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BANKRUPTCY AND THE ENVIRONMENTAL LAWS: THE RESOLVABLE CLASH¹

I. INTRODUCTION

“Man has suddenly become aware of the damage”reparable and irreparable“being done to his environment. Whether this concern has come too late is a perplexing question. Lawyers, in private life and public life, are being called upon with increasing frequency to aid in the fight to halt further ecological destruction and repair the damage already created.”²

Environmental concerns permeate every aspect of American life. No longer a society struggling to survive, we are attempting to preserve, conserve, and restore our natural surroundings.³ While the seventies and eighties initiated environmental awareness,⁴ the nineties is the Age of Enlightenment. Americans now realize the blessedness of the environment.

The purpose of environmental law is to protect the environment by placing liability for cleanup costs on polluters⁵ of the ground, air, and water. However, environmental liability is not cheap. Because environmental concerns are more pervasive than at first expected, the cost of complying with environmental laws has increased exponentially.⁶ Thus, a significant number of companies are finding themselves subject to environmental obligations far beyond their ability to pay⁷ and are seeking the broad protection of the Federal Bankruptcy Code.⁸

1. The author would especially like to thank Rod Notzon, law clerk for the Honorable Judge Micky Wilson of the Northern District of Oklahoma, Bankruptcy Division, for his invaluable guidance and assistance.

2. H. Floyd Sherrod Jr., *Preface to the 1970 Edition*, 1 ENVTL L. REV. iii (1970).

3. *Id.* at xiii.

4. Bernard F. Meroney, Comment, “Taking” on the Environment: The Takings Clause and Environmental Law“Some Observations, 36 LOY. L. REV. 1083 (1991).

5. Polluters are often referred to as “potentially responsible parties.”

6. Arlene Elgart et al., *The Interface Between Bankruptcy and Environmental Laws*, 46 BUS. LAW. 626 (1991).

7. Caroline C. Fuller, *The Effect of Bankruptcy on Environmental Obligations*, 21 COLO. LAW. 915 (1992).

8. See generally Frank R. Kennedy, *The Commencement of a Case Under the New Bankruptcy Code*, 36 WASH. & LEE L. REV. 977 (1979).

When one focuses on the interplay between environmental laws⁹ and the Bankruptcy Code, it becomes clear that the policies, considerations, and protections of each area of law do not mesh with one another. An example makes this point easier to visualize: Company X, a debtor with limited assets, becomes responsible for a significant environmental liability. How can it comply with environmental regulations without leaving creditors in a more unfavorable position or, in the worst case scenario, completely unsatisfied? Conversely, how can Company X get a "fresh start" under the Bankruptcy Code while it is potentially strictly liable for a costly environmental claim? If Company X is relieved of significant environmental liability through bankruptcy, the cleanup costs will be borne by innocent taxpayers.

9. The following is a cursory list and explanation of the primary environmental laws designed to regulate pollution-producing industries and abandoned hazardous waste sites in effect in our country today.

A. *The Comprehensive Environmental Response, Compensation, and Liability Act of 1980 ("CERCLA")*

CERCLA is often referred to as the Superfund Act or the Superfund Legislation. 42 U.S.C. §§ 9601-675 (1988). CERCLA imposes liability upon any potentially responsible parties for damages caused by a release or even a threatened release of a hazardous substance. The following types of damages are included in CERCLA:

"response costs incurred by the EPA;

"response costs incurred by private persons;

"natural resource damage claims;

"costs of health assessment or health effects studies. CERCLA imposes strict liability without regard to fault which is joint and several.

B. *The Resource Conservation and Recovery Act ("RCRA")*

RCRA, 42 U.S.C. §§ 6901-992 (1988), provides a comprehensive statutory scheme that requires the EPA to regulate the generation, transportation, storage, discharge and final disposal of solid and hazardous wastes. This act includes requirements for the post-disposal monitoring care of contaminated sites. *See generally* Morrison et al., *Survey of Environmental Issues*, 1-3 (December 1988). RCRA additionally authorizes the EPA to obtain injunctive relief to remediate past bad practices which present an imminent and substantial endangerment to health or the environment. 42 U.S.C. §§ 6973 (1988).

C. *The Clean Water Act*

The Clean Water Act, 33 U.S.C. §§ 1251-1387 (1988), addresses the pollution of surface water and ground water. This act is intended to regulate the discharge of pollutants into the navigable waters of the U.S. and requires notification of any spill or discharge of oil or hazardous substances therein. *Id.* § 1251 (a)(1). There are elaborate requirements for obtaining a permit necessary under the Clean Water Act to discharge a pollutant. 40 C.F.R. § 122 (1982).

D. *The Clean Air Act ("CCA")*

The Clean Air Act, 42 U.S.C. §§ 7401-7642 (1988), designed to protect and enhance the quality of the nation's air resources, regulates air pollution by air quality standards and emission limitations. The Clean Air Act encourages the EPA to have state and local governments prevent and control air pollution. *Id.* § 7401. Major amendments to this act are in the proposal stage currently and should be watched for in the near future.

E. *The Toxic Substance Control Act ("TSCA")*

The TSCA, 15 U.S.C. § 2601 (1976), regulates commercially produced chemical substances through identification and control of the manufacture, processing, commercial distribution, use or disposal of chemicals that pose an unreasonable risk. *Id.* § 2607(a)(2). This act primarily responds to problems posed by polychlorinated biphenyls (PCB's).

In furtherance of the need for environmental protection, there must be legislative reform in the Bankruptcy Code. The changes must reflect the importance, the priority, and the urgency of environmental laws while clarifying the role of environmental liability as a debt. Secondly, environmental creditors must be aware of the protections that the present Bankruptcy Code offers them.

II. BACKGROUND AND BENEFITS OF BANKRUPTCY LAW

There are two types of bankruptcy proceedings available to a corporation seeking bankruptcy: liquidation and reorganization.¹⁰ These procedures are named after the chapters of the Bankruptcy Code which govern their operation: Chapter 7 and Chapter 11. Chapter 7¹¹ allows prompt liquidation in a fire-sale style in accordance with statutory procedure.¹² Alternatively, Chapter 11 involves either a controlled liquidation varying in detail from the standard Chapter 7 procedure, or a reorganization and continuation of the business.¹³ Thus, Chapter 11 allows more freedom of action according to the particular circumstances.

