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# **Commercial: Hazard Ahead: The Thorny Interaction Between Environmental Law and Bankruptcy Law**

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Paisner LLP*

## **Eric S. Chafetz**

Lowenstein Sandler LLP | New York

## **John J. Cruciani**

Husch Blackwell LLP | Kansas City, Mo.

## **David W. Houston, IV**

Burr & Forman LLP | Nashville, Tenn.

## **Stacy J. Stotts**

Polsinelli | Kansas City, Mo.

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**HAZARD AHEAD: THE THORNY INTERACTION BETWEEN  
ENVIRONMENTAL LAW AND BANKRUPTCY LAW**



**Eric Chafetz**  
Lowenstein Sandler LLP | New York



**John J. Cruciani**  
Husch Blackwell LLP | Kansas City, Missouri



**David W. Houston, IV**  
Burr & Forman LLP | Nashville, Tennessee



**Stacy J. Stotts**  
Polsinelli | Kansas City, Missouri

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## An Overview of General Environmental Law Concepts

### Structure

- Federal Enactment of Laws/Regulations.
- Examples, Clean Air Act, Clean Water Act, Comprehensive Environmental Compensation and Liability Act (CERCLA) and many others.
- Delegation of implementation of federal environmental programs to state agencies upon submittal and approval of a State Implementation Plan to EPA. Local governments may also obtain delegated authority. The State/Local programs must be as stringent as the Federal Program and can be more stringent.

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### An Overview of General Environmental Law Concepts

#### Jurisdiction and Enforcement

- The EPA, and Delegated States and Local Governments have concurrent jurisdiction.
- These authorities can seek injunctive relief and/or penalties.
- Many environmental federal programs allow citizens to step into the shoes of EPA and can file a citizen suit against liable parties and re-coop attorney fees.
- There are different processes depending on the what party brings an action.

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### An Overview of General Environmental Law Concepts

#### Jurisdiction and Enforcement (continued)

- EPA can issue actions administratively or in civil court. These can include orders for injunctive relief and for penalties. Civil actions and some injunctive actions, involving contaminated sites will involve the DOJ.
- State actions also usually provide the agency the options to proceed through an administrative or civil proceeding and the same is true for local delegated authorities.
- Injunctive relief is specific to the situation and penalties are per violation/per day and vary from statute to statute. At present, some Clean Air Act violations for civil penalties are approximately 100K per day/per violation.

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## An Overview of General Environmental Law Concepts

### Jurisdiction and Enforcement *(continued)*

- Administrative actions are taken when the penalty assessments are less significant (350K or less) or in situations related to less significant remedial actions or those that involve fewer parties.
- Injunctive actions typically include orders to come into compliance with regulatory obligations or to investigate and remediate contaminated properties.
- The most used statute to issue an order to impose remedial actions is CERCLA.

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## An Overview of General Environmental Law Concepts

### CERCLA

- CERCLA imposes joint and several liability for those identified as responsible parties under the statute, which includes current owners and operators that have not caused contamination. CERCLA does not allow for an appeal of an order and if a party refuses to comply and EPA completes the remediation they can recover three times the cost incurred by EPA. There is also a private cost recovery provision in CERCLA.
- A typical remediation will include an investigation that may begin with what is called a Phase I, that it is a non-invasive investigation. If needed, invasive sampling will be conducted to determine the nature and extent of the contamination which is referred to as a Phase II.
- Next, a corrective action proposal will be submitted and remedy determination will be made.

## CERCLA Defenses

- **Innocent landowner defense**
  - Did not know and had no reason to know about contamination
  - Phase I assessment
  - Due care exercised after discovery
- **Bona fide prospective purchaser**
  - Phase I assessment—all appropriate inquiry
  - Due care exercised with known contamination
  - Cooperate with cleanup
- **Adjacent Landowner**
  - Phase I assessment
  - Due care
  - Access
- **Secured Lender**

## Secured Lender Defense

- A lender is not an owner or operator of a facility.
- Even if the lender holds a security interest, if that security interest is held primarily to protect the security interest of the lender in the facility, the lender is not considered an “owner” unless it participates in the management of the facility.
- Even after foreclosure, the lender is not an “owner” if it proceeds to sell the property at the earliest practicable, commercially reasonable time, on commercially reasonable terms, taking into account market conditions and legal and regulatory requirements.



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## What is a Phase I?

- Phase I is the beginning of a process designed to cost effectively determine the probability of contamination
- Phase I is not designed to find all contamination
- Phase I is a commercially reasonable evaluation
- Phase I does not find contamination (unless it was found already)
  - Determines conditions that are favorable for contamination
  - Focuses subsequent sampling for location and analytes
- Only a Phase II detects contamination

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## What is a Phase II?

- Targeted sampling guided by the Phase I results
- Generally, will only detect presence of absence of contaminants
- Magnitude and extent is typically done separately
- Generally not thorough enough to estimate costs



## An Overview of General Environmental Law Concepts

### Bankruptcy

- Respondents that file for bankruptcy protection may file for a stay of certain of the proceedings discussed above that are allowed under the Bankruptcy Laws as discussed in more detail below.
- EPA and other petitioners will leverage the monetary costs of those claims as much as possible; for example, they will seek the maximum fines and number of days of violation for any penalty action. Private parties will do the same. Remedial costs will also be maximized.



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## Environmental Liabilities: Dischargeable in Bankruptcy?

- Must constitute a “claim” under the Bankruptcy Code
- Must have arisen pre-petition or prior to confirmation of a plan
- The Creditor must have had sufficient notice of the bankruptcy case and the debtor’s liability

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## Environmental Liabilities: Do They Constitute a Claim Under the Bankruptcy Code?

