Hard "Core" Decision from U.S. Supreme Court
Sarah Pugh, NBH Advisors, Inc., Philadelphia, and Cary Hansing, NBH Advisors, Inc., Chicago

The Supreme Court of the United States was faced with a difficult decision regarding the definition and scope of "core" matters as defined under 11 U.S.C. §157(b)(2)(C). In a 5-4 decision released on June 23, 2011, the Supreme Court affirmed the Ninth Circuit Court of Appeals' ruling that overturned a judgment of $88 million dollars awarded to the Estate of Vickie Lynn Marshall a/k/a Anna Nicole Smith ("Smith"). The Supreme Court's decision not only had an immediate impact on the parties involved but results in a more enduring effect on the general practice of bankruptcy law.

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A Shocking Question: Is Electricity A "Good" Under 503(b)(9)?
Shane A. Lynch, Wright Ginsberg Brusilow P.C., Dallas

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Jeffrey M. Sklarz, Zeisler & Zeisler, P.C., Bridgeport, Connecticut

The wake of the global financial crisis of 2008-09 exposed a large number of long-running financial frauds. The perpetrators consist of small time con-artists to seemingly well-respected members of the Wall Street investment banking community. Lawyers, accountants, hedge fund managers and politicians have been both perpetrators and victims. Unfortunately, the same access to global financial markets that permit access to cash and credit anywhere in the world also affords thieves the ability to funnel their activities through legitimate channels. In the United States, law enforcement and regulatory agencies have many tools at their disposal to identify and protect the public against financial crimes, including obtaining information from banks concerning their customer’s unusual financial activities. The private litigant, however, as the victim of a financial crime, has far less ability to discover similar information and ascertain what the bank knew about the scam artists fraud, and when the bank knew it.
Lyondell Chemical and Chemtura Corp.: New Developments Regarding Contingent Environmental Bankruptcy Claims and Section 502(e)(1)(B) of the Bankruptcy Code

Melissa Murray, Bingham McCutchen LLP, Washington, D.C.

CERCLA is a sweeping federal remedial statute designed to encourage the prompt abatement of contamination and cleanup of hazardous waste sites and to allocate the costs for doing so against those responsible for the contamination. It is a strict liability statute, and provides broad authority to the President (delegated to the Environmental Protection Agency ("EPA")) to compel responsible parties to conduct cleanup and to recover EPA's own response costs from the four categories of potentially responsible parties ("PRPs"). CERCLA also provides causes of action to non-governmental entities for the recovery of appropriate response costs. A PRP that settles its liability to the government, however, escapes contribution liability for the matters settled. While liability for cost recovery under section 107 is joint and several, liability for contribution under section 113 of CERCLA is several.

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Legislative Update
Judith Greenstone Miller, Jaffe Raitt Heuer & Weiss PC, Southfield, Michigan, and Aisha L. Williams, Gilbert LLP, Washington, D.C.

Please see the ABA Business Bankruptcy Committee web page, "Legislative News," for the April 2011 Legislative Update and other postings of recently proposed and enacted legislation prepared by the Legislation Subcommittee on the ABA Business Bankruptcy Committee.

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Business Bankruptcy Committee Programs at the ABA 2011 Annual Meeting

The ABA 2011 Annual Meeting will be in Toronto, August 3-9. The Business Bankruptcy Committee is sponsoring or co-sponsoring several exciting programs you should attend.

The Global Response to the Financial Crisis: the Canadian, U.K. and U.S Perspective
August 5, 10:30 a.m. to 12:30 p.m.
Sponsored by the Banking Law Committee and co-sponsored by the Business Bankruptcy Committee
Paul L. Lee and John W. Teolis, Program Chairs

Career Management and Business Development for the Diverse Lawyer
August 6, 8:00 a.m. to 10:00 a.m.
Sponsored by the Diversity Committee and co-sponsored by, among others, the Business Bankruptcy Committee
Jacqueline Parker, Daria Boxer and Gary Zhao, Program Chairs

Jacqueline Parker, Daria Boxer and Gary Zhao, Program Chairs. In this challenging economic environment, diverse lawyers (lawyers of color,
women lawyers, lawyers with disabilities, gay, lesbian, bisexual and transgender lawyers, young lawyers, and senior lawyers) and law students may have additional considerations to ensure professional success. This program will explore ways in which diversity impacts business and professional development for attorneys at all experience levels and discuss practical strategies for managing your career, and developing or changing your practice in the current economy. Panelists will share their experiences, and explore navigating hiring, marketing and business development in the U.S. and Canada.

Cross-Border Bankruptcies: Current Issues and Trends  
August 6, 10:30 a.m. to 12:30 p.m.
Sponsored by the Business Bankruptcy Committee  
Michael St. Patrick Baxter, Program Chair

A panel of cross-border experts from the bench and the bar will address automatic-stay issues, free-and-clear sales in the context of the Blockbuster case, third-party releases, escrow issues in the context of the Nortel case, and credit bidding and court-to-court communications in cross-border cases.

The Kathryn R. Heidt Memorial Award

Please consider nominating a worthy candidate for this prestigious award in honor of a past Chair of the Business Bankruptcy Committee, Kate Heidt. Nominations are due August 31, 2011.

» 2011 Kathryn R. Heidt Memorial Award

Watch Recent Business Bankruptcy Committee Webinars

In June 2011, the Business Bankruptcy Committee presented a webinar entitled, "DBSD: Does it Portend The End of Gifting to Junior Classes and Claims Purchasing?" The Committee also recently presented a webinar entitled, "The Coming Flood(?) of Municipal Insolvencies: All You Need to Know About Chapter 9" And last spring, the Committee presented a webinar on several recent decisions that appear to limit the rights of secured creditors to credit bid in Chapter 11 cases. Below are links to the full webinars and to the slide show presentations.

» Business Bankruptcy Committee Webinars

Materials from the Business Bankruptcy Section 2011 Spring Meeting

At the Spring Meeting of the ABA Section of Business Law Business Bankruptcy Committee in Boston, members of the Committee presented a number of informative and interesting programs. Below is a link to all of the materials provided at these programs. (Access to some of the articles requires your ABA password.)

» 2011 Spring Meeting Business Bankruptcy Materials
Submit Articles for the Business Bankruptcy Newsletter

The Business Bankruptcy Committee invites you to submit articles for possible publication in future issues. The articles do not need to be long or in-depth, and it is a great way to get involved in the Business Bankruptcy Committee. Articles can survey the law nationally or locally, discuss particular business bankruptcy issues, or examine a specific case. If you are interested in submitting an article, please contact Newsletter Editor-in-Chief Kay Kress at KRESSK@pepperlaw.com or Editor Chris Alston at ALSTC@foster.com.

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Hard “Core” Decision from U.S. Supreme Court

By Sarah Pugh and Cary Hansing

The Supreme Court of the United States was faced with a difficult decision regarding the definition and scope of “core” matters as defined under 11 U.S.C. §157(b)(2)(C). In a 5-4 decision released on June 23, 2011, the Supreme Court affirmed the Ninth Circuit Court of Appeals’ ruling that overturned a judgment of $88 million dollars awarded to the Estate of Vickie Lynn Marshall a/k/a Anna Nicole Smith (“Smith”). The Supreme Court’s decision not only had an immediate impact on the parties involved but results in a more enduring effect on the general practice of bankruptcy law.

