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# ANALYSIS OF THE CONFLICTS BETWEEN ENVIRONMENTAL LAW AND BANKRUPTCY LAW

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Environmental law and bankruptcy law are two distinct and highly specialized areas of law which have increasingly clashed in the past decade. The courts have been forced to solve these conflicts one step at a time with very little legislative guidance. This article examines the relationship between and the policies underlying the two bodies of law, focusing upon the effect of the automatic stay upon governmental environmental enforcement actions; the dischargeability of obligations to clean up hazardous waste sites; and the power of a bankruptcy trustee to abandon contaminated property.

## BACKGROUND

Congress has reworked both environmental law and bankruptcy law in recent years.<sup>1</sup> Nevertheless, amendments to the major federal environmental laws and the revamping of the Bankruptcy Code,<sup>2</sup> both completed as late as 1986, have not resolved many of the conflicts that existed prior to their amendment. The conflicts which have arisen between the two bodies of law are primarily the result of their differing aims. While bankruptcy law deals with relieving legal obligations, environmental law imposes obligations in order to implement specific policies.<sup>3</sup> The Third Circuit has stated:

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1. *See, e.g.*, Bankruptcy Reform Act of 1978, 11 U.S.C. §§ 101-1330, as amended by Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353 (1990); Federal Water Control Act of 1948, 33 U.S.C. §§ 1251-1387, as amended by Water Quality Act of 1987 Pub. L. No. 100-4, 101 Stat. 60 (1987); Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA), 42 U.S.C. §§ 9601-9675, as amended by Superfund Amendments and Reauthorization Act of 1986 (SARA), 42 U.S.C. §§ 9601-9657 (1988).

2. 11 U.S.C. §§ 101-1330.

3. *See, e.g.*, Resource Conservation and Recovery Act (RCRA), 42 U.S.C. §§ 6901-6992 (1988); CERCLA, 42 U.S.C. §9606 (1988); Toxic Substances Control Act of 1976 (TSCA), 15 U.S.C. §§ 2601-2671 (1988).

On the one hand, the federally created bankruptcy policy requires that the assets of a debtor be preserved and protected, so that in time they may be equitably distributed to all creditors without unfair preference. On the other hand, the environmental policies . . . require those within its jurisdiction to preserve and protect natural resources and to rectify damage to the environment which they have caused.<sup>4</sup>

One body of law thus tends to impose liability, while the other is designed to relieve it.

Recent environmental legislation at both the state and federal levels has imposed strict liability in many instances on a variety of property owners and the operators of polluting facilities.<sup>5</sup> Many environmental laws subject defendants to joint and several liability for cleanup costs,<sup>6</sup> for injury to wildlife,<sup>7</sup> and for the cost of bringing continuing operations into compliance with the laws.<sup>8</sup> Additionally, the courts may order the environmental defendant to pay civil penalties<sup>9</sup> and may subject him to criminal prosecution for contempt of court should he be unable or unwilling to effectuate a cleanup as ordered.<sup>10</sup> Congress has recognized that each person or governmental or corporate entity has a responsibility to contribute to the

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4. *Penn Terra Ltd. v. Pennsylvania Dep't of Env'tl. Resources*, 733 F.2d 267, 269 (3d Cir. 1984).

5. *See, e.g.*, Federal Water Pollution Prevention and Control Act (FWPCA), 33 U.S.C. §§ 1251, 1321 (1988); SARA, 42 U.S.C. § 9607 (1988).

6. *Id.*

7. *See, e.g.*, FWPCA, 33 U.S.C. § 1321 (1988).

8. CERCLA § 107(a), 42 U.S.C. § 9607 (1988).

9. *See, e.g.*, RCRA, 42 U.S.C. §§ 6901-6992 (1988); CERCLA, 42 U.S.C. § 9606 (1988); TSCA, 15 U.S.C. §§ 2601-2671 (1988).