- Does the Liability create a right to payment? If yes, then it’s a Claim
- Does the Liability create an equitable remedy for breach of performance that gives rise to a right of payment? If yes, then it’s a Claim
- Does the Liability result in an Injunction or Order to Abate Pollution? If Yes, in most cases will not constitute a “claim” in bankruptcy subject to discharge

*Ohio v. Kovacs*, 490 U.S. 274 (1985); *U.S. v. LTV Corp (In re Chateaugay)*, 944 F.2d 997 (2d.Cir 1991)

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### Environmental Liabilities: When do They Arise for Purposes of a Bankruptcy Claims Analysis?

- “Pre-Petition Relationship Test”  
*In re Chateaugay, supra*
- “Fair Contemplation Test”  
*In re National Gypsum*, 139 B.R. 397 (N.D. Tex. 1992)

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### Environmental Liabilities: Prepetition Relationship Test

- Arose before the filing of the petition or resulted from pre-petition conduct fairly giving rise the claim, and
- There is some minimum contact or relationship between the debtor and claimant such that the claimant is identifiable

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### Environmental Liabilities: Fair Contemplation Test

- Claim arises when a claimant can fairly or reasonably contemplate the claim's existence even if a cause of action has not yet accrued under nonbankruptcy law
- Narrower than Pre-Petition Relationship
- Factors include knowledge by the parties of a site in which a PRP (Potentially Responsible Party) might be liable, listing the site on the National Priorities List, notification by the EPA of PRP liability, commencement of an investigation and cleanup activities, and incurrence of response costs

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### Environmental Liabilities: Entitled to Administrative Expense Priority ?

- Yes, if the liabilities arise post-petition and are the actual, necessary costs and expenses of preserving the estate
- Costs to bring property of the estate into compliance with environmental laws benefit the estate and may be entitled to administrative-expense priority
- If no known threat of damage to the environment or public, or no governmental order to take remedial action, may not be entitled to administrative-expense priority  
*In re Mahoney-Troast Constr. Co.*, 189 B.R. 57 (Bankr. D.N.J. 1995)

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## Certain Environmental Claim Issues

- Monetary claims related to pre-petition releases, including natural resources damages, are generally dischargeable in bankruptcy. *See generally Ohio v. Kovacs*, 469 U.S. 274 (1985); *In re Nat. Gypsum Co.*, 139 B.R. 397 (Bankr. N.D. Tex. 1992).
- This includes claims brought by the government. *See, e.g., Ohio v. Kovacs*, 469 U.S. at 283-85; *Peabody Energy Corporation*, 958 F.3d at 724; *In re Chateaugay Corp.*, 944 F.2d 997, 1008 (2d Cir. 1991); *In re G-I Holdings Inc.*, 654 Fed. Appx. at 572; *In re Jimmo*, 204 B.R. 655, 660 (Bankr. D. Conn. 1997).
- This also includes claims brought by private parties. *See, e.g., In re Chemtura Corp.*, 439 B.R. 561, 570 (Bankr. S.D.N.Y. 2010); *In re Texaco Inc.*, 182 B.R. 937, 953-54 (Bankr. S.D.N.Y. 1995).

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## Environmental Abandonment Issues In Bankruptcy

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## The Interaction Between the Bankruptcy Code's Abandonment Requirements and Environmental Law

### The Statutory Framework

- Section 554 of the Bankruptcy Code states in relevant part: "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 and benefit to the estate.*" 11 U.S.C. § 554(a) (emphasis added).
- Debtors-in-possession and trustees have the same rights, and must satisfy the same requirements, to abandon property of their estates. See 11 U.S.C. § 1107(a) ("a debtor in possession shall have all the rights... and powers, and shall perform all the functions and duties... of a trustee serving in a case under this chapter"); see also *S. Chi. Disposal, Inc. v. LTV Steel Co. (In re Chateaugay Corp.)*, 130 B.R. 162, 166 (S.D.N.Y. 1991) (permitting a debtor-in-possession to abandon property under section 554(a) of the Bankruptcy Code).

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## The Interaction Between the Bankruptcy Code's Abandonment Requirements and Environmental Law

### The General Standard

- The party seeking to abandon property is given significant discretion in determining whether to abandon such property, "and the Court will generally defer to the Trustee's [or debtor-in-possession's] judgment in determining whether to abandon a property." *In re Syntax-Brilliant Corp.*, Case No. 08-11407 (KJC), 2018 WL 3491758, at \*15 (Bankr. D. Del. July 18, 2018) (citations omitted).
- To approve abandonment, the Court "only needs to find the [debtor] made: (1) a business judgment; (2) in good faith; (3) upon some reasonable basis; and (4) within the [debtor's] scope of authority." *Id.* (quoting *In re Slack*, 290 B.R. 282, 284 (Bankr. D.N.J. 2003)).
- "The party opposing abandonment must show some likely benefit to the estate, not mere speculation about possible scenarios in which there might be a benefit to the estate." *Id.*; *In re Truong*, 557 B.R. 326, 340 (Bankr. D.N.J. 2016) (same).

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## The Interaction Between the Bankruptcy Code's Abandonment Requirements and Environmental Law

### The Supreme Court's *Midlantic* Decision

- The Supreme Court of the United States has recognized a limit on a debtor's or trustee's right to abandon property where doing so would cause ***an imminent threat to the public health or safety***. See *Midlantic Nat'l Bank v. N.J. Dep't of Env't Prot.*, 474 U.S. 494, 502, 506-07 (1986) (determining that the Bankruptcy Code does not permit a party to abandon property in contravention of certain state or local laws designed to protect the public health or safety).
- According to the Supreme Court in *Midlantic*, 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." *Id.* at 507.

