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A Quagmire of Obligations

Making Sense of the Intersection of CERCLA And the Bankruptcy Code

By Eric R. Wilson and Mark W. Page

Pending in bankruptcy court in Corpus Christi, TX, is *In re ASARCO, LLC, et al.*, the largest environmental bankruptcy case ever filed. Founded in 1899, ASARCO had diverse mining, smelting, and refining operations across the country. Unfortunately, ASARCO's 108 years of operation left a legacy of environmental liability spanning roughly 94 sites in 21 states. As a result, the United States, 16 states, and 73 private potentially responsible persons (PRPs) asserted more than $6 billion in environmental claims against ASARCO's bankruptcy estate.

At present, ASARCO is concluding the estimation of such claims for purposes of allowance (not just for plan voting or feasibility) at more than 30 sites. The estimation proceedings involve numerous unsettled issues arising at the intersection of the Bankruptcy Code and environmental law, including the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA). The Bankruptcy Code is premised on granting the debtor a discharge of its pre-bankruptcy obligations while CERCLA was enacted to ensure PRPs are held accountable for the cleanup of contaminated property. When a PRP

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Termination Premiums Under ERISA Held To Be Dischargeable Prepetition Claims

By William J.F. Roll, III, Michael H. Torkin and Solomon J. Noh

In a matter of first impression, the United States Bankruptcy Court for the Southern District of New York held that the termination premiums assessed against Oneida Ltd. ("Oneida") as a result of the termination of one of Oneida's pension plans during its Chapter 11 case were prepetition "claims" (as defined in § 101(5) of title 11 of the United States Code (the "Bankruptcy Code")) that were discharged under Oneida's confirmed plan of reorganization. *Oneida Ltd. v. Pension Ben. Guar. Corp. (In re Oneida Ltd.)*, Case No. 06-01920 (ALG), 2008 WL 516493 (Bankr. S.D.N.Y. Feb. 27, 2008) (the "Memorandum Opinion").

The controversy at issue in the court's decision originated from The Deficit Reduction Act of 2005 ("DRA"), which amended the Employee Retirement Income Security Act of 1974 ("ERISA") to require a debtor that effectuates a "distress" termination of an underfunded pension plan in Chapter 11 to pay termination premiums to the Pension Benefit Guaranty Corporation (the "PBGC") following its discharge in bankruptcy. (The termination premiums are not applicable to a debtor that does not receive a bankruptcy discharge, including a debtor that liquidates after terminating its pension plan obligations.) Those premiums, set at $1,250 per employee covered by the terminated plan, per year for three years, could amount to hundreds of millions of dollars in post-bankruptcy liabilities for reorganized debtors, and could limit significantly the benefits of terminating an underfunded pension plan in Chapter 11. In certain cases, the cost of the termination premiums could even exceed the amount of the terminated pension funding liability.

The bankruptcy court's decision establishing the dischargeability of these post-bankruptcy emergence obligations has broad-ranging implications, not just for troubled industries that are burdened with unsustainable "legacy" liabilities (such as the automotive sector, for example), but for all Chapter 11 debtors.

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BACKGROUND

Oneida is one of the world's largest marketers of stainless steel silverware and flatware products. Following an unsuccessful out-of-court financial restructuring in late 2004, Oneida and its domestic affiliates filed for Chapter 11 bankruptcy protection in March 2006, shortly after the enactment of the DRA on Feb. 8, 2006. Concurrently with the filing of its bankruptcy petition, Oneida filed a motion before the bankruptcy court seeking to terminate all of its pension plans pursuant to the distress termination procedures contained in § 4041(c)(2)(B)(ii) of ERISA. The PBGC, a governmental corporation that guarantees benefits offered under defined benefit pension plans (up to a statutory limit), stood to become the trustee of Oneida's pension plans if the bankruptcy court were to approve Oneida's motion.

In the course of the Chapter 11 case, Oneida and the PBGC arrived at a settlement whereby, among other things, Oneida agreed to retain and continue funding two of its three underfunded pension plans, the PBGC consented to the termination of the pension plan with the largest underfunding liability (the "Oneida Pension Plan") of nearly $35 million, and the parties agreed to reserve all of their rights with respect to the enforceability of the termination premiums. In May 2006, the bankruptcy court approved the distress termination of the Oneida Pension Plan on the basis of this settlement. In September 2006, Oneida emerged from Chapter 11 pursuant to a confirmed plan of reorganization that, among other things, provided for zero recovery on, and complete discharge of, all claims resulting from the distress termination of the Oneida Pension Plan.

