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What Happens When a Wetland Mitigation Bank Goes Bankrupt?

by Royal C. Gardner and Theresa J. Pulley Radwan

Editors' Summary: The wetland mitigation banking business has grown dramatically in the last decade. But as is true with any business, mitigation banks are subject to risk, including the risk of going bankrupt. This Article looks at how bankruptcy law can affect the rights and obligations of the mitigation banker and government agencies. After providing an overview of wetland mitigation banking and a primer on bankruptcy law, the Article examines two ongoing bankruptcy actions that involve mitigation banks. It then offers suggestions that regulatory agencies can adopt to protect against the consequences of a bankrupt mitigation bank.

I. Introduction

The wetland mitigation banking business continues to grow. From 1992 to 2001, the number of wetland mitigation banks increased from 46 to 219.[1] At a national mitigation banking conference in April 2005, it was reported that there are now approximately 400 wetland mitigation banks in the country.[2]

Much of this growth can be attributed to the rise of entrepreneurial mitigation bankers: entities that restore degraded wetlands, thus generating "mitigation credits" that are then sold to permittees who need to satisfy their own mitigation requirements under the Clean Water Act (CWA) or state or local laws.[3] As the National Research Council (NRC) and others have observed, mitigation banking offers advantages over traditional mitigation projects for which permittees remain responsible.[4] Yet, as is the case with any entrepreneurial venture, there are risks associated with mitigation banking.

Most of the risks are borne by the mitigation banker. The banker must devote significant resources to the mitigation project, and the financial return is uncertain. The banker must first navigate the regulatory hurdles to establish the framework for the construction and operation of the bank, which can take months or even years.[5] Then, to generate the mitigation credits, the banker must meet certain performance standards.[6] If the performance standards are not satisfied, the banker should have few or no credits to sell.[7] A properly structured mitigation banking arrangement should require the banker to demonstrate that the ecological success of the mitigation site is likely before the banker is able to recoup its investment.

The mitigation banker also shoulders the risk related to the demand for mitigation credits. Assuming that the banker has satisfied performance standards for the site and has credits to sell, there must be a willing buyer. The mitigation

Royal Gardner is a Professor of Law at the Stetson University College of Law and Director of the Stetson University Institute for Biodiversity Law and Policy. He served on the National Research Council's Committee on Mitigating Wetland Losses.

Theresa Radwan is Associate Dean of Academics and Associate Professor of Law at the Stetson University College of Law. Dean Radwan has represented creditors in business bankruptcies.

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1. Environmental Law Institute, Banks and Fees: The Status of Off-Site Mitigation in the United States 35 (2002) [hereinafter Banks and Fees].

2. *Cf.* Office of Wetlands, U.S. Environmental Protection Agency (EPA), A Watershed Decade 19 (2001), *available at* http://www.epa.gov/owow/home/accomplishments/wetlands.pdf (last visited June 29, 2005) (stating that "more than 300 mitigation banks are operating or in the final stages of approval").

3. Banks and Fees, *supra* note 1, at 37-40 (discussing the increase in private commercial or entrepreneurial banks from 1 in 1992 to 135 in 2001).

4. NRC, Compensating for Wetland Losses Under the Clean Water Act 9 (2001) [hereinafter NRC]. *See also* Society of Wetland Scientists, *Wetland Mitigation Banking*, *at* http://www.sws.org/wetlandconcerns/banking.html (last visited June 29, 2005) (position statement supporting "wetland mitigation banking to improve mitigation success and contribute to the goal of no net loss of wetlands"); Royal C. Gardner, *Banking on Entrepreneurs: Wetlands, Mitigation Banking, and Takings*, 81 Iowa L. Rev. 527, 540-42 & 558-62 (1996) (discussing failure of permittee-responsible mitigation and benefits of mitigation banking).

5. *See* John Ryan & David Urban, *Managing Mitigation: An Insider's Perspective on the Banking Industry*, Nat'l Wetlands Newsl., Nov./Dec. 2004, at 9. After a particular lengthy negotiation, one banker signed off on the letter transmitting the final agreement to agency officials not with "Sincerely" but with "Hallelujah." Letter from Ilan Silberstein, Wikiup Builders Ltd. Partnership, to Mike Monroe, EPA et al. (May 31, 1995).

6. *See* Federal Guidance for the Establishment, Use, and Operation of Mitigation Banks, 60 Fed. Reg. 58605 (Nov. 28, 1995) (available from the ELR Guidance & Policy Collection, ELR Order No. AD03037) [hereinafter Federal Mitigation Bank Guidance].

7. *Id.* at 58611-12. *See infra* note 33 for a discussion about the early release of mitigation credits.

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banker competes against other mitigation options such as in-lieu-fees and traditional, permittee-responsible mitigation.[8] Moreover, the demand for mitigation credits can be affected by changes in the regulatory regime. For example, the U.S. Supreme Court's decision in *Solid Waste Agency of Northern Cook County (SWANCC) v. U.S. Army Corps of Engineers*[9] called into question the federal government's ability to regulate impacts to isolated waters. If there is no federal jurisdiction over such impacts, there is no federal requirement to mitigate for the impacts, and, thus, there is no demand for mitigation credits (at least at the federal level).[10]

Another set of risks relates to the ecological conditions of the mitigation site. What if, in the course of the restoration project, site conditions deteriorate? What if, for example, the vegetation that was planted dies because of too little rain or is overwhelmed by invasive species? A properly structured mitigation banking arrangement should have financial assurances in place to deal with any needed remediation.[11] The financial assurances are necessary at two distinct stages: (1) when the bank is active (i.e., during the construction phase and while credits are being sold); and (2) after the bank's credits have been sold (i.e., during the long-term stewardship of the site). The presence of these financial assurances, especially arrangements that provide for funding of the long-term stewardship of mitigation sites, is one of the benefits that mitigation banking can provide over other types of mitigation.[12]

Considering these risks and the nature of entrepreneurial ventures generally, it is not surprising that some mitigation bankers have filed for bankruptcy. This Article examines how bankruptcy law can affect the rights and obligations of the mitigation banker and government agencies, potentially reallocating the risks relating to the site's ecological conditions. It is important to note at the outset that the financial condition of the banker does not necessarily correlate to the conditions of the mitigation site; a site may be ecologically successful even though the banker is in financial difficulties. Nevertheless, a banker's current financial difficulties and the bankruptcy proceeding itself could have significant consequences for the long-term stewardship of the mitigation sites.

After providing an overview of wetland mitigation banking and a primer on bankruptcy law, this Article will examine two ongoing bankruptcy actions that involve mitigation banks. Each of the bankruptcies was filed at a different phase of the life of the bank: one occurred during the initial restoration work while the other (which involves three mitigation banks) was instituted near the conclusion of the restoration efforts. We will offer relatively straightforward suggestions that regulatory agencies can adopt (and that some have already adopted) to protect against the consequences of a bankrupt mitigation bank. These proposals should be considered by the U.S. Army Corps of Engineers (the Corps) as it develops and finalizes its new wetland mitigation regulations, which are due by November 2005.[13]

II. Wetland Mitigation Banking: A Brief Overview

Wetland mitigation banking is a tool designed to remedy a great flaw of wetland permit programs. If a developer seeks to fill in a wetland, it will typically need a permit.[14] The governmental agency issuing the permit will typically do so on the condition that the developer take some action to offset the adverse environmental impacts of the project, such as restoring, enhancing, creating, and/or preserving wetlands.[15] In theory, at the end of the day, the developer has its project and the aquatic environment is no worse off. A mitigation project replaces the wetland functions and values affected by the development, and thus the goal of "no net loss" of wetlands is achieved.[16] The reality, however, is starkly different. Many studies have found that mitigation projects were unsuccessful in the short and long term, at least with respect to mitigation projects for which permittees were responsible.[17]

There are a number of factors that contribute to the failure of permittee-responsible mitigation. In the past, there was little incentive for the permittee to expend a great deal of ef-

8. *See* U.S. Army Corps of Engineers, Regulatory Guidance Letter No. 02-2: Guidance on Compensatory Mitigation Projects for Aquatic Resource Impacts Under the Corps Regulatory Program Pursuant to Section 404 of the Clean Water Act and Section 10 of the Rivers and Harbors Act of 1899, at 6 (2002), *available at* http://www.epa.gov/owow/wetlands/pdf/RGL_02-2.pdf (last visited June 29, 2005) (also available from the ELR Guidance & Policy Collection, ELR Order No. AD04782) (stating that "[p]ermit applicants may propose the use of mitigation banks, in-lieu-fee arrangements, or separate activity-specific projects") [hereinafter Regulatory Guidance Letter].

9. 531 U.S. 159, 31 ELR 20382 (2001). For a discussion of how state legislatures have reacted to *SWANCC*, see Jan Goldman-Carter, *Isolated Wetland Legislation: Running the Rapids at the State Capitol*, Nat'l Wetlands Newsl., May/June 2005, at 27.

10. *See* Ryan & Urban, *supra* note 5, at 10-11 (discussing the impact of *SWANCC* on the mitigation banking industry); Morgan Robertson, Drawing Lines in Water: Entrepreneurial Wetland Mitigation Banking and the Search for Ecosystem Service Markets 205 (2004) (unpublished Ph.D. thesis, University of Wisconsin) (reporting that after *SWANCC* "both sales volume and gross income in the industry [in the Chicago District] were at almost exactly half of their 2000 levels").

11. Federal Mitigation Bank Guidance, *supra* note 6, at 58613.

12. *See* NRC, *supra* note 4, at 91-92 (noting that stewardship conditions are required for mitigation banks but not for permittee-responsible mitigation) & 157-58 (recommending adequate provision for long-term stewardship for all types of mitigation).

13. National Defense Authorization Act for Fiscal Year 2004, Pub. L. No. 108-136, 117 Stat. 1392, 1431 (Nov. 24, 2003).

14. For a more detailed description of the CWA §404 permitting program, see Margaret N. Strand, Wetlands Deskbook (2d ed. 1997). In practice, the Corps infrequently denies permits. *See* U.S. Army Corps of Engineers, *Regulatory Statistics, All Permit Decisions FY 2003*, *at* http://www.usace.army.mil/inet/functions/cw/cecwo/reg/2003webcharts.pdf (last visited June 29, 2005) (noting that less than 1% of permits are denied). *See also* Craig Pittman, *They Won't Say No*, St. Petersburg Times, May 22, 2005, at 1A (finding that in Florida between 1999 and 2003, the Corps "approved more than 12,000 wetland permits and rejected one"). In light of these permit statistics, the need for effective mitigation becomes even more critical.

15. *See*, *e.g.*, Memorandum of Agreement [(MOA)] Between the Environmental Protection Agency and the Department of the Army Concerning the Determination of Mitigation Under the Clean Water Act Section 404(b)(1) Guidelines, 55 Fed. Reg. 9210 (Mar. 12, 1990) (available from the ELR Guidance & Policy Collection, ELR Order No. AD03042) [hereinafter 1990 Mitigation MOA]. For an excruciatingly detailed review of this document, see Royal C. Gardner, *The Army-EPA Mitigation Agreement: No Retreat From Wetlands Protection*, 20 ELR 10337 (Aug. 1990).

16. The goal, as articulated in the 1990 Mitigation MOA, is programmatic in nature. The agencies "recognized that no net loss of wetlands functions and values may not be achieved in each and every permit action." 1990 Mitigation MOA, *supra* note 15, at 9211.

