INSOL INTERNATIONAL

ENVIRONMENTAL CLAIMS AND LIABILITIES IN INSOLVENCY AND RESTRUCTURING

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UNITED STATES OF AMERICA

1. What are the relevant environmental protection laws, regulations, treaties or regimes in your jurisdiction, including with respect to:

- **clean-up and remediation;**
- **emissions; and**
- **any minimum standards, or environmental permit system?**

1.1 Introduction

In the United States, entities and individuals must comply with federal, state and local statutes and regulations that have been enacted to prevent the release of pollutants into waterways, groundwater, soil and air. Various federal, state and local agencies have been created to enforce environmental statutes and regulations by monitoring air, water and ground quality, and these authorities are authorised to impose considerable civil liabilities, such as substantial fines, on violators. Additionally, individuals may face criminal liability and imprisonment if they are found to have wilfully participated in various types of pollution. Therefore, compliance with all environmental regulations and statutes is of vital economic importance to companies operating in the United States.

In this Chapter, we discuss certain key federal environmental statutes, which are largely enforced by offices of the United States Environmental Protection Agency (the EPA) – an independent executive agency of the United States federal government – through the United States Department of Justice.

The following are summaries of key federal statutes that are commonly implicated in bankruptcies, as they relate to remediation of water pollutants, air emissions, hazardous waste and ground contamination. Most of these statutes authorise the EPA or similar oversight body to set and enforce minimum standards or permitting systems, in conjunction with local and state government oversight agencies. Each of these statutes shifts the burden to pay for the clean-up of contaminated property to the entity that caused such contamination, rather than leaving the clean-up costs to be borne by an applicable local, state and / or federal government.

1.2 Relevant legislation

1.2.1 Comprehensive Environmental Response, Compensation and Liability Act (CERCLA)[1]

CERCLA was enacted by the US Congress in 1980 and was later amended in 1986 to establish the US federal Superfund program, administered by the EPA's Office of Solid Waste and Emergency Response (OSWER). CERCLA's major emphasis is on the clean-up of inactive hazardous waste sites and the liability for clean-up costs on arrangers and transporters of hazardous substances and on current and former owners of facilities where hazardous substances were disposed.[2] It largely focuses on soil and groundwater contamination.

Sites managed under this program are referred to as "Superfund" sites. There are approximately 40,000 federal Superfund sites across the United States, of which approximately 1,600 have been listed on the National Priorities List (NPL). Sites on the NPL are considered the most highly contaminated and must be subjected to longer-term remedial investigation and remedial action / clean-ups.

Under CERCLA, the EPA is tasked with identifying parties that are responsible for polluting the environment with hazardous substances. The EPA then has the authority to compel parties to clean up contaminated sites. However, if a party is unable to or will not undertake EPA-mandated clean-

1 CERCLA, also known as "Superfund"; 42 USC, §§ 9601–9675.
2 See: https://www.epa.gov/enforcement/comprehensive-environmental-response-compensation-and-liability-act-cercla-and-federal.

up, the EPA may authorise clean-up using the Superfund (a trust fund) and seek to recover those costs from the responsible parties through settlements or other legal means.

The EPA and state agencies use the Hazard Ranking System (HRS) to calculate a site score (ranging from 0 to 100) based on the actual or potential release of hazardous substances from a site. A score of 28.5 places a site on the National Priorities List, eligible for long-term remedial action (that is, clean-up) under the Superfund program.

1.2.2 *Surface Mining Control and Reclamation Act (SMCRA)*[3]

The SMCRA establishes standards for surface mining activities and the reclamation of coal-mined federal and state lands, with oversight from the US Office of Surface Mining, Reclamation and Enforcement, in the Department of the Interior.

SMCRA's standards impose the following requirements on a mine operator:

- permits must be obtained for mineral prospecting, mine planning and development and back-filling of mine pits;
- payment of a bond must be made to appropriate federal or state regulatory authorities to ensure performance of permit and regulatory requirements in amounts sufficient to remediate mined property;[4] and
- payment of quarterly reclamation fees, based on amounts mined, must be made into trust funds for unfunded remediation costs to restore damaged land and water resources.[5]

1.2.3 *Clean Air Act (CAA)*[6]

The CAA is a comprehensive federal law that regulates air emissions from stationary and mobile sources.[7] Among other things, the CAA authorises the EPA to establish National Ambient Air Quality Standards (NAAQSs)[8] to protect public health and public welfare and to regulate emissions of hazardous air pollutants.

The CAA creates health-based standards to determine safe pollutant levels and technology-based standards to measure industries' pollution reduction requirements. Individual states are required to apply the CAA's standards by creating a State Implementation Plan or a "SIP". Each SIP must establish a system to determine whether the EPA's standards set forth in the CAA have been achieved and an enforcement program.

1.2.4 *Clean Water Act (CWA)*[9]

The CWA was enacted to reduce the release of toxic materials into US waters so that surface water standards can be achieved. The CWA protects all waters that have a "significant nexus" to navigable waters.

To ensure compliance with the CWA, tests are conducted to determine water quality by examining certain technology-based standards (for example, sewage treatment plant requirements). The EPA has also developed national water quality criteria recommendations for pollutants in surface waters.

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3 SMCRA; 30 USC, §§ 1201 – 1328.
4 30 USC, § 1259.
5 30 USC, § 1232. As further set forth below, these fees are considered non-dischargeable excise taxes under the Bankruptcy Code (see, e.g., *US v River Coal Co*, 748 F.2d 1103, 1106-1107 (6th Cir 1984)).
6 42 USC, §§ 7401–7431. Hereinafter referred to as the CAA.
7 See: https://www.epa.gov/laws-regulations/summary-clean-air-act.
8 42 USC, §§ 7401–7661.
9 33 USC, §§ 1251–1387. Hereinafter referred to as the CWA.

With several exceptions, under the CWA it is unlawful for industrial, municipal and other facilities to discharge and pollutant from a point source into navigable or surface waters without receiving a permit under the National Pollutant Discharge Elimination System (NPDES).

1.2.5 *Safe Drinking Water Act (SDWA)*[10]

The SDWA focuses on all waters actually or potentially designed for drinking use, whether from above ground or underground sources. The SDWA authorises the EPA to establish minimum standards to protect tap water and requires all owners or operators of public water systems to comply with health-related primary standards that have been established upon a detailed risk and cost assessment, with the best available peer-reviewed science.

State governments, which can be approved to implement the EPA's drinking water standards, also encourage attainment of nuisance-related secondary standards. Furthermore, the EPA is authorised under the SDWA to establish minimum standards for state programs to protect underground sources of drinking water from endangerment by underground injection of fluids.

2. Climate risk and disclosure has become a focus of a number of States and regulatory bodies and is becoming an important element of corporate governance. What are the relevant governance, corporate, securities and financial disclosure laws, regulations, rules or industry benchmarks with respect to the obligations of companies and / or directors to:

- **understand and continually assess existing and emerging environmental risks that may affect a company's business;**
- **disclose environmental risks; and**
- **factor environmental risks into financial reporting; and**
- **what are the consequences of non-compliance?**

2.1 Introduction

Climate change, including the impact of global warming, is an evolving area of law in the United States. Directors and officers can be subject to both government enforcement actions and private civil litigation related to environmental liability of a company, including in connection with material misstatements and omissions in securities offering documents under the Securities Act of 1933 and for public disclosures pursuant to the Securities Exchange Act of 1934.

2.2 Climate change disclosure regulations and guidance

In February 2010, the United States Securities and Exchange Commission (the SEC) issued an interpretive release providing guidance on public disclosure of the effects of climate change on businesses.[11] However, these rules are only applicable to public companies registered with the SEC and, therefore, many companies may not be subject to such direct and officer liabilities.