Following Oneida's emergence from bankruptcy, the PBGC demanded approximately $7 million in termination premiums from Oneida, an amount the PBGC argued was payable as a result of the distress termination of the Oneida Pension Plan in Chapter 11. In November 2006, Oneida commenced an adversary proceeding before the bankruptcy court seeking a declaratory judgment that the termination premiums owed to the PBGC were prepetition claims against Oneida's bankruptcy estate that were discharged pursuant to its confirmed Chapter 11 plan.

In December 2006, the PBGC filed a motion with the United States District Court for the Southern District of New York to "withdraw the reference" to the bankruptcy court of the adversary proceeding. The PBGC's motion cited to 28 U.S.C. § 157(d), which, among other things, requires district courts to withdraw the automatic reference to the bankruptcy court in the event that the resolution of the issues presented requires "significant interpretation, as opposed to simple application[,] of federal non-bankruptcy statutes." *Keene Corp. v. Williams Bailey & Wesner L.L.P. (In re Keene Corp.)*, 182 B.R. 379, 381-382 (S.D.N.Y. 1995). The PBGC argued that the adversary proceeding must be heard before the district court because the bankruptcy court would need to engage in a "significant interpretation" of ERISA in order to resolve the issues underlying the termination premium dispute, an act that is prohibited under 28 U.S.C. § 157(d). The district court disagreed with the PBGC and declined to withdraw the reference to the adversary proceeding, finding that in order to resolve the dispute in connection with the termination premiums, "the [bankruptcy court] will be required to do what it does on a routine basis: determine whether the [termination premiums] are post-petition obligations that must be paid by Oneida upon reorganization, or pre-petition 'claims' that may be discharged pursuant to [Oneida's plan of

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William J.F. Roll, III and **Michael H. Torkin** are partners at Shearman & Sterling LLP, New York, in the Litigation Group and the Bankruptcy & Reorganization Group, respectively. **Solomon J. Noh** is an associate in the firm's Bankruptcy & Reorganization Group.

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Rediscovering Chapter 9

Part One of a Two-Part Article

By Erica M. Ryland
and Mark G. Douglas

Even though Chapter 9 of the Bankruptcy Code has been in effect for over 30 years, fewer than 100 cases have been filed during that time. Municipal bankruptcy cases — or, more accurately, proceedings involving the adjustment of a municipality's debts — are a rarity, compared with reorganization cases under Chapter 11. The infrequency of Chapter 9 filings can be attributed to a number of factors, including the reluctance of municipalities to resort to bankruptcy protection due to its associated stigma and negative impact, perceived or otherwise, on a municipality's future ability to raise capital in the debt markets. Also, Chapter 9's insolvency requirement, which exists nowhere else in the Bankruptcy Code, actually discourages municipal bankruptcy filings.

As the enduring fallout from the sub-prime mortgage disaster and the commercial credit crunch that it precipitated continue to paint a grim picture portending hard times ahead for the U.S. economy, municipalities are suffering from a host of troubles. Among them are skyrocketing mortgage foreclosure rates and a resulting loss of tax base, bad investments in derivatives and the higher cost of borrowing due to the meltdown of the bond mortgage industry and the demise (temporary or not) of the $330 billion market for auction rate securities ("ARS"), which municipalities have relied upon for nearly two decades to float inexpensive debt. The cost of borrowing in the ARS market has almost doubled since January 2008, according to the Securities Industry and Financial Markets Association. This confluence of financial woes is likely to propel an increasing number of municipalities to the brink of insolvency and beyond. This, in turn, may mean a significant uptick in the volume of Chapter 9 filings. In anticipation of Chapter 9's emergence from relative obscurity, it is important to understand what degree of utility federal bankruptcy law has in addressing municipal financial problems.

Erica M. Ryland is a partner in the Business Restructuring and Reorganization Practice of Jones Day in New York. **Mark G. Douglas**, a member of this newsletter's Board of Editors, is Jones Day's Restructuring Practice Communications Coordinator and Managing Editor of the *Jones Day Business Restructuring Review*. The views expressed in this article are the personal views of the authors and do not necessarily reflect those of Jones Day or its clients.

Constitutional Conflict

Ushered in during the Great Depression to fill a vacuum that previously existed in both federal and state law, federal municipal bankruptcy law suffered from a constitutional flaw that endures in certain respects to this day — the Tenth Amendment reserves to the states' sovereignty over their internal affairs. This reservation of rights caused the U.S. Supreme Court to strike down the first federal municipal bankruptcy law as being unconstitutional in 1936, and it accounts for the limited scope of Chapter 9 as well as the severely restricted role that the bankruptcy court plays in presiding over a Chapter 9 case and in overseeing the affairs of a municipal debtor.

