

Revisiting Treatment of P&A Obligations in Oil & Gas Bankruptcies

Judge Marvin Isgur
U.S. Bankruptcy Court, Southern District of Texas

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**13th Anniversary
Bankruptcy Bench Bar Conference 2019
Sponsored by the Bankruptcy Law Section of the Texas State Bar
Fairmont Austin
April 17 - 19, 2019**

Marvin Isgur

United States Bankruptcy Court for the Southern District of Texas

Marvin Isgur has been a United States Bankruptcy Judge since February 1, 2004. He was appointed to a second term as a Bankruptcy Judge, which began on February 1, 2018. Chief Justice John Roberts, Jr. appointed Judge Isgur to the Judicial Conference Committee on Court Administration and Case Management. He is the sole bankruptcy judge appointed to the Committee.

Judge Isgur currently presides over more than 4,000 bankruptcy cases. He has been instrumental in reforming consumer bankruptcy practices and rules both in the Southern District of Texas and nationally. He is one of two judges who is assigned complex bankruptcy cases in the Southern District of Texas. In that capacity, he has presided over multiple bankruptcy cases with liabilities exceeding one billion dollars. In 2018, he was assigned the largest bankruptcy case filed in the United States.

In 1974, Judge Isgur received his bachelor's degree from the University of Houston. In 1978 he received his MBA, with honors, from Stanford University. After earning his MBA, Judge Isgur served as an executive with a large real estate development company in Houston. In 1987, Judge Isgur returned to the University of Houston to attend law school. Judge Isgur was awarded his law degree, with high honors in 1990 and began representing debtors and trustees in chapter 11 and 7 bankruptcy cases until his appointment as a Bankruptcy Judge.

Judge Isgur has written over 500 memorandum opinions. He was one of the first judges to issue opinions interpreting the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act.

Judge Isgur serves on the board of directors for the Houston Urban Debate League, a non-profit organization that works in partnership with the Houston Independent School District and the Harris County Department of Education to bring competitive academic debate to high school students. He is one of the principal organizers of the annual University of Texas Consumer Bankruptcy Conference and is a frequent speaker at continuing legal education programs.

When his volunteer and court activities permit, Judge Isgur spends his weekends sailing on Galveston Bay.

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David Curry is a partner in Okin Adams LLP's Houston office with a practice focused upon representing debtors, creditors, including creditors' committees, and other parties in interest through the restructuring process and in bankruptcy related litigation. David also represents parties-in-interest in bankruptcy-related appellate matters.

Prior Speaking Engagements

- "Offshore Plugging & Abandonment / Decommissioning Liabilities – Your Rights to Priority Payment From A Bankrupt Debtor...or So You Thought!," Turnaround Management Association Monthly Lecture Panelist; May 2017
- "Keeping Your Truck on the Road – Examining Challenges Arising in Ch. 11 Trucking Cases," Dallas County Bar Association; October 2018

Publications

- *Franchise Servs. of N. Am. V. U.S. Trs. (In re Franchise Servs. of N. Am.): Fifth Circuit Punts on Golden Share Issues*, [ABI Business Reorganization Newsletter](#); July 2018
- *Unplugging the Fifth Circuit's Abandonment Problem: A Reexamination of the Midlantic Exception in Offshore E&P Cases*, *Tulane Environmental Law Journal*, Volume 31, Issue 1 (Winter 2017).
- *Finding Acceptance: Using Strategic Impairment to Satisfy § 1129(a)(10)*; [ABI Business Reorganization Newsletter](#); June 2017; *Reprint in Harvard Law School Bankruptcy Roundtable*; October 2017
- *Czyzewski v. Jevic Holding Corp.: Structured Dismissal Must Follow Priority Rules Even in "Rare Cases"*; [ABI Business Reorganization Newsletter](#); June 2017



EDUCATION

University of Texas at Tyler,
B.S., Political Science / History, summa cum laude, 2005
Tulane University School of Law,
J.D., cum laude, 2008
Senior Managing Editor, *Tulane Environmental Law Journal*

COURT ADMISSIONS

United States Supreme Court
Fifth Circuit Court of Appeals
U.S. District Court, Northern District of Texas
U.S. District Court, Southern District of Texas
U.S. District Court, Eastern District of Texas
U.S. District Court, Western District of Texas



Lindsey M. Johnson



Lindsey's practice focuses primarily on oil and gas litigation and transactions, including matters related to contracts, title review, environmental issues, federal and state regulatory matters, litigation, and bankruptcies. Lindsey regularly provides advice on a wide array of federal regulatory matters, including bonding and financial assurance requirements for owners and operators of offshore oil and gas leases mandated by the Bureau of Ocean Energy Management ("BOEM") and analyzing and appealing decommissioning assessments from the Bureau of Safety and Environmental Enforcement ("BSEE"). Lindsey has experience in advising clients on how to successfully navigate Chapter 11 bankruptcies while remaining in compliance with the rules and regulations of BOEM/BSEE, the Louisiana Office of Conservation and other regulatory agencies. In *In re Black Elk Offshore Operations LLC*, she represented a surety that was instrumental in providing debtor-in-possession financing and successfully managing the Debtor's plugging and abandonment plan. In addition, Lindsey has served as special counsel to an offshore debtor-in-possession, advising the client in all BOEM and BSEE matters.

Education

- J.D., *cum laude*, Loyola University College of Law (New Orleans), 2012
- B.S., in Psychology, *magna cum laude*, University of New Orleans, 2007

Bar Admissions

- Louisiana
- Eastern District of Louisiana
- Middle District of Louisiana
- Western District of Louisiana
- Southern District of Texas

Midlantic Nat'l Bank v. N.J. Dep't of Env'tl. Prot.

Supreme Court of the United States

October 16, 1985, Argued ; January 27, 1986, Decided *

No. 84-801

* Together with No. 84-805, O'Neill, Trustee in Bankruptcy of Quanta Resources Corp., Debtor v. City of New York et al., and O'Neill, Trustee in Bankruptcy of Quanta Resources Corp., Debtor v. New Jersey Department of Environmental Protection, also on certiorari to the same court.

Reporter

474 U.S. 494 *; 106 S. Ct. 755 **; 88 L. Ed. 2d 859 ***; 1986 U.S. LEXIS 50 ****; 54 U.S.L.W. 4138; 23 ERC (BNA) 1913; Bankr. L. Rep. (CCH) P70,923; 13 Collier Bankr. Cas. 2d (MB) 1355; 13 Bankr. Ct. Dec. 1262; 16 ELR 20278

MIDLANTIC NATIONAL BANK v. NEW JERSEY
DEPARTMENT OF ENVIRONMENTAL PROTECTION

Subsequent History: [****1] 739 F.2d 912 and 739 F.2d 927, affirmed.

Prior History: CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

Syllabus

Quanta Resources Corp. (Quanta) processed waste oil at facilities located in New York and New Jersey. The New Jersey Department of Environmental Protection (NJDEP) discovered that Quanta had violated a provision of the operating permit for the New Jersey facility by accepting oil contaminated with a toxic carcinogen. During negotiations with NJDEP for the cleanup of the New Jersey site, Quanta filed a petition for reorganization under Chapter 11 of the Bankruptcy Code, and after NJDEP had issued an order requiring cleanup, Quanta converted the action to a liquidation proceeding under Chapter 7. An investigation of the New York facility then revealed that Quanta had also accepted similarly contaminated oil at that site. The trustee notified the creditors and the Bankruptcy Court that he intended to abandon the property under § 554(a) of the Bankruptcy Code, which authorizes a trustee to "abandon any property of the estate that is burdensome to the estate or that is of inconsequential value to the estate." The City and the State of New [****2] York objected, contending that abandonment would threaten the public's health and safety, and would violate state and federal environmental law. The Bankruptcy Court approved the abandonment, and, after the District Court affirmed, an appeal was taken to the Court of Appeals for the Third Circuit. Meanwhile, the Bankruptcy Court also approved the trustee's proposed abandonment of the New Jersey facility over NJDEP's objection, and NJDEP took a direct appeal to the Court of Appeals. In separate judgments, the Court of Appeals reversed, holding that the Bankruptcy Court erred in permitting abandonment.

Held: A trustee in bankruptcy 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. Congress did not intend for § 554(a) to pre-empt all state and local laws. A bankruptcy court does not have the power to authorize an abandonment without formulating conditions that will adequately protect the public's health and safety. Pp. 500-507.

(a) Before the 1978 revisions of the Bankruptcy Code, which codified in § 554 the judicially developed rule of abandonment, the trustee's [****3] abandonment power had been limited by a judicially developed doctrine intended to protect legitimate state and federal interests. In codifying the rule of abandonment, Congress also presumably included the corollary that a trustee could not exercise his abandonment power in violation of certain state and federal laws. Pp. 500-501.

(b) Neither this Court's decisions nor Congress has granted a trustee in bankruptcy powers that would lend support to a right to abandon property in contravention of state or local laws designed to protect public health or safety. Where the Bankruptcy Code has conferred other special powers upon the trustee and where there was no common-law limitation on such powers, Congress has expressly provided that the trustee's efforts to marshal and distribute the estate's assets must yield to governmental interests in public health and safety. It cannot be assumed that Congress, having placed such limitations upon other aspects of trustees' operations, intended to discard the well-established judicial restriction on the abandonment power. Moreover, 28 U. S. C. § 959(b), which commands the trustee to "manage and operate the property in his possession . . . according [****4] to the requirements of the valid laws of the State," provides additional evidence that Congress did not intend for the Bankruptcy Code to pre-empt all state laws. Pp. 502-505.

(c) Additional support for restricting the abandonment power is found in repeated congressional emphasis, in other statutes, on the goal of protecting the environment against toxic pollution. Pp. 505-506.

Counsel: A. Dennis Terrell argued the cause for petitioner in No. 84-801. With him on the brief was Kenneth S. Kasper. William F. McEnroe argued the cause for petitioner in No. 84-805. With him on the brief was Thomas J. O'Neill, pro se.

Mary C. Jacobson, Deputy Attorney General of New

Jersey, argued the cause for respondent in No. 84-801. With her on the brief were Irwin I. Kimmelman, Attorney General, James J. Ciancia, Assistant Attorney General, and Richard F. Engel and Ross A. Lewin, Deputy Attorneys General. Robert Hermann, Solicitor General of New York, argued the cause for respondents in No. 84-805. With him on the brief were Robert Abrams, Attorney General, Nancy Stearns, Norman Spiegel, and Christopher Keith Hall, Assistant Attorneys General, Frederick A. O. Schwarz, Jr., and Leonard Koerner. *

[****5]

Judges: POWELL, J., delivered the opinion of the Court, in which BRENNAN, MARSHALL, BLACKMUN, and STEVENS, JJ., joined. REHNQUIST, J., filed a dissenting opinion, in which BURGER, C. J., and WHITE and O'CONNOR, JJ., joined, post, p. 507.

Opinion by: POWELL

Opinion

[*496] [***862] [**757] JUSTICE POWELL delivered the opinion of the Court.

[1A]These petitions for certiorari, arising out of the same bankruptcy proceeding, present the question whether § 554(a) of the Bankruptcy [***863] Code, 11 U. S. C. § 554(a),¹ authorizes a trustee in bankruptcy to

*Thomas H. Jackson, pro se, filed a brief as amicus curiae urging reversal.

Briefs of amici curiae urging affirmance were filed for the United States by Acting Solicitor General Fried, Assistant Attorney General Habicht, Deputy Solicitor General Claiborne, Kathryn A. Oberly, and Dirk D. Snel; for the State of California by John K. Van de Kamp, Attorney General, Theodora Berger, Assistant Attorney General, and Reed Sato, Lisa S. Trankley, and Craig C. Thompson, Deputy Attorneys General; and for the State of West Virginia et al. by Charlie Brown, Attorney General of West Virginia, Steven Johnston Knopp, Assistant Attorney General, James D. Morris, and Howard J. Wein.

Ronald A. Zumbun and Robert K. Best filed a brief for the Pacific Legal Foundation as amicus curiae.

¹ Section 554(a) reads:

"After notice and a hearing, the trustee may abandon any property of the estate that is burdensome to the estate or that is of inconsequential value to the estate."

abandon property in contravention of state laws or regulations that are reasonably designed to protect the public's health or safety.

[****6] I

Quanta Resources Corporation (Quanta) processed waste oil at two facilities, one in Long Island City, New York, and [*497] the other in Edgewater, New Jersey. At the Edgewater facility, Quanta handled the oil pursuant to a temporary operating permit issued by the New Jersey Department of Environmental Protection (NJDEP), respondent in No. 84-801. In June 1981, Midlantic National Bank, petitioner in No. 84-801, provided Quanta with a \$ 600,000 loan secured by Quanta's inventory, accounts receivable, and certain equipment. The same month, NJDEP discovered that Quanta had violated a specific prohibition in its operating permit by accepting more than 400,000 gallons of oil contaminated with PCB, a highly toxic carcinogen. NJDEP ordered Quanta to cease operations at Edgewater, and the two began negotiations concerning the cleanup of the Edgewater site. But on October 6, 1981, before the conclusion of negotiations, Quanta filed a petition for reorganization under Chapter 11 of the Bankruptcy Code. The next day, NJDEP issued an administrative order requiring Quanta to clean up the site. Quanta's financial condition remained perilous, however, and the following month, it converted [****7] the action to a liquidation proceeding under Chapter 7. Thomas J. O'Neill, petitioner in No. 84-805, was appointed trustee in bankruptcy, and subsequently oversaw abandonment of both facilities.

After Quanta filed for bankruptcy, an investigation of the Long Island City facility revealed that Quanta had accepted and stored there over 70,000 gallons of toxic, PCB-contaminated oil in deteriorating and leaking containers. Since the mortgages on that facility's real property exceeded the property's value, the estimated cost of disposing of the waste oil plainly rendered the property a net burden to the estate. After trying without success to sell the Long Island City property for the benefit of Quanta's creditors, the trustee notified the creditors and the Bankruptcy Court for the District of New Jersey that he intended to abandon the property pursuant to § 554(a). No party to the bankruptcy proceeding disputed the trustee's allegation that the site

Technical amendments in the Bankruptcy Amendments and Federal Judgeship Act of 1984 added the words "and benefit" after "value" in § 554(a). Pub. L. 98-353, Tit. III, § 468(a), 98 Stat. 380.

was "burdensome" and of "inconsequential value to the estate" within the meaning of § 554.

