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Recording Date - May 8, 2018
Recording Availability – October 19, 2018

Meeting Location	Date	Time	Topic
King County Bar Association 1200 Fifth Avenue - Suite 700 Seattle, WA	**Tuesday, May 8, 2018**	12:00 PM to 1:15 PM	Environmental Claims in Insolvency Proceedings

AGENDA

12:00 PM Introduction

12:10 PM Presentation: 'Environmental Claims in Insolvency Proceedings', by Michael J. Gearin, K&L Gates and Brian T. Peterson, K&L Gates

- The policy conflict between bankruptcy and environmental laws
- Can environmental cleanup obligation claims be discharged in bankruptcy?
- What are environmental claims and when do they arise?
- Can property be sold free and clear of environmental claims?
- Can a lender foreclose on property that is burdened by environmental cleanup obligations?

1:15 PM Adjourn

SPEAKER BIOGRAPHY

Michael J. Gearin, K&L Gates – Michael Gearin concentrates his practice in insolvency, workouts and commercial reorganizations. His practice is broad based, encompassing transactional, litigation and other advice in the insolvency and creditors rights arenas. He represents debtors, creditors' committees, secured creditors, purchasers, and trustees in Chapter 11 cases. He has significant experience in the representation of pension interests in municipal bankruptcy cases. He represents secured creditors, purchasers and receivers in state law receivership proceedings, and has experience in real estate workouts and bankruptcies. He has substantial experience in the resolution of Ponzi schemes through the Chapter 11 plan confirmation process. He has represented debtors and purchasers in complex asset sales transactions in Chapter 11 bankruptcy cases.

Mr. Gearin is a past chair of the Seattle-King County Bar Association Bankruptcy Section, is a panel mediator under the United States Bankruptcy Court for the Western District of Washington's mediation program, and has been a frequent speaker at professional seminars on municipal bankruptcy, Chapter 11 plan confirmation, Ponzi cases in bankruptcy and other bankruptcy issues.

Brian T. Peterson, K&L Gates – Brian Peterson is an associate in the firm's Seattle office. He focuses his practice on bankruptcy and insolvency matters. He has experience representing borrowers, committees, chapter 7 and 11 trustees, creditors, and asset purchasers in in connection with both transactional and litigation matters in a variety of contexts, including federal bankruptcy proceedings, state court receiverships, foreclosures, and out-of-court workouts. He has significant experience representing bankruptcy trustees in Ponzi scheme cases, including fraudulent transfer litigation. He also has experience litigating various commercial disputes in both state and federal courts, and advises clients with respect to the structuring of transactions involving distressed situations.

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K&L GATES

Environmental Claims in Bankruptcy Proceedings

King County Bar Association
Bankruptcy Law Section Meeting, May 2018

Presenters: Michael J. Gearin, Brian T. Peterson

COMPETING INTERESTS OF BANKRUPTCY CODE AND ENVIRONMENTAL LAWS

- Bankruptcy Code purpose of providing debtor with a “fresh start”
- Purpose of environmental laws is to require that responsible parties comply with environmental standards for protection of human health and the environment

MAJOR ENVIRONMENTAL STATUTES FORMING BASIS OF ENVIRONMENTAL CLAIMS IN BANKRUPTCY

- Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA") 42 U.S.C. §§ 9601-9675
  - Aimed at cleanup of hazardous waste sites. Grants EPA authority to respond to releases or threatened releases of hazardous substances, including by seeking injunctive relief. Also creates liability for potentially responsible parties ("PRPs").
  - Section 107(a) imposes joint and several liability, and strict liability, for releases of hazardous substances on certain classes of PRPs.
  - Private parties may pursue cost recovery actions under Section 107 or contribution actions under Section 113(f).
- Resource Conservation and Recovery Act of 1976 ("RCRA")
  - Aimed at reducing generation of waste; regulates disposal, treatment, and storage of waste.
- State statutes, such as Washington's Model Toxic Controls Act ("MTCA")
  - RCW 7.105D.040(2) authorizes Department of Ecology to seek payment "for all remedial action costs and for all natural resource damages resulting from the releases or threatened releases of hazardous substances."
  - RCW 70.105D.080 allows a person to bring "a private right of action, including a claim for contribution or for declaratory relief, against any other person liable under RCW 70.105D.040 for the recovery of remedial costs."
  - According to Department of Ecology's website, there are more than 12,500 known or suspected contaminated sites in Washington.

CAN ENVIRONMENTAL OBLIGATIONS BE DISCHARGED IN BANKRUPTCY?

- Generally, pre-petition (in chapter 7) and pre-confirmation (in chapter 11) claims can be discharged in bankruptcy.
- Relevant Questions:
  - Is the environmental obligation in question a "claim"?
  - If so, when did it arise?