Chapter 9 Eligibility

Access to Chapter 9 is limited to municipalities. A "municipality" is defined by § 101(40) of the Bankruptcy Code as a "political subdivision or public agency or instrumentality of a State." Section 109(c) of the Bankruptcy Code sets forth other prerequisites to relief under Chapter 9:

- A state law or governmental entity empowered by state law must specifically authorize the municipality (in its capacity as such or by name) to file for relief under Chapter 9;
- The municipality must be insolvent;
- The municipality must "desire[] to effect a plan" to adjust its debts *and* must either: 1) have obtained the consent of creditors holding at least a majority in amount of claims in classes that will be impaired under the plan; 2) have failed to obtain such consent after negotiating with creditors in good faith; 3) be unable to negotiate because negotiation is "impracticable"; or 4) reasonably believe that a "creditor may attempt to obtain" a transfer that is avoidable as a preference.

The municipal debtor bears the burden of establishing that it is eligible for relief under Chapter 9. *In re Sullivan County Reg'l Refuse Disposal Dist.*, 165 B.R. 60, 72-73 (Bankr. D.N.H. 1994).

Prior to 1994, the authorization requirement had been construed to require general authority, rather than specific authorization by name, for a municipality to seek Chapter 9 relief. *See, e.g., In re Westport Transit Dist.*, 165 B.R. 93, 96 (Bankr. D. Conn. 1994) ("state law only needs to give 'some indication' that the entity is authorized to be a Chapter 9 debtor."). However, the Bankruptcy Reform Act of 1994 amended section 109(c)(2) to require that a municipality be "specifically authorized" to be a debtor under Chapter 9. Courts construing the amended provision have concluded that state law must provide express written authority for a municipality to seek Chapter 9 relief and that the authority must be "exact, plain, and direct with well-defined limits so that nothing is left to inference or implication." *In re County of Orange*, 183 B.R. 594, 604 (Bankr. C.D. Cal. 1995); *accord Suntrust Bank v. Alleghany-Highlands Econ. Dev. Auth. (In re Alleghany-Highlands Economic Dev. Auth.)*, 270 B.R. 647, 649 (Bankr. W.D. Va. 2001).

As noted, no other chapter of the Bankruptcy Code includes insolvency among the criteria for relief. "Insolvency" in the context of Chapter 9 eligibility does not refer to balance sheet insolvency. Instead, it requires a showing that, as of the filing date, the debtor either: 1) is generally not paying its undisputed debts as they become due; or 2) is

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unable to pay its debts as they mature. *See* 11 U.S.C. § 101(32)(C); *see also In re McCurtain Municipal Authority*, 2007 WL 4287604 (Bankr. E.D. Okla. Dec. 4, 2007) (observing that the test for insolvency under section 101(32)(C)(i) looks to current, general nonpayment, while the test under section 101(32)(C)(ii) is an "equitable, prospective test looking to future inability to pay."); *In re Mount Carbon Metropolitan Dist.*, 242 B.R. 18, 32-33 (Bankr. D. Colo. 1999) ("The insolvency requirement has a functional rather than a balance sheet focus; to be insolvent, a municipality either is not paying its debts as they come due or will be unable to do so."); *In re City of Bridgeport*, 129 B.R. 332, 337 (Bankr. D. Conn. 1991) (although city was in financial distress, it was not insolvent and was thus ineligible to file for Chapter 9; using cash flow analysis, "to be found insolvent a city must prove that it will be unable to pay its debts as they become due in its current fiscal year or, based on an adopted budget, in its next fiscal year.").

The dictate that a municipality "desires to effect a plan to adjust" its debts "requires that the purpose of the filing of the Chapter 9 petition not simply be to buy time or to evade creditors." 2 COLLIER ON BANKRUPTCY ¶ 109.04[d] (15th ed. rev. 2008). A debtor need satisfy only one of the pre-filing requirements set forth in section 109(c)(5), *see In re Ellicott Sch. Bldg. Auth.*, 150 B.R. 261, 265-66 (Bankr. D. Colo. 1992), all of which are unique to Chapter 9. The pre-filing negotiation requirements were inserted by Congress to prevent capricious Chapter 9 filings. 2 COLLIER ON BANKRUPTCY ¶ 109.04[e].

GOOD-FAITH FILING REQUIREMENT

Section 921(c) states that "[a]fter any objection to the petition, the court, after notice and a hearing, may dismiss the petition if the debtor did not file the petition in good faith or if the petition does not meet the requirements of this title." No other Chapter of the Bankruptcy Code expressly incorporates a good-faith filing requirement. *See Sullivan County*, 165 B.R. at 80. If the court does not dismiss the petition under section 921(c), it "shall" order relief under Chapter 9. 11 U.S.C. § 921(d). Notwithstanding its permissive language, section 921(c) has been construed as requiring dismissal of a petition filed by a debtor that is ineligible for relief under Chapter 9. *See In re Valley Health System*, 2008 WL 616283, *2 (Bankr. C.D. Cal. Feb. 20, 2008); *County of Orange*, 183 B.R. at 599; *see generally* 6 COLLIER ON BANKRUPTCY ¶ 921.04[4] at 921-7. Factors that may be relevant in determining whether a Chapter 9 petition has been filed in good faith include:

1. the debtor's subjective beliefs;
2. whether the debtor's financial problems can be addressed by Chapter 9;
3. whether the debtor's motivation for filing is consistent with the purposes of Chapter 9;
4. the extent of the debtor's prepetition negotiations, if practical;
5. the extent to which the debtor considered alternatives to Chapter 9; and
6. the scope and nature of the debtor's financial problems.

