Calling All PRPs With Contribution Claims: Pay Up, or Steer Clear of Bankruptcy Court

March/April 2011

Charles M. Oellermann
Mark G. Douglas

When a company that has been designated a responsible party for environmental cleanup costs files for bankruptcy protection, the ramifications of the filing are not limited to a determination of whether the remediation costs are dischargeable claims. Another important issue is the circumstances under which contribution claims asserted by parties coliable with the debtor will be allowed or disallowed in the bankruptcy case. This question was the subject of rulings handed down early in 2011 by the New York bankruptcy court presiding over the chapter 11 cases of Lyondell Chemical Co. and Chemtura Corp. In separate bench rulings, bankruptcy judge Robert E. Gerber held that environmental contribution claims remain contingent, and must be disallowed, until the coliable creditor actually pays for the cleanup or otherwise expends funds on account of the claim.

Disallowance of Contingent Claims for Contribution or Reimbursement

Section 502(e)(1) of the Bankruptcy Code disallows certain contingent claims asserted by codebtors for contribution or reimbursement. It provides as follows:

> Notwithstanding subsections (a), (b), and (c) of this section and paragraph (2) of this subsection, the court shall disallow any claim for reimbursement or contribution of an entity that is liable with the debtor on or has secured the claim of a creditor, to the extent that—
>
> (A) such creditor's claim against the estate is disallowed;

> (B) such claim for reimbursement or contribution is contingent as of the time of allowance or disallowance of such claim for reimbursement or contribution; or
>
> (C) such entity asserts a right of subrogation to the rights of such creditor under section 509 of this title.

Pursuant to section 502(e)(2), claims for reimbursement or contribution that become fixed postpetition must be determined, and be allowed or disallowed, as if the contingency had been resolved prepetition.

The purpose of section 502(e) is to protect the bankruptcy estate against the risk of double payment on claims. Without it, a debtor could be liable to the primary creditor as well as coliable parties seeking contribution. According to its legislative history, section 502(e)(1) "adopts a policy that a surety's claim for reimbursement or contribution is entitled to no better status than the claims of the creditor assured by such surety." The legislative history further explains that:

> The combined effect of section 502(e)(1)(B) and 502(e)(2) is that a surety or codebtor is generally permitted a claim for reimbursement or contribution to the extent the surety or codebtor has paid the assured party at the time of allowance. Section 502(e)(1)(C) alternatively indicates that a claim for reimbursement or contribution of a surety or codebtor is disallowed to the extent the surety or codebtor requests subrogation under section 509 with respect to the rights of the assured party. Thus, the surety or codebtor has a choice; to the extent a claim for contribution or reimbursement would be advantageous, such as in the case where such a claim is secured, a surety or codebtor may opt for reimbursement or contribution under section 502(e). On the other hand, to the extent the claim for such surety or codebtor by way of subrogation is more advantageous, such as where such claim is secured, the surety may elect subrogation under section 509.

The Bankruptcy Code does not define the terms "contingent," "reimbursement," "contribution," or "subrogation" or the phrase "liable with the debtor." The definition of these terms for purposes of section 502(e) has been left to the courts, with sometimes inconsistent results. Courts

generally look to applicable nonbankruptcy law for guidance (*e.g.*, state, federal statutory, or common law).

Application to Environmental Remediation Claims

In addition to claims arising from contractual codebtor relationships, section 502(e)(1)(B) disallows contingent reimbursement or contribution claims created by statute, including claims for contribution arising under the Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA"). Congress enacted CERCLA more than 30 years ago to hold "potentially responsible parties" ("PRPs") liable for remediating pollution. CERCLA imposes liability for environmental cleanup costs, natural-resource damages, and certain other categories of recovery on PRPs, including the current "owner or operator" of a site contaminated with hazardous substances and any person who previously owned or operated a contaminated site at the time of a hazardous waste disposal. PRPs who fund remediation actions can seek contribution from other PRPs "during or following any civil action" instituted under CERCLA. In addition, CERCLA permits "private parties" (nongovernmental entities) to seek contribution after they settle their liability with the Environmental Protection Agency ("EPA") or a state in an administrative or judicially approved settlement. It also protects PRPs who have settled with the EPA from contribution claims by other PRPs.

If a PRP or another private party files a claim against a debtor's estate for remediation costs, the claim may be disallowed under section 502(e)(1). The circumstances under which disallowance is warranted—and, more particularly, whether an environmental remediation contribution and/or indemnification claim is "contingent"—were addressed in *Lyondell* and *Chemtura*.