10. *Id.*

preservation and enhancement of the environment.<sup>11</sup> In order to ensure that these parties meet their responsibilities, Congress has directed the government to use all practicable means to assure that all Americans enjoy a safe and healthful environment.<sup>12</sup>

Four types of relief are provided to the debtor under the Bankruptcy Code. The specific type of relief available depends upon what the debtor is seeking to accomplish and his eligibility.<sup>13</sup> Although the relief varies in both scope and applicability, the underlying theme remains consistent: to give the debtor a "fresh start." For example, in a reorganization under Chapter 11, the debtor is given a fresh start through a court order confirming a reorganization plan that is binding on all parties.<sup>14</sup> Similarly, in a Chapter 7 bankruptcy in which the eligible property of the debtor is liquidated, the debtor is given a fresh start when the court discharges his prebankruptcy debts at the end of the case.<sup>15</sup>

In the mid 1980s, the Supreme Court decided two cases<sup>16</sup> which, along with an important case decided by the Third Circuit Court of Appeals<sup>17</sup>, serve as a focal point for the analysis of the interplay between bankruptcy and environmental law. Lower courts, in applying the reasoning of those cases to diverse factual situations and to other provisions of the Bankruptcy Code, have continued to

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11. National Environmental Policy Act of 1969 (NEPA), 42 U.S.C. §§ 4321, 4331 (1988).

12. *Id.*

13. 11 U.S.C. § 109 (1988); *see also* G. TREISTER, R. TROST, L. FORMAN, K. KLEE, & R. LEVIN, FUNDAMENTALS OF BANKRUPTCY LAW 15 (1986) [hereinafter TREISTER].

14. TREISTER, *supra* note 13, at 17.

15. *Id.* at 16-7.

16. *Midlantic Nat'l Bank v. New Jersey Dep't of Env'tl. Protection*, 474 U.S. 494 (1985); *Ohio v. Kovacs*, 469 U.S. 274 (1985).

17. *Penn Terra Ltd. v. Pennsylvania Dep't of Env'tl. Resources*, 733 F.2d 267 (3d Cir. 1984).

wrestle with conflicting statutes and questions of policy.<sup>18</sup> The significance of these issues is illustrated by the United States Environmental Protection Agency's (EPA) prediction that between twenty-five and thirty percent of businesses that run land disposal facilities will file for bankruptcy within the next fifty years.<sup>19</sup> In addition, the EPA estimates that cleanup costs will range between two and four million dollars per land disposal facility.<sup>20</sup>

#### THE EFFECT OF THE AUTOMATIC STAY

A considerable amount of recent litigation has involved the issue of whether the automatic stay provided in the Bankruptcy Code precludes environmental liability. Unique to bankruptcy law, the automatic stay acts as an umbrella over the property of the debtor's estate, protecting the property from any unilateral action that would either interfere with its possession or seek to enforce any rights against it.<sup>21</sup> The automatic stay operates to prevent:

the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to

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18. The purpose of this article is to provide an update on the interpretations given by the courts to these landmark cases in order to determine whether the subsequent decisions have strictly adhered to the holdings of the Supreme Court. Due to the fact that this is a developing area of the law, and because of the complexity of the issues involved, one should not depend upon this article as an exhaustive presentation of the law, but rather, should serve to alert practicing attorneys to the trends and developments which may merit close attention in future transactions or litigation.

19. Note, *Creditor's Rights When Federal Bankruptcy Laws Conflict with State Environmental Agency Enforcement Powers after Midlantic National Bank*, 48 U. PITT. L. REV. 879, 979 n.1 (1987).

20. U.S. GENERAL ACCOUNTING OFFICE, HAZARDOUS WASTE ENVIRONMENTAL SAFEGUARDS JEOPARDIZED WHEN FACILITIES CEASE OPERATING 18 (1986).

21. TREISTER, *supra* note 13, at 123.

recover a claim against the debtor that arose before the commencement of the case under this title.<sup>22</sup>

The stay operates automatically upon the filing of a voluntary, joint, or involuntary petition under any chapter of the Code.<sup>23</sup> Generally, the stay provides the debtor with complete, but temporary, relief from creditors and also serves to prevent the debtor's estate from being drained before a bankruptcy plan is effectuated.<sup>24</sup>

