Lyondell Chemical and *Chemtura Corp.*: New Developments Regarding Contingent Environmental Bankruptcy Claims and Section 502(e)(1)(B) of the Bankruptcy Code

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CERCLA[2] is a sweeping federal remedial statute designed to encourage the prompt abatement of contamination and cleanup of hazardous waste sites and to allocate the costs for doing so against those responsible for the contamination. It is a strict liability statute, and provides broad authority to the President (delegated to the Environmental Protection Agency ("EPA")) to compel responsible parties to conduct cleanup and to recover EPA's own response costs from the four categories of potentially responsible parties ("PRPs").[3] CERCLA also provides causes of action to non-governmental entities for the recovery of appropriate response costs.[4] A PRP that settles its liability to the government, however, escapes contribution liability for the matters settled.[5] While liability for cost recovery under section 107 is joint and several, liability for contribution under section 113 of CERCLA is several.

Although the nature of contaminated sites certainly varies, often there are numerous PRPs at a single site, particularly at former hazardous or industrial waste dumps to which hundreds of generators could have transported their wastes. In such cases, often one or more PRPs, voluntarily, or as a result of a CERCLA enforcement order under section 106,[6] form a working group and agree among themselves – usually in a consent decree with EPA – to fund the cleanup and perform the work in accordance with the consent decree.[7] Typically EPA will seek enforcement and issue section 106 orders only to those seemingly liable parties that are among the largest contributors of waste and are financially viable.[8] The core remediation group then is left to its own devices to recover what it can from recalcitrant PRPs at its own expense.

In recent twin opinions issued by the Bankruptcy Court for the Southern District of New York in the *Lyondell*[9] and *Chemtura*[10] cases, the Court disallowed as contingent all PRP claims –

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[2] The Comprehensive Environmental Response, Compensation, and Liability Act of 1980, as amended, 42 U.S.C. §§ 9601-9675 ("CERCLA" or the "Act").

[3] 42 U.S.C. § 9607. PRPs include the present owner or operator of the contaminated facility; former owners and operators of the facility, if there was a disposal of hazardous substances at the facility during such ownership or operation; arrangers for the disposal of hazardous substances; and transporters of such materials. *Id.* § 9607(a)(1)-(4).

[4] 42 U.S.C. § 9607(a)(4)(B). SARA amendments to CERCLA were enacted in 1986 expressly providing for contribution actions among those with (x) shared liability in the event a "civil action" under section 106 or 107 has been filed and (y) who have resolved their liability to the United States or a State "in an administrative or judicially approved settlement." 42 U.S.C. § 9613(f)(1), (f)(3)(B). Equitable factors are to be considered in determining cost allocation among liable parties. *Id*.

[5] 42 U.S.C. § 9613(f)(2).

[6] 42 U.S.C. § 9606.

[7] *See generally Environmental Law Handbook*, Eighteenth Edition, Chapter 9, § 4.3.

[8] *See Environmental Law Handbook*, Eighteenth Edition, Chapter 9, § 4.7.1.

[9] *In re Lyondell Chemical Co.*, 442 B.R. 236 (Bankr. S.D.N.Y. 2011) ("Lyondell").

[10] *In re Chemtura Corp.*, 443 B.R. 601 (Bankr. S.D.N.Y. 2011) ("Chemtura").

contract, contribution, and direct – except for the debtors' share of past environmental response costs. The rulings clearly favor debtors, calling into question the ability of PRPs to recover costs against other PRPs that subsequently file for bankruptcy.

Bankruptcy Code Section 502(e)(1)(B) and its Application to PRP Claims

Bankruptcy Code section 502(e)(1)(B) mandates disallowance of contingent claims for reimbursement or contribution of an entity that is co-liable with the debtor to a third party creditor.[11] Environmental claims asserted by PRPs have been particularly vulnerable to disallowance under this provision of the Bankruptcy Code.[12] Because the identification, and assessment of contamination, the identity and resolution of liability among multiple PRPs, and cleanup often take years, and bankruptcy is designed to resolve debtor's pre-petition debts in relatively short order, the nature and extent of environmental bankruptcy claims and the debtor's liability therefore are often unknown, unliquidated and/or contingent when the proof of claim is filed and when allowance is addressed by the bankruptcy court.[13] In addition, until recently, private party PRPs lacked a direct claim for cost recovery under section 107 of CERCLA. Their only remedy against other PRPs under CERCLA has been for contribution under section 113 which requires the establishment of plaintiff's liability to a third party.[14] Thus, Bankruptcy Code section 502(e)(1)(B) largely resulted in the disallowance of private party claims seeking recovery

