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HEALTH, SAFETY, AND WELFARE. NO MONEY.

Managing the closing of businesses in quick liquidations

Presented June 1, 2017, at the 12th Anniversary Bench/Bar Bankruptcy Conference, San Antonio, Texas

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Health, Safety and Welfare – Categories of Common Cases

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- Healthcare
- Environmental/ Regulatory
- Restaurants/Bars
- Ranches/Farms
- Private Prisons

Key Issues in Health Care Bankruptcy Cases (1 of 4)

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- Includes nursing homes, hospitals, and medical clinics
- Client Records
  - DIP and Trustees have duty to comply with state and federal law (28 U.S.C. § 959(b)). But see *In re Old Carco*, 424 B.R. 633, 648 (S.D.N.Y. 2010) (if there are no ongoing obligations, debtors/trustees may be excused from compliance)
  - Abandonment?
    - But see *Midlantic,*
    - But see applicable state law such as 25 Tex. Admin. Code § 133.41(j)(8) (generally requiring that medical records be maintained for at least 10 years)
- Patient Care Ombudsman?

Key Issues in Health Care Bankruptcy Cases (2 of 4)

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- Provider Agreements
  - Automatic successor liability for Medicare provider agreements
- Maintaining Value Before and During Sale Process
  - Patient Referrals
  - Patient A/R
  - Medical Equipment

Key Issues in Health Care Bankruptcy Cases (3 of 4)

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- Going Concern Sale?
  - What Can You Sell?
    - Texas law provides that hospital and nursing home licenses are not transferrable (25 Tex. Admin. Code § 133.21(f) (hospitals), 19.210 (nursing homes))
    - How to respond if applicable regulatory body may not issue license for several weeks or months after a sale?
      - Operational Transfer Agreement (OTA) – used to memorialize the allocation of responsibilities and time of transfer of key elements in the sale of an ongoing healthcare business.
      - Separate – or combined- Asset Purchase Agreement (APA).

Key Issues in Health Care Bankruptcy Cases (4 of 4)

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- Key issues in OTA/APA:
  - Transfer of assets, liabilities, operations
  - Purchase consideration
  - Timing of transfer
  - Transfer of employees (including WARN Act issues)
  - Regulatory filings/ requirements
  - Partitioning/collecting accounts receivable
  - Ownership of, and access to, patient records
  - Final cost reports
  - Proration of operating costs
  - Establishment of new vendor/contractor relationships
  - Assignment of contracts, agreements, and leases

Environmental/Regulatory Issues in Bankruptcy (1 of 2)

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- The Conflicting Goals of Bankruptcy and Environmental / Regulatory Law:
  - Bankruptcy: Provide the debtor a "fresh start" by addressing all liabilities. Allowing environmental / regulatory liabilities to survive or evade the otherwise comprehensive Chapter 11 plan may destroy a debtor's ability to reorganize.
  - Environmental / Regulatory: Prevent and cleanup contamination by imposing liability on responsible parties. Eliminating environmental claims in bankruptcy case may allow guilty parties to escape liability, delay or prevent cleanup, require other parties to overpay for their relative contributions to the contamination, and unnecessarily impose costs on the government

Environmental/Regulatory Issues in Bankruptcy (2 of 2)

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- What Environmental/Regulatory Obligations?

- Environmental/Regulatory obligations take many forms. For example:
  - An obligation to pay money;
  - An obligation to perform a cleanup; or
  - Ongoing compliance.

Dischargeability of Environmental / Regulatory Claims (1 of 3)

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- Three questions:
  - (1) is it a claim?
  - (2) when did the claim arise?
  - (3) did the creditor holding the claim have sufficient notice of the case and the debtor's liability to participate in the bankruptcy case?

Dischargeability of Environmental/ Regulatory Claims (2 of 3)

- The few clear answers:
  - Ongoing regulatory compliance obligations are generally not claims subject to discharge.
    - 28 U.S.C. § 959(b) – requires DIP to comply with applicable "state" laws during bankruptcy case (has been interpreted to mean federal laws as well)
    - §503(b)(1)(A) generally makes post-petition violations of environmental laws administrative expense claims. *See In re American Coastal Energy, Inc.*, 399 B.R. 805 (Bankr. S.D. Tex. 2009)
    - This continuing duty to comply with the law creates an administrative priority claim for many types of *government* environmental claims.
      - Treatment of claims by co-liable parties for work they perform is a thornier issue that depends on subrogation and other areas of law.
  - Debtor cannot keep property and avoid associated environmental liabilities. *Ohio v. Kovacs, 469 U.S. 274 (1985).*

Dischargeability of Environmental/ Regulatory Claims (3 of 3)

- Some cases have held that post-petition fines and penalties are also entitled to administrative expense status – even if the debtor isn't operating because the failure to clean a hazard is a continuing violation. *See e.g. Alabama Surface Mining*, 963 F.2d 1449 (11th Cir. 1992), *In re Appalachian Fuels, LLC*, 521 B.R. 779, 804 (Bankr. E.D. Ky. 2014).

