

Review of Environmental Liabilities, Creditors, and
Corporate Pollution: Evidence from the Apex Oil Ruling
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Idea of paper

- *U.S. vs. Apex Oil*: 2008 7th Circuit Court of Appeals ruling disallowing the discharge of environmental clean-up obligations during Chapter 11 bankruptcy put the onus on the company to pay, which means the creditors pay.
- The management and creditors of other high polluting firms near bankruptcy realize they will be affected.
- Only important for Chapter 11 bankruptcies in which the company is continuing to operate (versus Chapter 7 bankruptcies in which companies are liquidating).

Authors find differential effects after 2008 7th Circuit Court of Appeals Apex ruling

- **Heavy polluters**
High default probability

- RCRA emissions ↓
- non-RCRA emissions –
- CAR on bonds ↓
- Interest expenses ↑
- Bank loan spread ↑

- **Heavy polluters**
Low default probability

- RCRA-covered emissions –
- non-RCRA emissions –
- CAR on bonds –
- Interest expenses –
- Bank loan spread –

Example of importance

June 25, 2021 *Desert Sun*

- **Oil bankruptcies leave environmental cleanup bills to California taxpayers**
- Many environmental activists and researchers, along with some lawmakers, say oil and gas producers use the bankruptcy code to shed environmental liabilities, leaving taxpayers in the lurch.
- Much of the hazardous waste from oil and gas E&P was exempted from the RCRA, but many states have established laws and regulations.

Overall

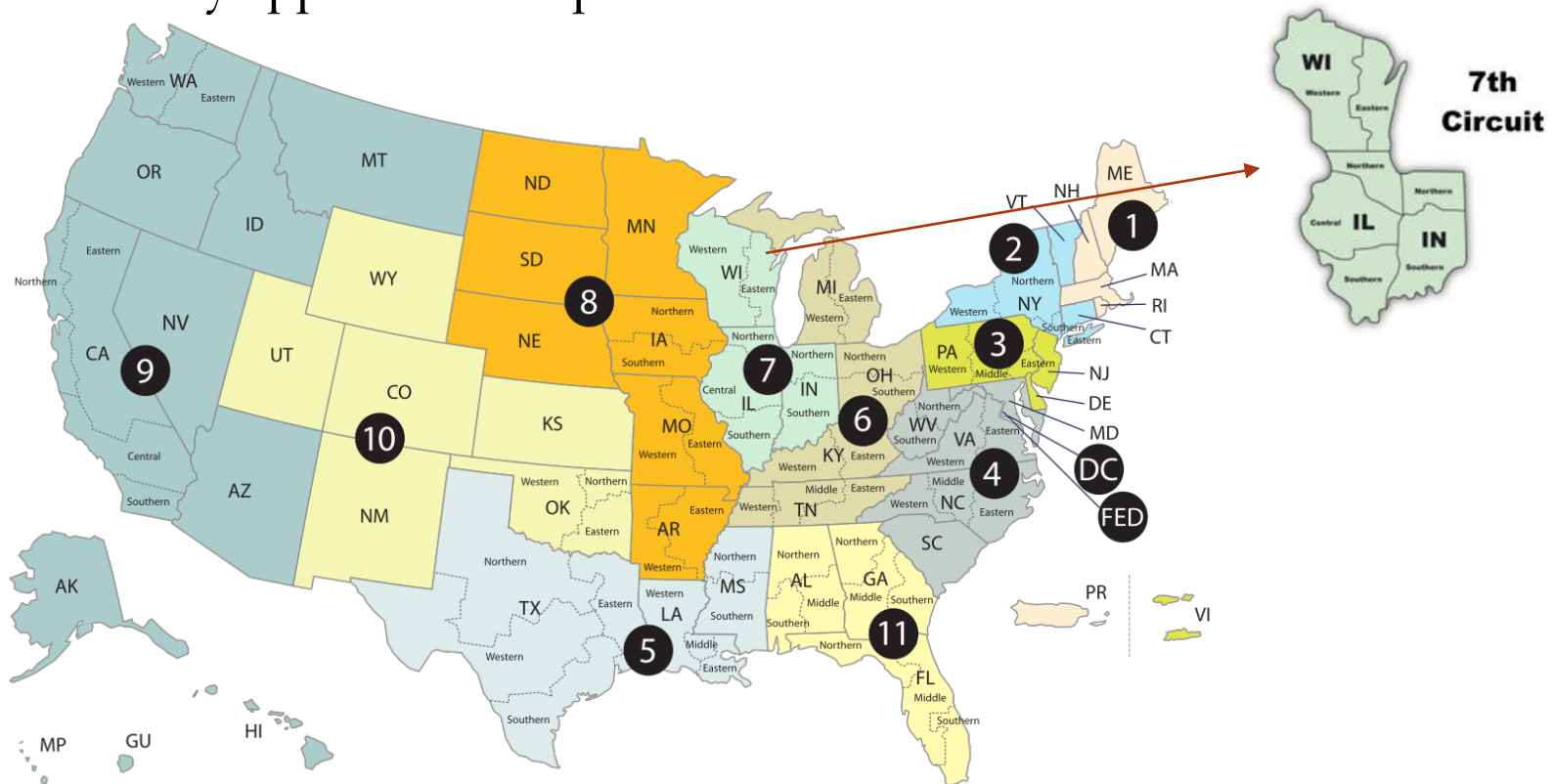
- Excellent paper: incredible data cleaning and construction of empirical tests
- Since the discussant's job is to look for areas of improvement I have five questions:
 1. Is the sample appropriate?
 2. What about state variation in EPA enforcements?
 3. Is July 2008 the correct event date?
 4. Are the toxic release reduction effects too large?
 5. What about the problems from illiquidity in bond markets?