[*498] The City and the State of New York (collectively New York), respondents in No. [**758] 84-805, nevertheless objected, contending that [****8] abandonment would threaten the public's health and safety, and would violate state and federal environmental law. New York rested its objection on "public policy" considerations reflected in applicable local laws, and on the requirement of 28 U. S. C. [***864] § 959(b) that a trustee "manage and operate" the property of the estate "according to the requirements of the valid laws of the State in which such property is situated." New York asked the Bankruptcy Court to order that the assets of the estate be used to bring the facility into compliance with applicable law. After briefing and argument, the court approved the abandonment, noting that "[the] City and State are in a better position in every respect than either the Trustee or debtor's creditors to do what needs to be done to protect the public against the dangers posed by the PCB-contaminated facility." The District Court for the District of New Jersey affirmed, and New York appealed to the Court of Appeals for the Third Circuit.

Upon abandonment, the trustee removed the 24-hour guard service and shut down the fire-suppression system. It became necessary for New York to decontaminate the facility, with the exception of [****9] the polluted subsoil, at a cost of about \$ 2.5 million.²

On April 23, 1983, shortly after the District Court had approved abandonment of the New York site, the trustee gave notice of his intention to abandon the personal property at the Edgewater site, consisting principally of the contaminated oil. The Bankruptcy Court approved the abandonment on May 20, over NJDEP's objection that the estate had [*499] sufficient funds to protect the public from the dangers posed by the hazardous waste.³

²The sole issue presented by these petitions is whether a trustee may abandon property under § 554 in contravention of local laws designed to protect the public's health and safety. New York is claiming reimbursement for its expenditures as an administrative expense. That question, however, like the question of the ultimate disposition of the property, is not before us.

³The trustee was not required to take even relatively minor steps to reduce imminent danger, such as security fencing, drainage and diking repairs, sealing deteriorating tanks, and removing explosive agents. Moreover, the trustee's

[****10] Because the abandonments of the New Jersey and New York facilities presented identical issues, the parties in the New Jersey litigation consented to NJDEP's taking a direct appeal from the Bankruptcy Court to the Court of Appeals pursuant to § 405(c)(1)(B) of the Bankruptcy Act of 1978.

A divided panel of the Court of Appeals for the Third Circuit reversed. *In re Quanta Resources Corp.*, 739 F.2d 912 (1984); *In re Quanta Resources Corp.*, 739 F.2d 927 (1984). Although the court found little guidance in the legislative history of § 554, it concluded that Congress had intended to codify the judge-made [***865] abandonment practice developed under the previous Bankruptcy Act. Under that law, where state law or general equitable principles protected certain public interests, those interests were not overridden by the judge-made abandonment power. The court also found evidence in other provisions of the Bankruptcy Code that Congress did not intend to pre-empt all state regulation, but only that grounded on policies outweighed by the relevant federal interests. [*500] Accordingly, [**759] the Court of Appeals held that the Bankruptcy Court [****11] erred in permitting abandonment, and remanded both cases for further proceedings.⁴

abandonment at both sites aggravated already existing dangers by halting security measures that prevented public entry, vandalism, and fire. Joint Appendix in No. 83-5142 (CA3), pp. 11-12 (affidavit of Richard Docyk, Deputy Chief Inspector for N. Y. City Fire Department); *id.*, at 26 (transcript of proceedings before DeVito, J.). The 470,000 gallons of highly toxic and carcinogenic waste oil in unguarded, deteriorating containers "present risks of explosion, fire, contamination of water supplies, destruction of natural resources, and injury, genetic damage, or death through personal contact." Brief for United States as *Amicus Curiae* 4, 23; see Joint Appendix, *supra*, at 17 (70,000 gallons at New York site); Appendix in No. 83-5730 (CA3), p. A7 (400,000 gallons at New Jersey site); *id.*, at A46 (deteriorating containers); Joint Appendix, *supra*, at 11 (deteriorating tanks); *id.*, at 26 (guard service); *id.*, at 12 (risk of fire); *id.*, at 11 (contamination of adjacent areas); *id.*, at 20 (health effects of exposure to PCBs and their derivatives).

⁴Judge Gibbons dissented, arguing that § 554 permits abandonment without any exception analogous to that provided to the automatic stay. The dissent further contended that the majority's interpretation of § 554 raised substantial questions under the Takings Clause by potentially destroying the interest of secured creditors, see *United States v. Security Industrial Bank*, 459 U.S. 70 (1982), and that the majority had failed to address the important underlying issue of the priority of the States' claims for reimbursement.

We granted certiorari and consolidated these cases to determine whether the Court of Appeals properly construed § 554, 469 U.S. 1207 (1985). We now affirm.

II

Before the 1978 revisions of the Bankruptcy Code, the trustee's abandonment power had been limited by a judicially developed doctrine intended to protect legitimate state or federal interests. This was made clear by [****12] the few relevant cases. In *Ottenheimer v. Whitaker*, 198 F.2d 289 (CA4 1952), the Court of Appeals concluded that a bankruptcy trustee, in liquidating the estate of a barge company, could not abandon several barges when the abandonment would have obstructed a navigable passage in violation of federal law. The court stated:

"The judge-made [abandonment] rule must give way when it comes into conflict with a statute enacted in order to ensure the safety of navigation; for we are not dealing with a burden imposed upon the bankrupt or his property by contract, but a duty and a burden imposed upon an owner of vessels by an Act of Congress in the public interest." *Id.*, at 290.

In *In re Chicago Rapid Transit Co.*, 129 F.2d 1 (CA7), cert. denied *sub nom. Chicago Junction R. Co. v. Sprague*, 317 U.S. 683 (1942), the Court of Appeals held that the trustee of a debtor transit company could not cease its operation [*501] of a branch railway line when local law required continued operation. While the court did not forbid the trustee to abandon property (*i. e.*, to reject an unexpired lease), it conditioned [****13] his actions to ensure compliance with state law. Similarly, in *In re Lewis Jones, Inc.*, 1 BCD 277 (Bkrtcy Ct. ED Pa. 1974), the Bankruptcy Court invoked its equitable power to "safeguard the public interest" by requiring the debtor public utilities to seal underground steam lines before abandoning them.

[2]Thus, when Congress enacted § 554, there were well-recognized restrictions on a trustee's abandonment power. In codifying the judicially developed rule of abandonment, Congress also presumably included the established corollary that a trustee could not exercise his [***866] abandonment power in violation of certain state and federal laws. The normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific. *Edmonds v. Compagnie Generale Transatlantique*, 443 U.S. 256, 266-267

(1979). The Court has followed this rule with particular care in construing the scope of bankruptcy codifications. If Congress wishes to grant the trustee an extraordinary exemption from nonbankruptcy law, "the intention would be clearly expressed, not [****14] left to be collected or inferred from disputable considerations of convenience in administering the estate of the bankrupt." *Swarts v. Hammer*, 194 U.S. 441, 444 (1904); see *Palmer v. Massachusetts*, 308 U.S. 79, 85 (1939) ("If this old and familiar power of the states [over local railroad service] was withdrawn when Congress gave district courts bankruptcy powers over railroads, we ought to find language fitting for so drastic a change"). Although these cases do not define for us the exact contours of the trustee's abandonment power, they do make clear that this power was subject to [**760] certain restrictions when Congress enacted § 554(a).

[*502] III

Neither the Court nor Congress has granted a trustee in bankruptcy powers that would lend support to a right to abandon property in contravention of state or local laws designed to protect public health or safety. As we held last Term when the State of Ohio sought compensation for cleaning the toxic waste site of a bankrupt corporation:

"Finally, we do not question that anyone in possession of the site -- whether it is [the debtor] or another in the event the receivership is [****15] liquidated and the trustee abandons the property, or a vendee from the receiver or the bankruptcy trustee -- must comply with the environmental laws of the State of Ohio. Plainly, that person or firm may not maintain a nuisance, pollute the waters of the State, or refuse to remove the source of such conditions." *Ohio v. Kovacs*, 469 U.S. 274, 285 (1985) (emphasis added).

Congress has repeatedly expressed its legislative determination that the trustee is not to have *carte blanche* to ignore nonbankruptcy law. Where the Bankruptcy Code has conferred special powers upon the trustee and where there was no common-law limitation on that power, Congress has expressly provided that the efforts of the trustee to marshal and distribute the assets of the estate must yield to governmental interest in public health and safety. *Infra*, at 503-504. One cannot assume that Congress, having placed these limitations upon other aspects of trustees' operations, intended to discard a well-established

judicial restriction on the abandonment power. As we held nearly two years ago in the context of the National Labor Relations Act, "the debtor-in-possession is not relieved [****16] of all obligations under the [Act] simply by filing a petition for bankruptcy." *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 534 (1984).

[*503] [***867] The automatic stay provision of the Bankruptcy Code, § 362(a), ⁵ has been described as "one of the fundamental debtor protections provided by the bankruptcy laws." S. Rep. No. 95-989, p. 54 (1978); H. R. Rep. No. 95-595, p. 340 (1977). Despite the importance of § 362(a) in preserving the debtor's estate, Congress has enacted several categories of exceptions to the stay that allow the Government to commence or continue legal proceedings. For example, § 362(b)(5) permits the Government to enforce "nonmonetary" judgments against a debtor's estate. It is clear from the

⁵ Section 362(a) provides:

"(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970 (15 U. S. C. 78eee(a)(3)), operates as a stay, applicable to all entities, of --

"(1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;

"(2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;

"(3) any act to obtain possession of property of the estate or of property from the estate;

"(4) any act to create, perfect, or enforce any lien against property of the estate;

"(5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;

"(6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;

"(7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and

"(8) the commencement or continuation of a proceeding before the United States Tax Court concerning the debtor."

legislative history that one of the purposes of this exception is to protect public health and safety:

[*504] [**761] "Thus, where a governmental unit is suing a debtor to prevent or stop violation of fraud, *environmental protection*, consumer protection, *safety*, or *similar police or regulatory laws*, or attempting to fix damages for violation of such a law, the action or proceeding is not stayed under the automatic stay." [****17] H. R. Rep. No. 95-595, *supra*, at 343 (emphasis added); S. Rep. No. 95-989, *supra*, at 52 (emphasis added).

[****18] Petitioners have suggested that the existence of an express exception to the automatic stay undermines the inference of a similar exception to the abandonment power: had Congress sought to restrict similarly the scope of § 554, it would have enacted similar limiting provisions. This argument, however, fails to acknowledge the differences between the predecessors of §§ 554 and 362. As we have noted, the exceptions to the judicially created abandonment power were firmly established. But in enacting § 362 in 1978, Congress significantly broadened the scope of the automatic stay, see 1 W. Norton, *Bankruptcy Law and Practice* § 20.03, pp. 5-6 (1981), an expansion that had begun only five years earlier with the adoption of the Bankruptcy Rules in 1973, see *id.*, § 20.02, at 4-5. Between 1973 and 1978, some courts had stretched the expanded automatic stay to foreclose States' efforts to enforce their antipollution [***868] laws, ⁶ and Congress wanted to overrule these interpretations in its 1978 revision. See H. R. Rep. No. 95-595, *supra*, at 174-175. In the face of the greatly increased scope of § 362, it was necessary for Congress to limit this new power expressly.

[****19]

[*505] [3A]Title 28 U. S. C. § 959(b) ⁷ provides

⁶ See, e. g., *In re Hillsdale Foundry Co.*, 1 BCD 195 (Bkrtcy Ct. WD Mich. 1974) (action by Michigan Attorney General to enforce State's antipollution laws held subject to automatic stay). The House Report also referred to an unreported case from Texas where a stay prevented the State of Maine from closing down a debtor's plant that was polluting a river in violation of the State's environmental protection laws. H. R. Rep. No. 95-595, pp. 174-175 (1977).

⁷ Section 959(b) provides:

"Except as provided in section 1166 of title 11, a trustee, receiver or manager appointed in any cause pending in any court of the United States, including a debtor in possession,

additional evidence that Congress did not intend for the Bankruptcy Code to pre-empt all state laws. Section 959(b) commands the trustee to "manage and operate the property in his possession . . . according to the requirements of the valid laws of the State." Petitioners have contended that § 959(b) is relevant only when the trustee is actually operating the business of the debtor, and not when he is liquidating it. Even though § 959(b) does not directly apply to an abandonment under § 554(a) of the Bankruptcy Code -- and therefore does not delimit the precise conditions on an abandonment -- the section nevertheless supports our conclusion that Congress did not intend for the Bankruptcy Code to pre-empt all state laws that otherwise constrain the exercise of a trustee's powers.

[****20] IV

Although the reasons elaborated above suffice for us to conclude that Congress did not intend for the abandonment power to abrogate certain state and local laws, we find additional support for restricting that power in repeated congressional emphasis on its "goal of protecting the environment against toxic pollution." *Chemical Manufacturers Assn., Inc. v. Natural Resources Defense Council, Inc.*, 470 U.S. 116, 143 (1985). Congress has enacted a Resource Conservation and Recovery Act, 42 U. S. C. §§ 6901-6987, to regulate the treatment, storage, and disposal of hazardous wastes [**762] by monitoring wastes from their creation until after their permanent disposal. That Act authorizes the United States to seek judicial or administrative restraint of activities involving [*506] hazardous wastes that "may present an imminent and substantial endangerment to health or the environment." 42 U. S. C. § 6973; see also S. Rep. No. 98-284, p. 58 (1983). Congress broadened the scope of the statute and tightened the regulatory restraints in 1984.⁸ In the

shall manage and operate the property in his possession as such trustee, receiver or manager according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof."

⁸Congress eliminated the small generator exception and subjected many more facilities to the regulations. Pub. L. 98-616, 98 Stat. 3221, 3248-3272 (codified at 42 U. S. C. § 6921(d) (1982 ed., Supp. III)). Another provision automatically broadens the Act's coverage by automatically assigning a hazardous rating to substances that the Environmental Protection Agency does not classify by a set deadline. 98 Stat. 3227-3231 (codified at 42 U. S. C. §§ 6924(d), (e), (f)(3), (g)(6) (1982 ed., Supp. III)). Amended enforcement provisions

Comprehensive Environmental [***869] Response, Compensation, and Liability Act, as amended by Pub. L. 98-80, [****21] § 2(c)(2)(B), Congress established a fund to finance cleanup of some sites and required certain responsible parties to reimburse either the fund or the parties who paid for the cleanup. The Act also empowers the Federal Government to secure such relief as may be necessary 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." 42 U. S. C. § 9606. In the face of Congress' undisputed concern over the risks of the improper storage and disposal of hazardous and toxic substances, we are unwilling to presume that by enactment of § 554(a), Congress implicitly overturned longstanding restrictions on the common-law abandonment power.

