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BP in the Wake of the Deepwater Horizon Incident and the Bankruptcy Implications of Mounting Environmental Liabilities

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On April 20, 2010, an explosion on the Deepwater Horizon oil drilling rig located off the coast of Louisiana killed eleven crewmen and set off what is now considered the largest offshore oil spill in U.S. history. As a result, BP p.l.c. ("BP"), the parent company of the British Petroleum multi-national corporation, faces mounting liabilities related to the damages caused by the disaster and hundreds of lawsuits that have been filed in numerous U.S. state and federal courts. This memorandum considers how BP may consolidate and address the present and future claims arising from the Deepwater Horizon incident, with particular attention to applicable environmental laws, non-bankruptcy alternatives available to BP, and the issues likely to be raised by a BP bankruptcy filing.

BP's Financials Prior to the Deepwater Horizon Incident

According to its Form-20K for the 2009 fiscal year, BP and its subsidiaries (the "Company") reported total assets of approximately \$235.9 billion and total liabilities of approximately \$133.9 billion as of December 31, 2009.¹ The Company reported approximately \$27.7 billion in net cash from operating activities in fiscal year 2009 before capital expenditures (which totaled \$20.6 billion) and dividends paid (which totaled approximately \$10.4 billion).² As of December 31, 2009, the Company reported \$8.33 billion in cash and cash equivalents.

As of March 31, 2010, just prior to the Deepwater Horizon incident, the Company reported total assets and liabilities of approximately \$240.6 billion and \$135.6 billion, respectively. Additionally, the Company's net cash and cash equivalents decreased by approximately \$1.5 billion to \$6.84 billion during the first quarter of 2010.

¹ See Form 20-K dated March 5, 2010 at 114.

² *Id.* at 115.

Estimates of BP's Liabilities Arising From the Deepwater Horizon Incident

Estimates regarding the total cleanup costs and other liabilities arising from the Deepwater Horizon incident have ranged from \$20 billion to \$400 billion.³ Many of these estimates rely on a Goldman Sachs report, which, using costs from the Exxon Valdez spill in today's dollars, concluded that the Deepwater Horizon incident will cost BP approximately \$40,000 per barrel for all containment, cleanup and litigation costs.⁴

U.S. Environmental Laws Implicated by the Deepwater Horizon Incident

Oil Pollution Act of 1990 ("OPA")

The OPA was enacted following the Exxon Valdez incident to improve the nation's ability to prevent and respond to oil spills. Pursuant to the OPA, a "responsible party"⁵ for a vessel or a facility from which oil is discharged is liable for all clean up costs necessitated by the spill plus up to \$75 million in additional damages.⁶ Accordingly, subject to certain exceptions, such as where the incident was proximately caused by gross negligence, willful misconduct or the violation of an applicable federal safety, construction, or operating regulation, the liability of a responsible party under the OPA for an offshore oil spill is capped at \$75 million plus cleanup costs.⁷

Clean Water Act

The Clean Water Act imposes liability on the owners and operators of vessels or facilities that discharge oil or hazardous substances into waters of the United States, including the territorial seas.⁸ Parties found to be in violation of the Clean Water Act may be liable for cleanup costs as well as civil and criminal penalties, subject to certain liability caps.

³ *Speculators Bet on BP (BP) Bankruptcy; Liabilities Could Reach \$400 Billion*, StreetInsider.com, June 9, 2010.

⁴ *Id.*

⁵ Section 1001(32)(C) of the OPA defines a "responsible party" with respect to an "Offshore Facility" as the "lessee or permittee of the area in which the facility is located or the holder of a right of use and easement granted under applicable State law or the Outer Continental Shelf Lands Act (43 U.S.C. 1301–1356) for the area in which the facility is located (if the holder is a different person than the lessee or permittee), except a Federal agency, State, municipality, commission, or political subdivision of a State, or any interstate body, that as owner transfers possession and right to use the property to another person by lease, assignment, or permit."

⁶ OPA §§ 1002, 1004.