17. NRC, *supra* note 4, at 113-22.

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fort on the mitigation. Agencies tended not to provide much oversight of mitigation projects, and enforcement of mitigation conditions was not a priority.[18] The mitigation did not need to be provided in advance of the development project but could be done concurrently or after the fact.[19] Requirements for the long-term stewardship of the mitigation site were rare.[20] Wetland mitigation in this context was, as has been noted before, based on promises that largely went unfulfilled.[21] "No net loss" in the regulatory program was achieved on paper but not on the ground.[22]

In November 1995, through a guidance document, the federal agencies involved with wetland regulation encouraged another approach to compensating for wetland impacts: wetland mitigation banking.[23] There would be more oversight; a team of agency specialists, the Mitigation Bank Review Team (MBRT), would review the establishment of the bank and remain involved in its operation.[24] The mitigation banker would do the mitigation work in advance of projects impacts, not after.[25] The MBRT would document the ecological baseline conditions of the mitigation site, and when the site met certain performance standards, the mitigation banker could then use or sell those credits to satisfy permit requirements in a specified service area.[26] The MBRT would ensure that financial assurances such as performance bonds, letters of credit, or escrow accounts, including provisions for the long-term stewardship of the mitigation site, were in place.[27] The details under which the mitigation bank would operate would be contained in a formal document, the mitigation banking instrument.[28] Although the MBRT process was cumbersome, the agencies had authorized a market-based trading system, thus creating economic incentives for mitigation providers to do their jobs well.[29]

The product that the permittee pays for is peace of mind (financial and legal). When the permittee purchases a mitigation credit from the mitigation banker, that transaction ends the permittee's responsibility for the mitigation.[30] The permittee has a fixed cost for the project and need not worry about maintaining or having to take remedial action at the mitigation site.[31] The legal responsibility for the mitigation site now rests with the mitigation banker.[32]

The product that the regulatory agency seeks is an ecologically successful mitigation site with adequate provisions for long-term stewardship. It is in the short- and long-term interest of the mitigation banker to provide functioning, self-sustaining mitigation. First, if the mitigation banker fails to meet the performance standards specified by the MBRT, mitigation credits will not be released for sale.[33] Second, if the bank site experiences problems after the credits have been sold, and if long-term stewardship provisions are ineffective, it is likely that the regulatory agencies will be highly skeptical if the mitigation banker seeks to establish another bank.

Recognizing the benefits of mitigation banking, the U.S. Congress soon expressed a preference that wetland mitigation for federally funded transportation projects come from mitigation banks.[34] Still, for most permittees, mitigation banking remains only an option, not a requirement. A permittee may choose to provide the mitigation itself or, in some circumstances, opt for in-lieu-fee mitigation.[35] Each

18. *Id.* at 122 (concluding that the Corps engages in "sparse compliance monitoring" of mitigation projects). Although the CWA allows citizen suits to supplement governmental enforcement (or the lack thereof), it makes a distinction between citizen suits brought under §402 and §404. In the former, a citizen suit may be brought against a permittee for violating the conditions of its permit; in the latter, citizen suits may not be brought to enforce permit conditions, such as mitigation requirements. *See* Northwest Envtl. Defense Ctr. v. Corps of Eng'rs, 118 F. Supp. 2d 1115 (D. Or. 2000) (holding that environmental group cannot maintain citizen suit based on violation of §404 permit condition).

19. NRC, *supra* note 4, at 88.

20. *Id.* at 92.

21. *See* Gardner, *supra* note 4, at 540-42.

22. NRC, *supra* note 4, at 2-3 (concluding that the "goal of no net loss of wetlands is not being met for wetland functions by the mitigation program, despite progress in the last 20 years").

23. Federal Mitigation Bank Guidance, *supra* note 6. Some mitigation banks were established prior to the issuance of the guidance. For example, the Woodbury Creek Wetland Mitigation Bank, discussed *infra*, was established in July 1995, and thus did not go through the Mitigation Bank Review Team (MBRT) process.

24. *Id.* at 58610. While the Corps is the chair of the MBRT, many other agencies may participate, including EPA, the U.S. Fish and Wildlife Service, the National Marine Fisheries Service, the Natural Resources Conservation Service, as well as "state, tribal and local regulatory and resource agencies." *Id.* The goal is for the MBRT to make decisions by consensus. *Id.*

25. *Id.* at 58607 (defining mitigation banking as "providing compensatory mitigation in advance of authorized impacts to similar resources"). *Cf.* NRC, *supra* note 4, at 88-89 (noting that mitigation is not fully complete before credits are released; rather, credits are released as certain performance standards are met).

26. Federal Mitigation Bank Guidance, *supra* note 6, at 58611-12.

27. *Id.* at 58613.

28. *Id.* at 58609-10.

29. *See* NRC, *supra* note 4, at 90 (observing that third-party mitigation providers, such as mitigation bankers, "have a financial (bonds and future business) or other (reputation with the agency) stake in meeting their mitigation obligations").

30. Federal Mitigation Bank Guidance, *supra* note 6, at 58612.

31. If a permittee retains responsibility for the compensatory mitigation and fails to meet those requirements, then in theory "the Corps may issue a compliance order, initiate a civil judicial action, and/or revoke or suspend the permit." NRC, *supra* note 4, at 86.

32. *Id.*

33. Federal Mitigation Bank Guidance, *supra* note 6, at 58611-12. Regulatory agencies may authorize an early release of credits—credits that may be sold before restoration work is performed. These credits should be available only after the agencies have approved the mitigation plan, the mitigation banker secures the mitigation site, and the mitigation banker obtains financial assurances, such as a performance bond, that offer an additional source of funds to draw on to complete the work. *Id.* at 58612. The amount of early credits that is considered appropriate varies from jurisdiction to jurisdiction and has been the subject of criticism. *See* Banks and Fees, *supra* note 1, at 63-65 & 119.

34. *See* Transportation Act for the 21st Century, Pub. L. No. 105-178, §103(b)(6)(M), 112 Stat. 107, 135 (1998). *See also* U.S. EPA et al., Federal Guidance on the Use of the TEA-21 Preference for Mitigation Banking to Fulfill Mitigation Requirements Under Section 404 of the Clean Water Act (2003), *available at* http://www.epa.gov/owow/wetlands/pdf/TEA-21Guidance.pdf.

35. The agencies define in-lieu-fee mitigation as "circumstances where a permittee provides funds to an in-lieu-fee sponsor instead of either completing project-specific mitigation or purchasing credits from a mitigation bank approved under the Banking Guidance." U.S. EPA et al., Federal Guidance on the Use of In-Lieu-Fee Arrangements for Compensatory Mitigation Under Section 404 of the Clean Water Act and Section 10 of the Rivers and Harbors Act 1 (2000), *available at* http://www.epa.gov/owow/wetlands/pdf/inlieufee.pdf (also available from the ELR Guidance & Policy Collection, ELR Order No. AD04566) [hereinafter ILF Guidance]. One essential difference between mitigation banking and in-lieu-fee arrangements is the timing of the mitigation

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of these different types of mitigation is held to varying standards, with mitigation banks held to the highest.[36] In 2003, Congress called on the Corps to issue regulations that "apply equivalent standards and criteria to each type of compensatory mitigation."[37]

As the Corps works with other agencies to develop these regulations, it may be helpful to keep in mind how mitigation standards—whether applicable to permittee-responsible mitigation, in-lieu-fee arrangements, or mitigation banks—can be affected by a bankruptcy action. Simply put, when a mitigation provider seeks bankruptcy protection, all bets are off.

III. Bankruptcy Basics

Bankruptcy, it has often been said, is for the "honest but unfortunate debtor."[38] Bankruptcy can allow an individual or business to purge certain debts and obligations, to reorganize, and to return to its affairs with a fresh start.[39] It can also lead to the liquidation of a business, including entities with mitigation banking responsibilities. Allowing for a fresh start or liquidation when an entity has continuing mitigation responsibilities can lead to a "clash of absolutes": the Bankruptcy Code versus an environmental agency's regulatory powers.[40]

A. 7-11: Liquidation Versus Reorganization

When entering into a bankruptcy, a debtor selects a particular chapter of the Bankruptcy Code by which to be governed. For a business entering bankruptcy, the choice usually involves either Chapter 7 or Chapter 11 of the Bankruptcy Code.

In the most general of terms, Chapter 7 involves a liquidation of the business. The bankruptcy trustee, a government-appointed[41] individual who represents the debtor's estate[42] and, thus, the interests of the creditors in the bankruptcy proceeding,[43] runs the business for the purpose of liquidation. While doing so, the trustee collects assets of the debtor, sells or otherwise disposes of them, and distributes the proceeds to creditors under a distribution scheme dictated by the Bankruptcy Code.[44] At the conclusion of the bankruptcy proceeding, the business terminates and, with it, all remaining unpaid debt.[45]

Chapter 11 envisions a reorganization of the debtor company and differs substantially from a Chapter 7 liquidation. In most cases, a Chapter 11 debtor's business is run by the "debtor-in-possession" rather than a bankruptcy trustee.[46] The debtor-in-possession is, essentially, the same entity as the debtor[47]; the business continues to operate itself, though it can select new management as needed. But rather than having an outside party run the company, the company decides for itself how to run.[48] Instead of paying debts through the sale of the company's assets, the debts are paid through the everyday operations of the company. In some cases, assets are sold to pay off debt, but in others, profits are used to pay off debt.

B. Chapter 11: Plan of Reorganization

While focusing on running the business and paying off debt, the debtor-in-possession also considers how to prevent future insolvency of the company. Often this involves restructuring the company in order to make it more profitable. All of the detail of restructuring the company and paying the company's debts is contained in a plan of reorganization. Though the debtor has the exclusive right to file a plan of reorganization in the early stages of the bankruptcy proceeding, eventually a creditor or other party-in-interest may also suggest its own plan of reorganization.[49] Regardless of the number of plans proposed, the process for choosing a plan is the same. Each plan proponent obtains the court's approval for its "Disclosure Statement."[50] The Disclosure Statement outlines the plan and, most importantly, often provides information on why the debtor filed for bankruptcy, what the debtor will look like during and after bankruptcy, and how the payments to creditors proposed by the plan will be funded. Once the court approves the Disclosure Statement, creditors vote on the plan and, if the proper configuration of votes is received, the plan is approved.[51] Multiple plans can be approved but only one may be confirmed. The bankruptcy court ultimately decides which of the approved plans to confirm.[52]

Though most Chapter 11 proceedings envision this type of reorganization, Chapter 11 also can result in liquidation of a business debtor. Sometimes, the debtor-in-possession will sell, essentially, its entire business to another entity, leaving behind a shell company or a litigation trust to handle remaining matters and, after doing so, dissolve. This accom-

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action. In-lieu-fee mitigation is after-the-fact mitigation. *See* Royal C. Gardner, *Money for Nothing? The Rise of Wetland Fee Mitigation*, 19 Va. Envtl. L.J. 1, 39-43 (2000) (discussing criticisms of in-lieu-fee mitigation).

36. *Compare* Federal Mitigation Bank Guidance, *supra* note 6, *with* Regulatory Guidance Letter, *supra* note 8 (discussing requirements for permittee-responsible mitigation) *and* ILF Guidance, *supra* note 35. *See also* NRC, *supra* note 4, at 82-93 (reviewing differences among mitigation options).

37. National Defense Authorization Act for Fiscal Year 2004, Pub. L. No. 108-136, 117 Stat. 1392, 1431 (Nov. 24, 2003).

38. Archer v. Warner, 538 U.S. 314 (2003).

39. 11 U.S.C. §1141.

40. Ingrid Michelsen Hillinger & Michael G. Hillinger, *Environmental Affairs in Bankruptcy: 2004*, 12 Am. Bankr. Inst. L. Rev. 331 (2004) (discussing how the "goals of bankruptcy law conflict with the goals of environmental law"). *Cf.* Laurence H. Tribe, Abortion: The Clash of Absolutes (1990) (discussing the conflict between a woman's procreational autonomy and the state's interest in life).

41. 11 U.S.C. §322(b)(1). The bankruptcy trustee is appointed by the U.S. Trustee for the region. The U.S. Trustee program is designed to ensure the integrity of the bankruptcy system through oversight of all bankruptcies, as well as bankruptcy trustees. 28 U.S.C. §586.

42. 11 U.S.C. §323(a).

43. Collier on Bankruptcy ¶ 704.02[1] (15th ed. 2005) (citing *In re P.R.T.C., Inc.*, 177 F.3d 774 (9th Cir. 1999), indicating that the interests of creditors equate to the interests of the bankruptcy estate).

