Environmental Liabilities Not Bankruptable: A Look at the State of West Virginia's Agreement with DLM Coal Corp.

John R. McGhee Jr.
West Virginia University College of Law

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ENVIRONMENTAL LIABILITIES NOT BANKRUPTABLE: A LOOK AT THE STATE OF WEST VIRGINIA’S AGREEMENT WITH DLM COAL CORP.

I. INTRODUCTION

The State of West Virginia boldly attempted to resolve a problem of environmental damage resulting from a strip mine operation. Fearing that the coal company involved would probably go bankrupt and leave the state with inadequate resources to apply toward the cleaning up of the site, the State entered into an agreement with the company releasing it of environmental liabilities in exchange for substantially all of the company's assets. The State would apply the money received to the clean-up operations necessary. As will be discussed, the State had alternative methods of gaining the assets of the company without releasing it from liability. Now, the only entity arguably responsible for the clean up of the environmental damage is the State, yet it claims that it is not required to clean up the site but will do so on a voluntary basis only. If the State decides it no longer wishes to oversee clean-up operations, will no one be responsible for doing so?

The West Virginia Department of Energy (DOE), the West Virginia Department of Natural Resources (DNR), and DLM Coal Corporation (DLM) entered into an agreement whereby DLM was released of liabilities stemming from its Upshur County, West Virginia, surface coal mining activities, which were plagued with problems of acid mine drainage. The State through the DOE and DNR took over all of DLM's remaining assets, including title to the Upshur County mining activities.

1. The production of acid mine drainage in eastern surface coal mining is generally a result of the introduction of water and oxygen to the acid-producing minerals found near coal deposits. As the soil and rock over the coal is disturbed and coal is extracted during mining, these pyritic materials (containing iron and sulfur) are exposed to increased oxygenation and water flows, both surface and subsurface. This material quickly begins to break down, reacting with the water and oxygen to form sulfuric acid and dissolved iron.
The State contends it entered into this agreement (which will be referred to simply as "Agreement") because it felt that this was the best way to protect the health, safety, and environment of West Virginia. It appears the State's contention is that had it not entered into the Agreement, DLM probably would have gone bankrupt and left the State with no resources to apply toward the cleaning up of the site other than forfeited performance bonds which DLM had posted in order to receive mining permits. By entering into the Agreement, the State obtained assets beyond the bond money, assets which they could apply to clean-up operations as well as to experimental methods of abating the common surface mining problem of acid mine drainage. Additionally, by obtaining title to the land, the State could have total control over future mining operations on the Upshur County site.

This article will discuss reasons why fear of a DLM bankruptcy should not have led to a release of environmental liabilities. At the time the decision was made to enter into the Agreement, the State did not have the benefit of some of the court decisions that will be discussed, but they did have options available to them which they did not choose to use. The result of the decision to enter into the Agreement has been a great yearly expenditure of money with no solution in sight to the acid mine drainage problem of the Upshur County property. The decision by the State, though innovative, may now be regrettable.

2. All of the facts pertaining to the history of DLM operations, the terms of the Agreement, and other background material (unless otherwise stated) come from the Agreement between the DOE, the DNR, and DLM (Aug. 27, 1985).

3. The Department of Energy was established as a separate agency growing out of the Department of Natural Resources in 1985. W. Va. Code § 22-1-4 (1985). The Agreement entered into included both the DOE and the DNR as parties. Most of the negotiations for the state were handled by the DOE. Since both departments are included as parties, the term "State" will be used throughout this article to indicate the DOE and the DNR together as one party to the Agreement.

4. DOE Commissioner Ken Faerber was quoted as saying, "We could have allowed DLM to forfeit the bonds and turn our heads, or take the position that we'd go on the offensive and see if we could put ourselves in a better posture." Charleston Gazette, Nov. 8, 1985, at 12A, col. 3.