When bankruptcy proceedings are initiated, the bankruptcy petition is filed and a bankruptcy "estate" is created. This estate will contain every right or interest of the debtor's that exists at the time the petition is filed.¹⁴ The property that comprises the estate is no longer the property of the debtor, and the bankruptcy court must approve any and all distributions of assets from the "estate" other than those made in the ordinary course of a continuing business.¹⁵

In a Chapter 7 proceeding, the corporate entity is dissolved, the debtor's assets are liquidated, and the proceeds are distributed to creditors.¹⁶ The estate is managed by a trustee who is either appointed by the United States Trustee or elected by the creditors.¹⁷

10. 11 U.S.C. §§ 701-66, 1101-74 (1988).

11. Note that entities can be forced into a Chapter 7 proceeding by the use of an involuntary bankruptcy petition. See 11 U.S.C. § 303 (1986).

12. 11 U.S.C. §§ 704-26 (1988).

13. *Id.* §§ 1101-74; See *Ionosphere Clubs, Inc. v. Eastern Airlines, Inc.*, 114 B.R. 379 (S.D. N.Y. 1990) (stating the bankruptcy court's primary objective is to enable the Chapter 11 debtor to restructure its business and continue operations).

14. 11 U.S.C. § 541 (1988 and Supp. IV 1992). The estate will include non-possessory interests like security interests and intangibles. *Id.*

15. *Id.* at § 363(c)(1).

16. See Carmen Hernandez-Lonstein et al., *ALI-ABA Course of Study Tax and Business Planning and Restructuring for the 90's: Overview of Chapters 7 and 11 under the U.S. Bankruptcy Code* (March 10, 1993).

17. 11 U.S.C. §§ 701(a)(1), 702(d) (1988).

The trustee has a duty to liquidate the debtor's assets and distribute the proceeds to creditors in order of statutory priority.¹⁸ According to the statutory scheme of priorities, the secured creditors receive the value of their collateral first. If a secured creditor's claim is not fully satisfied from the sale of the collateral, that secured creditor becomes an unsecured creditor for the amount of the claim left to be satisfied.¹⁹ Favored unsecured creditors are the next to be paid.²⁰ Finally, the remaining unsecured creditors are paid to the extent possible.²¹

Alternatively, Chapter 11²² bankruptcy may be available.²³ In Chapter 11, the estate is ordinarily managed by the debtor corporation's own officers, acting in lieu of a trustee.²⁴ The debtor, in this instance, is allowed to remain in possession of the estate property and is called a "debtor in possession."²⁵ The court may, however, remove the debtor from possession and entrust the estate to a specifically appointed trustee.²⁶ The court also retains power to intervene in the management of the debtor's business upon request of a party in interest and may fashion appropriate relief to address concerns of the creditors or equity holders.²⁷

The debtor in possession or trustee is expected to develop a plan for the liquidation or reorganization of the business and the payment of creditors' debts or claims. A plan must be approved by the creditors and confirmed by the court²⁸ following a hearing on the plan.²⁹ It is here that any party in interest may appear and object to confirmation.³⁰

There are three specific devices of a bankruptcy proceeding that are of particular relevance to any corporate debtor with environmental liability. These three areas will be examined in chronological order. First, in all types of bankruptcy cases, once the bankruptcy petition is

18. *Id.* §§ 704, 725, and 726.

19. *Id.* §§ 506(a) and 725.

20. Favored unsecured claims include wages, taxes, etc. *See* 11 U.S.C. §§ 704, 725, and 726 (1988).

21. 11 U.S.C. §§ 507(a) and 726 (1988).

22. *Id.* §§ 1101-74.

23. *Id.* § 109.

24. *Id.* § 1107(a).

25. *Id.* § 1101(1).

26. *Id.* § 1104.

27. *See In re Gaslight Club, Inc.*, 782 F.2d 767 (7th Cir. 1986).

28. 11 U.S.C. § 1129 (1988).

29. *Id.* § 1128(a).

30. It is important to note that an unsuccessful Chapter 11 bankruptcy may, and often does, end up converted to a Chapter 7. This conversion can happen either at the election of the debtor or by mandate of the court. *Id.* § 1112(b).

filed an automatic stay commences.³¹ This stay protects assets of the estate from all proceedings existing pre-petition or seeking to collect on a pre-petition claim³² and is one of the initial protections sought by all entities filing bankruptcy. The automatic stay gives the debtor relief from creditors while either planning reorganization under Chapter 11 or taking stock of all available assets under Chapter 7.

This "safe" period allows the debtor relief from the financial pressures that have culminated in a bankruptcy petition.³³ Simply, the automatic stay creates a safe harbor period where creditors must abstain from pursuing collections from the debtor. Importantly, Congress carved out a specific exception to the automatic stay: actions or proceedings brought by the government to enforce police or regulatory powers may be commenced and enforced notwithstanding the initiation of bankruptcy proceedings and the automatic stay.³⁴

The second greatest protection offered by the Bankruptcy Code is the power of abandonment.³⁵ To abandon under the Bankruptcy Code means for the estate to renounce ownership of, or to write off any legal interest in an item of property.³⁶ The trustee or debtor in possession then has the right to sell, use or lease property free and clear of liens or other interests.³⁷ Alternatively, the trustee or debtor in possession may simply rid himself of the land.³⁸ This valuable power allows the abandonment of any unprofitable asset that is burdensome or of relatively insignificant value to the estate.³⁹

Finally, the Chapter 11 corporate debtor is required to formulate a plan of liquidation or reorganization.⁴⁰ This plan of repayment must be approved by the creditors and confirmed by the court.⁴¹ Here, the

31. *Id.* §§ 362(a)(1) and (2).