[****22] V

[1B] [3B] [4]In the light of the Bankruptcy trustee's restricted pre-1978 abandonment power and the limited scope of other Bankruptcy Code provisions, we conclude that Congress did not intend for § 554(a) to pre-empt all state and local laws. The [*507] Bankruptcy Court does not have the power to authorize an abandonment without formulating conditions that will adequately protect the public's health and safety. Accordingly, without reaching the question whether certain state laws imposing conditions on abandonment may be so onerous as to interfere with the bankruptcy adjudication itself, we hold 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.⁹ Accordingly, we affirm the judgments of the Court of Appeals for the Third Circuit.

[1C]

[****23] *It is so ordered.*

allow more citizen suits, 98 Stat. 3271-3272 (codified at 42 U. S. C. § 6973 (1982 ed., Supp. III)), and authorize administrative orders or suits to compel "corrective action" after a leak has occurred. 98 Stat. 3257-3258 (codified at 42 U. S. C. § 6928(h) (1982 ed., Supp. III)).

⁹This exception to the abandonment power vested in the trustee by § 554 is a narrow one. 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.

Dissent by: REHNQUIST

Dissent

JUSTICE REHNQUIST, with whom THE CHIEF JUSTICE, JUSTICE WHITE, and JUSTICE O'CONNOR join, dissenting.

The Court today concludes that Congress did not intend the abandonment provision of the Bankruptcy Code, 11 U. S. C. § 554(a), to pre-empt "certain state and local laws." In something of a surprise ending, the Court limits the class of laws that can prevent an otherwise authorized abandonment by a trustee to those "reasonably designed to protect the public health or safety from identified hazards." While this limitation reduces somewhat the scope of my disagreement with the result reached, it renders both the *ratio decidendi* and the import of the Court's opinion quite [***870] unclear. More important, I remain unconvinced by the Court's arguments supporting state power to bar abandonment. [**763] The principal and only independent ground offered -- that Congress codified "well-recognized restrictions of a trustee's abandonment power" -- is particularly unpersuasive. It rests on a misreading of three pre-Code cases, the elevation of that [*508] misreading into a "well-recognized" exception to the abandonment power, and the unsupported assertion [****24] that Congress must have meant to codify the exception (or something like it). These specific shortcomings in the Court's analysis, which are addressed in greater detail below, stem at least in part from the Court's failure to discuss even in passing either the nature of abandonment or its role in federal bankruptcy.

Abandonment is "the release from the debtor's estate of property previously included in that estate." 2 W. Norton, *Bankruptcy Law and Practice* § 39.01 (1984), citing *Brown v. O'Keefe*, 300 U.S. 598, 602-603 (1937). Prior to enactment of the Bankruptcy Code in 1978, there was no statutory provision specifically authorizing abandonment in liquidation cases. By analogy to the trustee's statutory power to reject executory contracts, courts had developed a rule permitting the trustee to abandon property that was worthless or not expected to offset the costs of administration. 4 L. King, *Collier on Bankruptcy* para. 554.01 (15th ed. 1985) (hereinafter

Collier). ¹ This judge-made rule served the overriding purpose of bankruptcy liquidation: the expeditious reduction of the debtor's property [****25] to money, for equitable distribution to creditors, *Kothe v. R. C. Taylor Trust*, 280 U.S. 224, 227 (1930). 4 *Collier* para. 554.01. Forcing the trustee to administer burdensome property would contradict this purpose, slowing the administration of the estate and draining its assets.

[*509] The Bankruptcy Code expressly incorporates [****26] the power of abandonment into federal bankruptcy legislation for the first time. The relevant provision bears repeating:

"(a) After notice and a hearing, the trustee may abandon any property of the estate that is burdensome to the estate or that is of inconsequential value to the estate." 11 U. S. C. § 554(a) (amended 1984).

This language, absolute in its terms, suggests that a trustee's power to abandon is limited only by considerations of the property's value to the estate. It makes no mention of other factors to be balanced or weighed and permits no easy inference that Congress was concerned about state environmental regulations. ²

¹ Under the former Bankruptcy Act, title to the debtor's property vested in the trustee. Abandonment divested the trustee of title and revested it in the debtor. 4 *Collier* para. 554.02[2]. Under the Code, the trustee no longer takes title to the debtor's property, and he is simply divested of control over the property by the abandonment. *Ibid.* Although § 554 does not specify to whom the property is abandoned, the legislative history suggests that it is to the person having a possessory interest in the property. S. Rep. No. 95-989, p. 92 (1978); *Ohio v. Kovacs*, 469 U.S. 274, 284-285, n. 12 (1985).

² Last Term in *Ohio v. Kovacs*, *supra*, which involved the dischargeability of certain environmental injunctions in bankruptcy, we briefly addressed the abandonment of hazardous waste sites:

"After notice and hearing, the trustee may abandon any property of the estate that is burdensome to the estate or that is of inconsequential value to the estate. 11 U. S. C. § 554. Such abandonment is to the person having the possessory interest in the property. S. Rep. No. 95-989, p. 92 (1978). . . . If the site at issue were [the debtor's] property, the trustee would shortly determine whether it was of value to the estate. If the property was worth more than the costs of bringing it into compliance with state law, the trustee would undoubtedly sell it for its net value, and the buyer would clean up the property, in which event whatever obligation [the debtor] might have had to clean up the property would have been satisfied. If the property were worth less than the cost of cleanup, the trustee

Indeed, [***871] as the Court notes, when Congress was so concerned [**764] it expressed itself clearly, specifically exempting some environmental injunctions from the automatic stay provisions of § 362 of the Code, 11 U. S. C. §§ 362(b)(4), (5) (1982 ed. and Supp. II). See *Ohio v. Kovacs*, 469 U.S. 274 (1985).

[****27] Nor does the scant legislative history of § 554 support the Court's interpretation. Nowhere does that legislative history [**510] suggest that Congress intended to limit the trustee's authority to abandon burdensome property where abandonment might be opposed by those charged with the exercise of state police or regulatory powers.

The Court seeks to turn the seemingly unqualified language and the absence of helpful legislative history to its advantage. Adopting the reasoning of the Court of Appeals, the Court argues that in light of Congress' failure to elaborate, § 554 must have been intended to codify prior "abandonment" case law, and that under prior law "a trustee could not exercise his abandonment power in violation of certain state and federal laws," *ante*, at 501. I disagree. We have previously expressed our unwillingness to read into unqualified statutory language exceptions or limitations based upon legislative history unless that legislative history demonstrates with extraordinary clarity that this was indeed the intent of Congress. *E. g.*, *Garcia v. United States*, 469 U.S. 70, 75 (1984). I think that upon analysis the "legislative history" [****28] relied upon by the Court here falls far short of this standard.

The Court relies on just three cases for its claimed "established corollary" to the pre-Code abandonment power. A close reading of those cases, however, reveals that none supports the rule announced today. In *Ottenheimer v. Whitaker*, 198 F.2d 289 (CA4 1952), the Court of Appeals held that a trustee could not abandon worthless barges obstructing traffic in Baltimore Harbor when the abandonment would have violated federal law. The Court concluded that the "judge-made rule [of abandonment] must give way" to "an Act of Congress in the public interest." *Id.*, at 290. *Ottenheimer* thus depended on the need to reconcile a conflict between a judicial gloss on the Bankruptcy Act and the commands of another federal statute. We implicitly confirmed the validity of such an approach two Terms ago in *NLRB v. Bildisco & Bildisco*, 465 U.S. 513,

523-524 (1984). Here, by contrast, the "conflict" is with the uncertain commands of [**511] state laws that the [***872] Court declines to identify.³ In addition, the Court of Appeals relied heavily on the fact that [****29] the pre-Code law of abandonment was judge-made, which in turn raises the somewhat Delphic inquiry as to whether that court would have decided the case the same way under the present Code.

In re Lewis Jones, Inc., 1 BCD 277 (Bkrtcy Ct. ED Pa. 1974), was a Bankruptcy Court decision concluding that the principle of *Ottenheimer* did not apply because there was no conflicting statute. But because the right to abandon was based on judge-made law, the [****30] court nonetheless found itself free to protect the public interest by requiring a trustee seeking abandonment to first spend funds of the estate to seal manholes and vents in an underground pipe network. While this case admittedly comes closer to supporting the Court's position than does *Ottenheimer*, it too turns on the judge-made nature of the abandonment power. Moreover, I do not believe that the isolated decision of a single Bankruptcy Court rises to the level of "established law" that we can fairly assume Congress intended to incorporate. See *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 379-382 (1982).

In *In re Chicago Rapid Transit Co.*, 129 F.2d 1 (CA7), cert. denied *sub nom. Chicago Junction R. Co. v. Sprague*, 317 U.S. 683 (1942), the District Court sitting in bankruptcy had authorized the bankrupt to abandon a lease of a rail line, and a lessor appealed. The bankrupt did not appeal the District Court's imposition of conditions on the abandonment; the propriety of those conditions thus was not before the [**512] Court of Appeals, which affirmed the District Court's [****31] authorization of abandonment. So while there may be dicta in the Court of Appeals' opinion that would support some limitation on the power of abandonment, the holding of the case certainly does not. In short, none of these cases supports the Court's view that § 554(a) contains an implicit exception for "certain state and local laws."

³The Court finds "additional support" for its restriction of the abandonment power in recent federal statutes concerned with protecting the environment. If these statutes operated to bar abandonment here -- something neither respondents nor the Court suggests -- then this might be a different case. See *NLRB v. Bildisco & Bildisco*, 465 U.S. 513 (1984). But the statutes do not bar abandonment, and the majority's reference to their obvious concern over the risks of storing hazardous substances is little more than a makeweight.

would likely abandon it to its prior owner, who would have to comply with the state environmental law to the extent of his or its ability." *Id.*, at 284-285, n. 12.

Even assuming these cases stand for the proposition ascribed to them in the Court's opinion, that opinion's brief discussion of the cases, *ante*, at 500-501, certainly does not support the claim that they reflect an "established corollary" to pre-Code abandonment law. Generally speaking, three rather isolated cases do not constitute the sort of settled law that we can fairly assume Congress intended to codify absent some expression of its intent to do so. Perhaps recognizing this, respondents place substantial reliance for their view that the exception was "well settled" on the following statement in the (pre-Code) 14th edition of Collier on Bankruptcy, accompanying a citation to *Ottenheimer and Chicago Rapid Transit*: "Recent cases illustrate, [***873] however, that the trustee in the exercise of the power to abandon is subject to [****32] the application of general regulations of a police nature." 4A J. Moore, Collier on Bankruptcy para. 70.42[2], pp. 502-504 (14th ed. 1978); see also *In re Quanta Resources Corp.*, 739 F.2d 912, 916 (1984) (quoting same language from Collier). Respondents further observe that the section of this treatise addressing abandonment was cited in a note to an early precursor of § 554, § 4-611 of the proposed Bankruptcy Act of 1973, H. R. Doc. No. 93-137, Part II, p. 181, reprinted in A. Resnick & E. Wypyski, 2 Bankruptcy Reform Act of 1978: A Legislative History, Doc. No. 22 (1979). While resourceful, this argument is wholly unpersuasive.

The reference to Collier is not part of the Code's "legislative history" in any meaningful sense of the term, *Board of Governors, FRS v. Dimension Financial Corp.*, *ante*, at 372. And the proposition for which the section in Collier is cited is [*513] not the view that authority for abandonment is qualified by state police power, but instead the much less remarkable proposition that "[the] concept of abandonment is well recognized in the case law. See 4A Collier para. 70.42[3]." In order to divine that the statutory power [****33] to abandon in the proposed Code was to be conditioned on compliance with state police power regulations, therefore, a Senator or Congressman would not merely have had to look at the legislative history of the precursor to the Code, but also would have had to read the several-page treatise section cited in that earlier legislative history.

Neither the three cases cited by the Court nor the attenuated reference to the since superseded version of Collier supports the inference that Congress, while writing § 554 in unqualified terms, intended to incorporate so ill-defined and uncertain an exception to the abandonment authority of the trustee. After

suggesting that "if Congress intends for legislation to change the interpretation of a judicially created concept" it should do so expressly, *ante*, at 501, the Court concedes that these cases "do not define for us the exact contours of the trustee's abandonment power," *ibid*. The Court never identifies the source from which it draws the "exact contours" of the rule it announces today; congressional intent does not appear to be a likely candidate. Congress knew how to [**766] draft an exception covering the exercise of "certain" [****34] police powers when it wanted to. See 11 U. S. C. §§ 362(b)(4), (5) (1982 ed. and Supp. II); *supra*, at 509. It also knew how to draft a qualified abandonment provision. See § 1170(a)(2) (abandonment of railroad lines permitted only if "consistent with the public interest"). Congress' failure to so qualify § 554 indicates that it intended the relevant inquiry at an abandonment hearing to be limited to whether the property is burdensome and of inconsequential value to the estate.

I find the Court's discussion of 28 U. S. C. § 959(b) somewhat difficult to fathom. After suggesting that § 959(b) [*514] "provides additional evidence" for the self-evident proposition "that Congress did not intend for the Bankruptcy Code to pre-empt all state laws," *ante*, at 505, the Court concedes that the provision "does [***874] not *directly* apply to an abandonment under § 554(a) of the Bankruptcy Code," *ibid*. (emphasis added). The precise nature of its *indirect* application, however, is left unclear. Respondents contend that § 959(b) operates to bar abandonment in these cases. Assuming that temporary management or operation of a facility during liquidation is governed by [****35] § 959(b), I believe that a trustee's filing of a petition to abandon, as opposed to continued operation of a site pending a decision to abandon, does not constitute "[management]" or "[operation]" under that provision. Not only would a contrary reading strain the language of § 959(b), cf. *In re Adelphi Hospital Corp.*, 579 F.2d 726, 729, n. 6 (CA2 1978) (*per curiam*) (in pre-Code liquidation proceeding trustee "is in no sense a manager of an institution's operations"), it also would create an exception to the abandonment power without a shred of evidence that Congress intended one. As one commentator has noted, § 554(a) "is among the few provisions in the Bankruptcy Code that do not contain explicit exceptions." Note, 85 Colum. L. Rev. 870, 883 (1985). I would not read 28 U. S. C. § 959(b) as creating an implicit exception.

Citing *SEC v. United Realty & Improvement Co.*, 310 U.S. 434, 455 (1940), respondents argue that the Bankruptcy Court's equitable powers support the result

reached below. I disagree. While the Bankruptcy Court is a court of equity, the Bankruptcy Code "does not authorize freewheeling consideration [****36] of every conceivable equity." *Bildisco & Bildisco*, 465 U.S., at 527. The Bankruptcy Court may not, in the exercise of its equitable powers, enforce its view of sound public policy at the expense of the interests the Code is designed to protect. In these cases, it is undisputed that the properties in question were burdensome and of inconsequential value to the estate. Forcing the trustee to expend estate [*515] assets to clean up the sites would plainly be contrary to the purposes of the Code.

