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What Every EHS Professional Needs to Know (Or At Least Think) About Bankruptcy

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Commencement of the Case

- Purpose of Bankruptcy
  - Provide the debtor with a “fresh start”
  - Provide for the adequate protection of creditor’s interest
- How is a Bankruptcy Case commenced?
  - chapter 11/chapter 7
    - voluntary
    - involuntary

Commencement of the Case, con't

- Players
  - Debtor
  - Judge
  - United States Trustee
  - Committee
  - Creditors
  - Equity

Key Issues

1. Automatic Stay
2. Abandonment
3. Claim: Dischargeability
4. Claim: Allowance/Disallowance
5. Priority

Automatic Stay

- Generally stays any action against the debtor or its property
  - Creditors (including environmental claimants) required to pursue claims In the bankruptcy
  - Intent is to place creditors on even footing and insure equitable distribution of debtor's assets
- Does not extend to government exercise of police powers (e.g., order to clean up property)
- *City of New York v. Exxon Corp.* 932 F.2d 1020 (2d Cir. 1991)

Abandonment

- Bankruptcy Code allows debtors to abandon property that is burdensome
- But a debtor cannot abandon property if doing so may cause imminent harm
- *Midlantic Nat'l Bank v. New Jersey Dept. of Envtl. Prot.,* 474 U.S. 494 (1986)

Claims: Dischargeable In Bankruptcy

- A “claim” is a right to payment
- “Claims” that “arise” before the date the Chapter 11 Plan is Confirmed are dischargeable
  - Includes contingent claim for cleanup costs
  - Does not include obligations under cleanup orders

Claims: Dischargeable In Bankruptcy, con't

- *Ohio v. Kovacs*, 469 U.S. 274 (1985)
  - A right to an equitable remedy becomes a "claim" only when money damages are an alternative to (or substitute for) the equitable remedy itself, notwithstanding other money damages that may flow directly from the breach.
  - A dischargeable claim exists only if the right to payment is an "alternative" to the right to an equitable remedy ... [such that] the two remedies would be substitutes for one another.

Claims: Dischargeable In Bankruptcy, con't

- *United States v. Apex Oil Co.*, 579 F.3d 734 (7th Cir 2009)
  - An injunction requiring remediation under the Resource Conservation and Recovery Act (RCRA), 42 U.S.C. § 6973, did not give rise to a right of payment, was not a claim under the Bankruptcy Code, and was therefore not dischargeable.

Claims: Dischargeable In Bankruptcy, con't

- *In re Chateaugay Corp.*, 944 F.2d 997 (2d Cir. 1991)
  - Injunctions intended to remedy past contamination, which can be treated as a monetary obligation and discharged. Those that are intended to prevent future contamination, cannot be discharged.

Claims: Dischargeable In Bankruptcy, con't

- *In re CMC Heartland Partners*, 966 F.2d 1147 (7th Cir. 1992)
  - CERCLA Section 107 generally requires remediation of past contamination, which would be dischargeable; however, it also creates an "obligation that runs with the land." Any owner of contaminated property would have an obligation to remediate; thus, the debtor's obligation was deemed a post-bankruptcy obligation arising from the ownership of the land, and not from the disposal of waste by its predecessor in interest.
  - When does an environmental claim "arise?
    - When the release occurs?
      - *Chateaugay I*, 944 F.2d 997 (2d Cir. 1991))
    - When claim is foreseeable?
      - Future claim not fairly contemplated *(In re Nat'l Gypsum,* 139 B.R. 397 (N.D. Tx. 1992))

Claim Allowance/Disallowance Process (11 U.S.C. § 502)

- Costs Incurred Prepetition (Past Costs) are generally allowed
  - *In re G-I Holdings, Inc.*, 308 B.R. 196 (Bankr. D.N.J. 2004
- Contingent Claims (Future Costs)—It Depends
  - Allowance depends on nature of claim
  - Claims of co-liable parties for reimbursement of future costs or contribution often disallowed under Section 502(e)
  - *In re Lyondell Chem. Co.*, 442 B.R. 236 (Bankr. S.D.N.Y. 2011)

Priority (11 U.S.C. § 507; 11 U.S.C. § 503)

- General Unsecured Claims
  - Includes monetary claims for prepetition cleanup costs (past costs)
  - Entitled to distribution on pro rata basis with other general unsecured creditors after satisfaction of all secured and priority claims.

Priority (11 U.S.C. § 507; 11 U.S.C. § 503), Cont'd

- Administrative Expense Claims
  - Generally includes monetary claims for environmental costs incurred post-petition: (1) to address contamination that poses imminent danger to public health or the environment or (2) brings debtor's operations into compliance with applicable environmental laws.
  - Typically only applies to cleanup costs at site owned by the debtor

The Scenario

- Your Company purchases potentially contaminated property from Private Party.
- Private party agrees to provide Your Company with an indemnity against remediation costs.
- Several years later, but before indemnity expires, you find contamination and assert an indemnity claim.
- In the midst of negotiations, Private Party files a bankruptcy petition.
- What happens?

