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Toxins-Are-Us

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The Gross and the Fair of Toxic Tort Claims in Bankruptcy

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Environmental-contamination claims present tricky issues for debtors seeking a fresh start through bankruptcy, as well as for creditors and purchasers of distressed assets. Difficult issues emerge in the context of when exactly an environmental tort claim against a debtor "arises." Further challenges surround identifying claimants and potential claimants, then providing them with constitutionally sufficient notice of the bankruptcy proceedings.

For starters, does a claim arise when the initial action or exposure creating the claim occurs, or does the claim arise when the injured party becomes aware of the damage caused by the contamination? Does it arise when a claimant can "fairly contemplate" such damage? How does one provide adequate notice to all interested parties in cases involving environmental contamination issues sufficient to satisfy the constitutional requirements of due process? What efforts must be undertaken to ascertain potential claimants, and how should notice be provided to unknown, but likely ascertainable, potential claimants?

All these issues were addressed in an adversary proceeding filed by the plaintiff, West Salem Storage (a downstream purchaser of a chapter 11 debtor's lead-contaminated property), in the *Exide Technologies*[1] case, when Hon. **Kevin J. Carey** found that although West Salem did not sustain damages related to the property until 2017, such damages were nonetheless discharged by a 2015 confirmation order. As is common to many toxic-contamination situations, the root cause of the damages at issue in *Exide* can be traced back to industrial manufacturing activities that occurred decades prior to the debtor's bankruptcy and decades prior to the time when the purchaser acquired the property and sustained its damages.

Exide's Background

The story begins in 1983, when GNB Batteries Inc. acquired property in Salem, Ore. (the "property"). GNB manufactured batteries — specifically, automotive and industrial batteries.

In the early 1990s, the Department of Environmental Quality (DEQ) determined that lead contamination existed in soils at the property due to the spillage of lead that occurred during GNB's operations. In 1999, the DEQ determined that no further remediation was necessary at the property. However, it conditioned its determination on several requirements, including that the property would be subject to an easement and equitable servitude (the "easement") limiting the site to industrial use only.[2]

In 2001, GNB merged into Exide Corp., which was reported at that time to be the world's largest manufacturer of automotive batteries. In the spring of 2002, Exide filed its first chapter 11 case.

As part of Exide's 2002 bankruptcy case, it sold the property to Faries Salem Properties. The 2002 sale order specifically stated that the sale of the property did not release Exide from any liabilities to governmental entities exercising police and regulatory statutes and regulations. It is clear that the limiting provisions of the 2002 sale order were aimed at addressing the lead contamination found on the property by the DEQ.

Fast forward to 2013 when Exide is back in bankruptcy court, once again seeking relief under chapter 11 ("Exide II"). In the meantime, the property had changed hands three times and was now owned by West Salem, the soon-to-be unhappy plaintiff.

In its second bankruptcy, Exide filed what is referred to as a "Global Notes, Methodology and Specific Disclosures regarding its Schedules of

1 *In re Exide Technologies, West Salem Storage LLC v. Exide Technologies*, 2019 WL 1429381 (Bankr. D. Del. March 28, 2019).

2 *Id.*

Assets and Statement of Financial Affairs," therein identifying all properties owned by Exide that are subject to government notices of violations of environmental laws. The property was listed (although some might suggest buried) in Exide's filing in the last 25 pages of an almost 400-page document.

The schedules in Exide II listed Faries Salem (the purchaser of the property in the 2002 *Exide* case) as the owner of the property and a potential unsecured creditor. However, by 2013, West Salem owned the property. Nonetheless, West Salem was not listed in the schedules and was not provided actual notice of the case or claims bar date.

In March 2015, Exide once again obtained confirmation of a chapter 11 plan, and the confirmation order included discharge, claimholder release and injunction provisions. During the entire time *Exide II* was pending, West Salem was not aware of the substantial monetary damages it would soon incur stemming from the lead contamination at the property — contamination created by manufacturing activities dating back to 1983.

Plaintiff Purchases Property, Discovers Contamination, Incurs Damages and Sues Exide Post-Confirmation

Recall that West Salem purchased the property in 2011, two years prior to the filing of *Exide II*. Shortly before West Salem acquired the property, the DEQ relaxed its limitations on the use of the property and confirmed to West Salem that commercial and recreational uses were acceptable, so long as there was no contact with the contaminated soil. West Salem apparently took that as a green light that the property was free of environmental issues and purchased the property, then leased it to various tenants who in turn used the property for commercial and recreational means.