Most readers are probably aware of the relationship and history between Smith and her late husband, J. Howard Marshall II (“Marshall”). The legal dispute was between Smith and E. Pierce Marshall (“Pierce”), son and guardian of Marshall and primary beneficiary of the bulk of Marshall’s assets, which were held in a living trust. In April 1995, before Marshall died, Smith filed suit against Pierce and others for tortious interference in a Texas Probate Court (“Probate Court”), which was handling the Marshall’s guardianship proceedings. On August 4, 1995, Marshall died of heart failure and on August 7, 1995, Smith filed an application in Probate Court requesting that it determine that Marshall died intestate. On January 25, 1996, Smith filed for bankruptcy protection (“Bankruptcy”) in the United States Bankruptcy Court for the Central District of California (“Bankruptcy Court”).

Prior to the Bankruptcy, Pierce filed a lawsuit for defamation against her and her attorneys in a Texas court. Pierce dropped Smith from the lawsuit in Texas after the Bankruptcy and filed a non-dischargeable complaint in the Bankruptcy Court. Pierce sought a declaration from the Bankruptcy Court that, if Smith were to be found liable to Pierce, her liability to him would not be discharged in the Bankruptcy. On June 14, 1996, Smith filed an answer to the complaint which included counterclaims against Pierce, similar to Smith’s tortious interference suit filed in the Probate Court in April 1995.

On December 29, 2000, the Bankruptcy Court entered a $474,754,134 judgment against Pierce in favor of Smith. Pierce appealed the decision of the Bankruptcy Court. Then, on March 7, 2001, in the Probate Court, a Texas jury returned a verdict in favor of Pierce, leaving Smith without any distribution from J. Howard’s irrevocable trust. The jury unanimously answered a number of special verdict questions that: (a) deemed Marshall’s will and trust valid; (b) determined Marshall was not the victim of Pierce’s undue influence; (c) Marshall was mentally sound; and (d) Marshall did not make a promise to Smith of a gift to be made when he died. The Probate Court entered a final judgment in accordance with the jury’s verdict. Later, the Probate Court entered judgment in favor of Pierce on all claims and ruled that Pierce was entitled to his inheritance free and clear of claims by Smith.

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On March 7, 2002, the District Court affirmed the decision of the Bankruptcy Court. The District Court awarded Smith a reduced amount of $44,292,767.33 for compensatory damages and an additional $44,292,767.33 for punitive damages, for a total amount of $88,585,534.66. Pierce again appealed. On March 19, 2010, the Court of Appeals for the Ninth Circuit (the “Ninth Circuit”) reversed and remanded the decision of the District Court.

In its ruling, the Ninth Circuit found Smith’s counterclaim against Pierce in the Bankruptcy Court was not a core proceeding. The decision was based on three findings. First, Smith’s counterclaim did not fall under 157(b)(2)(C), which denotes counterclaims by the estate against persons filing claims against the estate as core proceedings. *Marshall v. Stern*, 600 F. 3d 1050, 1058 (9th Cir. 2010). Second, the evidence required for Pierce’s claim and Smith’s counterclaim was not related closely enough (*Id.* at 1059-1060) because the evidence required to establish a counterclaim for tortious interference is not quite the same evidence required to rebut a determination of non-dischargeability of a claim deriving from a defamation award. Third, there were differences in the legal elements for Pierce’s claim and Smith’s counterclaim (*Id.* at 1060). These reasons explain, in part, why the Ninth Circuit determined that both the Bankruptcy Court and the District Court erred in affording core proceeding status to the controversy and in rendering judgment. This establishes the backdrop of facts leading to Smith’s and Pierce’s second journey to the Supreme Court (in 2006, the Supreme Court reversed and remanded the decision from the Ninth Circuit for construing the probate exception too broadly (*Id.* at 1038)). Smith appealed the Ninth Circuit decision.

On January 18, 2011, the U.S. Supreme Court heard oral arguments from representatives of the Smith Estate and the Pierce Estate. The issue before the Court was whether the authority of a bankruptcy judge to rule on counterclaims asserted as part of the claims allowance process; whether 28 U.S.C. §157(b)(2)(C) is extraneous to 28 U.S.C. §157(b)(2)(B). Section 157(b)(2)(B) states core proceedings include, but are not limited to, the “allowance or disallowance of claims against the estate..., and estimation of claims or interests for the purposes of confirming a plan under chapter 11, 12, or 13 of title 11,...” While Smith argued that a counterclaim to a filed claim falls within the plain language of §157(b)(2)(C), the Ninth Circuit chose a stricter approach examining the relationship between the claims including the evidence and the legal elements. It is important to understand not only the reasons for the Ninth’s Circuit’s decision, but the context in which the reasons apply to the historical development of the authority of the bankruptcy courts.

Congress, through the Bankruptcy Act of 1898, established bankruptcy as a subject matter within the jurisdiction of the Federal District Courts and created referees to help District Court Judges with bankruptcy matters (*Marshall v. Stern*, 600 F. 3d 1050 (9th Cir. 2010), citing *Bankruptcy Act of 1898 §§ 1-2, 33-43*). The Bankruptcy Reform Act of 1978 eliminated these referees, created adjunct Courts and assigned these Courts the right to exercise the same bankruptcy powers held by the District Courts. In *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982), the Supreme Court found the creation of these adjunct Courts by Congress was a violation of the independent judiciary established by Article III of the Constitution, and ordered a local rule be created in each district so all the bankruptcy courts would continue operating without disruption. Subsequently, Congress passed the Bankruptcy Amendments and Federal Judgeship Act of 1984 (the “Act”). The Act, among other things, articulated which matters were to be included as core proceedings and, therefore, subject to the
bankruptcy court’s authority. Another item worth noting is that Title 28 U.S.C. §157 identifies the authority of the bankruptcy courts in each district and sets out the judicial procedures to be followed, including §§157 (b)(2)(B) and 157 (b)(2)(C).

Bankruptcy practitioners eagerly awaited the ruling in the case. There were palpable concerns over topics as narrow as the administration of Smith’s estate and as broad as the potential implications to the daily practice of bankruptcy law by trustees and professionals. Court-watchers forecasted that the Supreme Court would remand the case back to the lower court with direction as to the additional subjective examination needed for §157(b), to more clearly differentiate §157(b)(2)(B) from §157(b)(2)(C) to avoid redundancy, thus allowing Smith’s counterclaim to be re-examined under this revised judicial guidance to determine its ultimate inclusion as a core proceeding under §157(b)(2)(C). They were partially correct.