Id. at 921-6 (citations omitted). Standing alone, a municipal debtor's refusal to impose or raise assessments or to borrow funds is not sufficient to warrant a finding of bad faith. *See McCurtain*, 2007 WL 4287604, at *6; *In re Chilhowee R-IV School Dist.*, 145 B.R. 981, 983 (Bankr. W.D. Mo. 1992). Dismissal of a Chapter 9 case is the only option if the debtor does not seek Chapter 9 relief in good faith or cannot confirm a plan — the assets of a Chapter 9 debtor cannot be liquidated involuntarily.

Part Two of this article will discuss the bankruptcy court's limited role, a plan for adjustment of debts, the dismissal option, and the outlook for Chapter 9.

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reorganization]." *See Oneida Ltd. v. Pension Ben. Guar. Corp.*, 372 B.R. 107, 111 (S.D.N.Y. 2007).

With the procedural dispute as to where to conduct the adversary proceeding having been resolved, in October 2007, Oneida filed a motion for summary judgment in its favor on all counts asserted in its complaint. The PBGC countered with a summary judgment motion opposed to the requested relief.

DECISION

On Feb. 27, 2008, the bankruptcy court issued the Memorandum Opinion granting Oneida's summary judgment motion and denying the PBGC's summary judgment motion. In the Memorandum Opinion, the bankruptcy court expressly held that the termination premiums assessed against reorganized Oneida were prepetition claims that were discharged under Oneida's confirmed Chapter 11 plan of reorganization. *Oneida Ltd. v. Pension Ben. Guar. Corp. (In re Oneida Ltd.)*, Case No. 06-01920 (ALG), 2008 WL 516493, at *13 (Bankr. S.D.N.Y. Feb. 27, 2008).

In holding that "the [termination premium] in a Chapter 11 case is a classic contingent claim," *Id.* at *6, the bankruptcy court reaffirmed the well-established principle that the term "claim," as defined in the Bankruptcy Code, is to be interpreted broadly to ensure "that all legal obligations of the debtor, *no matter how remote or contingent*, will be … dealt with in the bankruptcy case." *Id.* at *5 (emphasis added) (quoting *United States v. LTV Corp. (In re Chateaugay Corp.)*, 944 F.2d 997, 1003 (2d Cir. 1991)). Rejecting the PBGC's argument that the termination premiums cannot be "claims" because the obligation to pay such amounts does not arise until after the date of the debtor's discharge, the bankruptcy court held that, although non-bankruptcy law (here, ERISA) governs the liquidated value of, the enforceability of, and defenses to, a right of payment, bankruptcy law determines whether a claim exists and whether such claim arose pre- or post-petition. *Id.* at *6.

The bankruptcy court noted that in order for it to adopt the PBGC's

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position that the termination premiums had survived Oneida's Chapter 11 discharge, the court would have to find that the DRA had impliedly amended the Bankruptcy Code to provide for the non-dischargeability of the termination premium obligations. The bankruptcy court was unable to make such a finding because of the strong presumption that a later law does not impliedly amend an established one, such as the Bankruptcy Code. *Id.* at *8. Indeed, the PBGC had made no effort to overcome this presumption on the basis that an irreconcilable conflict exists between the amended ERISA statute and the Bankruptcy Code. *Id.* To the contrary, the bankruptcy court found that a proper reconciliation of the DRA with the Bankruptcy Code's discharge provision produces a contingent unsecured claim in the amount of the termination premiums that is subject to compromise through the bankruptcy process. *Id.*, n. 11. (The court noted, however, that pursuant to Oneida's confirmed Chapter 11 plan of reorganization, the PBGC's prepetition claims for the termination premiums had received zero recovery and been discharged. *Id.*)

Although the PBGC made no attempt to rebut the presumption against implied repeal and amendment by demonstrating a "clear and manifest" intent of Congress to amend the Bankruptcy Code through the DRA, the bankruptcy court nevertheless found that no such showing could have been made. *Id.* In fact, the bankruptcy court found evidence to the contrary, noting, for example, that only a few months prior to the adoption of the DRA, Congress had amended the Bankruptcy Code to create several new non-dischargeable claims, but it had not included the termination premiums in that amendment. *Id.* The court, therefore, found that the DRA had not impliedly amended the Bankruptcy Code to provide for the non-dischargeability of the termination premiums.