Exception to Automatic Stay for Governmental Agencies (1 of 2)

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- §362(b)(4) – Exception to automatic stay for governmental unit enforcing police or regulatory power
  - "Governmental unit" defined in § 101(27) – includes state and federal environmental agencies
  - Pecuniary purpose and public policy tests (*In re Halo Wireless, Inc.,* 684 F.3d 581, 588 (5th Cir. 2012))
    - Enforcement actions generally fall into exception under either test (*See e.g. In re Gandy*, 327 B.R. 796, 805 (Bankr. S.D. Tex. 2005).

Exception to Automatic Stay for Governmental Agencies (2 of 2)

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- Most states have laws creating liens for environmental obligations; terms and conditions of the laws vary widely by jurisdiction.

- Laws that create environmental liens that prime preexisting liens are referred to as "superlien" laws, and have been enforced. (*See e.g. 229 Main Street*, 262 F.3d 1 (1st Cir. 2001)).

- Highlights need for due diligence in advance, adequate covenants and reporting requirements, and prompt action if governmental action is taken against borrower or collateral.

Contingent Environmental Claims

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- Many environmental claims involve multiple potentially liable parties, especially co-investors and predecessors in title, who may have rights against the debtor.

- Section 502(e)(1)(B) disallows contingent pre-petition claims by co-liable parties, such as speculative contribution claims.

- Claims for cleanup expenses actually incurred by a co-liable party post-petition, with respect to assets possessed by the debtor, may be entitled to administrative expense status.

Disposition of Contaminated Assets: Abandonment (1 of 4)

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- Can debtors limit environmental administrative claims by abandoning property under § 554, so that it is no longer in their "possession" under 28 U.S.C. § 959?

- In *Midlantic*, a trustee moved to abandon two overburdened waste facilities packed with toxic, carcinogen-contaminated, and explosive chemicals, without taking steps like erecting fencing or maintaining the fire suppression systems.

Disposition of Contaminated Assets: Abandonment (2 of 4)

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The Supreme Court held that the trustee in *Midlantic* could not abandon the waste sites, and that "[t]he bankruptcy court does not have the power to authorize the abandonment without formulating conditions that will adequate protect the public's health and safety…" It characterized its rule as "narrow" and identified several situations where abandonment may be permitted to avoid environmental laws:

- A state law may be so "onerous as to interfere with the bankruptcy adjudication itself"
- The bankruptcy court may establish "conditions that will adequately protect the public's health and safety"
- The violation at issue is a "speculative or indeterminate future violation"

Disposition of Contaminated Assets: Abandonment (3 of 4)

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- Factors considered by Court:
  - Whether the Court can set conditions to protect public health
  - Whether state law interferes with bankruptcy case
  - Whether statute is designed to protect public health and safety
  - Whether the harm is speculative
  - Whether the debtor has unencumbered assets from which to satisfy the environmental obligations
  - Whether allowing abandonment will aggregate already dangerous conditions
  - Whether there is a present or imminent threat to public health
- *See Environmental Obligations in Bankruptcy*, Lawrence R. Ahern, III, and Darlene T. Marsh (2017), § 5.22.

Disposition of Contaminated Assets: Abandonment (4 of 4)

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- If property cannot be abandoned, continuing cleanup costs and/or costs to protect public administrative expense claims may be "actual, necessary costs" of preserving the estate under § 503(b)(1)(A).

- Accordingly, in some cases, whether the property can be abandoned is outcome determinative of the priority of the government's claim.

- Many bankruptcy courts have found that debtors need not comply with all environmental laws, just those that pose threat to public. Additionally, as a practical matter, debtor may be unable to pay the costs of complying with all applicable environmental laws as administrative expenses.

Disposition of Contaminated Assets: Environmental Reserves & Trusts

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- Distribution reserve for contingent, unliquidated or disputed claims (*In re Chemtura Corp.*, 448 B.R. 625 (Bankr. S.D.N.Y. 2011))?
- 363/Plan sale with trust established to satisfy environmental remediation liabilities; parties generally negotiate regulatory and technical approvals as part of plan confirmation?
  - For example: *In re Shoreline Energy LLC,* Case No. 16-35571 (Bankr. S.D. Tex. Feb. 11, 2017) (Court denied confirmation of debtor's plan because it failed to protect public health and safety. Plan proposed to sell assets free and clear while inadequately funding trust to address environmental issues. Additionally, trust did not provide specifics for addressing or maintaining abandoned assets).

Sources / Credits

- *Environmental Obligations in Bankruptcy*, Lawrence R. Ahern, III, and Darlene T. Marsh (2017)
- *Environmental Aspects of Real Estate and Commercial Transactions* (James B. Witkin ed., 4th ed. 2011), Chapter 15 – Treatment of Environmental Liabilities in Bankruptcy, available for purchase at www.ababooks.org.
- *Treatment of Environmental Obligations in Bankruptcy*, Christin L. Childers, and Keri L. Holleb Hotaling, IICLE Press (2014)