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[11] 11 U.S.C. § 502(e)(1)(B); *see also In re Pinnacle Brands, Inc.*, 259 B.R. 46, 55 (Bankr. D. Del.2001). The purpose of the provision was to prevent double payouts, once to the assured primary creditor and again to the surety or guarantor. See 124 Cong. Rec. H 11,094 (Sept. 28, 1978); 124 Cong. Rec. S 17,410-11 (Oct. 6, 1978). The legislative history talks of the surety or co-debtor having a choice to pay the primary creditor and obtain an allowed claim or not, depending on what would be most advantageous. Governmental entities are not typically subject to 502(e)(1)(B) because they are rarely co-liable with the debtor on the CERCLA claim.

[12] *See In re Eagle-Picher Indus. Inc.*, 164 B.R. 265, 272 (S.D. Ohio 1994) ("502(e)(1)(B) fosters the primary objective of CERCLA by requiring those who seek contribution to incur the expenses relating to cleanup before stating an allowable claim."); *In re APCO Liquidation Trust*, 370 B.R. 625 at 636 (Bankr. D. Del. 2007) (and cases cited) and *In re Tri-Union Dev. Corp.*, 314 B.R. 611 (Bankr. S.D. Tex. 2004) ("[C]laims remain 'contingent' for purposes of Bankruptcy Code § 502(e)(1)(B) until the co-debtor has paid the creditor."); *In re Alper Holdings USA*, No. 07-12148, 2008 WL 4186333,*6-7 (Bankr. S.D.N.Y. Sept. 10, 2008); *see also* Donald R. Korobkin, "Killing the Husband": Disallowing Contingent Claims for Contribution or Indemnity in Bankruptcy, 11 CARDOZO L. REV. 735, 757 (1990) (the author severely criticizes the statute and makes a case for its repeal).

[13] Contingency is determined as of the date the claim is allowed or disallowed, as the case may be. 11 U.S.C § 502(e)(1)(B). This is typically at the time the court rules on the debtor's objection to the claim or estimates the claim pursuant to 11 U.S.C § 502(c). Since only the contingent portion of the claim is subject to disallowance, a claim for recoverable response costs actually paid out by the claimant will not be barred. *In re G-I Holdings, Inc.*, 308 B.R. 196, 212 (Bankr. D. N.J. 2004) ("Here, the funds have been expended and thus the claim to that extent is not contingent."); *see also In re Lyondell*, 442 B.R. 236, 246, n.16 (Bankr. S.D.N.Y 2011) ("I think the Debtors have now acknowledged that past costs incurred by Weyerhaeuser are not contingent, and cannot be disallowed for that reason, but to the extent the debtors continue to argue otherwise, I reject their position in that regard."). The disallowances under section 502(e)(1)(B) typically involve the disallowance of a claim for *future* response costs to be incurred at the site. *Norpak v. Eagle-Picher Indus., Inc. (In re Eagle-Picher Indus., Inc.)*, 131 F.3d 1185, 1190 (6th Cir. 1997) ("*Eagle-Picher*"); *see also In re APCO Liquidation Trust*, 370 B.R. 625 (Bankr. D. Del. 2007).

[14] *See Cooper Indus., Inc. v. Aviall Servs., Inc.*, 543 U.S. 157, 169 (2004) (citing numerous decisions of the Courts of Appeals holding that a private party that is itself a PRP may not pursue a section 107(a) claim against other PRPs). The Supreme Court held, however, that the plain language of section 107(a) authorizes cost recovery claims by private parties, including PRPs. *See United States v. Atlantic Research Corp.*, 551 U.S. 128, 127 S. Ct. 2331, 168 L. Ed 2d 28 (2007) ("Atlantic Research"). *See also* infra notes 12 through 16 and accompanying text.

for the debtor's share of future cleanup costs that the PRP is or may be required to advance based on its own liability.[15]