I fully appreciate the Court's concern that abandonment may "[aggravate] already existing dangers by halting security measures that [prevent] public entry, vandalism, and fire." *Ante*, at 499, n. 3. But in almost all cases, requiring the trustee to notify the relevant authorities before abandoning will give those authorities adequate opportunity to step in and provide needed security. As the Bankruptcy Court noted in No. 84-805: "The City and State are in a better position in every respect than either the Trustee or debtor's creditors to do what needs to be done to protect the public against the dangers posed by the PCB-contaminated facility." App. to Pet. for [****37] Cert. 73a. And requiring notice before abandonment in appropriate cases is perfectly consistent with the Code. It advances the State's interest in protecting the public health and safety, and, unlike the rather uncertain exception to the abandonment power propounded by the Court, at the same time allows for the orderly liquidation and distribution of the estate's assets. Here, of course, the trustee provided such notice and the relevant authorities were afforded an opportunity to take appropriate preventative and remedial measures.

I likewise would not exclude the possibility that there may be a far narrower condition [**767] on the abandonment [***875] power than that announced by the Court today, such as where abandonment by the trustee itself might create a genuine emergency that the trustee would be uniquely able to guard against. The United States in its brief as *amicus curiae* suggests, for example, that there are limits on the authority of a trustee to abandon dynamite sitting on a furnace in the basement of a schoolhouse. Although I know of no situations in which trustees have sought to abandon dynamite under such circumstances, the narrow exception that I would [****38] reserve surely would embrace that situation.

[*516] What the Court fails to appreciate is that

respondents' interest in these cases lies not just in protecting public health and safety but also in protecting the public fisc. In No. 84-805, before undertaking cleanup efforts, New York unsuccessfully sought from the Bankruptcy Court a first lien on the Long Island City property to the extent of any expenditures it might make to bring the site into compliance with state and local law. New York did not appeal the court's denial of a first lien, and proceeded to clean up the site (except for the contaminated subsoil). It now presses a claim for reimbursement, maintaining that the trustee should not have been allowed to abandon the site. The New Jersey Department of Environmental Protection, in No. 84-801, apparently seeks to undo the abandonment and force the trustee to expend the estate's remaining assets cleaning up the site, thereby reducing the cleanup costs that must ultimately be borne by the State.⁴

[****39] The Court states that 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." *Ante*, at 507, n. 9. Because the Court declines to identify those laws that it deems so "reasonably calculated," I can only speculate about its view of respondents' claim that abandonment can be conditioned on a total cleanup. One might assume, however, that since it affirms the judgments below the Court means to adopt respondents' position. The Court of Appeals, as I read its opinions in these cases, apparently would require the trustee to expend all of Quanta's available assets to clean up the sites.⁵ But barring abandonment and forcing a cleanup would effectively [*517] place respondents' interest in protecting the public fisc ahead of the claims of other creditors. Congress simply did not intend that § 554 abandonment hearings would be used to establish the priority of particular claims in bankruptcy. While States retain considerable latitude to ensure that priority status is allotted to their cleanup claims, see *Ohio v. Kovacs*, 469 U.S., at 285-286 [****40] (O'CONNOR, J., concurring), I believe that the Court errs by permitting them to impose conditions on the abandonment power that Congress [****876] never contemplated. Accordingly, in each of these cases I would reverse the judgment of the Court of Appeals.

⁴ NJDEP does not contend that the estate, including any assets otherwise subject to Midlantic's secured claim, contains sufficient assets to complete the cleanup.

⁵ I would think that this command qualifies, in the words of the Court, as a "[condition] on abandonment . . . so onerous as to interfere with the bankruptcy adjudication itself," *ante*, at 507.

References

9 Am Jur 2d, Bankruptcy 26, 253-257

5 Federal Procedure, L Ed, Bankruptcy 9:333-9:336

4 Federal Procedural Forms, L Ed, Bankruptcy 9:751-9:758

4 Am Jur PI & Pr Forms (Rev), Bankruptcy, Forms 257, 258

11 USCS 554(a), 959(b)

1 Bankruptcy Service, L Ed, 4:17-4:21; 3 Bankruptcy Service, L Ed, 23:110-23:115; 8 Bankruptcy Service, [****41] L Ed, 71:139.7-71:141.5 (Supp.)

US L Ed Digest, Bankruptcy 15, 305; Statutes 87

L Ed Index to Annos, Bankruptcy; Pollution

ALR Quick Index, Bankruptcy or Insolvency; Pollution; Waste Materials

Federal Quick Index, Bankruptcy; Pollution

In re ATP Oil & Gas Corp.

United States Bankruptcy Court for the Southern District of Texas, Houston Division

June 19, 2013, Decided; June 19, 2013, Filed; June 20, 2013, Entered

Case No. 12-36187, Chapter 11

Reporter

2013 Bankr. LEXIS 2608 *; 58 Bankr. Ct. Dec. 28; 2013 WL 3157567

IN RE: ATP OIL & GAS CORPORATION, Debtor(s).

Counsel: [*1] For ATP Oil & Gas Corporation, Debtor: Charles Stephen Kelley, Mayer Brown LLP, Houston, TX; Timothy Aaron Million, Munsch Hardt Kopf & Harr, P.C., Houston, TX.

For US Trustee, U.S. Trustee: Nancy Lynne Holley, U S Trustee, Houston, TX.

For The Official Committee of Unsecured Creditors of ATP Oil & Gas Corporation, Creditor Committee: John F Higgins, IV, James Matthew Vaughn, Joshua W. Wolfshohl, Porter Hedges LLP, Houston, TX.

Judges: Marvin Isgur, UNITED STATES BANKRUPTCY JUDGE.

Opinion by: Marvin Isgur

Opinion

MEMORANDUM OPINION

On June 13, 2013, the Court approved ATP Oil and Gas Corporation's proposed termination of its nongovernmental obligations related to the Gomez Properties. The Court approved the abandonment of the Gomez Properties, the rejection of related executory leases and contracts, as well as the breach of related nonexecutory contracts. This Memorandum Opinion provides the basis for the ruling.

Background

ATP's primary business is the ownership, development and operation of oil and gas properties, most of which are in the Gulf of Mexico. ATP filed a chapter 11 bankruptcy petition on August 27, 2012.

The Gomez Properties are among the many properties ATP owns or in which it has an interest. The Gomez

[*2] Properties consist of a floating offshore platform along with a network of wells and gathering facilities. Prior to filing bankruptcy, ATP entered into a series of sales or financing arrangements ¹ in which ATP lost its right to the bulk of the cash proceeds from hydrocarbon production at the Gomez Properties.

It is undisputed that even at times when hydrocarbons are being produced, ATP loses millions of dollars each month from operating the Gomez Properties (as it is not entitled to retain all of the proceeds of the hydrocarbon production).

The Gomez Properties lie on a Federal offshore lease. As operator, ATP has an obligation to the United States to plug and abandon the Gomez Properties via a decommissioning process mandated by federal regulations. The process's total cost may exceed \$100,000,000.00.

During this bankruptcy case, the United States issued an order requiring ATP to terminate hydrocarbon production at the Gomez Properties. ATP complied. Expenses continue to accumulate enough though hydrocarbon production has ceased. The floating platform must be manned. The wells and gathering facilities [*3] must be maintained and monitored. ATP presently receives no income from, but incurs substantial expenses on, the Gomez Properties.

On May 22, 2013, ATP filed a motion seeking to abandon the Gomez Properties and to reject the related executory contracts and leases.

Multiple parties objected. With one exception, all objections were resolved by agreement.

The Remaining Objection

Anadarko E & P Onshore LLC is a predecessor-in-

¹The true nature of these transactions is the subject of multiple adversary proceedings.

interest to ATP with respect to a portion of the Gomez Properties. As a predecessor-in-interest, Anadarko has potential liability for all or a portion of the decommissioning costs. ATP's abandonment of the property prior to decommissioning may force Anadarko to absorb all or a portion of the more than \$100,000,000 cost.

Anadarko's objection focuses on the Supreme Court's decision in *Midlantic Nat'l. Bank v. New Jersey Dep't of Environmental Protection*, 474 U.S. 494, 106 S. Ct. 755, 88 L. Ed. 2d 859 (1986). In the course of the evidentiary hearing on its objection, Anadarko presented evidence that abandonment of the Gomez Properties will pose a serious, imminent threat both to navigation and to the environment. Anadarko argues that *Midlantic* prevents the Court from allowing ATP to abandon the Gomez Properties, [*4] an act which Anadarko believes would be in derogation of public health and safety.

In *Midlantic*, the chapter 7 trustee of the Estate of Quanta Resources Corporation sought to abandon contaminated properties located in New Jersey and in New York. The New Jersey Department of Environmental Protection and the City and State of New York challenged the proposed abandonments because state laws and regulations prohibited the abandonment of the contaminated properties before they were remediated. The Supreme Court held that the property could not be abandoned prior to its decontamination, as abandonment in a contaminated state would be in contravention of a state statute or regulation that is reasonably designed to protect the public health or safety from identified hazards.²

Justice Powell framed the question in the opening paragraph of the opinion:

These petitions for certiorari, arising [*5] out of the same bankruptcy proceeding, present the question of whether § 554(a) of the Bankruptcy Code, 11 U.S.C. § 544(a), authorize a trustee in bankruptcy to abandon property in contravention of state laws or regulations that are reasonably designed to protect the public's health or safety.

Midlantic Nat'l. Bank v. New Jersey Dep't of Environmental Protection, 474 U.S. 494, 496, 106 S. Ct. 755, 88 L. Ed. 2d 859 (1986). Anadarko would have *Midlantic* expanded well beyond its facts and law. While the Supreme Court held that the properties in *Midlantic* could not be abandoned in derogation of New York or New Jersey laws reasonably designed to protect the public's health or safety, it did not hold that property posing a risk to public health and safety may never be abandoned. It certainly did not hold that such property may not be abandoned where abandonment would be consistent with (and perhaps in furtherance of) an environmental regulatory scheme.

In *Midlantic*, the bankruptcy court had erroneously allowed for an abandonment that was in derogation of state and local law "without formulating conditions that will adequately protect the public's health and safety." *Midlantic Nat'l. Bank v. New Jersey Dept. of Environmental Protection*, 474 U.S. 494, 507, 106 S. Ct. 755, 88 L. Ed. 2d 859 (1986).

At [*6] the hearing, the Court pressed Anadarko's counsel to explain how to adequately protect the public's health and safety consistent with *Midlantic*. Anadarko argued that the Court should require ATP to retain the Gomez Properties until ATP arrived at a solution. Anadarko acknowledged that there was no available cash to pay for the decommissioning costs, but argued that creating a "stalemate" in the case would force ATP's secured lenders to fund a cleanup.

Unlike the regulators in *Midlantic*, the United States has agreed to the relief requested by ATP. The United States will come into possession of the Gomez Properties upon termination of the underlying lease. To ensure public health and safety, the United States can commence decommissioning and seek reimbursement. Under its agreement with ATP, the United States will retain an administrative claim for the decommissioning costs. As it is unlikely the estate will be capable of paying such a large administrative claim, presumably the United States will attempt to protect taxpayers by pursuing ATP's predecessors-in-interest (like Anadarko) for some or all of the decommissioning costs.

This case presents two starkly contrasting choices for dealing [*7] with the Gomez Properties, which the evidence shows pose a risk to public health and safety:

- Allow a "stalemate" to occur by requiring that ATP retain the Gomez Properties. Pending the resolution of the stalemate, public health and safety will be at risk because ATP does not have the funds

²The Supreme Court did not hold that this prohibition was absolute. A bankruptcy court has some discretion if precluding abandonment would "be so onerous as to interfere with the bankruptcy adjudication itself." *Midlantic Nat'l. Bank v. New Jersey Dep't of Environmental Protection*, 474 U.S. 494, 505, 106 S. Ct. 755, 88 L. Ed. 2d 859 (1986).

to maintain its platform or to decommission its wells and gathering facilities. /s/ Marvin Isgur

- Allow abandonment of the Gomez Properties, thereby allowing the United States to undertake the decommissioning on a temporary or permanent basis, and seek reimbursement or performance from other responsible parties and from ATP.

Marvin Isgur

UNITED STATES BANKRUPTCY JUDGE

End of Document

ATP and the United States agree that the second course should be pursued. The principle underlying *Midlantic* is that a bankruptcy court should not allow abandonment where it would be in derogation of laws reasonably designed to protect the public's health and safety. The Court believes that it would potentially violate *Midlantic* by requiring ATP to retain the Gomez Properties when the United States has chosen an alternate course of action to protect the public health and safety.

The Court is not unsympathetic to Anadarko. It may be forced to bear a substantial cost as a result of ATP's financial [*8] woes. Nevertheless, like many things in a bankruptcy case, the cost that Anadarko may bear is a reflection of the credit risk it took. Anadarko sold a portion of the Gomez Properties to ATP, and required ATP to bear the financial burden of plugging and abandonment in accordance with applicable federal law. This unfortunate position is no different from that of any other creditor that relies on the promise of performance from an eventually failed entity.

Anadarko is not without some potential help from the law. The Court has previously held that a party paying decommissioning costs may be subrogated to the economic rights of the United States. *In re Tri-Union Development Corp.*, 314 B.R. 611 (Bankr. S.D. Tex. 2004). As to whether Anadarko can prevail on such a claim is well beyond the purview of the present dispute. However, if it is subrogated to the economic rights of the United States, Anadarko may be entitled to enforce an administrative claim for the costs of the cleanup.

Conclusion

By separate order, the Court will approve ATP's motion to terminate its continued obligations to nongovernmental entities regarding the Gomez Properties. The consequences of that termination will be the [*9] subject of future hearings.

Anadarko's *Midlantic* objection is overruled.

SIGNED June 19, 2013.

Unplugging the Fifth Circuit’s Abandonment Problem: A Reexamination of the *Midlantic* Exception in Offshore E&P Cases

David L. Curry, Jr.* and Ryan A. O’Connor†

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I. INTRODUCTION

Beginning in spring 2014, oil prices began a prolonged, significant drop from over \$100 per barrel to below \$30 per barrel in January 2016. Since May 2015, oil has remained below \$60 per barrel. The impact on oil and gas companies—specifically offshore exploration and production (E&P) companies—has been devastating. From the beginning of 2015 through October 2016, more than 213 North American oil and gas companies filed for bankruptcy.¹ When an offshore E&P company fails, one of the most significant questions that must be answered is how the company’s decommissioning or plugging and abandonment (P&A) obligations will be met. Such liabilities are significant—as of January 2017, the estimated net present value of P&A liabilities in the Gulf of Mexico alone exceeds \$23 billion. These liabilities also pose a significant financial risk to U.S. regulatory agencies who have obtained less than \$589 million in posted bonds to secure these claims.²

This Article will examine how a judicially created public policy limitation to the abandonment powers provided under Bankruptcy Code § 554³ espoused by the Supreme Court in *Midlantic National Bank v. New Jersey Department of Environmental Protection*⁴ has deprived E&P debtors of the ability to control their own destinies in chapter 11 cases. Section 554(a) of the Bankruptcy Code provides that “[a]fter notice and

1. See David Hunn, *Woe in the Oilfield: 213 Companies Have Now Declared Bankruptcy*, FUELFIX (Oct. 25, 2016), <http://fuelfix.com/blog/2016/10/25/213-oil-companies-have-declared-bankruptcy-how-hard-it-is-to-be-an-oilfield-service-company/>.

