By Benjamin Woodruff

Revisiting *Midlantic* During COVID

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The recent price war of the Organization of the Petroleum Exporting Countries (OPEC) on oil, coupled with the unprecedented economic effects of the COVID-19 pandemic, will provide ample opportunity for bankruptcy courts to revisit the tenets of *Midlantic*.[1] Returning to the original teachings of this case — limiting abandonment of estate property in violation of "laws or regulations not reasonably calculated to protect the public health or safety from imminent and identifiable harm"[2] — would both pay due respect to congressional intent on limiting a debtor's power to abandon impaired property, and allow the federal and state agencies charged with promoting domestic energy production to balance the environmental and default risk posed by such operations.

Energy production constitutes one of the most financially risky ventures in modern American business. Of the 1,175 large public company chapter 11 cases filed since 1979, nearly 10 percent come from just two industrial sectors: (1) oil and gas extraction; and (2) coal mining.[3] While the risks are often industry-specific, the result of business failures and public assumptions of remedial liability is not. The result of this risk is drawn into sharpest focus at the nexus of energy production and public lands.

Energy production from federal lands represents approximately 21 percent of all domestic oil production,[4] 16 percent of all natural gas production,[5] and 40 percent of all coal production.[6] Estimates to decommission and reclaim these operations exceed $55 billion, but financial assurances made in favor of the public total just under $10 billion.[7]

State and local governments own significant mineral interests throughout the U.S., even in areas without significant federal land ownership. While energy production on federal lands has historically been confined to the western U.S. and the federal waters of the Gulf of Mexico, new interest in renewable energy installations on public lands and waters will extend decommissioning and reclamation challenges to new areas unaccustomed to energy-production operations.

The challenges that federal and state agencies face in protecting the environment and the public fisc are unique among creditors present in a normal bankruptcy case. These agencies generally have no capacity to tailor the terms of the "credit" that they extend to energy companies; rather, only the blunt instruments of law and regulation are available. However, when bankruptcy courts read the purpose of the statute requirement out of *Midlantic*,[8] these instruments are muted, and the public is left with little ability to protect the environment and its coffers.

The facts of the *Midlantic* case are useful to understand the context and impact. Two waste oil facilities were operated by the debtor, Quanta Resources Corp., under a temporary operating permit from the New Jersey Department of Environmental Protection (NJDEP).[9] As part of the conditions of the permit, Quanta was prohibited from accepting any waste oil shipments contaminated with polychlorinated biphenyls (PCBs),[10] yet Quanta accepted at least 400,000 gallons of PCB-contaminated oil at a New Jersey site, while an additional 70,000 gallons were discovered at a similar facility in New York.[11] The remediation costs at the New York site alone topped $2.5 million, a sum far in excess of the site's value.[12]

In reversing the bankruptcy court and affirming the Third Circuit, the U.S. Supreme Court began by first setting out the state of the law prior to the 1978 enactment of the Bankruptcy Code. There, they concluded that it was well recognized when § 554 was

1 *Midlantic Nat'l Bank v. New Jersey Dept. of Envtl. Prot.*, 474 U.S. 494 (1986).
2 *Id.* at 506-07, n. 9.
3 Of the 1,175 bankruptcy cases for large (more than $100 million in assets) public companies filed since Oct. 1, 1979, oil and gas extraction companies filed 93 cases, and coal mining filed 12 cases. *See* "Industry — Study Summary," UCLA-LoPucki Bankruptcy Research Database, *available at* lopucki.law.ucla.edu/design_a_study.asp?OutputVariable=SICMajGroup (unless otherwise specified, all links in this article were last visited on June 25, 2020).
4 Marc Humphries, Cong. Research Serv., R42432, U.S. Crude Oil and Natural Gas Production in Federal and Nonfederal Areas 3 (2016).
5 *Id.* at 4.
6 "The War on Coal Is Over: Interior Announces Historic Coal Projects in Utah," U.S. Dept. of the Interior (Feb. 14, 2019), *available at* doi.gov/pressreleases/war-coal-over-interior-announces-historic-coal-projects-utah.
7 Federal offshore petroleum production decommissioning liabilities are estimated at $38.2 billion against bonds of $2.9 billion. *See* GAO-17-642T, "Offshore Oil and Gas Resources: Information on Infrastructure Decommissioning and Federal Financial Risk," U.S. Gov't Accountability Off. (May 2017). Onshore petroleum production reclamation liabilities of federal lands are estimated at $6.1 billion, and bonds of $162 million are in place. *See* "Reclaiming Oil and Gas Wells on Federal Lands: Estimate of Costs," ECONorthwest 11 (February 2018), *available at* westernpriorities.org/wp-content/uploads/2018/02/Bonding-Report.pdf; GAO-10-245, "Oil and Gas Bonds: Bonding Requirements and BLM Expenditures to Reclaim Orphaned Wells," U.S. Gov't Accountability Off. 15 (2010). Coal mining reclamation for federal lands production is estimated at $10.8 billion with bonds in place of $7.8 billion. *See* GAO-18-305, "Coal Mine Reclamation: Federal and State Agencies Face Challenges in Managing Billions in Financial Assurances," U.S. Gov't Accountability Off. 11-12 (March 2018).
8 *See infra* n.22.
9 *Id.*
10 *In re Quanta Res. Corp.*, 739 F.2d 927, 928 (3d Cir. 1984).
11 *Midlantic*, 474 U.S. at 497.
12 *Id.* at 498-99. The factual conditions and issues of law at the New Jersey site were not recounted in the Supreme Court's opinion, but apparently were indistinguishable. The separate appeals from New Jersey and New York were ultimately consolidated on *certiorari* to the Supreme Court.