Although Congress intended that the stay would give debtors breathing room by suspending actions other than the bankruptcy proceedings, Congress also recognized that the stay was vulnerable to abuse by debtors seeking to frustrate necessary government functions. Congress had a legitimate concern "that the bankruptcy court would become a sanctuary for environmental wrongdoers, among others."<sup>25</sup> To combat this concern, Congress enacted several exceptions to the stay. Sections 362(b)(4) and (5) for example, exempt from the stay the commencement or continuation of an action by a governmental unit utilizing its police or regulatory power.<sup>26</sup> That exception, however, contains an exception of its own that leaves money judgments subject to the stay.<sup>27</sup> Commentators have referred to this "exception to the exception" as the "pecuniary interest rule."<sup>28</sup>

The first major case to consider the conflict between environmental and bankruptcy law, *Penn Terra Limited v. Pennsylvania Department of Environmental Resources*,<sup>29</sup> discussed the "exception to

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22. 11 U.S.C. § 362(a)(1) (1988).

23. *Id.* at 183.

24. *Penn Terra Ltd. v. Pennsylvania Dep't of Env'tl. Resources*, 733 F.2d 267, 271 (3d Cir. 1984).

25. *United States v. Nicolet, Inc.*, 857 F.2d 202, 207 (3d Cir. 1988).

26. 11 U.S.C. § 362(b)(4),(5) (1988).

27. *Id.* § 362(b)(5).

28. Smillie, *The Effect of the Bankruptcy Stay on Environmental Cleanup Litigation*, 8 TEMP. ENVTL. L. & TECH. J. 77 (1989).

29. 733 F.2d 267 (3d Cir. 1984).

the exception." In *Penn Terra*, the Pennsylvania Department of Environmental Resources (PDER) found that Penn Terra Limited (Penn Terra), a coal mining concern, was operating its mines in violation of various state environmental protection statutes.<sup>30</sup> Penn Terra entered into a consent order and agreement to rectify those violations.<sup>31</sup> Approximately one year after entering into the consent agreement, Penn Terra filed for bankruptcy under Chapter 7. PDER then brought an equitable action against Penn Terra to enforce the terms of the consent order.<sup>32</sup> In response, Penn Terra filed a Petition for Contempt in the bankruptcy court contending that PDER's equitable action violated the automatic stay.<sup>33</sup> PDER claimed in defense that the proceedings fell under the police power exception to the stay under section 362(b)(4) and (5).<sup>34</sup>

On appeal, the Third Circuit applied the "pecuniary interest rule"<sup>35</sup> and held that PDER's actions did not violate the automatic stay.<sup>36</sup> The pecuniary interest rule states "that a governmental unit will not be permitted to proceed against the debtor when it seeks simply to collect a monetary obligation or otherwise to protect its own pecuniary interests."<sup>37</sup> Applying this rule to the facts of *Penn Terra*, in which the company filed its bankruptcy petition after the entry of a consent order requiring it to take steps to comply with state law, the court held that the automatic stay was inapplicable because the state of Pennsylvania sought an injunction requiring

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30. *Penn Terra*, 733 F.2d at 269.

31. *Id.*

32. *Id.* at 270.

33. *Id.*

34. *Id.*

35. Smillie, *supra* note 28, at 82.

36. *Penn Terra*, 733 F.2d at 278.

37. Smillie, *supra* note 28, at 82.

compliance, rather than monetary damages.<sup>38</sup> The court stated that PDER's goal was not to collect money damages for civil fines or cleanup costs because the agency had not undertaken a cleanup at the time of the suit.<sup>39</sup> The fact that a successful injunction would require the expenditure of money by the debtor did not render the state's claim in violation of the stay.<sup>40</sup> The court held that the test to be applied in *Penn Terra* was whether the relief sought was the type traditionally settled by the payment of damages.<sup>41</sup>

Although the Supreme Court has not addressed the applicability of the automatic stay to actions to enforce compliance with environmental laws, the Court did discuss a party's reliance upon *Penn Terra* in a footnote of another opinion. In *Ohio v. Kovacs*,<sup>42</sup> the state of Ohio obtained an injunction ordering the defendant to clean up a hazardous waste site.<sup>43</sup> After the court appointed a receiver to accomplish this purpose, the defendant filed for bankruptcy under Chapter 11.<sup>44</sup> The State of Ohio then filed suit in bankruptcy court seeking a declaration that Kovacs' obligation under the prior injunction was not dischargeable within the meaning of the Code.<sup>45</sup> The State argued that the pecuniary interest rule of *Penn Terra*, which would stay a suit to enforce a monetary judgement, has applicability in the context of whether or not a debt is dischargeable.<sup>46</sup> The Court

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38. *Penn Terra*, 733 F.2d at 278.