2. See Annie Gallay, *Gulf of Mexico: Shelf Life*, OIL & GAS INV. (Jan. 5, 2017), <https://www.oilandgasinvestor.com/gulf-mexico-shelf-life-1456941#p=full>.

3.

Section 554 of the Bankruptcy Code provides a mechanism by which the bankruptcy trustee may abandon property if it is not needed by the estate and its retention serves no purpose in effectuating the goals of the Bankruptcy Code. The section sets a standard for determining property that may be abandoned: Property may be abandoned if it is burdensome to the estate or of inconsequential value and benefit to the estate.

5 HENRY J. SOMMER & RICHARD LEVIN, COLLIER ON BANKRUPTCY 554.01 (16th ed. 2017).

4. 11 U.S.C. § 554 (2010); *Midlantic Nat’l Bank v. N.J. Dep’t of Env’tl. Prot.*, 474 U.S. 494 (1986).

hearing, the trustee may abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate.”⁵ Ultimately, the *Midlantic* Court held that a bankruptcy court did not have the power to authorize the abandonment of hazardous properties without formulating conditions that will adequately protect the public’s health and safety.⁶ This exception to the abandonment power vested in the trustee by § 554 is intended to be narrow. The question becomes: how did the narrow *Midlantic* exception become the lynchpin in a broad priority-shifting rule depriving offshore oil and gas debtors of the ability to control their own destinies in a chapter 11 case?

Part II examines the *Midlantic* opinion and subsequent cases that have misapplied the *Midlantic* holding to create an administrative expense priority classification for P&A liabilities. Part III examines the scope and nature of P&A liabilities and their proper treatment under the Bankruptcy Code. Part IV examines existing policies that, if properly enforced, could more adequately address the mounting P&A liabilities left unresolved by failing E&P companies. Part V concludes with a call to reconsider a series of judicially created public policy exceptions to the Bankruptcy Code’s carefully constructed restructuring scheme.

II. OFF-COURSE AND ADRIFT: JUDICIAL POLICY-MAKING AND PLUGGING AND ABANDONMENT LIABILITY

The ripple effect of *Midlantic*, a case involving real property situated on the Atlantic Coast, has been felt by offshore E&P debtors with wells and platforms throughout the Gulf of Mexico. Although the *Midlantic* Court framed its decision as creating a “narrow” exception to a trustee’s abandonment powers under Bankruptcy Code § 554, the Fifth Circuit has applied the *Midlantic* exception broadly, which has resulted in a judicially created priority class of environmental claims in E&P cases. In offshore E&P cases where such claims can exceed tens of millions of dollars, the creation of this priority class of claims poses a significant threat to the administration of offshore E&P chapter 11 cases.

A. *Midlantic: Abandon (Ship)?*

The ideological bedrock supporting the treatment of P&A liability as an administrative expense is found in the Supreme Court’s decision in *Midlantic*. The holding set forth therein, though purportedly narrow, has

5. 11 U.S.C. § 554(a).

6. *Midlantic*, 474 U.S. at 507.

had a broad impact in shaping the treatment of P&A obligations in offshore E&P bankruptcies. Because the *Midlantic* opinion weighs heavily on this analysis, an in-depth review of the opinion is warranted.

In *Midlantic*, the debtor was in the business of processing waste oil at facilities in New York and New Jersey and operated a facility in New Jersey pursuant to a permit issued by the New Jersey Department of Environmental Protection (NJDEP).⁷ When NJDEP discovered the debtor had accepted contaminated oil and was operating in violation of its permit, NJDEP ordered the debtor to cease operations while the parties negotiated a cleanup of the contaminated site.⁸ During the negotiation process, the debtor filed a chapter 11 petition for reorganization.⁹ The next day, NJDEP issued an administrative order requiring the debtor to decontaminate the site.¹⁰

During the bankruptcy proceeding, an investigation into the debtor's New York facility found that the debtor had also accepted and stored contaminated oil in that location, and that the contaminants were leaking from the storage containers.¹¹ Meanwhile, the debtor's chapter 11 case was converted to a chapter 7 proceeding and a trustee was duly appointed.¹² In evaluating the debtor's assets, the chapter 7 trustee determined that the mortgages exceeded the property's total value and any cost to remediate the environmental contamination would be a net burden to the debtor's estate.¹³ As a result, when efforts to market and

7. *Id.* at 496-97.

8. *Id.* at 497.

9. *Id.*

10. *Id.*

11. *Id.*

12. *Id.* Chapter 11 of the Bankruptcy Code provides an opportunity for a debtor to reorganize its business or financial affairs or to engage in an orderly liquidation of its property either as a going concern or otherwise. 7 HENRY J. SOMMER & RICHARD LEVIN, COLLIER ON BANKRUPTCY 1100.01 (16th ed. 2017). Chapter 7, colloquially known as "straight bankruptcy," is the "operative" chapter of the Bankruptcy Code that normally governs liquidation of a debtor. Liquidation is a form of relief afforded by the bankruptcy laws that involves the collection, liquidation, and distribution of the nonexempt property of the debtor and culminates, if the debtor is an individual, in the discharge of the liquidation debtor. 6 HENRY J. SOMMER & RICHARD LEVIN, COLLIER ON BANKRUPTCY 700.01 (16th ed. 2017). Fundamentally, the primary distinction between chapter 11 and chapter 7 is that, under chapter 11, the debtor remains in control of its assets as a "debtor-in-possession," whereas in chapter 7 cases, the liquidation is administered by a court appointed fiduciary, the chapter 7 trustee.

13. *Midlantic*, 474 U.S. at 497.

sell the properties failed, the trustee moved to abandon¹⁴ both properties pursuant to § 554 of the Bankruptcy Code.¹⁵

Both New York City and the State of New York (collectively, New York) objected to the chapter 7 trustee's proposed abandonment of the New York facility and offered a two-pronged public policy argument against abandonment: (1) abandonment would pose a threat to public health and safety, and (2) abandonment would violate state and federal law.¹⁶ Specifically, New York pointed to 28 U.S.C. § 959(b)'s requirement that a trustee manage and operate the property of the estate in accordance with applicable state law.¹⁷ The bankruptcy court rejected these arguments and approved the abandonment, observing that the government would be in a better position, relative to the trustee or creditors, to protect public health and safety.¹⁸

After successfully abandoning the New York facility, the trustee sought an order approving abandonment of the New Jersey facility.¹⁹ Again, the abandonment was approved by the bankruptcy court over the objection of NJDEP, which appealed directly to the Third Circuit Court of Appeals.²⁰

On appeal, the Third Circuit reversed the bankruptcy court's decision, declaring that Congress intended certain state laws and equitable interests that protect the public interest to prevail over a trustee's abandonment power.²¹ The chapter 7 trustee next appealed to the United States Supreme Court. Upon granting *certiorari*, the Supreme Court faced a narrow issue: does § 554(a) of the Bankruptcy Code authorize a trustee in bankruptcy to abandon property in the face of state laws designed to protect public health and safety?²² In a 5-4 decision, the Supreme Court held that it does not.²³

Arguing against the holding of the Third Circuit, the trustee reasoned that if Congress had intended to limit a trustee's abandonment power, such limitations should be expressly stated in the Bankruptcy

14. "Abandonment is the release from the debtor's estate of property previously included in the estate." *Id.* at 508 (Rehnquist, W., dissenting).

15. *Id.* at 497 (majority opinion).

16. *Id.* at 498.

17. *Id.*

18. *Id.*

19. *Id.*

20. *Id.* at 498-99.

21. *Id.* at 499.

22. *Id.* at 496.

23. *Id.* at 504.

Code.²⁴ Indeed, the trustee pointed out that Congress had provided certain express exceptions and limitations to various other powers granted to trustees under the Bankruptcy Code.²⁵ Given that Congress had provided such explicit limitations elsewhere, the trustee argued, no similar exception or limitation should be read into § 554.²⁶ The Court disregarded this contention, distinguishing what it called “firmly established” exceptions to abandonment under § 554 from other provisions of the Bankruptcy Code.²⁷

Writing for the majority, Justice Powell crafted a public policy exception to one of the most significant express powers granted to trustees and debtors-in-possession under the Bankruptcy Code. The Court held 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.²⁸ The Court explained that when Congress enacted § 554 of the Bankruptcy Code, there were established restrictions on a trustee’s abandonment power; therefore, the restrictions were “presumably included” in § 554, although not explicitly stated.²⁹

The Court found additional support for its holding in 28 U.S.C. § 959(b), which mandates that a trustee manage and operate the debtor’s property in accordance with state laws.³⁰ Because § 959(b) requires that trustees adhere to state laws, the Court reasoned that Congress could not have intended for the Bankruptcy Code to preempt all state laws constraining a trustee’s abandonment powers.³¹

Finally, the Court turned its attention to Congress’ environmental concerns, noting the “goal of protecting the environment against toxic pollution.”³² Given the congressional emphasis on protecting the environment and the public from imminent and substantial endangerment, the Court was not convinced that Congress would be willing to permit a trustee to abandon hazardous properties.³³

Ultimately, the *Midlantic* Court held that the bankruptcy court did not have the power to authorize the abandonment of hazardous properties

24. *Id.* at 504.

25. *Id.* at 502.

26. *Id.* at 504.

27. *Id.*

28. *Id.* at 506-07.

29. *Id.* at 501.

30. *Id.* at 505.

31. *Id.*

32. *Id.*

33. *Id.* at 506-07.

without formulating conditions that will adequately protect the public's health and safety.³⁴ Importantly, the Court left open the question of whether certain state laws imposing conditions on abandonment may be so onerous as to interfere with the bankruptcy adjudication itself.³⁵

Notwithstanding the resulting broad ramifications, the *Midlantic* Court intended this exception to a trustee's abandonment powers to be narrowly applied. The Court provided the following admonition to lower courts applying the *Midlantic* exception:

This exception to the abandonment power vested in the trustee by § 554 is a narrow one. 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.³⁶

Despite this admonition to apply the *Midlantic* exception narrowly, this judicially crafted public policy rule has served as the basis for another judicially crafted deviation from the Bankruptcy Code—the *per se* treatment of P&A liabilities as post-petition administrative priority expenses.³⁷ While the treatment of P&A liabilities as post-petition administrative expenses is appropriate under *Midlantic* in certain very limited circumstances, a *per se* rule granting administrative expense priority or prohibiting the abandonment of oil and gas producing properties by a trustee or debtor-in-possession constitutes a misapplication of the *Midlantic* exception.

B. A “Necessary” Examination of Key Fifth Circuit Cases

The question becomes: how did the narrow *Midlantic* exception become the lynchpin in a broad priority-shifting rule depriving offshore oil and gas debtors of the ability to control their own destiny in a chapter 11 case? As we will examine, that particular odyssey begins with the determination that certain claims for reimbursement of expenses related to plugging and abandonment activities performed on behalf of a debtor

34. *Id.* at 507.

35. *Id.*

36. *Id.* at n.9. Further, in his dissent, Justice Rehnquist quipped that the limitation was a nice surprise that somewhat limited his disagreement with the majority. *Id.* at 507 (Rehnquist, W., dissenting).

37. *See, e.g., In re Am. Coastal Energy, Inc.*, 399 B.R. 805, 812, 816-17 (Bankr. S.D. Tex. 2009); *In re ATP Oil & Gas Corp.*, 2014 WL 1047818, at *7-8 (Bankr. S.D. Tex. Mar. 18, 2014).

were entitled to priority payment ahead of other creditors under § 503 of the Bankruptcy Code. From this relatively benign determination, bankruptcy courts and practitioners have wrongfully divined a rule that grants immense determinative powers over a debtor to government agencies charged with enforcing statutory P&A obligations and, potentially, any other party that may be jointly liable for such obligations.

1. What Is an Administrative Expense, and Why Does It Matter?

Section 503 of the Bankruptcy Code provides that “the actual, necessary costs and expenses of preserving the estate” are to be characterized as administrative expenses, and § 507 provides that these administrative expenses are entitled to priority payment.³⁸ Under § 1129, a chapter 11 plan may only be confirmed if the plan provides for the payment in full of administrative expense claims on the date the plan becomes effective, except to the extent that a claimant agrees to accept different treatment.³⁹ As such, creditors holding large administrative expense claims often have the *de facto* power to block a debtor’s proposed plan of reorganization. This *de facto* veto is especially powerful in E&P cases where a debtor is in some capacity liable for post-petition P&A work that can often cost tens, if not hundreds, of millions of dollars.

Given this tremendous leverage afforded to the holder of such a large administrative expense claim, the decision to afford P&A claims administrative priority is substantial. Typically, to be entitled to an administrative priority claim, a claimant must show that its claim arises from (1) a necessary cost or expense; (2) that has actually been incurred; (3) by or on behalf of the debtor.⁴⁰ In early cases examining the treatment of P&A expenses under the Bankruptcy Code, courts allowed administrative expense priority for amounts *actually* expended by non-debtors to perform P&A activities on behalf of a debtor.⁴¹ However, the progeny of case law discussed herein has led to the common practice whereby potential P&A claimants, and in particular the United States government, file claims in a debtor’s bankruptcy case and then seek allowance of such claims as administrative expenses—regardless of whether such claims are contingent in nature or have not yet been

38. 11 U.S.C. §§ 503, 507 (2012).

39. *Id.* § 1129(a)(9).

40. *Id.*

41. *See, e.g., Texas v. Lowe (In re H.L.S. Energy Co.)*, 151 F.3d 434 (5th Cir. 1998); *In re Am. Coastal Energy, Inc.*, 399 B.R. 805.

liquidated.⁴² Given the size of these potential claims, the mere possibility that such claims could be treated as administrative expenses—even though, under the elements set forth above, contingent and unliquidated claims should not be considered “actual” or “necessary” costs or expenses—can threaten a debtor’s ability to fashion a plan for the benefit of all creditors.