The Supreme Court stated the Bankruptcy Court had the statutory authority to enter a judgment on counterclaims pursuant to §157(b)(2)(C), but lacked the constitutional authority to rule on the subject matter involved in the Smith counterclaim for three reasons. First, the nature of the counterclaim of tortious interference was based in common law between two private parties Stern v. Marshall, No. 10-179, slip op. at 27 (S. Ct. June 23, 2011). Any claim based in common law, equity, or admiralty requires an Article III judge to issue a final judgment. Second, a ruling on Pierce’s claim does not necessarily resolve Smith’s counterclaim (Id. at 21). The Supreme Court noted that there was some overlap between the claim and counterclaim, but distinguished them by further noting that the process of ruling on the claim would not necessarily resolve the counterclaim. Third, Smith’s counterclaim was not derived from or dependent upon bankruptcy law (Id. at 34). When dealing with a counterclaim that is just arguably derived from or dependent upon bankruptcy law, the presumption is in favor of an Article III judge making the final judgment.

Chief Justice Roberts wrote the opinion of the Court and was joined by Justice Scalia, Justice Kennedy, Justice Thomas, and Justice Alito. The opinion stated that any law or procedure found in bankruptcy that made, or would make, the process of administration better will not stand if it infringed on the judicial powers within Article III of the Constitution of the United States. (Id. at 36). Congress originally intended bankruptcy courts to aid Federal District Courts by adjudicating specific matters, thus sharing in the division of legal labor. However, in light of this opinion, that aid will not be accepted if it encroached on the subject matter reserved only for Article III Judges; Smith’s tortious interference counterclaim constitutes subject matter for Article III Judges. Bankruptcy practitioners, therefore, will need to carefully examine the origins for claims and counterclaims.

The dissenting opinion of Justice Breyer expressed a less formalistic rule for what would infringe on the authority of Article III Judges. Justice Breyer was joined by Justice Ginsburg, Justice Sotomayor, and Justice Kagan. Citing Commodity Futures Trading Commission v. Schor et al, 478 U.S. 833 (1986), Justice Breyer noted the following five factors used previously by the Supreme Court as a more flexible approach to determine if a non-Article III Judge had overstepped his/her authority: (i) the adjudicated right’s origins and importance. Stern v. Marshall, No. 10-179, slip op. at 8 (S. Ct. June 23, 2011) (dissenting opinion); (ii) the degree to which a non-Article III forum exercised Article III court powers and subject matter jurisdiction (Id. at 8 (dissenting opinion)); (iii) the powers reserved by the non-Article III forum normally
held by Article III courts (Id. at 8 (dissenting opinion)); (iv) the consent given by the parties to the non-Article III forum; and (v) the reasons Congress created the non-Article III forum (Id. at 8 (dissenting opinion)). These factors provided direction in the investigation previously used by the Supreme Court without any one factor causing a final determination. Justice Breyer and those that joined him concluded, based on using this flexible approach, that the Bankruptcy Court judge had the constitutional authority to issue final judgment (Id. at 16 (dissenting opinion)).

The 5-4 decision arguably clarified certain issues and clouded others. The majority believed the ruling will have minimal effect on the general practice of bankruptcy law. As such, we have a firm decision on the Stern v. Marshall case, the relevance of §157(b)(2)(C) to certain counterclaims, and the Supreme Court’s view on who would have the proper authority where non-Article III and Article III courts intersect. Those dissenting believed the effect will be much larger as this ruling will create a type of “constitutionally required game of jurisdictional ping-pong between courts…” (Id. at 17 (dissenting opinion)).

Only time will tell if Stern v. Marshall will have a significant effect on bankruptcy proceedings. One thing is clear: with this ruling that the authority of Congress to act under Article I conflicted with the authority of the Judiciary to act under Article III, unless and until Congress revises the law, bankruptcy courts and districts courts will face a number of hard “core” decisions in the future.
A Shocking Question:  
Is Electricity A “Good” Under 503(b)(9)?

Shane A. Lynch

Debtors’ counsel know the story all too well: it’s early in a case, and everyone knows that money is tight and the distribution to general unsecured creditors will be thin, so all of the creditors do their best to get the court to qualify their claims as priority or administrative expense claims. After counsel deals with all of the normal priority issues – pensions, employee wages, among others – some creditors begin to make some relatively unusual arguments. This article looks at one of those arguments: whether an electricity provider, who has already received adequate assurance pursuant to section 366 of the Bankruptcy Code, is entitled to an administrative expense claim, under section 503(b)(9) of the Bankruptcy Code, for the services that it provided to a debtor in the 20-day period prior to bankruptcy.

Section 503(b)(9) of the Bankruptcy Code provides:

(b) After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, including . . .

(9) the value of any goods received by the debtor within 20 days before the date of commencement of a case under this title in which the goods have been sold to the debtor in the ordinary course of such debtor’s business.

Do electricity providers fall under section 503(b)(9)? In most cases, there is no question that the electricity provider provided service to the debtor in the ordinary course

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1 Shane Lynch is an attorney in the Dallas office of Wright Ginsberg Brusilow P.C., where he practices in the Bankruptcy Reorganization and Bankruptcy Law group.
of business, and that it provided such service during the 20 days prior to bankruptcy. Thus the final issue arises: is electricity a good for the purposes of section 503(b)(9)?

Section 503(b)(9) was added to the Bankruptcy Code by the Bankruptcy Abuse Prevention and Consumer Protection Act (“BAPCPA”) in 2005. Unfortunately, the word “goods” was not defined in the Bankruptcy Code prior to BAPCPA, and BAPCPA itself added no such definition. However, over the last few years, several courts have examined the issue of whether electricity is a good for the purposes of section 503(b)(9).

One of the first bankruptcy court opinions that considered whether electricity is a good was Judge D. Michael Lynn’s opinion in In re Pilgrim’s Pride Corporation, 421 B.R. 231 (Bankr. N.D. Tex. 2009). In that case, the Court determined that it should apply the definition of “goods” found in Article 2 of the Uniform Commercial Code (the “UCC”) when considering whether electricity (and natural gas, sewage service and trucking service) constitutes goods under section 503(b)(9). Pilgrim’s Pride, 421 B.R. at 236. Since Pilgrim’s Pride, several other courts have considered the question of whether electricity constitutes goods, also relying on the definition of goods found in Article 2 of the UCC. See, e.g., GFI Wisconsin, Inc. v. Reedsburg Utility Com’n, 440 B.R. 791, 797-8 (W.D. Wis. 2010); In re Erving Industries, Inc., 432 B.R. 354, 365 (Bankr. D. Mass. 2010).

While courts generally agree the UCC definition should be used to determine whether electricity is a good, they have come to different conclusions. The Pilgrim’s Pride

2 “Goods” means all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid, investment securities (Article 8) and things in action. “Goods” also includes the unborn young of animals and growing crops and other identified things attached to realty as described in the section on goods to be severed from realty (Section 2–107). UCC § 2-105.
Pride court determined that electricity is not a good for the purpose of section 503(b)(9), while the Bankruptcy and District Courts in GFI and the Bankruptcy Court in Erving both determined that electricity is a good.