⁷ See OPA §§ 1004(a), (c).

⁸ 33 U.S.C. § 1251 *et seq.*

State Environmental and Other Applicable Laws

In addition to the aforementioned federal environmental statutes, BP may also be exposed to liability under similar state laws. For example, complaints filed against BP have asserted claims under Florida's Pollution Discharge Prevention and Control Act and the Louisiana Oil Spill Prevention and Response Act. These state environmental statutes supplement causes of action that may be available to parties impacted by the Deepwater Horizon incident under traditional state law negligence, strict-liability, and breach of contract provisions.

Piercing the Corporate Veil in Environmental Actions

A critical issue presented by the environmental actions asserted against BP is whether claimants can reach the assets of BP or may only pursue BP's subsidiaries that were lessees of the Deepwater Horizon or related seafloor.

Violations of the Clean Water Act have been imputed to an entity's parent company where such entity was found to be a mere alter ego to the parent.⁹ In *United States v. Bushey & Sons, Inc.*, the United States District Court for the District of Vermont extended certain injunctive relief granted in response to violations of the Clean Water Act and other state and federal statutes to a parent corporation after finding that the parent corporation's wholly owned subsidiaries violated the statutes at issue. In reaching this conclusion, the district court noted that the parent corporation wholly owned, controlled, managed, operated and in all ways supervised the operation of the subsidiaries, which were "mere corporate shells established for purposes of avoiding tort liability to the parent for the acts of the subsidiaries which are the alter egos of [the parent corporation]."¹⁰ The court later reasoned that the "public interest in preserving the environmental integrity of Lake Champlain . . . is sufficiently paramount that the parent corporation, Bushey, which profits from the operations of its alter-ego subsidiaries, should be accountable for any violation or continuing threat of violations to that integrity."¹¹

Courts have also pierced the "corporate veil" in cases involving other federal environmental statutes. In *United States v. Kayser-Roth Corp.*, the United States District Court for the District of Rhode Island extended liability to a parent corporation after finding that its subsidiary violated the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA").¹² In its analysis, the court noted that other courts framing a federal rule regarding piercing the corporate

⁹ *United States v. Ira S. Bushey & Sons, Inc.*, 363 F. Supp. 110 (D. Vt. 1973), aff'd mem., 487 F.2d 1393 (2d Cir. 1973).

¹⁰ *Id.* at 119.

¹¹ *Id.*

¹² *United States v. Kayser-Roth Corp.*, 724 F. Supp. 15 (D.R.I. 1989).

veil in CERCLA cases focused on the following factors: "(1) inadequate capitalization in light of the purposes for which the corporation was organized, (2) extensive or pervasive control by the shareholder or shareholders, (3) intermingling of the corporation's properties or accounts with those of its owner, (4) failure to observe corporate formalities and separateness, (5) siphoning of funds from the corporation, (6) absence of corporate records, and (7) nonfunctioning officers or directors."¹³ The court explained that the general rule is that "a corporate entity may be disregarded in the interest of public convenience, fairness and equity," and the factors utilized by the courts "simply add flesh to that proposition."¹⁴ Finding that CERCLA places no special importance upon the corporate structure, the court imposed liability of about \$850,000 on the parent corporation for a violation by its subsidiary.

Lawsuits Filed Against BP Related to the Deepwater Horizon Incident

To date, more than 250 complaints have been filed in state and federal courts related to the Deepwater Horizon incident.¹⁵ These complaints generally name as defendants BP p.l.c. and certain of its U.S. subsidiaries, as well as Transocean Ltd., Anadarko Petroleum Corp., Halliburton Co., Moex USA Corp. and certain of their affiliated entities. The complaints allege liability on a number of grounds, which include: (i) negligence; (ii) gross negligence; (iii) willful misconduct; (iv) wantonness; (v) strict liability stemming from ultra-hazardous activity; (vi) breach of contract from violations of the lease with the Minerals Management Service; (vii) violations of general maritime law; (viii) public nuisance; (ix) trespass; and (x) violations of the OPA and Clean Water Act.