Question 1: Is the sample appropriate?

- Authors use bankruptcy data from all over the U.S., but technically, the 7th Circuit Court of Appeals ruling on Apex Oil only applies to companies within the 7th Circuit.

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- “As we show, the rest of the country quickly applied Apex and using the complete set of firms increases the sample from 55 7th Circuit firms to over 700 firms.”
- Where is the evidence? The previous work by an NYU law professor (Ohlrogge) uses only the 55 7th Circuit firms.

The law discussions of the case are not definitive that it would apply universally

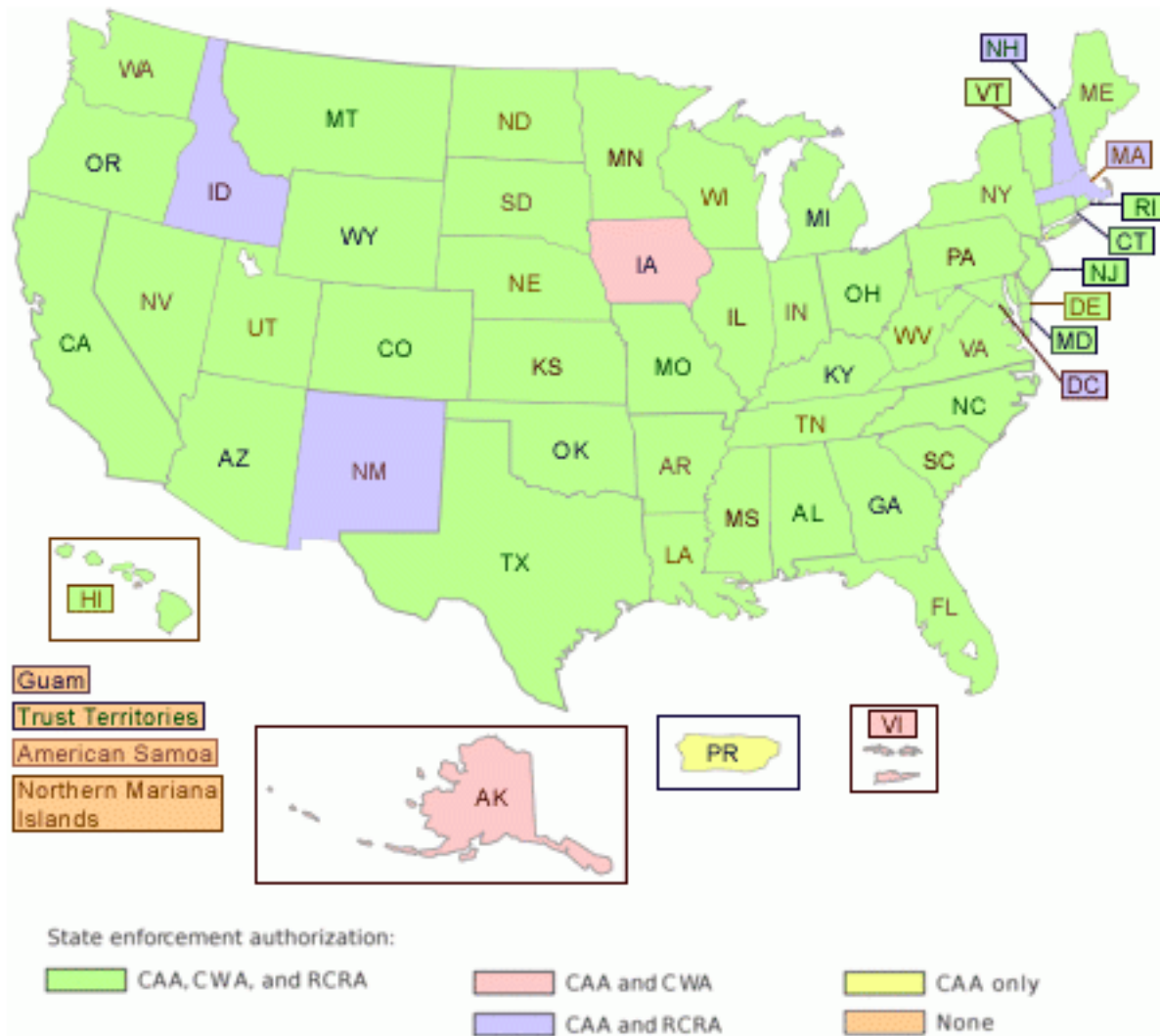
- Weil Restructuring Blog October 2010: The consequence of the Court's refusal to take the case is to reinforce a trend in the case law holding that the federal or State government's right to compel a debtor to perform an environmental cleanup *may not be dischargeable* under the U.S. Bankruptcy Code, even if the only way that the debtor could comply is to spend substantial amounts of money.
- Law 360 October 2010: While this case is not inconsistent with other case law, *it adds to the uncertainty of the level of protection provided by bankruptcy discharge.*
- Akin Gump October 2010: *The decision leaves in doubt the extent to which a discharge relieves a reorganizing entity of certain environmental liabilities.* Accordingly, investors and stakeholders in reorganized entities should assess—and, if appropriate, take additional measures to mitigate—the risk of environmental liabilities.

