

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

In re:

MIRON BUILDING PRODUCTS, CO., INC.,

Chapter 11

Debtor.

Case No.: 00-14489

APPEARANCES:

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Hon. Robert E. Littlefield, Jr., United States Bankruptcy Judge

Memorandum-Decision and Order

Before the court is the Order to Show Cause of Cranesville Block Co., Inc. (“Cranesville”) for an order pursuant to 11 U.S.C. §§ 503 and 507 requesting the (1) allowance of a \$68,008.91 administrative priority claim for reimbursement of environmental remediation costs incurred by Cranesville for the clean-up of an environmental condition on property it purchased pre-petition from Miron Building Products Co., Inc. (the “Debtor”) (the “Remediation Claim”), and (2) establishment of an escrow to fund future costs of bringing the property within compliance of environmental laws, for which Cranesville also requests administrative priority status. The Debtor does not dispute that Cranesville has a valid “Remediation Claim”, but it opposes the Order to Show Cause because it contends that the Remediation Claim should be classified as a pre-petition unsecured claim. Moreover, the Debtor challenges the amount of the Remediation Claim based on the

contingent nature of the cost projections for the estimated completion of the project in 2006. Because this case involves payment of civil penalties for violations of New York State Navigation Law, the State of New York (the “State”) and the Department of Environmental Conservation (“DEC”) appear *amicus curiae* in support of Cranesville.

Jurisdiction

This is a core matter pursuant to 28 U.S.C. §§ 157(a)(2)(A) and (B). The court has jurisdiction to hear and determine this core matter pursuant to 28 U.S.C. §§ 1334(a) and (b).

Facts

On January 10, 2003, this court issued a Memorandum, Decision and Order (the “Decision”) holding the Debtor wholly responsible for the costs that give rise to the Remediation Claim. The court’s findings and conclusions, however, were limited to liability since Cranesville did not earlier request a determination of claim status. Accordingly, the court adopts its previous findings as modified and set forth below:

1. Prior to the commencement of this case and pursuant to an October 22, 1999 Sales Agreement (“Sales Agreement”), Cranesville purchased from the Debtor certain real estate and improvements, including a concrete plant, located at Eastchester Street By-Pass in Kingston, New York (the “Kingston Property”).
2. In connection with the Sales Agreement, the parties entered into a supplemental agreement dated October 22, 1999 (“Supplemental Agreement”), wherein they allocated responsibility for environmental remediation required by the DEC in connection with the Kingston Property, and established a \$50,000 escrow fund to pay for remediation expenses.
3. The Supplemental Agreement included a “hold harmless” clause (the “Indemnification Clause”) which stated, in pertinent part:

Seller [Miron] shall indemnify and save Purchaser [Cranesville] harmless from all loss or damage resulting from New York State Department of Environmental Conservation Spill #9907472, except for those responsibilities to be performed by Purchaser as set forth in Letter Agreement dated October 20, 1999, and attached hereto as Exhibit A. The environmental spill remediation associated with the property located at [Eastchester Street By-Pass] is also known as Chazen Job No. 49935.00.

(Supplemental Agreement ¶ 1.)¹ Exhibit A provided that Cranesville would contribute a maximum of \$12,587 to the remediation efforts, but that the Debtor retained sole remediation and payment responsibility associated with the environmental spill on the property. (Memorandum of Agreement dated October 22, 1999.)

4. The Debtor filed its Chapter 11 bankruptcy petition on August 16, 2000.
5. After the commencement of this case and pursuant to an Asset Purchase Agreement dated September 27, 2000 (“Asset Purchase Agreement”), Cranesville agreed to purchase from the Debtor a second parcel of real property located on Route 52, Liberty, New York (the “Liberty Property”).
6. Paragraph 23 of the Asset Purchase Agreement provided:

It is acknowledged that Seller has certain warranty obligations associated with the environmental remediation at the real property located at [Eastchester Street Bypass], Kingston, New York (the “Kingston Facility”) previously conveyed by Seller to Purchaser, and that an escrow exists to pay for a portion of the remediation (the “Initial Escrow”). Said escrow is held by the law firm of Vasti & Sears, P.C. . . . In order to ensure that the remediation is completed in accordance with the plan of remediation approved by the New York State [DEC] (the “Remediation Plan”), the parties agree as follows:

- a. Seller ratifies and reaffirms the Supplemental Agreement . . . and agrees that the Initial Escrow, established for the benefit of the Purchaser, is not property of the estate within the definition of Section 541 of the Bankruptcy Code.