32. *Id.*

33. See H.R. REP. NO. 595, 95th Cong., 2nd Sess. 340-42 (1977), reprinted in 1978 U.S.C.C.A.N. 6296-99; see also S. Rep. No. 989, 95th Cong., 2nd Sess. 49-55 (1978), reprinted in 1978 U.S.C.C.A.N. § 787, §§ 5835-41.

34. 11 U.S.C. § 362(b) (1988).

35. *Id.* §§ 363 and 554.

36. An ordinary property owner does not have the right to sell his land out from under legal encumbrances, but to some extent a bankruptcy trustee or debtor in possession can do so. *Id.* § 363(f). Additionally, an ordinary property owner does not have the right to rid himself of contaminated land by merely announcing, "I do not want this land," but again to some extent a bankruptcy Trustee or debtor in possession may do just that. *Id.* at § 554.

37. *Id.* § 363(f).

38. 11 U.S.C. § 554 (1988 & Supp. IV (1992)).

39. *Id.* § 554(a).

40. *Id.* § 1121.

41. See *id.* § 1129.

court may implement the absolute priority rule⁴² which allows a creditor to demand full payment before any creditor junior to him may be paid at all.

III. AREAS OF CONCERN IN THE INTERFACE OF ENVIRONMENTAL LAW AND THE BANKRUPTCY CODE

A number of issues are raised when environmental liability is addressed under the Federal Bankruptcy Code. The following three issues are the most significant and, unfortunately, the most unclear:

A. Is environmental liability for reimbursement of remediation costs and government orders requiring cleanup of contamination subject to the automatic stay?

B. Can a trustee or debtor in possession sell or abandon property regardless of environmental liability associated with the land?

C. Can a debtor escape environmental liability through confirmation of a creative Chapter 11 plan?⁴³

The remainder of this paper will address the issues presented in regard to the corporate debtor only. Additionally, this paper will suggest changes to clarify the role of environmental liability in a bankruptcy proceeding. These suggestions are based upon the premise that while bankruptcy is a useful and needed tool for the floundering debtor, environmental laws must have priority over bankruptcy security.

IV. ANALYSIS OF ISSUES

A. *Automatic Stay*

Upon the initial filing of the bankruptcy petition,⁴⁴ the property of the estate is protected by an automatic stay of most proceedings that could have been brought pre-petition and all proceedings seeking to collect on a pre-petition claim.⁴⁵ This is the "breathing spell" phase of the bankruptcy process.⁴⁶ The stay detains creditors from racing to the courthouse with pre-bankruptcy claims and, instead, forces them

42. *See id.* § 1129(b).

43. *See id.* § 1141(d)(1).

44. A bankruptcy case begins with the filing of a voluntary petition by the debtor or an involuntary petition against the debtor. *Id.* §§ 301 and 303.

45. *Id.* § 362(a).

46. H.R. REP. No. 595, 95th Cong., 2nd Sess. 340 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6296-97.

into court all at once. The Bankruptcy Code sets out specific exceptions to the automatic stay.⁴⁷ One of the exceptions states that proceedings brought by the government to enforce police or regulatory powers are exempt from the stay.⁴⁸ Legislative history regarding this exception indicates it was intended to exempt actions designed to prevent or to stop violations of environmental laws.⁴⁹

Although this exception is especially relevant in the environmental arena, it does not apply to governmental proceedings seeking to enforce a money judgment.⁵⁰ Thus, while it appears that environmental proceedings enforce police or regulatory powers and are not subject to the automatic stay, exactly what constitutes "enforcing police or regulatory power" is not clear. This issue has been the subject of much litigation and no clear standard has yet emerged.

Where the government seeks exemption from the automatic stay, recent case law has created two distinct hurdles. First, is the governmental action an exercise of regulatory or police power?⁵¹ Second, if so, is it merely an action to collect a money judgment?⁵² It appears, however, that while ostensibly analyzing under two prongs, courts often run the questions together. The result is that both parts of the test are usually analyzed in one argument and lead to a single conclusion.

Generally speaking, bankruptcy will not interfere with an action to cleanup a site that is posing a direct threat to public welfare and safety. On the other hand, bankruptcy will interfere with the collection of debts - in the nature of fines or reimbursement of costs - which are merely the aftermath of situations where public welfare and safety have already been protected. In the most simplistic terms, if the government is actually attempting to right an imposing threat to the community, bankruptcy will allow the action to proceed. However, if the government is attempting merely to reimburse themselves for previous expenditures, bankruptcy will halt this process to the benefit of the debtor's estate.

47. 11 U.S.C. § 362(b) (1988 & Supp. IV 1992).

48. *Id.* § 362(b)(4).

49. H.R. REP. NO. 595, *supra* note 46, at 343, *reprinted in* 1978 U.S.C.C.A.N. at 6299. This report provides one of the few references to environmental laws.

50. 11 U.S.C. § 362(b)(5) (1988 & Supp. IV 1992).

51. *Id.* § 362(b)(4).

52. *Id.* § 362(b)(5).

1. Is the Governmental Action an Exercise of Regulatory or Police Power?

When debtors in possession and trustees are faced with claims for reimbursement of cleanup and remediation costs, they often plead that these claims are actually not police or regulatory powers but, instead, actions to collect a pre-petition debt. Thus, they claim the actions are subject to the automatic stay.

When this issue is presented, courts focus their reasoning on the primary purpose of the action: whether the government is using regulatory or police powers. One test used by the courts is the "pecuniary purpose test."⁵³ Under this test, the court questions whether the governmental action relates primarily to property or to matters of public health, safety, and welfare.⁵⁴ If a proceeding is found to relate primarily to matters of public safety, health, and welfare, it is excepted from the automatic stay.⁵⁵ An alternative test is the "public policy test"⁵⁶ where the court looks to a proceeding to determine if the proceeding effectuates a public policy or if it adjudicates a private right. Only proceedings that effectuate a public policy are excepted from the automatic stay.