5. DOE Commissioner Faerber spoke to this issue in the article. Charleston Gazette, Sept. 2, 1985, at 6A, col. 4.

6. Id.
II. BACKGROUND ON STATE/DLM AGREEMENT

DLM, a West Virginia corporation, began development of property in Upshur County in 1971, after receiving valid permits from the DNR. Between 1971 and 1981, DLM conducted surface mining activities in accordance with applicable state and federal laws and regulations. Because it was incurring substantial environmental cleanup costs resulting from acid mine drainage, DLM ceased its surface mining operations in 1981. DLM worked with the DNR in efforts to abate the acid mine drainage. From 1981 to 1985, DLM engaged in various clean-up activities and spent large sums of money in an attempt to clean up the site. In 1985, DLM adopted a "best available technology" strategy in its efforts to solve the problem. According to recital six of the Agreement, DLM possessed the funds "to complete the 1985 best available technology strategy and believes that the completion of the strategy will abate future acid mine drainage." In an attempt to achieve a "permanent resolution of its environmental liabilities with respect to the Upshur County Property," DLM came to the DOE seeking to enter into an agreement.

DLM asserted that it had been "without any substantial source of operating revenue" since it had ceased operations in 1981. It was agreed that the remaining funds of DLM, rather than being spent on "corporate purposes" and further clean-up, would be better spent by transferring "the remaining assets of DLM... to the DOE, and the DOE using those assets in the public interest, solely for environmental protection purposes." The acid mine drainage in this case affects the public because it runs into the Buckhannon River, which is used as a water source by some communities and is a source of trout fishing in the State. The DOE contends that the Agreement is protecting the health of the State's citizenry and the well-being of the environment.

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10. Agreement, Recital 8.
11. Id.
The specific terms of the Agreement include:

1. DLM turns over $437,000 cash and $50,000 in securities to the State;
2. Substantially all assets of DLM not listed in (1) are relinquished to the State including: (a) Reclamation Bonds ($220,006.44), (b) Oil, Gas, and Chemicals ($28,000.00), and (c) Equipment ($117,258.42) totalling $365,264.86;
3. Reclamation Bonds, posted so that mining permits could be obtained, are forfeited ($559,000.00), and all DLM mining permits are revoked;
4. The State releases DLM of all past, present, or future environmental liabilities; and
5. Title to DLM's property is relinquished to the State.\(^\text{12}\)

DLM gave up its assets in order to reach "a permanent resolution of its environmental liabilities with respect to the Upshur County Property."\(^\text{13}\) The State is to use the money on experimental clean-up methods and the development of new clean-up technology.\(^\text{14}\) Though the State released DLM of liability, the State did not assume any responsibility to clean up the site, and any clean-up activities engaged in by the State were envisioned as purely voluntary.\(^\text{15}\) The State has conducted clean-up activities up to the writing of this article.

The State justified the entering into of the Agreement on the grounds that, if it had not done so, the only assets the State could recover would have been forfeited performance bonds, a sum totaling $559,000.\(^\text{16}\) The State contends that absent the making of the Agreement, DLM would have forfeited its bonds and left the State with no other assets.\(^\text{17}\) By entering into the Agreement, the State received the bond money, over $630,000 in DLM assets and title to DLM's Upshur County real property.\(^\text{18}\) However, an assumption that

\(^{12}\) Terms of the Agreement.
\(^{13}\) Agreement, Recital 7.
\(^{14}\) See Charleston Gazette, _supra_ note 4.
\(^{15}\) DOE Commissioner Ken Faerber was quoted as saying that the State will be liable for clean up of the Upshur County site "as long as we choose to." Charleston Gazette, _supra_ note 4.
\(^{16}\) Total amount of all bonds posted with DOE for DLM operation in Upshur County.
\(^{17}\) DOE head Ken Faerber said that, had the State not acted, DLM would have forfeited their bonds, indicating that this was the best solution under the circumstances. Charleston Gazette, _supra_ note 4.
\(^{18}\) Agreement, Recital 8.
the DLM bankruptcy would have left the State with only forfeited bond money may have been incorrect; the current weight of legal authority holds that environmental liabilities are not dischargeable in bankruptcy, so that assets at least as substantial as those received through the Agreement could come to the State without releasing DLM of liability.

III. ALTERNATIVES TO THE STATE ENTERING INTO AGREEMENT WITH DLM

Although the State's innovative attempt to obtain as much money as it could to solve the acid mine drainage problem of the DLM site was laudatory, alternatives exist that would have accomplished the final results the State desired. The primary goal of the State was to solve the problem of acid mine drainage on the DLM site in order to protect the waters of the Buckhannon River. The first and most obvious solution would have been to continue to hold DLM liable for the clean-up and/or control of acid mine drainage on its property. The State opted against this solution because it feared that DLM would file for bankruptcy and leave the State with only the forfeited performance bond money.