According to BP's website, BP has accepted its designation as a responsible party under the OPA and "will carry out its responsibility under OPA and will pay all necessary response costs and legitimate claims for damages recoverable under OPA that were caused by the . . . Deepwater Horizon Incident . . ." In early May, BP established a claims process to intake and process claims arising from the Deepwater Horizon incident and paid 18,000 claims totaling \$48 million as of June 7. BP has allegedly stated that it will pay all legitimate claims regardless of the \$75 million cap under the OPA.¹⁶

On June 16, 2010, following a meeting with President Obama, BP announced that it will fund a \$20 billion escrow account to facilitate payment of all OPA and tort claims, excluding state and

¹³ *Id.* at 20.

¹⁴ *Id.*

¹⁵ Special Report: BP oil spill a gusher for lawyers, Reuters.com, June 30, 2010.

¹⁶ BP Cap Waiver May Be Moot in Light of Possible Lapses (Update 1), Businessweek.com, May 21, 2010.

federal claims.¹⁷ BP will contribute \$5 billion annually to the account over the next four years and will “set aside” \$20 billion in assets until the account is fully funded. The account will be administered by Kenneth Feinberg, who previously administered funds created to compensate families of the victims of the September 11, 2001 terrorist attacks.¹⁸ BP will also contribute \$100 million to a separate account to be established for the benefit of unemployed oil rig workers.

Non-Bankruptcy Alternatives to Consolidate Environmental Actions

To efficiently address the mounting liabilities related to the Deepwater Horizon incident, BP will likely consider strategies designed to consolidate the pending and future lawsuits in a single judicial forum. As explained below, consolidation outside of the bankruptcy context implicates the Judicial Panel on Multidistrict Litigation (“JPML”), as well as the Federal Rules of Civil Procedure.

Consolidation of Pretrial Proceedings

Pursuant to section 1407 of title 28 of the United States Code, the JPML is authorized to consolidate “pretrial” proceedings for federal actions pending in different jurisdictions before a single district court in order to “promote efficiency in discovery,” prevent conflicting pretrial rulings, and conserve the resources of all litigants, witnesses, and counsel.¹⁹ Section 1407 directs the JPML to remand consolidated actions to the individual transferor courts “for further proceedings and trial” after the pretrial proceedings have concluded.²⁰ It has generally been recognized, however, that the JPML has no power to consolidate state actions with federal actions for pretrial purposes under section 1407.²¹

As of the June 30, 2010, approximately 200 federal complaints have been filed in 15 different federal district courts related to the Deepwater Horizon incident. On May 20, 2010, BP Exploration & Production, Inc. (“BPXP”), an indirect subsidiary of BP p.l.c., filed a motion with the JPML requesting that the pretrial proceedings for these actions be consolidated before the United States District Court for the Southern District of Texas, Houston Division. In arguing that the Southern District of Texas, Houston Division is the proper transferee forum, BPXP cited the existence of BP corporate offices and corporate offices for other defendants in Houston, the location of key

¹⁷ *BP Establishes \$20 Billion Claims Fund for Deepwater Horizon Spill and Outlines Dividend Decisions*, BP Press Release, June 16, 2010.

¹⁸ *White House Explanation of BP Claims Process*, Reuters.com, June 17, 2010.

¹⁹ See David F. Herr, *MANUAL FOR COMPLEX LITIGATION* § 22.31 (4th ed. 2008).

²⁰ *Id.* at § 20.133.

²¹ *Id.* at § 20.3.

documents and witnesses, and the already overburdened dockets of the federal district courts in which other actions have been initiated.²²

Various plaintiffs groups have filed responsive pleadings contesting consolidation in the Southern District of Texas and separate motions requesting consolidation before other federal district courts. The JPML has scheduled a hearing to consider these pleadings on July 29, 2010 in Boise, Idaho.