An illustrative case is *United States v. Mattiace*.⁵⁷ In *Mattiace*, the E.P.A. asked that one million dollars be paid to them to implement a clean up of the company's waste site. Mattiace filed Chapter 11 bankruptcy. The debtor in possession argued that the government was not exercising regulatory or police power but, instead, was merely seeking to further their pecuniary interest. The court, reasoning that CERCLA was enacted for the purpose of protecting public health, safety, and welfare,⁵⁸ held that actions by the government under CERCLA were actions for the enforcement of police or regulatory power. As such, these actions were exempt from the automatic stay.⁵⁹

53. *In re Commerce Oil Co.*, 847 F.2d 291, 295 (6th Cir. 1988).

54. *Id.*

55. *Id.* Note that the vagueness of the word "related" could potentially lead to inconsistent results.

56. *Id.*

57. 73 B.R. 816 (Bankr. E.D. N.Y. 1987).

58. The third circuit noted earlier that "the exception to the automatic stay provision . . . should itself be construed broadly, and no unnatural efforts be made to limit its scope." *Penn Terra Ltd. v. Dept. of Envtl Resources*, 733 F.2d 267, 273 (3d Cir. 1984). The court further observed that no more obvious exercise of the state's power to protect the health, safety, and welfare of the public can be imagined than to rectify harmful environmental hazards.

59. *Mattiace*, 73 B.R. at 819. See also 11 U.S.C. § 362(b)(4) (1988). The response in *Mattiace* seems inconsistent with the policies of bankruptcy because the site in question was not continuing to contaminate and, thus, was not an immediate threat to public safety. Bankruptcy should

In another of these cases, *In Re Commonwealth Oil Refining Co.*,⁶⁰ a debtor in possession operating a RCRA interim status refining facility⁶¹ did not submit Part B of the RCRA permit application.⁶² The E.P.A. issued a compliance order requiring the debtor in possession to either submit Part B or to file a closing plan. The debtor in possession requested that this action be subject to the automatic stay because it was only compelling "technical violation" compliance.⁶³ The debtor in possession further argued that the exception to the automatic stay for police and regulatory powers was only invocable when there was a threat of immediate and identifiable harm.⁶⁴ The court rejected this argument and held that compliance with information gathering and permitting procedures, "falls squarely within the police and regulatory powers."⁶⁵ Thus, this action was exempt from the automatic stay.⁶⁶

2. Is the Action Merely an Action to Collect a Money Judgment?

If the action is found to be merely an action seeking to collect a money judgment, it will fit within the "exception to the exception" and, thus, will be subject to the automatic stay. Therefore, even if the action seeking to collect money damages is a valid use of the government's police or regulatory powers, it will not be excepted and will be subject to the automatic stay.

Debtors in possession and trustees have argued that any action by the government that ultimately requires them to expend money is an action equivalent to the enforcement of a money judgment and consequently should be subject to the automatic stay. Essentially, this argument is all-encompassing. Should the ability of a claim to be stayed merely depend upon the bankrupt's ability to wrangle the claim into a

not interfere where the government seeks to remedy an existing public hazard. It *should* interfere when the action seeks to reimburse a unit for a specific sum.

60. 805 F.2d 1175 (5th Cir. 1986).

61. The facility was interim because it was not technically approved by the E.P.A. until all reports were filed.

62. *Commonwealth*, 805 F.2d at 1179.

63. *Id.* at 1182.

64. *Id.*

65. *Id.* at 1186 (quoting *Penn Terra Ltd. v. Dept. of Env'tl. Resources*, 733 F.2d 267, 274 (3d Cir. 1984)). The result here is consistent with the purposes of bankruptcy in as much as requiring either part B or a closing plan does not take estate property from other creditors. Additionally, the action may help the government to determine whether there is a situation requiring immediate cleanup.

66. *See also Penn Terra Ltd. v. Dept. of Env'tl. Resources*, 733 F.2d 267, 274 (3d Cir. 1984); *In re Security Gas and Oil, Inc.*, 70 B.R. 786 (Bankr. N.D. Cal. 1987).

form of a money judgment? Courts are presently divided on this issue.

In *Ohio v. Kovacs*,⁶⁷ the U.S. Supreme Court held that the automatic stay does apply in an action which ultimately requires the expenditure of money.⁶⁸ Conversely, the *Penn Terra*⁶⁹ court came to the realistic conclusion that almost anything in today's society necessitates the spending of money.⁷⁰ They refused to construe the term "money judgment" broadly and, instead, defined it as a collection of a sum certain.⁷¹

When determining if a claim is for a money judgment and thus subject to the automatic stay, courts have categorized environmental claims into three areas. First, "money judgments" occur when a party is seeking to be reimbursed for money spent on cleaning up contamination. Second, "essentially money judgments" exist when a party has no practical ability to do a clean up, yet the government seeks to compel the party to do so. Finally, injunctive relief occurs when a court issues an order to a party to clean up a site that is continuing to contaminate the air, water, or ground.

Pure money judgments generally are subject to the automatic stay. In *Brock v. Morysville Body Works, Inc.*,⁷² for example, the court refused to enforce \$21,000 in fines for violations of OSHA⁷³ regulations. The court noted the fines were merely punishment for past violations and OSHA was strictly seeking the enforcement of a money judgment. They ruled that the collection of fines was not a governmental police power and was not exempt from the automatic stay.⁷⁴ An analogous situation occurred in *United States v. Standard Metal Corp.*⁷⁵ There, a debtor in possession faced with penalties for violations of the Clean Water Act advanced the argument that the government was merely enforcing a money judgment. The court held that assessment of civil penalties was within the classic regulatory enforcement power advanced by the automatic stay provision.⁷⁶ Although

67. 469 U.S. 274 (1985).

68. *Id.* at 282. See also *In re Thomas Solvent Co.*, 44 B.R. 83 (Bankr. W.D. Mich. 1984).

69. 733 F.2d 267 (3d Cir. 1984).

70. *Id.* at 277-78.

71. *Id.* at 277.

72. 829 F.2d 383 (3d Cir. 1987).

73. Occupational Safety and Health Act, 29 U.S.C. §§ 651-78 (1988 & Supp. III 1991).

74. *Brock*, 829 F.2d at 389-90.

75. 49 B.R. 623 (Bankr. D. Colo. 1985).