Even if DLM had in fact filed for bankruptcy, DLM's environmental responsibilities arguably continued. This theory was plausible at the time the Agreement was entered into and has been judicially reaffirmed since then.

A Fourth Circuit case decided prior to the entering of the Agreement which supports the theory of continuing to hold DLM responsible is *Webb v. Gorsuch.* In this case, Webb sought to review the validity of mining permits granted to Brooks Run Coal Company. Though the validity of the permits was upheld by the court, it was held that mining companies are responsible for post-mining activity mine drainage under the permits themselves and under the Surface Mining Control and Reclamation Act (SMCRA).

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19. *See infra* Section III of this article.
does not allow for the release of performance bonds until all environmental laws are complied with and the problem of acid mine drainage has been abated.22 The idea of the mining company remaining liable until environmental problems are solved and protective environmental laws are complied with appeared in cases decided before the agreement was entered into and has been reaffirmed since then.

One of the reasons the State may have opted for the Agreement and was particularly concerned with the threat of DLM's bankruptcy may have been an interpretation of the Supreme Court ruling in Ohio v. Kovacs, decided in January, 1985, which held that the obligation of a debtor to comply with a court order to clean up the environmental problems at a site is equivalent to a "debt" or a "liability on a claim" which can be bankrupted.23 The particular problem in that case was the clean up of a waste disposal site. Citing from a lower court ruling on the case before its appeal to the Supreme Court, the Court quoted,

[T]here is no suggestion by plaintiff that defendant can render performance under the affirmative obligation other than by payment of money. We therefore conclude that plaintiff has a claim against defendant within the meaning of 11 U.S.C. §104(4), and defendant owes plaintiff a debt within the meaning of 11 U.S.C. §101(11). Furthermore, we have concluded that that debt is dischargeable.24

At first blush, Kovacs may suggest that if DLM bankrupted, any court order compelling clean up of the Upshur County property could also be a bankruptable debt (since money would need to be expended to abate the acid mine drainage problem) and that the State would be left with only the money from the forfeited performance bonds. However, it is important to take note of what the Court said at the end of the Kovacs opinion. The Court commented that although they held the court-ordered clean-up injunction to be a "money judgment" and thereby dischargeable in bankruptcy, a fine or other penalty requiring the payment of money levied upon Kovacs prior to bankruptcy would not have been dischargeable.25

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24. Id. at 281 (quoting In re Kovacs, 29 Bankr. 816, 816 (S.D. Ohio 1982)).
25. Kovacs, 469 U.S. at 284.
The Court also commented that any party who may have been in possession of the site remained bound to comply with the environmental laws of the State of Ohio.\textsuperscript{26} West Virginia could have looked to the language at the end of \textit{Kovacs} to support a position of continuing to hold DLM accountable for the acid mine drainage problem.

Further support for the position that DLM should have remained liable for clean-up can be found in the 1984 case \textit{Penn Terra Ltd. v. Dept. of Environmental Resources}.\textsuperscript{27} This case also dealt with the conflict of federal bankruptcy law and state environmental law. The Third Circuit distinguished the earlier holding in \textit{Kovacs} (as decided by the Sixth Circuit and subsequently affirmed by the Supreme Court) by holding that the definition attached to "money judgment" was "unduly broad."\textsuperscript{28} The court held that the automatic stay provisions of the bankruptcy code should not apply because the actions of environmental agencies in enforcing clean-up responsibilities on mining companies is an exercise of police power as provided for under 11 U.S.C. § 362(b)(5).\textsuperscript{29} In reasoning that the term "money judgment" found in this provision should be narrowly construed, the court noted that "in contemporary times, almost everything costs something" and that "an injunction which does not compel some expenditure or loss of monies may often be an effectively nullity."\textsuperscript{30} In distinguishing a clean-up order from a traditional "money judgment", the court held that the purpose of the order was to prevent future harm to the environment.\textsuperscript{31} The Supreme Court in \textit{Kovacs} distinguished \textit{Penn Terra} on the grounds that in \textit{Kovacs}, a receiver had been appointed to obtain money from the bankrupt. The Court noted, "the automatic stay provision does not apply to suits to enforce the regulatory statutes of the State, but the enforcement of