44. 11 U.S.C. §704.

45. David G. Epstein et al., Bankruptcy §7-1 (1993).

46. *See* 11 U.S.C. §§1104 (detailing when a trustee may be appointed) and 1107 (providing that debtor-in-possession serves as trustee if a trustee is not appointed).

47. *Id.* §1101(1).

48. *Id.* §§1107, 1108.

49. *Id.* §1121.

50. *Id.* §1125(b).

51. *Id.* §1126.

52. *Id.* §§1128, 1129.

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plishes the same objectives as a Chapter 7 liquidation but without a trustee's involvement.[53]

C. The Automatic Stay

Regardless of which chapter of bankruptcy is invoked, bankruptcy offers a debtor certain protections that can affect the rights of creditors. As soon as a debtor files its petition to enter into the bankruptcy system, an "automatic stay" is placed on actions against the debtor.[54] There are notable exceptions, including the ability of a governmental entity to continue to enforce its police powers against the debtor[55] and the ability for a creditor to seek relief from the stay.[56] But unless the creditor falls within one of the exceptions or obtains relief, the creditor cannot sue, continue litigation activities, collect amounts due, or take other collection-based actions against the debtor. And the automatic stay applies even if the creditor is not yet aware of the bankruptcy filing.[57]

D. Proving a Claim and Types of Claims

In order to share in the distribution to creditors, a creditor usually must file a proof of claim form.[58] In a Chapter 7 proceeding, the need to file a proof of claim is presumed unless the court orders otherwise. The proof of claim typically must be filed within 90 days of the date set for the first meeting of creditors.[59] In a Chapter 11 proceeding, a creditor must file a proof of claim only if: (1) the creditor was not listed by the debtor in the bankruptcy schedules; (2) the creditor was listed by the debtor with a disputed, contingent, or unliquidated claim[60]; (3) the creditor was listed by the debtor but disagrees with how the debtor listed the creditor; or (4) the court orders otherwise. The court sets a deadline for filing proofs of claim—known as the bar date—in a Chapter 11 proceeding.[61]

Claims generally fall into one of three categories: secured claims; priority unsecured claims; or general unsecured claims. Secured claims are those claims whose value is ensured by collateral.[62] All other claims are unsecured. But among unsecured claims, some claims have priority given to them by the Bankruptcy Code.[63] In a Chapter 7 bankruptcy, secured claims are generally paid from the value of the collateral securing the debt. Priority claims receive first payment from the unencumbered collateral and, to the extent that any funds remain after payment to the priority claimants, general unsecured claims will be paid.[64] Though a Chapter 11 proceeding gives more flexibility to determine the order of payment, priority creditors often receive more in a bankruptcy proceeding than general unsecured creditors.[65]

E. Miscellaneous

While in bankruptcy, the trustee or debtor-in-possession has the right to decide how to handle executory contracts—contracts under which each party has remaining obligations.[66] In short, the debtor-in-possession, with the approval of the court, may choose to continue under the contract (assumption),[67] to not continue under the contract (rejection),[68] or to substitute another party in its place (assignment).[69] Because of the likelihood that a mitigation bank will have contracts with other entities under which substantial commitments remain, the trustee or debtor-in-possession will need to make determinations regarding how to handle those contracts. It is important to note that the non-debtor party to the executory contract has no choice regarding whether the debtor accepts or rejects the contract, but the debtor has the burden of estab-

53. *See, e.g.*, *id.* §1141(3).
54. *Id.* §362(a).
55. *Id.* §362(b)(4).
56. *Id.* §362(d).
57. Creditors typically become aware of the bankruptcy filing when sent a notice of the filing. Notice goes out to all creditors that the debtor lists in the bankruptcy schedules filed with the court. Margaret M. Mahoney, *Debts, Divorce, and Disarray in Bankruptcy*, 73 UMKC L. Rev. 83, 115 (2004). A creditor who knowingly violates the automatic stay may be responsible for damages and fines. 11 U.S.C. §362(h).
58. The proof of claim form is a short form, detailing the type of claim and the amount of the claim. The standard form can be found at U.S. Courts, *Form B10*, *at* http://www.uscourts.gov/bkforms/official/b10.pdf (last visited June 29, 2005).
59. Fed. R. Bankr. Proc. 3002(c). The first meeting of creditors, typically known as the "341 meeting," is an opportunity for the trustee, the U.S. Trustee, and any creditors to question the debtor or, if a business, its principals, regarding the debtor's affairs. It is not held in a courtroom and a judge is not present. 11 U.S.C. §341; 5 William L. Norton Jr., Norton Bankruptcy Law and Practice ch. 29, §1 (2d ed. 2005).
60. 11 U.S.C. §1111(a); Fed. R. Bankr. Proc. 3003(b)(1). An unliquidated claim is one in which the amount of the claim is unknown; a contingent claim is one that is not yet definite in its existence. Alison J. Brehm et al., *To Be, or Not to Be: The Undiscovered Country of Claims Estimation in Bankruptcy*, J. Bankr. L. & Prac., Mar./Apr. 1999, at 197, 230-32.
61. Fed. R. Bankr. Proc. 3003(c)(3).
62. 11 U.S.C. §506.
63. *Id.* §507. Priority claim categories include, inter alia, administrative claims, "gap" claims incurred during the beginning of an involuntary bankruptcy proceeding, wage and employee claims up to a set dollar amount, alimony and other support claims, and certain taxes. *Id.* Entities that do business with a debtor in bankruptcy may have administrative claims entitled to priority in the bankruptcy proceeding. *See infra* note 142. *See also* Hillinger & Hillinger, *supra* note 40, at 390-407. The Bankruptcy Code offers claims priority for "the actual, necessary costs and expenses of preserving the estate . . . ." 11 U.S.C. §503(b). Generally, these administrative expenses include professional fees for work done for the estate, utility payments, and other expenses directly tied to the continuation of the business after the filing of the bankruptcy petition.
64. One category of claims, equity claims, is necessarily subordinated to general unsecured claims. *See* 11 U.S.C. §726(a)(6) (providing for final distribution after unsecured claims to debtor); *id.* §1129(b)(2)(B)(ii) (requiring that general unsecured claims be paid before lower priority claims).
65. *Id.* §1129(a)(9) (requiring payment in full of priority claims on "effective date" of plan of reorganization absent agreement of the claimant). *See, e.g.*, In re Pillowtex, 304 F.3d 246, 249 (3d Cir. 2002); In re Virginia-Carolina Fin. Corp., 954 F.2d 193, 199 (4th Cir. 1992); and In re Tejano, 135 B.R. 686, 688 (Bankr. D. Kan. 1991) (each noting that unsecured creditors would only be paid "pennies on the dollar," a small percentage of claims, in the bankruptcy proceeding).
66. Executory contracts are not defined in the Bankruptcy Code. For a more detailed analysis of the case law definitions of an executory contract, see Epstein et al., *supra* note 45, §5-4.
67. Assumption of a contract requires curing any defaults on the contract and providing proof that the contract can continue. 11 U.S.C. §365(b).
68. A contract rejection constitutes a breach of contract, for which the creditor can file a proof of claim. *Id.* §365(g).
69. Assignment is prohibited to the extent that law or the contract terms so prohibit. *Id.* §365(c).

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lishing that the choice is in "the best interests" of the creditors and that all of the technical requirements are met.[70]

Finally, to the extent that a creditor's claim is not paid in full in the bankruptcy proceeding, it is necessary to know whether the remaining claim will survive post-bankruptcy. In a Chapter 7 proceeding, the answer is clearly "no" unless there is liability on the part of a successor entity. Because Chapter 7 is designed to liquidate the business, there will no longer be a debtor from which to collect the claim post-bankruptcy.[71] With a successful Chapter 11, however, there will often be a surviving debtor and, thus, the possibility of collecting claims after the bankruptcy is over. But the vast majority of claims are discharged under Chapter 11 either as a matter of the discharge provisions or through the plan of reorganization.[72]

In sum, creditors with general unsecured claims are in one of the worst positions in bankruptcy proceedings. Often, they receive little or nothing. As discussed below, courts have sometimes found governmental agencies to be general unsecured creditors when they are proceeding under environmental law.

IV. Environmental "Claims" in Bankruptcy

A. Supreme Court Precedent: Ohio v. Kovacs[73]

How, and how much of, an environmental cost will be paid in bankruptcy depends on the classification of that cost, starting with whether that cost even constitutes a "claim" in bankruptcy. In 1985, the Court in *Kovacs* considered whether environmental cleanup costs constituted a claim in a bankruptcy proceeding. As chief executive officer of a chemical company, the debtor, Kovacs, had been charged with violating numerous environmental laws of Ohio. The parties agreed that among other remedies, Kovacs and his company would clean up the affected sites. When Kovacs failed to do so, a receiver was appointed to take control of Kovacs' assets and to clean up the site.[74] Following the appointment, Kovacs filed for individual Chapter 11 bankruptcy protection but later converted the bankruptcy into one under Chapter 7.[75] The state sought a declaration by the bankruptcy court[76] that the money due to it as a result of Kovacs' failure to clean up the site was not dischargeable as a result of the bankruptcy.[77]

In order to determine dischargeability,[78] the Court first considered whether the money due constituted a "claim" in the bankruptcy proceeding.[79] In so doing, the Court focused on the state's *right* to money for a violation of its environmental laws. At first glance, the legislative history of the Bankruptcy Code implies that the mere right to payment creates a claim:

> Section 101(4)(B) . . . is intended to cause the liquidation or estimation of contingent rights of payment for which there may be an alternative equitable remedy with the result that the equitable remedy will be susceptible to being discharged in bankruptcy. For example, in some States, a judgment for specific performance may be satisfied by an alternative right to payment in the event performance is refused; in that event, the creditor entitled to specific performance would have a "claim" for purposes of a proceeding under title 11.[80]

However, the Court's interpretation of the provision considered not the state's *ability* to seek a monetary judgment but its *choice* to do so. The Court noted that by seeking a receivership over Kovacs, Ohio took away Kovacs' ability to clean up the site. In so doing, the state was no longer enforcing its environmental laws; rather, it was seeking repayment of costs already incurred. The state, therefore, had a monetary claim against Kovacs that was subject to the Chapter 7 proceedings. The Court suggested that had the state "prosecute[d] Kovacs under the environmental laws or [brought] civil or criminal contempt proceedings," the result might have been different.[81]

B. Lower Court Interpretations of Kovacs

Lower court interpretations of *Kovacs* have not been consistent. At the extremes, there does seem to be consensus: the

70. Thomas E. Plank, *The Constitutional Limits of Bankruptcy*, 63 Tenn. L. Rev. 487, 551-52 (1996).

71. Note that this does not equate to having a discharge of the debt. A business is not entitled to a discharge of debt in a Chapter 7 proceeding. 11 U.S.C. §727. However, to the extent that a claim is effectively discharged by the liquidation of the debtor, this Article shall consider it to be "discharged" for purposes of discussion.

72. Exceptions to Chapter 11 discharge apply primarily to individuals who either would not be entitled to discharge under §523 of the Bankruptcy Code, or to liquidating businesses that would not be entitled to discharge in a Chapter 7 proceeding. 11 U.S.C. §1141(d)(2) & (d)(3).

73. 469 U.S. 274, 15 ELR 20121 (1985).

74. *Id.* at 276. The Ohio receivership law, as in many states, provides a state alternative to bankruptcy by which a receiver may be appointed upon the petition of a creditor for a financially troubled company. Ohio Rev. Code Ann. §2735.01 to .06; Sonja Larsen, *Receivers*, Ohio Jurisprudence 3d, Aug. 2004, §33.

75. *Kovacs*, 469 U.S. at 276 n.1.