76. *Id.* at 625.

the court entered a judgment for the government,⁷⁷ it ruled that collection had to be done in accordance with bankruptcy proceedings.⁷⁸ This decision seems to make a very valid and very necessary point: the state can *assess* penalties but it cannot *collect* them except by getting in line with everybody else.

An interesting compromise was reached in *In re Thomas Solvent Co.*,⁷⁹ where a debtor in possession sought to enjoin a state court order requiring the debtor in possession to remediate⁸⁰ polluted groundwater. The court found that the enforcement of the cleanup order was in fact an enforcement of a money judgment. Thus, they held that a governmental unit could not deplete the assets of a bankrupt's estate to comply with a cleanup order because Congress had not afforded priority to environmental claims.⁸¹ However, in a victory for environmental activists, the court also ruled that a debtor in possession could not continue to operate as a viable business and avoid its environmental obligations to society by simply initiating Chapter 11 proceedings.⁸² The court enjoined the state from enforcing the cleanup order, forcing the debtor to file a Chapter 7 proceeding. It further threatened to grant the state relief from the automatic stay if the debtor in possession did not file a Chapter 7 liquidation plan within 90 days.⁸³

The second category the courts have used in determining if an action is merely for a money judgment is that of "essentially a money judgment." In *In re Kovacs*,⁸⁴ the state demanded that the debtor pay for cleanup costs after the state had appointed a receiver to perform the cleanup.⁸⁵ The court noted that the debtor had been divested of his property and, therefore, was personally unable to perform the cleanup. Thus, the only way the debtor could comply with the directive was by paying the money to the receiver. The court found that

77. *Id.* The court further noted the fine would serve as a deterrent to future releases.

78. *Id.* Note that penalties against a debtor in possession or a trustee for post-petition violations are outside of the automatic stay and are collectable from the estate. *United States Dep't of Interior v. Elliot*, 761 F.2d 168, 171 (4th Cir. 1985).

79. 44 B.R. 83 (Bankr. W.D. Mich. 1984).

80. To remediate in the environmental sense means to cleanup and restore the contaminated area.

81. *See Thomas*, 44 B.R. at 87-88.

82. *Id.* at 88.

83. *Id.*

84. 681 F.2d 454 (6th Cir. 1982), *rev'd on other grounds by Ohio v. Kovacs*, 469 U.S. 274 (1985).

85. The state cleaned up the site and was requesting refund of the cost from the bankrupt.

the state was essentially trying to enforce a money judgment and was subject to the automatic stay.⁸⁶

The third category is that of injunctions. These are not usually subject to the automatic stay.⁸⁷ Generally, however, a debtor in possession or a trustee will argue that an injunction is merely an order compelling them to spend money and, therefore, is seeking to enforce a money judgment. Consequently, they argue that the action is subject to the automatic stay.

Recent decisions⁸⁸ have limited the definition of "money judgment". In *Illinois v. Electric Utilities*,⁸⁹ Illinois sought to enjoin the debtor from disposing PCB's under TSCA and to remediate existing contamination. Before judgment was entered, the debtor filed a Chapter 11 petition and argued that the injunction should be stayed. The court ruled that states were insulated from automatic stay provisions when initiating proceedings to protect citizens from environmental hazards.⁹⁰

In a situation where the government was seeking an injunction requiring the debtor to perform reclamation work at an abandoned mine site, the action was found to be within the regulatory and police power exception to the automatic stay.⁹¹ The government was seeking performance by the debtor to correct a continuing threat, not a payment of money.⁹²

Likewise, in *United States v. ILCO, Inc.*,⁹³ an order forcing a debtor to clean up a hazardous site was found not to be an enforcement of a money judgment. The court observed that Congress indicated preservation of the debtor's estate was not always the dominant goal and the "enforcement of an injunction ordering compliance with environmental laws is more important than the debtor's right to have a breathing spell."⁹⁴

86. *In Re Kovacs*, 681 F.2d at 456.

87. *Illinois v. Electric Utilities*, 41 B.R. 874 (Bankr. N.D. Ill. 1984).

88. One of the earliest decisions on injunctive relief in the bankruptcy context is *United States v. Johns-Manville Sales Corp.*, 13 Env'tl. L. Rep. (Env'tl. L. Inst.) 20310, 20311 (D.N.H. Nov. 15, 1982), in which the court ruled that an injunction requiring the debtor to abate a long-existing asbestos dump resembled a money judgment and was subject to the automatic stay. A possible explanation here is that had the problem been dealt with earlier and not been long-existing, the court might have been more willing to believe the government had it felt the dump was a public welfare threat.

89. 41 B.R. 874 (Bankr. N.D. Ill. 1984).

90. *Id.* at 875-76.

91. *United States v. Gregory and Sons, Inc.*, 58 B.R. 590, 591 (Bankr. W.D. Pa. 1986).

92. *Id.* at 593.

93. 48 B.R. 1016 (Bankr. N.D. Ala. 1985).

94. *Id.* at 1023.

The most notable case in the realm of injunctions, however, is *Penn Terra Ltd. v. Department of Environmental Resources*.⁹⁵ Here the Pennsylvania Department of Environmental Resources obtained a consent decree which required Penn Terra to reclaim subsurface coal mines.⁹⁶ Penn Terra had, by this time, ceased all mining operations. Before complying with the order, Penn Terra filed Chapter 7 bankruptcy, and Pennsylvania attempted to require the debtor and trustee to comply with the consent order.⁹⁷ The court held that the state injunction directing the debtor to perform the reclamation work was not an enforcement of a money order and, therefore, was not subject to the automatic stay.

The court in *Penn Terra* set forth two criteria for determining if an order is a money judgment: (1) the form, and (2) the purpose of the relief sought. As to form, a money judgment is one that identifies the parties and defines a sum certain that the debtor is required to pay to the state.⁹⁸ As to the purpose of the relief, the court must inquire whether the remedy would compensate for past wrongs or protect against future harm. The court pointed out that it is unlikely that any action which seeks to prevent culpable conduct in the future will manifest itself as an action for a money judgment or one to enforce a money judgment.⁹⁹

The *Penn Terra* court held that an action seeking to require a debtor to clean up an environmental hazard does not become an action to enforce a money judgment solely because the debtor must expend money to comply with the order.¹⁰⁰ It also noted that compliance with virtually any injunction costs money.¹⁰¹ The action in *Penn Terra* was found to be intended to prevent future harm and not subject to the stay.¹⁰²

In summary, if the enforcement of a money judgment requires the debtor to pay a sum certain either for cleanup costs or fines, the action will be subject to the automatic stay. However, actions under CERCLA enforcing cleanup mandates are generally the exception

95. 733 F.2d, 267 (3d Cir. 1984).