. . . .

- f. In the event that this Agreement is approved by the Bankruptcy Court, as additional consideration for this Agreement, Purchaser shall escrow an additional sum of Forty Thousand Dollars (\$40,000) at Closing with Escrow Agent to insure completion of the remediation at the Kingston Facility (the “Additional Escrow”).
- g. If the cost to complete the remediation exceeds the Initial Escrow, Seller shall be entitled to draw on the Additional Escrow but only after the Initial Escrow has been fully depleted.
- h. Any balance remaining in the Additional Escrow after the remediation has been certified as completed shall be paid to Seller.

¹ All documents pertaining to the sale of the Kingston Property were attached as Exhibits to the September 28, 2000 Motion of Debtor in Possession for Authorization to Sell Real Property, Furniture, Fixtures and Equipment of Debtor’s Rapid Mix and Precast Concrete Business at Route 52, Liberty, New York, Free and Clear of Liens and Other Interests Pursuant to 11 U.S.C. § 363(b)(1), Docket Number 65. Familiarity with that motion is assumed.

- i. In the event the remediation is not completed within six (6) months of Closing (the “Completion Period”), any monies remaining in the Initial Escrow or the Additional Escrow shall be released to Purchaser who may then complete any remaining remediation. Notwithstanding, Purchaser shall agree to extend the Completion Period for an additional six (6) months if continuous progress is being made under the Remediation Plan but additional time is required to complete the remediation in accordance with the Remediation Plan. “Continuous progress” means that Seller has reasonably and timely executed the work schedule in accordance with the Remediation Plan.
 - j. The provisions of this paragraph shall be exclusive to this Agreement between Purchaser and Seller, and shall survive the Closing.
7. In September 2000, the Debtor moved to sell the Liberty Property to Cranesville (the “Liberty Sale Motion”). By Order dated October 19, 2000, the court approved the sale of the Liberty Property (the “Liberty Sale”) according to the terms of the Asset Purchase Agreement, and ordered the Debtor to distribute the sale proceeds to Congress Financial Corporation pursuant to the court’s August 24, 2000 Order.²
8. The closing occurred on January 25, 2001, and Cranesville is now the record owner of both the Kingston and Liberty Properties.
9. By Order dated April 30, 2003, the court confirmed the Debtor’s Third Amended Plan of Reorganization (the “Plan”), which does not provide for the Debtor’s indemnification obligations to Cranesville. Cranesville now seeks to include the Remediation Claim as an unimpaired Class 3 administrative claim. Class 3 provides for the fees of the Debtor’s environmental consultant, who is responsible for ensuring compliance with consent orders entered into between the Debtor and the DEC for the remediation of property owned post-petition by the Debtor, but not for environmental costs associated with the Kingston Property. The Plan is silent with respect to the Kingston Property.
10. Both the Initial and Additional Escrows were depleted prior to the instant Order to Show Cause.
11. Cranesville initially requested an administrative priority claim totaling \$65,734.73; however, it amended its request in response to the Debtor’s opposition and now seeks \$68,008.91. (Tesiero June 2003 Aff. ¶ 12.)
12. In support of Cranesville’s request for an additional escrow fund totaling \$80,800, Cranesville submitted the Affidavit of the Project Manager, Edward T. Bailey, who advises the court that the estimate “provides a fair representation of the expected costs that will be necessary to comply with the Corrective Action Plan reviewed, approved and closely

² The court conducted a noticed § 363 hearing prior to issuing its unopposed October 19, 2000 Order approving the sale.

monitored by the NYSDEC for the remediation of the Kingston property.” (Bailey June 2003 Aff. ¶ 10.)