Environmental Considerations When Acquiring Assets from Solvent Seller

- If seller files for bankruptcy:
  - Negotiations seeking payment under indemnity agreement must cease under automatic stay provision of the Bankruptcy Code. *See* 11 U.S.C. § 362(a).
  - Obligations to buyer to provide indemnity and perform remediation are likely to be bankruptcy claims, not ongoing obligations. *See Route 21 Associates of Belleville, Inc. v. MHC, Inc.,* 486 B.R. 75 (S.D.N.Y. 2012) (debtor not required to fulfill contractual obligation to private party to complete remediation).
  - Seller may be required to continue any free-standing obligation to government to perform remediation.

SCENARIO #1: YOU PURCHASE POTENTIALLY CONTAMINATED PROPERTY AND SELLER FILES FOR BANKRUPTCY, con't

- Government may look to buyer for additional protection
- If sale was made when seller was insolvent, consider risk that transaction may constitute a fraudulent transfer. *Tronox Inc. v. Anadarko Petroleum Corp. (In re Tronox Inc.)*, 503 B.R. 239 (Bankr. S.D.N.Y. 2013) (fraudulent transfer where environmental and tort liability transferred without sufficient resources).
- Executory contract concepts may not be relevant

Solvency/Bankruptcy Tips to Consider When Purchasing Property

SCENARIO #2: YOU REMEDIATE AND FILE CERCLA CLAIM AGAINST SELLER

The Scenario

- Same as Scenario #1, except:
  - Your Company remediates the purchased property and files a CERCLA cost recovery claim against Private Party
  - Private Party then files a bankruptcy petition.
- What happens?

SCENARIO #2: YOU REMEDIATE AND FILE CERCLA CLAIM AGAINST SELLER, con't

Pursuing a Cost Recovery Claim Against a Private Party in Bankruptcy

- CERCLA provides for a private right of action to recover for environmental costs.
  - *United States v. Atl. Research Corp*., 551 U.S. 128, 140-41(2007)
- General Unsecured Claim
  - Cost recovery claim would constitute a general unsecured claim.
  - Creditor would need to file a proof of claim by the bar date and prove damages.
- Automatic Stay Applies
  - Filing of bankruptcy petition stays the continuation of any judicial proceeding and prohibits any act to "collect, assess, or recover a claim against the debtor." 11 U.S.C. § 362(a)(1) and (6).

The Scenario

- Your Company has a Subsidiary Company that operates a contaminated site that is impacting neighbors.
- Neighbors sue Your Company for diminution in value, nuisance, and personal injury.
- Subsidiary Company files for bankruptcy protection.
- What happens?

Subsidiary Liability in Bankruptcy

- General Rule: Corporate parents are not liable for debts of subsidiaries.
  - *United States v. Bestfoods*, 524 U.S. 51, 61 (1998) ("deeply ingrained in our economic and legal systems that a parent corporation . . . is not liable for acts of its subsidiaries").
- Exceptions: Piercing the corporate veil or alter ego
  - If Parent and Subsidiaries are actually operated as one company (corporate formalities are not observed), then courts will treat parent/subsidiary as one entity for liability purposes.
  - Parent can also be directly liable under CERCLA if it manages, directs, or conducts activities relating to disposal or release of hazardous substances.
  - *See United States v. Best Foods,* 524 U.S. 51, 63 (1998); *see also United States v. ConAgra Grocery Prods. Co., LLC*, 4 F. Supp. 3d 243, 255 (D. Me. 2014).

SCENARIO #3: PARENT COMPANY'S POTENTIAL LIABILITY FOR CONTAMINATED SITE OWNED BY SUBSIDIARY, con't

- Automatic Stay Likely Would Not Apply
  - Claims against Parent would not be stayed by Subsidiary's filing of bankruptcy petition.
- Discharge:
  - Whether a Parent could obtain a release arising from its Subsidiary's environmental damage is dependent on the Circuit where the chapter 11 case is filed.
    - the Ninth and Tenth Circuit Courts of Appeals have long held that they are not permissible under the Bankruptcy Code.
    - The Second Circuit's test in Metromedia is rigorous, but not impossible, and requires the bankruptcy court to find that "truly unusual circumstances render the release terms important to the success of the plan."
    - The Fifth Circuit has rejected an attempt to protect certain third parties under a plan from claims relating to the implementation and administration of the plan.

SCENARIO #4: GOVERNMENTAL AGENCY ORDERS SUBSIDIARY TO CEASE VIOLATIONS OF ENVIRONMENTAL LAWS AND REMEDIATE

The Scenario

- Same as #4, except:
  - Prior to filing of bankruptcy petition, governmental agency serves Subsidiary with order to (a) cease any violations of environmental laws and (b) remediate property.
- What is the impact of the bankruptcy filing on the agency's order?

Governmental Agency's Order in Bankruptcy

- Governmental Unit Exception to Automatic Stay Provision:
  - Government is not restrained by automatic stay if enforcement is made pursuant to regulatory authority.
    - *See* 11 U.S.C. § 362(b)(4)
    - *U.S. v. Nicolet Inc*., 857 F. 2d 202 (1990) (holding that CERCLA cleanup costs fall within regulatory power exception to bankruptcy stay).