Moreover, given the development of case law in the Fifth Circuit, such preferential treatment is not a mere possibility but is perhaps a certainty. Indeed, post-*Midlantic*, the Fifth Circuit has found that state or federal law requires a debtor to complete P&A work related to oil and gas properties during the pendency of a bankruptcy case and has implicitly adopted a rule prohibiting abandonment of properties burdened by outstanding P&A liabilities.⁴³ Under such a determination, the costs to satisfy such obligations (including those that remain contingent or unliquidated) are entitled to administrative priority treatment under the Bankruptcy Code. Two cases form the foundation for this outcome. In *Texas v. Lowe (In re H.L.S. Energy Co.)*, the Fifth Circuit Court of Appeals held that the costs incurred by a state regulatory agency to satisfy a debtor’s P&A obligations arising post-petition were actual and necessary costs of managing a debtor’s estate and were entitled to administrative priority.⁴⁴ In *In re American Coastal Energy, Inc.*, the Bankruptcy Court for the Southern District of Texas took *H.L.S. Energy* a step further and held that post-petition expenditures satisfying pre-petition P&A obligations are also entitled to administrative priority status.⁴⁵ These decisions developed the concept—completely without support from the Bankruptcy Code—that all P&A obligations that are not satisfied by a debtor’s petition filing date, whether contingent or unliquidated and whether the debtor is the primary obligor or not, are to be treated as administrative expense claims and must be paid in full before the debtor can emerge from bankruptcy.

42. See, e.g., Proof of Claim No. 102, *In re Black Elk Energy Offshore Operations, LLC*, No. 15-34287 (Bankr. S.D. Tex. 2017); Proof of Claim No. 56, *In re Bennu Oil & Gas, LLC*, No. 16-35930 (Bankr. S.D. Tex. 2017); Proof of Claim No. 45, *In re Bennu Oil & Gas, LLC*, No. 16-35930 (Bankr. S.D. Tex. 2017).

43. *In re H.L.S. Energy Co.*, 151 F.3d at 438.

44. *Id.* at 439.

45. *In re Am. Coastal Energy, Inc.*, 399 B.R. at 816-17.

2. *H.L.S. Energy* and the Battle of Post-Petition P&A

In *H.L.S. Energy*, the issue before the Fifth Circuit was “the [determination of the] priority to be afforded a state’s claim on the bankruptcy estate, for costs incurred by the state in satisfaction of the estate’s post-petition environmental obligations.”⁴⁶ The facts and procedural history of the case are significant.

When H.L.S. Energy Co., Inc. filed its petition for reorganization under chapter 11 of the Bankruptcy Code, it entered into bankruptcy holding a number of inactive wells for which P&A work had not commenced.⁴⁷ After selling off its viable assets, the debtor’s case was converted to a chapter 7 liquidation.⁴⁸ Prior to the conversion, the State of Texas brought an enforcement action seeking to require H.L.S. Energy to commence P&A activities pursuant to title 16, section 3.9 of the Texas Administrative Code, which requires that P&A operations on each dry or inactive well be commenced within a period of one year after drilling or operations cease.⁴⁹ Importantly, while the wells at issue ceased production at various times before and after the petition date, none had been inactive for more than a year prior to the filing of the bankruptcy case.⁵⁰ After negotiations with the chapter 11 trustee, the State agreed to plug the wells and charge the cost against the bankruptcy estate.⁵¹ The State expended \$41,808, for which it asserted an administrative expense claim.⁵² After the case converted to chapter 7 liquidation, the chapter 7 trustee challenged the priority of the State’s claim, arguing that P&A work provided no benefit to the debtor’s estate.⁵³ The bankruptcy court found, and the district court agreed, that the State’s claim should be entitled to priority treatment as an administrative expense.⁵⁴

Applying the broad interpretation of actual, necessary costs espoused by the United States Supreme Court in *Reading Co. v. Brown*, the Fifth Circuit affirmed the lower court’s holding, which afforded priority status to the State’s claim.⁵⁵ The court’s determination that the debtor was under an existing requirement to complete P&A work and

46. *In re H.L.S. Energy Co.*, 151 F.3d at 436 (emphasis added).

47. *Id.*

48. *Id.*

49. *Id.*; 16 TEX. ADMIN. CODE § 3.9 (2017).

50. *In re H.L.S. Energy Co.*, 151 F.3d at 436.

51. *Id.*

52. *Id.*

53. *Id.*

54. *Id.*

55. *Id.* at 439; *see Reading Co. v. Brown*, 391 U.S. 471, 485 (1968).

that its continuing failure to do so was actively resulting in a reduction of available assets was critical to the holding.⁵⁶ The court reasoned:

Under federal law, bankruptcy trustees must comply with state law. Furthermore, a bankruptcy trustee may not abandon property in contravention of a state law reasonably designed to protect public health or safety. And there is no question that under Texas law, the owner of an operating interest is required to plug wells that have remained unproductive for a year. Furthermore, because the wells became inactive post-petition or after a year prior to the petition, the plugging obligations on these wells accrued post-petition. Thus, a combination of Texas and federal law placed on the trustee an inescapable obligation to plug the unproductive wells, an obligation that arose during the chapter 11 proceedings.

The fulfillment of this, the estate's obligation, can only be seen as a benefit to the estate. In this sense, the state's action resembles the sort of "salvage" work that lies at the heart of the administrative expense priority. No one would challenge the expense of shoring up the sagging roof on a bankrupt's warehouse, for example, where carpentry was needed to prevent further damage to the structure or liability from injury to passers-by. The laws of Texas compelled action in this case just as surely as would the laws of physics in that one. The unplugged unproductive wells operated as a legal liability on the estate, a liability capable of generating losses in the nature of substantial fines every day the wells remained unplugged.⁵⁷

As such, the *H.L.S. Energy* court held, "because we conclude that the cost of plugging the wells in accordance with Texas law was an 'actual and necessary cost' of managing the estate, we agree that such cost must be afforded priority as an administrative expense."⁵⁸

3. *American Coastal* Commandeers Pre-Petition P&A

Curiously, *H.L.S. Energy* left open the question of whether the cost of performing P&A work for liabilities arising pre-petition is likewise entitled to administrative priority status. This question was addressed by the Bankruptcy Court for the Southern District of Texas in *American Coastal*, wherein the Bankruptcy Court expanded upon the *H.L.S. Energy* holding and found that costs incurred post-petition to satisfy outstanding P&A obligations are entitled to administrative priority even if such P&A obligations arose pre-petition.⁵⁹ Like the debtor in *H.L.S. Energy*, the debtor in *American Coastal* entered bankruptcy holding a

56. *In re H.L.S. Energy Co.*, 151 F.3d at 438.

57. *Id.* (citations omitted).

58. *Id.* at 439.

59. *In re Am. Coastal Energy, Inc.*, 399 B.R. 805, 816 (Bankr. S.D. Tex. 2009).

number of inactive wells.⁶⁰ Unlike *H.L.S. Energy*, however, the wells at issue in *American Coastal* had been idle for more than a year prior to the petition date.⁶¹ Immediately following the petition date, the Texas Railroad Commission expended \$496,952.35 to decommission the debtor's wells.⁶² Of that amount, the debtor paid \$75,000.00 under a settlement and listed the remaining \$421,952.35 as a general unsecured claim in the plan—i.e., not an administrative expense.⁶³ The State objected, arguing that it was entitled to payment as an administrative expense claimant.⁶⁴

Like the Fifth Circuit in *H.L.S. Energy*, the Bankruptcy Court in *American Coastal* resolved the priority dispute by focusing upon the determination that the debtor was under an enforceable obligation to complete the P&A work.⁶⁵ The court stated:

Under § 959 and *Midlantic*, the debtor's obligation to plug the wells in accordance with Texas law is a continuing post-petition obligation. [Accordingly, the debtor's] continuing post-petition duty to conform with Texas law renders expenditures necessary to conform with that law actual and necessary costs of preserving the estate entitled to § 503(b)(1)(A) administrative priority.⁶⁶

Thus, the court held that the “the Commission's expense clearly benefited [the debtor's estate] by expending funds that fulfilled [the debtor's] continuing plugging obligations and precluded the accrual of monetary fines.”⁶⁷

C. A Course Correction?

The impact of *H.L.S. Energy* and *American Coastal* has been significant. The broad application of the *Midlantic* exception in these cases essentially granted a relatively small number of creditors in E&P bankruptcy cases an inordinate amount of leverage over plan construction and confirmation. While the Fifth Circuit cited *Midlantic* as support for its holding in *H.L.S. Energy*, the court misapplied the *Midlantic* exception. Indeed, the Fifth Circuit significantly overstated the

60. *Id.* at 807.

61. *Id.*

62. *Id.*

63. *Id.* at 808.

64. *Id.*

65. *Id.* at 811.

66. *Id.* at 811-12.

67. *Id.* at 816.

Midlantic exception, stating that abandonment is prohibited if such abandonment would contravene any state law reasonably designed to protect public health or safety generally—not from an imminent and identifiable harm.⁶⁸ Further, in reaching its conclusion in *H.L.S. Energy*, the Fifth Circuit failed to consider whether its application of Texas law imposed conditions on abandonment that are so onerous that they interfere with the bankruptcy adjudication itself.

At least one court in the Fifth Circuit appears to have noticed this significant omission in the application of *Midlantic* espoused by the *H.L.S. Energy* and *American Coastal* courts. In *In re Howard*, the Bankruptcy Court for the Southern District of Mississippi examined a trustee's abandonment power *vis-a-vis* *Midlantic* and noted that the majority of courts to consider the issue have relied upon footnote nine to limit *Midlantic*'s restrictions.⁶⁹ In *In re Howard*, the Bankruptcy Court cited to several cases from other circuits that emphasized the limited nature of the *Midlantic* exception:⁷⁰

The majority of Courts that have interpreted footnote nine (9) in *Midlantic* have held that the “narrow” exception to a trustee's abandonment power only applies in situations where an imminent and identified harm to the public health and safety exists. *See N.M. Env't Dep't v. Foulston (In re L.F. Jennings)*, 4 F.3d 887, 890 (10th Cir. 1993) (“[B]efore abandonment of a property can violate *Midlantic* the property must represent an immediate and identifiable harm to public health or safety.”) (citations omitted); *Borden, Inc. v. Wells-Fargo Business Credit (In re Smith-Douglass, Inc.)*, 856 F.2d 12, 16 (4th Cir. 1988) (“[T]his narrow exception applies where there is a serious health risk, not where the hazards are speculative or may await appropriate action by an environmental agency.”); *Minn. Pollution Control Agency v. Gouveia (In re Globe Building Materials)*, 345 B.R. 619, 629 (Bankr. N.D. Ind. 2006) (“This Court also deems the *Midlantic* decision to stand solely for the proposition that a chapter 7 trustee may not abandon property from a bankruptcy estate under 11 U.S.C. § 554(a) without taking actions necessary to abate conditions which pose an ‘imminent and identifiable harm’ to ‘the public health or safety.’”); *In re Guterl Special Steel Corp.*, 316 B.R. 843, 858-59 (Bankr. W.D. Pa. 2004) (“If there is no imminent threat to public health or safety, abandonment pursuant to § 554(a) may be permitted even though state laws or

68. *In re H.L.S. Energy Co.*, 151 F.3d 434, 438 (5th Cir. 1998).

69. *In re Howard*, 533 B.R. 532, 545-46 (Bankr. S.D. Miss. 2015).

70. *Id.*

regulations designed to protect public health or safety will be violated as a consequence.”⁷¹

The sheer length of this comprehensive citation makes a powerful point regarding the significance of *Midlantic*'s footnote nine and how the Supreme Court intended it to be interpreted by the district courts. *Howard* also indirectly calls into question *H.L.S. Energy* and its progeny such as *American Coastal*, which assume, without application of footnote nine's limiting element, that E&P debtors may not abandon properties subject to burdensome P&A liabilities.

The resultant fallout of this misapplication of *Midlantic* has been far reaching. *H.L.S. Energy* has been read to require a near *per se* rule prohibiting the abandonment of properties with outstanding P&A liabilities.⁷² Further, as a corollary to this prohibition against abandonment, bankruptcy courts have further found that P&A obligations—whether matured and owing, contingent, or unliquidated—may be entitled to payment as administrative expenses in almost any circumstance. In essence, what was initially crafted as a narrow exception to the Bankruptcy Code's abandonment provisions has become a nearly insurmountable hurdle to confirmation of chapter 11 plans in offshore E&P cases.

Yet, while *Howard* makes clear that the foundation of *H.L.S. Energy*—i.e., the unexamined assumption that the trustee was prohibited from abandoning the subject properties—misinterprets the *Midlantic* exception, *Howard* does not address the appropriate priority to be granted P&A claims. Part III of this Article examines this question primarily in the offshore E&P context.

III. SETTING ANCHOR: UNDERSTANDING P&A LIABILITY AND TIMING

Generally speaking, the goal of bankruptcy law is to provide debtors a means of financial rehabilitation. For offshore E&P debtors with end-of-life oil and gas properties, the swell of claims resulting from statutory P&A liability has placed a significant obstacle in the pursuit of plan confirmation. As discussed in Part II *supra*, in the Fifth Circuit this significant hurdle results from an apparent *per se* rule that end-of-life

71. *Id.*

72. *In re H.L.S. Energy Co.*, 151 F.3d 434; *In re Am. Coastal Energy, Inc.*, 399 B.R. 805. *But see In re ATP Oil & Gas Corp.*, No. 12-36187, 2013 Bankr. LEXIS 2608, at *9 (Bankr. S.D. Tex. June 19, 2013) (wherein the Bankruptcy Court for the Southern District of Texas acknowledged that, when a debtor lacks sufficient funds to meet its P&A obligations, abandonment may actually further the environmental regulatory scheme).

E&P properties may not be abandoned and the corollary judicial development that grants claims arising from statutory P&A regulations treatment as administrative expense claims. The enormity of this burden is easily illustrated. In a recent case in the Southern District of Texas, *In re Black Elk Energy Offshore Operations, LLC*, the debtor owned and operated numerous platforms in the Gulf of Mexico.⁷³ During the bankruptcy, the government filed a proof of claim in excess of \$660 million.⁷⁴ The government later filed an administrative expense request seeking the allowance of more than \$714 million for the debtor's decommissioning obligations.⁷⁵ It is easy to see how the determination of allowance and priority for such a claim has a dramatic impact upon the debtor's ability to formulate a feasible plan and upon any resulting distributions to creditors.⁷⁶ As oil prices do not appear to be poised for any imminent rebound, offshore E&P bankruptcy cases will likely continue in the near term. Determining a workable solution for the allowance and treatment of P&A claims is a must.