Arguments

In its opening Memorandum of Law, Cranesville argues that the Remediation Claim should be elevated to administrative expense priority because the remediation costs are “actual, necessary costs and expenses of preserving the estate.” Cranesville contends that the Debtor entered into the transaction giving rise to the Remediation Claim post-petition and that Cranesville furnished substantial consideration for the transaction which was beneficial to the bankruptcy estate. Cranesville defines the pivotal “transaction” as the post-petition Liberty Sale, premised upon the Asset Purchase Agreement, rather than the pre-petition sale of the Kingston Property that gave rise to the Debtor’s original indemnification obligations. Cranesville states that it required Paragraph 23 of the Asset Purchase Agreement “for no other reason than to ensure that Debtor’s prior agreement and obligation to fully and completely indemnify Cranesville for the cost of the environmental remediation of the Kingston Property would continue as a post-petition contractual obligation.” (Breakell March 2003 Aff. ¶ 11.) Relying on the bankruptcy court’s reasoning in the case of *In re New York Trap Rock Corporation*, 137 B.R. 568 (Bankr. S.D.N.Y. 1992), Cranesville suggests that the Debtor could have eliminated it as a post-petition creditor either by refusing to enter into the Asset Purchase Agreement or by renegotiating the terms of the Asset Purchase Agreement to omit any reference to continued liability for remediation costs associated with property that was no longer property of the estate.

According to Cranesville, the demonstrative benefit to the estate was Cranesville’s inducement to enter into the Asset Purchase Agreement and complete the Liberty Sale, which resulted in significant proceeds for the Debtor’s reorganization. Cranesville suggests the Debtor’s current position that it was denied an opportunity to consider whether the “assumption of liability” was beneficial or detrimental to the estate is without merit since the Debtor previously recited several benefits of the Asset Purchase Agreement when it recommended the same to the court in support of the Liberty Sale Motion.

Cranesville’s argument that the Liberty Sale benefitted the estate gains support from the State and

the DEC, who add that Cranesville's expenditure of remediation funds reduced the Debtor's liability under the New York State Navigation Law and caused the State to curtail its enforcement action to compel the Debtor to perform the very remediation actions undertaken by Cranesville. (NYS's Brief at 4.) Relying upon the Second Circuit's holding in the case of *In re Chateaugay Corp.*, 944 F.2d 997, 1009 (2d Cir. 1991) and 28 U.S.C. § 959(b), the State proffers that if the Debtor continued to own the contaminated Kingston Property, it could have been forced to fund remediation as an administrative expense even if the contamination occurred pre-petition.³ (*Id.* at 10.)

The Debtor, however, suggests that Cranesville has improperly framed the issue before the court. The Debtor articulates the central question as whether and to what extent the court granted Cranesville administrative priority status in October 2000 when it approved the Liberty Sale Motion. (Debtor's Mem. in Opp'n at 3.) Moreover, the Debtor proposes that Cranesville is now estopped from asserting administrative priority status for the Remediation Claim because it "springs" from the Liberty Sale Motion.

The Debtor contemporaneously argues that it and the parties in interest were denied a fair opportunity to determine the benefit, if any, of its alleged assumption of a pre-petition obligation because there was never an underlying § 365 motion and hearing. The Debtor diverts Cranesville's attention to whether the Asset Purchase Agreement constitutes a valid assumption of the pre-petition Indemnification Clause. While recognizing that the Asset Purchase Agreement is not an executory contract, the Debtor nonetheless contends that Cranesville is procedurally barred from achieving administrative priority status because the Sales Contract and Supplemental Agreement were not properly assumed by the Debtor. Relying upon *In re Klein Sleep Products, Inc.*, 78 F.3d 18 (2d Cir. 1996), the Debtor suggests that, in the case of an assumption, the entitlement to administrative priority status must be shown at the time of the motion to assume rather than through a subsequent motion for allowance of an administrative expense under

³ Because this case does not involve contaminated property owned or operated by the Debtor post-petition, the court distinguishes *In re Chateaugay Corp.*, without further discussion about whether the Debtor would have incurred administrative liability if it had continued to own the Kingston Property.

§ 503(a)(1)(A).