Although the SEC has continued to consider issues relating to climate change as part of its review of annual and periodic reporting, it has not yet established standardised rules for disclosure of climate issues.[12] Most recently, on 21 March 2022, the SEC proposed rule changes, which included

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[10] 42 USC, §§ 300f–300j–9. Hereinafter referred to as the SDWA.

[11] See Commission Guidance Regarding Disclosure Related to Climate Change, SEC Release No 33-9106 (Feb 8, 2010).

[12] See, e.g., SEC Chairman Jay Clayton, January 30, 2020, "Proposed Amendments to Modernize and Enhance Financial Disclosures; Other Ongoing Disclosure Modernization Initiatives; Impact of the Coronavirus; Environmental and Climate-Related Disclosure", available at:

the addition of a new "Subpart 1500" to Regulation S-K and new "Article 14" to Regulation S-X.[13] Specifically, the proposed rules would require that registrant public company include climate-related disclosures in their registration statements and periodic reports that include:

- information about climate-related risks that are reasonably likely to have a material impact on their business, results of operation or financial condition;
- greenhouse gas (GHG) emissions associated with the registrant that could include an attestation report by a GHG emissions attestation provider (which have become a commonly used metric to assess a registrant's exposure to such risks); and
- climate-related financial metrics to be included in the registrant's audited financial statements.[14]

According to an updated rulemaking agenda that was made public on 6 December 2023, although the March 2022 was made subject to public comment, the SEC has delayed finalising the proposal until the spring of 2024.

If the March 2022 proposal is finalised, climate reporting will no longer be a largely voluntary disclosure for public company registrants, but rather a mandatory, regulated disclosure in a consistent format like many other specific line items in current standardised periodic reports. The ultimate goal of the proposal is to increase transparency around climate risks and enhance accountability for climate-related claims for public companies – a significant leap forward for the US Government's response to climate change. Standardised and consistent climate disclosure in periodic reports can assist investors and other stakeholders alike to understand how climate change might affect the companies they work with, oversee and allocate capital to.

In addition to finalising the SEC's March 2022 proposal or the SEC issuing further proposals later this year, we should generally expect further governmental action to increase the required disclosures that companies need to make regarding climate issues.

2.3 Compliance

When it comes to compliance and director and officer liability, individual states, rather than the SEC, spearhead investigations into companies in connection with climate change matters. Upon completion of an investigation, a state may commence enforcement actions that can spin into private civil litigation against directors and officers.

Over the last eight years, among others, the Attorneys General of New York and Massachusetts have launched investigations to determine whether Exxon Mobil Corporation (Exxon) misrepresented to investors the risks of how climate change might impact its business and filed lawsuits against Exxon.[15]

In its complaint, the Attorney General for New York (AG NY) sued Exxon for various types of investor fraud under New York state statutes, alleging that Exxon disclosed a higher "proxy cost" of carbon to investors (which Exxon created to address how developing climate change regulation may impact its business) but, internally for making investment and business decisions, Exxon utilised a

https://www.sec.gov/news/public-statement/clayton-mda-2020-01-30; SEC Press Release, available at: https://www.sec.gov/news/press-release/2022-46 (Mar. 21, 2022).

[13] SEC Press Release, available at https://www.sec.gov/news/press-release/2022-46 (Mar 21, 2022).

[14] *Ibid*.

[15] Gerard G Pecht, Seth M Kruglak and Lisa Schapira, "Directors and Officers Face Increased Liability Risk Due to Climate Change" (March 2020), available at: https://www.nortonrosefulbright.com/en/knowledge/publications/09038445/directors-and-officers-face-increased-liability-risk-due-to-climate-change.

lower "greenhouse gas price".[16] After a trial was held, the presiding New York state court rejected the AG NY's fraud claims in their entirety, and the AG NY declined to appeal the decision.[17]

The Attorney General for Massachusetts also filed a lawsuit against Exxon, asserting that it had repeatedly violated Massachusetts' consumer and investor protection laws and related regulations.[18] Specifically, the complaint alleged, among other things, that Exxon:

- misled consumers regarding its long-standing knowledge of material climate-driven risks to its business,
- deceived consumers and investors about the systemic financial risk of climate change to the global economy by (among other items) advertising Exxon as leading efforts in clean energy research and climate action (and the central role Exxon's fossil fuel products play in causing climate change), and
- misrepresented that it factored the proxy cost of carbon into its financial planning and investment decisions.[19]

The case is still pending.

On March 22, 2022 (following the SEC's landmark proposal), the top appeals court of Massachusetts ruled that Exxon's motions to dismiss were properly denied, and it must face a lawsuit by the state accusing it of misleading investors and consumers about the impact of climate change on its business and products.[20] The lawsuit is still pending.[21]

Similarly, in April 2023, the US Supreme Court declined to hear bids by Exxon and other large oil companies to move lawsuits filed by state and local governments accusing them of worsening climate change out of state courts and into federal courts.[22] The justices turned away five appeals by the oil companies of lower court decisions that determined that the lawsuits belonged in state court, a venue often seen as more favourable to plaintiffs than the federal court. The lawsuits were filed by the state of Rhode Island and municipalities or counties in California, Colorado, Hawaii and Maryland.

Ultimately, this signals that states will retain oversight as to compliance lawsuits, despite developing federal guidance at the SEC.

3. Identify the insolvency regimes that are available and how they interplay with the environmental protection regimes – including the obligations that insolvency practitioners or lenders have with respect to environmental protection regimes (e.g. remedial action, disclosures to the market and the management of environmental risks)

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[16] *Ibid* (citing *People v Exxon Mobil Corp*, No 452044/2018, 65 Misc 3d 1233(A), 2019 NY Slip Op 51990(U) (Sup Ct NY Cnty Dec 10, 2019).

[17] *Ibid*. See also Erik Larson, "New York Won't Appeal Its Defeat in Exxon Climate Trial," Bloomberg Green, Jan 10, 2020, available at: https://www.bloomberg.com/news/articles/2020-01-10/exxon-climate-trial-loss-won-t-be-appealed-n-y-a-g-says.

[18] *Ibid*. See also *Commonwealth v Exxon Mobil Corp*, No 19-3333 (Mass Super Ct) (Oct 24, 2019).

[19] *Ibid*. See also Press Release, "AG Healy Sues Exxon for Deceiving Massachusetts Consumers and Investors" (Oct 24, 2019), available at: https://www.mass.gov/news/ag-healey-sues-exxon-for-deceiving-massachusetts-consumers-and-investors.

[20] Bloomberg News, Erik Larson, "Exxon Must Face Massachusetts Suit Claiming Climate Deception" (Mar. 24, 2022), available at: https://www.bloomberglaw.com/bloomberglawnews/environment-and-energy/XFQ9VVEC000000?bna_news_filter=environment-and-energy#jcite.

[21] See the Mass.gov website for case updates: https://www.mass.gov/lists/attorney-generals-office-lawsuit-against-exxonmobil.

[22] See Reuters, Clark Mindock and Nate Raymond, "US Supreme Court Rebuffs Exxon, Chevron Appeals in Climate Cases", available at: https://www.reuters.com/business/energy/us-supreme-court-rebuffs-exxon-chevron-appeals-climate-litigation-2023-04-24/ (Apr 24, 2023).

3.1 Generally

There is a stark juxtaposition between the goals of the US Bankruptcy Code[23] and related bankruptcy case law and environmental laws. On one hand, the US Bankruptcy Code was enacted to protect debtors from being crippled with debt and liabilities by giving them a "fresh start"; on the other hand, environmental laws have been enacted to ensure parties are held accountable for following environmental standards in order to protect public health and the environment. Due to the competing interests of these two bodies of law, there has been extensive litigation related to the interplay between the bankruptcy and environmental laws, of which bankruptcy practitioners must be aware.