As discussed *supra*, the *H.L.S. Energy* and *American Coastal* courts both determined that the respective debtors defaulted under their existing obligations to perform statutorily required P&A work. These findings were key to the ultimate determination of priority. In other words, much like the trustee in *Midlantic*, abandonment of the *H.L.S. Energy* or *American Coastal* properties would have operated to relieve the debtor's estate from a statutory obligation designed to protect the health and safety of the public. Under *Midlantic*, however, this public health and safety policy goal, no matter how warranted, is not sufficient. Instead, *Midlantic* requires that § 554 be limited only in situations where there is (1) an imminent and identifiable harm to the public health or safety; and (2) the underlying regulation does not pose a requirement so onerous as to interfere with the bankruptcy adjudication itself. As noted in *Howard*, *Midlantic* should not be read to *per se* prohibit the abandonment of P&A

73. Second Am. Disclosure Statement, *In re Black Elk Energy Offshore Operations, LLC*, No. 15-34287 (Bankr. S.D. Tex. 2016), ECF No. 828.

74. Proof of Claim No. 102, *In re Black Elk Energy Offshore Operations, LLC*, No. 15-34287 (Bankr. S.D. Tex. 2016).

75. U.S. Am. Mot. for Allowance of Admin. Exp. Pursuant to 11 U.S.C. § 503(b), *In re Black Elk Energy Offshore Operations, LLC*, No. 15-34287 (Bankr. S.D. Tex. 2016), ECF No. 894 (Ultimately the Department of Interior (DOI) accepted a negotiated settlement that provided for the performance of a significant portion of the debtor's P&A obligations on its operated properties).

76. In fact, resolution of the DOI claim became one of the primary focal points in negotiating the Black Elk plan.

burdened properties. If abandonment is not *per se* prohibited, should P&A liabilities ever be afforded administrative expense priority?

The answer, of course, is not simple. Indeed, while neither *H.L.S. Energy* nor *American Coastal* actually examined the abandonment question, it is not difficult to envision circumstances—such as the presence of an uncontrolled flow at a well or a well with a significantly damaged platform—that would justify restricting abandonment under § 554. Further, abandonment may not always be the best answer. In order to determine a just and equitable treatment of P&A obligations and liabilities, it is important to first examine the nature and scope of these claims.

A. *Defining the Debtor's Decommissioning Obligations*

A debtor's "plugging and abandonment" or "decommissioning" obligations generally refer to state or federal statutory liabilities that arise at the end of an oil and gas well's useful life.⁷⁷ These obligations include "plugging" of the well, removal of platforms and other facilities, and site clearance.⁷⁸ The scope and performance of such activities are governed by acts of Congress (or state legislatures) and a host of regulatory agencies whose purpose is to oversee and intervene where appropriate.⁷⁹

These laws and regulations are administered both at the state and federal levels of government. At the federal level, this includes the Bureau of Ocean Energy Management (BOEM) and the Bureau of Safety and Environmental Enforcement (BSEE). Most states also have their own regulatory agency charged with enforcing similar laws and regulations. For example, in Texas, as seen in the cases discussed above,

77. Mark A. Chavez, Philip G. Eisenberg, & Omer F. Kuebel III, *Decommissioning/Plugging and Abandonment Liabilities in Bankruptcy: What Priority Should They Be Afforded?* 57 ANN. INST. OIL & GAS L. 11-1, 11-2 n.1 (2006).

78. *Id.*

79. Initially, it is important to note that the risk of harm to the environment accompanying offshore E&P activities necessarily mandates a prudent level of regulation. Consider the BP oil spill in 2010, which caused upwards of \$60 billion in damage to the environment and resulted in a \$20 billion settlement with the government. Steven Mufson, *BP's Big Bill for the World's Largest Oil Spill Reaches \$61.6 Billion*, WASH. POST (July 14, 2016), https://www.washingtonpost.com/business/economy/bps-big-bill-for-the-worlds-largest-oil-spill-now-reaches-616-billion/2016/07/14/7248cdaa-49f0-11e6-acbc-4d4870a079da_story.html?utm_term=.90aa646a5604; Tim Stelloh, *Judge Approves \$20 Billion Settlement in BP Oil Spill*, NBC NEWS (Apr. 4, 2016), <https://www.nbcnews.com/business/business-news/judge-approves-20-billion-settlement-bp-oil-spill-n550456>. Thus, the risks associated with these ventures cannot be taken lightly; for that reason, the industry is subject to stringent laws and regulations.

the Texas Railroad Commission is charged with regulating oil and gas production.

The multitude of regulatory agencies have generated various regulatory requirements and environmental obligations, including decommissioning obligations. At the federal level, these regulations are set forth in the Code of Federal Regulations (C.F.R.).⁸⁰ Collectively, these regulations establish the duties and obligations imposed upon E&P companies operating offshore on federal leases, including decommissioning obligations. Chapter 30, § 250.1700 of the C.F.R. defines “decommissioning” as (1) ending oil, gas, or sulphur operations; and (2) returning the lease or pipeline right-of-way to a condition that meets the regulations and requirements of BSEE and other agencies with jurisdiction over the decommissioning activities.⁸¹ Pursuant to these regulations, when a debtor’s facilities are no longer useful for operations, the debtor must take the following actions:

- (1) Get approval from the appropriate District Manager before decommissioning wells and from the Regional Supervisor before decommissioning platforms and pipelines or other facilities;
- (2) Permanently plug all wells . . . ;
- (3) Remove all platforms and other facilities, except as provided in §§ 250.1725(a) and 250.1730;
- (4) Decommission all pipelines;
- (5) Clear the seafloor of all obstructions created by [the] lease and pipeline right-of-way operations . . . ; and
- (6) Conduct all decommissioning activities in a manner that is safe and does not unreasonably interfere with other uses of the OCS, and does not cause undue or serious harm or damage to the human, marine, or coastal environment.⁸²

Guidance regarding the timing of permanent P&A work is provided in §§ 250.1710 and 250.1711, which require that such work be accomplished within one year of the termination of a lease (§ 250.1710) or upon a BSEE order if such well is no longer useful or poses an imminent environmental risk (§ 250.1711).⁸³ Although, on the one hand, BOEM/BSEE typically assert that P&A liability arises the moment the environment is invaded for E&P operations,⁸⁴ the regulations make clear

80. See 30 C.F.R. §§ 250.1700-.1754 (2017); 28 U.S.C. § 959(b) (2012).

81. 30 C.F.R. § 250.1700.

82. 30 C.F.R. § 250.1703.

83. 30 C.F.R. §§ 250.1710-.1711.

84. 30 C.F.R. § 250.1702.

that such liability ripens only upon the determination that properties are either no longer useful or pose an imminent environmental risk.

Applying these timing mandates, it is possible to divide a debtor's P&A obligations into two distinct categories. First, there are matured obligations for properties that are "no longer useful for operations." For purposes of this Article, we refer to these properties as "Non-Producing Properties." Second, there are unmatured and unliquidated obligations for properties that remain useful for operations. We refer to these properties as "Producing Properties."

Additionally, while a debtor may be the primary obligee as to decommissioning work on properties where the debtor is the operator of record (Operated Properties), such is not the case for properties in which a debtor merely holds a joint interest or is a predecessor in title (Non-Operated Properties). As to these Non-Operated Properties, the debtor may be subject to joint and several liability and, in the event of a default by the operator or other party with primary liability, could be ordered to satisfy P&A obligations, but is not the primary obligee. As such, regardless of whether the associated P&A liabilities arise from a Non-Producing Property or a Producing Property, the statutory liability of the debtor for Non-Operated Properties is contingent in nature.

With these categories in mind, we must now turn back to § 503 of the Bankruptcy Code to determine a just treatment. Section 503 provides that "the actual, necessary costs and expenses of preserving the estate" are to be characterized as administrative expenses and are entitled to priority under § 507.⁸⁵ Thus, a claim under § 503 must meet two elements: actual and necessary. We will analyze these in reverse order.

B. Is Compliance with P&A Obligations "Necessary"?

1. Necessary?—Yes. Necessary to the Administration of a Bankruptcy Case?—Probably Not.

As discussed above, the *H.L.S. Energy* court ultimately decided that expenses advanced to satisfy the debtor's outstanding and owing P&A liabilities were "necessary" because the debtor was being fined daily due to a lack of compliance and the debtor was unable to abandon the property.⁸⁶ We have examined the fault in the court's conclusion regarding abandonment and now turn to examining the underlying question of whether P&A liabilities are "necessary" under the *Reading*

85. 11 U.S.C. §§ 503, 507 (2012).

86. *In re H.L.S. Energy Co.*, 151 F.3d 434, 438 (5th Cir. 1998).

definition. *H.L.S. Energy* provides a succinct analysis of “necessary” under the Bankruptcy Code.⁸⁷ As set forth therein:

An “actual and necessary cost” must have been of benefit to the estate and its creditors. This requirement is in keeping with the conceptual justification for administrative expense priority: that creditors must pay for those expenses necessary to produce the distribution to which they are entitled. “That is, the costs of salvage are to be paid.” The “benefit” requirement has no independent basis in the Code, however, but is merely a way of testing whether a particular expense was truly “necessary” to the estate: If it was of no “benefit,” it cannot have been “necessary.”⁸⁸

As to the P&A claims at issue before the court, the Fifth Circuit placed significant weight upon the increasing amount of the debtor’s liability deriving from daily fines.⁸⁹ The court explained:

The fulfillment of this, the estate’s obligation, can only be seen as a benefit to the estate. In this sense, the state’s action resembles the sort of “salvage” work that lies at the heart of the administrative expense priority. No one would challenge the expense of shoring up the sagging roof on a bankrupt’s warehouse, for example, where carpentry was needed to prevent further damage to the structure or liability from injury to passers-by. The laws of Texas compelled action in this case just as surely as would the laws of physics in that one. The unplugged unproductive wells operated as a legal liability on the estate, a liability capable of generating losses in the nature of substantial fines every day the wells remained unplugged.⁹⁰

Although the *H.L.S. Energy* court appears to have accorded great weight in the incurrence of daily fines, it is not difficult to conclude that P&A expenses, even without daily regulatory fines, are similar in nature to the sagging roof cited by the court.⁹¹ Offshore E&P facilities pose some inherent risk to the public health and safety. Yet, the costs to decommission these facilities are extremely high, and given the timing of when such decommissioning expenses become due (i.e., the end of an E&P property’s useful life) these costs easily render properties with outstanding P&A liabilities a burden to a debtor’s estate. Accordingly, unless some rule prohibits such properties from being abandoned, then abandonment under § 554 is the most appropriate course.⁹²

87. *Id.* at 437 (citations omitted).

88. *Id.* (citations omitted).

89. *Id.* at 438.

90. *Id.* (citation omitted).

91. *Id.*

92. *See* 11 U.S.C. § 554 (2010).

2. Does *Midlantic* Prohibit Abandonment?

Reading further into *Midlantic*, one can see that the case does not prohibit abandonment of property unless, as set forth in footnote 9, certain conditions are met.⁹³ Indeed, a thorough reading of the case demonstrates that a trustee's abandonment power should remain unfettered, unless abandonment of the property would pose an "imminent and identifiable" harm to public health or safety.⁹⁴ This begs the question: who has the burden of demonstrating the existence of an imminent and identifiable harm? Surely the onus is not on the trustee of an offshore E&P debtor to prove that *none* of the wells and platforms are at risk. As mentioned by the Court in *Midlantic*, perhaps the government, or a similarly situated objecting party, is in the best position to set forth which specific properties pose threats.⁹⁵

What is clear, however, is that the presumption that all end-of-life E&P properties pose an imminent threat to the public health and safety is meritless. Indeed, C.F.R. § 250.1711, which contemplates a BSEE-issued order to commence decommissioning work upon a determination that a well poses an imminent environmental threat, inherently supports the opposite conclusion.⁹⁶ If all end-of-life facilities posed an imminent threat, why would there be a need for BSEE to make such a finding prior to the conclusion of the one-year grace period? Of course, § 250.1711 also implicates circumstances that may exist, such as uncontrolled flow or deteriorated platforms, which require immediate P&A activities.⁹⁷ Put another way, the applicable Code of Federal Regulations sections already contemplate *Midlantic*'s "imminent and identifiable" standard, and permitting abandonment except when such circumstances exists is not entirely contrary to the existing regulatory scheme.⁹⁸ Further, programs such as the temporary abandonment and the Rigs to Reefs programs (discussed below) illustrate a regulatory acknowledgement that abandonment—whether temporary or permanent—may be accomplished in such a manner as to minimize any identifiable threat to the public health and safety.⁹⁹

93. *Midlantic Nat'l Bank v. N.J. Dep't of Env'tl. Prot.*, 474 U.S. 494, 507 n.9 (1986).

94. *Id.* at 506.

95. *Id.* at 498.

96. 30 C.F.R. § 250.1711 (2017).

97. *Id.*

98. *Midlantic*, 474 U.S. at 506; *id.* at 515 (Rehnquist, W., dissenting).

99. John McKinney, *After the Oil Runs Out: Rigs to Reefs*, PAC. STANDARD (July 15, 2010), <https://psmag.com/environment/after-the-oil-runs-out-rigs-to-reefs-19272>.

Finally, bankruptcy courts examining abandonment of the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) Superfund¹⁰⁰ properties or other properties with contained environmental contamination have found that abandonment is appropriate under *Midlantic* unless immediate remediation of an identified health and safety threat is required. For example, in *In re Purco, Inc.*, the court found that a “necessary corollary to [*Midlantic*’s holding] is that abandonment will be permitted when the conditions are such that abandonment will not render the public health and safety inadequately protected.”¹⁰¹ Likewise, in *In re Franklin Signal Corp.*, the court held that a trustee need only take adequate precautionary measures to ensure that there is no imminent danger to the public as a result of the abandonment.¹⁰² In that case, the court did not believe a strict reading of *Midlantic* would produce the result the Supreme Court would have intended.¹⁰³ Rather, the court found the “total disregard for potential hazards is the concern the majority seemed be addressing” and cited the *Midlantic* trustee’s failure to take any action whatsoever to safeguard the public.¹⁰⁴

C. Are Estimated P&A Costs “Actual” Expenses?

Even if P&A costs and expenses are deemed necessary, in order to be granted administrative priority, the costs and expenses must actually be incurred.¹⁰⁵ In *In re Rock & Republic Enterprises*, the court explained “[a]lthough a claim may be contingent, only ‘actual’ administrative expenses, not contingent expenses, are entitled to priority under § 503.”¹⁰⁶ The *Rock & Republic* court found the reasoning of courts allowing contingent environmental claims administrative priority on the grounds that the definition of “claim” includes contingent rights to payment

100. CERCLA, or Superfund, is a federally administered program through which the Environmental Protection Agency (EPA) works with state and tribal governments to perform remediation services and clean up hazardous waste sites. The statute also allows the EPA to force responsible parties to perform cleanup services directly or reimburse the government for cleanups performed by the EPA. ENVTL. PROT. AGENCY, OFFICE OF SOLID WASTE & EMERGENCY RESPONSE, THIS IS SUPERFUND: A COMMUNITY GUIDE TO EPA’S SUPERFUND PROGRAM 3 (2011), <https://semsub.epa.gov/work/HQ/175197.pdf>.