Consolidation For Purposes of Trial

While section 1407 applies exclusively to pretrial proceedings, rule 42 of the Federal Rules of Civil Procedure (“F.R.C.P.”) allows for the consolidation of separate actions for the purposes of trial if common questions of law or fact exist. While F.R.C.P. 42 applies only to actions pending before a single district judge, actions pending in different jurisdictions can be transferred to a single district under 28 U.S.C. § 1404(a) and later consolidated under F.R.C.P. 42. However, section 1404(a) requires, among other things, that the party moving for a transfer establish that the action could have been brought originally in the transferee court and that the transfer serve the interests of justice and the parties to the litigation. Accordingly, in order to consolidate litigation pending in the different federal courts before a single district judge for the purposes of trial, BP would have to establish the jurisdiction of the transferee court and satisfy other convenience focused requirements.

It should be noted that related mass tort cases pending in different jurisdictions have been previously consolidated under the various class action provisions present in the Federal Rules of Civil Procedure. However, the Manual for Complex Litigation notes that federal courts have “ordinarily disfavored . . . using class actions in dispersed mass tort cases” and later adds that “after experimentation with class treatment of some mass torts during the 1980s and 1990s, the courts have generally restricted its use in mass tort litigation.”²³

Potential BP Bankruptcy Filing

Whether BP seeks bankruptcy protection will depend on the size of the liabilities that arise from the Deepwater Horizon incident, which remains uncertain. Oil-industry insider Matt Simmons, head of the Texas-based, energy-focused investment bank Simmons & Co., told Fortune magazine on June 9 that BP will likely need to file for bankruptcy. Specifically, when asked about the future of BP, Mr. Simmons stated that:

²² *In re: Oil Spill by the Oil Rig “Deepwater Horizon” in the Gulf of Mexico, on April 20, 2010, MDL-2179, Pleading No. 13 – Motion of BP Exploration & Production, Inc. to transfer all consolidated actions to the United States District Court for the Southern District of Texas, Houston Division (May 20, 2010).*

²³ MANUAL FOR COMPLEX LITIGATION, *supra* note 19 at § 22.7.

They have about a month before they declare Chapter 11. They're going to run out of cash from lawsuits, cleanup and other expenses. One really smart thing that Obama did was about three weeks ago he forced BP CEO Tony Hayward to put in writing that BP would pay for every dollar of the cleanup. But there isn't enough money in the world to clean up the Gulf of Mexico. Once BP realizes the extent of this my guess is that they'll panic and go into Chapter 11.²⁴

Citigroup analyst Mark Fletcher disagrees and has been quoted in recent articles as saying that a BP bankruptcy looks unlikely because "the cash the company generates is more than adequate to cover costs related to the disaster."²⁵ Other bankruptcy professionals maintain that the chance of a BP bankruptcy filing is remote.²⁶ Indeed, BP's liquidity position is considered to be strong and supported by considerable cash on the balance sheet, positive cash flow and significant back-up facilities.

Issues Related to a BP Bankruptcy Filing

A bankruptcy filing by BP could address the liabilities arising from the Deepwater Horizon incident through the application of the automatic stay, the use of channeling injunctions and trusts and ultimately, the discharge of environmental claims upon confirmation of a plan of reorganization.

Which BP Entities Would Commence Bankruptcy Cases

Any filing involving BP p.l.c. or its affiliates almost certainly would not occur until after the leakage of oil from the Deepwater Horizon is capped and BP receives assurances that the existing leaks will not reopen in the future because, as explained below, cleanup costs related to postpetition leakage would likely constitute administrative expense claims that must be paid in cash in full.

Pursuant to section 109 of the Bankruptcy Code, any BP entity incorporated or doing business in the United States can commence a case under chapter 11.²⁷ Thus, BP p.l.c., which maintains a corporate office in Houston, Texas, could be a debtor.²⁸ BP may also attempt to control liabilities

²⁴ *The Gulf Coast oil spill's Dr. Doom*, Fortune Magazine, June 9, 2010.

²⁵ See, e.g., *Street Wire: BP Bankruptcy Unlikely*, Analyst Says, DailyFinance.com, June 10, 2010.