To address the tension between United States environmental and bankruptcy schemes, various bankruptcy and non-bankruptcy statutory laws and case law have instituted the following limitations on powers granted by bankruptcy law that a debtor-in-possession or a trustee (referred to collectively herein as a debtor) would otherwise be able to utilise to shed liabilities. For instance, during its bankruptcy proceeding, a debtor must comply with the following with respect to environmental obligations and liabilities:[24]

- a debtor has a statutory duty to operate property in a manner consistent with the laws of the state in which the property is located, including state environmental laws and local ordinances;[25]
- a debtor cannot utilise section 554 of the Bankruptcy Code to abandon property that is subject to environmental liabilities, if the abandonment would be in contravention of non-bankruptcy laws "reasonably designed to protect the public health or safety from identified hazards"[26] when it is likely to pose an "imminent and identifiable" threat to human health or environmental safety;[27]
- post-petition environmental obligations and costs of a debtor or a governmental unit (for example, EPA-mandated cleanup under the CERCLA that is allocable to a debtor post-petition) are usually chargeable to the estate as higher priority expenses – referred to as administrative expenses under the Bankruptcy Code – that must be paid in full in order to confirm a Chapter 11 plan; and
- performance obligations relating to ongoing threats to environmental health and public safety cannot be discharged through a bankruptcy case.

The EPA has published a "Cases and Settlements Database" that reflects the developments in litigation and enforcement of settlement agreements by debtor PRPs.[28] Practitioners should review this database, along with their own research, to stay current on the evolving legal landscape.

3.2 The automatic stay

In general, upon filing a petition for bankruptcy in the United States, the automatic stay comes into place under section 362 of the Bankruptcy Code. The automatic stay is one of a debtor's greatest

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[23] 11 USC (the Bankruptcy Code).

[24] Practical Law Company, "Strategies for Addressing Environmental Obligations in Bankruptcy", Practical Law Practice Note w-003-5388.

[25] 28 USC, § 959(b).

[26] *Midlantic Nat Bank v New Jersey Dep't of Env't Prot*, 474 US 494, 506–07 (1986) ("we conclude that Congress did not intend for § 554(a) to pre-empt all state and local laws. The Bankruptcy Court does not have the power to authorize an abandonment without formulating conditions that will adequately protect the public's health and safety. Accordingly … 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").

[27] *In re Venoco, LLC*, 572 B.R. 105, 114 (Bankr. D. Del. 2017) (finding that section 554 of the bankruptcy code "does not pre-empt such local and state statutes which protect the public health" and describing as "narrow" the "exception described in *Midlantic*").

[28] See the US Environmental Protection Agency website, "Recovering Costs from Parties in Bankruptcy," available at: https://www.epa.gov/enforcement/recovering-costs-parties-bankruptcy#practice.

protections as, once it is in place, parties are automatically enjoined from taking any actions to assess, collect or recover claims that arose prior to the petition date against the debtor or against a debtor's property.[29] Further, the automatic stay halts all pending legal actions against a debtor. If a party wishes to continue a legal proceeding against a debtor, it must first obtain an order from the presiding bankruptcy court to "lift" the automatic stay and allow the party to proceed with such legal action.[30]

However, under section 362(b)(4) of the Bankruptcy Code – sometimes referred as the "police and regulatory exception" – the automatic stay is not enforceable against a governmental agency exercising police and regulatory powers. Debtors and debtor professionals should be aware that environmental agencies are likely to assert this exception when seeking to continue any pre-petition legal actions based on alleged violations of various environmental laws, including, but not limited to, claims regarding environmental site remediation.

Although the police and regulatory exception generally does not apply when a governmental entity seeks to enforce a monetary judgment, bankruptcy courts have usually read the exception broadly, in favour of allowing an environmental agency to continue its actions against a debtor, including when the agency seeks pecuniary relief (e.g. to fix penalty amounts, damages, or clean-up costs to be allocated against a debtor under the CERCLA).[31] However, the automatic stay does protect a debtor from a governmental entity seeking to litigate or enforce a judgment outside of the debtor's bankruptcy proceeding.[32]

However, analysis of the police and regulatory exception is fact-intensive and is determined on a case-by-case basis. The key to the exception is that the governmental agency must be enforcing its police and regulatory powers. Some bankruptcy courts, including in the Third Circuit (which is one of the most common jurisdictions for bankruptcy filings), will apply what is referred to as the "pecuniary interest / public policy test" to determine whether an action by a governmental agency falls under the police and regulatory exception.[33]

In short, a bankruptcy court will look to see whether a governmental agency's proceeding against the debtor relates primarily to the protection of a pecuniary interest in the debtor's property, rather than to its public policy interest in general safety and welfare, the bankruptcy court may hold that the proceeding is subject to the automatic stay.[34] If the governmental agency is seeking a financial reward or executing on a monetary judgment, court approval and relief from the automatic stay are required.

3.3 Environmental claims and the interplay between monetary and remediation obligations – governmental entity claimants

Generally, in a Chapter 11 case a debtor obtains a discharge or, in a liquidating plan case, a plan injunction, for claims that arose prior to the petition date, subject to limited exceptions.[35] To "discharge" a claim means that there is a legal release or termination of debt, so a debtor is no longer liable. Therefore, a key issue relating to environmental liabilities is whether they can be discharged in bankruptcy.

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[29] 11 USC, § 362(a).

[30] *Ibid*.

[31] See *US v Jones & Laughlin Steel Corp*, 804 F.2d 348 (6th Cir 1986) (regarding a judicial proceeding to fix the amounts debtor owed to various government entities not stayed, as resolution represented a regulatory action and would not affect the assets available to other creditors); *Penn Terra Ltd v Dep't of Env't Res, Com of Pa*, 733 F.2d 267 (3d Cir 1984).

[32] *New Jersey v WR Grace & Co (In re WR Grace & Co)*, 412 BR 657, 663 (D Del 2009); *US v LTV Steel Co, Inc*, 269 BR 576, 582 (WD Pa 2001).

[33] *Idem*. See also *United States v Nicolet, Inc*, 857 F.2d 202, 209 (3d Cir 1988).

[34] *In re WR Grace & Co*, 412 BR 657, 663 (D Del 2009) (citing *United States v Nicolet, Inc*, at 209–10, "the Court found that the government was not seeking redress for 'private wrongs' or 'a private contract breach,' but rather, the government's action provided a 'deterrence element ... ensuring that responsible parties will be held accountable for their environmental misdeeds'").

[35] 11 USC, § 523(a).

As a general rule of bankruptcy, only pre-petition claims can be discharged through a bankruptcy proceeding. However, environmental claims can in effect take two forms – on the one hand, monetary; on the other hand, remediation obligations, such as clean-up. When addressing whether an environmental claim is dischargeable, courts first determine whether the environmental obligations constitute a "claim" under the Bankruptcy Code. Section 101(5)(A) of the Bankruptcy Code states that a claim includes 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."[36]

Any pre-petition right to payment of money pursued by a governmental unit constitutes a claim and is subject to discharge (subject to the limitations discussed above with the automatic stay). Governmental agency claimants, like all creditors, must timely file proofs of claim in the bankruptcy case and such monetary claims are typically treated as general unsecured claims, which often only receive cents on each dollar owed.

But what about claims that concern a debtor being subject to a cleanup order directing the debtor to clean up pre-petition contamination on property owned by a debtor or a third party? The US Supreme Court has held that an obligation to comply with a state court injunction requiring cleanup at a third-party owned hazardous waste disposal site is a "debt" or "liability on a claim" subject to discharge under the Bankruptcy Code.[37] Therefore, when an order for environmental remediation occurs prepetition for a third party-owned site, the claim is generally dischargeable under a Chapter 11 plan. Relying on this decision in *Kovacs*, debtors and their professionals often assert that if the debtor would be compelled to spend money to comply with a clean-up order, an injunction is effectively a "right to payment" and, therefore, a dischargeable claim. However, the US Supreme Court's *Kovacs* decision did not address a debtor's cleanup obligation for its own site or the broader question of whether a debtor can obtain a discharge for obligations relating to contamination that poses an ongoing threat to human health or the environment.