In 2017, West Salem decided it wanted to have the easement removed entirely. In order to do so, the DEQ required an investigation of the prior contamination and further testing. During this investigation, high levels of lead were discovered on the property, and authorities required that the building be closed until cleaning and further assessment could be completed. The resulting clean-up, investigation and remediation cost West Salem almost $1.5 million, including reimbursements to displaced tenants. Relying on the Comprehensive Environmental Response Compensation and Liability Act (CERCLA) and related state environmental laws, West Salem commenced its adversary proceeding in *Exide II*, seeking a declaratory judgment that the confirmed plans in both *Exide* cases did not discharge West Salem's claims.

Exide filed a motion to dismiss West Salem's complaint, arguing that its claims arose before Exide filed its 2013 bankruptcy petition and were therefore subject to the discharge, release and injunction provisions of the confirmation order entered in the 2013 bankruptcy. West Salem countered that its claims were not discharged because they arose after confirmation of the plan in Exide's 2013 bankruptcy, and because it did not receive constitutionally sufficient notice of the bankruptcy case or bar date for filing claims.

West Salem Discovers What's Gross Is Also Fair

In addressing the issue of when West Salem's claim arose, Judge Carey relied on the Third Circuit's *Grossman*[3] "exposure test" as expanded in *Wright v. Owens Corning*.[4] Under *Grossman*'s exposure test, "a claim arises when an individual is exposed pre-confirmation to a product or other conduct giving rise to an injury that underlies a 'right to payment' under the [Bankruptcy] Code."[5] The Third Circuit confirmed that *Grossman*'s "exposure test" is actually a combination of the "conduct test" and "pre-petition relationship test" — two other tests generally followed by other courts of appeals.

Under the conduct test, a claim arises "when the acts giving rise to the liability were performed, not when the harm caused by those acts was manifested."[6] The pre-petition relationship test requires not only that the acts giving rise to the claim occur pre-petition, but also that there must be some "pre-petition relationship between the debtor and the claimant, such as a purchase, use, operation of or exposure to the debtor's product."[7]

In a nutshell, the "exposure test" requires individuals to recognize that by virtue of exposure to a debtor's product or conduct, they might have claims against the debtor, even where there are no evident damages.

West Salem argued that *Grossman*'s exposure test should not be applied to its claims because (1) the plaintiffs in *Grossman* were pursuing product-liability claims, and (2) the *Grossman* court specifically noted that it was not deciding whether the "exposure test" should apply to environmental clean-up claims. West Salem asserted that rather than the "exposure test," the "fair contemplation" test found in the Ninth Circuit was the appropriate test to be applied to its environmental clean-up claims. The fair-contemplation test provides that "all future response and natural resource damages cost[s] based on pre-petition conduct that can be fairly contemplated by the parties at the time of the Debtors' bankruptcy are claims under the [Bankruptcy] Code."[8]

West Salem argued that pre-petition, it was not exposed to Exide's product (the batteries) or its conduct (manufacturing the batteries). The company also argued that at the time it purchased the property, the DEQ confirmed that occupational uses were acceptable as long as there was no contact with the contaminated soil, and that therefore at the time of confirmation of the 2015 plan in *Exide II*, it could not have reasonably predicted or "fairly contemplated" that it would incur more than $1 million investigating and remediating lead contamination at the property. Judge Carey disagreed.

The court noted that when West Salem acquired the property in 2011, it was informed of the easement that restricted the property's use due to environmental contamination caused by Exide's products and conduct. The easement stated on its face that it was designed to give notice to any future property owners of the site's condition and his-

3 *See In re Grossman's Inc.*, 607 F.3d 114 (3d Cir. 2010).
4 *Wright v. Corning*, 679 F.3d 101 (3d Cir. 2011).
5 *In re Exide Technologies* at *4.
6 *Id.*
7 *Id.*
8 *Id.* at *5.

tory of contamination. Judge Carey found that even though West Salem was not aware of any injury until 2017, by virtue of the easement, it was undoubtedly on notice that the property had been exposed to Exide's product (lead), or Exide's conduct (environmental contamination), well before the 2015 plan confirmation, and thus, under either the *Grossman*'s "exposure test" or the fair-contemplation test, West Salem's claims arose pre-petition and would be subject to the discharge provisions of the 2015 confirmation order in *Exide II*.