96. *Id.* at 269.

97. *Id.* at 269-70.

98. *Id.* at 275.

99. *Id.* at 276-77.

100. *Penn Terra Ltd. v. Dept. of Env'tl. Resources*, 733 F.2d 267, 277 (3d Cir. 1984)

101. *Id.* at 277-78.

102. *Id.* at 278. See also *Friends of the Sakonnet v. Dutra*, 125 B.R. 69, 71-72 (Bankr. D.R.I. 1991); *In re Laurinburg Oil Co., Inc.*, 49 B.R. 652, 654 (Bankr. M.D. N.C. 1984). *But cf.* *Ohio v. Kovacs*, 469 U.S. 274 (1985) (noting debtor no longer possessed the property and thus could not fulfill the injunction).

and are not subject to the automatic stay. Secondly, actions in which the debtor is no longer in possession of the property and can comply in no way but by tendering money to the state receiver are deemed "essentially money judgments" and are also subject to the automatic stay. Finally, injunctive actions compelling action by the debtor to prevent future harm will usually be exceptions to the automatic stay. Injunctive actions will be carefully scrutinized in their form and purpose.

In practice, the enforcement of injunctive cleanup orders may mean depletion of the assets of a bankrupt's estate and a non-statutory priority for environmental claims. However, non-enforcement could cause continuing environmental damage. Thus, where the debtor's operation causes continuing pollution, the only reasonable alternative is to shut the debtor down even where such action will ruin an attempted reorganization.

B. *Abandonment of Property*

A trustee or debtor in possession has the power to dispose of burdensome property by selling, leasing, or abandoning it.¹⁰³ This abandonment option is a powerful temptation to a debtor in possession or trustee of environmentally burdensome property. The question central to this area of the Code is whether the power to abandon burdensome property exists regardless of associated environmental liability.

The Code generally allows the bankrupt to abandon an asset when the cost of removing or decontaminating the asset is greater than the value of the asset.¹⁰⁴ Often, environmentally contaminated land is worth less than the cleanup costs. When the estate chooses to abandon this liability-strapped land, control of the land reverts back to the debtor or, in the alternative, to any party with a possessory interest in the land. The person to whom the land reverts is then weighted with the burden of complying with the cleanup mandate.¹⁰⁵ Thus, it is possible that the land and its associated liability will revert to the assetless debtor.¹⁰⁶

103. 11 U.S.C. §§ 363 and 554 (1988).

104. *Id.*

105. *Kovacs*, 469 U.S. at 285; see also *In re Purco*, 76 B.R. 523 (Bankr. W.D. Pa. 1987).

106. The Code and present case law is unclear as to what happens when land reverts to an assetless corporate debtor. It is probable that the land again becomes part of the bankruptcy estate.

The government does not approve of abandonment in this context. The benefit of removing the encumbered property from the estate and allowing a more equitable reorganization or liquidation ultimately flows to the creditors. The burden of cleaning up the contaminated property, however, falls on the taxpayers.

The U.S. Supreme Court began a reconciliation of the right of abandonment under the Bankruptcy Code with the state's environmental laws.¹⁰⁷ A debtor, Quanta Resources Corp., filed a Chapter 11 petition which they later converted into a Chapter 7 proceeding. The site in question contained rusting storage drums containing 70,000 gallons of PCB¹⁰⁸ contaminated waste oil.¹⁰⁹ Quanta's trustee attempted a sale of the site which proved futile.¹¹⁰ The trustee then notified the bankruptcy court that he intended to abandon this burdensome property¹¹¹ that was of insignificant value to the estate.¹¹² The state immediately sought to bar the abandonment on the theory that the abandoned site would threaten public safety and would be an unlawful discharge of hazardous waste.¹¹³ Arguing that abandonment would revert title into Quanta "an entity with no assets and unable to effectuate a cleanup" the state asked that the trustee be ordered to bring the site into environmental compliance.¹¹⁴ The state reasoned that abandonment of the site would effectuate a disposal of hazardous waste resulting in a continuing violation.¹¹⁵

The court agreed with the state's argument and held that the trustee could not abandon property in contravention of state and local laws aimed at protecting public health and safety.¹¹⁶ Thus, the decision greatly restricted the power of abandonment when the land in question is environmentally substandard. The lower court's decision,¹¹⁷ upheld by the Supreme Court, noted that the state's interest in protecting the public was greater than that of the creditors' of Quanta.¹¹⁸

107. *Midlantic Nat'l Bank v. New Jersey Dept. of Env'tl Protection*, 474 U.S. 494 (1986).

108. Polychlorinated Biphenyls.

109. *Midlantic*, 474 U.S. at 497.

110. *Id.*

111. 11 U.S.C. § 554(a) (1988).

112. *Midlantic Nat'l Bank v. New Jersey Dept. of Env'tl Protection*, 474 U.S. 494 (1986).

113. *Id.* at 498.

114. *Id.*

115. *Id.*

116. *Id.* at 502.

117. *In re Quanta Resources Corp.*, 739 F.2d 912 (3d Cir. 1984).

118. *Id.* at 922. The dissent suggested this was allowing the trustee to "reach into the creditor's pockets for the cost of the cleanup." This valid point is mitigated only by a narrow reading of the majority ruling. *Midlantic*, 474 U.S. at 923.