76. Interestingly, by filing its motion, the state of Ohio precluded itself from another possible argument—sovereign immunity. The Court recently determined that a state as a student loan provider cannot claim sovereign immunity from having its claim determined and discharged in a bankruptcy proceeding. Tennessee Student Assistance Corp. v. Hood, 541 U.S. 440 (2004). However, in so doing, the Court did not actually determine whether states enjoy sovereign immunity from federal bankruptcy laws, finding instead that the proceeding was an in rem proceeding not subject to sovereign immunity. *Id.* at 447. However, it is clear that a state waives sovereign immunity as to a particular proceeding when it voluntarily files a pleading, including a proof of claim, in the proceeding. Epstein et al., *supra* note 45, §3-34; Hillinger & Hillinger, *supra* note 40, at 417-18.

77. *Kovacs*, 469 U.S. at 277.

78. Though the Court's decision of dischargeability focused on the definition of a claim, its decision rested in part on the policies of dischargeability. Individual debtors receive a discharge of some unpaid debts in bankruptcy. 11 U.S.C. §§727, 1141, 1228, 1328. To the extent that the district court considered the effect on the debtor post-petition if Ohio's right to payment was not deemed a claim, such a consideration is not relevant in a corporate liquidation because corporations that liquidate essentially receive a discharge of *all* debts simply by ceasing to exist at the end of the bankruptcy proceeding. *See Kovacs*, 469 U.S. at 285-86 (O'Connor, concurring).

79. The *Kovacs* Court considered the definition of a claim under §101(4) of the Bankruptcy Code. *Kovacs*, 469 U.S. at 278. Though the definition of a claim is now located in §101(5) of the Bankruptcy Code, it is identical to the provision considered by the *Kovacs* Court.

80. *Id.* at 280 (citing 124 Cong. Rec. 32393 (Sept. 28, 1978) (remarks of Rep. Don Edwards (D-Cal.))).

81. *Id.* at 282. Indeed, though in the context of discharge, the Court specifically refused to find "that Kovacs' discharge will shield him from prosecution for having violated the environmental laws of Ohio or for criminal contempt for not performing his obligations . . . [or] what the legal consequences would have been had Kovacs taken bankruptcy before a receiver had been appointed . . . ." *Id.* at 284.

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government seeking monetary reimbursement of funds already spent on remediation or restoration is a claim (and thus dischargeable),[82] whereas an injunction ordering the debtor to cease affirmative actions that harm the environment is not a claim (and not dischargeable).[83] In situations falling between these two extremes, however, the same consensus does not hold. Court decisions have been mixed where the government does not seek reimbursement but rather seeks to require that the debtor remediate past environmental problems and prevent further environmental harm of a site.

For example, less than one month after *Kovacs*, the U.S. Bankruptcy Court for the Middle District of Florida held in *In re Robinson*[84] that a claim includes the federal government's right to enforce a wetland restoration order if that restoration would entail "substantial direct expenditure" by the debtor. In that case, the debtor destroyed a salt marsh in violation of the CWA and was ordered to fix the area. Rather than complying with the order, the debtor filed for Chapter 7 bankruptcy protection.[85] The federal government did not seek a money judgment and did not file a proof of claim in the bankruptcy proceeding. Instead, the government argued that because it did not have a "claim" in the bankruptcy proceeding, the obligations of the debtor could not be discharged.[86] The bankruptcy court rejected the government's position. That decision was subsequently reversed on procedural grounds because the debtor failed to file a brief in the subsequent appeal.[87] Nevertheless, the case illustrates that a bankruptcy court may conclude that an obligation to restore (or maintain) a wetland site is a claim that may be discharged.

In contrast, in 1993 the U.S. Court of Appeals for the Third Circuit concluded in *Torwico Electronics, Inc. v. New Jersey*[88] that no claim existed when New Jersey demanded that a debtor remediate a hazardous waste site despite the fact that the cleanup would require a substantial expenditure by the debtor. Torwico Electronics filed a Chapter 11 bankruptcy petition and listed New Jersey as a potential creditor. A few months later, the bankruptcy court set a bar date and all creditors were notified. Between receiving that notice and the bar date for filing proofs of claim, the state discovered numerous environmental law violations on Torwico's property. An administrative order mandated that the debtor clean up the site.[89] New Jersey failed to file a proof of claim by the bar date. Failure to file a proof of claim extinguishes the claim. In determining whether New Jersey held a claim, the court distinguished *Torwico* from *Kovacs* because New Jersey did not have the ability to clean up the site and ask for payment from the debtor; its only option was to require the debtor to clean up the site.[90] The real focus, said the court, is on whether the action is one to remedy "an ongoing and continuing threat" rather than seeking compensation.[91] As in many of the cases before it, *Torwico* makes a distinction between the government's desire to obtain money and its desire to enforce its environmental policies.[92]

C. The Key Characterization: Police Power or Mere Reimbursement?

The same distinction between a state enforcing its police powers and simply receiving money arises frequently in the context of bankruptcy's automatic stay provisions. Under the automatic stay,[93] the filing of a bankruptcy petition precludes creditors from seeking payment from the debtor. All actions will instead come into the bankruptcy court's jurisdiction. However, some actions are excluded from the automatic stay, such as actions to enforce a "governmental unit's . . . police and regulatory power, including the enforcement of a judgment other than a money judgment . . . ."[94] Though at least one court has stated that nondischargeability is a different consideration than the automatic stay, the automatic stay is the more-encompassing of the provisions.[95] Thus, to the extent that a particular action does not fit within the scope of the automatic stay, it should not be dischargeable (as the automatic stay covers claims that will eventually be dischargeable as well as claims that will eventually be denied discharge). It simply defies logic to have a claim that is dischargeable—uncollectible after bankruptcy—but that can be collected during the pendency of the bankruptcy proceedings in a non-bankruptcy action. The ability to discharge debt is akin to an extension of the automatic stay post-bankruptcy.[96]

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82. For a wetland-related case, see Durham Inland Wetlands & Watercourses Agency v. Jimmo, 204 B.R. 655, 659-60 (Bankr. D. Conn. 1997), which concluded that a state seeking reimbursement for its own restoration costs was a claim against the debtor.

83. For example, an order to stop polluting a river would not constitute a claim. *See* In re Robinson, 46 B.R. 136, 139 (Bankr. M.D. Fla. 1985), *rev'd on procedural grounds*, United States v. Robinson, 55 B.R. 355 (Bankr. M.D. Fla. 1985) (Robinson II).

84. 46 B.R. 136, 139 (Bankr. M.D. Fla. 1985).

85. *Id.* at 137-38.

86. *Id.* at 138.

87. *Robinson II*, 55 B.R. at 355.

88. 8 F.3d 146, 24 ELR 20016 (3d Cir. 1993), *cert. denied*, 511 U.S. 1046 (1994).

89. *Torwico*, 8 F.3d at 147-48. In apparent anticipation of the claim question, the order noted:

> No obligations imposed [by this order] . . . are intended to constitute a debt, damage claim, penalty or other civil action which should be limited or discharged in a bankruptcy proceeding. All obligations are imposed pursuant to the police powers of the State of New Jersey, intended to protect the public health, safety, welfare, and environment.

Id. at 148.

90. *Id.* at 149-50.

91. *Id.* at 150. The *Torwico* court noted that even if the debtor has to pay money to end that "ongoing and continuing threat," the mere payment of money does not create a claim. "Were we to adopt [that] position that any order requiring the debtor to expend money creates a dischargeable claim, it is unlikely that the state could effectively enforce its laws: virtually all enforcement actions impose *some* cost on the violator." *Id.* at 150 n.4 (emphasis added).

92. *See*, *e.g.*, In re Chateaugay Corp, 944 F.2d 997, 1008 (2d Cir. 1991) (distinguishing whether the enforcing agency (EPA) *could* take a monetary payment in lieu of compliance with the environmental protection orders, finding that "any order [designed to] end[ ] or ameliorate[ ] continued pollution" is not a claim).

93. 11 U.S.C. §362.

94. *Id.* §362(b)(4).

95. In re Robinson, 46 B.R. 136, 138 (Bankr. M.D. Fla. 1985) ("However valid the plaintiff's statement of the law concerning the automatic stay may be, it is not applicable to an adversary complaint alleging non-dischargeability of a debt. . . . Indeed, most debts which the Court ultimately finds not to be dischargeable are nonetheless within the scope of the automatic stay.").

96. Indeed, the automatic stay terminates under the Bankruptcy Code when a discharge is either granted or denied to a debtor. 11 U.S.C. §362(c).

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The connection between the automatic stay and the definition of a claim was evident to the *Kovacs* Court, which cited an automatic stay case in its decision.[97] In *Penn Terra Ltd. v. Department of Environmental Resources*,[98] the Third Circuit examined an agreement between the debtor and the commonwealth of Pennsylvania to, among other things, backfill mines. In determining that Pennsylvania's attempt to enforce the agreement did not violate the automatic stay, the court considered the purpose of the action. The court expressly rejected the debtor's arguments that any action seeking to remedy a prepetition violation or any remedy that will cost the debtor money are inherently stayed. Instead, the court concluded that Pennsylvania's suit intended "to prevent future harm" and, thus, could not be stayed.[99] The Pennsylvania state courts agreed in another decision, noting that when the state seeks remediation rather than monetary compensation, the automatic stay does not apply.[100] But earlier this year, the U.S. Bankruptcy Court for the Eastern District of Wisconsin noted that enforcement of an agreement between a debtor and the U.S. Environmental Protection Agency, in which the debtor had to pay part of the monitoring expenses of a site, would be subject to the automatic stay.[101] Nevertheless, the bankruptcy court's focus—"whether plaintiff seeks compensation for past damages or prevention of future harm"[102]—mirrors that of the other courts considering the automatic stay question.

V. Woodbury Creek Wetland Mitigation Bank

The Woodbury Creek Wetland Mitigation Bank raises issues related to early release of credits, the vitality of financial assurances, and the ability of regulators to take enforcement actions against a mitigation banker. The bankruptcy of the mitigation bank's controlling corporation[103] and the sale of most of its assets have complicated the state's efforts to ensure that damaged wetlands are replaced.

A. From Establishment to Enforcement

In a July 1995 resolution, the New Jersey Freshwater Wetlands Mitigation Council granted conditional approval to U.S. Wetland Services, Inc., to establish and operate a wetland mitigation bank in Gloucester County.[104] At the time, the resolution contemplated that U.S. Wetland Services would "enhance 128.73 acres of degraded wetlands, create 38.14 acres of freshwater wetlands, and establish 18.59 acres of upland buffers," thus generating 99.64 credits that could be sold to developers.[105] Eventually, LandBank (which was the owner of U.S. Wetland Services) took over as the party legally responsible for the Woodbury Creek Wetland Mitigation Bank.[106]

The resolution, the terms of which were later incorporated into a 1996 permit,[107] allowed for an early release of credits. LandBank could sell up to one-third of the credits once it recorded a conservation restriction, received all permits necessary for the mitigation work, posted bonds to cover construction and maintenance costs, and entered into an agreement transferring the site to a governmental or nonprofit conservation organization "upon completion of the maintenance and monitoring requirements."[108] Additional credits could be sold when the site met certain performance standards pertaining to planting and grading.[109] Unfortunately, LandBank encountered significant problems on the site early on.

In the course of its creation efforts, LandBank inadvertently drained almost 19 acres of wetlands.[110] The New Jersey Department of Environmental Protection (NJDEP) turned to the performance bond as a source of funds to conduct remediation work. LandBank, however, had failed to pay the premiums on the bonds.[111] Accordingly, the performance bonds had lapsed and there was no ready pool of money that could be drawn upon.

The NJDEP brought an administrative enforcement action against LandBank. On July 17, 2002, the NJDEP found that LandBank violated the July 1995 resolution "by failing to maintain the financial assurance, draining existing wetlands and failing to continue to monitor the site."[112] Accordingly, the NJDEP ordered LandBank to restore the approximately 19 acres at a 3 to 1 ratio.[113] In addition, the NJDEP levied a $9,000 penalty,[114] although the fine paled in

97. *Kovacs*, 469 U.S. at 283 n.11 (citing Penn Terra Ltd. v. Department of Envtl. Resources, 733 F.2d 267, 14 ELR 20475 (3d Cir. 1984)).