Discussion

The Bankruptcy Code (11 U.S.C. §§ 101 et seq.) promotes rehabilitation of a debtor-in-possession's business for the benefit of all the estate's creditors by granting special priority to those creditors who continue to do business with the debtor-in-possession. *Trustees of the Amalgamated Insurance Fund v. McFarlin's, Inc. (In re McFarlin's, Inc.)*, 789 F.2d 98, 101 (2d Cir. 1986). As a means of balancing the competing bankruptcy policy of promoting parity among creditors, the Code rewards administrative priority to creditors' claims in only two situations: (1) special priority is accorded to expenses incurred under new contracts with the debtor, as "administrative expenses" of the estate, *In re Klein Sleep Products, Inc.*, 78 F.3d at 20; and (2) "[t]he same priority is given to expenses arising under pre-existing contracts that the debtor 'assumes' – contracts whose benefits and burdens the debtor decides, with the bankruptcy court's approval, are worth retaining." *Id.* "Because the presumption in bankruptcy cases is that the debtor's limited resources will be equally distributed among his creditors, statutory priorities are narrowly construed." *In re McFarlin's, Inc.*, 789 F.2d at 100 (citations omitted).

Section 507(a)(1) gives first priority to "administrative expenses allowed under section 503(b)." According to § 503(b)(1)(A), "there shall be allowed administrative expenses . . . including . . . the actual, necessary costs and expenses of preserving the estate . . ." This section has been further qualified by case law to include only those expenses arising out of a transaction between the creditor and the bankrupt's trustee or debtor-in-possession, *id.* at 101 (citations omitted), but "only to the extent that the consideration supporting the claimant's right to payment was both supplied to and beneficial to the debtor-in-possession in the operation of the business." *Id.* (quoting *In re Mammoth Mart, Inc.*, 536 F.2d 950, 954 (1st Cir. 1976)).

The basic controversy as to whether environmental remediation costs constitute administrative expenses pursuant to § 503(b)(1)(A) that warrant a first priority in repayment under § 507(a)(1) is not novel within the Chapter 11 bankruptcy arena. See COLLIER ON BANKRUPTCY ¶ 503.06[4] at 503-30 (15th ed. 2003) ("Administrative expenses under section 503(a)(1)(A) may include those necessary to abate violations of state

and federal environmental regulations, and the payment of fines and penalties resulting from postpetition violations of state and federal environmental regulations”). The Second Circuit has addressed “the important issues at the intersection of bankruptcy law and environmental law” in the case of *In re Chateaugay Corp.*, 944 F.2d at 999, wherein the court held that environmental response costs incurred by the United States Environmental Protection Agency during the bankruptcy at sites owned or operated by the debtor constitute expenses of administration entitled to priority. *Id.* The United States Bankruptcy Court for the Southern District of New York has also addressed the issue, but ruled that the Debtor’s rejection of a pre-petition lease prevented any continuing obligation on the part of the Debtor to maintain or preserve the property in compliance with environmental laws and, therefore, the environmental clean-up costs stemming from the Debtor’s pre-petition actions were not entitled to an administrative expense priority. *In re McCrory Corp.*, 188 B.R. 736, 770 (Bankr. S.D.N.Y. 1995).

“Generally, to the extent [an environmental] claim arises or ripens during the pendency of the bankruptcy case, it may be considered to be a ‘transaction’ with the debtor’s estate which is necessary to the preservation of the estate, and, therefore, may be afforded administrative expense status.” COLLIER ¶ 503.06[4] at 503-31. As demonstrated by the above cases, the requisite analysis for determining whether environmental remediation costs warrant administrative expense status is largely fact specific because the court must pinpoint the exact temporal point at which the environmental claim arose.

Here, the court is faced with unique circumstances that do not involve either contaminated property owned by the Debtor post-petition or the Debtor’s post-petition assumption or rejection of an executory contract. The vast number of § 503(b)(1)(A) cases arise from the explicit assumption or rejection of executory contracts. According to the Debtor, § 365 should guide the courts resolution of this matter. The Debtor focuses exhaustively on the need for a valid assumption of the Supplemental Agreement in order to impose administrative liability for the Remediation Claim, but it contends that the Supplemental Agreement could not have been properly assumed because it was not an executory contract. Nonetheless, the Debtor points to the procedural omission of a § 365 motion and hearing to show that it was denied an opportunity

to consider whether an assumption of pre-petition liability for indemnification costs would be beneficial or detrimental to the estate. This argument is circular and indefensible. For reasons discussed *infra*, the court finds that § 365 is nothing more than a red herring in this case.