In 2007, however, the Supreme Court in *U. S. v. Atlantic Research Corp.*[16] held that a PRP was not foreclosed from bringing a direct action against other PRPs for recovery of clean up costs under section 107(a) of CERCLA and were not limited solely to contribution claims under section 113 of the Act.[17] The Court recognized that "[a] private party may recover under § 107(a) without the establishment of liability to a third party."[18] This was good news for PRPs and site remediation groups trying to recover from other PRPs who sought protection under the Bankruptcy Code because *Atlantic Research* arguably removed the cloud over PRP claims by section 502(e)(1)(B) of the Bankruptcy Code.[19]

Atlantic Research left open the question as to what happens when a PRP meets the criteria to file under section 107 and 113. In 2010, the Second and Third Circuits, respectively, found that PRPs who meet the criteria to assert contribution claims under CERCLA section 113 could not bring a direct cost recovery claim under section 107.[20] Because most cleanups are not voluntary, and those who resolve their liability to the government are expressly eligible to bring a contribution action under section 113(f)(3)(b),[21] under the holdings of *Niagara Mohawk* and *Agere*, most PRPs will once again be limited to contribution claims. Moreover, based on the recent holdings in *Lyondell* and *Chemtura* discussed below, even *direct* PRP claims under

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[15] *See In re Eagle-Picher*, 131 F.3d at 1190; *see also In re APCO Liquidation Trust*, 370 B.R. 625 (Bankr. D. Del. 2007) (and cases cited) and *In re Tri-Union Dev. Corp.*, 314 B.R. 611 (Bankr. S.D. Tex. 2004); *In re Cottonwood Canyon Land Co.*, 146 B.R. 992 (Bankr. D. Colo.1992) ("Cottonwood Canyon"); *Fine Organics Corp. v. Hexcel Corp. (In re Hexcel Corp.)*, 174 B.R. 807 (Bankr. N.D. Cal. 1994) ("Hexcel") (disallowing debtor's contractual obligation to perform remediation even though claimant was not co-liable with the debtor.). *But see In re Allegheny Int'l, Inc.*, 126 B.R. 919 (W.D. Pa. 1991), *aff'd without opinion*, 950 F.2d 721(3d Cir. 1991) ("Allegheny") (finding section 502(e)(1)(B) does not exclude claimant's *direct* claim for future costs under CERCLA section 107(a)); *In re Harvard Indus., Inc.*, 138 B.R. 10 (Bankr. D. Del. 1992) ("Harvard Industries") (finding section 502(e)(1)(B) does not apply when claimant rather than EPA is performing cleanup and seeks costs claimant would expend on cleanup in the future.)

[16] Atlantic Research, supra n.11.

[17] *Atlantic Research*, 551 U.S. at 128.

[18] *Atlantic Research*, 551 U.S. at 139.

[19] Reading Company filed an amicus brief in the *Atlantic Research* case, admonishing the Court to consider the effect in bankruptcy of renewed CERCLA section 107 claims. It cautioned that a section 107 claim would diminish the value to the reorganized debtor of any settlement or discharge of CERCLA liability to the government and by giving rise to direct claims not necessarily covered by the Bankruptcy Code's discharge provisions or contribution protection under CERCLA section 113(f)(2). *See* Brief of Reading Co. as Amicus Curiae in support of the Petitioner, 2007 WL 697587 (hereafter "Reading Brief") at 8-9. In dicta the Delaware Bankruptcy Court posited that under the *Atlantic Research* decision a PRP has a direct claim under CERCLA section 107(a) and thus, "[w]ith a direct claim, of course, disallowance under section 502(e)(1)(B) of the Code would not be proper due to the lack of co-liability." *In re Apco Liquidating Trust*, 370 B.R. at 637.

[20] *Niagara Mohawk Power Corp. v. Chevron U.S.A., Inc.*, 596 F. 3d 112, 127-29 (2d Cir. 2010) ("Niagara Mohawk") (involving claim under section 113(f)(3)(B)); *Agere Sys., Inc. v. Advanced Envtl. Tech. Corp.*, 602 F.3d 204, 227-29 (3d Cir. 2010) ("Agere"). In *Agere* the Court said that it would be a perverse and unnecessary result if a PRP eligible for contribution relief and entitled to contribution protection could assert a section 107 claim for joint and several liability against another PRP, since it could bar a CERCLA contribution counterclaim and thereby recover its own allocable share of cleanup costs. *See Agere*, 602 F.3d at 228-29.