98. 733 F.2d 267, 269-70, 14 ELR 20475 (3d Cir. 1984).

99. *Id.* at 278.

100. Commonwealth Dep't of Envtl. Resources v. Ingram, 658 A.2d 435, 439 (Pa. 1995) (citing *Penn Terra*, 733 F.2d at 267, Torwico Elecs. v. New Jersey, 8 F.3d 146, 24 ELR 20016 (3d Cir. 1993), and distinguishing *Kovacs*, 469 U.S. at 274).

101. In re FV Steel & Wire Co., 2005 WL 1006063 (Bankr. E.D. Wis. 2005).

102. *Id.* at *4.

103. *See infra* note 117 for a discussion of the relationship between LandBank and The IT Group.

104. Resolution of the New Jersey Freshwater Wetlands Mitigation Council Conditionally Approving Phases I and II of Woodbury Creek Wetlands Mitigation Bank (July 11, 1995) [hereinafter NJ Wetlands Resolution].

105. In the Matter of LandBank, New Jersey Department of Environmental Protection Administrative Order and Notice of Civil Administrative Penalty Assessment at 1, ¶ 2 (July 17, 2002) [hereinafter Administrative Order].

106. *Id.* at 1, ¶ 1 (noting that U.S. Wetland Services, Inc., "became manager of the mitigation bank on behalf of LandBank"). *See also* Motion of the IT Litigation Trustee for an Order (I) Enforcing (A) the Bar Date Order, (B) the Administrative Bar Date Order, (C) the Confirmation Order, and (D) the Plan Injunction; (II) Directing the New Jersey Department of Environmental Protection to Dismiss Certain Administrative Actions Against the Debtors Pursuant to the Court's Orders, the Plan Injunction and 11 U.S.C. §§105(a) and 1142 (b); and (III) Granting Related Relief at 7, No. 02-10118 (Bankr. D. Del. Nov. 16, 2004) (stating that LandBank "created the [m]itigation [b]ank" and "formed a subsidiary, U.S. Wetland Services, Inc . . . to manage the site") [hereinafter IT Litigation Trust Motion].

107. Administrative Order, *supra* note 105, at 1, ¶ 3.

108. NJ Wetlands Resolution, *supra* note 104, at 3-4.

109. *Id.* at 4.

110. Administrative Order, *supra* note 105, at 2, ¶ 6 (finding that "in an effort to build wetlands on the site, LandBank drained 18.924 acres of existing wetlands which is in violation of the Freshwater Wetlands Protection Act"). LandBank's consultant submitted a report to the NJDEP that notified the agency that some of the "existing wetlands on the site no longer appear to exhibit wetland hydrology." *Id.* at 2, ¶ 5.

111. *Id.* at 1-2, ¶ 3. *See also* Banks and Fees, *supra* note 1, at 88 (discussing a case in New Jersey where "the agency found that the sponsor had failed to pay the yearly premiums on it [a performance bond], making it impossible to call").

112. Administrative Order, *supra* note 105, at 2, ¶ 3.

113. *Id.* at 3, ¶ 11.

114. *Id.* at 4, ¶ 15.

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comparison to the costs associated with restoring 57 acres. Well aware that LandBank's controlling corporation, The IT Group, Inc., had filed for bankruptcy, the NJDEP took care to state that the order was binding on bankruptcy trustees and the obligations it imposed were not dischargeable in bankruptcy.[115]

As the NJDEP soon learned, however, a state administrative order does not necessarily trump a federal bankruptcy judge's decision.

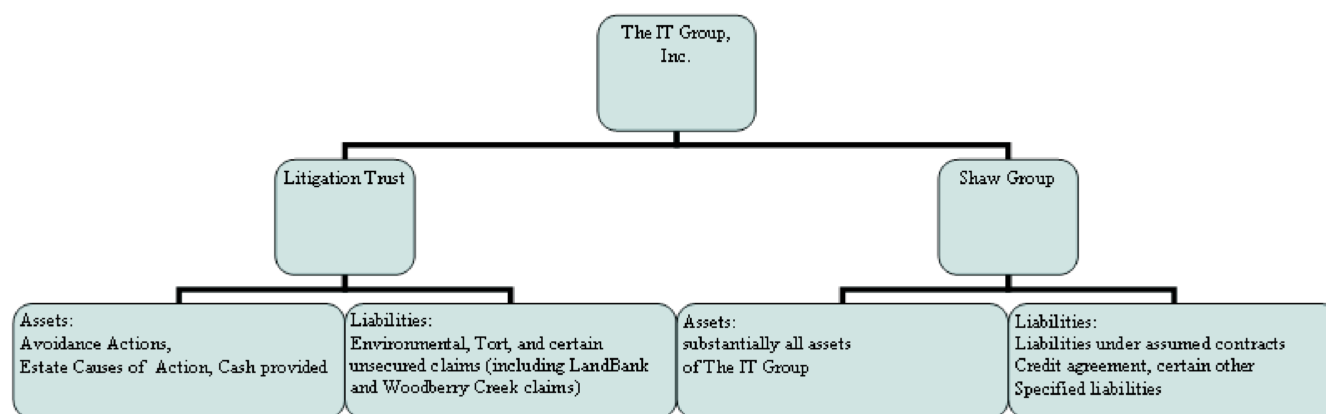
B. The Bankruptcy Proceeding

The IT Group voluntarily filed for bankruptcy protection under Chapter 11 of the Bankruptcy Code on January 13, 2002, in the U.S. Bankruptcy Court for the District of Delaware.[116] Seventy affiliated debtors were included in the IT Group filing, including seven LandBank entities.[117] At the time of the filing, the IT Group reported approximately $1.3 million in assets and just over $1 million in debt, with over 23 million shares of stock outstanding.[118] A few months after the initial filing, the IT Group submitted its schedules.[119] The debtor included the NJDEP as a potential claimant, holding a contingent, unsecured, nonpriority claim in an unlisted amount.[120]

1. Sale of Assets to The Shaw Group, Inc.

In its reorganization, the IT Group sold the vast majority of its assets to another entity, the Shaw Group.[121] Under the terms of the agreement, the Shaw Group purchased both the assets and the liabilities of the IT Group for $105 million in cash and stock[122]; however, the IT Group retained certain assets and liabilities.[123] With those assets, the IT Group formed litigation trusts to pay off the excluded liabilities. What was left of the former IT Group was essentially a shell corporation overseeing the liquidation of remaining claims.[124] Significantly, one of the assets (and liabilities) retained was the Woodbury Creek property.[125]

Figure 1



115. *Id.* at 4, ¶ 19 & 5, ¶ 22. Once the NJDEP issues an administrative order, the "violator may request an adjudicatory hearing to contest" the matter. N.J. ADMIN. CODE tit. 7, §7A-16.7. The matter was before the Office of Administrative Law of the State of New Jersey (OAL Dkt. No. ESA 06949-2002, Agency Ref. No. 0820-94-0013) when the Bankruptcy Court intervened.

116. Voluntary Petition, In re The IT Group, Inc., No. 02-10118 (Bankr. D. Del. filed Jan. 13, 2002) [hereinafter IT Petition].

117. *Id.* at Annex A. The affiliated debtors included LandBank Acquisition I, Ltd. Liability Company; LandBank Acquisition II, Ltd. Liability Company; LandBank Acquisition III, Ltd. Liability Company; LandBank Environmental Properties, Ltd. Liability Company; LandBank Remediation Corporation; LandBank, Inc.; and LandBank Wetlands, Ltd. Liability Company. *Id.* The relationship of LandBank to the IT Group and its role in the corporate structure, as defined by The IT Group, Inc., was noted in the IT Group's 1999 filings with the Securities and Exchange Commission:

> Through our LandBank subsidiary, we provide integrated solutions for environmentally impaired property assets. We acquire and redevelop environmental properties to achieve their highest values, while mitigating risks through innovative risk management programs. Our unique combination of real estate, environmental, legal, financial and insurance expertise has achieved success by tackling the difficult issues inherent in environmental property transactions. By balancing all interests and aspects of real estate transactions, we can find solutions and create value for sellers, investors, developers and end users.

THE IT GROUP, INC., 1999 ANNUAL REPORT (Filing No. 50005174) (1999).

118. IT Petition, *supra* note 116, at Exh. A.

119. Statement of Financial Affairs and Schedules of Assets and Liabilities, No. 02-10118 (Bankr. D. Del. filed Apr. 3, 2002).

120. *Id.* at 6.

121. Asset Purchase Agreement By and Among The IT Group, Inc., and The Shaw Group, Inc., No. 02-10118 (Bankr. D. Del. filed Jan. 23, 2002) [hereinafter Shaw Agreement].

122. *Id.* §2.05.

123. *Id.* §§2.01 to 2.04.

124. IT Litigation Trust Motion, *supra* note 106, at 5. The figure includes information derived from the First Amended Disclosure Statement Pursuant to Section 1125 of the Bankruptcy Code with respect to the First Amended Joint Chapter 11 Plan for The IT Group, Inc., and its Affiliated Debtors Proposed by the Debtors and the Official Committee of Unsecured Creditors, Exh. A, §§1.1, 7.10 et al., No. 02-10118 (Bankr. D. Del. filed Feb. 9, 2004) [hereinafter IT Plan]; Shaw Agreement, *supra* note 121, §2.01 to 2.04, sched. 1.01; and THE SHAW GROUP INC., 2002 ANNUAL REPORT (Filing No. 02068305) (2002).

125. *See* IT Litigation Trust Motion, *supra* note 106.

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However, before a creditor could enjoy a payment from the litigation trust arrangement,[126] the creditor needed to establish the right to receive payment. For the state of New Jersey, that requirement came into issue.

2. Payment of Claims by the IT Litigation Trust

Per an order of the bankruptcy court, all creditors seeking reimbursement of claims in the IT Group bankruptcy needed to submit a proof of claim establishing entitlement to be paid by July 15, 2002.[127] The state of New Jersey did not file a claim. The IT Group then filed an adversary proceeding seeking a determination that by not filing a proof of claim, the state of New Jersey waived its right to payment in the bankruptcy proceedings.[128]

The basis for the adversary proceeding rests in the meaning of "claim" under the Bankruptcy Code.[129] In its order, the bankruptcy court found that New Jersey did have a right to payment, albeit an undetermined one, from LandBank that constituted a claim in bankruptcy.[130] The court's order supports the broad reading frequently given to the definition of a claim under the Bankruptcy Code.[131] Indeed, as the debtor noted, the legislative history demands a broad reading of this definition.[132] But even a broad definition has some limits.

The motion to enforce the bar date recognized one potential problem with defining New Jersey's action as a claim. Despite its broad definition, a claim focuses on a "right to payment."[133] But the New Jersey administrative proceeding, while clearly having a monetary component, was about more than just money. It sought injunctive relief to require the creation and maintenance of new wetlands. The trustee argued that such relief can be classified as a claim because "the Trust can perform the obligation only by payment of money."[134] Thus, noted the trustee, because LandBank no longer exists, any injunctive relief that New Jersey could otherwise seek would be reduced to a monetary judgment.[135] This argument is reminiscent of the post-*Kovacs* cases that declare that so long as monetary payment is involved—even if not directly to the government—the government has a claim. On December 6, 2004, the bankruptcy court agreed with the trustee, entering an order directing New Jersey to dismiss its administrative proceeding against LandBank.[136]

C. Recommendations Regarding a Bankruptcy in the Early Stages of a Mitigation Bank

When a mitigation bank is bankrupt, it will likely not have funds available to fulfill its continuing obligations regarding the mitigation site. This is especially problematic if the mitigation bank has received an early release of credits and has sold them. In LandBank's case, it sold 32.75 credits while creating 36.64 credits.[137] Although LandBank had not oversold its mitigation credits, it had a continuing obligation to monitor the site, which the NJDEP determined it was not doing.[138] Furthermore, LandBank needed to account for the 19 acres of wetlands it drained.