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## The Interaction Between the Bankruptcy Code's Abandonment Requirements and Environmental Law

### The Supreme Court's *Midlantic* Decision (cont'd)

- Despite this limitation, the Supreme Court clarified that this exception to the abandonment power is limited:

This exception to the abandonment power vested in the [debtor] 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***.  
*Id.* at 507 fn 9. (emphasis added)



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## The Interaction Between the Bankruptcy Code's Abandonment Requirements and Environmental Law

### The Supreme Court's *Midlantic* Decision (cont'd)

- Courts have reached conflicting rulings concerning whether this exception is broad, narrow, or somewhere in between.
- According to one court in Delaware, the vast "majority of courts," including those in the Third Circuit and the District of Delaware, "have read the exception to abandonment narrowly by disallowing abandonment only where there is [both (i)] an imminent and identifiable harm to the public health or safety" and (ii) where the debtor is "attempting to abandon property in contravention of state or local laws or regulations designed to protect the public" *In re Unidigital, Inc.*, 262 B.R. 283, 286-87 (Bankr. D. Del. 2001).

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## The Interaction Between the Bankruptcy Code's Abandonment Requirements and Environmental Law

### The Supreme Court's *Midlantic* Decision (cont'd)

- Numerous other courts have reached the same conclusion as the Delaware Bankruptcy Court in the *Unidigital* case.
- *In re Exide Holdings, Inc.*, 2021 WL 3145612, at \*8 (D. Del. July 26, 2021) ("Courts disallow abandonment only where both (i) the abandonment itself poses 'an imminent and identifiable harm to the public health or safety' and (ii) the debtor is 'attempting to abandon property in contravention of state or local laws or regulations designed to protect the public'") (quoting *In re Unidigital*, 262 B.R. at 286-87 (Bankr. D. Del. 2001)) – This decision will be discussed in more detail in the next section.
- *City of Beverly Hills v. Venoco, LLC (In re Venoco, LLC)*, 572 B.R. 105, 114 (Bankr. D. Del. 2017) (no likelihood of success on the merits for plaintiff opposing abandonment at preliminary injunction stage where abandonment is likely permissible because "the Site is in good order" and "[t]here is no imminent and identifiable harm present").
- *In re St. Lawrence Corp.*, 239 B.R. 720, 724 (Bankr. D.N.J. 1999) ("Following *Midlantic*, abandonment of contaminated real property is permitted unless there is a showing of imminent and identifiable harm.") (citations omitted).

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## The Interaction Between the Bankruptcy Code's Abandonment Requirements and Environmental Law

### The Supreme Court's *Midlantic* Decision (cont'd)

- Numerous other courts have reached the same conclusion as the Delaware Bankruptcy Court in the *Unidigital* case (cont'd).
- *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 regulations designed to protect public health or safety will be violated as a consequence.").
- *In re Pilz Compact Disc, Inc.*, 229 B.R. 630, 641 (Bankr. E.D. Pa. 1999) ("[I]t would be inaccurate to conclude that a trustee may never abandon property which does not comply with various state environmental regulations. If there is no evidence of danger of immediate harm, the property may be abandoned....").

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## The Interaction Between the Bankruptcy Code's Abandonment Requirements and Environmental Law

### The Supreme Court's *Midlantic* Decision (cont'd)

- Numerous other courts have reached the same conclusion as the Delaware Bankruptcy Court in the *Unidigital* case (cont'd).
- *N.M. Env't Dep't v. Foulston (In re L.F. Jennings Oil Co.)*, 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 Bus. Credit (In re Smith-Douglass, Inc.)*, 856 F.2d 12, 16 (4th Cir. 1988) ("[W]here the public health or safety is threatened with imminent and identifiable harm, abandonment of the contaminated property must be conditioned on the performance of procedures that will adequately protect public health and safety.").

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## The Interaction Between the Bankruptcy Code's Abandonment Requirements and Environmental Law

### The Supreme Court's *Midlantic* Decision (cont'd)

- Numerous other courts have reached the same conclusion as the Delaware Bankruptcy Court in the *Unidigital* case (cont'd)
- *In re Oklahoma Refining Co.*, 63 B.R. 562, 565 (Bankr. W.D. Okla. 1986) (allowing abandonment where it "will not aggravate the existing situation, create a genuine emergency nor increase the likelihood of disaster or intensification of polluting agents").

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## The Interaction Between the Bankruptcy Code's Abandonment Requirements and Environmental Law

### The Supreme Court's *Midlantic* Decision (cont'd)

- A minority of courts have taken a broader, or much broader, approach in interpreting the limits on a debtor's right to abandon property arising from the Supreme Court's decision in *Midlantic*.
- *In re Wall Tube & Metal Prods. Co.*, 831 F.2d 118, 122 (6th Cir. 1987) (disallowing abandonment where a continuing violation of state environmental laws would occur; without regard for the existence of an imminent and identifiable harm to public health and safety).
- *In re Franklin Signal Corp.*, 65 B.R. 268, 272 (Bankr. D. Minn. 1986) (applying a balancing test and requiring the consideration of: "(1) the imminence of danger to the public health and safety; (2) the extent of probable harm, (3) the amount and type of hazardous waste, (4) the cost to bring the property into compliance with environmental laws, and (5) the amount and type of funds available for cleanup.").

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## The Interaction Between the Bankruptcy Code's Abandonment Requirements and Environmental Law

### The Supreme Court's *Midlantic* Decision (cont'd)

- A minority of courts have taken a broader, or much broader, approach in interpreting the limits on a debtor's right to abandon property arising from the Supreme Court's decision in *Midlantic*.
- *In re Am. Coastal Energy Inc.*, 399 B.R. 805, 813 (Bankr. S.D. Tex. 2009) ("The Court reads the Supreme Court's *Midlantic* opinion to require the Court to determine whether the debtor is violating a statute 'reasonably designed to protect the public health or safety from identified hazards,' not the extent to which particular conduct imposes actual and imminent threats").
- *In re Microfab, Inc.*, 105 B.R. 161, 169 (Bankr. D. Mass. 1989) ("This Court concludes that *Midlantic* requires full compliance with state environmental laws").
- *In re Peerless Plating Co.*, 70 B.R. 943, 946-47 (Bankr. W.D. Mich. 1987) (holding that a property cannot be abandoned without full compliance with all applicable environmental law unless: (1) the environmental law in question is so onerous as to interfere with the bankruptcy adjudication itself; (2) the environmental law in question is not reasonably designed to protect the public health or safety from identified hazards; or (3) the violation caused by abandonment would merely be speculative or indeterminate).