[21] *Atlantic Research* left open the issue of whether cleanups pursuant to unilateral administrative orders are pursuant to a section 106 or 107 action and thus render the remediators eligible to assert contribution claims.

section 107 for cost recovery are claims for "reimbursement" that are equally subject to disallowance under section 502(e)(1)(B) to the extent such costs have not yet been paid by the claimant.

The Significant Holdings in *Lyondell* and *Chemtura*

In *Lyondell*[22] and *Chemtura*,[23] the Court disallowed under section 502(e)(1)(B) of the Bankruptcy Code, multiple non-governmental claims that were based on debtors' uncontested liability for environmental contamination at numerous superfund sites. The PRP claims addressed by Judge Robert E. Gerber included CERCLA direct claims under section 107(a), CERCLA contribution claims under section 113, contract claims arising from pre-petition PRP agreements, and claims arising from pre-petition consent decrees or administrative orders to which the debtors were a party.[24] The Court found that with two exceptions,[25] all of the outstanding private-party PRP claims to which the debtors objected were contingent, contribution or reimbursement claims of an entity co-liable with the debtor and thus, disallowance compelled by 11 U.S.C. § 502(e)(1)(B).

The decisions, while not the first to block private party environmental claims under section 502(e)(1)(B), are nevertheless remarkable for their survey and application of case law in the absence of any Code definitions for the terms "contingent," "contribution," "reimbursement" or "liable with the debtor" and because these are the first decisions in which a bankruptcy court (or any court) has ruled on the disallowance under section 502(e)(1)(B) of a PRP's CERCLA *direct* section 107(a) claim since the Supreme Court resurrected such claims in its *Atlantic Research* decision. The decisions also signal a turning point away from the use of trusts previously implemented by other bankruptcy courts to prevent double recoveries when claims do not otherwise meet the section 502(e)(1)(B) criteria.[26]

The contingent claim element.

The Court held that for purposes of section 502(e)(1)(B) "contingency" relates to both payment *and* liability and thus, in a section 502(e)(1)(B) analysis, a claimant's claim is "contingent" until its liability is established *and* it has actually paid the primary creditor.[27] The Court rejected arguments that it is the *accrual* of the primary creditor's claim against the claimant that transforms the claimant's contingent claim to a non-contingent one, stating that:

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22 *In re Lyondell Chemical Co.*, 442 B.R. 236 (Bankr. S.D.N.Y. 2011) ("Lyondell").

23 *In re Chemtura Corp.*, 443 B.R. 601 (Bankr. S.D.N.Y. 2011) ("Chemtura").

24 *Id.*

25 In *Chemtura*, Judge Gerber held that a trust that was to receive remediation payments (unlike those who might have to contribute to the trust) was not "co-liable" with the Debtor, and in both *Lyondell* and *Chemtura*, the Court held that to the extent the claims were for reimbursement or contribution of past cleanup costs already paid by the claimant, such claims were not "contingent" within the meaning of section 502(e)(1)(B). *See supra* n.12 and accompanying text.

26 *See Chemtura*, 443 B.R. at 622-23 (rejecting *Allegheny* and use of a trust to avoid possibility of redundant payments, citing to other courts that have disagreed with *Allegheny*.) and *Lyondel*l, 442 B.R. at 254, n. 57 (rejecting *Havard Industries* and use of a trust).

27 *Lyondell*, 442 B.R. at 248-49.

> …the fact that an EPA claim may have *accrued* against any of Georgia-Pacific, Weyerhaeuser, or Hamilton Beach does not mean that any of their separate claims against the Debtor are no longer contingent. We don't know whether either of them will lay out the funds necessary to engage in the curative action, and, if so, to what extent.[28]

The Court reasoned that the government has a multitude of ways to accomplish a remediation that "might or might not call for – or result in – payment by the separate PRP that is asserting the claim against the debtor. And the PRP might or might not wind up actually making the payment for which it then would be seeking reimbursement or contribution."[29] Significantly, the Court chose to reject the use of a trust from which the claim distributions could be made as and when the claimant actually advances the costs to avoid the possibility of redundant payments, even when the claimant's claims are direct and claimant – not EPA – is cleaning up the site as has been employed by other courts.[30]

With little discussion, the Court also held that claims arising from prepetition PRP contracts pursuant to which the claimant and debtor allocated site liabilities and cleanup costs among them, were also contingent to the extent the claimant has not yet incurred any costs.[31]

The co-liability element.

