

Bankruptcy Fundamentals and Ways to Calculate a Proof of Claim

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Prepared for the Association of State and Territorial
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Purpose of the course

- Explain the basics of bankruptcy.
- Identify opportunities that the bankruptcy code presents.
- Information is based on past experience.
- This is not a substitute for seeking advice and guidance from legal counsel.

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Fundamental Principles of Bankruptcy

- Fresh Start for the Debtor
- Provides for an Orderly Liquidation or Distribution to Creditors
- Allows for Fair & Equitable Treatment of Similarly Situated Creditors
- A federal proceeding that is different from a state receivership proceeding.



Types of Bankruptcy Cases

- Chapter 7
 - Liquidation
- Chapter 9
 - Municipalities
- Chapter 11
 - Reorganization
- Chapter 12
 - Family Farmer
- Chapter 13
 - Wage Earner



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Bankruptcies

- Bankruptcy is a federal proceeding that may provide for an organized way to deal with the debts owed by a person.
- Once a bankruptcy petition is filed, an automatic stay is created.
- Violation of the automatic stay can result in you, and/or others in your office, being held in contempt of court.

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Bankruptcies continued

- What do you need to ask?
 - Who filed for bankruptcy?
 - When did you file?
 - Where did you file?
 - What type of bankruptcy did you file?
(Chapter 7, 11, 13?)
 - What is the docket number?
 - Who is the bankruptcy attorney?
 - Ask for a copy of the bankruptcy petition and the statement of financial affairs (SOFA)?
 - Ask if other related entities file for bankruptcy?

Bankruptcies continued

- What do you do with this information?
 - Get it to you attorney!
 - Let other Offices know about the bankruptcy.
- With proper approval
 - Work on creating a description of the continuing environmental obligations of the property.
 - List environmental concerns that relate to the property, especially future use of the property.
 - Identify future clean up activities and, if possible, the costs that relate to those activities.
 - Consider enforcing the action against other liable parties

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Bankruptcies continued

- What should I not do?
 - Make a demand for payment!!!
 - Act without consulting your attorney.
 - Assume the bankruptcy exists without verifying the filing.
 - Convert injunctive relief obligations into a demand for cost recovery (unless directed by your attorney) .

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Bankruptcies continued

- Watch for deadlines
 - Petition Date
 - Bar Date
- Look for Prior Transfer of Assets
 - Preference Rule (90 days and one year)
 - Set Off

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Bankruptcies continued

- Does bankruptcy mean that I have to stop work?
 - No. Although notice may be given to the bankruptcy court, actions needed to protect human health and the environment should continue.
- Does bankruptcy mean that your office will get no money?
 - No. Depending on the type of bankruptcy, it may improve the chances of cost recovery and require future cleanup actions.
- How does effect me?
 - You may be asked to provide more information, such as why is the cleanup necessary? Can the property be used without the cleanup?

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Authority and Jurisdiction

- Process is controlled by a federal bankruptcy judge.
- Most records are available to the public.
- Bankruptcy Judge has authority over claims.

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Bankruptcy Timeline

- Filing of Bankruptcy Petition
- First meeting of Creditors
- Bar Date
 - Proof of Claim
 - Protective Claim
- Approval of Plan for Reorganization
- Challenges to the amount of a claim
 - Estimation Hearing

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What is a Claim? §101(12)

- Right to Payment or Equitable Remedy
 - need not be reduced to judgment
 - liquidated or unliquidated
 - fixed or contingent
 - mature or unmature
 - disputed or undisputed
 - legal or equitable
 - secured or unsecured
- If it is a claim, the Bankruptcy Judge has authority.

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The Automatic Stay - §362(a)

- After the filing of a bankruptcy petition, it prohibits:
 - Any act to create, perfect, or enforce lien against property of estate
 - Any act to create, enforce, or perfect lien securing pre-petition debt;
 - Any act to collect, access, or recover pre-petition claim;
 - set-off of pre-petition debt

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Automatic Stay

Exceptions of Interest §362(b)

- Criminal actions
- Government exercise of police & regulatory authority (Injunctive Relief)

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Injunctive Relief

(Possibly not a claim and possibly not be subject to the automatic stay)

- 28 U.S.C. §959(b) – debtor must comply with all other laws applicable to its operations
- Mandatory injunctions - Authority to issue cleanup orders is not a claim and therefore not subject to discharge.
- Focus is on current and future actions that are needed to comply with a law.
- The focus is not on the dollar costs of an activity.