Having established that they qualified as "claims" under the Bankruptcy Code, the bankruptcy court also found that the termination premiums were *prepetition* claims that are subject to compromise in Chapter 11 (and thus can be paid cents on the dollar), as opposed to *postpetition administrative expenses* that must be paid in full before a debtor can emerge from Chapter 11. *Id.* at *13. The bankruptcy court's decision was based on the fact that the termination of the Oneida Pension Plan was well within the realm of possibilities contemplated by Oneida and the PBGC prior to Oneida's Chapter 11 filing. The DRA was enacted prior to Oneida's petition date, and, as the bankruptcy court noted, the parties had met on at least two separate occasions prior to the bankruptcy filing to negotiate the terms of the pension plan termination. *Id.* at *10. In other words, the termination premiums were *prepetition* unsecured claims for many of the same reasons that they qualified as *contingent* claims in the first instance. Moreover, the bankruptcy court reasoned that the termination premiums could not qualify as administrative expense claims because the imposition of such amounts had not benefited Oneida in the operation of its business during the pendency of the Chapter 11 case. *Id.* at *11.

On March 28, 2008, the PBGC filed a notice of appeal in connection with the bankruptcy court's decision.

Ramifications

The Memorandum Opinion allows a debtor that effectuates a distress termination of a pension plan in Chapter 11 to exit bankruptcy without the potentially crippling post-emergence costs associated with the termination premiums. Under the bankruptcy court's ruling, the PBGC's claim for termination premiums owed by a debtor would be subject to compromise (as a prepetition unsecured claim) through the plan of reorganization confirmed in the debtor's Chapter 11 case, and it would be discharged upon its emergence from bankruptcy. Given the formula for calculating the termination premiums, the claim amount likely would constitute a substantial portion of the debtor's claims pool, which could materially diminish the recovery of competing creditors. It therefore is possible that going forward, the debtor, or the official committee of unsecured creditors appointed in the debtor's Chapter 11 case, will seek to characterize the termination premiums as "penalties" and move to equitably subordinate such claims under section 510(c) of the Bankruptcy Code. *See, e.g., In re Justin Colin*, 44 B.R. 806, 810 (Bankr. S.D.N.Y. 1984) (in subordinating a penalty claim pursuant to § 510(c) of the Bankruptcy Code, bankruptcy court considers impact on competing creditors).

Moreover, a debtor that effectuates a distress termination of a pension plan in Chapter 11 may be able to avoid incurring the termination premiums in the first instance by appropriately structuring its bankruptcy case. As the bankruptcy court discussed in the Memorandum Opinion, based on the plain reading of the DRA — under which bankruptcy discharge is one of the conditions to the incurrence of the termination premiums — the termination premiums are not assessed against a debtor that liquidates in Chapter 11. *Oneida*, 2008 WL 516493, at *6, n. 8 ("If a corporate debtor liquidates in Chapter 11, it does not obtain a discharge [citation omitted]."). As a result, it is possible that a debtor could avoid the imposition of termination premiums by conducting a sale of its assets in Chapter 11 under section 363 of the Bankruptcy Code, and then distributing the proceeds under a liquidating Chapter 11 plan.

In addition to the importance for companies needing to terminate their pension plans in Chapter 11, the Memorandum Opinion also is significant because it reaffirms the truly expansive scope of the term "claim" under the Bankruptcy Code and enhances the ability of debtors to emerge from bankruptcy with a "fresh start." The bankruptcy court also made clear in its decision that in order to render an obligation that otherwise qualifies as a "claim" non-dischargeable in bankruptcy, Congress must express its clear and

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unambiguous intent to that effect, which the court found to be lacking with respect to the termination premiums.

It remains to be seen whether Congress will further legislate an amendment to the Bankruptcy Code to clarify its original intent. In the meantime, at least until the termination premium dispute is finally resolved through appellate review, debtors and the PBGC would be well-served to negotiate up-front how the termination premiums should be treated in the bankruptcy case. For a debtor, raising this issue in its prepetition negotiations with the PBGC would allow it to argue that the termination premiums are *prepetition* claims because the parties had contemplated, prior to the filing of the Chapter 11 case, the possibility that such premiums may be incurred. The PBGC also has incentives to negotiate how the termination premiums are treated in the debtor's plan of reorganization, because alternatively, it runs the risk of having its claim for the termination premiums discharged without having received any recovery on that claim. In other words, at least in the short term, the bankruptcy court's decision in *Oneida v. PBGC* is likely to incentivize debtors and the PBGC to arrive at a consensual resolution regarding the treatment of the termination premiums arising under the newly amended ERISA.