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## The Interaction Between the Bankruptcy Code's Abandonment Requirements and Environmental Law

### The Supreme Court's *Midlantic* Decision (cont'd)

- Debtors often argue that the application of *Midlantic* renders any focus on **future risks** of imminent threats to public health and safety at a given site as completely irrelevant, as the courts do not focus on the state of the relevant property at the time of abandonment, but rather on whether abandonment itself will in any way aggravate an imminent threat of harm to public health or safety.
- *See N. Am. Prods.*, 137 B.R. 8, 12 (D.N.J. 1992) ("[I]f the bankruptcy court finds that abandonment will not aggravate the threat of harm to the health and safety of the public or create some additional harm[,] abandonment should be permitted").
- *See also In re Anthony Ferrante & Sons, Inc.*, 119 B.R. 45, 50 (D.N.J. 1990) (authorizing abandonment where it "would not aggravate any danger to the public").

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## The Interaction Between the Bankruptcy Code's Abandonment Requirements and Environmental Law

### The Supreme Court's *Midlantic* Decision (cont'd)

- Concerns about who will pay for remediation are also arguably irrelevant to the *Midlantic* imminent harm standard. See *N. Am. Prods*, 137 B.R. at 12 (recognizing that “the State was concerned primarily with the public fisc, and not the public welfare” and finding that “[t]here is no indication on the record that abandonment will aggravate the situation.”).
- See, e.g., *Guterl Special Steel*, 316 B.R. at 858-59 (permitting abandonment of site containing radioactive uranium after the case was pending for 22 years and “unlike fine wine, they have not improved with age” and holding that “[i]f there is no imminent threat to public [health] or safety, abandonment pursuant to § 554(a) may be permitted even though state laws or regulations designed to protect public health or safety will be violated as a consequence”).

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## The Interaction Between the Bankruptcy Code's Abandonment Requirements and Environmental Law

### The Supreme Court's *Midlantic* Decision (cont'd)

- See *In re McCrory Corp.*, 188 B.R. 763, 769 (Bankr. S.D.N.Y. 1995) (finding, among other factors, that because “the state agency never attempted to expedite the clean-up” and “[i]f any required clean-up could be deferred,” then such environmental liabilities were “hardly the type of ‘imminent’ harm to public health or safety that was envisioned by the Supreme Court when it restricted the trustee’s power to abandon burdensome estate property”).

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## The Interaction Between the Bankruptcy Code's Abandonment Requirements and Environmental Law

### Exide Holdings Inc., et al. - Case Study

- Exide Holding Inc. and various affiliates filed for Chapter 11 bankruptcy protection in Delaware on May 19, 2020 (Chapter 33 - Third Case since 2002).
- The prior two cases were reorganizations, while this case from the outset was a section 363 sale case.
- From the beginning of the case, the Debtors sought to either sell or abandon their Vernon, California facility (the "Vernon Facility"), along with several other non-performing/shuttered facilities. The environmental issues associated with the Vernon Facility were also the main driver of the Debtors' prior bankruptcy case in 2013.
- Several other states aside from California eventually agreed to abandonment of other non-performing properties through a global settlement embodied in a plan of liquidation, but California did not sign on until after plan confirmation.

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## The Interaction Between the Bankruptcy Code's Abandonment Requirements and Environmental Law

### Exide Holdings Inc., et al. - Case Study (cont'd)

- The Debtors purchased the Vernon Facility in September 2000 and conducted lead battery recycling operations at the facility.
- The Debtors were regulated by, among other regulators, the California Department of Toxic Substances and Controls (the "DTSC").
- After Exide purchased the Vernon Facility, the facility was operating under "interim status" while waiting for the DTSC's review and final determination of approval under the Resource Conservation and Recovery Act ("RCRA"), a federal statute concerning the treatment of hazardous waste from "the cradle to the grave," in which the Environmental Protection Agency delegated authority to the states.
- Also, during the relevant time period, Exide was implementing corrective action activities under a 2002 Corrective Action Consent Order with the DTSC, which allowed the DTSC to access the Vernon Property and conduct any work "it deems necessary to protect human health or environment"



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## The Interaction Between the Bankruptcy Code's Abandonment Requirements and Environmental Law

### Exide Holdings Inc., et al. - Case Study (cont'd)

- Exide ceased recycling operations at the Vernon Facility in March 2014 during the second bankruptcy case as they could not reach consensus with the DTSC and other regulators about continuing operations.
- In March 2015, Exide entered into a non-prosecution agreement with the U.S. Department of Justice and the DTSC in which Exide agreed to withdraw its RCRA permit application and permanently close the Vernon Facility through implementation of a DTSC approved closure plan.
- On December 8, 2016, the DTSC approved Exide's final closure plan which proposed a phased approach for decontamination, deconstruction, and disposal of hazardous waste management and equipment structures at the Vernon Facility.
- As part of this agreement, Exide had to provide approximately \$26 million of financial assurance mechanisms including a surety bond in the amount of approximately \$11.2 million and a trust fund in the amount of approximately \$15.3 million. These funds would not be available to any party until the Vernon Facility was no longer property of the estates.