In Pilgrim’s Pride, the court considered that electricity is not something that occupies physical space, or that can be picked up and moved, and that it is more like television signals and internet bandwidth – things that are not goods under the UCC. Pilgrim’s Pride, 421 B.R. at 239. The court also noted that, in the Fifth Circuit, the words “actual” and “necessary,” found in section 503(b)(1)(A) of the Bankruptcy Code, are to be narrowly construed. Id. at 240, n. 9 (citing In re TransAmerican Natural Gas Corp., 978 F.2d 1409, 1416 (5th Cir. 1992)). In addition, the court found that “[a] party claiming priority must fit clearly within the priority statute in order to be granted a priority claim.” Id. at 240 (citing Howard Delivery Serv. v. Zurich Am. Ins. Co., 547 U.S. 651, 669, 126 S.Ct. 2105, 165 L.Ed.2d 110 (2006)). Because electricity does not strictly fit the definition of goods under the UCC, the court determined that electricity providers should not be afforded an administrative expense under section 503(b)(9).

The Erving court begins its discussion of whether electricity is a good with quotes by Richard P. Feynman3 and Robert A. Millikan4, two brilliant physicist, that demonstrate the challenge posed to a court in trying to determine exactly what is

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3 “It is important to realize that in physics today, we have no knowledge of what energy is. We do not have a picture that energy comes in little blobs of a definite amount. It is not that way.” – Richard P. Feynman, Richard P. Feynman, “Conservation of Energy”, in Six Easy Pieces: essentials of physics explained by its most brilliant teacher 71–72 (Basic Books 1995).

4 “… I give the experimentalist’s answer to the very fundamental but very familiar query: “What is electricity?” His answer is naïve, but simple and definite. He admits at once that as to the ultimate nature of electricity he knows nothing.” – Robert A. Millikan, Robert A. Millikan, Nobel Lecture: The Electron and the Light-quant from the Experimental Point of View, at 55 (May 23, 1924), available at <http://nobelprize.org/nobel_prizes/physics/laureates/1923/millikan-lecture.pdf> (last visited May 26, 2011).
electricity. *Erving*, 432 B.R at 366. In its analysis, the court cites to *Pilgrim’s Pride* and notes the court in that case compared electricity to television signals and internet bandwidth. But the *Erving* court pointed out that there is a difference between electricity on the one hand and television signals and internet bandwidth on the other: electricity “is not merely a medium of delivery [like television signals and bandwidth], but is *the thing* the customer seeks to purchase.” *Id.* at 368 (emphasis in original). The *Erving* court also found that electricity meets the UCC requirement that goods be “movable at the time of identification to the contract for sale” under UCC § 2-105. The court so concluded because, “[a]t the time the electricity is identified to the contract, it is literally moving, and it remains movable for some period of time thereafter. The electricity continues to move through the customer’s electrical wiring until it is ultimately put to use.” *Id.* 432 B.R. at 370 (emphasis in original). The court therefore determined, electricity is a good within the meaning of the UCC and section 503(b)(9) of the Bankruptcy Code. *Id.*

The last court to write in detail about whether electricity is a good for the purpose of section 503(b)(9) was the District Court for the Western District of Wisconsin in *GFI*, taking the issue on appeal from the Bankruptcy Court. The bankruptcy court wrote a very short opinion in which it found that electricity is a good for the purpose of 503(b)(9), because electricity is both identifiable and moveable at the time that it is metered. *In re Grede Foundries, Inc.*, 435 B.R. 593, 595-6 (Bankr. W.D. Wis. 2010). On appeal, the district court ultimately agreed that electricity is a good under both the UCC and for the purpose of section 503(b)(9) of the Bankruptcy Code. *GFI*, 440 B.R. at 799. In reaching its decision, the district court found that electricity is both moveable and

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5 In contrast, the *Pilgrim’s Pride* found that “[o]nce electricity has been ‘identified’ by measurement at the meter, it has already been consumed by the end user.” *Pilgrim’s Pride*, 421 B.R. at 239.
identifiable: “E]lectricity begins flowing through power lines when a circuit is formed and continues moving at least until it is metered. The metering satisfies the identification requirement of the UCC and the movement is sufficient to satisfy the movability requirement, even if it reaches the speed of light.” Id. at 800-1 (citing In re Pacific Gas & Electric Co., 271 B.R. 626 (N.D.Cal.2002)).

While there are other decisions in which courts have considered whether electricity is a good under section 503(b)(9), see, e.g., In re Samaritan Alliance, LLC, 2008 WL 2520107 (Bankr. E.D. Ky. June 20, 2008) (holding that electricity is not a good for the purpose of section 503(b)(9) of the Bankruptcy Code), the opinions cited above have some of the most in depth discussions of the issue. Clearly, there is a split among courts about whether electricity providers should receive administrative expense treatment for the electricity that they provide to debtors in the days just before bankruptcy. But which side is correct?

Until the various circuit courts take the issue, there will continue to be uncertainty as to whether electricity is a good for the purpose of section 503(b)(9) of the Bankruptcy Code. However, this author, as an attorney that regularly represents debtors, urges other practitioners to consider the generally accepted doctrine that the administrative expense provisions of the Bankruptcy Code must be narrowly construed. See, e.g., Howard Delivery Serv. v. Zurich Am. Ins. Co., 547 U.S. 651, 669, 126 S.Ct. 2105, 165 L.Ed.2d 110 (2006); In re Federated Dep’t Stores, Inc., 270 F.3d 994, 1000 (6th Cir. 2001); In re Commercial Fin. Servs., Inc., 246 F.3d 1291, 1293 (10th Cir. 2001); In re TransAmerican Natural Gas Corp., 978 F.2d 1409, 1416 (5th Cir. 1992); In re Dant & Russel, Inc., 853 F.2d 700 (9th Cir. 1988). Like the Courts above, I struggle with the concept of
whether electricity fits within the UCC definition of goods. Unlike other “goods,” electricity cannot be touched or physically moved without wires, yet it can be identified by a meter and stored in a battery. I conclude electricity should not be considered goods under section 503(b)(9), because it does not fit clearly and cleanly within that definition. Hopefully, the circuit courts will soon provide guidance on the issue.
PRIVATE PARTY DISCOVERY OF FINANCIAL FRAUDS
AND SUSPICIOUS ACTIVITIES: A REGULATORY COVER UP?

Jeffrey M. Sklarz

The wake of the global financial crisis of 2008-09 exposed a large number of long-
running financial frauds. The perpetrators consist of small time con-artists to seemingly well-
respected members of the Wall Street investment banking community. Lawyers, accountants,
hedge fund managers and politicians have been both perpetrators and victims. Unfortunately, the
same access to global financial markets that permit access to cash and credit anywhere in the
world also affords thieves the ability to funnel their activities through legitimate channels. In the
United States, law enforcement and regulatory agencies have many tools at their disposal to
identify and protect the public against financial crimes, including obtaining information from
banks concerning their customer’s unusual financial activities. The private litigant, however, as
the victim of a financial crime, has far less ability to discover similar information and ascertain
what the bank knew about the scam artist’s fraud, and when the bank knew it.