²⁶ Analysis: Possibility of BP bankruptcy seen remote for now, Reuters.com, June 10, 2010 (quoting Brad Sandler of Pachulski Stang Ziehl & Jones as stating that "at this moment, the likelihood of BP filing for bankruptcy is probably remote because it has access to billions of dollars in credit, solid cash flow and a healthy balance sheet.").

²⁷ 11 U.S.C. § 109.

²⁸ While BP p.l.c. could also conceivably file for bankruptcy under British law, such a filing would either be a liquidation or a reorganization controlled by a court appointed administrator, which suggests that the autonomy available under chapter 11 of the Bankruptcy Code would be a more attractive alternative if BP's parent company required bankruptcy protection.

stemming from the Deepwater Horizon incident without placing BP p.l.c. into bankruptcy by commencing chapter 11 cases for each of its subsidiaries that are parties to either the Deepwater Horizon lease or the applicable seafloor lease, as well as any other affiliated entities that may be jointly and/or severally liable or guarantors of the obligations under such leases.

While there is limited public information on the particular BP entities with relevant contractual obligations, certain sources suggest which subsidiaries would likely be included in a bankruptcy filing. According to information provided by the Minerals Management Service website regarding the history of the seafloor lease # G32306, the original lessee was BP Exploration & Production Inc (the same BP entity party to the JPMI proceeding described above). The Mineral Management Service website does not identify any guarantors or other lessees under the seafloor lease.

Recently filed complaints for damages related to the Deepwater Horizon incident name the following BP subsidiaries as parties to the Deepwater Horizon lease and/or the seafloor lease: (i) BP America, Inc.; (ii) BP Products North America, Inc.; (iii) BP Exploration & Production, Inc.; (iv) BP Corporation North America, Inc., f/k/a BP Amoco Corporation; (v) BP Company North America, Inc.; and (vi) BP America Production Company.

Application of the Automatic Stay to Environmental Actions

Pursuant to section 362 of the Bankruptcy Code, the filing of a bankruptcy petition by BP or its affiliates would automatically stay all judicial, administrative and other actions against the filing entities, as well as the enforcement of any judgment obtained prior to the filing.²⁹ The automatic stay does not apply, however, to actions by a governmental unit “to enforce such governmental unit’s . . . police and regulatory power, including the enforcement of a judgment other than a money judgment, obtained in an action or proceeding by the governmental unit to enforce such governmental unit’s . . . police or regulatory power.”³⁰

To be exempt from the automatic stay under the police and regulatory exception, an action by a governmental unit must address a present threat to public, health, safety or welfare.³¹ Generally, courts have treated environmental enforcement actions and other governmental environmental claims as invoking the government’s police or regulatory powers, thus exempting such actions from the automatic stay.³² Courts are divided, however, as to whether the automatic stay prevents the

²⁹ 11 U.S.C. § 362(a).

³⁰ 11 U.S.C. § 362(b)(4) (emphasis added).

³¹ See Adam P. Strochak, Jennifer L. Wine & Erin K. Yates, ENVIRONMENTAL ISSUES IN BANKRUPTCY CASES § 5[1][b] (2009).

³² *Id.* at § 5[1][b] (citing *City of New York v. Exxon*, 932 F.2d 1020 (2d Cir. 1991); *United States v. Nicolet, Inc.*, 857 F.2d 202 (3d Cir. 1988); *Penn Terra, Ltd. v. Dep’t of Envtl. Resources*, 733 F.2d 267 (3d Cir. 1984)).

government from enforcing a judgment for injunctive relief if that injunction would require the debtor to spend money to clean up environmental contamination.³³

Channeling Injunctions and Trusts

In any chapter 11 case, BP could attempt to channel liabilities related to the Deepwater Horizon incident to a trust established for the benefit of existing and future claimants and enjoin future actions related to the incident. This approach first appeared in the context of the Johns-Manville bankruptcy proceedings in 1986, when the United States Bankruptcy Court for the Southern District of New York allowed a debtor to establish a trust to pay present and future asbestos claims.³⁴ Creditors were enjoined from asserting such claims against the debtor or the reorganized company and could only look to the trust to resolve their asbestos-related actions. Subsequently, Congress amended the Bankruptcy Code in 1994 to codify the *Johns-Manville* decision in section 524(g).