39. *Id.*

40. *Id.* at 278-79.

41. *Id.* at 278.

42. 469 U.S. 274 (1985).

43. *Id.* at 275.

44. *Id.* at 276.

45. *Id.* at 276-77. This article discusses the issue of dischargeability in the following section.

46. *Id.* at 277.

implicitly agreed with the Third Circuit's analysis in *Penn Terra*, but differentiated that case from the facts in *Kovacs*:

[I]n [*Penn Terra*], there had been no appointment of a receiver who had the duty to comply with the state law and who was seeking money from the bankrupt. The automatic stay provision does not apply to suits to enforce the regulatory statutes of the state, but the enforcement of such a judgment by seeking money from the bankrupt . . . is another matter.<sup>47</sup>

Following the *Kovacs* decision, the Court summed up the pecuniary interest rule in *Midlantic National Bank v. New Jersey Department of Environmental Protection*<sup>48</sup> when it stated that section 362(b)(5) "permits the Government to enforce 'nonmonetary' judgments against a debtor's estate."<sup>49</sup>

Since the *Penn Terra* decision, some courts have followed the bright line rule of pecuniary interest, but most courts have expanded the exceptions to the automatic stay provisions. In *In re Commonwealth Oil Refining Co.*,<sup>50</sup> the Fifth Circuit followed the analysis set out in *Penn Terra* in holding that the EPA's suit to force compliance with the Resource Conservation and Recovery Act of 1976 (RCRA)<sup>51</sup> was not stayed.<sup>52</sup> The dispute in *Commonwealth Oil* arose when the EPA brought administrative actions against Commonwealth Oil Refining Company (CORCO) to force the corporation to comply with state and federal hazardous waste laws.<sup>53</sup> CORCO subsequently filed for bankruptcy under Chapter 11 and moved for an order from the bankruptcy court to determine the

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47. *Id.* at 283 n.11.

48. 474 U.S. 494 (1985).

49. *Id.* at 503.

50. 805 F.2d 1175 (5th Cir. 1986), *cert. denied*, 483 U.S. 1005 (1987).

51. 42 U.S.C. §§ 6901-6991 (1976).

52. 805 F.2d at 1183.

53. *Id.* at 1179.

applicability of the automatic stay to the EPA's impending enforcement actions.<sup>54</sup> CORCO averred that section 362 (a)(1), the Bankruptcy Code's automatic stay provision, stayed the EPA's order to cease storing, treating, or disposing of hazardous waste.<sup>55</sup> CORCO argued unsuccessfully that no imminent and identifiable harm existed because its facility was shut down.<sup>56</sup> On appeal CORCO asserted that the EPA's administrative action required the expenditure of money and thus would fall within the monetary judgment exception under Section 362(b)(5).<sup>57</sup> The court held that the expenditure of money by CORCO required for its compliance was merely incidental and did not operate to convert an enforcement action into a suit for money damages.<sup>58</sup> The Fifth Circuit thus employed the *Penn Terra* analysis regarding applicability of the stay to environmental enforcement actions.<sup>59</sup>

Other courts have not followed the *Penn Terra* analysis as closely. In *United States v. Nicolet, Inc.*,<sup>60</sup> the third circuit retreated from its earlier holding in *Penn Terra*. In *Nicolet*, the EPA detected and cleaned up contamination in violation of the Comprehensive

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54. *In re Commonwealth Oil Refining Co.*, 58 Bankr. 608 (Bankr. W.D. Tex. 1985).

55. *Id.* at 610.

56. CORCO relied on *Midlantic* for this argument which the court ultimately rejected on the grounds that the language of the exceptions to the automatic stay is unambiguous and does not limit the police or regulatory power exceptions to situations of urgent public necessity. *Commonwealth Oil*, 805 F.2d at 1185-86.

57. *Id.* at 1186.

58. *Id.* at 1187.