\begin{itemize}
  \item \textsuperscript{26} \textit{Id.} at 285.
  \item \textsuperscript{27} \textit{Penn Terra Ltd. v. Department of Envtl. Resources}, 733 F.2d 267 (3d Cir. 1984).
  \item \textsuperscript{28} \textit{Id.} at 277.
  \item \textsuperscript{29} 11 U.S.C. § 362(b)(5) (1979) provides that there is no stay "under subsection (a)(2) of this section, of the enforcement of a judgment, other than a money judgment, obtained in an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power;" \textit{Id.}
  \item \textsuperscript{30} \textit{Penn Terra}, 733 F.2d at 278.
  \item \textsuperscript{31} \textit{Id.}
\end{itemize}
such a judgment by seeking money from the bankrupt . . . is another matter.”32 The concept of preventing future harm and restoring damaged property are also present in the West Virginia/DLM scenario. The State could have distinguished the Kovacs reasoning, as did the Third Circuit, by pointing out that any enforcement orders rendered by a court or by the DOE were not “money judgments” but, rather, were exercises of police power to prevent future harm. Further, the State should not have been as concerned with the holding in Kovacs since the Supreme Court distinguished fact patterns such as those in Penn Terra.

The distinguishing arguments set forth in Penn Terra have been subsequently adopted in an Illinois bankruptcy case. It is significant to note that the bankruptcy court adopted the arguments set forth in Penn Terra even after the final adjudication of Kovacs. The Illinois bankruptcy court in In Re Lenz Oil Service Inc.33 even cited the portion of Kovacs which spoke to the distinguishing facts of Penn Terra. The facts of Penn Terra, Lenz, and the present DLM situation are all similar in that prevention of future harm is sought. Lenz involved the question of whether the automatic stay provision of 11 U.S.C. § 362 applied to a state’s suit to enforce environmental liabilities against a debtor in bankruptcy. The Illinois bankruptcy court recognized the distinction between an order to provide compensatory awards for past harm and an order designed to prevent future harm. In holding that the automatic stay provision did not apply to their case (involving the clean-up of a contaminated business site), the court held that the term “money judgment” was not to be construed to include orders preventing future harm to property that is suffering from environmental damage.34

The argument that injunctions ordering clean up of environmental liabilities are merely directed at preventing future harm and are not “money judgments” dischargeable in bankruptcy has been recently reiterated in a Commonwealth Court of Pennsylvania decision, Department of Environmental Resources v. Norwesco De-

32. Kovacs, 469 U.S. at 283 n.11.
34. Id. at 297.
This case involved pollution to groundwater resulting from certain drilling activities. The Pennsylvania court held that "inasmuch as DER did not seek to remedy past injuries, but to prevent future harm and restore the environment, DER was not attempting to enforce a money judgment." The court held that the DER's order to restrain performance of acts of a nuisance character, and require Norwesco to submit a permanent water supply plan was not dischargeable in bankruptcy.

Thus far, the ability to discharge a court order for environmental clean-up in bankruptcy has been discussed. In addition, support exists for the theory that a bankruptcy trustee or debtor in possession may not escape environmental responsibility by bankrupting and abandoning the property. The Supreme Court in *Midlantic Bank v. New Jersey Dept. of Environ. Protection*, a 1986 case, held that "a trustee may not abandon property in contravention of a state statute or regulation that is reasonably designed to protect the public health or safety from identified hazards." This case involved a corporation that processed waste oil (containing PCB's) and that after filing for a Chapter 11 bankruptcy, could not clean up the site as required by an administrative order. The corporation then filed for liquidation proceedings under Chapter 7 of the Bankruptcy Code and desired to abandon the property as burdensome to the estate. The Court held that "[N]either the Court nor Congress has granted a trustee in bankruptcy powers that would lend support to a right to abandon property in contravention of state or local laws designed to protect public health or safety." Thus, DLM could not file for bankruptcy and then try to abandon the site (which is suffering from acid mine drainage polluting the waters of the Buck-

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36. Id. at 97.
37. Id.
39. Id.
40. Id. at 497.
41. 11 U.S.C. § 554(A) (1982). "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 to the estate." Id.
42. Midlantic, 474 U.S. at 502.
hannon River) in contravention of the provisions of the West Virginia Surface Coal Mining and Reclamation Act or the West Virginia Water Pollution Control Act.\(^{43}\)