Section 524(g) is limited by its terms to asbestos-related liabilities. However, the legislative history behind the 1994 amendments to the Bankruptcy Code indicates that the enactment of section 524(g) was "not intended to alter any authority bankruptcy courts may already have to issue injunctions in connection with a plan [of] reorganization."³⁵ Specifically, section 105(a) of the Bankruptcy Code already authorized bankruptcy courts to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]."³⁶ As such, bankruptcy courts have allowed debtors to utilize the trust and channeling injunction approach in mass tort liability situations outside of the asbestos context under section 105(a).³⁷

This approach was specifically implemented to resolve existing and future environmental liabilities in *In re Met-Coil Sys. Corp.*³⁸ In *Met-Coil*, the debtor faced mass tort claims stemming from a chemical spill that contaminated the groundwater supply in the area.³⁹ The debtors' plan of reorganization included a personal injury trust and corresponding channeling injunction protecting

³³ *Id.* at §§ 5[1][a], [b].

³⁴ See *In re Johns-Manville Corp.*, 68 B.R. 618 (Bankr. S.D.N.Y. 1986), *aff'd*, 78 B.R. 407 (S.D.N.Y. 1987), *aff'd*, 843 F.2d 636 (2d Cir. 1988).

³⁵ See 140 CONG. REC. H10752–01, H10766 (1994).

³⁶ 11 U.S.C. § 105(a).

³⁷ See, e.g., Memorandum Opinion and Order, *In re N. Am. Refractories Co.*, Case No. 02-20198 (Bankr. W.D. Pa. Sept. 24, 2007) [Docket No. 5382].

³⁸ Case No. 03-12676 (MFW) (Bankr. D. Del.).

³⁹ Eric D. Green, James L. Patton, Jr. & Edwin J. Harron, *Future Claimant Trusts and "Channeling Injunctions" to Resolve Mass Tort Environmental Liability in Bankruptcy: The Met-Coil Model*, 22 Bank. Dev. J. 95, 157 (2005).

the debtor from future liabilities related to the chemical spill.⁴⁰ Notably, the injunction granted under section 105(a) also protected the debtor's parent company, which had not filed for bankruptcy protection, in addition to certain insurers.⁴¹ Accordingly, there is precedent that would generally support an attempt by any of BP's subsidiaries that file chapter 11 petitions to address liabilities related to the Deepwater Horizon incident through a trust and channeling injunction.

Discharge of Environmental Claims

Upon confirmation of a chapter 11 plan of reorganization, a debtor is generally discharged of all claims that arose prior to the date of the order confirming the plan.⁴² Accordingly, through bankruptcy, BP could be discharged of all environmental liabilities arising from the Deepwater Horizon incident to the extent that such liabilities constitute a "claim" for purposes of the Bankruptcy Code. A "claim" is broadly defined to include any "right to payment" or any "right to an equitable remedy for breach of performance if such breach gives rise to a right to payment."⁴³ Obligations to pay cleanup costs incurred prior to confirmation would likely constitute claims. However, courts are divided as to whether an injunction directing a debtor to ameliorate pollution at its own cost is a dischargeable claim.⁴⁴ If a prepetition liability is determined not to be a "claim," the obligation will pass through the bankruptcy unaffected along with any such liabilities that arose after confirmation of the plan.

Priority of Environmental Claims in Bankruptcy

If an environmental obligation constitutes a "claim," the recovery on such claim in a BP bankruptcy case will likely depend on the priority afforded to the claim. Claims for administrative expenses are paid in full before any payment is made to general unsecured creditors.⁴⁵ An "administrative

⁴⁰ *Id.* at 158.