CERCLA

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becomes a debtor, courts struggle to reconcile the competing objectives of these comprehensive statutes.

This article provides an overview of four significant areas of contention. It starts with a brief summary of CERCLA to serve as a foundation for the discussion of bankruptcy issues that follows. It then addresses the scope of the debtor's liability for cleanup costs, discharge of the debtor's obligations to clean up contaminated property, abandonment of contaminated property, and treatment of contingent PRP reimbursement and contribution claims.

CERCLA Basics

CERCLA permits the government to clean up a site or to compel PRPs to perform the cleanup. In either case, the government is entitled to recover response costs from PRPs. *Cooper Indus., Inc. v. Aviall Servs., Inc.*, 543 U.S. 157, 161 (2004).

Generally, in CERCLA cost recovery actions, each PRP is jointly and severally liable for all of the government's response costs. Liability may be apportioned among PRPs only in narrow instances where a PRP can establish it caused a distinct harm or only part of a single, divisible harm. *See, e.g., United States v. Burlington N. & Santa Fe Ry. Co.*, 502 F.3d 781, 793-800 (9th Cir. 2007).

The Supreme Court has confirmed that PRPs faced with joint and several liability may recover from other PRPs in two ways. In *Cooper Industries, Inc. v. Aviall Services, Inc.*, 543 U.S. at 167, the Court held that CERCLA § 113(f) permits a PRP to seek contribution from other PRPs provided that: 1) the government has commenced a cost recovery suit against the PRP; or 2) the PRP has entered into a judicially or administratively approved settlement with the government. In a contribution action, the court allocates response costs among co-PRPs based on equitable factors such that each PRP is only responsible for its fair share of the costs.

In *United States v. Atlantic Research Corp.*, 127 S. Ct. 2331, 2338 (2007), the Court held that CERCLA § 107(a) also permits a PRP that performs a voluntary or administratively compelled cleanup to bring a direct action against other PRPs to recover costs.

Based on these provisions and analogous state statutes, PRPs have asserted claims against ASARCO for its allocable share of past costs incurred at the sites and costs that may be incurred in the future for which ASARCO bears partial or full responsibility.

CERCLA Joint and Several Liability in Bankruptcy

Whether a debtor is jointly and severally liable for response costs can have a tremendous impact on a bankruptcy case. For example, if jointly and severally liable, ASARCO estimates its exposure for just five sites at more than $6 billion. If, however, ASARCO is only severally liable, ASARCO estimates its exposure at the same sites to be less than $728 million.

Notwithstanding CERCLA's rule of joint and several liability, ASARCO has maintained that, because of the bankruptcy filing, its liability should be limited to its allocable share based on the equitable factors used to allocate liability among PRPs in contribution actions.

Whether joint and several liability under CERCLA applies in bankruptcy would seem to be controlled by *Butner v. United States*, 440 U.S. 48 (1979), and its progeny. In *Butner*, the Supreme Court held that non-bankruptcy law governs the substance of claims in bankruptcy and that "undefined considerations of equity" provide no basis for departing from that law. The Court has consistently applied this principle to reject special bankruptcy rules for adjudicating claims not founded in the Bankruptcy Code. *See Travelers Cas. & Sur. Co. of Am. v. Pacific Gas & Elec. Co.*, 127 S. Ct. 1199 (2007) (rejecting special bankruptcy rule categorically disallowing certain contractual claims for attorneys' fees); *Raleigh v. Illinois Dep't of Rev.*, 530 U.S. 15 (2000) (rejecting special bankruptcy rule reversing burden of proof on tax claim).

Indeed, the only bankruptcy decision to address this question, *In re National Gypsum Co.*, 139 B.R. 397 (N.D. Tex. 1992), flatly rejected a special bankruptcy rule abrogating joint and several liability under CERCLA. Like ASARCO, the debtors in that case argued that the equitable nature of bankruptcy required that the government's response cost claims be limited to the debtors' equitable share of liability. The court, however, held that, absent a finding of divisibility, the debtors would be jointly and severally liable.

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Although this issue has been raised in *ASARCO*, it has not been necessary for the bankruptcy court to rule on the issue. A ruling adverse to ASARCO would greatly reduce its leverage in settlement negotiations with the government and significantly alter the landscape of any reorganization plan.

Discharge of Cleanup Obligations in Bankruptcy

ASARCO reports that it has spent millions of dollars during bankruptcy cleaning up contaminated property it owns, and that post-bankruptcy cleanup obligations will cost millions more. ASARCO has asserted that it is not required to clean up property it no longer owns or possesses, and any such obligations are dischargeable in bankruptcy as general unsecured claims.