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## The Interaction Between the Bankruptcy Code's Abandonment Requirements and Environmental Law

### Exide Holdings Inc., et al. - Case Study (cont'd)

- Throughout the closure process, the DTSC had retained third party consultants that operated on site and conducted regular inspections.
- On March 21 2020, due to COVID-19, Exide wrote a letter to the DTSC advising that Exide was suspending many closure activities due to a *force majeure* event caused by the pandemic.
- The DTSC responded to Exide's letter approximately a month later on April 20, 2020 and disputed Exide's *force majeure* declaration and Exide's interpretation of California's stay at home orders.
- Exide responded to the DTSC's letter on April 22, 2020 reiterating its position on the existence of a *force majeure* event and view on the stay at home orders.
- On July 3, 2020, over two months after Exide's letter, the DTSC responded to Exide's letter, again refuting Exide's view on whether there was a *force majeure* event and its view on California's stay at home orders.
- In the letter, among other things, the DTSC described "a substantial amount of unsecured lead-contaminated dust outside of the [Full Enclosure Tent] ("FEU")" and how work to be completed on the tent to address multiple tears was "time-critical work". These issues were memorialized in a corresponding Interim Measures Order issued by the DTSC.

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## The Interaction Between the Bankruptcy Code's Abandonment Requirements and Environmental Law

### Exide Holdings Inc. et al. - Case Study (cont'd)

- On July 8, 2020, Exide, this time through counsel, responded to the DTSC's letter; again raising issues with the DTSC's interpretation of the stay-at-home orders and Exide's *force majeure* declaration, and refuting how the work associated with the FEU tent was "time critical" as the FEU tent had recently been "repaired and solidified", there were no ambient air samples with any elevated levels of lead or arsenic, even before the tent repairs, and the only dust samples collected (in November 2019) were not identified by the DTSC until almost 8 months after the samples were taken.
- Exide did not hear from the DTSC after the July 8, 2020 correspondence despite the "time critical work".
- Notwithstanding, Exide continued the same reduced set of tasks described in its letters through the filing of its motion to abandon the Vernon Facility on October 13, 2020 (the "Abandonment Motion"), in which it focused on "preventing lead or other contaminants from escaping the property, rather than abatement"
- During this same time period, the DTSC continued visiting the Vernon Facility on a weekly basis and had not: (i) initiated any additional enforcement action, and/or (ii) communicated to on-site staff any requests or orders that any additional actions be taken with respect to the dust referenced in the aforementioned Interim Measures Order.

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## The Interaction Between the Bankruptcy Code's Abandonment Requirements and Environmental Law

### Exide Holdings Inc. et al. - Case Study (cont'd)

- Upon filing for Chapter 11 protection, the Debtors sought to sell the Vernon Facility along with their other non-performing properties, but for a variety of reasons the Debtors could not find a suitable buyer for the Vernon Facility, as all potential buyers required the environmental liabilities to be resolved or the property remediated.
- With respect to the Vernon Facility, the Debtors had spent more than \$75 million implementing the plan and complying with the various DTSC requirements, and at the time of the filing of the motion were still spending \$750,000 a month.
- According to the Debtors, up until the filing of the Abandonment Motion, the Vernon Facility was "still fenced, secured, and daily ambient air testing and sampling ha[d] consistently demonstrated that there are no uncontrolled releases of hazardous material or unsecured or exposed waste materials on site."
- The Debtors also had "retained and continue[d] to pay multiple environmental consulting firms, contractors, and employees to, among other tasks, conduct daily inspections and maintain the baghouses, the storm water collection system, a surface impoundment pond, and a wastewater treatment plant, as well as to collect and analyze daily perimeter ambient air samples for lead and arsenic"
- Moreover, the DTSC had continued its weekly inspections far more actively.

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## The Interaction Between the Bankruptcy Code's Abandonment Requirements and Environmental Law

### Exide Holdings Inc., et al. - Case Study (cont'd)

- In addition, the consultants and contractors performing closure operations at the Vernon Facility at the time of the filing of the Abandonment Motion were likely both willing and available to continue their respective work streams if the DTSC decided to assume the Debtors' contracts or otherwise negotiate new agreements. The DTSC had started conversations with these parties prior to backing out of the global settlement.
- According to the Debtors, even if there was a delay in transitioning from the Debtors to DTSC oversight post-abandonment, the site was expected to remain stable and secured even if there were no on-site activities for several weeks.

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## The Interaction Between the Bankruptcy Code's Abandonment Requirements and Environmental Law

### Exide Holdings Inc., et al. - Case Study (cont'd)

- After preliminarily agreeing to the aforementioned global settlement, the DTSC reneged and objected to confirmation of the Debtors' plan of liquidation on October 7, 2020.
- The Debtors' liquidating plan was confirmed on October 16, 2020 and became effective on October 26, 2020.
- On October 19, 2020, the DTSC sought a stay of entry of the confirmation order pending appeal, which was denied by the Delaware District Court on October 22, 2020.
- On October 18, 2020, the DTSC filed a notice of appeal of the confirmation order. That appeal was eventually denied by the Delaware District Court on July 26, 2021.
- On or around October 23, 2020, while the appeal was still pending, the DTSC agreed to take control over the Vernon Facility by executing an environmental trust agreement and also agreed to a transition period offered by the Debtors during the stay/appeal process to allow for control of the Vernon Facility to be transferred to the DTSC in an orderly fashion.

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## Environmental Automatic Stay Issues In Bankruptcy

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### The Interaction Between the Bankruptcy Code's Automatic Stay and Environmental Law

#### The Automatic Stay – Section 362 of the Bankruptcy Code

(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, 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 action or 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 or to exercise control over property of the estate;

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



The Interaction Between the Bankruptcy Code's Automatic Stay and Environmental Law

The Automatic Stay – Section 362 of the Bankruptcy Code (cont'd)

(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, operates as a stay, applicable to all entities, of—

\* \* \*

(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 a tax liability of a debtor that is a corporation for a taxable period the bankruptcy court may determine or concerning the tax liability of a debtor who is an individual for a taxable period ending before the date of the order for relief under this title.