SCENARIO #4: GOVERNMENTAL AGENCY ORDERS SUBSIDIARY TO CEASE VIOLATIONS OF ENVIRONMENTAL LAWS AND REMEDIATE, con't

- Injunctive Orders Likely Survive Bankruptcy:
  - Injunction orders do not constitute a "claim" in bankruptcy and not dischargeable.
  - This means order continues even after bankruptcy case
    - *AM Int'l v. Datacard Corp*. 106 F.3d 1342, 1348-49 (7th Cir. 1997) (RCRA cleanup order nondischargeable)
    - *In re Chateaugay*, 944 F.2d 997 (2nd Cir. 1991)
  - Injunctive order that is "monetized by the conclusion of the bankruptcy case is a claim, and hence may be discharged."
    - *CMC Heartland Partners, 966 F.2d 1143, 1148 (7th Cir. 1992)*

SCENARIO #5: POTENTIAL MERGER WITH COMPANY THAT HAS POTENTIAL ENVIRONMENTAL LIABILITIES

The Scenario

- Your Company, a conglomerate, is looking to merge with Potential Partner
- Potential Partner is burdened by "dirty" businesses and related environmental liabilities
- Investment Banker propose packaging Your Company's dirty businesses with Potential Partner's dirty businesses and spinning it off to investors.
- What are the potential risks?

Potential Bankruptcy Risks Involved with Spinning Off Entities with Environmental Liabilities

- *Tronox Inc. v. Anadarko Petroleum Corp. (In re Tronox Inc.), 503 B.R. 239 (Bankr. S.D.N.Y. 2013)*

Kerr-McGee Corporation
(1929)

- 800 Oil and Gas Outlets
- Uranium mining and milling
- Wood-Treatment
- Ammonium Perchlorate Production
- Radioactive thorium Production
- Titanium Dioxide Production

SCENARIO #5: POTENTIAL MERGER WITH COMPANY THAT HAS POTENTIAL ENVIRONMENTAL LIABILITIES, con't

2002-2005

Kerr-McGee Corporation
• Oil and Gas Exploration
  ○ Operating Profits $1.8 Billion
• Titanium Dioxide Production
  ○ Operating Profits $106 Million
• Enormous Environmental and Tort Liabilities
  ○ Annual Remediation Costs $106 Million
  ○ 40 Employees dedicated to Safety/Environment
  ○ 2000-2005 Creosote Tort Liability Costs: $98 Million
  ○ 2000-2005 Environmental Response Costs: $1 Billion
  ○ 9,450 Pending Tort Claims
  ○ 2,700 Environmental sites in 47 states
  ○ 7 Federal Superfund Sites

Project Focus/Project Titan • *"There were sound business reasons for the corporate reorganization…The E&P and chemical businesses would do better as independent players in their respective markets than as a complex whole."* • Sale of Chemical Business: $1.2 billion without Legacy Environmental Liabilities; $300 million with them. • Series of complex transactions spanning about 3 years, costing Kerr-McGee $22 million in transaction costs

SCENARIO #5: POTENTIAL MERGER WITH COMPANY THAT HAS POTENTIAL ENVIRONMENTAL LIABILITIES, con't

<table>
<tr>
<td>New Kerr-McGee
(Andarko Petroleum Corp.)
Oil and Gas Exploration and Production

<u>Assets</u>
Free of Legacy Liabilities
Thriving Oil and Gas Exploration and Production Business.</td>
<td>Old Kerr-McGee
(Tronox Inc.)
Titanium Dioxide Production

<u>Assets</u>
$40 million in cash
Limited Indemnity from New-Kerr-McGee (capped at 7 years and $100 million)
<u>Liabilities</u>
Legacy Environmental Liabilities
(plus millions in pension and employee liabilities)

Filed for Chapter 11 2009
Lawsuit Against New Kerr-McGee 2009
• The Separation of Old and New Kerr-McGee was a Fraudulent Conveyance—
• Intentionally fraudulent, with intent to “delay, defraud, and hinder” creditors efforts to pursue and receive payment on claims”; and
• Constructively fraudulent, where Old Kerr-McGee received less than reasonably equivalent value in exchange for the transfer of the Oil and Gas Assets to New Kee-McGee; was insolvent or became insolvent as a result of the conveyance; was undercapitalized as a result of the conveyance; and was unable to pay its debts as they became due as a result of the conveyance</td>
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SCENARIO #5: POTENTIAL MERGER WITH COMPANY THAT HAS POTENTIAL ENVIRONMENTAL LIABILITIES, con't

May 2014: Settled with payment of defendants to Litigation Trusts in amount of $5.15 billion.
Takeaway: *Tronox* also makes clear the difficulty inherent in attempting to 'cleanse' assets from underlying liabilities through corporate transactions. This is especially true when there are significant involuntary creditors such as present and anticipated tort creditors, whose interests cannot be ignored without substantial risk.