11 U.S.C. § 503(b)(1)(A)
Administrative Expense
Environmental Clean Up

United Soil Recycling, Inc., Case No. 03-39320-rld7

08/01/2006 RLD Unpub.

Debtor corporation was in the business of decontaminating soil owned by third parties that was contaminated by toxic waste. Debtor filed a chapter 11 petition, but three weeks later moved to convert to chapter 7.

Upon conversion, the chapter 7 trustee promptly moved to abandon contaminated soil located on premises the debtor had leased prepetition on Kodiak Island, Alaska. The lessor objected to the proposed abandonment. Following multiple status hearings and extensive negotiations between the parties regarding clean up of environmental hazards, the court authorized the abandonment.

Meanwhile, in the face of a demand from the State of Alaska, the lessor effectuated clean up of the contaminated soil left by the debtor on its premises. Lessor then filed a motion seeking payment of $112,004.16 incurred in evaluation and clean up costs, including personnel expenses and legal fees, as an administrative expense in the pending chapter 7 case. The trustee objected on the basis that the expenses resulted from a claim that arose prepetition and were therefore not entitled to administrative expense priority treatment.

The court held that under the controlling Ninth Circuit precedent as set forth in In re Dant & Russell, Inc., 853 F.2d 700 (9th Cir. 1988), in the absence of a benefit to the estate from the clean up expenditures the lessor had a general unsecured claim rather than a priority administrative expense claim under § 503(b)(1)(A). The court found that the clean up did not benefit the estate where the estate will have no subsequent use of the soil, having abandoned it.

U.S. BANKRUPTCY COURT
DISTRICT OF OREGON
FILED
August 01, 2006
Clerk, U.S. Bankruptcy Court

Below is an Order of the Court.

RANDALL L. DUNN
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF OREGON

In Re:	) Bankruptcy Case No. 03-39320-rld7
UNITED SOIL RECYCLING, INC.,	)
Debtor.	) MEMORANDUM OPINION

This contested matter came before me for hearing (the "Hearing") on June 29, 2006, on creditor Koniag, Incorporated's ("Koniag") Motion for Payment of Administrative Expenses under 11 U.S.C. § 503 (the "Motion"). The chapter 7 trustee ("Trustee") objected to the Motion, and by consent of the parties, I bifurcated issues so that the sole issue considered at the Hearing was whether Koniag's claim should be denied treatment as a priority administrative expense claim as a matter of law.

Following the Hearing, I have reviewed the parties' memoranda and other relevant documents from the docket, and I have considered applicable legal authorities, both as recommended to my attention by the parties and such as I have found through my own research. I have considered the parties' arguments carefully in light of that review.

Based upon my understanding of governing precedents from the Ninth Circuit and the Supreme Court, I will deny Koniag's Motion. I state the reasons for my decision as follows.

Background Information

This case originally was filed as a chapter 11 reorganization case by United Soil Recycling, Inc. ("United Soil Recycling") on August 18, 2003. See Docket No. 1. Prepetition, United Soil Recycling was engaged in the business of decontaminating soil owned by third parties that was contaminated by toxic waste. Apparently, the prospects for United Soil Recycling continuing in business were wishful thinking because only three weeks after the chapter 11 petition was filed, United Soil Recycling moved to convert its bankruptcy case to a liquidation in chapter 7. See Docket No. 18. The Motion to Convert was granted on September 10, 2003, and Michael A. Grassmueck, Inc. was appointed as the Trustee. See Docket No. 22.

Koniag leased land on Kodiak Island, Alaska (the "Kodiak Site") to United Soil Recycling prepetition. At the time that United Soil Recycling filed its bankruptcy petition, it had approximately 250 tons of untreated soil contaminated with benzene on the Kodiak Site. The Trustee filed a Notice of Intent to Abandon the contaminated soil at the Kodiak Site and contaminated soil at two other sites in Juneau, Alaska and Marion County, Oregon on October 15, 2003. See Docket No. 39. The Trustee stated the reasons for the proposed abandonment as follows:

> The debtor is no longer operating its business. Since the debtor is no longer operating its business, there is no benefit to the estate in retaining the soil. The cost of cleaning the contaminated soil would be burdensome to the estate. Id.

Objections to the Trustee's proposed abandonment of contaminated soil were filed by the State of Alaska, Marion County, Oregon, the State of Oregon, Channel Construction Inc., and Koniag. I held a series of preliminary hearings on the proposed abandonment on November 24, and December 23, 2003; March 30, June 23, and October 20, 2004; and January 19, and June 22, 2005. The multiple hearings resulted from the concerns of the parties and the court that adequate arrangements be made to clean up any environmental hazards, including potential ground water contamination, with respect to disposal of contaminated soil on the subject properties, in light of United Soil Recycling's having ceased operations. Fortunately, adequate environmental clean up measures were implemented with respect to all of the subject properties, including the Kodiak Site, and all objections to the Trustee's proposed abandonment ultimately were resolved. An Order Authorizing Abandonment of Property (the "Abandonment Order"), encompassing the approximately 250 tons of soil at the Kodiak Site, was entered on July 14, 2005. See Docket No. 195.