There are several approaches that regulatory agencies can take to reduce the likelihood of this situation reoccurring. First, as the NJDEP later did, an agency could limit the amount of early releases. Based in part on this experience, the NJDEP modified its regulations to provide that no more than 10% of the total credits from a mitigation bank may be

126. Under the plan of reorganization, any "claim" by the state of New Jersey pursuant to the wetland case would be paid through a litigation trust, funded by property that was the subject of the litigation itself and proceeds of that property. IT Plan, *supra* note 124, §7.10. The Litigation Trust is distinct from the Environmental Liquidating Trust, formed under an agreement with the California Department of Toxic Substances Control, to deal with certain properties in California. *Id.* §7.10(II). The Environmental Trust is not included in the figure herein.

127. Order Establishing Bar Date for Filing Proofs of Claim and Approving Form and Manner of Notices Thereof, No. 02-10118 (Bankr. D. Del. filed May 24, 2002) ("*all* persons or entities holding a Claim against the Debtors are required to file a proof of claim . . .") (emphasis added) [hereinafter IT Bar Date Order]. Notice of the Bar Date was listed as being sent to the state of New Jersey. IT Litigation Trust Motion, *supra* note 106, at 4. Pursuant to the court's order, notice of the establishment of the bar date had to be sent to "all known or reasonably ascertainable holders of a Claim . . . ." IT Bar Date Order, *supra*, at 4.

128. Motion of the IT Litigation Trust Trustee for an Order Enforcing the Bar Date, No. 02-10118 (Bankr. D. Del. Nov. 16, 2004) [hereinafter IT Bar Date Motion]. Though most of New Jersey's claims involved prepetition claims, to the extent that amounts due to the NJDEP accrued post-petition, a bar date had been set for such administrative claims, and the debtor apparently sent notice of such date to New Jersey. *Id.* at 5.

129. A claim is defined as a

> right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; . . . or right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured . . . .

11 U.S.C. §101(5).

130. Order Granting Motion of the IT Litigation Trust Trustee for an Order (I) Enforcing (A) the Bar Date Order, (B) the Administrative Bar Date Order, (C) the Confirmation Order, and (D) the Plan Injunction; (II) Directing the New Jersey Department of Environmental Protection to Dismiss Certain Administrative Actions Against the Debtors Pursuant to the Court's Orders, the Plan Injunction and 11 U.S.C. §§105(a) and 1142(b); and (III) Granting Related Relief at 2 (Bankr. D. Del. filed Dec. 6, 2004) [hereinafter IT Litigation Trust Order].

131. Johnson v. Home State Bank, 501 U.S. 78, 83 (1991) (citing Pennsylvania Dep't of Public Welfare v. Davenport, 495 U.S. 552, 558, 563-64 (1990), and Ohio v. Kovacs, 469 U.S. 274, 279, 15 ELR 20121 (1985)).

132. IT Bar Date Motion, *supra* note 128, at 10, *citing* H.R. Rep. No. 95-595, at 309 (1977); S. Rep. No. 95-989, at 21 (1978) ("By this broadest possible definition, . . . the bill contemplates that all legal obligations of the debtor, no matter how remote or contingent, will be able to be dealt with the in the bankruptcy case.").

133. 11 U.S.C. §101(5).

134. IT Bar Date Motion, *supra* note 128, at 12.

135. *Id.* at 13. In its response to the motion, New Jersey distinguished its actions from *Kovacs*, noting that New Jersey sought remediation by the debtor, rather than reimbursement of remediation done by the state. Thus, argued the state, New Jersey did not seek a claim from the debtor; instead, it sought to enforce the policies of the statute. Opposition of the New Jersey Department of Environmental Protection to the Motion of IT Litigation Trust Trustee for an Order Directing the New Jersey Department of Environmental Protection to Dismiss Certain Administrative Actions Against the Debtors Pursuant to the Court's Orders, No. 02-10118 at 3 (Bankr. D. Del. Dec. 2, 2004).

136. IT Litigation Trust Order, *supra* note 130, at 2. New Jersey has appealed the decision of the Bankruptcy Court to the U.S. District Court for the District of Delaware. Notice of Appeal, No. 02-10118 (Bankr. D. Del. filed Dec. 17, 2004).

137. Administrative Order, *supra* note 105, at 2, ¶ 6.

138. *Id.* (stating that "[i]f the mitigation monitoring is successfully completed, the amount of credits sold can be offset by the 36.64 mitigation credits established on the site").

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released once the banker has signed the New Jersey Freshwater Wetlands Mitigation Council resolution approving the bank, obtained required construction permits and financial assurances, completed the easement, and agreed to convey the site at the conclusion of the bank's life.[139] Of course, the regulatory agency is confronted with the challenge of finding the proper balance: what level of early releases of credits will encourage and foster mitigation banking without unduly risking wetland losses in case a bank fails?

Ideally, the banker's financial assurance should provide funds to complete the mitigation project if a bank fails. But as we have seen with LandBank, performance bonds can only be drawn upon if the premiums have been paid. In response to this experience, the NJDEP also modified its regulations to remove an express reference to performance bonds as a financial assurance; rather, the regulations now suggest that letters of credit be used.[140] Florida offers another approach if an agency still wishes that performance bonds remain an option. In Florida, the bonding company must provide 120-day notice to the regulators prior to canceling a surety or performance bond.[141] The notice requirement allows the regulators to call the bond, if necessary. The possibility of an unpleasant surprise—discovering that no financial assurances exist when they are most needed—is thus minimized.

What if, however, an agency finds itself in the NJDEP's position: a mitigation provider (whether a permittee, mitigation banker, or in-lieu-fee sponsor) has filed for bankruptcy and has no valid financial assurances to complete its mitigation obligations? If the agency has instituted an enforcement action, the agency must first determine whether the automatic stay applies to the ongoing action and, second, whether it holds a claim in the bankruptcy proceeding.[142] In the myriad of cases that consider the intersection of state or federal environmental protection and payment to creditors in bankruptcy, one factor predominates. In short, in order to avoid bankruptcy as a governmental claimant on environmental matters—whether in the context of the automatic stay, filing a proof of claim, or dischargeability—the governmental creditor must establish that its rights prevent *future* environmental law violations rather than remedying *past* violations.

Fortunately, most (but not all) courts look beyond the simple question of whether money is involved to the more complicated question of how the regulation is structured. To the extent that the government (or even the debtor) has the choice of money or remediation, it is more likely to have a claim in bankruptcy. The best chance that a governmental creditor has to avoid such a claim is to establish that the enforcement action's underlying purpose is the prevention of future harm.

In the wetland context, the "continuing violation" theory may assist an agency in establishing that a restoration order is designed, in part, to prevent future harm. Under this theory, each day that unpermitted fill in a wetland remains in place constitutes a violation of the CWA.[143] A wetland restoration order thus may be viewed as both an effort to remedy a past violation and an effort to prevent a continuing violation, i.e., future harm.[144] Accordingly, an agency could rely

139. N.J. ADMIN CODE tit. 7, §7A-15.23(e)1.

140. *Compare* N.J. ADMIN. CODE tit. 7, §7A-14.1(c), at 28 N.J. Reg. 4891(a) (Dec. 2, 1996) (discussing the use of a "performance bond" related to the construction of proposed mitigation) *with* N.J. ADMIN. CODE tit. 7, §7A-15.13 (requiring "a letter of credit or other financial assurance that meets the requirements of this section"). *See also* BANKS AND FEES, *supra* note 1, at 88 (noting that the NJDEP "now encourages bank sponsors to use letters of credit for financial assurances").

141. FLA. ADMIN. CODE ANN. r. 62-342.700(5)(e).

142. Should a government entity seek status as a claim in bankruptcy, the government's position will be improved if it can establish that the claim is entitled to administrative priority status. For an interesting discussion of the possible consequences of treating an environmental claim as an administrative priority claim, see Hillinger & Hillinger, *supra* note 40, at 390 ("Essentially, granting administrative expense priority to environmental obligations can upset the bankruptcy game plan. It can undermine a debtor's opportunity to reorganize, and it can redistribute most of the 'wealth' to a single party contrary to bankruptcy's 'equality is equity' creed."). But in order for the government to establish administrative priority for cleanup costs incurred in the bankruptcy proceeding, the government must establish that the cleanup protected the value of property for the bankruptcy estate. *See id.* at 390-406. The Hillingers review the case law in the area, as well as nonenvironmental case law. They note that "although several cases deny the environmental claimant administrative expense status for post-petition cleanup, . . . [a]ll of the cases involve property that was not property of the estate . . . ." *Id.* at 400. *See also* Pennsylvania v. Conroy, 24 F.3d 568, 569-70, 24 ELR 21365 (3d Cir. 1994) (allowing administrative expense priority for cleanup costs incurred prepetition because "the estate could not avoid such costs through abandonment, [thus] 'the expenses to remove the threat posed by such substances are necessary to preserve the estate'") (citing In re Chateaugay Corp., 944 F.2d 997, 1009-10 (2d Cir. 1991)); In re Wall Tube & Metal Prods. Co., 831 F.2d 118, 123-24 (6th Cir. 1987), *cited in* Joe Lee, *Power of Court; Issuance of Orders, Processes, and Judgments; Priority*, BANKR. SERV., LAW. ED., Apr. 2005, at 12.567, and in Hillinger & Hillinger, *supra* note 40, at 363-64, 395-96, 399; In re Mowbray Eng'g Co., 67 B.R. 34, 35 (Bankr. M.D. Ala. 1986) (allowing administrative expense priority for cost of cleaning property abandoned by the trustee because of need to protect "public health and safety"), *cited in* Joe Lee, *Allowance of Administrative Expenses; Environmental Claims; Abandonment of Property*, BANKR. SERV., LAW. ED., Apr. 2005, at 23.652; *In re Chateaugay Corp.*, 944 F.2d at 997 (giving EPA administrative expense priority for cleanup costs assessed prepetition and post-petition, even if debtor chooses to liquidate). *But cf.* In re Hanna, 168 B.R. 386, 388 (B.A.P. 9th Cir. 1994) (denying administrative expense priority for ongoing cleanup costs and noting that administrative expenses must be "incurred post-petition," render a benefit to the debtor's estate, and be "actual and necessary" costs) (citation omitted).

Whether a trustee or debtor in possession may abandon property in the bankruptcy that is of little value to the bankruptcy estate when that property has environmental obligations associated with it appears to be a critical issue in determining whether the environmental obligations are administrative expenses. For an in-depth analysis of abandonment of such property, see Hillinger & Hillinger, *supra* note 40, at 361-71. It appears at least arguable that the costs to clean (or restore and maintain) property that the reorganizing debtor intends to keep and use in order to become profitable are, indeed, costs that "preserve" property of the estate and, thus, qualify as administrative expenses. *Id.* at 402-03. The Hillingers also discuss the possibility of fines as administrative expenses but note that as with cleanup costs, the area is not clear. *Id.* at 403-06.

143. *E.g.*, Atlantic States Legal Found. v. Hamelin, 182 F. Supp. 2d 235 (2001) (discussing continuing violation theory and citing cases, including Sasser v. EPA, 990 F.2d 127, 23 ELR 21022 (4th Cir. 1993); and United States v. Reaves, 923 F. Supp. 1530, 26 ELR 21394 (M.D. Fla. 1996)). The continuing violation theory has been helpful to plaintiffs bringing citizen suits for CWA §404 violations. Under §505 of the CWA, a citizen suit may not be brought for "wholly past violations." *See* Gwaltney of Smithfield, Ltd. v. Chesapeake Bay Found., 484 U.S. 49, 18 ELR 20142 (1987). Courts have permitted CWA §404 citizen suits on unauthorized filling to proceed, reasoning that each day the fill remains in place constitutes a violation. *See, e.g.*, *Atlantic States*, 182 F. Supp. 2d at 235. While a citizen suit may be brought for unauthorized discharges, as noted earlier citizens may not bring suit for violation of permit conditions (such as failure to perform mitigation). *See supra* note 18.