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What this means for you?

- When does the claim arise? At time of release? Upon notice of Violation?
- What is included in the claim
 - Past costs
 - Estimated future costs that are beyond the definition of injunctive relief.
- What gets discharged by the bankruptcy?
- What happens if a bankruptcy is dismissed instead of discharged?
- What happens when the debtor owns contaminated property?

The Bankruptcy Estate - §541

- Created upon filing of bankruptcy case
- Includes all legal or equitable interests of the debtor in property as of the commencement of the case.
 - May include the ability to recover funds in the future (e.g. Insurance, other contractual claims).



Exemptions -§522

- Individual debtors may exempt certain property from estate
- Exemptions determined by State or local law if such laws exist; otherwise Federal exemptions apply

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Priorities §507



- Not all claims are equal.
- Priority claims must be paid in full before any claims of a lower priority are paid.
- Claims of equal priority are paid pro rata.

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Order of Claims

- Priority Claims
- Secured Claims
- Unsecured Claims
 - Within each class of claims there may be priorities.
 - Unsecured penalty claims are often the lowest of the unsecured class of claim.
- Post-petition claims, including penalty claims, may rise to the level of Priority Claims.

Examples of Priority Claims

- Administrative Expenses are
 - the actual, necessary costs and expenses of preserving the estate
 - This may include Response costs incurred post-petition to cleanup debtor owned property
 - Penalties for post-petitions violations
- Wages
- Certain Tax Claims

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Secured Status §506

- A claim is secured only to the extent that there is sufficient value in the collateral securing such claim
- If the value is not sufficient, the difference is treated as an unsecured claim.
 - E.g. \$1,000,000 mortgage on contaminated property.
 - If the current value of the property is \$10,000, the mortgage company has a \$10,000 secured claim and \$990,000 unsecured claim,

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Chapter 7 The Liquidation Chapter

- Chapter 7 Trustee:
- Normally an attorney who is paid for the service.
- May decline the engagement if the money in the Estate is too small.
- One Trustee is appointed in every Chapter 7 case
- Trustee has authority over assets of the estate
- No Asset 7 means secured debt exceeds value of the assets.

Goals in a Chapter 7 Liquidation

- Determine what assets are in the estate;
- Protect and preserve assets;
- Sell or otherwise liquidate assets;
- Evaluate claims of creditors and object when appropriate;
- Distribute assets in accordance with priority scheme.

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Chapter 11

Reorganization

- Goal: to formulate a plan of reorganization acceptable to creditors and the bankruptcy court that restructures the debtor's liabilities and provides a solution to its financial problems

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Chapter 11 - The Players

- DIP - Debtor in Possession - §1101(1)
- Bankruptcy Judge
- Creditors Committee(s) - §1102
- Individual Creditors
- United States Trustee
- Chapter 11 Trustee - §1104
- Examiner - §1104



The Plan

- No statutorily prescribed form
- Allocates the value of the debtor to all parties in interest
- May pay claims at a fraction of their allowed amounts
- May issue stock in reorganized debtor to satisfy claims
- May involve a corporate merger of debtor or the sale of debtor's assets

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**BANKRUPTCY
ATTORNEY**



**BEING
INSOLVENT
ISN'T ALL THAT
BAD...JUST BE
THANKFUL YOU'RE
NOT ONE OF YOUR
CREDITORS**

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Classifying Claims & Voting

- The plan must classify claims and interests §1122
- Each class of claims that are impaired vote on the plan §1124
 - If Claim is not impaired, you have no vote.
- Acceptance of plan is determined by whether the class accepts, not by how individual creditors vote §1126

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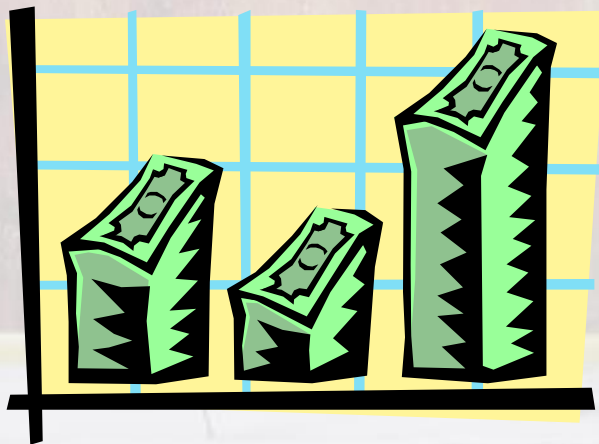
Confirmation Requirements §1129

- Plan must be proposed in good faith.
- Each creditor under plan must receive at least as much as it would under Chapter 7 (best interests test).
- All administrative claims must be paid.
- Not likely to be followed by further reorganization (feasibility test).