BANKRUPTCY DEFINITION OF "CLAIM"

- Bankruptcy Code Section 101(5) provides that a claim means " (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured."

WHEN IS AN ENVIRONMENTAL OBLIGATION A "CLAIM"?

- The issue is often whether the government's right to injunctive relief constitutes a "claim."

- Supreme Court's Decision in *Ohio v. Kovacs*, 469 U.S. 274 (1985)

CASES AFTER *OHIO V. KOVACS*

- *United States v. Apex Oil Co., Inc*., 579 F.3d 734 (7th Cir. 2009)
- *In re Chateaugay*, 944 F.2d 997 (2d Cir. 1991)
- *In re Torwico Electronics, Inc*., 8 F.3d 146 (3d Cir. 1993)
- *In re Mark IV Industries, Inc.*, 438 B.R. 460 (Bankr. S.D.N.Y. 2010)

MARK IV INDUSTRIES' FACTORS FOR DETERMINING WHETHER A CLEANUP OBLIGATION IS DISCHARGEABLE

- Is the debtor capable of executing the equitable decree or can it only comply by paying someone else to do it?
- Is the pollution ongoing?
- If not, does the environmental agency have the option under the applicable statute giving rise to the equitable obligation to remove the waste and seek reimbursement from the debtor?

WHEN DOES AN ENVIRONMENTAL CLAIM ARISE?

- "Fair Contemplation Test"
- *In re Jensen*, 995 F.2d 925 (9th Cir. 1993)
  - Claim of California Department of Health Services was discharged because the state had "sufficient knowledge of the Jensens' potential liability to give rise to a contingent claim for cleanup costs before the Jensens filed their bankruptcy petition."
  - *In re Nat'l Gypsum Co.,* 139 B.R. 397 (N.D. Tex. 1992).

OTHER TESTS FOR DETERMINING WHEN A CLAIM ARISES IN BANKRUPTCY

- The "conduct test"
  - Claim arises when conduct giving rise to the claim occurs as opposed to when the harm occurs. *See, e.g., Grady v. A.H. Robins Co.*, 839 F.2d 198 (4th Cir. 1988); *In re Parker*, 264 B.R. 685, 697 (BAP 10th Cir. 2001).
  - Test has been rejected in environmental cases.

OTHER TESTS FOR DETERMINING WHEN A CLAIM ARISES IN BANKRUPTCY

- "Relationship Test"
  - Bankruptcy claim arises where there is prepetition conduct giving rise to the claim *and* where there is also some pre-petition relationship between the debtor and the claimant. *See In re Chateaugay*, 944 F.2d 997 (2d Cir. 1991).
- "Accrual Test"
  - Claim arises when state law cause of action accrues. *See In re Frenville Co*., 744 F.2d 332 (3d Cir. 1984).
  - Widely criticized. Rejected in *In re Grossman's Inc*., 607 F.3d 114 (3d Cir. 2010).

CAN PROPERTY BE SOLD FREE AND CLEAR OF ENVIRONMENTAL LIABILITIES?

- Section 363(f) of the Bankruptcy Code provides:

"The Trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if -- (1) applicable nonbankruptcy law permits sale of such property free and clear of such interest; (2) such entity consents; (3) such interest is a lien and the price at which the property is to be sold is greater than the aggregate value of all liens on such property; (4) such interest is in bona fide dispute; or (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest."

CAN PROPERTY BE SOLD FREE AND CLEAR OF ENVIRONMENTAL LIABILITIES?

- Federal Courts are split on whether a sale free and clear of interests in a property shields an asset purchaser from environmental liabilities.
- Some courts have held that environmental claims are not “interests” within meaning of section 363(f), or have determined that Bankruptcy Courts do not have the authority to override federal environmental laws.
- Other courts enjoin creditors from pursuing claims based on successor liability.

CAN PROPERTY BE SOLD FREE AND CLEAR OF ENVIRONMENTAL LIABILITIES?

- There is an ongoing debate over whether sales can be free and clear of successor liability claims in general—is successor liability an interest?
- Does interests mean *in rem* interests like liens and encumbrances?
- Majority of courts broadly interpret "interests" to "include other obligations that may flow from ownership of the Property." *In re Grumman Olson Indus.*, 467 B.R. 694, 702 (S.D.N.Y. 2012).

CAN PROPERTY BE SOLD FREE AND CLEAR OF ENVIRONMENTAL LIABILITIES?

- To the extent that environmental liabilities are “claims,” sale free and clear is more likely.
- Sales free and clear of future cleanup obligations and injunctive relief not as likely.
- Example of General Motors case, *In re GMC,* 407 B.R. 463 (Bankr. S.D.N.Y. 2009).
  - Sale free and clear of environmental claims and successor liability, but sale order preserved purchaser’s obligation to comply with environmental law post-closing.

