AKIN GUMP
STRAUSS HAUER & FELD LLP

Bankruptcy Alert

Apex Oil Decision: Discharge May Not Extinguish Environmental Liability

October 29, 2010

A confirmed plan of reorganization granting the debtor a discharge and release from all claims does not guarantee that the reorganized entity will not be required to pay for a cleanup of prepetition environmental contamination. On October 4, 2010, the Supreme Court declined to review the 7th Circuit's decision in *Apex Oil Co. v. United States*. In that decision, the 7th Circuit held that an injunction obtained by the Environmental Protection Agency (EPA) under the Resource Conservation and Recovery Act of 1976 (RCRA) was not a "claim" under the Bankruptcy Code and, therefore, was not discharged by confirmation of a plan of reorganization. The decision leaves in doubt the extent to which a discharge relieves a reorganizing entity of certain environmental liabilities. Accordingly, investors and stakeholders in reorganized entities should assess—and, if appropriate, take additional measures to mitigate—the risk of environmental liabilities.

In 1987, Apex Oil Company's predecessor, the Clark Oil & Refining Company, filed a petition for relief under Chapter 11 of the Bankruptcy Code. Prior to the petition date, the EPA became aware that Clark was potentially responsible for a subsurface hydrocarbon plume in Hartford, Illinois, near certain of Clark's operations. Clark never owned or held any interest in the contaminated site (which was adjacent to the refinery and pipelines that Clark owned), and it had sold all property and equipment associated with the contaminated site prior to confirming its plan of reorganization. Although the EPA was aware of Clark's potential liability prior to the Chapter 11 reorganization, the EPA chose not to file a claim in Clark's Chapter 11 reorganization for cleanup of the hydrocarbon plume. In 1990, Clark confirmed a plan of reorganization, and the bankruptcy court entered a confirmation order that purported to "discharge and release the Consolidated Debtors and their Estates and all property of the Consolidated Debtors and their Estates, from any and all Claims, debts and Liens that arose before the Confirmation Date . . . whether or not . . . [a] proof of claim based on such Claim or debt is filed or deemed filed."[1]

Thirteen years later, the EPA gave notice to Apex, Clark's corporate successor, that Apex was potentially liable for the contamination under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA). After Apex declined to participate in the remediation of the site, the EPA filed suit in federal district court. But, rather than seeking relief under CERCLA (under which the EPA may seek monetary damages for the cost of cleaning up a contaminated site), the EPA sought relief under RCRA, under which the EPA may "bring suit" against any person who was involved in the storage of hazardous waste and request that the district court "order such person to take such . . . action as may be necessary."[2] The district court found that Apex had stored such hazardous waste and ordered Apex to clean up the site. Apex, which had neither the in-house capability to clean up the contamination nor access to the contaminated site, estimated that it would have to pay a third-party contractor more than $150 million to perform the work.

Although Apex asserted that the discharge, which had been granted to Clark 13 years earlier, relieved it of liability, the district court held that the EPA's suit could proceed because Clark's liability under RCRA was not a "claim" and, therefore, was not subject to payment and discharge under the Bankruptcy Code. The Court of Appeals for the 7th Circuit, in an opinion penned by Judge Richard A. Posner, affirmed. The court held that RCRA authorizes only equitable relief and "does not entitle a plaintiff to demand, in lieu of action by the defendant that may include hiring of another firm to perform a clean up ordered by the court, payment of clean-up costs" and that Apex's obligation under RCRA, therefore, did not fit within the Bankruptcy Code's definition of "claim."[3]

---

[1] *In re Apex Oil Co*., No. 87-03804-BKC-BSS (Bankr. E.D. Mo. Aug. 10, 1990), Debtors' Confirmed First Amend. Joint Partially Consolidating Plan of Reorganization, 116.
[2] 42 U.S.C. § 6973(a).
[3] *U.S. v. Apex Oil Co., Inc*., 579 F.3d 734, 736 (7th Cir. 2009).

www.twitter.com/akin_gump

© 2010 Akin Gump Strauss Hauer & Feld LLP This document is distributed for informational use only; it does not constitute legal advice and should not be used as such.