144. Many of the "future harm" cases involve hazardous materials. A bankruptcy court might be less willing to extend the reasoning of

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on the "continuing violation" theory in a bankruptcy proceeding to contend that the agency should not be treated as a mere claimant.[145]

VI. Ecobank: Florida and North Carolina Mitigation Banks

The Ecosystems Land Mitigation Bank Corporation, a Florida corporation, is legally responsible for at least three mitigation banks: the Lake Louisa/Green Swamp Regional Mitigation Bank and the East Central Florida Regional Mitigation Bank (also known as the Hunter Mitigation Bank), both in central Florida[146]; and the Barra Farms Cape Fear Regional Mitigation Bank in North Carolina.[147] In contrast to Woodbury Creek, the mitigation work at these sites has nearly been completed and, based on the credit releases, has largely been successful.[148] The long-term management accounts, however, are currently unfunded, which raises questions about the long-term stewardship of the sites.

A. A Joint Venture and Contrasting Financial Assurances for Long-Term Maintenance

Because the three banks were established after November 1995, each went through the MBRT process and each operates under a mitigation banking instrument. The Lake Louisa and Hunter Banks are similar in size; the former is 1,007 acres while the latter is 1,061 acres.[149] Their mitigation banking instruments contemplate restoring and enhancing freshwater forested and herbaceous wetlands.[150] The Barra Farms Bank is a 632-acre site consisting of "interstream flats, former Carolina Bays, and historic stream origins which have been ditched and drained to support agricultural and silvicultural activities."[151] The MBRT found that the Barra Farms Bank provided opportunities for wetland and stream restoration and enhancement.[152]

Ecosystems, through its subsidiary Ecobank, entered into a joint venture with Da Capo al Fine, Ltd. The Lake Louisa, Hunter, and Barra Farm Banks were among the joint venture's projects.[153] In this joint venture between Ecobank and Da Capo, Ecobank provided the wetland mitigation expertise while Da Capo provided the financing. As part of this agreement, Da Capo obtained letters of credit and guarantees of payment.[154]

The financial assurances for long-term maintenance for each of the three banks differ in amount and type. In the Lake Louisa Bank, the mitigation banking instrument calls for a trust account of approximately $600,000.[155] Da Capo supplied a letter of credit to cover this amount.[156] The long-term maintenance of the Lake Louisa Bank will require restricting access to the site, removing exotic and invasive species, and conducting prescribed burning.[157] The Hunter Bank also must have a trust account but in the much smaller amount of $44,700.[158] This apparently was also guaranteed by a letter of credit supplied by Da Capo.[159] The plan for long-term maintenance for this site consists of conducting prescribed burns and maintaining a protective fence.[160]

The long-term maintenance requirements for the Barra Farms Bank in North Carolina are much looser. The mitigation banking instrument does not set a specific dollar amount; instead, it leaves the details of the long-term trust fund to be resolved in the future:

> A separate, long-term trust fund will be provided by the Sponsor [Ecosystems Land Mitigation Bank Corporation] for long-term maintenance, management, and remedial actions acceptable to the MBRT. The trust fund will be established upon completion of debiting of the

these cases to a wetland violation where there is no imminent threat to human health.

145. Of course, if the restoration order goes beyond the site in question, then it may be solely directed at remedying a past violation. While the NJDEP's order to restore the approximate 19 acres at the Woodbury Creek site could be viewed at least in part as preventing future harm, the portion of the order calling for an additional 38 acres to be restored would seem to be more remedial or punitive in nature. As such, the restoration of the 38 acres would not be directed at preventing future harm.

146. *See* Florida DEP, *Mitigation and Mitigation Banking*, *at* http://www.dep.state.fl.us/water/wetlands/mitigation/mitbanks.htm (last visited June 29, 2005) (listing an Ecobank contact for the two banks).

147. U.S. Army Corps of Eng'rs, *NC Mitigation Banks*, *at* http://www.Saw.usace.army.mil/WETLANDS/Mitigation/Banks/imap1/index.html (last visited June 29, 2005) (listing Ecobank as the bank sponsor).

148. *See* Letter from Osvaldo Collazo, Jacksonville District Corps of Engineers, to William Gerber, Ecobank (Mar. 17, 2005) (releasing an additional 45.2 federal credits from the Hunter Bank based on four years of monitoring reports). As of March 2005, the Corps had authorized 144.64 credits released from the Hunter Bank, and 69.44 credits were still available to be sold. *See* East Central Florida Regional Mitigation Bank Ledger, Mitigation Credit Accounting Schedule (enclosure with Letter from Osvaldo Collazo, *supra*). The final release consists of 36.16 credits and "will depend on the future vegetative conditions" at two areas on the site. Letter from Osvaldo Collazo, *supra*. A letter from Ecobank also indicates that the Lake Louisa Bank has an existing inventory of released credits. *See* Letter from William G. Gerber et al., Ecobank, to Gerry Seitz, Da Capo al Fine, Ltd., at 2 (June 23, 2004) [hereinafter Gerber Letter]. With respect to the Barra Farms Bank, the Corps' website indicates that credits are currently available. *See* U.S. Army Corps of Engineers, *NC Mitigation Banks*, *supra* note 147.

149. *See* Florida DEP, *Mitigation and Mitigation Banking, supra* note 146 (listing acreage and potential state credits).

150. *See* Mitigation Banking Instrument, Lake Louisa and Green Swamp Regional Mitigation Bank, Lake County, Florida at 2-5 (1996) (U.S. Department of the Army Permit No. 199502208) [hereinafter Lake Louisa MBI]; Mitigation Banking Instrument, East Central Florida Regional Mitigation Bank (South), Orange County, Florida at 2-5 (1997) (U.S. Department of the Army Permit No. 199506135 (IP-ME)) [hereinafter Hunter Bank MBI].

151. Mitigation Banking Instrument, Agreement to Establish the Barra Farms Cape Fear Regional Mitigation Bank in Cumberland County, North Carolina at 3 (1999) [hereinafter Barra Farms MBI].

152. *Id.*

153. Debtor's Second Amended Disclosure Statement, In re Ecosystems Land Mitigation Bank Corp., No. 6:04-bk-07391-KSJ at 5 (Bankr. M.D. Fla. filed Mar. 4, 2005) [hereinafter Ecosystems Disclosure Statement].

154. *Id.* at 4.

155. *See* Gerber Letter, *supra* note 148, at 2 (noting "requirement for a $600,000 long-term maintenance trust to be established" for Lake Louisa Bank).

156. The Lake Louisa property is currently the subject of a letter of credit provided by Da Capo that guarantees payment of the loan used to purchase the property and, in order to terminate the letter of credit, a "Long-Term Maintenance Trust" of $600,000 would need to be established. Disclosure Statement of Da Capo Al Fine, Ltd., in Support of its Proposed Plan for the Reorganization of Ecobank, In re Ecosystems Land Mitigation Bank Corp., No. 6:04-bk-07391-KSJ at 5-6, 12 (Bankr. M.D. Fla. filed Mar. 4, 2005) [hereinafter Da Capo Disclosure Statement].

157. Lake Louisa MBI, *supra* note 150, at 5-6.

158. Hunter Bank MBI, *supra* note 150, tbl.10.0.

159. *See* Ecosystems Disclosure Statement, *supra* note 153, at 4 (indicating that Da Capo was to provide letters of credit for the joint venture).

160. Hunter Bank MBI, *supra* note 150, tbl. 10.0 (identifying long-term maintenance as prescribed burns every 2 years and fence replacement every 10 years).

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bank or at the end of the monitoring period, which ever is longer.[161]

The trust fund for the Barra Farms Bank has yet to be established.[162]

Although the mitigation bank sites were satisfying the performance standards established by the MBRT, thus making credits available for sale, Ecosystems encountered financial challenges. The joint venture between Ecobank and Da Capo failed due to a "difficult relationship" between the parties.[163] The ensuing bankruptcy raises the question of who had rights in the joint venture property, including the mitigation credits and proceeds from the sale of those credits.[164] The bankruptcy also raises the question of whether, and to what extent, the long-term maintenance trust accounts will be funded.

B. The Bankruptcy Proceeding

Ecosystems filed for Chapter 11 bankruptcy protection on June 25, 2004, in the Middle District of Florida, Orlando Division.[165] Its president also filed a personal Chapter 11 bankruptcy on October 22, 2004.[166] Though still relatively new bankruptcy filings, plans of reorganization have been filed in each bankruptcy. Indeed, in the Ecosystems bankruptcy, competing plans of reorganization have been filed by Ecosystems and by its joint venture partner[167] and creditor Da Capo.[168]

Under its plan of reorganization, Ecosystems would pay all creditors, including Da Capo, in full from earnings during the reorganization.[169] However, Ecobank—Ecosystem's subsidiary that entered into the joint venture with Da Capo—noted that its success would depend on obtaining complete title to the Lake Louisa property.[170] Though the Da Capo plan also proposes to pay all creditors in full, it alters the management of Ecosystems from the current management to a mitigation marketing firm.[171]

The creditors are likely to have voted on the competing plans of reorganization by the summer of 2005. The bankruptcy court must then decide whether to confirm one of the accepted plans, if indeed both are accepted. Even if a plan is accepted by the creditors, the court may deny confirmation if the plan does not meet the requirements of the Bankruptcy Code.[172]

Although it is early in the bankruptcy proceedings, it is nevertheless instructive to consider the status of the long-term maintenance arrangements. The banks in Florida—Lake Louisa and Hunter—appear to be in the better position. Initially, Ecosystems' plan of reorganization overlooked the obligation to fund the long-term accounts.[173] Now, however, both competing plans acknowledge that duty.[174] More importantly, it is Da Capo, an entity that is *not* in bankruptcy, that has supplied the letter of credit.[175] While it is always risky to predict what will occur in a bankruptcy proceeding, it would seem that the long-term maintenance accounts will be fully funded.

The financial arrangements for the Barra Farms Bank in North Carolina are an entirely different story. If there is no performance bond, letter of credit, or some other financial assurance backing the long-term maintenance trust account, it may be difficult for government agencies to hold Ecobank to its obligation. The bankruptcy court could find that the obligation to fund the trust account is a claim—if not a contingent claim (because the obligation arises upon the occurrence of future events), then certainly an unliquidated claim (because the amount of the claim is unknown and depends on what amount the MBRT finds "acceptable"). Moreover, the claim would be a general unsecured claim, which would likely only be partially paid or be discharged in its entirety.

In this context, it would be difficult for the government agencies to argue that they are exercising their police powers and should not be viewed as claimants. Agencies have been successful in making this argument when they are seeking to prevent future harm to the environment and public, especially in hazardous waste cases. Maintaining a functioning wetland site would not seem to rise to the same level of urgency. A court could conclude that an agency's attempt to procure monies for a long-term maintenance fund is less

161. Barra Farms MBI, *supra* note 151, at 12.

162. *See* Gerber Letter, *supra* note 148, at 2 (noting need to "fund long-term maintenance trust and negotiate transfer of long-term maintenance" to a local land trust).

163. Ecosystems Disclosure Statement, *supra* note 153, at 7.

164. Da Capo's Motion for Preliminary Injunctive Relief and For Appointment of Trustee and/or Dismissal of Case, In re Ecosystems Land Mitigation Bank Corp., No. 6:04-bk-07391-KSJ (Bankr. M.D. Fla. filed Jan. 10, 2005). Though both parties agreed that Da Capo would receive $6,600 for the sale of Lake Louisa credits and $2,000 for the sale of Hunter credits, the parties disagreed about the likelihood of the credit sales, with Da Capo viewing Ecosystems' projections as overly optimistic. Furthermore, the owners of the Hunter Bank property (Hunter's Development Fund I, Ltd.) have called into question whether the Hunter Bank credits are properly characterized as part of the debtor's inventory. Objection to Debtor's Second Amended Disclosure Statement, In re Ecosystems Land Mitigation Bank Corp., No. 6:04-bk-07391-KSJ at 3 (Bankr. M.D. Fla. filed June 15, 2005). The Objection states that

> [t]o the extent that the Debtor has represented to creditors and the Court in all three of its Disclosure Statements that the HUNTER Credits are part of its "inventory" and that the supply of the HUNTER Credits are therefore definite and unconditionally available for sale throughout the term of the proposed Chapter 11 Plan, such representations are false and call in to question the good faith of the Debtor and the feasability [sic] of the Debtor's Chapter 11 Plan.