The crux of Cranesville's argument is that the Debtor's indemnification obligations, while they originated pre-petition, constitute a new, post-petition obligation because they were ratified as part of the Asset Purchase Agreement. The court agrees. Although the Debtor's focus is misplaced on whether the Asset Purchase Agreement constitutes a valid assumption, the Debtor apparently acquiesces to Cranesville's identification of the relevant transaction as the post-petition Liberty Sale. Thus, Cranesville has satisfied the first prong under *McFarlin's*.

The Debtor, however, disputes whether the Liberty Sale was beneficial to the estate. By Cranesville's account, it would not have continued to do business with the Debtor but for the inclusion of Paragraph 23 in the Asset Purchase Agreement. Cranesville correctly states that the Debtor could have avoided administrative liability for remediation costs associated with the Kingston Property through bankruptcy planning by either rejecting Cranesville's offer for the Liberty Property or negotiating alternate contractual terms. The Debtor did neither; instead, it represented to the court that the Liberty Sale was in the best interest of the estate. The Debtor stated, "the sale . . . is justified because the proposed sale of Assets will afford the Debtor the opportunity to reduce its expenses in maintaining the assets. Further, payment of the sale proceeds to [Congress Financial Corporation] will reduce both the principal and accruing interest owed to Congress on its secured claims, which, in turn, will be of benefit to the estate and unsecured creditors." (Liberty Sale Motion ¶ 11.) As the proponent of the consummated Liberty Sale, the Debtor cannot now claim that it erred in its earlier recommendation of the same to the court solely because it has the benefit of hindsight and wishes to avoid administrative expense liability. It is abundantly clear that the Liberty Sale was in the best interest of the estate because it enabled the Debtor to reduce its secured debt and relieved the Debtor of any continuing operating costs it may have had as the record owner of that property. Interestingly, the Debtor refused to sign the DEC's proposed administrative enforcement consent order for the remediation of the

Kingston Property and the payment of civil penalties because it claimed that the Kingston Property was no longer property of the estate. (NYS Br. at 2, 3.). The Debtor clearly recognized the benefit of transferring ownership of the Kingston Property to Cranesville, and it subsequently weighed the burden of the indemnification costs against the benefit of the Liberty Sale. For these reasons, the court finds that Cranesville has satisfied the second prong of *McFarlin's*.

Nevertheless, the Debtor asserts that Cranesville should be equitably estopped from requesting administrative priority status because Cranesville did not do so at the time of the Liberty Sale Motion, thereby mooting the *McFarlin's* inquiry altogether. For the following reasons, the court disagrees: (1) the Liberty Sale Motion, on its face, properly apprised the parties of the benefits and consequences associated with the Liberty Sale; and (2) Cranesville's deadline to file a proof of claim did not expire until approximately two months after the Liberty Sale Motion; thus, any request for determination of claim status at that time would have been premature. Moreover, based upon the parties anticipated cost projections and the existence of the Additional Escrow, Cranesville had no reason to anticipate a future claim.

Finally, the court must address the Debtor's contention that the Remediation Claim must be disallowed to the extent that it is contingent, or that Cranesville should be held jointly and severally liable for the future remediation costs. The court has previously ruled that "the Debtor is the party responsible for remediation." (Decision at 7.) Therefore, either the disallowance of certain costs or the imposition of joint and several liability would negate the implications of the Indemnification Clause and the Decision. Thus, the court finds no basis for granting either of the Debtor's requests.

Conclusion

Based on the foregoing, the court concludes that Cranesville has met its burden and Cranesville is, therefore, entitled to administrative priority status pursuant to §§ 503(b)(1)(A) and 507(a)(1). Accordingly, the court grants Cranesville's requests for (1) an administrative claim of \$68,008.91, representing out-of-pocket remediation costs as of the date of the Order to Show Cause, and (2) the establishment of an escrow

of \$80,800 for future remediation costs.⁴

The court shall retain jurisdiction pursuant to 28 U.S.C. § 1334(b) of this matter for the sole purpose of hearing and determining particular requests by Cranesville for future payments.

It is SO ORDERED.

Dated:
Albany, New York

Hon. Robert E. Littlefield, Jr.
United States Bankruptcy Judge

⁴ Based on the Decision, the Debtor would be responsible for all costs in excess of \$80,800, if such costs arise. However, the court limits the amount of the escrow to \$80,800 in this instance because that is the amount requested by Cranesville.