101. *In re Purco Inc.*, 76 B.R. 523, 533 (Bankr. W.D. Pa. 1987).

102. *In re Franklin Signal Corp.*, 65 B.R. 268, 272 (Bankr. D. Minn. 1986).

103. *Id.* at 271.

104. *Id.*

105. 11 U.S.C. § 503(b)(1)(a) (2012).

106. *In re Rock & Republic Enters.*, No. 10-11728 (AJG), 2011 Bankr. LEXIS 3903, at *13 (Bankr. S.D.N.Y. Oct. 7, 2011).

unpersuasive.¹⁰⁷ The court expressly held that the definition of “claim” is irrelevant to the determination of priority pursuant to § 503(b)(1)(a).¹⁰⁸ Other courts considering the issue have also determined that contingent environmental remediation costs are not entitled to administrative priority.¹⁰⁹

D. Too Great A Weight?

Finally, given the growing size of P&A claims, it is conceivable that in the near future bankruptcy courts will be required to consider the question left open by the Supreme Court in *Midlantic*: whether decommissioning requirements placed an unfair burden on the debtor’s estate.¹¹⁰ This issue was left open by the Court in *Midlantic* wherein the Court issued its holding “without reaching the question whether certain state laws imposing conditions on abandonment may be so onerous as to interfere with the bankruptcy adjudication itself.”¹¹¹ Thus, even when Non-Producing Properties are deemed to pose an imminent and identifiable threat to public health and safety, resolving such issues in compliance with federal or state law may simply be impossible.¹¹²

Indeed, the *American Coastal* court acknowledged “the possibility that environmental liabilities may be so significant in relation to the debtor’s ability to pay that characterizing all or a portion of an environmental claim as an administrative expense may unduly ‘interfere with the bankruptcy adjudication itself.’”¹¹³ However, in that case the debtor did not allege the government’s claim was unduly onerous and

107. *Id.*

108. *Id.*

109. *See* *Juniper Dev. Grp. v. Kahn (In re Hemingway Transp., Inc.)*, 993 F.2d 915, 930 (1st Cir. 1992) (finding claims for future response costs to be unavailing insofar as the right to contribution for such costs remained contingent at the time the court considered the claim); *see also In re Oldco M. Corp.*, 438 B.R. 775, 786 (Bankr. S.D.N.Y. 2010) (disallowing request for administrative expense related to future environmental remediation costs that debtor may or may not have to pay in the future as too speculative to support the allowance of an administrative expense); *In re Microfab, Inc.*, 105 B.R. 161, 166 (Bankr. D. Mass. 1989) (denying as premature the state’s request for allowance of an administrative expense as the state had not yet expended any funds to clean up the site and it “cannot speculate as to what amounts might eventually be allowable as ‘actual’ and ‘necessary’ expenses of the estate”).

110. *Midlantic Nat’l Bank v. N.J. Dep’t of Env’tl. Prot.*, 474 U.S. 494, 516 (1986) (Rehnquist, W., dissenting).

111. *Id.* at 507 (majority opinion).

112. *See id.* at 508 (explaining the purpose of bankruptcy liquidation is the expeditious reduction of the debtor’s property to money, for equitable distribution to creditors) (Rehnquist, W., dissenting).

113. *In re Am. Coastal Energy, Inc.*, 399 B.R. 805, 814 (Bankr. S.D. Tex. 2009).

instead provided that, via its plan, 100% of the government's claim would be paid on the effective date.¹¹⁴

Ultimately, what becomes most apparent is that the misapplication of the *Midlantic* exception espoused by Fifth Circuit courts in E&P bankruptcy cases is not workable. Section 554 is a significant power that should not be fettered in the absence of a significant public interest. As shown above, while, generally speaking, the enforcement of environmental regulations is a necessary regulatory exercise, a *per se* rule that prohibits abandonment of E&P properties subject to outstanding P&A obligations is supported by neither the Bankruptcy Code nor the Supreme Court's exception thereto set forth in *Midlantic*. As abandonment may indeed be permissible when *Midlantic* is properly applied, the seeming conclusion that all P&A liabilities remaining unsatisfied as of a debtor's bankruptcy filing are entitled to administrative priority treatment often read into *H.L.S. Energy* fails. If abandonment is possible, performing P&A work on a Non-Producing Property may provide little or no benefit to an estate. However, when a Non-Producing Property can be shown to represent an imminent and identifiable threat to the public health, at least some P&A work—either temporary or permanent—must be performed in order to comply with *Midlantic*. In such circumstances, as espoused by the *H.L.S. Energy* court, the cost to perform such P&A work should be granted administrative priority.

Further, granting administrative priority to regulatory bodies may often be inappropriate because in many instances the responsible regulatory authority will not perform P&A work itself, and in fact may never expend any funds related to the performance of P&A work. In such cases, unlike the claims of the Texas Railroad Commission in *H.L.S. Energy* and *American Coastal*, the enforcing agency's claim should not be considered an actual and necessary expense of the estate. Thus, even for those Non-Producing Properties for which P&A work is necessary, a claimant should be required to show that it has actually expended funds to bring the debtor into legal compliance to be entitled to an administrative expense claim. Extending the same reasoning, claims related to future P&A work involving Producing Properties and contingent claims for a debtor's share of P&A costs involving Non-Operated Properties should never be granted administrative priority status.

114. *Id.*

IV. PRACTICAL SOLUTIONS TO THE P&A PROBLEM

The minority of the *Midlantic* Court approached the case in a more logical manner. Indeed, in a rather pointed dissent, Justice Rehnquist reminds readers that the very purpose of the judge-made abandonment rule was to further the purpose of the bankruptcy liquidation process; that is, the expeditious reduction of the debtor's property to money for equitable distribution to creditors.¹¹⁵ Further, the plain language of § 554 expresses a rule in which the only material consideration to be made is the value of the property to the debtor's estate.¹¹⁶ Although precedent would dictate the Court should not read exceptions or limitations into such unqualified statutory language, the *Midlantic* Court engaged in a judicial triage of sorts to reach the ultimate conclusion that a trustee's abandonment power, although seemingly unlimited on its face, must actually yield to other considerations not enumerated in the Bankruptcy Code.¹¹⁷

The *Midlantic* exception is seemingly the only judicially established limitation placed upon the abandonment powers set forth in § 554. Notably, subsequent case law acknowledges that the Bankruptcy Code itself does not explicitly limit the abandonment powers of § 554.¹¹⁸ Likewise, nothing in the code expressly provides for administrative priority to contingent, unliquidated P&A liabilities. While a trustee certainly should not "have *carte blanche* to ignore nonbankruptcy law,"¹¹⁹ she should also not be hamstrung by such nonbankruptcy law in effectuating her duties as trustee. Yet, the concerns underlying decisions such as *Midlantic*, *H.L.S. Energy*, and *American Coastal* are significant, legitimate concerns. If § 554 abandonment is not forced to yield to such concerns, and abandonment of E&P properties is unfettered, what mechanisms exist to curtail the potential for abuse? The following existing policies or statutory requirements may be of aid.

115. *Midlantic*, 474 U.S. at 508 (Rehnquist, W., dissenting).

116. *Id.* at 509.

117. *Id.* at 510.

118. *See, e.g. In re Am. Coastal Energy, Inc.*, 399 B.R. at 811 ("*Midlantic* was not decided based on the statutory language of the Bankruptcy Code."); *see also Midlantic*, 474 U.S. at 504 (acknowledging and analyzing the argument that Congress did not place express limitations on § 554).

119. *Midlantic*, 474 U.S. at 502 (majority opinion).

A. *Temporary Abandonment and Idle Iron*

Historically, oil and gas producers have been reluctant to permanently plug wells and decommission platforms until the final decommissioning regulatory requirements were triggered.¹²⁰ Even for Non-Producing wells and facilities, offshore E&P companies maintained that these properties added value to the lease or could one day be used to support other producing properties.¹²¹

However, in 2010, as part of the federal government's initiative to improve environmental health and safety of oil and gas production on the Outer Continental Shelf in the wake of the Deepwater Horizon disaster, BSEE published its Notice to Lessee (NTL) 2010-G05, entitled *Decommissioning Guidance for Wells and Platforms*, which is more commonly known as the "Idle Iron" policy.¹²² The purpose of the NTL was

to establish guidelines that provide a consistent and systematic approach to determine the future utility of idle infrastructure on active leases and to ensure that all wells, structures, and pipelines on terminated leases, and pipelines on terminated pipeline rights-of-way (ROW) are decommissioned within the timeframes established by regulations, conditions of approval, and lease instruments.¹²³

The term itself, "idle iron," refers to wells, platforms, and pipelines that are no longer producing or serving exploration, or that support functions related to a company's lease.¹²⁴ The policy is applicable to wells that need to be plugged, or platforms that need to be removed, because they are no longer useful for operations.¹²⁵

For offshore E&P debtors, idling wells, if done properly, could provide an avenue for delaying noncontingent P&A expenditures during the bankruptcy and altogether eliminate contingent future P&A work. Indeed, the so-called Idle Iron policy establishes an expectation that

120. Press Release, U.S. Dep't of the Interior, Interior Department Issues "Idle Iron" Guidance (Sep. 15, 2010), <https://www.doi.gov/news/pressreleases/Interior-Department-Issues-Idle-Iron-Guidance>.

121. *Id.*

122. *What Is the "Idle Iron" Policy and Why Does it Exist? FAQs*, BUREAU SAFETY & ENVTL. ENFORCEMENT, <https://www.bsee.gov/faqs/what-is-the-idle-iron-policy-and-why-does-it-exist> (last visited Nov. 9, 2017).

123. Lars T. Herbst, *Notice to Lessees and Operators of Federal Oil and Gas Leases and Pipeline Right-Of-Way Holders in the Outer Continental Shelf, Gulf of Mexico OCS Region*, U.S. DEP'T INTERIOR, BUREAU OCEAN ENERGY MGMT. (Sep. 15, 2010), <https://www.bsee.gov/sites/bsee.gov/files/notices-to-lessees-ntl/notices-to-lessees/10-g05.pdf>.

124. Press Release, *supra* note 120.

125. *What Is the "Idle Iron" Policy and Why Does it Exist? FAQs*, *supra* note 122.

facilities may be safely idled for a period of at least five years without posing an imminent threat to the public health and safety.¹²⁶ The procedures for temporary abandonment are set forth in 30 C.F.R. § 250.1721.¹²⁷ Read in conjunction with 30 C.F.R. § 250.1721, the Idle Iron policy provides bankruptcy courts ample support for the position that, unless otherwise proven by an objecting party, adherence to temporary abandonment guidelines should be sufficient to protect the public from any perceived imminent threat. In other words, requiring a debtor/trustee to temporarily abandon properties in accordance with § 250.1721 as a pre-condition to abandonment should satisfy the policy concerns espoused in *Midlantic*.

B. Incentivize the Rigs to Reef Program

BSEE's Rigs to Reefs program could also play a role in E&P bankruptcies, giving trustees an alternative to burdensome and costly P&A work. For a debtor who runs the risk of incurring substantial fines as a result of its failure to meet its P&A obligations, the Rigs to Reef program offers a very practical and cost-efficient solution.

The program began in 1984 with the passing of the National Fishing Enhancement Act in response to coastal states' concerns about losing the marine life that had developed around the artificial structures in the Gulf of Mexico.¹²⁸ It was warmly welcomed by conservationists and fishermen who recognized the social and economic value the oil and gas platforms could provide as artificial reefs.¹²⁹ According to BSEE's website, as of July 1, 2015, 470 platforms had been converted to permanent artificial reefs.¹³⁰ Converting a debtor's Non-Producing Properties into artificial reefs during the pendency of a bankruptcy could eliminate certain P&A obligations altogether while providing a potential environmental and recreational boon. The end result is a win-win situation for all interested parties. Specifically, the debtors would be relieved of P&A obligations, the disparate impact on other creditors would be reduced or eliminated altogether, and the government's objective of protecting (and even helping) the environment would be satisfied.

126. *Id.*

127. 30 C.F.R. § 250.1721 (2017).

128. *Rigs to Reefs*, BUREAU SAFETY & ENVTL. ENFORCEMENT, <https://www.bsee.gov/what-we-do/environmental-focuses/rigs-to-reefs> (last visited Nov. 8, 2017).

129. *Id.*

130. *Id.*

Still, the Rigs to Reefs program has not been without its detractors, and there are open questions regarding ownership and future liability of the rigs. The critics are mainly environmentalists who argue that leaving rusting steel rigs on the ocean floor could have a negative long-term impact on aquatic life and could create pollution.¹³¹ Regardless, the Rigs to Reef program has been widely viewed as the most practical alternative to full decommissioning, and in the bankruptcy context could be incredibly beneficial if debtors are permitted to utilize the program.

V. CONCLUSION

As many offshore E&P debtors have learned, the Gulf of Mexico is rich in natural resources. Unfortunately for their creditors and bankruptcy estates, there generally is not enough loot to go around. If bankruptcy courts continue with this broad policy of granting administrative priority to the government and other P&A claimants in such exorbitant amounts, the objectives underscoring the entire bankruptcy process are at risk of falling by the wayside. Giving this priority to the government and other P&A claimants results in secured creditors exiting the estate with the valuable property leaving the unsecured creditors to foot the bill. Such a result could not have been intended by *Midlantic* or the provisions of the Bankruptcy Code.

Midlantic's holding has been misapplied by a number of federal courts applying the case in the E&P context. This misapplication has resulted in a blockade of caselaw that acts to prevent the expeditious confirmation of chapter 11 plans. Moreover, the policy adopted in *H.L.S. Energy* and expanded upon in *American Coastal* has placed an unfair burden on debtors who enter bankruptcy seeking financial rehabilitation. Together, these cases have strung together a safety net for offshore regulators, such as BOEM and BSEE, who are charged with ensuring the financial viability of offshore E&P companies. By denying a significant bankruptcy power to E&P debtors, courts have allowed these offshore regulators to become more lax in their duties, while asserting massively underfunded P&A claims.

It is time we rethink this judicially created policy. Fresh ideas, such as Idle Iron and Rigs to Reef, are sorely needed. The current mechanisms for handling the P&A problem are simply not sustainable.

131. McKinney, *supra* note 99.