59. In *United States v. F.E. Gregory & Sons, Inc.*, 58 Bankr. 590 (Bankr. W.D. Pa. 1986), the District Court for the Western District of Pennsylvania employed the *Penn Terra* analysis as well, highlighting the relevance of a petition filed under Chapter 11 as opposed to Chapter 7. The court stated that under Chapter 11, the debtor should be able to cleanup the site himself after reorganization and, therefore, the government sought performance rather than money damages. *Id.* at 592.

60. 857 F.2d 202 (3d Cir. 1988).

Environmental Response, Compensation, and Liability Act (CERCLA)<sup>61</sup> prior to Nicolet's petition for Chapter 11 reorganization. When the EPA brought a suit to recover response costs from Nicolet, the district court stayed the proceeding.<sup>62</sup> EPA objected and moved for reconsideration on the grounds that it was exercising its police or regulatory power, and therefore was exempt from the stay provision. The district court agreed with the EPA's argument and Nicolet appealed.<sup>63</sup> The EPA maintained that "assuming a verdict for the agency -- no execution in the judgment would be sought."<sup>64</sup> The Third Circuit held that both parties' interpretations of the statutory language were legitimate and turned to the legislative history to resolve whether the EPA's action was of the type Congress had intended to fall within the exception to the stay.<sup>65</sup> The court quoted the legislative committee reports as follows:

[W]here a governmental unit is suing a debtor to prevent or stop violation of fraud, environmental protection, consumer protection, safety, or similar police or regulatory laws, *or attempting to fix damages for violation of such a law*, the action or proceeding is not stayed under the automatic stay.<sup>66</sup>

The court, therefore, held that the government should be allowed to go forward to establish its claim.

At first glance the result in *Nicolet*, allowing the government to go forward to prove liability in order to enter a judgment against the debtor, appears inconsistent with the court's analysis in *Penn*

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61. 42 U.S.C. § 9601-75 (1980).

62. *Nicolet*, 857 F.2d. at 203.

63. *Id.*

64. *Id.*

65. *Id.* at 208.

66. *Id.* (quoting S. Rep. No. 989, 52, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5838; H.R. Rep. No. 595, 343, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 6299).

*Terra*, which looked to whether the relief sought was the type traditionally settled by the payment of money damages. The court in *Nicolet* justified this apparent inconsistency by noting that the plaintiff in *Penn Terra* sought to seize the debtor's property in order to satisfy the judgment, but in the case at hand the EPA was merely seeking to enter a judgment.<sup>67</sup> The court reasoned that "[b]y simply permitting the government's claim to be reduced to a judgment, no seizure of property takes place."<sup>68</sup> The court further justified exempting the action from the stay provision because its deterrent effect related to the police power exception detailed in *Penn Terra*.<sup>69</sup>

In environmental cases courts have rejected the premise that the debtor's estate should be protected from expending resources to litigate the application of the stay.<sup>70</sup> In considering this question the Sixth Circuit Court of Appeals declined to adopt the premise that "preservation of the debtor's estate is of greater priority in the statutory scheme set forth by Congress in Title 11 than is the enforcement of environmental protection laws explicitly intended to be excepted from the automatic stay."<sup>71</sup> Therefore, a debtor may

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67. *Nicolet*, 857 F.2d at 209.

68. *Id.*

69. *Id.* at 210. Several other courts have used a similar line of reasoning. See, e.g., *United States v. Standard Metals Corp.*, 49 Bankr. 623 (Bankr. D. Colo. 1985) (EPA permitted to establish liability for a suspended civil penalty under the Clean Water Act). Several other courts have used a similar line of reasoning. *United States v. Mattiace Industries Inc.*, 73 Bankr. 816 (Bankr. E.D.N.Y. 1987) (EPA allowed to maintain action to establish amount due from the company for CERCLA response costs); *United States v. ILCO, Inc.*, No. 85-H-823-S (JHH) (N.D. Ala. Sept. 27, 1985) (unpublished Memorandum Opinion and Order) [Available on Westlaw, DCT Database] (government allowed to proceed with claim to establish civil penalties under the Clean Water Act, and to establish liability for, and enter judgment against, the company for the recovery of response costs under CERCLA).