As to remediation claims involving ongoing harm, United States courts have held that injunctions to protect public health or the environment are not dischargeable when the injunction or statute requires performance rather than payment for performance.[38] For context, in the *In re Torwico Elec, Inc* case, the Third Circuit has held that the environmental obligations owed by a debtor are not claims at all, but rather "an exercise of the state's inherent regulatory and police powers" – thereby rendering the remediation obligations non-dischargeable.[39] At issue in *In re Torwico Elec, Inc* was the clean-up of a hidden seepage pit at a property formerly leased by the debtor that was only discovered after the debtor filed for Chapter 11 bankruptcy. The debtor asserted that it had no knowledge of the seepage pit or any of the related waste.[40] The Third Circuit held that the debtor had an ongoing responsibility as the waste from the seepage pit presented a continuing hazard to public health and the environment and, as such, the debtor's obligation to remediate was not a claim and could not be discharged.

In sum, following the decisions in *Kovacs* and *In re Torwico Elec*, bankruptcy practitioners and debtors should note at the outset of a bankruptcy case that generally:

- obligations relating to ongoing, imminent and identifiable threats to human health, or the environment may not be characterized as "claims" and therefore may not be dischargeable;
- statutory reclamation fees for unfunded remediation costs[41] are considered non-dischargeable excise taxes;[42] and

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[36] 11 USC, § 101(5)(A).
[37] *Ohio v Kovacs*, 469 US 274, 274-76 (1985).
[38] *In re Torwico Elec, Inc*, 8 F.3d 146, 151 (3d Cir 1993); *In re Chateaugay Corp*, 944 F.2d 997, 1008 (2d Cir 1991); *In re Taylor*, 572 BR 592, 601 (Bankr EDNC 2017); *accord In re GI Holdings Inc*, 654 Fed Appx 57, 2016 WL 3878160 (3rd Cir 2016).
[39] *In re Torwico Elec, Inc* at 151.
[40] *Idem* at 147.
[41] 30 USC, § 1232.
[42] *United States v River Coal Co*, 748 F.2d 1103, 1106-1107 (6th Cir 1984).

- statutory claims or causes of action (for example, under CERCLA or SMCRA) arising post-petition are not dischargeable.

In light of these rules, companies should consider what cleanup will need to be budgeted as it cannot be recharacterised as a dischargeable monetary claim. Even pre-bankruptcy, companies should consider these factors when making disclosures with the SEC or to investors.

3.4 Environmental claims and the interplay between monetary and remediation obligations – private party claimants

While the above is limited to governmental entity claimants asserting environmental claims, how are private parties who assert a claim against a debtor treated within the confines of bankruptcy? In fact, courts have generally found that similar rules apply to private parties that assert environmental claims. Pre-bankruptcy claims for payment asserted by private parties are often found to constitute a claim and are subject to discharge in bankruptcy. Similar to governmental entities, private party creditors must file proofs of claim in a debtor's bankruptcy proceeding and such claims are generally treated as general unsecured claims, usually resulting in recovery of only cents on each dollar of their claim. If a debtor can successfully assert that its cleanup obligations are claims only because they can be satisfied by payment of money, the issue becomes whether, and in what circumstances, other potentially responsible parties (referred to as PRPs) will be able to assert claims against the debtor to recover at least some of the future cleanup costs the debtor would otherwise been responsible for under environmental remediations statues, such as CERCLA.[43]

This issue implicates Bankruptcy Code section 502(e)(1)(B), under which a bankruptcy court "shall disallow any claim for reimbursement or contribution of an entity that is liable with the debtor on or has secured the claim of a creditor, to the extent that … [such claim] is contingent as of the time of allowance or disallowance".[44] Courts interpreting Bankruptcy Code section 502(e)(1)(B) have consistently applied a three-part test to determine whether a private party's claim is subject to disallowance.[45] Each part of the test must be satisfied for a claim to be disallowed:

- the claim is for reimbursement or contribution;
- the entity asserting the claim is co-liable with the debtor on the claim; and
- the claim is contingent at the time of its allowance or disallowance.[46]

There are two key bankruptcy policies that underlie a court's application of section 502(e)(1)(B) of the Bankruptcy Code: (i) the prevention of double recovery on the same claim to further equitable distribution among creditors; and (ii) timely distribution to unsecured creditors without delay to await resolution of contingent claims.[47] Applying these basic and key bankruptcy principles to its three-part test, both the district and bankruptcy courts in the Southern District of New York have adopted broad interpretations of each of the above three elements and disallowed essentially all claims seeking recovery of future remediation costs.[48]

Therefore, a debtor can use section 502(e)(1)(B) to shield certain future, contingent environmental liabilities, as it has been used to disallow claims for future environmental clean-up costs where PRPs other than the debtor are co-liable with the debtor on the same claim. Some courts have interpreted section 502(e)(1)(B) broadly to provide for the disallowance of claims based on the

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43 B David Naidu, Dawn Monsen Lomparello, Emily S Tabak, "Key Environmental Liability Considerations in Bankruptcy Actions", *New Jersey Lawyer* (Oct 2016).

44 11 USC, § 502(e)(1)(B).

45 Naidu, et al, "Key Environmental Liability Considerations in Bankruptcy Actions", *New Jersey Lawyer* (Oct 2016), 56.

46 *In re Lyondell Chemical Co*, 442 BR 236 (Bankr SDNY 2011); *In re Apco Liquidating Trust*, 370 B.R. 625 (Bankr D Del 2007).

47 Naidu, "Key Environmental Liability Considerations in Bankruptcy Actions", *New Jersey Lawyer* (Oct 2016), 56.

48 See, e.g., *Route 21 Associates of Belleville, Inc v MHC, Inc*, 486 BR 75 (SDNY 2012), aff'd, 542 Fed Appx 41 (2d Cir 2013); *Lyondell*, 442 BR 236; *In re Chemtura Corp*, 443 BR 601 (Bankr SDNY 2011).

potential enforcement of claims under CERCLA against another PRP.[49] Recently, courts have found that section 502(e)(1)(B) does not apply to remediation costs that have already been paid by the claimant because they are no longer contingent.[50] Likewise, section 502(e)(1)(B) does not apply to claims for which the debtor has been released by the primary claimant.[51] For context, in the *Lyondell* decision, the bankruptcy court found that CERCLA section 113(f) claims were for contribution and section 107(a) cost recovery claims were for reimbursement.[52] Based on this reasoning, a creditor PRP would only be able to assert an allowable bankruptcy claim for costs already paid or incurred, because only these costs would qualify as non-contingent.[53] With respect to past costs, it would not matter whether the claims were brought under CERCLA section 107(a) for cost recovery or section 113(f) for contribution.[54]

However, to the extent that PRPs are able to assert a claim for future costs under CERCLA Section 107(a) (but not CERCLA section 113(f)), they may be able to recover these costs in bankruptcy proceedings in the Third Circuit, even where the EPA has issued orders and filed its own claims. Under section 502(c) of the Bankruptcy Code, a bankruptcy court must estimate contingent or unliquidated claims when fixing or liquidating the claim is likely to "unduly delay the administration of the case."[55] Several bankruptcy courts have used this power to estimate environmental clean-up obligations, thereby rendering them non-contingent obligations.[56] In short, a PRP's ability to withstand a Bankruptcy Code section 502(e)(1)(B) challenge to its cost recovery claims for future costs appears to be better in the Third Circuit than in the Second Circuit, based on current precedent.

Although forum shopping is disfavoured, in light of the above, debtors may consider the risk of such PRP claims when determining where to file a bankruptcy case. Company management should also consider the risk of having to pay out these claims when making financial disclosures to investors or the SEC.