Lower courts have emerged with an array of interpretations of *Midlantic*. The narrow interpretation¹¹⁹ is that abandonment is allowed where there will be no imminent and identifiable harm to the public despite noncompliance with environmental laws. For example, in *In Re Oklahoma Refining Co.*¹²⁰ a trustee attempted to abandon a closed oil refinery from which toxic waste was leaching into a creek and surrounding areas. The leach, however, did not pose imminent harm to public health, safety, and welfare. The trustee attempted to insure the contamination would go no further than the site. The court approved the abandonment stating that *Midlantic* did not require strict compliance with environmental laws but only that the court weigh the laws as factors when contemplating the abandonment.¹²¹ The court also looked favorably upon the fact that this trustee took steps to mitigate the contamination and that this site posed no "immediate and menacing harm" to the public.¹²² Finally, the court suggested that to enforce strict compliance with environmental laws would create a bankruptcy case in perpetuity and fetter the estate to an unresolvable situation.¹²³

The broader interpretation of *Midlantic* is that trustees or debtors in possession may not abandon any property that is not in full compliance with environmental laws. For example, in *In re Stevens*¹²⁴ the operator of a scrap metal business was improperly storing drums containing PCB contaminated oil in a tractor-trailer box. The operator filed a Chapter 7 petition, and, subsequently, the state contended the storage continued to violate the law and requested the trustee to have the waste oil removed. The trustee did not do so and, instead, held a sale at the site. During the sale, the trustee roped off the tractor-trailer box and posted warning signs. The state removed the drums and then sought to recover costs from the debtor's estate. The court rejected the trustee's argument that it had reasonably protected the public by roping off the drums and posting warning signs.¹²⁵ Instead, they ruled that *Midlantic* leaves no room for an estate to avoid its cleanup obligations by abandonment.¹²⁶

119. See *In re Pierce Coal and Construction, Inc.*, 65 B.R. 521 (Bankr. N.D. W. Va. 1986); *In re Shore Co., Inc.*, 134 B.R. 572, 578 (Bankr. E.D. Tex. 1991).

120. 63 B.R. at 563 (Bankr. W.D. Okla. 1986).

121. *Id.* at 565.

122. *Id.*

123. *Id.*

124. 68 B.R. 774 (Bankr. D. Me. 1987).

125. See *id.* at 778.

126. *Id.* at 781.

Likewise, in another broad interpretation of *Midlantic*, the court in *In re Peerless Plating Co.*¹²⁷ said that abandonment would only be permitted in three circumstances: (1) if the environmental laws were so onerous that they interfered with the bankruptcy proceeding; (2) if the environmental laws were not designed to protect public health and safety from identifiable hazards;¹²⁸ or (3) if the violation created by the abandonment would be merely speculative or indeterminate. The *Peerless* court found that even the depletion of an estate's assets in order to comply with environmental law is not a condition so onerous as to interfere with bankruptcy proceedings.¹²⁹

In summary, courts are not in agreement as to when abandonment of environmentally burdened property will be permitted. It does appear, however, that any property posing a clear and dangerous threat to the public cannot be abandoned.

C. *The Reorganization or Liquidation Plan and Discharge*

To attempt to remain in business and avoid liquidation, a corporation may opt to file Chapter 11 bankruptcy. Chapter 11 reflects the Code's theory that allowing a floundering business to restructure benefits our economy by preserving jobs and business ethics. In Chapter 11 the debtor, trustee, or creditor(s) must formulate a liquidation or reorganization plan.¹³⁰ The plan must be presented to and confirmed by the court in order for the corporation to remain in chapter 11.¹³¹

In order to appreciate the importance of the plan in bankruptcy actions involving environmental liability, it is necessary to understand the meaning and ramifications of discharge. Discharge renders any unpaid debt forever uncollectible and such debt literally ceases to exist.¹³² Discharge occurs in Chapter 11 when a plan is confirmed.¹³³ Therefore, in order to mitigate the adverse effect of discharge, a creditor should see to it that the plan that is confirmed leaves as little debt unpaid as possible.

127. 70 B.R. 943 (Bankr. W.D. Mich. 1987).

128. It would a rare environmental law that was not designed to protect public health and safety from identifiable hazards.

129. *Peerless*, 70 B.R. at 947.

130. 11 U.S.C. §§ 1121(c), (d) (1988).

131. *Id.*

132. *Id.* § 524(a). The debtor's plan must be satisfied for the debtor to emerge from bankruptcy. When a plan is not satisfied, a forced Chapter 7 may result.

133. 11 U.S.C. § 1141(d) (1988).

The amount paid on a particular debt (or conversely, unpaid and discharged) depends on the provisions of each plan, which are variable. The provisions of a plan depend, in turn, on a combination of negotiation and statutory requirements. The creditor who knows how to use the statutory requirements improves his ability to negotiate favorable treatment in the plan.

The first option creditors need to be aware of is that, if the debtor stalls, the creditor can write his own plan.¹³⁴ The serious threat of a creditor's plan is often sufficient to make a debtor extremely reasonable. If the plan is the debtor's, the creditor needs to know the following three provisions. First, a creditor is entitled to vote on a plan if it hurts or impairs the creditor.¹³⁵ A creditor is impaired when he will not be fully satisfied. Second, if the creditor or his class vote against the plan, it cannot be confirmed¹³⁶ unless, third, the debtor satisfies the absolute priority rule. The absolute priority rule essentially guarantees a dissenting creditor full repayment.¹³⁷ Under this rule, the plan will only be confirmed when (1) the debtor requests confirmation; (2) the plan does not discriminate unfairly; and (3) the plan is fair and equitable.¹³⁸ In practice, this standard means that a creditor may not receive or retain any property under a reorganization plan unless all creditors senior to him have their claims paid in full.¹³⁹ Thus, environmental debt will be satisfied in full where the creditor actively pursues repayment.¹⁴⁰

Consequently, if a corporate debtor is relieved of environmental liability through discharge by the plan, the fault lies with the creditor for not being actively involved in the bankruptcy proceeding. Without strict scrutiny of the debtor's plan by the environmental creditor, the debtor may escape environmental liability by discharge of the debt. Hence, even where environmental creditors find themselves unable to obtain relief from the automatic stay, they can use Chapter 11 to their

134. *Id.* § 1121(c)(d).