70. See, e.g., *In re Commerce Oil Co.*, 847 F.2d 291 (6th Cir. 1988) (state governmental unit allowed to proceed to litigate to determine company's liability and to fix civil penalties under Tennessee's Water Quality Control Act).

71. *Id.* at 297.

have to use estate resources to petition the court to stay the proceedings and to finance a defense, should the court allow the government to go forward. Such a result is at odds with the fundamental concept that the stay should allow parties to concentrate on reorganization through consolidation of suits in the bankruptcy court, rather than having to deal with the possibility of a number of suits in various courts and jurisdictions.

#### DISCHARGEABILITY OF DEBTS

In *Ohio v. Kovacs*,<sup>72</sup> the Supreme Court addressed another conflict between bankruptcy and environmental law: the dischargeability of debts. The State of Ohio sued Kovacs in 1976 for water pollution and the resulting fish kills. Individually and on behalf of his business, Kovacs signed a stipulation which required him to clean up the property, enjoined him from causing further harm, and ordered a payment of \$75,000 to the state to compensate for injury to wildlife.<sup>73</sup> When Kovacs did not comply with his obligations under the stipulation, the State obtained the appointment of a receiver for Kovacs' assets in order to initiate the cleanup. Subsequently, Kovacs filed for bankruptcy. The State of Ohio pursued Kovacs for the remainder of the costs of the cleanup by seeking to discover his post bankruptcy income. The State's complaint sought a declaration that Kovacs' obligations under the stipulation were not "debts" subject to discharge and the Supreme Court granted *certiorari* to consider the question. Debts that arise before filing for bankruptcy are dischargeable under section 727, subject to nine exceptions listed in section 523. The State of Ohio did not rely on any of the exceptions, but claimed instead that Kovacs' obligations were not "debts" at all. The Code defines "debt" as "liability on a claim."<sup>74</sup> A "claim" is:

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72. 469 U.S. 274 (1985).

73. *Id.* at 276.

74. 11 U.S.C. § 101(11) (1979).

(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, legal, equitable, secured or unsecured; or

(B) *right to an equitable remedy for breach of performance if such breach gives rise to a right to payment*, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured or unsecured.<sup>75</sup>

Despite the clear import of section 101(4), the State argued that the injunction was not a "claim" because Kovacs' default was a breach of a statute, not of a commercial contract.<sup>76</sup> The Court determined that the State's argument was not consistent since it had conceded that the \$75,000 penalty for injury to wildlife was dischargeable.<sup>77</sup>

The Court ruled for Kovacs and held that the State's action, seeking to require Kovacs to clean up the site, was an attempt to collect monetary damages and, therefore, was a debt dischargeable in bankruptcy.<sup>78</sup> The Court agreed with the lower court's conclusion that Ohio's right to an equitable remedy had been converted into money damages by virtue of the fact that the State had appointed a receiver and Kovacs could not comply with an order to clean up the property.<sup>79</sup> By appointing a receiver "[the State] dispossessed Kovacs, removed his authority over the site, and divested him of assets that

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75. 11 U.S.C. § 101(4) (emphasis added). Dischargeability is a distinct issue from the applicability of the automatic stay provision. *See United States v. Gregory & Sons, Inc.*, 58 Bankr. 590, 592 (Bankr. W.D. Pa. 1986).

76. Ohio also argued that the breach did not give rise to a right to payment. The Court, however referred to the legislative history of the Code, which considered a right to an equitable remedy for a breach of performance of a claim within the meaning of section 101(4)(B). *Kovacs*, 469 U.S. at 279.

77. *Id.*

78. *Id.* at 283.