Lyondell and *Chemtura*

The facts involved in the cases are substantially similar. Prior to filing for chapter 11 protection in New York, certain of the debtors as well as various other private parties were designated as PRPs for past and estimated future environmental remediation costs under CERCLA. The other private parties filed contribution claims against the debtors' estates for past and future estimated remediation costs. The debtors objected to the claims for *future* (but not past) cleanup costs, maintaining that such claims should be disallowed pursuant to section 502(e)(1)(B).

In *Lyondell*, one of the PRPs asserted that a claim is contingent only if it has not "accrued" under applicable law, regardless of whether the underlying remediation costs have actually been paid. Thus, the PRP argued, no part of its claim was contingent because its contribution claim against the debtors had accrued under CERCLA. Other PRPs relied on the Delaware bankruptcy court's 2007 ruling in *In re RNI Wind Down Corp.* for the proposition that their claims for future response costs were *unliquidated*, but not contingent. The debtors in both *Lyondell* and *Chemtura* argued that the Second Circuit Court of Appeals' 1991 ruling in *In re Chateaugay Corp.* constrained the court to conclude that contribution claims under CERCLA remain contingent unless and until remediation costs are actually paid by the claimant.

The Bankruptcy Court's Rulings

Judge Gerber declined to view *Chateaugay* as controlling authority for the proposition that a contribution claim is contingent until the claimant actually makes an expenditure. *Chateaugay*, Judge Gerber wrote, was "not a 502(e)(1)(B) case." He found it instructive, however, that in both *Chateaugay* and the Second Circuit's 2000 ruling in *In re Manville Forest Products Corp.*, "it was undisputed that the debtors faced some environmental liability, but the Second Circuit

nevertheless described those claims as contingent because the scope, amount, and form of that liability was undetermined."

Nevertheless, Judge Gerber found compelling the reasoning articulated in other decisions applying section 502(e)(1)(B) in denying contribution claims on the basis of nonpayment by the claimant. According to Judge Gerber, the key inquiry is not whether liability has "accrued," but whether the coliable party has actually paid for the investigation and cleanup. Because the PRPs had not expended any amounts on future cleanup costs, the judge ruled that their contribution claims for future remediation costs remained both contingent and unliquidated. This approach, Judge Gerber reasoned, "advances not just bankruptcy policy, but environmental policy as well." Disallowance of such claims under the circumstances, he wrote, "advances CERCLA's policy goal of encouraging expeditious cleanup, because claimants are encouraged to remediate promptly by the threat of disallowance of claims that have not been fixed."

Outlook

Lyondell and *Chemtura* do not represent a sea change in this area of bankruptcy law, even for Judge Gerber. The rulings are consistent with another 2010 ruling in *Chemtura*, where he determined that section 502(e)(1)(B) mandated disallowance of claims for contribution by downstream distributors of the debtor's allegedly defective products, because such claims depended on the success of the parties allegedly injured by those products on their tort claims against distributors and were not just unliquidated but contingent as well. Even so, *Lyondell* and *Chemtura* reinforce the principle that an environmental remediation contribution claim will remain contingent, and therefore subject to disallowance under section 502(e)(1)(B), if the claimant has not actually expended payment for the cleanup, provided, of course, that the other

elements of section 502(e)(1)(B)—a claim for "reimbursement or contribution" and coliability of the debtor and the creditor—are satisfied.

In re Lyondell Chemical Co., 442 B.R. 236 (Bankr. S.D.N.Y. 2011).

In re Chemtura Corp., 2011 WL 109081 (Bankr. S.D.N.Y. Jan. 13, 2011).

In re RNI Wind Down Corp., 369 B.R. 174 (Bankr. D. Del. 2007).

In re Chateaugay Corp., 944 F.2d 997 (2d Cir. 1991).

In re Manville Forest Products Corp., 209 F.3d 125 (2d Cir. 2000).

In re Drexel Burnham Lambert Group, Inc., 148 B.R. 983 (Bankr. S.D.N.Y. 1992).

In re APCO Liquidating Trust, 370 B.R. 625 (Bankr. D. Del. 2007).

In re Alper Holdings USA, 2008 WL 4186333 (Bankr. S.D.N.Y. Sept. 10, 2008).

In re Wedtech Corp., 85 B.R. 285 (Bankr. S.D.N.Y. 1988).

Aetna Casualty & Surety Company v. Georgia Tubing Corp., 93 F.3d 56 (2d Cir. 1996).

In re Chemtura Corp., 436 B.R. 286 (Bankr. S.D.N.Y. 2010).