One primary tool used by the government is the Suspicious Activity Report (“SAR”).
Under the Bank Secrecy Act, 31 U.S.C. §§ 5311-5330, financial institution are required to report
potentially questionable activity of customers to the Financial Crimes Enforcement Network, an
office of the Treasury Department. This information is often useful to the victim of a financial
fraud (or a receiver or a bankruptcy trustee appointed to attempt to recover assets to distribute to
victim/claim holders) in order to ascertain how the fraud was committed and whether the victim
has a basis to bring suit a financial institution used by a thief. This article discusses some of the

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businesses and individuals in complex financial and litigation matters, including Debtor/Creditor Rights, Bankruptcy
Reorganization & Litigation, Commercial Litigation and Tax Litigation.
difficulties private litigants may face when trying to obtain discovery from a bank through which a financial fraud was perpetrated.

The SAR Regulation (12 C.F.R. §12.11(k)) and Scope of the SAR Privilege

Pursuant to the Bank Secrecy Act, the Treasury Department has promulgated rules concerning SARs and, in particular, how financial institutions must treat them. 12 C.F.R. § 21.11 (the “SAR regulation”) establishes a prohibition against production in litigation of SARs and materials created by a financial institution for the specific purpose of complying with federal laws concerning the filing of SARs: “A SAR, and any information that would reveal the existence of a SAR, are confidential, and shall not be disclosed except as authorized in this paragraph (k).” 12 C.F.R. § 12.11(k) (defining the SAR privilege). The scope of what constitutes “any information that would reveal the existence of a SAR” is, however, narrow:

This paragraph (k)(1) shall not be construed as prohibiting:
(A) The disclosure by a national bank, or any director, officer, employee or agent of a national bank of… (2) The underlying facts, transactions, and documents upon which a SAR is based, including, but not limited to, disclosures: (i) To another financial institution, or any director, officer, employee or agent of a financial institution, for the preparation of a joint SAR; or (ii) In connection with certain employment references or termination notices, to the full extent authorized in 31 U.S.C. 5318(g)(2)(B).

The official commentary authored by the Office of the Comptroller of the Currency (the “OCC”), addresses the issue of disclosure of banks documents in litigation:

While a financial institution is prohibited from producing documents in discovery that evidence the existence of a SAR, factual documents created in the ordinary course of business (for example, business records and account information, upon which a SAR is based) may be discoverable in civil litigation under the Federal Rules of Civil Procedure.
75 Fed. Reg. at 75580. Because of a perceived lack of clarity concerning whether account
related information was the only information subject to disclosure, the OCC clarified that it was
not:

The OCC did not intend for these examples to be exhaustive and
does not believe the text, as proposed, implies that the examples
are exhaustive. For purposes of clarity, however, like FinCEN
[Financial Crimes Enforcement Network], the OCC is revising the
final rule’s language at § 21.11(k)(2) to read ** * [t]he
underlying facts, transactions, and documents upon which a SAR
is based, including but not limited to, disclosures’ expressly listed
as illustrative examples in the rule.

75 Fed. Reg. at 75581 (emphasis in the original). Thus, any materials created in a bank’s
ordinary course of business, including monitoring of customer accounts for fraudulent activity,
would be discoverable:

Institutions should distinguish between certain types of statistical
or abstract information or general discussions of suspicious activity
that may indicate that an institution has filed SARs, and
information that would reveal the existence of a SAR in a manner
that could enable the person involved in the transaction potentially
to be notified, whether directly or indirectly.

75 Fed. Reg. 75579.

What Information Can be Obtained by the Private Litigant?

Applying the distinction set forth in the OCC’s commentary, the determination of
whether a document is subject to the SAR privilege is whether the disclosure would reveal the
existence of a SAR. The difficulty for banks, requesting parties and courts is the nature of the
130167 (S.D.N.Y Dec. 8, 2010), the Southern District of New York recently dealt with a
common factual theme. The plaintiff sought information concerning an admittedly criminally
fraudulent transaction that caused a plaintiff substantial loss of money. The bank refused to
produce relevant documents that led to the loss, interposing the SAR privilege.
In *Freedman & Gersten*, the plaintiff, a law firm, received what turned out to be a fraudulent check from a client. The plaintiff deposited the check into its IOLTA account. After the bank cleared the check, and the plaintiff verified the availability of funds, the plaintiff issued several wires to third-parties. Thereafter, having discovered that the check was fraudulent, the bank *reversed* the credit to the plaintiff’s IOLTA account, causing it to be overdrawn. The plaintiff brought suit against the bank (Bank of America) for its reversal of the credit claiming “BOA owed Plaintiff a duty to more thoroughly investigate the legitimacy of the check at issue.” *Id.* at *3. Accordingly, the plaintiff sought discovery concerning the “the internal investigation surrounding its transactions with BOA,” and requested production of documents including: internal investigations, employee personnel files, and intra-bank correspondence. *Id.* at *5, 11, 14-15, 17. Further, the plaintiff sought “BOA’s general policies and procedures concerning the handling of suspicious activity, and more specifically, all documents contained in the bank’s Corporate Security File regarding the investigation of the activity at issue.” *Id.* at *5.

Recognizing the narrow scope of the SAR privilege, the court held: “In most cases, however, the disclosure of supporting documentation would not reveal the filing of an SAR, and such documentation cannot be shielded from otherwise appropriate discovery simply because it has some connection to an SAR.” *Id.* at *8.

The court further reasoned, “[a]lthough BOA may have undertaken an internal investigation in anticipation of filing a SAR, it is also a standard business practice for banks to investigate suspicious activity and BOA does not cite any binding precedent on this Court which bars the production of this relevant documentation.” *Id.* at *11. Thus, internal communications and risk-management materials, are subject to discovery and financial institutions cannot refuse to produce information simply because it has some connection to a potentially suspicious
activity. See, Union Bank of California, N.A. v. The Superior Court of Alameda County, 130 Cal. App. 4th 378, 392, 29 Cal. Rptr. 3d 894, 903 (Cal. App. 2005) (“Financial institutions may have risk management procedures in place for detecting suspicious activity wholly apart from their procedures for complying with federal reporting obligations. A bank may not cloak its internal reports and memoranda with a veil of confidentiality simply by claiming they concern suspicious activity or concern a transaction that resulted in the filing of a SAR.”).

If a financial institution performs risk-management or fraud detection procedures in the ordinary course of its business, it cannot claim the SAR privilege as to materials developed pursuant to the those function. The court, however, also denied production of the bank’s procedures concerning preparation or filing of SAR as protected by the SAR privilege. Hence, the court applied a narrow reading of the SAR privilege consistent with the OCC commentary.

Conclusion

A financial institution’s own internal investigations (or lack thereof) and procedures concerning monitoring and reporting of a customer’s suspicious activities (or lack thereof) are important evidence in any lawsuit that can be used against a bank for its involvement in a financial crime. Moreover, when a bankruptcy trustee or receiver is investigating a fraud, the information is useful to understand how the perpetrator carried out his misconduct, irrelevant of whether a lawsuit is ultimately brought against the financial institution. Whether due to a desire to adhere to the requirement of the SAR privilege or an attempt to avoid a lawsuit, banks often attempt to read the SAR privilege more broadly than it was ever meant to be applied.