79. *Id.* at 282-83.

might have been used by him to clean up."<sup>80</sup> Since the state sought money damages rather than personal performance on the part of Kovacs, the Court agreed with the district court that disallowing the discharge "would subvert Congress' clear intention to give debtors a fresh start."<sup>81</sup> The Court therefore affirmed the lower court's decision to discharge Kovacs' obligations under the prebankruptcy injunction, which required Kovacs to compensate the state for injury to wildlife and to clean up the existing pollution. The Court suggested that a different outcome might have resulted if the State had prosecuted Kovacs for noncompliance with environmental laws or for civil or criminal contempt of court. Such prosecutions would not have left Kovacs powerless to comply with the environmental order.<sup>82</sup>

The Court in *Kovacs* stressed that even though the state could not pursue its claim for cleanup costs, Kovacs, or anyone else ultimately in possession of the property, "must comply with the environmental laws of the state of Ohio."<sup>83</sup> This language indicates that no further damage to the environment would be excused under the auspices of bankruptcy law. In addition, Kovacs remained subject to prosecution for his violations of environmental law.<sup>84</sup>

Subsequent cases addressing the issue of the dischargeability of environmental claims have expanded the rule established in *Kovacs*. The decision in *In re Robinson*<sup>85</sup> enlarged the rule enunciated in *Kovacs*, which discharged debts of a purely monetary nature, by permitting the discharge of facially nonmonetary debts. In *Robinson*

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80. *Id.*

81. *Id.* at 281-82 (citation omitted).

82. *Id.* at 282-83.

83. *Id.* at 285.

84. *Id.* at 284.

85. 46 Bankr. 136 (Bankr. M.D. Fla.), *rev'd on other grounds*, 55 Bankr. 355 (Bankr. M.D. Fla. 1985).

the debtor was under an affirmative duty to restore marshlands after unlawfully using the property as a landfill in violation of both the River and Harbor Act<sup>86</sup> and the Clean Water Act.<sup>87</sup> The EPA sought to force Robinson to perform the restoration work, but the bankruptcy court discharged the debt. The court reasoned that to comply with the order would cost the debtor money since he could not comply solely through his own labor. The court reasoned that:

Because we do not have before us a case in which a receiver or similar entity has entered the scenario, we must either extend the reasoning contained in *Kovacs* or hold that it is materially distinguishable from the case before us. We have concluded that extension will allow greater fidelity to the principles expressed by the Supreme Court as we understand them, than would finding the factual difference to require a legal distinction.<sup>88</sup>

Even though the obligation was not on its face or *de facto* a money judgment, the court found that one could easily convert it into dollars by allowing persons equipped to restore the land to make bids for the work. The court therefore expanded the definition of a "claim," limited in *Kovacs* to a situation where the debtor was dispossessed of the land, to a situation where the debtor retained control of the property.

In *United States v. Whizco*<sup>89</sup> the debtor was obligated to reclaim a mining surface area under the Surface Mining Control and Reclamation Act of 1977.<sup>90</sup> The Sixth Circuit Court of Appeals employed the same reasoning found in *Robinson* and discharged the debt to the extent that it required the payment of money. The court

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86. 33 U.S.C. § 403 (1990).

87. 33 U.S.C. § 1311 (1990).

88. *In re Robinson*, 46 Bankr. at 139.

89. 841 F.2d 147 (6th Cir. 1988).

90. 30 U.S.C. §§ 1209-1279 (1990).

did not discharge the debtor's personal obligation to reclaim portions of the land with equipment he might own in the future.<sup>91</sup> Although affirmative obligations requiring the expenditure of money are likely to be discharged under *Robinson* and *Whizco*, criminal remedies remain a prosecutorial option.<sup>92</sup> This option is viable because the debts from the resulting fines are not dischargeable in bankruptcy.<sup>93</sup>

In *In re Charter*<sup>94</sup> the district court discussed the dischargeability of contingent claims under section 502 of the Bankruptcy Code.<sup>95</sup> The plaintiffs in that case were private parties who sought indemnification by Charter for response costs for which they were potentially liable.<sup>96</sup> Although the plaintiffs appropriately presented their claim in bankruptcy proceedings, liability for the environmental damage had not been established. Therefore, the claim was contingent within the meaning of section 502(e)(1)(B) of the Code and, was accordingly dischargeable. Plaintiffs tried to avoid the application of section 502 by characterizing their claim as

91. *In re Robinson*, 46 Bankr. at 151.

92. *Id.* at 139.

93. An exception to the general dischargeability of debts is provided in the Code for claims which are fines or penalties payable to the government which are not compensation for pecuniary loss. 11 U.S.C. § 523(a)(7) (1990). *See, e.g., In re Carracino*, 53 Bankr. 513 (Bankr. D.N.J. 1985) (fine imposed for violations of New Jersey state environmental law).