enacted that the trustee's abandonment power was limited by requirements of local law and equitable principles of safeguarding the public interest.[13] Since the Bankruptcy Code did not demonstrate a clear congressional intent to change the limitations on a trustee's abandonment power found at common law, such restrictions presumably were incorporated into the enactment.[14]

The second line of reasoning presented by the Court analyzed the limits that Congress specifically placed on the trustee: "Congress has repeatedly expressed its legislative determination that the trustee is not to have *carte blanche* to ignore nonbankruptcy law."[15] Given that Congress had placed limitations on the trustee's power in other aspects, there was no reason to believe that it had intended to reject the common law limits on abandonment power, with the Court pointing out, for example, that it had previously held that simply filing a bankruptcy petition did not excuse the debtor-in-possession from compliance with the National Labor Relations Act.[16] Finally, the Court said, Congress had made a clear statement of its intent, through the enactment of 28 U.S.C. § 959(b), to require a trustee to comply with valid state laws.[17]

In *dicta*, the Court added that bracketing the 1978 Bankruptcy Act, Congress had enacted both the Resource Conservation and Recovery Act (RCRA) in 1976 and the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) in 1980, demonstrating the "congressional emphasis on its goal of protecting the environment against toxic pollution."[18] The RCRA authorized the U.S. to employ judicial and administrative remedy against hazardous-waste activities, while CERCLA established a fund for cleanup and required responsible parties to reimburse those paying for cleanup.[19] From these enactments, the Court concluded that Congress had expressed "undisputed concern over the risks of the improper storage and disposal of hazardous and toxic substances," such that there was no reasonable way to also conclude that Congress had "implicitly overturned longstanding restrictions on the common law abandonment power" by enacting § 554(a).[20]

In the intervening years, courts have often seized on the *dicta* and a footnote in *Midlantic* to effectively narrow the scope of the holding. The specific reference by the Court to a provision of CERCLA empowering the U.S. to seek relief to avert "imminent and substantial endangerment to the public health or welfare or the environment because of an actual or threatened release of a hazardous substance" has become a *de facto* test to determine when a trustee may abandon property from the estate.[21] The *Midlantic* Court added in another footnote that the exception to the § 554 abandonment power 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 protect the public health or safety from imminent and identifiable harm."[22]

The problem is that several bankruptcy courts since then have not approached either the reference to CERCLA or the footnote in the most natural reading of the Court's language. Rather, they have treated "imminent and identifiable" harm as a required condition precedent to restricting the trustee's abandonment power, when the most natural reading in both instances is with regard to the purpose and policy of the underlying law the state is seeking to enforce.

For example, a debtor in possession was permitted to abandon an oil and gas production site with 19 unplugged wells located on the grounds of Beverly Hills High School in California because the court found that there was no immediate and identifiable harm to the general public, despite the site being approximately 80 feet from a home and less than 250 feet from a hospital.[23] The court accepted evidence suggesting that because the wells were low pressure, they would not flow on their own, meaning there was no immediate harm at the site.[24] The remedy available to Beverly Hills and the state of California in the *Venoco* case, the court concluded, was to file a claim in the bankruptcy proceedings.[25]

Not all bankruptcy courts have read *Midlantic* as creating the imminent and identifiable harm test. For example, the U.S. Bankruptcy Court of the Southern District of Texas read the *Midlantic* opinion to "require the Court to determine whether the debtor is violating a statute 'reasonably designed to protect the public health or safety from identified hazards,' not the extent to which particular conduct imposes actual and imminent threats."[26]

The cases are split and little circuit authority controls the choice between the narrow imminent and identifiable harm reading of *Midlantic* and the broader purpose of the underlying statute reading. A slight majority of cases appear to favor the narrower approach.

The second approach that bankruptcy courts have taken in narrowing the effect of *Midlantic* is to treat the availability of estate funds for remediation as a prerequisite to disallowing abandonment.[27] Some courts have found that when the debtor does not have enough unencumbered assets in the estate to bring the property into compliance with state law, *Midlantic* should not serve as a categorical bar to abandonment.[28]

A close reading of *Midlantic* reveals no discussion of the estate's capability to pay for cleanup as providing any sort of factor in the determination of whether a trustee may aban-

13 *Id.* at 500-01. For example, the trustee was not allowed to abandon several barges that would have obstructed a navigable passage in violation of federal law. *See Ottenheimer v. Whitaker*, 198 F.2d 289 (CA4 1952). The trustee's power to abandon a branch railway line was conditioned on compliance with local law requiring continued operation. *See In re Chicago Rapid Transit Co.*, 129 F.2d 1 (CA7 1942). The debtor was required to safeguard the public interest by sealing underground steam pipes before abandoning them. *See In re Lewis Jones Inc.*, 1 BCD 277 (Bankr. E.D. Pa. 1974).