On January 10, 2005, the Alaska Department of Environmental Conservation demanded that Koniag clean up the contaminated soil left by United Soil Recycling at the Kodiak Site, pursuant to Alaska Statutes § 46.03.822. Koniag has spent a total of $112,004.16 in evaluation and clean up costs, personnel expenses and legal fees with respect to environmental clean up of the Kodiak Site that Koniag seeks to have treated as an administrative expense of the United Soil Recycling bankruptcy through the Motion. The Trustee objects on the basis that any such expenses result from a claim that arose prepetition and are not

entitled to administrative expense priority treatment.

Jurisdiction

This contested matter is within the core jurisdiction of this court pursuant to 28 U.S.C. §§ 1334, 157(a), 157(b)(1) and 157(b)(2)(A) and (B), and United States District Court for the District of Oregon Local Rule 2100.

Legal Discussion

Section 503(b)(1)(A)[1] provides in pertinent part that "[a]fter notice and a hearing, there shall be allowed administrative expenses...including--the actual, necessary costs and expenses of preserving the estate...."

The property of the estate concerned here is approximately 250 tons of soil at the Kodiak Site, that was contaminated on the date that United Soil Recycling filed its bankruptcy petition. It is not clear from the record whether United Soil Recycling conducted any operations postpetition at the Kodiak Site prior to the bankruptcy case converting to chapter 7. The record is clear that the Trustee did not continue United Soil Recycling's business operations after the conversion, and the Trustee noticed abandonment of the subject soil relatively quickly after appointment. Abandonment was approved by order of this court entered on July 14, 2005. So, the estate has not realized and will not realize any

[1] Unless indicated otherwise, all statute section and chapter references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330, prior to its amendment by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 ("BAPCPA"). United Soil Recycling's bankruptcy petition was filed in advance of the effective date for all relevant BAPCPA provisions.

economic benefit from the subject soil.

Accordingly, if I am to approve Koniag's administrative expense claim, such approval must be based on a finding that Koniag's expenditures benefitted the United Soil Recycling bankruptcy estate by preserving the estate from the attrition that would have resulted if the Trustee had been required to pay the environmental clean up costs for the Kodiak Site from estate assets other than the contaminated soil.

The leading case in the Ninth Circuit dealing with the issue before me is In re Dant & Russell, Inc., 853 F.2d 700 (9th Cir. 1988), a case that originated from this district. In Dant & Russell, the Ninth Circuit considered whether a lessor's claim for environmental clean up costs for property leased by the chapter 11 debtor-in-possession should be treated as a priority administrative expense claim, where the environmental contamination occurred prepetition. In interpreting Section 503(b)(1)(A), the Ninth Circuit noted,

> The statute is explicit. Any claim for administrative expenses and costs must be the actual and necessary costs of preserving the estate for the benefit of its creditors. [Citation omitted.] The terms "actual" and "necessary" are construed narrowly so as "to keep fees and administrative costs at a minimum." [Citations omitted.] An actual benefit must accrue to the estate. Id. at 706. [Emphasis added.]

In response to the lessor's argument that its claim should be treated as an administrative expense as a matter of public policy, the Ninth Circuit stated,

> ...Congress alone fixes priorities. [Citation omitted.] Courts are not free to formulate their own rules of super or sub-priorities within a specifically enumerated class. Id. at 709.

Accordingly, the lessor's claim for environmental clean up expenses in Dant & Russell was denied priority expense treatment. See also In re Allen Care Centers, Inc., 96 F.3d 1328 (9th Cir. 1996).

In Dant & Russell, the Ninth Circuit had the benefit of the Supreme Court's analysis of related issues in Ohio v. Kovacs, 469 U.S. 274 (1985), and Midlantic Nat'l Bank v. New Jersey Dep't of Environ. Protection, 474 U.S. 494 (1986). In Kovacs, the state of Ohio had obtained a prepetition injunction requiring the debtor to clean up a hazardous waste site. Postpetition, the state sought a determination that the debtor's obligation to clean up the site was not dischargeable in bankruptcy and further sought an injunction to prevent the trustee from pursuing recovery of assets of the debtor from the state court receiver who had been appointed prepetition to clean up the subject site. The Supreme Court characterized the obligation of the debtor under the prepetition injunction as having "been converted into an obligation to pay money." 469 U.S. at 283. Accordingly, the debtor's obligations to the state constituted a claim of the state subject to discharge in the debtor's bankruptcy. The Supreme Court does not state in Kovacs what kind of claim the state of Ohio had, priority administrative expense versus general nonpriority unsecured.

In her concurring opinion in Kovacs, Justice O'Connor addressed the state's concern that the Supreme Court's decision would hinder states' enforcement of their environmental laws.