4. What potential causes of action are available in relation to environmental risks against companies, directors, and any other relevant stakeholders, which insolvency practitioners and lenders should be aware of in an insolvency and restructuring process?

As discussed above, bankruptcy professionals and debtors must be aware of how a claim may be construed – is the claim monetary or remedial? Fixed or contingent? Pre-petition or post-petition? For contribution? Can the debtor assert that having to comply with a clean-up order is solely a "right to payment" and, therefore, a dischargeable claim? Does the claim present a continuous harm to public health or the environment?

In a bankruptcy proceeding, private parties (including PCPs) and governmental entities must file proofs of claim. Claims will be subject to a debtor's claims administration process.

All claimants are subject to the automatic stay to the extent that they must be brought through the bankruptcy proceeding, with some exceptions for governmental entities.

5. Having regard to the obligations, liabilities and potential causes of action identified in the previous questions, in what circumstances, if any, could an insolvency practitioner or lender be personally liable for environmental claims and liabilities of

[49] *In re Hemingway Transport, Inc*, 126 BR 656 (1st Cir 1993); *In re Cottonwood Canyon Land Co*, 146 BR 992 (Bankr D Colo 1992); *In re Eagle-Picher Indus, Inc*, 144 BR 765 (Bankr SD Ohio 1992).
[50] *In re Chemtura Corp*, 443 BR 601 (Bankr SDNY 2011).
[51] *In re Hercules Offshore, Inc v Axon Pressure Products, Inc (In re Hercules Offshore, Inc)*, 571 BR 633 (Bankr D Del 2017).
[52] *Lyondell*, 442 BR at 24.
[53] Naidu *et al*, "Key Environmental Liability Considerations in Bankruptcy Actions", *New Jersey Lawyer* (Oct 2016), 56.
[54] *Ibid.*
[55] 11 USC, § 502(c).
[56] *In re Allegheny Int'l, Inc*, 126 BR 919 (WD Pa 1991); *In re National Gypsum*, 1992 WL 426464 (Bankr ND Tex 1992); *In re Specialty Prods Holding Corp*, 2013 WL 2177694 (Bankr D Del 2013).

a company, including with respect to the management of environmental risks? What protective steps can insolvency practitioners and lenders take to avoid such personal liability?

5.1 Lender liability

Environmental liability poses special risks for lenders, including:

- reduction in collateral values;
- threatening a borrower's ability to repay the loan; and
- potential responsibility as a PRP under CERCLA.

Commercial real estate lenders must particularly be aware of potential liability in relation to CERCLA. CERCLA establishes four categories of PRPs:

- current owners and operators of a facility from which there has been a release or a threatened release of a hazardous substance;
- prior owners or operators of a facility at the time hazardous substances were disposed of;
- arrangers who, by contract, agreement, or otherwise, arrange for the disposal or treatment of their hazardous substances at a facility from which there has been a release or threatened release; and
- transporters who transport hazardous substances to disposal sites, treatment facilities or other locations from which there has been a release or threatened release, if the site is selected by the transporter.[57]

While lenders are not specifically defined as PRPs, they can be found liable for CERCLA cleanup if they fall into one of the enumerated PRP categories.[58] For instance, foreclosure on mortgaged property can give rise to owner liability under certain circumstances if the lender takes title to the contaminated property. This type of pervasive control over a debtor's environmental operations may give rise to operator liability in certain circumstances.[59] However, it is less likely that a lender would be found liable as an "arranger" or "transporter" unless the lender assumes responsibility over the off-site disposal of hazardous substances.

The risk of lender liability under CERCLA has been lessened by safeguards protecting lenders from owner and operator liability for actions taken primarily to protect their security interests. As enacted, CERCLA contains an exemption from owner and operator liability with respect to lenders that, without participating in the management of a facility, hold *indicia* of ownership primarily to protect their security interest.[60] However, since CERCLA does not define the scope of this exemption, there is uncertainty as to how active lenders may be to protect or enforce their rights without incurring CERCLA liability.

In sum, lenders must be vigilant to avoid participation in a debtor's management, as such affiliation may lead to lender responsibility as a PRP.

5.2 Bankruptcy practitioners

In the United States, upon filing for Chapter 11 bankruptcy, a debtor must seek retention of professionals, including, among others, legal counsel, accountants, auctioneers, appraisers,

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[57] Practical Law Company, "Commercial Real Estate Loans: Minimizing the Environmental Risk for Lenders under CERCLA", Practical Law Practice Note 9-525-7439.
[58] *Ibid*.
[59] *Ibid*.
[60] *Ibid*. See also 42 USC, § 9601(20)(A).

investment bankers and consultants. Notably, these professionals are professionals of the debtor's estate – in essence, the "new" debtor-in-possession entity or the applicable trustee. As a general rule, professionals must be disinterested parties who do not have an interest adverse to the estate. In Chapter 11 cases, creditors' committees are also eligible to retain professionals to perform services on behalf of such committee. Upon the confirmation of a plan of reorganisation or liquidation or the discharge of a bankruptcy proceeding, such professionals are typically granted a release from liability, absent a showing of fraud or malpractice.

6. How are climate change and environmental claims recognised in determining a company's solvency (for example, as present, contingent or future liabilities) and when will they provide a basis for seeking insolvency protections?

At its core, the goal of the Bankruptcy Code is to allow a debtor to have a "fresh start" – such that it can maximise the value of its estate by alleviating the problem of financial distress. In order for a Chapter 11 petition to be filed in "good faith," a debtor must be experiencing some degree of financial distress – but the US Congress did not expressly limit Chapter 11 protection to debtors who are insolvent or who suffer any other particular form of financial distress.[61]

Courts applying the "good-faith filing" doctrine are also uniform in stating that insolvency is not a prerequisite to seeking Chapter 11 relief and that solvency alone will not result in dismissal for an absence of good faith.[62] Therefore, solvent debtors are capable of filing plans in "good faith" and, thus, confirming plans of reorganisation.[63]

In practice, this means that if a company is in financial distress – but not yet insolvent – and is aware that it faces massive contingent or unliquidated environmental liabilities, it may be able to file for bankruptcy in an effort to discharge some of the environmental claims and restructure. However (and as further explained below), if the claims are too large or too complicated for a bankruptcy court to estimate, it may make it unfeasible for a debtor to be able to confirm a plan, which would be a reason to convert the Chapter 11 to a liquidation for lack of "good faith". Also, if a bankruptcy court were to pursue a lengthy and costly claim estimation proceeding – which would cause the debtor to incur large administrative claims – a debtor may be forced to pay nearly the same costs that it would during non-bankruptcy litigation of the environmental claim. Therefore, contingent and unliquidated claims may not prevent a debtor from filing for Chapter 11 but may create challenges to a debtors ability to successfully restructure through a Chapter 11 plan.

7. How are climate change and environmental claims and claimants recognised in insolvency processes, including with respect to voting rights, the priority rankings of claims in insolvency (including with respect to claims of governments for penalties) and with respect to affected collateralised assets?

To understand the potential voting rights or priority of payment of environmental claims, one must first understand the Bankruptcy Code's priority scheme and plan confirmation process.

The goal of a Chapter 11 case is to have a plan confirmed so that a debtor may emerge from bankruptcy with debts discharged and manageable liabilities. The Bankruptcy Code sets forth a priority scheme for distributing assets to creditors with which a debtor must comply when formulating its plan of reorganisation or liquidation. A Chapter 11 plan will include, among other things, the terms of repayment regarding each class of claims established under the plan.[64] Additionally, the plan must provide a structure and means for the debtor to emerge from bankruptcy, sell itself as a going concern, or liquidate its assets and distribute the proceeds.

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[61] Robert J Keach, "Solvent Debtors and Myths of Good Faith and Fiduciary Duty," *Am Bankr Inst J*, December / January 2005, 36.