Accordingly, the plan of reorganization and discharge, which only can discharge "debt" or "liability on a claim," did not prevent the EPA from using RCRA to obtain an order forcing Apex to clean up the contamination. In other words, because the EPA could not seek monetary damages under RCRA, EPA had no claim that could be discharged, even though Apex would have to spend a significant sum of money to comply with such an order.

The 7th Circuit's *Apex Oil* decision seems to broaden a heretofore narrow exception to the dischargeability of environmental claims set forth in a seminal Supreme Court ruling. In *Ohio v. Kovacsl*, the Supreme Court held that an obligation to clean up a contaminated site was a dischargeable claim because the defendant, which had been dispossessed of the contaminated property by a receiver, could only comply with the order by paying the receiver or another entity money to clean up the site.[4] The Court narrowed its opinion by stating that its holding did not mean that anyone in possession or control of a site was free to ignore environmental laws.[5]

Apex Oil also calls into question a much-relied-upon decision by the 6th Circuit allowing for the discharge of certain environmental claims. The 6th Circuit, following *Kovacsl*, had held in *U.S. v. Whizco, Inc*.[6] that an order requiring the debtor to spend money to perform an environmental cleanup on property from which he was dispossessed was a "claim" and, therefore, was subject to discharge. While other circuit courts of appeal have held that certain environmental liabilities could pass through, even though a defendant had received a discharge, they did so where the court had ordered the defendant to ameliorate or end ongoing pollution at sites still owned and controlled by the defendant. The 2nd and 3rd Circuits in *In re Chateaugay Corp.*, 944 F.2d 997, 1008 (2d Cir. 1991), and *In re Torwico Electronics, Inc*., 8 F.3d 146, 151 (3d Cir. 1993), respectively, held that the cleanup orders in those cases were not "claims" under the Bankruptcy Code and, therefore, were not subject to discharge. The clean-up orders in those cases were orders to end or ameliorate ongoing pollution at sites still owned and controlled by the defendants.

In contrast, the 7th Circuit in *Apex Oil* held that the defendant was required to clean up the site, even though it did not own or control the contaminated site or any property or equipment related to the contamination and had not owned them at any time since its reorganization and discharge more than 13 years prior to the EPA bringing suit. The 7th Circuit distinguished its ruling from *Kovacsl* on the basis that the receiver in *Kovacsl* was seeking money with which to clean up the site, while the EPA was seeking an injunction for Apex to clean up the site itself (even though the only way that Apex could comply was to pay the EPA or a third party to clean up the site). The 7th Circuit's ruling is significant because it calls into question (i) whether the Supreme Court's ruling in *Kovacsl* has any remaining practical applicability and (ii) the extent to which obligations to clean up environmental contamination will be dischargeable.

The Supreme Court's decision not to review the 7th Circuit's decision in *Apex Oil* means that, for the time being, the efficacy of a discharge to extinguish prepetition environmental liability of a reorganizing entity remains in doubt. Unless the doubt is removed by the Supreme Court in a subsequent decision or by Congress through legislation, investors and stakeholders in reorganized entities would be well-advised to perform due diligence to assess potential environmental liabilities that may pass through a reorganization and, if appropriate, seek advice about alternative strategies for mitigating such liabilities. Such strategies may include (i) a sale of assets under section 363 or pursuant to a plan of reorganization, (ii) the purchase of environmental liability insurance, (iii) the assumption of environmental liabilities by a financially responsible third party by contract and (iv) the negotiation and implementation of a structured settlement involving the government agencies responsible for environmental law enforcement prior to the proposed acquisition. Each strategy has advantages and disadvantages to be considered that will vary with the debtor's corporate structure, assets, businesses, potential environmental liabilities and other factors.

CONTACT INFORMATION

If you have any questions concerning this alert, please contact —

David P. Simonds
dsimonds@akingump.com
310.552.6692
Los Angeles

Thomas C. Goldstein
tgoldstein@akingump.com
202.887.4060
Washington, D.C.

Brian M. Rothschild
brothschild@akingump.com
310.728.3734
Los Angeles

[4] 469 U.S. 274, 283 (1985).
[5] *Id*. at 284-85.
[6] 841 F.2d 147, 150 (6th Cir. 1988).

© 2010 Akin Gump Strauss Hauer & Feld LLP This document is distributed for informational use only; it does not constitute legal advice and should not be used as such.