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The Best Interest of Creditors Test

- What would creditors receive if the estate were liquidated under Chapter 7?
- What will creditors receive if the plan is confirmed under Chapter 11?



Feasibility Test

- Will the Plan solve the debtor's financial problem?
- Are the financial projections sound?
- Are the underlying assumptions upon which the Plan is based sound?
- Are environmental costs that relate to ongoing business activities considered?



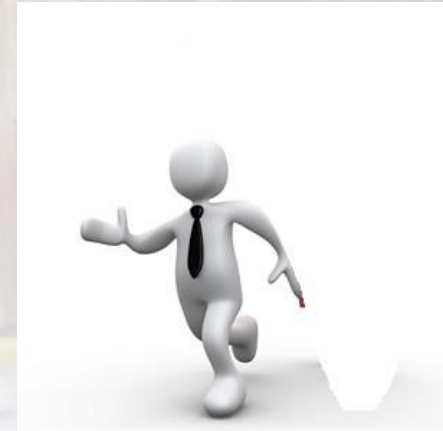
Cram Down

- Plan may be confirmed over the objection of a class of impaired creditors if:
 - Meets all requirements except for creditor acceptance
 - does not violate absolute priorities rule
 - does not unfairly discriminate

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Consequences of Confirmation §1141

- Binds all parties to the terms of the plan regardless of how they voted;
- Revests property from the estate to the debtor;
- Discharges the debtor from all claims arising prior to confirmation.





Liquidating Plan

- When a plan of liquidation is confirmed and the debtor does not continue in business, there is no discharge.
- Also, there is usually no one to collect against.
- Title to property that is not sold will go back to debtor.

Where to find financial information

- Bankruptcy schedules & statement of financial affairs (SOFA)
- Question 17 of SOFA – Environmental disclosures
- Monthly operating reports
- Post-petition credit documents - §364
- Sale and Use of Property - §363
- Executory Contracts - §365
- Plan & Disclosure Statement
- Bankruptcy Rule 2004
- Creditors' Committees

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Bankruptcy Rule 2004

- The examination of the debtor may relate to the acts, conduct, or property or to the liabilities and financial condition of the debtor, or to any matter which may affect the administration of the debtor's estate, or to the debtor's right to a discharge.
- The reason for the 2004 meeting is to allow the Trustee and debtor to go over the paperwork that has been provided.
- Great opportunity to gather information.

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Unique Powers of the Bankruptcy Judge

- Preferences - §547
 - 90 day and one year limits
- Fraudulent Transfers - §548
 - two year limit to an insider
- Setoff
 - allows a creditor to offset a mutual debt owing to the debtor against a claim against the debtor
- Executory Authority - Ability to void existing contracts and to convey assets free of liability.

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Abandonment of Property of the Estate

- §554 allows trustee to abandon property that is burdensome or of inconsequential value.
- This right is not absolute - trustee cannot abandon property in contravention of statute or regulation reasonably designed to protect public health & safety from identified hazards.
- Opportunity to negotiate.

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How to prepare for a Bankruptcy Filing?

- Look for the warning signs.
 - Late payments.
 - Delays in work being performed.
 - Inability to pay claim.
- Improve your status, before the filing!!!
 - Do your notice letters ask that your office be listed as a creditor?
- Review Financial Assurance
 - Are Dollars values sufficient?
 - Is Financial Assurance accessible?
 - Can you improve your status?
 - Move Unsecured Claim to Secured?
 - Define Injunctive Relief Obligations

Is Filing a Proof of Claim in your best Interest?

1. How much money is at risk?
 - A. Fair share of all past and future costs
 - B. Paid consistent with the status of the claim.
2. How serious is the risk at the property?
 - A. Environmental Obligations may not rise to the level of a claim.
 - B. Providing notice of the obligations may be helpful.