LENDER LIABILITY EXCEPTION

- Exemption from owner or operator liability under CERCLA and MTCA for secured creditor that takes title primarily to protect its security and does not participate in management of property. *See* 42 U.S.C. § 9601(20)(F)(i); RCW 70.105D.020(22)(b)(ii).
- What does it mean to participate in management?
  - Exercise of decision making control over environmental compliance; or exercise of control at a level comparable to that of a manager of the facility
- Foreclosing lender does not lose exemption provided that it "seeks to sell . . . The facility at the earliest practicable, commercially reasonable time on commercially reasonable terms, taking into account market conditions and legal and regulatory requirements." 42 U.S.C. § 9601(20)(E)(ii).

LENDER LIABILITY EXCEPTION

- MTCA secured creditor exemption, RCW 70.105D.020(22)(b)(ii), exempts “any person who, without participating in the management of a facility, holds indicia of ownership primarily to protect the person’s security interest in the facility.”
- A secured creditor that forecloses on property does not lose the MTCA secured creditor exemption if it satisfies six post-foreclosure requirements, including maintenance of environmental compliance measures, compliance with orders and regulatory requirements, provision of access to persons performing remedial actions and not exacerbating an existing release.

LENDER LIABILITY EXCEPTION

- CERCLA/MTCA secured creditor exemption is narrowly construed and the lender has the burden of proof on the applicability of the exemption. *Foster v. Dept. of Ecology* 184 Wn.2d 465, 473 (2015).
- A foreclosing lender must sell the property at the earliest practicable commercially reasonable time in order to preserve its exemption to CERCLA or MTCA liability as an owner or operator.
- Where a lender forecloses on property and subsequently leases it, the lender risks owner or operator liability.

ABANDONMENT OF CONTAMINATED PROPERTY MAY BE RESTRICTED

- *Midlantic Nat'l Bank v. New Jersey Department of Environmental Protection*, 474 U.S. 494 (1986).
- Abandonment power more likely to be upheld when there is no immediate threat to public health or safety.

ADMINISTRATIVE PRIORITY FOR ENVIRONMENTAL CLAIMS

- Courts have afforded cleanup costs administrative expense priority where necessary to preserve the estate.
  - 28 U.S.C. § 959(b)
  - Cleanup costs may be necessary to preserve estate where abandonment not an option.

SECTION 502(C) CLAIMS ESTIMATION

- 11 U.S.C. § 502(c) provides that "contingent or unliquidated claims[s]" must be "estimated for the purpose of allowance" where the fixing or liquidation of such claims would "unduly delay the administration of the case."
- "In general, a bankruptcy court has discretion to determine the appropriate method of estimation in light of the particular circumstances of the bankruptcy case before it." *In re G-I Holdings, Inc.,* 323 B.R. 583, 599 (Bankr. D. N.J. 2005).

DISALLOWANCE OF CONTINGENT CLAIMS FOR CONTRIBUTION

- 11 U.S.C. § 502(e)(1)(B) provides for the disallowance of a claim for "reimbursement or contribution of an entity that is liable with the debtor on . . . the claim of a creditor, to the extent that– . . . (B) such claim for reimbursement or contribution is contingent as of the time of allowance or disallowance of such claim for reimbursement or contribution . . . .
- Purpose is to prevent a double recovery on the same claim, furthering equitable distribution among creditors; and enabling bankruptcy case to proceed with distribution to unsecured creditors without awaiting resolution of contingency.

DISALLOWANCE OF CONTINGENT CLAIMS FOR CONTRIBUTION

- Party seeking to disallow claim under 502(e)(1)(B) as a contingent claim for reimbursement must establish that
  - (1) the claim is for reimbursement or contribution;
  - (2) the party asserting the claim is liable with the debtor on the claim; and
  - (3) the claim is "contingent at the time of its allowance or disallowance."

DISALLOWANCE OF CONTINGENT CLAIMS FOR CONTRIBUTION

- PRP claims against debtors for recovery of future environmental response costs
  - Such claims, if in the nature of contribution or reimbursement claims, may be subject to disallowance where liability has not been established, costs have not been incurred, and liability is premised on co-liability to government.
  - Where liability is associated with site where state and federal agencies are not involved and have not asserted liability, claims may not be subject to disallowance on basis that co-liability element has not been met.
  - *In re Dant & Russell, Inc*., 951 F.2d 246 (9th Cir. 1991) (creditor's claim for future cleanup costs not disallowed by 502(e)(1)(B) because cleanup costs were for cleanup not ordered by EPA).

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