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The Automatic Stay – Section 362 of the Bankruptcy Code (cont'd)

(b) The filing of a petition under section 301, 302, or 303 of this title, or of an application under section 5(a)(3) of the Securities Investor Protection Act of 1970, does not operate as a stay—

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(3) under subsection (a) of this section, of *any act to perfect, or to maintain or continue the perfection of, an interest in property to the extent that the trustee's rights and powers are subject to such perfection under section 546(b) of this title or to the extent that such act is accomplished within the period provided under section 547(e)(2)(A) of this title*

(4) under paragraph (1), (2), (3), or (6) of subsection (a) of this section, of the commencement or continuation of an action or proceeding by a governmental unit... *to enforce such governmental unit's or organization's police and regulatory power; including the enforcement of a judgment other than a money judgment, obtained in an action or proceeding by the governmental unit to enforce such governmental unit's or organization's police or regulatory power;*

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## The Interaction Between the Bankruptcy Code's Automatic Stay and Environmental Law

### The Automatic Stay – Section 362 of the Bankruptcy Code (cont'd)

- A Chapter 11 debtor must comply with environmental laws prior to the filing of a plan of reorganization, and afterwards, if it remains in possession. See *Ohio v. Kovacs*, 469 U.S. 274, 285 (1985); *In re CMC Heartland Partners*, 966 F.2d 1143, 1146 (7th Cir. 1992); *In re Industrial Salvage, Inc.*, 196 B.R. 784, 790 (Bankr. S.D. Ill. 1996).
- The application of the police and regulatory power exception to the automatic stay (section 362(b)(4)) is very fact-specific and analyzed on a case-by-case basis. *In re Goodwin*, 163 B.R. 825 (Bankr. D. Idaho 1993) (Idaho Department of Health and Welfare's suit seeking injunction stayed as a pre-petition claim because under the applicable statute, the state could have sought money damages instead); *City of New York v. Exxon Corp.*, 932 F.2d 1020 (2d Cir. 1991) (New York City's suit for Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA") recovery, which sought reimbursement of waste removal costs, natural resource damages, and a declaratory judgment that debtor was liable for future costs, was not stayed).

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## The Interaction Between the Bankruptcy Code's Automatic Stay and Environmental Law

### The Automatic Stay – Section 362 of the Bankruptcy Code (cont'd)

- Courts will generally apply one of two tests when making a determination whether the police and regulatory exception applies. See *In re Dingley*, 852 F.3d 1143, 1146 (9th Cir. 2017); *In re Commerce Oil Co.*, 847 F.2d 291, 295 (6th Cir. 1988).
- (i) The pecuniary purpose test - A reviewing court focuses on whether the proceeding relates primarily to the government's pecuniary interest or to matters of public safety, with matters of public safety falling within the exception to the automatic stay.
- (ii) The public policy test - A court excepts proceedings effectuating public policy from the stay, whereas those adjudicating private rights (for example, a government agency's suit to recover from a contractor who failed to deliver goods) will be stayed.



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## The Interaction Between the Bankruptcy Code's Automatic Stay and Environmental Law

### The Automatic Stay – Section 362 of the Bankruptcy Code (cont'd)

- The automatic stay will not generally be effective against proceedings to fix penalty amounts, natural resource damage amounts or involving the share of costs to be allocated to a Potentially Responsible Party ("PRP") under CERCLA. *See U.S. v. Jones & Laughlin Steel Corp.*, 804 F.2d 348 (6th Cir. 1986) (judicial proceeding to fix the amounts debtor owed to various government entities not stayed, as resolution represented a regulatory action and would not affect the assets available to other creditors). *See also City of New York v. Exxon Corp.*, 932 F.2d 1020 (2d Cir. 1991); *U.S. v. Nicolet, Inc.*, 857 F.2d 202 (3d Cir. 1988); *In re Commerce Oil Co.*, 847 F.2d 291 (6th Cir. 1988); *U.S. v. Sugarhouse Realty*, 162 B.R. 113 (E.D. Pa. 1993); *U.S. v. Alsol Corp.*, 2014 WL 46775 (D.N.J. Jan. 2, 2014).

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## The Interaction Between the Bankruptcy Code's Automatic Stay and Environmental Law

### The Automatic Stay – Section 362 of the Bankruptcy Code (cont'd)

- The automatic stay will, however, be effective against the enforcement of monetary judgments, even if such enforcement is in furtherance of the government's regulatory powers, because otherwise, the government would receive unfair treatment compared with other creditors. *See U.S. v. Nicolet, Inc.*, 857 F.2d 202 (3d Cir. 1988); *In re Commonwealth Oil Refining*, 805 F.2d at 1183; *Penn Terra Ltd. v. Dep't of Env'tl. Res.*, 733 F.2d 267, 272 (3d Cir. 1984); *Sugarhouse Realty*, 162 B.R. at 117.

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## The Interaction Between the Bankruptcy Code's Automatic Stay and Environmental Law

### The Automatic Stay – Section 362 of the Bankruptcy Code (cont'd)

- Courts are sometimes skeptical of attempts by government agencies to collect a monetary claim arising from a pre-petition act of the debtor by characterizing the claim as a regulatory action to address ongoing pollution. *See, e.g., In re Peabody Energy Corp.*, 958 F.3d 717 (8th Cir. 2020) (state statutory and common law tort claims discharged in bankruptcy as claims to recover money, not claims brought under the police or regulatory power of the state); *In re G-I Holdings Inc.*, 654 Fed. Appx. 571, 574 (3d Cir. 2016) (New York City Housing Authority's claims seeking asbestos removal discharged in bankruptcy as a monetary claim for property damage, not a regulatory action to abate ongoing pollution).