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How to Estimate the Environmental Claim?

- A. What is the Debtor's percentage of responsibility at this Site?
- B. What are the Site Costs?
- C. Are there additional claims such as Penalties?
- D. $A \times B + C$ equals the Environmental Claim.
- E. Adjustments can be made based on the class of the environmental Claim.

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How Can you improve the value of a Proof of Claim?

- What is the basis for Allocation of Responsibility?
 - Number of Responsible Parties
 - Number of settling Responsible Parties
 - Waste-In List
 - Period of Ownership
 - Nexus to each operable Unit?

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Does this make a difference? (Method of Allocation)

	Number of Parties	Percentage of Time Owned	Waste-In List
Total Cost	\$10,000,000		
	1 of 50	20%	30%
Allocated Share	\$200,000	\$2,000,000	\$3,000,000

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How Can you improve the value of a Proof of Claim?

- What can be included in the Proof of Claim?
 - Past Costs;
 - Penalties;
 - Direct Future Costs;
 - Oversight Costs;
 - Contingent Remedies; and
 - Other Response Actions that may be necessary but are not within the definition of a “Injunctive Obligations.”

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What should not be in the Proof of Claim?

Injunctive Relief Obligations

Mandatory injunctions are not claims and are not subject to discharge because a polluter may not have the option to pay the government in lieu of cleaning up environmental hazards.

Torwico- cleanup obligation ongoing regulatory obligation that runs with the Waste.

Torwico Elecs., Inc. v. N.J. Dep't of Env'tl. Prot. (In re Torwico Elecs., Inc.), 8 F.3d 146, 151 n.6 (3d Cir. 1993)

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How Can you improve the value of a Proof of Claim? Injunctive Obligations

- If this is a Chapter 7, with an Abandonment component, or a Chapter 11 where the surviving Debtor may not be able to continue its injunctive obligations, then a Protective Claim may be needed.
- A Protective Claim is often seen as informational and not an actual claim.
- A protective claim is often not subject to discharge.

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How Can you improve the value of a Proof of Claim?

- Financial Assurance
 - Did the debtor maintain financial assurance?
 - What is the amount?
 - Can the financial assurance be reached?
- If the Financial Assurance mechanism provided for payment (or work performed) by a 3rd party, such as a letter of credit or surety bond, it normally is not subject to the automatic stay,
 - but it may trigger an action in the bankruptcy proceeding by the 3rd party payor.
 - Due to this, an information notice may be helpful. (to the Court, the Debtor and the Payor.)
 - Confirm your ability to access the financial assurances.

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How Can you improve the value of a Proof of Claim?

- SETOFF –
 - Where a creditor also owes money to a debtor, a setoff may be appropriate.
 - Evidence of Government Contracts
<http://www.fedspending.org/>
 - Tax Refunds
 - Must act quickly.

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How Can you improve the value of a Proof of Claim?

- How are future costs valued?
 - How current is the cost estimate?
 - What is the Discount Rate?
 - Is inflation considered?
 - How many years will the work continue?
 - Are all environmental costs considered?
Especially if the plant is to be dismantled!
 - DOJ has used the Brattle Group and Axlor Consulting LLC to estimate the claim.
- Can others assist you when calculating costs?
 - NAAG, Bankruptcy Workgroup, other Responsible Parties

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Can assumptions make a difference?

Impact of Interest and years

Annual Payment	Discount Rate	Number of Years	Total Payments	Amount of Claim
\$10,000	7%	25	\$250,000	\$116,000
\$10,000	3%	25	\$250,000	\$143,000
\$10,000	7%	100	\$1,000,000	\$143,000
\$10,000	3%	100	\$1,000,000	\$316,000

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How Can you improve the value of a Proof of Claim?

- Additional Concepts for future costs
 - How can you support your claim for future costs?
- Technical Staff (Inspector, Tanks Manager)
 - Are cost estimates based on a private sector 3rd party or your costs?
 - Are indirect cost included?
 - Is interest charged for costs up to the Petition date?

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Bankruptcy Summary

- Awareness of the bankruptcy laws is important.
- When possible, be prepared.
- Gather the docket information and get it to your attorney.
- Be aware of the automatic stay.
- Work as a team and reach out for help.
 - National Association of Attorney Generals (NAAG)
 - EPA Bankruptcy Team.

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