Consequently, when litigating with, or investigating, financial institutions and their relationships to a scam artist/customer, counsel must be vigilant to fight for access to all relevant documents concerning the financial fraud at issue, and not just those the bank chooses to provide.
CERCLA\(^2\) is a sweeping federal remedial statute designed to encourage the prompt abatement of contamination and cleanup of hazardous waste sites and to allocate the costs for doing so against those responsible for the contamination. It is a strict liability statute, and provides broad authority to the President (delegated to the Environmental Protection Agency (“EPA”)) to compel responsible parties to conduct cleanup and to recover EPA’s own response costs from the four categories of potentially responsible parties (“PRPs”).\(^3\) CERCLA also provides causes of action to non-governmental entities for the recovery of appropriate response costs.\(^4\) A PRP that settles its liability to the government, however, escapes contribution liability for the matters settled.\(^5\) While liability for cost recovery under section 107 is joint and several, liability for contribution under section 113 of CERCLA is several.

Although the nature of contaminated sites certainly varies, often there are numerous PRPs at a single site, particularly at former hazardous or industrial waste dumps to which hundreds of generators could have transported their wastes. In such cases, often one or more PRPs, voluntarily, or as a result of a CERCLA enforcement order under section 106,\(^6\) form a working group and agree among themselves – usually in a consent decree with EPA – to fund the cleanup and perform the work in accordance with the consent decree.\(^7\) Typically EPA will seek enforcement and issue section 106 orders only to those seemingly liable parties that are among the largest contributors of waste and are financially viable.\(^8\) The core remediation group then is left to its own devices to recover what it can from recalcitrant PRPs at its own expense.

In recent twin opinions issued by the Bankruptcy Court for the Southern District of New York in the Lyondell\(^9\) and Chemtura\(^10\) cases, the Court disallowed as contingent all PRP claims –
contract, contribution, and direct – except for the debtors’ share of past environmental response costs. The rulings clearly favor debtors, calling into question the ability of PRPs to recover costs against other PRPs that subsequently file for bankruptcy.

**Bankruptcy Code Section 502(e)(1)(B) and its Application to PRP Claims**

Bankruptcy Code section 502(e)(1)(B) mandates disallowance of contingent claims for reimbursement or contribution of an entity that is co-liable with the debtor to a third party creditor. Environmental claims asserted by PRPs have been particularly vulnerable to disallowance under this provision of the Bankruptcy Code. Because the identification, and assessment of contamination, the identity and resolution of liability among multiple PRPs, and cleanup often take years, and bankruptcy is designed to resolve debtor’s pre-petition debts in relatively short order, the nature and extent of environmental bankruptcy claims and the debtor’s liability therefore are often unknown, unliquidated and/or contingent when the proof of claim is filed and when allowance is addressed by the bankruptcy court. In addition, until recently, private party PRPs lacked a direct claim for cost recovery under section 107 of CERCLA. Their only remedy against other PRPs under CERCLA has been for contribution under section 113 which requires the establishment of plaintiff’s liability to a third party. Thus, Bankruptcy Code section 502(e)(1)(B) largely resulted in the disallowance of private party claims seeking recovery

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11 U.S.C. § 502(e)(1)(B); see also In re Pinnacle Brands, Inc., 259 B.R. 46, 55 (Bankr. D. Del.2001). The purpose of the provision was to prevent double payouts, once to the assured primary creditor and again to the surety or guarantor. See 124 Cong. Rec. H 11,094 (Sept. 28, 1978); 124 Cong. Rec. S 17,410-11 (Oct. 6, 1978). The legislative history talks of the surety or co-debtor having a choice to pay the primary creditor and obtain an allowed claim or not, depending on what would be most advantageous. Governmental entities are not typically subject to 502(e)(1)(B) because they are rarely co-liable with the debtor on the CERCLA claim.


13 Contingency is determined as of the date the claim is allowed or disallowed, as the case may be. 11 U.S.C § 502(e)(1)(B). This is typically at the time the court rules on the debtor’s objection to the claim or estimates the claim pursuant to 11 U.S.C § 502(c). Since only the contingent portion of the claim is subject to disallowance, a claim for recoverable response costs actually paid out by the claimant will not be barred. In re G-I Holdings, Inc., 308 B.R. 196, 212 (Bankr. D. N.J. 2004) ("Here, the funds have been expended and thus the claim to that extent is not contingent."); see also In re Lyondell, 442 B.R. 236, 246, n.16 (Bankr. S.D.N.Y 2011) ("I think the Debtors have now acknowledged that past costs incurred by Weyerhaeuser are not contingent, and cannot be disallowed for that reason, but to the extent the debtors continue to argue otherwise, I reject their position in that regard."). The disallowances under section 502(e)(1)(B) typically involve the disallowance of a claim for future response costs to be incurred at the site. Norpak v. Eagle-Picher Indus., Inc. (In re Eagle-Picher Indus., Inc.), 131 F.3d 1185, 1190 (6th Cir. 1997) ("Eagle-Picher"); see also In re APCO Liquidation Trust, 370 B.R. 625 (Bankr. D. Del. 2007).

14 See Cooper Indus., Inc. v. Aviall Servs., Inc., 543 U.S. 157, 169 (2004) (citing numerous decisions of the Courts of Appeals holding that a private party that is itself a PRP may not pursue a section 107(a) claim against other PRPs. The Supreme Court held, however, that the plain language of section 107(a) authorizes cost recovery claims by private parties, including PRPs. See United States v. Atlantic Research Corp., 551 U.S. 128, 127 S. Ct. 2331, 168 L. Ed 2d 28 (2007) (“Atlantic Research”). See also infra notes 12 through 16 and accompanying text.
for the debtor’s share of future cleanup costs that the PRP is or may be required to advance based on its own liability.\textsuperscript{15} 

In 2007, however, the Supreme Court in \textit{U. S. v. Atlantic Research Corp.}\textsuperscript{16} held that a PRP was not foreclosed from bringing a direct action against other PRPs for recovery of clean up costs under section 107(a) of CERCLA and were not limited solely to contribution claims under section 113 of the Act.\textsuperscript{17} The Court recognized that “[a] private party may recover under § 107(a) without the establishment of liability to a third party.”\textsuperscript{18} This was good news for PRPs and site remediation groups trying to recover from other PRPs who sought protection under the Bankruptcy Code because \textit{Atlantic Research} arguably removed the cloud over PRP claims by section 502(e)(1)(B) of the Bankruptcy Code.\textsuperscript{19} 

\textit{Atlantic Research} left open the question as to what happens when a PRP meets the criteria to file under section 107 and 113. In 2010, the Second and Third Circuits, respectively, found that PRPs who meet the criteria to assert contribution claims under CERCLA section 113 could not bring a direct cost recovery claim under section 107.\textsuperscript{20} Because most cleanups are not voluntary, and those who resolve their liability to the government are expressly eligible to bring a contribution action under section 113(f)(3)(b),\textsuperscript{21} under the holdings of \textit{Niagara Mohawk} and \textit{Agere}, most PRPs will once again be limited to contribution claims. Moreover, based on the recent holdings in \textit{Lyondell} and \textit{Chemtura} discussed below, even direct PRP claims under


\textsuperscript{16} \textit{Atlantic Research,} supra n.11.