165. Voluntary Petition, In re Ecosystems Land Mitigation Bank Corp., No. 6:04-bk-07391-KSJ (Bankr. M.D. Fla. filed June 24, 2004).

166. Voluntary Petition, In re McCarthy, No. 6:04-bk-11540-KSJ (Bankr. M.D. Fla. filed Oct. 22, 2004).

167. Ecosystems sought to reject the joint venture contract in bankruptcy. Debtor's Motion for Authority to Reject Joint Venture Agreement as Executory Contract, In re Ecosystems Land Mitigation Bank Corp., No. 6:04-bk-07391-KSJ (Bankr. M.D. Fla. filed July 1, 2004). The motion to reject was denied. Order Denying Debtor's Motion to Reject Joint Venture Agreement as Executory Contract, In re Ecosystems Land Mitigation Bank Corp., No. 6:04-bk-07391-KSJ (Bankr. M.D. Fla. filed Oct. 12, 2004).

168. Debtor's Second Amended Plan of Reorganization, In re Ecosystems Land Mitigation Bank Corp., No. 6:04-bk-07391-KSJ (Bankr. M.D. Fla. filed Mar. 4, 2005); Da Capo Al Fine, Ltd.'s Plan of Reorganization, In re Ecosystems Land Mitigation Bank Corp., No. 6:04-bk-07391-KSJ (Bankr. M.D. Fla. filed Mar. 4, 2005).

169. Ecosystems Disclosure Statement, *supra* note 153, at 11.

170. *Id.* at 2. Apparently, Da Capo and Ecosystems had agreed that upon payment of $1.85 million, the property would be transferred from Da Capo, the purchaser, to the joint venture. Da Capo Disclosure Statement, *supra* note 156, at 10.

171. Da Capo Disclosure Statement, *supra* note 156, at 16.

172. 11 U.S.C. §1129.

173. Da Capo Disclosure Statement, *supra* note 156, at 5.

174. *Id*. Exh. C (Pro Forma Financial Statement); Ecosystems Disclosure Statement, *supra* note 153, Exh. C (Pro Forma Financial Statement).

175. *See supra* notes 155-56 and accompanying text.

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an exercise of police powers and more a demand for payment. And, of course, as we have seen, such an obligation on the part of the mitigation banker would be subject to discharge in bankruptcy.

C. Recommendations to Ensure the Presence of Long-Term Maintenance Funds in the Event of Bankruptcy

First, we recommend avoiding the Barra Farm model.[176] There may be some benefits associated with delaying the decision about how the long-term maintenance account will be funded and at what level; waiting until after the restoration is complete can allow the MBRT to identify with more specificity what maintenance is necessary, thereby providing a better estimate of the funds needed. The downside to delaying the decision until the credits are sold is that the mitigation banker may be unable to come up with the funds that the MBRT decides is appropriate.

A benefit to identifying the amount of the long-term maintenance fund up front is that a mitigation banker can build this cost into the price of the mitigation credits. Still, identifying the long-term costs up front, but putting off the actual funding of the account or trust, does not reduce the risk of the mitigation banker running into financial difficulties. Requiring an irrevocable letter of credit or performance bond that cannot be canceled without notifying the agency (as is the case with the Lake Louisa and Hunter Banks) reduces such concerns. To eliminate the risk, however, we recommend that the Corps and other agencies consider the approach used with other mitigation banks in Florida: fund the long-term maintenance account with cash as mitigation credits are released or sold.[177]

For example, the Bluefield Ranch Mitigation Bank is a 2,675-acre site where a variety of wetland communities will be restored, enhanced, and preserved.[178] The mitigation banking instrument notes that the banker has established a trust for the long-term maintenance of the site but has provided no other financial assurances.[179] Instead, prior to selling mitigation credits from the initial two phases of the bank, the banker will fund the trust at $565 per acre.[180] Later phases will require the banker to fund the trust with $1,121 when selling a credit.[181] Once all credits are sold, the banker will have contributed over $1.5 million, "which represents the MBRT's current estimated fund balance necessary to generate sufficient returns to manage the bank in perpetuity."[182] The cash in such a trust would not be subject to the mitigation banker's control and thus would not be included in any subsequent bankruptcy proceeding involving the banker.

Other mitigation banks have entered into similar arrangements to fund trust accounts in advance of credit sales. The Myakka Mitigation Bank in Sarasota County will contribute $1,050 to the perpetual maintenance trust fund for each credit sold until the trust fund is fully capitalized at $234,260.[183] The Boran Ranch Mitigation Bank in DeSoto County will pay $1,000 per credit sold until the trust fund is capitalized at $156,400.[184] The Boran Ranch banking instrument also ensures that the trust fund is sufficiently capitalized to pay for maintenance activities. For each credit sold, an additional $200 will be placed into an interest-generating escrow account.[185] After 10 years, any escrow account funds, "which in the trustee's opinion are not required to fund the long-term maintenance program," will be returned to the mitigation banker.[186]

Whatever mechanism for long-term stewardship is employed for mitigation bankers, it is important for several reasons to impose similar requirements on other mitigation providers (such as permittees). First, there is a need for long-term care of mitigation sites.[187] Second, other mitigation

176. The model mitigation banking instrument currently on the Corps Wilmington District's website is also too vague. It simply states:

> **Long-term Management**
> 24. The Sponsor shall implement the long-term management measures described in the Mitigation Plan by **{time frame}**.

WILMINGTON DISTRICT, U.S. ARMY CORPS OF ENGINEERS, MODEL MITIGATION BANKING INSTRUMENT FOR NON-UMBRELLA BANKS 6 (2003), *available at* http://www.saw.usace.army.mil/wetlands/Mitigation/Documents/nonumbrellaTEMPLATE%20MBI.doc (last visited July 18, 2005). The elements of the Mitigation Plan, however, do not appear to require a discussion of long-term management. *See id.* at 2-3.

In response, the Wilmington District noted that it has

> a strong preference for mitigation projects that do not require long term active maintenance measures, such as controlled burns, controlling flashboard risers, and selective timbering to achieve the desired functions. Generally speaking, most, if not all, of the banks in [North Carolina] do not have long-term active maintenance requirements, and Barra Farms is such a site. These sites do require permanent protection, which is provided by recorded conservation easements or fee conveyances to conservation entities, either public or private, which have demonstrated a long-term interest and experience in managing such properties. Prohibited activities include cutting or other damage to vegetation, manipulations of water budgets, and any construction or development of the site, without the approval of the easement holder.

E-mail from Mickey Sugg, U.S. Army Corps of Engineers, to Royal C. Gardner (June 21, 2005). The NRC, however, has questioned the conclusion that active long-term management or care of mitigation sites is not necessary. NRC, *supra* note 4, at 152. Furthermore, there is a difference between legal protections (such as easements) and the ability to enforce those legal protections (which requires funds).

177. Under Florida regulations, a mitigation banker has several options for establishing the long-term maintenance fund: (1) an irrevocable letter of credit with a standby trust; (2) a surety or performance bond with a standby trust; or (3) a trust fund. FLA. ADMIN. CODE ANN. r. 62-342.700(9).

178. Bluefield Ranch Mitigation Banking Instrument at i-ii (executive summary) (2001). The mitigation plan contemplates restoring

> improved and unimproved pasture to hydric/mesic pine flatwoods, wet prairie, and freshwater habitat (1,913 acres), [enhancing] freshwater marsh, wet prairie, and bay swamp habitat (424 acres), and [preserving] stream bottomwood (194 acres), freshwater marsh (55 acres), mesic/hydric pine flatwoods (19 acres) and xeric oak (70 acres) habitat.

Id. at ii.

179. *Id.* at iv.

180. *Id.*

181. *Id.*

182. *Id.*

183. Perpetual Management Financial Assurance at 3, Myakka Mitigation Bank (U.S. Department of the Army Permit No. 43003997.005, June 29, 2004).

184. Mitigation Banking Instrument, Boran Ranch Mitigation Bank at 11-12 (U.S. Department of the Army Permit No. 199601134 (IP-ML)).

185. *Id.* at 12.

186. *Id.*

187. As the NRC recognized, "[t]he presumption that once mitigation sites meet their permit criteria they will be self-sustaining in the absence of any management or care is flawed." NRC, *supra* note 4, at 152. The continuing care needed may range from vigilantly removing exotics to protecting from trespassers to conducting prescribed burning. *Id.*

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providers are also likely to encounter financial difficulties and some will file for bankruptcy; mitigation sites need to be protected from this risk as well.[188] Finally, imposing such a requirement for all mitigation providers—permittees, in-lieu-fee sponsors, and mitigation bankers—would level the playing field, as Congress has encouraged. An agency should only permit those mitigation options that take into account the full cost of the mitigation work, which must include long-term stewardship.

VII. Conclusion

The challenges with bankruptcies are not limited to entrepreneurial wetland mitigation bankers. A bankruptcy can occur with any type of mitigation provider, including permittees and in-lieu-fee sponsors (even with nonprofit organizations). Nor is it a problem limited to the active life of a mitigation bank; a bankruptcy can occur during the tenure of a long-term steward. Indeed, The Environmental Trust, a nonprofit corporation in California that oversees several conservation banks (akin to endangered species habitat banks),[189] has filed for a Chapter 11 bankruptcy.[190] While it is too early to ascertain how that situation will unfold, it does suggest a need for careful consideration for determining the true costs of long-term maintenance.

As the Corps and other agencies develop new mitigation regulations, it is imperative that they ensure that financial assurances are available to be drawn on at every stage of a mitigation site's life. For example, during the construction/restoration phase of a mitigation bank, regulators must be given notice before performance bonds or other financial guarantees are canceled. Funds for long-term stewardship must be provided when credits are sold to ensure that a pool of money will be available after the bank is closed. But the closing of the bank—the sale of the final credit—merely opens another chapter: that of long-term maintenance and stewardship. It is critical that the funds set aside for long-term care of the site reflect the true costs of the endeavor. If appropriate financial assurances are not in place, the risk of failure will be shifted to government agencies and the public.

Finally, the Corps and other agencies must ensure that mitigation bankers are held to high standards. But other mitigation providers must be held to the same or very similar standards. Otherwise, in the quest for perfection, we will merely drive permittees to less expensive—and likely less reliable—mitigation providers, thus depriving the public of the environmental benefits of mitigation banking.

188. Moreover, the NRC emphasized that "individual permittees with no expertise and no long-term interest in a wetland site cannot be expected to manage that site over time." *Id.* Accordingly, the best scenario for long-term success is if a stewardship organization has a legal interest in the mitigation site and it receives a "cash contribution appropriate for the long-term monitoring, management, and maintenance of the site." *Id.* at 154.

189. For background on conservation banking, see Michael Bean & Lynn Dwyer, *Mitigation Banking as an Endangered Species Conservation Tool*, 30 ELR 10537 (July 2000); and U.S. Department of the Interior, Guidance for the Establishment, Use, and Operation of Conservation Banks (2003), *available at* http://www.endangered.fws.gov/policies/conservation-banking.pdf (last visited June 29, 2005) (also available from the ELR Guidance & Policy Collection, ELR Order No. AD04868).

190. Voluntary Petition, The Environmental Trust, Inc., No. 05-02321-LA11 (Bankr. S.D. Cal. filed Mar. 23, 2005).