Because of the expense involved, the debtor's ability to discharge cleanup obligations can have a significant impact on a bankruptcy case. The extent to which a debtor-PRP must clean up property turns on whether the cleanup obligations can be discharged as a bankruptcy claim. The Bankruptcy Code defines a claim, in pertinent part, as a "right to an equitable remedy for breach of performance if such breach gives rise to a right to payment." 11 U.S.C. § 101(5)(B). The question is whether the debtor's breach of its cleanup obligations gives rise to a right to payment as an alternative to the equitable remedy, typically an injunction, requiring the cleanup.

The leading case on the issue is *Ohio v. Kovacs*, 469 U.S. 274 (1985). There, Kovacs agreed to a cleanup order on behalf of himself and his company. When the cleanup was not performed, the state obtained appointment of a receiver, who took possession of the site and divested Kovacs of his assets. Kovacs then filed for bankruptcy, and the Supreme Court held that his cleanup obligations under the order were dischargeable.

In reaching its holding, the Court reasoned that the receiver had completely disabled Kovacs from performing the cleanup himself and that the only performance the state sought from Kovacs was the payment of money. In these circumstances, the Court held that the state had converted the cleanup order into a dischargeable obligation to pay money.

The Court, however, emphasized that "anyone in possession of the site … must comply with the environmental laws of the State of Ohio. Plainly, that person or firm may not maintain a nuisance, pollute the waters of the State, or refuse to remove the source of such conditions." 469 U.S. at 285.

Courts have relied on *Kovacs* both to preclude debtors from discharging obligations to clean up contaminated property they own or possess, and to permit debtors to discharge such obligations at contaminated sites they do not own or possess. *Compare In re CMC Heartland Partners*, 966 F.2d 1143 (7th Cir. 1992) (holding that debtor who is current owner of property must comply with environmental laws because such obligations "run[] with the land"), *with United States v. Whizco, Inc.*, 841 F.2d 147 (6th Cir. 1988) (holding debtor's obligations under order to clean up and reclaim abandoned mines are discharged to extent debtor would have to spend money to comply with order).

However, in *In re Torwico Electronics, Inc.*, 8 F.3d 146 (3d Cir. 1993), a decision that continues to generate considerable debate, the Third Circuit construed *Kovacs* narrowly to preclude the debtor from discharging its obligations under an order requiring the debtor to clean up property it operated before bankruptcy pursuant to a lease. Even though the debtor had moved from the site almost four years before filing bankruptcy, the court held that the debtor had continuing obligations under state law to clean up waste posing an ongoing hazard at the site. According to the Third Circuit, the obligations "run with the waste." *See also AM Int'l, Inc. v. Datacard Corp.*, 106 F.3d 1342, 1348 (7th Cir. 1997) (refusing to recognize discharge of debtor's obligations under order obtained by private party to clean up property debtor had sold before bankruptcy and no longer possessed).

ASARCO has relied on *Kovacs* for the proposition that its cleanup obligations at sites it no longer owns or possesses are dischargeable. Although the government, not surprisingly, has taken a contrary position, it has not actively pursued enforcement of orders requiring ASARCO to clean up such sites.

Abandonment of Contaminated Property in Bankruptcy

An issue lurking in the background in *ASARCO* is whether ASARCO could avoid its cleanup obligations by abandoning owned property. Bankruptcy Code § 554 provides that a debtor may, subject to court approval, abandon property of the estate that is burdensome or of inconsequential value and benefit. As discussed below, abandonment probably does little to help a reorganizing Chapter 11 debtor like ASARCO avoid its cleanup obligations.

Limitation on Abandonment: 'Imminent and Identifiable Harm'

The leading case on abandonment of contaminated property is *Midlantic National Bank v. New Jersey Department of Environmental Protection*, 474 U.S. 494 (1986). The *Midlantic* court held that § 554 does not authorize abandonment of property in contravention of state laws reasonably designed to protect the public's health or safety from identified hazards. The court cautioned that this exception is narrow: it does not "encompass a speculative or indeterminate future violation of such laws that may stem from abandonment. The abandonment power is not to be fettered by laws or regulations not reasonably calculated to

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Eric R. Wilson is a partner at Kelley Drye & Warren LLP, resident in the New York office. **Mark W. Page** is special counsel at the firm, resident in the Chicago office. Their practices focus on corporate restructuring, bankruptcy and creditors' rights, including the representation of PRPs and other creditors. This article reflects the opinions of the authors and does not represent the views of Kelley Drye & Warren LLP or its clients. You can contact the authors by e-mailing ewilson@kelleydrye.com or mpage@kelleydrye.com.

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protect the public health or safety from imminent and identifiable harm." *Id.* at 507 n.9.