In a 1986 West Virginia bankruptcy case, *In Re Pierce Coal and Construction, Inc.*, the court held "that where imminent and identifiable harm is present, the priorities of the Bankruptcy Code may be subservient to the environmental laws designed to protect public safety."\(^{44}\) The court cited Title 28 U.S.C. § 959(b), which requires that a trustee, including a debtor in possession, shall manage and operate the property in his possession as such trustee, receiver or manager according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof.\(^{45}\)

The court made reference to *Kovacs* and *Mid-Atlantic* and ultimately found that damage caused by a debtor in possession was entitled to administrative priority.\(^{46}\) The result of the case was that the percentage of damage done to the land after the filing for bankruptcy was to be calculated and to be given administrative priority.\(^{47}\) However, the total amount of damage was limited to the bond amounts, since there was no independent showing of the actual amount of damage to the land. In the DLM instance, the State could have shown that the actual damage to the land greatly exceeded the bond amounts. Therefore, the State would have been entitled to an administrative priority on assets for postpetition damages to the land. If the amount of damages was high enough, which is likely in this case, then the State would have been entitled to the same assets of DLM as it was under the Agreement.

The State, by entering into the Agreement with DLM, seemed to overlook, or at least decide not to advance, the theory of continuing to hold DLM responsible for the clean-up of the acid mine drainage at the Upshur County Property. As has been seen in cases,

\(^{44}\) *In Re Pierce Coal and Const., Inc.*, 65 Bankr. 521, 531 (Bankr. N.D. W. Va. 1986).
\(^{45}\) *Id.* at 525.
\(^{46}\) *Id.* at 530.
\(^{47}\) *Id.*
such a theory would have provided the State with similar assets as they received under the Agreement and would have avoided releasing DLM of liability and closing the door to possible recovery of damages. By releasing DLM of liability, the State is now the only source to look to for clean-up operations. If DLM were still liable, but had no assets, the State could investigate DLM’s parent company, General Energy, for potential liability, even in the event of DLM’s bankruptcy. The author assumes that the State knew a parent company existed because the deed conveying title of land from DLM to the DNR for the use and benefit of DOE was executed in Lexington, Kentucky, one of General Energy’s home offices. The State could have looked into piercing the corporate veil.\textsuperscript{48} Looking for a deep pocket seems a better solution to the acid mine drainage problem than releasing DLM from liability and the State using attained assets to attack the problem itself.

Another possible avenue of relief available to citizens adversely affected by any environmental degradation is a citizen suit pursuant to the federal Clean Water Act\textsuperscript{49} or SMCRA.\textsuperscript{50} Generally, the citizen suit provisions allow for affected citizens to sue, in federal district court, either the violator, or the governmental agency charged with enforcement responsibility for any failure to perform to perform non-discretionary acts or duties under the statute. However, the recent decision by the Supreme Court in \textit{Gwaltney v. Chesapeake Bay Foundation} severely limits the applicability of citizen suits under the Clean Water Act to wholly \textit{past} violations.\textsuperscript{51} This construction could arguably preclude any citizen suit against DLM itself, since all of its potential violations resulting in acid mine drainage are undoubtedly past acts; DLM relinquished its property back in 1985 and has had no active responsibility since then.

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\item \textsuperscript{48} It may have been better for the state to look to General Energy for the clean-up costs than entering into the Agreement releasing DLM of all liability.
\item \textsuperscript{49} 33 U.S.C. § 1365 (1982).
\item \textsuperscript{50} 30 U.S.C. § 1270 (1982).
\item \textsuperscript{51} Gwaltney v. Chesapeake Bay Found., 56 U.S.L.W. 4017 (Dec. 1, 1987) (§ 505 of the Clean Water Act does not permit citizen suits for wholly past violations; and need allegations of continuing violations).
\end{itemize}
IV. CONCLUSION

Since there was precedent at the time West Virginia entered into the Agreement with DLM that clean-up orders were not dischargeable in bankruptcy and that precedent has been subsequently affirmed, it appears that the State may have been unduly concerned with being left with no remedy had DLM filed for bankruptcy. By entering into the Agreement, the State is now burdened with the effort and expense of cleaning up the site. Although the State has not explicitly assumed the responsibility of the clean-up operation, it has done so up to now on a voluntary basis. Should the State decide that the burden of cleaning up the site becomes too great, it claims, it can simply walk away. If this were to happen, the waters of the Buckhannon River would suffer from acid mine drainage coming from the Upshur County site, and no one would be liable for or active in cleaning it up.

John R. McGhee, Jr.