\textsuperscript{17} \textit{Atlantic Research,} 551 U.S. at 128.

\textsuperscript{18} \textit{Atlantic Research,} 551 U.S. at 139.

\textsuperscript{19} Reading Company filed an amicus brief in the \textit{Atlantic Research} case, admonishing the Court to consider the effect in bankruptcy of renewed CERCLA section 107 claims. It cautioned that a section 107 claim would diminish the value to the reorganized debtor of any settlement or discharge of CERCLA liability to the government and by giving rise to direct claims not necessarily covered by the Bankruptcy Code’s discharge provisions or contribution protection under CERCLA section 113(f)(2). \textit{See Brief of Reading Co. as Amicus Curiae in support of the Petitioner,} 2007 WL 697587 (hereafter “Reading Brief”) at 8-9. In dicta the Delaware Bankruptcy Court posited that under the \textit{Atlantic Research} decision a PRP has a direct claim under CERCLA section 107(a) and thus, “[w]ith a direct claim, of course, disallowance under section 502(e)(1)(B) of the Code would not be proper due to the lack of co-liability.” \textit{In re Apco Liquidating Trust,} 370 B.R. at 637.

\textsuperscript{20} \textit{Niagara Mohawk Power Corp. v. Chevron U.S.A., Inc.,} 596 F. 3d 112, 127-29 (2d Cir. 2010) (“Niagara Mohawk”) (involving claim under section 113(f)(3)(B)); \textit{Agere Sys., Inc. v. Advanced Envtl. Tech. Corp.,} 602 F.3d 204, 227-29 (3d Cir. 2010) (“Agere”). In \textit{Agere} the Court said that it would be a perverse and unnecessary result if a PRP eligible for contribution relief and entitled to contribution protection could assert a section 107 claim for joint and several liability against another PRP, since it could bar a CERCLA contribution counterclaim and thereby recover its own allocable share of cleanup costs. \textit{See Agere,} 602 F.3d at 228-29.

\textsuperscript{21} \textit{Atlantic Research} left open the issue of whether cleanups pursuant to unilateral administrative orders are pursuant to a section 106 or 107 action and thus render the remediators eligible to assert contribution claims.
section 107 for cost recovery are claims for “reimbursement” that are equally subject to disallowance under section 502(e)(1)(B) to the extent such costs have not yet been paid by the claimant.

The Significant Holdings in Lyondell and Chemtura

In Lyondell and Chemtura, the Court disallowed under section 502(e)(1)(B) of the Bankruptcy Code, multiple non-governmental claims that were based on debtors’ uncontested liability for environmental contamination at numerous superfund sites. The PRP claims addressed by Judge Robert E. Gerber included CERCLA direct claims under section 107(a), CERCLA contribution claims under section 113, contract claims arising from pre-petition PRP agreements, and claims arising from pre-petition consent decrees or administrative orders to which the debtors were a party. The Court found that with two exceptions, all of the outstanding private-party PRP claims to which the debtors objected were contingent, contribution or reimbursement claims of an entity co-liable with the debtor and thus, disallowance compelled by 11 U.S.C. § 502(e)(1)(B).

The decisions, while not the first to block private party environmental claims under section 502(e)(1)(B), are nevertheless remarkable for their survey and application of case law in the absence of any Code definitions for the terms “contingent,” “contribution,” “reimbursement” or “liable with the debtor” and because these are the first decisions in which a bankruptcy court (or any court) has ruled on the disallowance under section 502(e)(1)(B) of a PRP’s CERCLA direct section 107(a) claim since the Supreme Court resurrected such claims in its Atlantic Research decision. The decisions also signal a turning point away from the use of trusts previously implemented by other bankruptcy courts to prevent double recoveries when claims do not otherwise meet the section 502(e)(1)(B) criteria.

The contingent claim element.

The Court held that for purposes of section 502(e)(1)(B) “contingency” relates to both payment and liability and thus, in a section 502(e)(1)(B) analysis, a claimant’s claim is “contingent” until its liability is established and it has actually paid the primary creditor. The Court rejected arguments that it is the accrual of the primary creditor’s claim against the claimant that transforms the claimant’s contingent claim to a non-contingent one, stating that:

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24 Id.
25 In Chemtura, Judge Gerber held that a trust that was to receive remediation payments (unlike those who might have to contribute to the trust) was not “co-liable” with the Debtor, and in both Lyondell and Chemtura, the Court held that to the extent the claims were for reimbursement or contribution of past cleanup costs already paid by the claimant, such claims were not “contingent” within the meaning of section 502(e)(1)(B). See supra n.12 and accompanying text.
26 See Chemtura, 443 B.R. at 622-23 (rejecting Allegheny and use of a trust to avoid possibility of redundant payments, citing to other courts that have disagreed with Allegheny.) and Lyondell, 442 B.R. at 254, n. 57 (rejecting Havard Industries and use of a trust).
27 Lyondell, 442 B.R. at 248-49.
…the fact that an EPA claim may have accrued against any of Georgia-Pacific, Weyerhaeuser, or Hamilton Beach does not mean that any of their separate claims against the Debtor are no longer contingent. We don’t know whether either of them will lay out the funds necessary to engage in the curative action, and, if so, to what extent.28

The Court reasoned that the government has a multitude of ways to accomplish a remediation that “might or might not call for – or result in – payment by the separate PRP that is asserting the claim against the debtor. And the PRP might or might not wind up actually making the payment for which it then would be seeking reimbursement or contribution.”29 Significantly, the Court chose to reject the use of a trust from which the claim distributions could be made as and when the claimant actually advances the costs to avoid the possibility of redundant payments, even when the claimant’s claims are direct and claimant – not EPA – is cleaning up the site as has been employed by other courts.30

With little discussion, the Court also held that claims arising from prepetition PRP contracts pursuant to which the claimant and debtor allocated site liabilities and cleanup costs among them, were also contingent to the extent the claimant has not yet incurred any costs.31

The co-liability element.