[62] *Ibid*.

[63] *Ibid* (citing *In re Marshall*, 298 BR 670, 676 (Bankr CD Cal 2003)).

[64] *See* Philippe J Kahn, "Bankruptcy Versus Environmental Protection: Discharging Future CERCLA Liability in Chapter 11", 14 *Cardozo L Rev*, 1999, 2005–06 (1993).

Claims may be secured by valid, pre-existing security interests or liens over the debtor's property, or may be unsecured, in which case they are ranked for payment in order of a statutory priority.[65] To entice third parties, including debtor professionals, to continue providing a debtor with goods or services after it has commenced a Chapter 11 case, certain post-petition claims are given "administrative expense priority" and receive the highest payment priority of all unsecured claims.[66] At the other end of the spectrum are unsecured claims that arose pre-petition and are not listed in the Bankruptcy Code's statutory priority scheme.[67] These are considered "general" unsecured claims and will typically be "impaired" under the reorganisation plan, meaning the amount of the debtor's liability on the claim will be reduced in the plan to an amount less than the full value of the claim.[68] As mentioned above, general unsecured claims often receive only cents on each dollar.

If a creditor's claim is not deemed an "allowed" claim, the creditor is not entitled to vote on a proposed Chapter 11 plan, and a plan will put classes of creditors (for example, classes holding different types of unsecured claims) into various classes for the purpose of voting on a plan. In addition to having an allowed claim, a creditor's ability to vote on the debtor's plan depends on what type of claim or interest such creditor holds against the debtor. Under Bankruptcy Code section 1124, a class of claims may be "impaired" unless the plan: (i) leaves unaltered the legal, equitable and contractual rights to which the claim or equity interest entitles the holder of such claim or equity interest; or (ii) cures any default, reinstates the original terms of such obligation, compensates the holder for certain damages or losses, as applicable, and does not otherwise alter the legal, equitable or contractual rights to which such claim or equity interest entitles the holder of the claim or equity interest.

A class that is unimpaired, because the plan does not alter the legal, equitable, or contractual rights of the holder of claims or interests, is not eligible to vote on the plan and, instead, is deemed to accept. A holder of an environmental claim will be eligible to vote on the debtor's plan if the holder is placed in a class that is "impaired." In the event that an environmental claim is treated as an administrative expense claim, the claim will be considered "unimpaired" and the holder would not be entitled to vote on the plan. In the event that an environmental claim is treated as a general unsecured claim, the claim may be considered "impaired".

After a period of solicitation of the plan negotiation of plan terms between a debtor and its creditors, the plan is often accepted by the creditors and confirmed by the court.[69] Once the bankruptcy court confirms the plan, the debtor is discharged from any pre-confirmation liabilities that are not set forth in the bankruptcy plan.[70] Thus, if a claim is impaired under the bankruptcy plan, the debtor will be liable only for the reduced amount of the claim provided for in the plan and will be discharged from any further liability on the claim.[71]

The Bankruptcy Code does not specifically address the priority of environmental claims, the rights of governments or regulators as creditors of the company with respect to environmental liabilities and whether environmental liabilities attach to land assets. As explained above, governmental agency rights with respect to the automatic stay are different than those of private parties, which

65 *Ibid*. See also 11 USC, § 1123(a)(1)-(3).

66 *Ibid*. See also 11 USC, § 503 (generally designating claims subject to administrative expense priority); 11 USC, § 507(a)(1) (ranking administrative expenses as first in priority); 11 USC, §§ 1123(a)(1), 1129(a)(9)(A) (regarding the treatment of administrative claims in the bankruptcy plan).

67 *Ibid*.

68 *Ibid*. See 11 USC, § 1124 (describing an impaired claim); 11 USC, § 1129(a)(7) (providing for inclusion of impaired claims in the confirmed reorganization plan). Under 11 USC, § 1129(a)(7)(A)(ii), a claim may be impaired down to the amount that the creditor would have received under a liquidation under Ch 7 of the Bankruptcy Code.

69 *Ibid*. See also 11 USC, § 1126 (dealing with acceptance of the plan by creditors); 11 USC, § 1129 (dealing with confirmation of the plan by the court). A commonly used Chapter 11 alternative to the reorganization plan is the liquidation plan (*see* 11 USC, § 1123(b)(4)), which similarly provides for sale of the company's assets and distribution of proceeds to be paid in accordance with the Bankruptcy Code's priority scheme.

70 *Ibid. See* 11 USC, § 1141(d)(1) ("Except as otherwise provided in this subsection, in the plan, or in the order confirming the plan, the confirmation of a plan–(A) discharges the debtor from any debt that arose before the date of such confirmation").

71 *Ibid*.

may affect claims related to environmental remediation. The issue with environmental liability claims, especially under CERCLA, is that they often consist of complex, contingent or future liabilities that are difficult to value or prioritise. Therefore, it makes it difficult for parties or the bankruptcy court to figure out to what extent, if at all, certain environmental claims should be deemed "allowed" in a debtor's bankruptcy for the purposes of voting on a plan, and what priority they should be given if allowed.

A debtor's ability to restructure under a confirmable plan may hinge upon issues surrounding environmental claims can be determined.

The underlying validity of an environmental claim is determined by non-bankruptcy substantive law (for example, CERCLA), the allowability in bankruptcy of claims against a debtor is determined by the bankruptcy court using the federal bankruptcy law priority scheme explained above (and, if estimated, the application of that law, as described below).[72] Contingent and unliquidated claims may be estimated by the bankruptcy court to avoid undue delay in the administration of a Chapter 11 case.[73] The claims objection process and estimation litigation can be costly and time consuming. If the proceedings are not resolved quickly, disputed, contingent, or unliquidated claims could give rise to questions about the feasibility of the plan – which could ultimately substantially delay, at substantive cost, or prevent, plan confirmation.

Bankruptcy courts have wide discretion in selecting the procedures for a claim estimate proceeding, and the methods employed have ranged from costly, time-consuming evidentiary trials to a simple review of briefs in motion practice.[74] If a bankruptcy court undertakes a full-blown claim estimation hearing, the amount of a claim should be estimated in accordance with the statute or other law (for example, CERCLA) from which the claim arose – however, the bankruptcy court has broad discretion to deviate from a strict construction of that law.[75] Therefore, estimation of a contingent or unliquidated environmental claim will hinge on the substantive merits of the claim and will require evidence from the creditor and debtor about the claims and potential defences thereto.[76] If there is any uncertainty as to the debtor's liability, the nature and extent of contamination, the dollar amount required to clean the site, and the degree to which the bankruptcy court should consider potential insurance (if available), successor liability or other issues, will render the estimate process complex, time consuming, and expensive.[77] Intrinsically, this process also renders the results unpredictable. In the absence of proving the likelihood of success on the merits, claims may be estimated at zero.[78]

Also, as explained above, in order for clean-up liabilities to be estimated – and ultimately potentially discharged by confirmation of a plan of reorganisation – the claim must have arisen before the debtor filed bankruptcy. Determining when the claim arose is critical and will affect the estimation of the claim and determining its priority of payout (for example, general unsecured or priority). This analysis can also be complicated, especially for contingent claims, such as claims seeking future response costs and future natural resource damage costs. Claimants, such as the EPA, would likely to seek to have their claim deemed to be "administrative" and therefore given priority in payment.

[72] Sandra Franco and Melissa Murray, "Treatment of Environmental Liabilities in Bankruptcy" (2011), https://www.morganlewis.com/-/media/files/docs/archive/treatment-of-environmental-liabilites-chapter-15_6242pdf.pdf (reprinted from James B Witkin, *Environmental Aspects of Real Estate and Commercial Transactions* (4th ed, American Bar Association, 2011)).