> To say that Kovacs' obligation in these circumstances is a claim dischargeable in bankruptcy does not wholly excuse the obligation or leave the State without any recourse against Kovacs' assets to enforce the order. Because "Congress has generally left the determination

> of property rights in the assets of a bankrupt's estate to state law," *Butner v. United States*, 440 U.S. 48, 54, 99 S.Ct. 914, 918, 59 L. Ed.2d 136 (1979), the classification of Ohio's interest as either a lien on the property itself, a perfected security interest, or merely an unsecured claim depends on Ohio law. That classification--a question not before us--generally determines the priority of the State's claim to the assets of the estate relative to other creditors....Thus, a State may protect its interest in the enforcement of its environmental laws by giving cleanup judgments the status of statutory liens or secured claims. Id. at 285-86.

In Midlantic, the Supreme Court held that a trustee could not abandon environmentally contaminated real property in contravention of state laws or regulations reasonably designed to protect the public's health and safety and further held that bankruptcy courts do not have the authority to approve an abandonment "without formulating conditions that will adequately protect the public's health and safety." 474 U.S. at 507. However, the Supreme Court in Midlantic expressly reserved the question as to whether a third party's environmental clean up expenses are entitled to treatment as administrative expenses of the bankruptcy. Id. at 498 n.2.

Since Dant & Russell was decided, the issue of potential administrative expense treatment for environmental clean up costs has been revisited by the Ninth Circuit Bankruptcy Appellate Panel ("BAP"). In In re Hanna, 168 B.R. 386 (9th Cir. BAP 1994), the BAP, citing Dant & Russell, strictly construed § 503(b)(1)(A) and held that a neighboring landowner's postpetition clean up costs with respect to prepetition spills of petroleum products from underground storage tanks on the debtor's property were not entitled to priority administrative expense status.

The Supreme Court recently interpreted a priority expense provision of the Bankruptcy Code in Howard Delivery Service, Inc. v. Zurich American Ins. Co., 547 U.S. ___, 126 S. Ct. 2015 (2006), and stated the following:

> In holding that claims for workers' compensation insurance premiums do not qualify for § 507(a)(5) priority, we are mindful that the Bankruptcy Code aims, in the main, to secure equal distribution among creditors. [Citations omitted.] We take into account, as well, the complementary principle that preferential treatment of a class of creditors is in order only when clearly authorized by Congress. See *Nathanson v. NLRB*, 344 U.S. 25, 29 (1952); *United States v. Embassy Restaurant, Inc.*, 359 U.S. 29, 31 (1959). Id. at 2109.
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> ...
>
> Rather than speculating on how workers' compensation insurers might react were they to be granted an (a)(5) priority, we are guided in reaching our decision by the equal distribution objective underlying the Bankruptcy Code, and the corollary principle that provisions allowing preferences must be tightly construed. [Citations omitted.]
>
> Every claim granted priority status reduces the funds available to general unsecured creditors and may diminish the recovery of other claimants qualifying for equal or lesser priorities. Id. at 2115.

The same principles apply in considering whether Koniag's claim in this case should be treated as a priority administrative expense claim, as opposed to a nonpriority general unsecured claim.

The conclusion to be drawn from the foregoing authorities is that in situations, such as in this case, where the activities of a debtor prepetition have resulted in environmental contamination of a lessor's real property requiring the expenditure of clean up costs postpetition, in the absence of a benefit to the estate from the clean up

expenditures, the party absorbing such costs has a general unsecured claim rather than a priority administrative expense claim under § 503(b)(1)(A) in the debtor's bankruptcy case.

Koniag has incurred expenses for environmental clean up at the Kodiak Site. The Kodiak Site is owned by Koniag and is not an asset of the United Soil Recycling bankruptcy estate. No benefit will be realized by the estate from subsequent use or disposition of the Kodiak Site. Arguably, at least some of Koniag's expenses may have resulted from decontamination of the approximately 250 tons of contaminated soil at the Kodiak Site in which United Soil Recycling had an interest when its bankruptcy petition was filed. The Trustee has abandoned any estate interest in the subject soil, and the abandonment was approved by order of this court entered on July 14, 2005. If the soil has any value, from the estate's perspective, Koniag is welcome to it, whether as an asset left behind on the lessor's real property by a defaulting tenant or through an exercise of lien rights under Alaska law.[2]

I do not find any benefit to the United Soil Recycling bankruptcy estate from Koniag's environmental clean up expenditures with respect to the Kodiak Site or the contaminated soil that would be recognized under the standards discussed in Dant & Russell that bind me.

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[2] At the Hearing, counsel for Koniag cited Alaska Statutes § 46.08.075 as providing lien rights to the state of Alaska for environmental clean up costs incurred by the state with respect to subject property. Apparently, when Justice O'Connor spoke in her concurring opinion in Kovacs, Alaska listened. With the estate's interest in the subject soil abandoned in this case, there is nothing to prevent Koniag from asserting any subrogation rights that it may have to the lien rights of the state of Alaska in the soil.

The Trustee's objection to the Motion is sustained. The court will enter a separate order consistent with this Memorandum Opinion.

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cc: David B. Mills
Robert J Vanden Bos