Applying these principles, courts typically permit abandonment unless the contamination poses an actual danger of imminent and identifiable harm to the public health and safety. *See, e.g., In re L.F Jennings Oil Co.*, 4 F.3d 887, 890-91 (10th Cir. 1993) (permitting abandonment when state failed to introduce sufficient data to establish such a threat and had indicated it was not considering further action at site).

Effect of Abandonment On Cleanup Obligations

The utility of abandonment depends on what happens to the abandoned property. While § 554 does not specify to whom estate property is abandoned, its legislative history explains that property may be abandoned to any party with a possessory interest in the property. *See In re Interpictures Inc.*, 217 F.3d 74, 76 (2d Cir. 2000). That party is typically the debtor.

In a Chapter 7 case, abandonment of contaminated property to the debtor allows the trustee to avoid cleanup obligations as owner of that property. In a Chapter 11 liquidation, the debtor typically ends up as an assetless shell without resources to clean up abandoned property. Consequently, the cleanup proponent's recourse when property is abandoned to a liquidating debtor is limited to filing a claim for cleanup costs. However, in a Chapter 11 reorganization such as *ASARCO*, abandonment to the debtor would seem to accomplish little as the reorganized debtor will continue as owner. *See CMC*, *supra*.

DISPOSITION OF PRP CLAIMS

In *ASARCO*, approximately 73 PRPs are potentially liable with ASARCO to the government for past and future cleanup costs. Because future cleanup costs may not be established for many years, the government often files contingent, unliquidated claims for such costs. PRPs generally file related claims for the debtor's share of any such costs they may be required to pay the government in the future based on joint and several liability. ASARCO has objected under Bankruptcy Code § 502(e)(1)(B) to certain PRPs' contingent reimbursement and contribution claims for future costs. That section provides for disallowance of a PRP's contingent reimbursement and contribution claims where the PRP is co-liable with the debtor to the government. ASARCO maintains that, unless such claims are fixed at the time of allowance, § 502(e)(1)(B) requires that they be disallowed to prevent ASARCO from being held liable to both the government and co-PRPs for the same claim.

Section 502(e)(1)(B) is intended to avoid exposing the estate to multiple claims for the same underlying obligation. In the context of environmental claims, the section prevents such "double-dipping" by disallowing PRP claims in favor of government claims. *In re Hemingway Transp., Inc.*, 993 F.2d 915, 923 (1st Cir. 1993).

Section 502(e)(1)(B) can work a harsh result, however, if the government never files a claim against the bankruptcy estate as the potential for liability to the government alone can trigger application of the provision to a PRP's claim. In that case, the PRP can be held fully liable to the government for all response costs, while the debtor avoids any liability. To avoid that result, the Bankruptcy Code permits the debtor and the PRP to file claims on the government's behalf. 11 U.S.C. § 501; Fed. R. Bankr. P. 3004, 3005. If the government never enforces its claim, the distribution can be paid into trust to ensure the PRP does not receive a windfall if the government does not seek to recover the debtor's share from the PRP. *See, e.g., Hemingway*, 993 F.2d at 934 n.26 (suggesting lower court consider use of trust).

To avoid the potential pitfalls of § 502(e)(1)(B), PRPs have sought to establish direct claims against the debtor. The Supreme Court recently reinvigorated such efforts with *Atlantic Research*'s affirmation that a PRP performing a voluntary or administratively compelled cleanup may bring a direct cost recovery action against other PRPs under CERCLA § 107(a). Indeed, it has been argued in *ASARCO* that, unlike a contribution claim under CERCLA § 113(f), a direct claim under § 107(a) is not a claim for reimbursement or contribution founded on co-liability to the government, and therefore § 502(e)(1)(B) does not apply.

Similar arguments have met with mixed success in the past. *Compare In re Eagle-Picher Indus., Inc.*, 131 F.3d 1185 (6th Cir. 1997) (possibility that government could file claim after claims bar date sufficient to create co-liability under § 502(e)(1)(B) for purposes of disallowance of PRP's direct claims), with *In re Dant & Russell, Inc.*, 951 F.2d 246 (9th Cir. 1991) (prohibition against contingent, co-liable claims under § 502(e)(1)(B) did not prevent direct claim under CERCLA § 107(a) for future cleanup costs where government had not compelled further cleanup). This issue was recently briefed and argued in *ASARCO* and has been taken under advisement.

CONCLUSION

The intersection of bankruptcy and environmental law has been referred to as the "Clash of the Titans." We hope this overview will be a useful starting point for parties attempting to negotiate this unsettled and complex area of the law. While we await further developments in *ASARCO*, to date, resolution through settlement has prevailed. Unless the Supreme Court provides clarity, this area of the law will continue to present the parties with the choice of settlement or costly litigation.

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