[73] *Ibid*. See also 11 USC, § 502(c) (citing that the bankruptcy court is required to estimate a contingent or unliquidated claim if its resolution in another forum would unduly delay the administration of the bankruptcy case).

[74] *Ibid*.

[75] *Ibid*.

[76] *Ibid*.

[77] *Ibid*.

[78] *Ibid*.

Different jurisdictions apply various tests to determine when an environmental claim arose, with many endorsing the "fair contemplation" approach.[79] In *In re Jensen*, the US Court of Appeals for the Ninth Circuit held that all future response and natural resource damage costs based on pre-petition conduct that can be "fairly contemplated by the parties" at the time of the debtor's bankruptcy are dischargeable claims under the Bankruptcy Code.[80] Relevant factors include "knowledge by the parties of a site in which there may be liability, notification by the creditor to the debtor of potential liability, commencement of investigation and cleanup activities, and the incurrence of response costs."[81] Other courts have held that an environmental claim arises "when a potential claimant can tie the bankruptcy debtor to a known release of a hazardous substance,"[82] look to when the acts giving rise to the liability occurred[83] or consider when there was a relationship in which liability could arise.[84]

When a spill is applicable, bankruptcy courts generally hold that clean-up liability arises when a spill occurred.[85] Environmental liability will have arisen – and therefore potentially be a dischargeable claim – if the release or threatened release occurred prior to bankruptcy.[86] The effect of the "when the spill occurred" rule is to protect reorganised entities that may receive or realise claims years after a court confirmed their bankruptcy plan. This soft rule does not depend on whether, for example, adjoining property owners had knowledge of the damage the release did to their property[87] or whether the EPA knew about the release before bankruptcy.[88] This is highlighted by the discussion of the recent Peabody Chapter 11 case, below.

As explained above, the Bankruptcy Code grants priority to the payment of administrative expenses, which it defines as the "actual, necessary costs and expenses of preserving the estate."[89] Costs of cleaning up a debtor's site or bringing debtor's operations into compliance with environmental law have been found to benefit the debtor's estate and may therefore be entitled to administrative priority.[90] In the context of environmental claims, courts have expanded the

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79 Dianne R Phillips and Maria de la Motte, "When Considering Bankruptcy, Don't Forget About Environmental Obligation," Holland & Knight Alert (Sept 17, 2020), available at: https://www.hklaw.com/en/insights/publications/2020/09/when-considering-bankruptcy-dont-forget-about-environmental (citing, eg, *In re Crystal Oil Co*, 158 F.3d 291, 298 (5th Cir 1998); *In re Jensen*, 995 F.2d 925, 930 (9th Cir 1993); *In re Nat Gypsum Co*, 139 BR 397, 409 (ND Tex 1992); *In re Motors Liquidation Co*, 598 BR 744, 756 (SDNY 2019)).

80 *Ibid*. See also *In re Jensen*, 995 F.2d 925, 930 (9th Cir 1993).

81 *Ibid*. See also *United Artists Theatre Circuit, Inc v Cal Regional Water Quality Control Bd*, 255 Cal Rptr 3d 796, 831 (2019).

82 *Ibid* (citing *In re Crystal Oil Co*, 158 F.3d at 298).

83 *Ibid* (citing *In re Parker*, 313 F.3d 1267, 1269–70 (10th Cir 2002); *Grady v AH Robins Co*, 839 F.2d 198, 203 (4th Cir 1988)).

84 *Ibid* (citing *In re Motors Liquidation Co*, 598 BR 744, 755 (SDNY 2019)).

85 See *LTV Corp v United States (In re Chateaugay Corp)*, 944 F.2d 997, 1005 (2d Cir 1991) (demands for Superfund response costs from debtor LTV Steel are dischargeable, even if "EPA does not yet know the full extent of the hazardous waste removal costs that it may one day incur and seek to impose upon LTV, and it does not yet even know the location of all the sites at which such waste may yet be found").

86 *Ibid*.

87 See Tom Monteer, "Seven Things to Keep in Mind about Treatment of Environmental Liabilities in Bankruptcy," Paul Hastings Client Alerts (May 20, 2020), available at: https://www.paulhastings.com/insights/client-alerts/seven-things-to-keep-in-mind-about-treatment-of-environmental-liabilities-in-bankruptcy#_ednref13; *see also In re Texaco, Inc*, 182 BR 937, 952 (Bankr SDNY 1995) ("[T]he fact that the alleged contamination damage to Respondents' property was not manifest at the surface does not mean that it was not capable of detection prior to confirmation. There can be no dispute that the alleged subsurface contamination was susceptible of detection by a variety of scientific testing methods which could be performed by environmental engineers … Based on the evidence presented, I find as a fact that any subsurface contamination of Respondents' property that existed prior to the Confirmation Order could have been detected and reasonably quantified or evaluated prior to the Confirmation Order either by Texaco or by the Respondents.").

88 *Ibid*. See also *LTV Corp*, *supra* note 91, 944 F.2d at 1005 ("EPA does not yet know the full extent of the hazardous waste removal costs that it may one day incur and seek to impose upon LTV, and it does not yet even know the location of all the sites at which such waste may yet be found").

89 11 USC, §§ 507(a), 503(b)(1)(A).

90 See Greg Rogers, "Accounting for Environmental Liabilities in Bankruptcy," Eratosthenes (2016), available at: http://www.era-tos-thenes.com/wp-content/uploads/2016/09/Accounting-for-Environmental-Liabilities-in-Bankruptcy.pdf.

meaning of "preserving the estate", under Bankruptcy Code section 503, to encompass protection of the environment and public health.[91] Because 28 U.S.C. § 959(b) requires a debtor to comply with applicable laws, including environmental laws, any future cleanup that a bankruptcy court deems to necessarily benefit the estate as it permits the estate to remain in compliance.[92]

To put this in perspective: if, for example, after a debtor's bankruptcy filing the EPA incurs clean-up costs under CERCLA at property the debtor held during its reorganisation, the EPA's costs would be entitled to administrative priority.[93] On the other hand, a landlord's costs of removing underground storage tanks on its debtor tenant's leasehold, where there was no evidence the tanks had leaked and no government agency ordered the tanks' removal, were not entitled to administrative expense priority.[94] This is because the landlord's tank removal did not benefit the debtor tenant's estate.

Once a bankruptcy court is able to ascertain whether an environmental claim is indeed a claim, when it is an allowed claim, the creditor will have the right to vote on a plan. The claimant can object to its classification (for example, if it was not classified as a priority claim, but a general unsecured claim, but it has ongoing ascertainable clean-up). In order to confirm a plan, section 1126 of the Bankruptcy Code requires that a majority in number (that is, more than half) and two-thirds in dollar amount of the claims voting (of each impaired class of claims) vote to accept the debtor's plan.[95]

Bankruptcy professionals should consider the timing of a claim and how it will be prioritised prior to the commencement of a Chapter 11 case, as there is no set scheme for environmental claims in the United States. Practitioners should be aware of the various approaches to determining when a claim arose as compared to the jurisdiction in which the debtor plans to file its case and the amount of time and effort it may need to expend to have the bankruptcy court estimate a contingent and unliquidated environmental claim.

8. What insolvency and restructuring tools are available to deal with or extinguish environmental liabilities and how effective are they?

As set forth herein, the key to assessing environmental liability of a debtor hinges on the classification of a claim as monetary or remedial, such that it can be discharged in a bankruptcy case. The hallmark principal of the Bankruptcy Code is to give a debtor a "fresh start" upon its successful emergence from bankruptcy.

Bankruptcy practitioners must consider the evolving case law on climate change and interpretations of CERCLA, among other key environmental statutes, and be prepared to address potential environmental liabilities at the commencement of a bankruptcy proceeding.

