

ENVIRONMENTAL
CREDITORS' RIGHTS & BUSINESS RESTRUCTURINGFEBRUARY
2013

A L E R T

BANKRUPTCY LOSES ARGUMENTS FOR SPECIAL
RELIEF UNDER PREPETITION AGREEMENTS FOR
ENVIRONMENTAL LIABILITY

By Levi Jones

A recent case from the U.S. District Court for the Southern District of New York addressed the recurring conflict between the goals of bankruptcy law, which seeks to give debtors a fresh start, and the goals of federal and state environmental cleanup laws, which seek to ensure remediation of contaminated properties. The court's decision provides useful insight regarding when and how bankruptcy law should convert a prepetition contractual obligation to remediate a site into a claim to be managed like any unsecured creditor claims in a bankruptcy proceeding.

In *Route 21 Associates of Belleville v. MHC, Inc.*,¹ the parties' dispute involved responsibility for remediating contamination of a site Route 21 had long ago bought from a company to which MHC is a successor in interest. About a year after purchasing the site from MHC's predecessor, Route 21 discovered contamination, and MHC's predecessor remediated that contamination and warranted that the site was clean. But seven years later, Route 21 discovered more contamination in the form of a leaking underground storage tank. Route 21 sued MHC under the New Jersey Spill Compensation and Control Act, a state law equivalent to the federal Superfund law. The parties eventually settled this action. MHC's predecessor agreed to do two things as part of the settlement. First, it agreed to remediate the newly-discovered contamination under the direction of the New Jersey Department of Environmental Protection ("NJDEP") to a sufficient degree of cleanliness so as to obtain a "no further action" letter from

the state. Second, it agreed to indemnify Route 21 for any future environmental clean-up liability Route 21 might incur as a result of the past contamination.

Another eight years later, the site still had not been fully remediated. Route 21 decided to enter an agreement with NJDEP under the New Jersey Brownfield and Contaminated Site Remediation Act. (Brownfield laws can provide more streamlined processes for site cleanup, sometimes with public financial support, where the contamination does not present an acute threat, and where faster cleanup may facilitate a return of the property to productive use in the community.) Under the brownfields agreement developed for this site, Route 21 provided a good faith estimate of the remediation costs, and agreed to do the remediation itself in accordance with NJDEP guidance. The agreement then provided for reimbursement by NJDEP of 75 percent of Route 21's remediation costs. This agreement became an addendum to Route 21's earlier agreement with MHC's predecessor, and MHC agreed to reimburse Route 21 for the remaining 25 percent of the remediation costs. MHC further agreed to maintain groundwater monitoring wells which had been installed at the site, and to sign certifications required by the disposal sites receiving the wastes produced by the cleanup. Finally, there was a provision in the modified agreement requiring MHC to complete groundwater remediation if the site was sold to the Lowe's home improvement store chain (such a sale never happened).

Just over a year after these new agreements were finalized, MHC and its related entities entered vol-

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1. No. 12 Civ. 5361 (PAE) (S.D.N.Y. Dec. 19, 2012) available at http://scholar.google.com/scholar_case?case=13326300006223547217&hl=en&as_sdt=2&as_vis=1&oi=scholar.

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untary bankruptcy under Chapter 11. Route 21 filed a proof of claim against the debtor's estate seeking over a million dollars, constituting MHC's share of the costs incurred in the remediation. NJDEP also filed a claim seeking to recover costs to be incurred at this and other sites contaminated by the debtor, MHC. The court-appointed trustee, on behalf of the debtor, objected to the claims. Route 21 then filed cross-claims against the debtor seeking specific performance of the agreements.

The bankruptcy judge denied the claims for specific performance, holding that they were executory contracts which had been rejected by the debtor. The judge also denied Route 21's claim that it was entitled to administrative priority because the agreements were entered into prior to the bankruptcy petition and did not provide a direct benefit to the debtor's post-petition estate. As for Route 21's claim for remediation costs already incurred and for future costs, the judge allowed the incurred costs as an unsecured claim, but disallowed claims for future remediation costs under section 502(e)(1)(B) of the Bankruptcy Code as contingent claims of a co-liable party.

On appeal to the District Court, the bankruptcy judge's ruling was upheld in all respects. The District Court agreed with the bankruptcy court's conclusion that MHC's agreements regarding remediation of the site were executory because of the ongoing obligations on both sides, and contingencies such as the sale to Lowe's. Significantly, the court also based its decision on the positions taken by both parties that the agreements were executory; Route 21 was bound by its prior position. The District Court held that the debtor's plan of reorganization, which deemed all executory contracts to be rejected, served as sufficient rejection of MHC's site remediation agreements with Route 21, and specific performance therefore was not warranted. The District Court also rejected Route 21's arguments that specific performance is injunctive relief which may not be addressed and discharged as a claim. This argument was based on cases involving clean-up injunctions sought by environmental agencies; because this case involved an agreement between private entities, not one between a polluter and

a government agency, Route 21 did not meet the criteria for that argument. The District Court likewise rejected Route 21's argument that its claim for specific performance could not be rejected because it was an equitable remedy; the court concluded that the claim could be monetized and that monetary claim would be an acceptable substitute for specific performance in the bankruptcy context.

The District Court next agreed with the bankruptcy judge's conclusion that Route 21's claims were not entitled to administrative priority for the Route 21 claims (which would grant recovery of the actual amounts expended). The claims were the result of agreements entered into before the debtor filed its bankruptcy petition, and giving them priority would not further the purposes of granting such priority, which are to encourage entities to do business with a post-petition debtor, or preserve assets needed to continue the business. Addressing Route 21's claim for reimbursement of remediation costs not yet incurred, the District Court held that such future costs were contingent claims and thus rightfully rejected by the bankruptcy court. Route 21 admitted its liability in prosecuting its claims. As a self-admitted co-liable party, it is not entitled to recover contingent costs which it is obligated to pay whether or not the debtor can contribute. Moreover, the court noted that the State of New Jersey had already recovered much of the costs, and the Bankruptcy Code prevents the unfairness to other creditors which would result from any double recovery on claims.

The District Court's opinion concludes with a brief discussion of the fairness of an outcome that relieves MHC of nearly all of the cleanup responsibility for the site: "That outcome may seem harsh, but it treats Route 21 no worse than the debtor's other unsecured creditors, who equally are left holding the bag in the wake of the debtor's bankruptcy."

Private parties entering into remediation and monitoring agreements with former landowners should bear in mind that any obligations agreed to by the former landowners may be discharged should the obligated party enter bankruptcy, and those claims may not be

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allowed priority over any others in the bankruptcy proceeding. Moreover, the case points out that the characterization of an environmental claim, its framing and presentation, may be done in a variety of ways due to the many overlapping state and federal environmental laws that may govern a site. Careful framing of the claim and a consistent presentation may be extremely important to the final determination on the claim. Given the superior position enjoyed by government agencies in the exercise of the police power, it may also be important to try to work with the government to achieve the maximum recovery from the debtor's estate by presenting the best combination of government enforcement and private claims. A well-prepared and well-presented set of claims and other requested relief may convince the trustee or debtor-in possession to negotiate a settlement which provides better relief than the court may award, thus avoiding the risk of a judgment that allows a full cost recovery. ♦

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