⁴¹ Subsequent courts have expressed more reluctance to approve non-debtor third party injunctions provided under a plan of reorganization. See, e.g., *Deutsche Bank AG v. Metromedia Fiber Network, Inc.* (*In re Metromedia Fiber Network, Inc.*), 416 F.3d 136, 143 (2d Cir. 2005) ("[a] non-debtor release in a plan of reorganization should not be approved absent the finding that truly unusual circumstances render the release terms important to the success of the plan. . . .").

⁴² 11 U.S.C. § 1141(d).

⁴³ 11 U.S.C. § 101(5).

⁴⁴ ENVIRONMENTAL ISSUES IN BANKRUPTCY CASES, *supra* note 31 at § 6[1][b] (citing *Ohio v. Kovacs*, 469 U.S. 274 (1985) (holding a cleanup injunction to be a dischargeable claim where the individual was forced to spend money to comply); *United States v. Whizco, Inc.*, 841 F.2d 147 (6th Cir. 1988) (holding an injunction directing a mine operator to reclaim surface mines to be a dischargeable claim because the operator would be required to purchase equipment in order to comply with the injunction); *United States v. LTV Corp.* (*In re Chateaugay Corp.*), 944 F.2d 997 (2d Cir. 1991) (holding that neither a prohibitory injunction nor a mandatory injunction directing a debtor to remedy contamination existing or emanating from property held by the debtor is a claim)).

⁴⁵ *Id.* at § 6[5][b] (citing 11 U.S.C. §§ 503(b), 507(a)(1), 1123(a)(1), 1129(a)(9)(A)).

expense" is defined, in relevant part, as the "actual necessary costs and expenses of preserving the estate."⁴⁶ Generally, to qualify for an administrative expense priority, a claim must (1) arise out of a postpetition transaction with the debtor and (2) benefit the bankruptcy estate.⁴⁷

Costs incurred by governmental entities or private parties to respond to the postpetition release of hazardous substances have been held to constitute administrative expenses to the extent that such expenses enhance the value of the estate.⁴⁸ Courts are divided as to whether postpetition costs incurred by a creditor to cleanup prepetition releases should be afforded administrative expense priority.⁴⁹ Prepetition environmental claims that do not qualify for a priority will be deemed general unsecured claims and will share pro rata with other non-priority unsecured claims.

Conclusion

Through a bankruptcy filing, BP could attempt to use a chapter 11 plan of reorganization to consolidate all oil-related liabilities arising from the Deepwater Horizon incident into a segregated class of claims and resolve such claims through the mechanisms described above. However, in light of the volume and complexity of potential issues posed by a bankruptcy filing, it is not surprising that BP has expressed a preference for a non-bankruptcy resolution of such liabilities.

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⁴⁶ 11 U.S.C. § 503(b)(1)(A).

⁴⁷ ENVIRONMENTAL ISSUES IN BANKRUPTCY CASES, *supra* note 31 at § 6[5][b][i] (*citing In re G-1 Holdings, Inc.*, 308 B.R. 196 (Bankr. D.N.J. 2004)).

⁴⁸ *Id.* at § 6[5][b][ii] (*citing Texas v. Lowe (In re H.L.S. Energy Co.)*, 151 F.3d 434 (5th Cir. 1998)).

⁴⁹ *Id.* at § 6[5][b][iii] (*citing In re Chateaugay Corp.*, 112 B.R. 513 (S.D.N.Y. 1990) (money spent to comply with environmental laws postpetition for releases occurring prepetition can be treated as administrative expenses), *aff'd*, 944 F.2d 997 (2d Cir. 1991); *Pennsylvania Dep't of Envtl. Resources v. Conroy*, 24 F.3d 568 (3d Cir. 1994) (allowing administrative expense priority for postpetition cleanup costs); *In re Pierce Coal & Constr., Inc.*, 65 B.R. 521 (Bankr. N.D. W. Va. 1986) (administrative expense priority allowed for damages which occurred during the bankruptcy case but not allowed for portion of claim for damages caused prepetition)).