As described above in section 2 above, climate change claims are a relatively new concept under United States law. On 6 May 2020, in a case of first impression, *In re Peabody Energy Corp*, the US Court of Appeals for the Eighth Circuit found that state statutory and common law climate change tort claims are dischargeable in bankruptcy.[96] The Eleventh Circuit also held that all causes of action brought against the debtor were dischargeable "claims" within the meaning of the Bankruptcy Code and Peabody's confirmed plan, and that none fell into any exception to discharge in the plan.[97]

For context, debtor Peabody Energy Corporation (Peabody), a California energy company, emerged from its Chapter 11 bankruptcy with a confirmed plan of reorganisation effective as of 3

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[91] *Ibid*.
[92] *Ibid*.
[93] Tom Monteer, "Seven Things to Keep in Mind about Treatment of Environmental Liabilities in Bankruptcy" (citing *Pennsylvania v Conroy*, 24 F.3d 568 (3rd Cir 1994); *In re Hemingway Transport, Inc*, 993 F.2d 915 (1st Cir 1993); *In re Smith Douglas, Inc*, 856 F.2d 12 (4th Cir 1988)).
[94] *Ibid* (citing *In re Mahoney-Troast Construction Co*, 189 BR 57 (Bnkr D NJ 1995)).
[95] 11 USC, § 1126.
[96] *In re Peabody Energy Corp*, 2017 WL 4843724 (Bankr ED Mo 2017), offd, 599 BR 610 (ED Mo 2019).
[97] *Ibid*.

April 2017.[98] Several months after the plan was confirmed, three California municipalities – San Mateo County, Marin County and the City of Imperial Beach – sued Peabody and more than thirty other energy companies in California state court for their alleged contributions to global warming between 1965 and 2015.[99] Specifically, the municipalities' complaint alleged that the defendants were responsible for greenhouse gas emissions between 1965 and 2015 that caused sea levels to rise and subsequent damage to property.[100] The complaint asserted a number of causes of action that were rooted in California statutory law for public nuisance and common law theories, including claims for strict liability, design defect, negligence, failure to warn, trespass and private nuisance.[101] The plaintiff municipalities sought compensatory damages, equitable relief, punitive damages, attorneys' fees, disgorgement of profits and cost of suit.[102]

The plaintiff municipalities had not participated in Peabody's Chapter 11 proceedings. Peabody petitioned the bankruptcy court to order the municipalities to dismiss their claims with prejudice, citing that the type of claims asserted by the municipalities had been discharged by its confirmed plan of reorganisation. The bankruptcy court agreed with Peabody and enjoined the municipalities from pursuing their claims against Peabody.[103] The district court upheld the bankruptcy court's order on appeal and both courts refused to grant a stay pending appeal. Refusing to dismiss their claims, the municipalities appealed to the US Court of Appeals for the Eighth Circuit.[104]

In its holding, the Eighth Circuit rejected the municipalities' contention that language in Peabody's Chapter 11 plan exempted their claims from discharge. First, the Eighth Circuit explained that the bankruptcy court had not abused its discretion when interpreting the term "environmental law" in the plan not to include the types of tort claims, ultimately rooted in the common law, that the municipalities sought to bring.[105] Second, the Eighth Circuit rejected the municipalities' attempt to characterise their claims as exercises of "police or regulatory law" (an exception to the automatic stay), citing that the municipalities were asking for a pecuniary advantage over creditors who, unlike them, had participated in the reorganisation proceedings.[106] Finally, the Eighth Circuit held that the municipalities' representative public nuisance actions were dischargeable claims under the Bankruptcy Code, even though the municipalities sought equitable relief.[107] The Eighth Circuit explained that obligations to pay money are construed as "claims" under the Bankruptcy Code, and because a California court could order payments into an abatement fund, the nuisance causes of action were indeed dischargeable claims.[108]

In sum, the Eighth Circuit's *Peabody* decision reaffirmed the Bankruptcy Code's broad definition of "claims" that are dischargeable in bankruptcy and upheld the central principal of US bankruptcy law to give a debtor a "fresh start" upon completing a Chapter 11 reorganisation that was open to all stakeholders.

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[98] Heather Lennox and Matthew C Corcoran, "Peabody Secures Eighth Circuit Victory Upholding Chapter 11 Discharge of Global Warming Claims" (May 2020), available at: https://www.jonesday.com/en/practices/experience/2020/05/peabody-secures-eighth-circuit-victory-upholding-chapter-11-discharge-of-global-warming-claims.

[99] *Ibid*.

[100] *Ibid*.

[101] Dianne R Phillips and Maria de le Motte, "U.S. Court of Appeals Holds That Climate Change Tort Claims Are Dischargeable in Bankruptcy", Holland & Knight Energy and Natural Resource Blog, available at: https://www.hklaw.com/en/insights/publications/2020/08/us-court-of-appeals-holds-that-climate-change-tort-claims.

[102] *Ibid*.

[103] Jones Day, "Peabody Secures Eighth Circuit Victory Upholding Chapter 11 Discharge of Global Warming Claims" (May 2020).

[104] *Ibid*.

[105] *Ibid*.

[106] *Ibid*.

[107] *Ibid.*

[108] *Ibid*.

9. What, if any, implications are there for insurance coverage in relation to environmental claims before, during and post-insolvency proceedings?

A bankruptcy estate is automatically created upon the filing of a bankruptcy petition. Bankruptcy Code section 541(a) defines the scope of the property of the estate, which broadly includes all legal or equitable interests of the debtor in tangible and intangible property, by whomever held or wherever located (the debtor or a third party), as of the petition date. Generally, a debtor's insurance policies are considered property of a debtor's estate. To the extent that proceeds of an insurance policy are payable to a debtor due to loss or damage of property, such proceeds are also considered part of the estate.

Indeed, the United States Trustee operational guidelines[109] and other applicable law require debtors to maintain insurance policies while operating in a Chapter 11 case. Insurance premiums that arise post-petition can be paid in the ordinary course of business without approval of the bankruptcy court. If pre-petition insurance premiums remain unpaid as of the petition date, the debtor must obtain authority from the bankruptcy court to pay the premiums as pre-petition claims under sections 105, 363, 364, or 365 of the Bankruptcy Code – such relief is the subject of what is commonly known as a "first day" motion (meaning it is filed on the first day of a case). Since a debtor is required to maintain insurance, "first day" insurance motions typically do not draw objection.

In practice, this means that once a Chapter 11 case is commenced, a debtor's insurance policies, including those that would cover director and officer liability (D&O), environmental liabilities or property damage that could be caused from contamination (to the extent it was included in the policy) would remain effective. Third parties are eligible to receive payments from insurance companies for such claims, which may be settled through legal proceedings (with bankruptcy court relief of stay) or privately between the debtor and insurance company. To the extent that an insurance policy is capped in the amount it can payout (for example, if there is a claim for USD 1,000,000 in contamination damage, the debtor's insurance policy will only pay out USD 500,000), such party would need to seek relief from stay for payment of the balance. Depending on when the claim arose, the claim would be characterised and pre- or post-petition (or administrative) and be subject to the debtor's claims administration process or discharge under a plan.

10. Are there any cross-border insolvency and restructuring issues that may arise in relation to environmental claims and liabilities?

International lenders must be aware of potential environmental liabilities that may be imputed to them when exercising their rights over collateral. Also, to the extent that there have been international contamination issues, claims may be discharged if they were not brought as part of a United States debtor's bankruptcy proceeding (similar to the *Peabody* case discussed above). However, this area of law is continuously evolving and may be subject to future update.

[109] When a debtor files for Chapter 11 bankruptcy in the United States, an office of the United State Department of Justice, the Office of the United States Trustee (US Trustee), oversees the administration of the bankruptcy case. The US Trustees' offices are broken out by region – for instance, "region 2" covers the US bankruptcy courts seated in New York, Connecticut and Vermont. Each region publishes guidelines that debtors must follow when submitting pleadings and administering their cases.

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