Many of the claimants in *Lyondell* argued that the co-liability element was not satisfied because their claims were based on direct claims under CERCLA section 107(a) and not contribution under section 113, pointing to *Atlantic Research* and its holding that a PRP may recover under section 107(a) without establishment of any third party liability.[32] The Court rejected this argument finding that co-liability to the government can still exist whether or not the claimant's claim against the debtor is a direct claim rather than one for contribution. The Court then noted that the claimants and the debtor were both designated by EPA as PRPs.[33] The court also stated that section "502(e)(1)(B) imposes no requirements as to *how* or *why* the party asserting the claim potentially subject to section 502(e)(1)(B) must be liable with the debtor on the claim of the third party. There is no statutory requirement, for example, that the debtor and

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[28] *Id*. at 250 (emphasis supplied).

[29] *Id*. at 249-50.

[30] *Id.* at 254. Judge Gerber rejected the proposed use of a trust as in *Allegheny* and *Harvard Industries*, which involved direct claims for costs expended by the claimants. *Id*. at 253-54.

[31] *Id.* at 251("Although Hamilton Beach has entered into a settlement agreement in which the parties allocated the liability with respect to the two sites, there is no indication that the money has been spent. For the same reasons that I determined that Georgia-Pacific's claim is contingent, I determine that Hamilton Beach's claim is contingent as well."); *see also Chemtura*, 443 B.R. at 615 ("Several of the Claimants assert that their claims are not contingent because (a) they have been fixed by contracts, settlement, consent decrees, or administrative orders; or (b) the right to payment has accrued and is not dependent on a future event. As in *Lyondell*, I agree that claims for remediation costs already paid by the Claimants are no longer contingent. But I find that claims for future remediation costs, not already paid for, are contingent, and satisfy the 'Contingency' Element of section 502(e)(1)(B) doctrine.").

[32] Claimants also relied upon the decisions in *Allegheny* and *Harvard Industries* with which the Court disagreed. *See Lyondell*, 442 B.R. at 253-54.

[33] *See Lyondell*, 442 B.R. at 253.

the party asserting the claim be liable on the claim of the third party in the same action, under a common statute, or on the same legal theory."[34]

The "reimbursement or contribution" element.

The Court in *Lyondell* and *Chemtura* rejected the arguments made by claimants that their claims were not claims for reimbursement or contribution because theirs were direct claims under CERCLA section 107(a) and not contribution claims under section 113(f). The Court concluded that a direct claim for cost recovery under CERCLA section 107 is a claim for "reimbursement" within the meaning of section 502(e)(1)(B) of the Bankruptcy Code.[35] The Court found that the risk that debtor would make duplicative payments was paramount and "revealed that the clear character of the claim was that debtor was not being asked to satisfy a [direct] claim for injury to the claimants [sic] property but rather was being sought for reimbursement."[36] Similarly, the Court found that the direct contract claims should be disallowed under section 502(e)(1)(B), because "in substance" they are claims for reimbursement.[37] In short, claiming substance over form, the Court found that the direct claims under section 107(a) were for reimbursement.[38]

The Significance of the *Lyondell* and *Chemtura* Decisions in Relation to Recent Government Settlements with Debtors of Significant Environmental Liabilities

In another recent and significant environmental bankruptcy case, the U.S. Court of Appeals for the Seventh Circuit held in *U.S. v. Apex Oil Co., Inc*., that the discharge from liability due to a 1990 bankruptcy did not extend to EPA's petition for a cleanup order under the Resource Conservation and Recovery Act ("RCRA"), effectively requiring the reorganized debtor to engage outside services to undertake a $150 million cleanup at a non-owned site. The contamination appears to have been well known long before the bankruptcy.

