

Bankruptcy Court Issues Important Environmental Enforcement Decision in Awarding \$2.7 Million to West Virginia DEP

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In highly complex commercial litigation revolving around the West Virginia Department of Environmental Protection's application for allowance of priority claims for reclamation, water treatment, and penalties in a large coal company bankruptcy case, a federal bankruptcy court in Kentucky issued an important decision of first impression giving regulators a strong hand in enforcing the environmental laws against coal companies in bankruptcies.

When Appalachian Fuels and its affiliates wound up in liquidating chapter 11 bankruptcy cases, they owned a number of mining complexes they had shuttered just before the bankruptcy cases commenced. A mining complex located in Alloy, West Virginia represented their largest and most important complex. Typical of large mining complexes, Appalachian Fuels and several of its affiliates held several dozen DEP-issued mining permits at the Alloy site.

Having shut down its operations, Appalachian Fuels immediately commenced liquidating its assets in the bankruptcy cases. The Alloy complex was the first to be sold. The sale resulted in the transfer to the purchaser of all but three permits, covering three separate areas that had not been used in active mining operations for many years but that neither Appalachian Fuels nor its predecessors had fully reclaimed.

As the case proceeded and Appalachian Fuels sold its other mining sites over the next two years, Appalachian Fuels continued to attempt to dispose of the three permits to other operators in the area. In the end, however, it proved unable to transfer the permits. On the eve of the confirmation of its liquidating chapter 11 plan, Appalachian Fuels walked away from the three permits.

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Once Appalachian Fuels walked away, federal and state law required DEP to take over the permits and perform the reclamation required under them on the former permit holders' behalf and authorizes DEP to take steps to recover the costs from the former permit holders. By the time the court confirmed the chapter 11 plan and ended the case, DEP had started the process of securing the permits and analyzing the required reclamation, but had not yet begun to reclaim the site. Nevertheless, it filed an application seeking to recover the estimated reclamation costs as well as certain outstanding penalties from Appalachian Fuels as administrative expenses of the chapter 11 cases.

The bankruptcy court initially denied DEP's application. The Sixth Circuit bankruptcy appellate panel overturned that decision and ordered a full evidentiary hearing to consider the matter. At that point, DEP hired Bailey Glasser to continue the prosecution of its administrative expense claims.

After extensive discovery and a three-day trial, the bankruptcy court issued a well-reasoned and detailed forty-page opinion granting DEP's administrative expense application in full. In doing so, the bankruptcy court issued two important decisions on issues of first impression. First, the bankruptcy court held that Appalachian Fuels had to perform the reclamation obligations of its subsidiary which nominally held the permits, as Appalachian Fuels had always performed all the mining and reclamation obligations on the permitted sites. Second, the bankruptcy court held that DEP's claims were entitled to administrative expense priority despite the fact that DEP had not incurred any reclamation costs during the pendency of the bankruptcy case and would not incur significant reclamation costs until years later. In accordance with the decision, the court granted DEP an administrative claim totaling more than \$2.7 million, including up to \$1.9 million in reclamation and water treatment costs and in excess of \$700,000 in penalties.

The decision is an important decision. With the rise of significant coal company bankruptcy cases in the past two years and with others on the horizon in a tough coal market, the decision imposes broader corporate responsibility for environmental legacy liabilities. It also makes clear that the responsibility to remediate environmental issues does not end upon the commencement of a bankruptcy case and, indeed, may give rise to significant priority claims that a coal company must satisfy as a condition to reorganizing in chapter 11. The combination gives federal and state environmental regulators a stronger hand in coal company bankruptcy cases.

Kevin W. Barrett, a bankruptcy attorney and commercial litigator at Bailey Glasser's New York office, led the firm's representation of DEP.

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Practice Areas

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