135. Any class not impaired is deemed to have accepted the plan and the debtor and court need not solicit acceptance. 11 U.S.C. § 1126(f) (1988); *In re American Solar King Corp.*, 90 B.R. 808, (Bankr. W.D. Tex. 1988).

136. 11 U.S.C. § 1129(a)(8)(A) (1988).

137. *Id.* This section is also often referred to as the cram down provision.

138. 11 U.S.C. § 1129(b) (1986).

139. *See* H.R. Rep. No. 595, 95th Cong., 2d Sess. 413 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6369 (stating that the court may confirm a plan over the dissent of a class of unsecured claims only if the members of the class will receive property under the plan equal to the amount of their unsecured claim; in other words, if the creditor is not paid in full, creditors junior to him will receive nothing at all.).

140. *In re Ruti-Sweetwater, Inc.*, 836 F.2d 1263 (10th Cir. 1988).

advantage and make the debtor repay the debt sooner or later. Chapter 11 is truly a sword for the environmental creditor and not merely a shield for the environmental debtor as commonly believed.

V. SUGGESTIONS FOR CHANGE

Bankruptcy and environmental protection policies clash because fulfillment of one policy weakens the other.¹⁴¹ One set of laws must be given some type of priority. Although bankruptcy is a useful and needed tool for the struggling debtor, the unequaled importance of our environment dictates that environmental laws have priority over bankruptcy security and a well defined role in bankruptcy proceedings. Therefore, I propose several changes in the Bankruptcy Code. Additionally, this paper points out provisions of the Code that environmental creditors should be aware of and use to their benefit.

A. *Automatic Stay*

I suggest that Congress adopt a specific environmental provision in the automatic stay section¹⁴² of the Code. This provision would demand that in cases of continuing environmental contamination posing a threat to public welfare, the debtor rectify the contamination immediately as a requirement of remaining in Chapter 11. Even though such action might deplete the bankruptcy estate, this outcome is preferable to allowing continuing contamination.

The environmentalist will realize the true crux of the issue is not who pays but how the contamination can be stopped, cleaned up and rectified as quickly as possible. By adopting this provision the immediate and potentially dangerous problem will be solved, although it may be at the cost of the debtor's additional creditors. Further, this provision would merely parallel the legislature's evident desire for environmental accountability in the environmental laws. The government's interest in a healthy and pure environment is vital to the long term future of its people.

B. *Abandonment*

The second change in the Code I propose is that the estate's power of abandonment be restricted to prohibit the abandonment of

141. Lowell E. Blackham, *The Unstoppable Force Hits the Immovable Wall, Should Environmental Liability Be Discharged in Bankruptcy?*, 25 CREIGHTON L. REV. 1357, 1381 (1992).

142. 11 U.S.C. § 362 (1990).

any land continuing to pollute or continuing to be contaminated and, thus, creating a public welfare crisis. The provision should require the estate to bring the land into environmental compliance and rectify the causes of the continuing contamination prior to abandonment. Again, the essential goal must be to rectify environmental hazards. After the land is in compliance, the estate should be allowed to sell the land, thus, creating revenue with which other creditors may be satisfied.

It is not just or equitable for the assetless debtor, who generally has no method by which to remedy the situation, or a potentially innocent prior owner to become responsible for the environmental cleanup. It is especially unjust where the land is not an immediate threat requiring immediate attention. The Bankruptcy Code poses far too great a temptation to an owner of contaminated property to file Chapter 11, dispose of the land and the financial responsibility attached with it, reorganize, and continue operations.

C. *Plan of Liquidation or Reorganization and Discharge*

Finally, as the Code exists today, environmental creditors should be aware of the absolute priority rule and should not allow a poor plan to become an approved plan. For the good of society at large, environmental creditors must use Chapter 11 as a sword to demand repayment of their debts. Active creditor pursuit of environmental priority assures creditors, debtors, and citizens that environmental liability cannot be escaped under the Bankruptcy Code.

D. *Effects of Proposed Changes*

It is certain that such consequential changes would alter the bankruptcy process with regard to environmental obligations. The changes could, most notably, place the additional creditors of the estate in a more unfavorable position than they would have been had the environmental liability disappeared whether by discharge or abandonment.¹⁴³ This result however, is more favorable than allowing

143. This possibility should cause the creditor to be more careful in selecting debtors and lead to more long-range planning by both the debtor and creditor. The higher cost of capital markets and trade credit should be reflected in the debtor company's prices, thus, passing along the cost of environmental compliance to the consumer of the debtor company's products. Such cost internalization is efficient from an economic perspective. Thus, it is more sensible for the creditors who choose to deal with a particular company to bear the costs of bad business decisions or lost opportunities than it is for the taxpayer. Perhaps such a practice will induce creditors to run more thorough investigations before making the decision to deal with a particular business.

contamination to continue to harm the environment while the corporate debtor attempts to reorganize its business. Surely, the damage done to the debtor's additional creditors is outweighed by the need for environmental compliance. The Bankruptcy Code should not be available as a tool for the ridding of environmental liability.

With the proposed changes, Congress should expect longer periods of repayment of response costs, however, this result is preferable to having claims left unsatisfied as the case tends to be presently. Additionally, with a less permissive bankruptcy option, corporations would necessarily be more aware and conscious of their environmental actions and inactions. This increased awareness should ultimately lead to purer lands, air, and waters.

Most importantly, the proposed changes would in each and every situation provide a mechanism for immediate cleanup of threatening contamination. The monetary fight can continue after the land, air, or water has been freed of contamination. This change would be a giant step towards the protection of the environment for those who are the environment's greatest threat. The maintenance of our environment is paramount to any other concern for it is the environment that sustains our race.

VI. CONCLUSION

The Bankruptcy Code plays an important role in the maintenance of our economy. Unfortunately, federal courts are overlooking the public policy concerns behind the bankruptcy/environmental conflict. Debtors must be held accountable for all on going environmental hazards and should not be able to dismiss liability through a poorly approved reorganization plan under the guise and protection of the Bankruptcy Code. When this is allowed to happen the message to other entities with substantial environmental liabilities is clear: declare bankruptcy.

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