Longing to Be Noticed

Not quite ready to hang up its gloves, West Salem next argued that *Exide II* did not discharge its environmental claims because it did not receive adequate notice of the bankruptcy. Indeed, it was undisputed that West Salem did not receive actual notice of the filing of *Exide II* or the claims bar date. After all, notice and an opportunity to be heard are fundamental underpinnings of the bankruptcy process.

Due process requires that notice be accomplished in a manner reasonably calculated to reach all interested parties, and that it reasonably conveys all required information and that it provides a reasonable time to respond.[9] The extent of notice required, however, turns on whether a creditor is a "known" or "unknown" claimant.

How do the notice rules differ for known vs. unknown creditors or potential creditors? Let's start with a known creditor. A known creditor is "one whose identity is either known or 'reasonably ascertainable by the debtor.'" Known creditors are entitled to actual notice of the claims bar date.[10]

An unknown creditor is one whose "interests are either conjectural or future or, although they could be discovered upon investigation, do not come to the debtor's attention in due course of business."[11] Constructive notice by publication is sufficient to provide unknown creditors with notice that satisfies the due-process requirements.

At first glance, it would seem that West Salem would qualify as a "reasonably ascertainable" and therefore known creditor. West Salem was the record owner of the property at the time of the *Exide II* bankruptcy, and, as argued by West Salem, it is undeniable that a simple title search would have revealed West Salem's identity. If that is not "reasonably ascertainable," then what is? West Salem also argued that in the alternative to a title search, the debtor could have sent notice directly to the property, addressed to the "current occupant."

Unfortunately for West Salem, the court found that the fact that West Salem could have been discovered through a title search did not render its identity reasonably ascertainable. Under Third Circuit law, the "reasonably ascertainable" standard provides that a debtor is not required to conduct impracticable and extended searches, and does not have a duty to search out each conceivable or possible creditor. Instead, the requisite search focuses on the debtor's own books and records.[12] In this case, Exide's books and records showed Faries Salem, the 2002 buyer, as the owner of the property.

9 *Id.* at *7.
10 *Id.*
11 *Id.*
12 *Id.* at *8.

While a title search would have revealed West Salem's identity, in this case the debtor would have been required to conduct more than 200 similar searches, which the court deemed to be the type of impractical exercise not intended under the relevant bankruptcy case law.[13] Moreover, because Exide's publication notice was provided in more than 130 state, local, regional and national publications in the U.S. and Canada, including one in the region in which the property was located, the court found this notice to be sufficient to put West Salem on notice of the bankruptcy case.

The court also summarily rejected West Salem's argument regarding the "current occupant" notice by finding that "reasonable diligence" does not require a debtor to provide "back-up notices" to entities other than those listed in a debtor's books and records. Accordingly, the court granted Exide's motion and dismissed West Salem's complaint.

Lessons Learned

While Judge Carey noted that the extraordinary number of title searches that Exide would have been required to conduct was outside that contemplated by the Bankruptcy Code, he also noted that situations may arise where creditors are "reasonably ascertainable," although not identifiable, through the debtor's books and records. This suggests that there might be situations where a title search would be necessary. For example, what if the debtor owned three properties or five properties? What if the debtor kept horrific books and records, or the books and records were somehow destroyed? Thus, *Exide II* provides some important takeaways to debtors, purchasers and lenders alike. For example, while debtors cannot use the "books and records limitation" as an excuse for incomplete books, debtors can for the most part be confident — at least in the Third Circuit — that a diligent search of their books and records should satisfy the "reasonably ascertainable" standard.

Moreover, the importance of knowing the history of an industrial or commercial property, and of conducting an independent title search, investigation and due diligence of any property to be purchased and/or that is to serve as collateral, cannot be overstated. This case turned in large measure on the easement. An independent understanding of all documents related to any property, especially those related to environmental issues, is of paramount importance when valuing or underwriting a property. To the extent that environmental issues are present, an indemnification provision should also be considered as a condition of any purchase or sale agreement, and environmental professionals should be consulted. abi

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13 *Id.*