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- Suggestion: The authors should provide more justification for why the original 7th Circuit Court of Appeals decision and the Supreme Court decision implies the use of firms from all over the U.S.
 - Evidence from credit rating agency reports
 - Evidence from media stories
 - Evidence from later cases (the ones cited are not definitive)

Question 2: What about state variation in EPA enforcements?

- U.S. federal regulation *usually enforced at state-level* – cross-sectional variation
- Enforcement for Clean Water Act (CWA), Clean Air Act (CAA) and Resource Conservation and Recovery Act (RCRA)

EPA versus state enforcement



Question 2: What about state variation in EPA enforcements?

- U.S. federal regulation *usually enforced at state-level* – cross-sectional variation
- Enforcement for Clean Water Act (CWA), Clean Air Act (CAA) and Resource Conservation and Recovery Act (RCRA)
- It seems that negotiating becomes important in these potential discharges. Do these negotiations require state authorities? If so, should state variation in enforcement be taken into account?

Question 2: Why not take advantage of state variations in environmental enforcements?

- The political science literature has methods for measuring differences in state enforcement (e.g., Konisky, 2007 and Konisky and Woods, 2012).
- After a shock to climate regulatory risk (the Paris Agreement) corporate bonds were affected with higher credit ratings and lower yield spreads and the heavy polluters in states with stricter regulation were hit the worst.
 - Seltzer, Starks and Zhu (2022)

Question 3: Is July 2008 the correct event date?

- Why is the event date July 2008? The company appealed the ruling.
- Why not October 2010 when the U.S. Supreme Court denied certiorari, i.e., refused to hear the appeal?
- Issues with 2008 date:
 - Great Recession of 2008-2009
 - 210 public companies filed for chapter 7 or chapter 11 bankruptcy protection in 2009, compared to 138 in 2008. Highest on record except for 2001. Tens of thousands of private firms filed.
 - New White House administration 7 months later
 - Precedes Obama Administration's 2009 EPA push to increase enforcement of hazardous waste and GHG emissions and decreases in pollution, which should have asymmetric influences on the heavy polluters versus the light polluters.

Question 4: Are the toxic release reduction effects too large?

- After the Apex decision in 2008, authors find heavy polluters close to bankruptcy are associated with a 19.48% reduction in toxic releases relative to the subsample's mean.
- This seems like a very large reduction to be associated with the 7th Circuit Court ruling, particularly as Apex appealed to the Supreme Court.
- Authors did many robustness checks including:
 - Added parent-firm fixed effects
 - Estimated whether production was lowered at a facility by looking at whether employment was reduced and did not find this.
 - Checked parallel trends for heavy polluters and low polluters in the high default probability subsample (but is this an appropriate approach)?

Question 5: What about the problems from illiquidity in bond markets?

- Corporate bonds are notoriously illiquid. On average, bonds trade only 5% of trading days and this declines as bonds age. Spiegel and Starks (2016)
Consider using the repeat sales method
- The authors have other measures such as total interest expenses and bank loan spreads so this isn't critical.
- What about credit ratings? Wouldn't they be cleaner? Plus, the credit rating analysts would be the most up-to-date with the effects of this court case.

Overall

- Highly important topic
- Great ideas
- Immense amount of work
- Would just like to see the answers to my questions...