14 *Midlantic*, 474 U.S. at 501.

15 *Id.* at 502.

16 *Id.*

17 *Id.* at 505.

18 *Id.*

19 *Id.* at 505-06.

20 *Id.* at 506.

21 *Id.* (quoting 42 U.S.C. § 9606(a)).

22 *Id.* at 506-07, n. 9.

23 *City of Beverly Hills v. Venoco LLC (In re Venoco LLC)*, 572 B.R. 105, 108, 114-15 (Bankr. D. Del. 2017).

24 *Id.* at 112.

25 *Id.* at 116.

26 *In re Am. Coastal Energy Inc.*, 399 B.R. 805, 813 (Bankr. S.D. Tex. 2009); *see also In re Wall Tube & Metal Prods. Co.*, 831 F.2d 118, 122 (6th Cir. 1987) (concluding that trustee could not have abandoned property that was in violation of state law designed to protect public health or safety from identifiable hazards); *Montgomery Cty. v. Barwood Inc.*, 422 B.R. 40, 47 (D. Md. 2009) (concluding that *Midlantic* stands for nature of underlying law, not if there is violation); *In re Stevens*, 68 B.R. 774, 781 (D. Me. 1987) ("The *Midlantic* message is that 'a trustee may not abandon property in contravention of a state statute or regulation that is reasonably designed to protect the public health or safety from identified hazards.'").

27 *In re ATP Oil & Gas Corp.*, No. 12-36187, 2013 Bankr. LEXIS 2608 at *6 (Bankr. S.D. Tex. June 19, 2013) (deciding that since ATP had insufficient funds to pay decommissioning costs, abandonment to U.S. was better choice).

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don property. What such reading of *Midlantic* does reveal is an inference that has informed the alternate use of this case in the context of environmentally impaired property abandonments: allowance of administrative expense priority for remediation costs upon abandonment from the estate.

This advantageous priority has been seized upon by environmental creditors and bankruptcy judges alike as a way to split the baby: Allow abandonment of such impaired properties in exchange for a priority claim. In *Midlantic*, this was exactly the sort of relief that the state of New York sought, since the abandonment had already occurred and it had already incurred sizable costs associated with the clean-up.[29] While the Supreme Court did not specifically address the propriety of the environmental liability for administrative-expense exchange, it did not foreclose such bargain. This exchange was an underlying premise of why the U.S. Bankruptcy Court for the Southern District of Texas allowed abandonment of an offshore oil platform with an estimated $203 million decommissioning liability: Since the U.S. could make an administrative claim and could complete the decommissioning, the public health and safety was protected.[30]

Given the relatively low commodity prices for oil, natural gas and coal, coupled with an uncertain economic recovery from the COVID-19 pandemic, scores of energy operations on public lands will be of no economic value to a debtor's estate and logically should be abandoned. At the same time, reduced tax revenues as a result of the pandemic have put increased pressure on public budgets that were already ill-equipped to absorb environmental liabilities.

Charting a course nearer to the original holding of *Midlantic* would help shift the risk from the public to the creditors of energy producers, who are in a far better position to tailor the terms of credit than is the public. Keeping the environmentally impaired property in the debtor's estate will require reorganizing companies or asset-purchasers to address the remediation requirements for which they are responsible. Such an approach will better follow the background common law limits on the trustee's abandonment power incorporated into the Bankruptcy Code and help ensure that both Congress and state governments can adequately protect the public against business default. abi

28 *See, e.g., In re Guterl Special Steel Corp.*, 316 B.R. 843, 860 (Bankr. W.D. Pa. 2004) (allowing abandonment of 9.1-acre parcel contaminated with radioactive waste, in part because estate had no funds remaining for remediation); *In re H.F. Radandt Inc.*, 160 B.R. 323, 327 (Bankr. W.D. Wis. 1993) (implying that cost-benefit of requiring remediation would not confer benefit on estate, therefore both abandonment and denial of administrative expense was warranted). For a more in-depth analysis of the approaches various courts have taken to *Midlantic*, *see generally* Stephen B. Kong, "A Chapter 7 Trustee's Abandonment of Environmentally-Impaired Property: *Midlantic*, Post-*Midlantic* Interpretation and the Plague of Results-Oriented Legal Analysis," 5 *Fordham Envt'l L.J.* 221 (2011).

29 *See Midlantic Nat'l Bank*, 474 U.S. 494, 498 n.2 (1986).

30 *In re ATP Oil & Gas Corp.*, No. 12-36187, 2013 Bankr. LEXIS 2608 at *7.