme Court held that the Trustee could not abandon the properties and avoid responsibility for cleanup under state law – priority given to laws designed to preserve and protect the health and welfare of the community.



Trustee Liability

- *Midlantic Nat'l Bank v. New Jersey Dep't of Environmental Protection*, 474 U.S. 494 (1985)
 - Opening exists under Supreme Court precedent to craft orders that allow for abandonment of contaminated property while preserving the health and welfare of the Community
 - “[W]ithout reaching the question whether certain state laws imposing conditions on abandonment may be so onerous as to interfere with the bankruptcy adjudication itself, we hold that a trustee may not abandon property in contravention of a state statute or regulation that is reasonably designed to protect the public health or safety from identified hazards.” *Id.* at 507-08.



Sales Free and Clear

- Circuits split on ability of a debtor in bankruptcy to sell property free and clear of environmental liability claims
 - The following circuits have permitted a sale free and clear of successor environmental liability: Second Circuit, Third Circuit and Fourth Circuit.
 - The following courts have held that there is no basis for a sale free and clear of successor environmental liability: Sixth Circuit, Seventh Circuit and the Bankruptcy Court in the Western District of Texas.



Sales Free and Clear

- Second Circuit favorable venue for sales free and clear of environmental liabilities.
 - *In re Chrysler LLC*, 405 B.R. 84 (Bankr. S.D.N.Y. 2009)
 - *In re General Motors Corp.*, 407 B.R. 463 (Bankr. S.D.N.Y. 2009)



Thank You

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Pointers for Businesses Facing Insolvency

- Be aware that once a bankruptcy filing is initiated, environmental agencies may be spurred into action to address known violations that might otherwise be a lower priority
- Consider whether CERCLA injunctions genuinely require action by the business itself because of ongoing pollution or whether the injunction may really be a cloaked claim for payment that is dischargeable in bankruptcy
- Understand what injunctive requirements are likely to survive bankruptcy and account for them while preparing the initial bankruptcy filing
- Consider whether environmental obligations and liabilities may extend beyond the corporation and involve personal liability
- Know how government agencies approach bankruptcy:
 - “Interim Protocol for Coordination,” May 10, 2005 explains how EPA coordinates bankruptcy matters among multiple regions
 - “Guidance on EPA Participation in Bankruptcy Cases,” Sept. 30, 1997 identifies factors EPA considers in determining whether to file a proof of claim

Thank You

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Advantages of Bankruptcy for the Debtor

- Where Debtor is the owner of contaminated property the goals may be to:
 - Cram Down Plan to reduce amount of liens
 - Establish “pot” plan with a separate pool to pay for remediation particularly where the property is being sold, but watch out – the goal may be to avoid a “pot” plan under some scenarios
 - Discharge Liability



Advantages of Bankruptcy for the Debtor *(continued)*

- Where Debtor is the Former Owner of contaminated property but retains some liability for clean up the goal is to:
 - Reduce liability to a pre-petition unsecured claim that is dischargeable
 - Reject executory contract that requires contractual clean-up obligation
 - Avoid a contractual agreement as a preference
- Concerns: Injunctions may not be dischargeable



THANK YOU

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Creditor Perspective: Post-Bankruptcy

- Consider informing state and regulatory agencies about the claim
- Consider preparation of independent cost estimate for cleanup costs
- Work with debtor and state on settlement
- Consider formation of a trust account

THANK YOU

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