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## The Interaction Between the Bankruptcy Code's Automatic Stay and Environmental Law

### The Automatic Stay – Section 362 of the Bankruptcy Code (cont'd)

- The exception to the automatic stay under section 362(b)(3) of the Bankruptcy Code in the context of environmental superlien statutes was applied in *In re 229 Main Street Limited Partnership*, 262 F.3d 1 (1st Cir. 2001).
- Under the Bankruptcy Code, a debtor's power to avoid certain statutory liens is "subject to any generally applicable law that permits perfection of an interest in property to be effective against an entity that acquires rights in such property before the date of perfection." 11 U.S.C. §546(b) (1)(A).
- In *In re 229 Main Street*, the court outlined three elements necessary for a creditor to be able to "reach the haven contemplated by § 546(b)(1)(A) -- (1) the creditor must act pursuant to a law of general applicability; (2) that law must allow the creditor to perfect an interest in property; and (3) such perfection must be effective against previously acquired rights in the property." *229 Main Street*, 262 F.3d at 10.

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## The Interaction Between the Bankruptcy Code's Automatic Stay and Environmental Law

### The Automatic Stay – Section 362 of the Bankruptcy Code (cont'd)

- The debtor in *229 Main Street* conceded to the first element but, argued that the other two elements were not present.
- The court rejected the debtor's suggestion that "a state statute must explicitly provide that perfection relate back to a pre-petition date in order to fit within the safe harbor contemplated by §546(b)(1)(A)." *Id*
- The court found no support for the debtor's argument in the plain language of the statute, the legislative history, or case law. The court held that the:  
  
environmental superlien statute permits the perfection of an interest in property by recording, registering or filing that interest. Such perfection plainly is effective against entities which already had acquired rights in the property [like Massachusetts in this case]. These credentials satisfy §546(b)(1)(A)'s third criterion...and therefore, the environmental superlien statute meets all the eligibility requirements for inclusion within §546(b)(1)(A).  
  
*Id* at 12 (citations omitted).

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## The Interaction Between the Bankruptcy Code's Automatic Stay and Environmental Law

### The Automatic Stay – Section 362 of the Bankruptcy Code (cont'd)

- The court's view that "interest in property" is broader than just a "lien" arguably expands the reach of 11 U.S.C. § 362(b)(3).
- Massachusetts's expenditure of funds, notice of its intent to record the lien, and its pursuit of the lien through pre-petition administrative actions were sufficient for the court to rule that the Commonwealth had an "interest in property."
- In other words, more formal action by Massachusetts was not required like oftentimes in the context of materialman, mechanics and oil and gas liens.

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## Environmental Sale Issues In Bankruptcy

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### Environmental Liabilities: Free and Clear of Successor Liability in Section 363 Bankruptcy Sales?

- Due to CERCLA's definition of PRP (Potentially Responsible Party) to include current owners, successor liability is a major issue for bankruptcy sales
- Purchaser may be able to establish certain "landowner" defenses:
- Innocent landowner;
- Contiguous property owners who can demonstrate that they did not know, and had no reason to know, of the contamination prior to acquiring the property;
- *Bona Fide* prospective purchaser defense (most common in 363 sales)

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## Environmental Liabilities: Section 363 Bankruptcy Sales

- Ways the Debtor/Seller Can Maximize Value
  - Engage environmental consultant to prepare Phase 1s or Phase 2s
  - Secured Creditors may consent to the use of cash collateral for reports if it can be demonstrated that the cost to do so may generate a larger sales price.

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## Sale Issue: Simple APA Language

- Sale Without Warranties. Seller has provided Buyer certain information about the Tract and Assets prior to the sale, which information includes, but is not limited to the preliminary title report, a written Phase I and if recommended by \_\_\_\_\_, a written Phase II environmental assessment of the Tract, each prepared by \_\_\_\_\_, all of which Seller believes to be accurate and reliable. However, Seller does not warrant the accuracy or completeness of such information or reports, and Buyer acknowledges it has made its own assessment and evaluation of the Tract and Assets and that Buyer has determined that the present condition of the Tract and all Assets are acceptable to Buyer, and that Buyer has made its own determination as to the suitability of the Tract and Assets for Buyer's intended use. Buyer specifically agrees it is not relying upon any representations made by Seller including, but not limited to the Phase I and Phase II environmental assessments, relating to the condition of the Tract or Assets or the fitness or suitability of the Tract or any portion of the Assets for any use or purpose. Buyer understands and agrees that it is acquiring the Tract and Assets hereunder strictly in an "as is, where is" condition and location, without warranties of any kind or type, expressed or implied, either as to condition or as to fitness or suitability for any intended use or purpose, and that Seller's only warranties are warranties of title as otherwise herein provided.

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### Sale & Plan Issues – Remediation Trusts

- In situations with environmentally challenged properties, Debtors may propose to establish trusts (often referred to as remediation trusts) as a part of a Plan whereby the assets are transferred to the trust(s) and the trusts are funded with sufficient capitalization for the maintenance, remediation and/or disposition of the properties.
  - Debtors typically estimate and propose the appropriate funding amount
  - This amount can be challenged by the applicable environmental agency or other parties in interest
    - Ability to pay can factor into resolution of the funding amounts.
  - The Bankruptcy Court will typically determine the amount of the funding if the parties cannot agree

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### Sale & Plan Issues – Remediation Trusts

- Benefits of Remediation Trusts:
  - Results in transfer of environmentally challenged properties to Trusts to allow for the ongoing remediation and/or to ready the assets for sale.
  - Sets at confirmation a funding amount for remediation that constitutes sufficient capitalization by court order.
  - Allows the remainder of the Debtor's assets to be separately monetized or administered.
  - Provides a mechanism for the assets to be sold later in time.