Many of the claimants in Lyondell argued that the co-liability element was not satisfied because their claims were based on direct claims under CERCLA section 107(a) and not contribution under section 113, pointing to Atlantic Research and its holding that a PRP may recover under section 107(a) without establishment of any third party liability.32 The Court rejected this argument finding that co-liability to the government can still exist whether or not the claimant’s claim against the debtor is a direct claim rather than one for contribution. The Court then noted that the claimants and the debtor were both designated by EPA as PRPs.33 The court also stated that section “502(e)(1)(B) imposes no requirements as to how or why the party asserting the claim potentially subject to section 502(e)(1)(B) must be liable with the debtor on the claim of the third party. There is no statutory requirement, for example, that the debtor and

28 Id. at 250 (emphasis supplied).
29 Id. at 249-50.
30 Id. at 254. Judge Gerber rejected the proposed use of a trust as in Allegheny and Harvard Industries, which involved direct claims for costs expended by the claimants. Id. at 253-54.
31 Id. at 251 (“Although Hamilton Beach has entered into a settlement agreement in which the parties allocated the liability with respect to the two sites, there is no indication that the money has been spent. For the same reasons that I determined that Georgia-Pacific’s claim is contingent, I determine that Hamilton Beach’s claim is contingent as well.”); see also Chemtura, 443 B.R. at 615 (“Several of the Claimants assert that their claims are not contingent because (a) they have been fixed by contracts, settlement, consent decrees, or administrative orders; or (b) the right to payment has accrued and is not dependent on a future event. As in Lyondell, I agree that claims for remediation costs already paid by the Claimants are no longer contingent. But I find that claims for future remediation costs, not already paid for, are contingent, and satisfy the ‘Contingency’ Element of section 502(e)(1)(B) doctrine.”).
32 Claimants also relied upon the decisions in Allegheny and Harvard Industries with which the Court disagreed. See Lyondell, 442 B.R. at 253-54.
33 See Lyondell, 442 B.R. at 253.
the party asserting the claim be liable on the claim of the third party in the same action, under a common statute, or on the same legal theory.”

The “reimbursement or contribution” element.

The Court in Lyondell and Chemtura rejected the arguments made by claimants that their claims were not claims for reimbursement or contribution because theirs were direct claims under CERCLA section 107(a) and not contribution claims under section 113(f). The Court concluded that a direct claim for cost recovery under CERCLA section 107 is a claim for “reimbursement” within the meaning of section 502(e)(1)(B) of the Bankruptcy Code. The Court found that the risk that debtor would make duplicative payments was paramount and “revealed that the clear character of the claim was that debtor was not being asked to satisfy a [direct] claim for injury to the claimants [sic] property but rather was being sought for reimbursement.” Similarly, the Court found that the direct contract claims should be disallowed under section 502(e)(1)(B), because “in substance” they are claims for reimbursement. In short, claiming substance over form, the Court found that the direct claims under section 107(a) were for reimbursement.

The Significance of the Lyondell and Chemtura Decisions in Relation to Recent Government Settlements with Debtors of Significant Environmental Liabilities

In another recent and significant environmental bankruptcy case, the U.S. Court of Appeals for the Seventh Circuit held in U.S. v. Apex Oil Co., Inc., that the discharge from liability due to a 1990 bankruptcy did not extend to EPA’s petition for a cleanup order under the Resource Conservation and Recovery Act (“RCRA”), effectively requiring the reorganized debtor to engage outside services to undertake a $150 million cleanup at a non-owned site. The contamination appears to have been well known long before the bankruptcy. Although courts have long construed the term “claim” under the Bankruptcy Code broadly to foster Congress’ goal of a fresh start, the Seventh Circuit held that the cleanup injunction to which EPA is entitled under RCRA’s imminent and substantial endangerment authority is purely an equitable remedy that does not give rise to a right to payment, and is, thus, not a “claim.” Because it was not a “claim,” it, therefore, was not discharged by the Chapter 11 Plan and Confirmation Order. Significantly, the Seventh Circuit rejected the argument that, because EPA could have sought a money judgment under the Clean Water Act or sued for restitution of cleanup costs after EPA conducted its own cleanup, EPA had an alternative

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34 Id. at 244, n.10. The court appears to deflect attention away from claimant’s specific causes of action (such as CERCLA 107 and breach of contract) and when they accrue or when they become non-contingent, in favor of a more generalized analysis of the “claim” and the relief sought, concluding that if the claimant and debtor are co-liable under CERCLA, that satisfies the co-liability element of 502(e)(1)(B) even if the Claimant’s claim includes or is based in part on breach of contract.

35 Id. at 256.

36 Id. at 257.

37 Id. at 258; see also Chemtura, 443 B.R. at 626.

38 Lyondell, 442 B.R. at 257-58; Chemtura, 443 B.R. at 626-27.
payment remedy and therefore its RCRA action was within the Bankruptcy Code’s definition of “claim.”39

The stunning ruling in Apex Oil has prompted environmental debtors to seek global settlements with the government that significantly reduce or eliminate the risk that the reorganized debtor will emerge from bankruptcy with the lingering threat of burdensome cleanup orders. Such settlements include those approved in the Lyondell, Chemtura, and GM bankruptcies, all of which involved significant environmental liabilities and significant contributors to the environmental contamination. The settlements range from large cash payments to the government in exchange for a release of the otherwise non-dischargeable claims,40 to the funding of environmental response trusts (“ERTs”) established to take title to owned sites and/or manage cleanup of non-owned sites. In addition to the government’s release and covenant not to sue, the debtors are negotiating contribution protection provisions that bar contribution claims by other co-liable PRPs.41

These settlements can have a significant impact on the claims and liabilities of the non-debtor remediating PRPs that are cleaning up the sites pursuant to consent decrees and similar orders, even more so now due to the holdings in Lyondell and Chemtura. Their claims for debtor’s share of future cleanup costs are barred as contingent under 502(e)(1)(B), and even their past cost claims for contribution can be subject to disallowance because of contribution protection the debtor obtains in the bankruptcy settlement. PRPs have been largely excluded from participation in the negotiations of these settlements even though they can have much at stake and often have better data on the debtor’s share of liability and future cleanup costs. The monetary settlements only generally provide that EPA or the state will deposit the funds into a site-specific account for future cleanup and usually provide the government with broad discretion as to how and where the debtor’s contributed cash or trust funds will be spent or managed. The government’s unilateral decisions can dramatically affect whether and how a PRP or remediation group may benefit from the recovery.42 Given the recent rulings on disallowance of PRP claims and the recent bankruptcy environmental settlements approved by the governments and the bankruptcy court with little regard for the interests of the PRP groups remediating the sites, remediation PRP groups will need to carefully assess and negotiate their own agreements with the government and agreements among themselves to address and effectively prepare for the potential bankruptcy of one or more PRPs for the applicable site.

39 See also In re Mark IV Industries, Inc., 438 B.R. 460, 470 (Bankr. S.D.N.Y. 2010)(The “focus is the statute under which [the government] elected to proceed.”)

40 It is somewhat perverse that the debtors are paying money to the government for a release of their liability to conduct future remediation and that the government is able to extract these payments in bankruptcy because the statutory remedy outside bankruptcy does not give rise to a right to payment and thus is a non-dischargeable debt.

41 See and compare the debtors’ bankruptcy court-approved environmental settlement agreements with the United States and various states in In re Lyondell Chemical Company, Case Nos. 09-10023-reg and In re Chemtura Corporation Case No. 09-11233-reg, respectively, and the EPA settlement agreement in In re Tronox, Incorporated, Case No. 09-10156-alg, all of which are Chapter 11 cases presently pending in the U.S. Bankruptcy Court for the Southern District of New York. The PRP objections to the settlements have been overruled with great deference being granted to the government and the benefits resolution of the environmental liabilities confer on the debtor and the other estate constituencies.

42 Although CERCLA requires that non-settling PRPs’ liability be reduced by the amount of the settlement received by the government, how and when are not proscribed and such credits are rarely applied before the remediation is complete.