Although courts have long construed the term "claim" under the Bankruptcy Code broadly to foster Congress' goal of a fresh start, the Seventh Circuit held that the cleanup injunction to which EPA is entitled under RCRA's imminent and substantial endangerment authority is purely an equitable remedy that does not give rise to a right to payment, and is, thus, not a "claim." Because it was not a "claim," it, therefore, was not discharged by the Chapter 11 Plan and Confirmation Order. Significantly, the Seventh Circuit rejected the argument that, because EPA could have sought a money judgment under the Clean Water Act or sued for restitution of cleanup costs after EPA conducted its own cleanup, EPA had an alternative

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[34] *Id.* at 244, n.10. The court appears to deflect attention away from claimant's specific causes of action (such as CERCLA 107 and breach of contract) and when they accrue or when they become non-contingent, in favor of a more generalized analysis of the "claim" and the relief sought, concluding that if the claimant and debtor are co-liable under CERCLA, that satisfies the co-liability element of 502(e)(1)(B) even if the Claimant's claim includes or is based in part on breach of contract.

[35] *Id.* at 256.

[36] *Id.* at 257.

[37] *Id.* at 258; *see also Chemtura*, 443 B.R. at 626.

[38] *Lyondell*, 442 B.R. at 257-58; *Chemtura*, 443 B.R. at 626-27.

payment remedy and therefore its RCRA action was within the Bankruptcy Code's definition of "claim."[39]

The stunning ruling in *Apex Oil* has prompted environmental debtors to seek global settlements with the government that significantly reduce or eliminate the risk that the reorganized debtor will emerge from bankruptcy with the lingering threat of burdensome cleanup orders. Such settlements include those approved in the *Lyondell*, *Chemtura*, and *GM* bankruptcies, all of which involved significant environmental liabilities and significant contributors to the environmental contamination. The settlements range from large cash payments to the government in exchange for a release of the otherwise non-dischargeable claims,[40] to the funding of environmental response trusts ("ERTs") established to take title to owned sites and/or manage cleanup of non-owned sites. In addition to the government's release and covenant not to sue, the debtors are negotiating contribution protection provisions that bar contribution claims by other co-liable PRPs.[41]

These settlements can have a significant impact on the claims and liabilities of the non-debtor remediating PRPs that are cleaning up the sites pursuant to consent decrees and similar orders, even more so now due to the holdings in *Lyondell* and *Chemtura*. Their claims for debtor's share of *future* cleanup costs are barred as contingent under 502(e)(1)(B), and even their *past* cost claims for contribution can be subject to disallowance because of contribution protection the debtor obtains in the bankruptcy settlement. PRPs have been largely excluded from participation in the negotiations of these settlements even though they can have much at stake and often have better data on the debtor's share of liability and future cleanup costs. The monetary settlements only generally provide that EPA or the state will deposit the funds into a site-specific account for future cleanup and usually provide the government with broad discretion as to how and where the debtor's contributed cash or trust funds will be spent or managed. The government's unilateral decisions can dramatically affect whether and how a PRP or remediation group may benefit from the recovery.[42] Given the recent rulings on disallowance of PRP claims and the recent bankruptcy environmental settlements approved by the governments and the bankruptcy court with little regard for the interests of the PRP groups remediating the sites, remediation PRP groups will need to carefully assess and negotiate their own agreements with the government and agreements among themselves to address and effectively prepare for the potential bankruptcy of one or more PRPs for the applicable site.

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[39] *See also In re Mark IV Industries, Inc*., 438 B.R. 460, 470 (Bankr. S.D.N.Y. 2010)(The "focus is the statute under which [the government] elected to proceed.")

[40] It is somewhat perverse that the debtors are paying money to the government for a release of their liability to conduct future remediation and that the government is able to extract these payments in bankruptcy because the statutory remedy outside bankruptcy does not give rise to a right to payment and thus is a non-dischargeable debt.

[41] *See and compare* the debtors' bankruptcy court-approved environmental settlement agreements with the United States and various states in *In re Lyondell Chemical Company*, Case Nos. 09-10023-reg and *In re Chemtura Corporation* Case No. 09-11233-reg, respectively, and the EPA settlement agreement in *In re Tronox, Incorporated*, Case No. 09-10156-alg, all of which are Chapter 11 cases presently pending in the U.S. Bankruptcy Court for the Southern District of New York. The PRP objections to the settlements have been overruled with great deference being granted to the government and the benefits resolution of the environmental liabilities confer on the debtor and the other estate constituencies.

[42] Although CERCLA requires that non-settling PRPs' liability be reduced by the amount of the settlement received by the government, how and when are not proscribed and such credits are rarely applied before the remediation is complete.