# Faculty

**Eric S. Chafetz** is a partner in the Bankruptcy & Restructuring Department of Lowenstein Sandler LLP in New York and advises creditors' committees and individual trade creditors, debtors and plan/liquidating trustees involved in complex chapter 11 bankruptcies throughout the U.S. He advises clients across a wide range of industries on all aspects of the chapter 11 process, from pre-filing negotiation and preparation of first-day pleadings, including financing and sale documents, through the drafting and negotiation of plans of reorganization and all related ancillary documentation. Through his extensive work in two separate bankruptcies filed in 2013 and 2020, respectively, by lead-acid battery manufacturer Exide Holdings, Inc., *et al.* and Exide Technologies, LLC, Mr. Chafetz was instrumental in reaching settlements with the EPA and various state environmental agencies in both cases, which resulted in confirmed plans and successful exits from bankruptcy. His work also includes investigating and prosecuting actions against officers, directors and lenders, as well as in prosecuting and defending preference/fraudulent transfer actions. Mr. Chafetz is a frequent speaker on current bankruptcy and creditors' rights topics, including serving as a guest lecturer at the Columbia University School of Professional Studies, where he has lectured on such subjects as the intersection of bankruptcy and construction law. He participated in the ABI Commission on the Reform of Chapter 11's Avoidance Power Subcommittee's study of aspects of the Bankruptcy Code involving preferences, creditors' reclamation rights and creditors' rights under § 503(b)(9). He also is a prolific author, and he has published numerous articles addressing various cutting-edge issues in journals geared toward trade and other categories of creditors, including publications by the National Association of Credit Management, the Credit Research Foundation and the *New York Law Journal*. Active in the firm's *pro bono* efforts, Mr. Chafetz has represented several individuals who have filed for chapter 7 protection. He received his B.A. in 2000 from the University of Michigan and his J.D. *cum laude* in 2004 from Brooklyn Law School.

**John J. Cruciani, CPA** is a partner with the Kansas City, Mo., office of Husch Blackwell LLP, where he practices in the areas of bankruptcy, insolvency, creditors' rights and commercial litigation. He is the leader of its Insolvency & Commercial Bankruptcy team. He is licensed to practice in Kansas and Missouri, and he is Board Certified in Business and Consumer Bankruptcy Law by the American Board of Certification (ABC), also having previously served on its board of directors. Mr. Cruciani was a contributing author for the bankruptcy treatise *Small Business Bankruptcy Reorganization* (John Wiley & Sons Inc. 1994) and has published articles on bankruptcy matters for various publications. He has been a speaker for programs for the Midwestern Bankruptcy Institute and other organizations in the areas of bankruptcy and insolvency, and in 2018, he chaired the Midwestern Bankruptcy Institute's advisory board. Mr. Cruciani has been listed in *The Best Lawyers in America* for Bankruptcy and Creditor/Debtor Rights/Insolvency and Reorganization Law since 2009, and was named the 2014, 2018 and 2020 Lawyer of the Year in Kansas City for Bankruptcy and Creditor/Debtor Rights/Insolvency and Reorganization Law. In March 2019, he was inducted as a Fellow in the 30th class of the American College of Bankruptcy. Mr. Cruciani received his J.D. in 1994 from the University of Missouri-Kansas City School of Law.

**David W. Houston, IV** is a partner with Burr & Forman LLP's Creditors' Rights & Bankruptcy group in Nashville, Tenn. He focuses on commercial bankruptcy matters, including the representa-

tion of secured and unsecured creditors, committees, defendants in preference actions, corporate debtors, and parties involved in out-of-court restructurings and state and federal receiverships. He also represents trustees and numerous other constituencies in all aspects of chapter 11 bankruptcy cases. Mr. Houston has co-chaired ABI's Southeast Bankruptcy Workshop and its Professional Compensation & Ethics Committee, and he has served as vice co-chair of ABI's Civility Task Force. He has been recognized in *The Best Lawyers in America* as "Lawyer of the year" in Litigation – Bankruptcy in Nashville (2022), and in *Lawdragon 500 Leading U.S. Bankruptcy and Restructuring Lawyers* (2022). He also has been ranked in *Chambers USA* for Bankruptcy/Restructuring (2014-22) and in *Mid-South Super Lawyers* for Bankruptcy: Business (2016-22). Mr. Houston received his B.P.A. in criminal justice administration from the University of Mississippi and his J.D. in 2000 from the University of Mississippi School of Law.

**Stacy J. Stotts** is a shareholder with Polsinelli PC in Kansas City, Mo. She is a member of the firm's Environmental and Natural Resources group, and her practice centers on representing businesses, organizations and individuals in environmental regulatory and administrative matters, enforcement matters, private-party suits, compliance counseling, and corporate and property transactions. Ms. Stotts has represented clients in the areas of air, water, superfund and hazardous waste law. Her work also includes assisting clients in commenting on proposed agency rulemakings, and her expertise extends to advising clients on compliance and regulatory obligations in California, including Proposition 65 compliance and obtaining carbon credits. Ms. Stotts is a board member of the Midwest Chapter of the AWMA, a board member of the Midwest Chapter of the EBA, a board member of the Kansas City Young Audiences and a board member and president-elect of the Brookwood Education Foundation. She also is a member of the American Bar Association's Section on Energy and Environment, and has served on The Kansas City Metropolitan Bar Association's Environmental Committee and the Kansas City Chamber Air Quality Committee. Ms. Stotts has been listed in *The Best Lawyers in America* for Environmental Law from 2013-16 and 2018-23, ranked in *Chambers USA: America's Leading Lawyers for Business, Environment (Kansas City & Surrounds)* from 2009-present, and named to the "40 Under 40" class by *Ingram's Kansas City Business Magazine* in 2009. She received her B.A. in 1991 from the University of Kansas, her J.D. with honors in 1995 from Chicago-Kent College of Law, where she was a recipient of an Environmental Law certificate, and her LL.M. in environmental and natural resources law from Lewis & Clark Law School.