94. 81 Bankr. 644 (Bankr. M.D. Fla. 1987), *aff'd*, 862 F.2d 1500 (11th Cir. 1989).

95. Section 502 provides, in relevant part:

[T]he court shall disallow any claim for reimbursement or contribution of an entity that is liable with the debtor on or has secured the claim of a creditor to the extent that . . .

(B) such claim for reimbursement or contribution is contingent as of the time of allowance or disallowance of such claim for reimbursement or contribution. . . .

11 U.S.C. § 502(e)(1) (1990).

96. Section 113(f)(1) of CERCLA allows a person to seek contribution or reimbursement from any other liable or potentially liable party. 42 U.S.C. § 9613(f)(1) (1988).

indemnification rather than contribution. The court pointed out, however, that plaintiffs seeking indemnification are parties falling squarely within the language of section 502. The court discharged the claim reasoning that the bankrupt's estate "should not be burdened by estimated claims of a contingent nature when the underlying claimant has recourse against the entity who is liable on the claim with the debtor."<sup>97</sup>

#### ABANDONMENT OF CONTAMINATED PROPERTY

In *In re Quanta Resources Corporation*,<sup>98</sup> the New Jersey Department of Environmental Protection issued an administrative order requiring the corporation, Quanta, to clean up a site which was polluted by leaking barrels of carcinogenic waste in violation of state law. Quanta filed a petition for reorganization under Chapter 11. Subsequently, similar violations of New York's environmental laws were discovered at Quanta's operations in New York. Quanta's trustee decided to abandon the property in New York and New Jersey according to section 554(a) of the Code which provides that "[a]fter notice and a hearing, the trustee may abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate." The bankruptcy courts in both states approved the abandonment.<sup>99</sup> Both states objected on the grounds that allowing abandonment in contravention of state environmental laws violated section 959(b) of Title 28 of the United States Code, which requires a trustee in bankruptcy to

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97. *In re Charter*, 81 Bankr. at 648.

98. 739 F.2d 912 (3d Cir. 1984).

99. Title to abandoned property passes from the estate to the party with a prepetition possessory interest, *Ohio v. Kovacs*, 469 U.S. 274, 284 n.12 (1985), which means in a Chapter 7 case that the individual debtor or shell corporation regains title but is without the resources to remedy the situation which creates an ongoing violation.

manage the property in compliance with state law.<sup>100</sup> A divided panel of the Third Circuit held that the abandonment power could not override state law designed to protect the public interest.<sup>101</sup> The court of appeals expressed its view of the public policy concerns as follows:

If trustees in bankruptcy are to be permitted to dispose of hazardous wastes under the cloak of the abandonment power, compliance with environmental protection laws will be transformed into governmental cleanup by default. It cannot be said that the bankruptcy laws were intended to work such a radical change in the nature of local public health and safety regulation - the substitution of governmental action for citizen compliance without an indication that Congress so intended.<sup>102</sup>

In *Midlantic National Bank v. New Jersey Department of Environmental Protection*<sup>103</sup> the Court applied similar reasoning in considering the relationship between public health and safety and

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100. Section 959(b) provides:

Except as provided in section 1166 of title 11, a trustee, receiver or manager appointed in any cause pending in any court of the United States, including a debtor in possession, shall manage and operate the property in his possession according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof.

28 U.S.C. § 959(b) (1990). Although this provision appears to resolve the question of whether a trustee can abandon property in contravention of state law, it does not directly apply to an abandonment. Petitioner argued that section 959(b) applied only when a trustee was operating a business and not when he was liquidating it. The Court did make an analogy between the two provisions to support the proposition that Congress did not intend for the Code to preempt all state law, *Midlantic Nat'l Bank*, 474 U.S. at 762, without commenting on the precise applicability of the section. Cf. *In re Stevens*, 68 Bankr. 774, 781 (Bankr. D. Me. 1987).

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

102. *Id.* at 921-22.

103. 474 U.S. 494 (1986).

bankruptcy laws. The Court held that "a trustee may not abandon property in contravention of a state statute or regulation that is reasonably designed to protect the public health or safety from identified hazards."<sup>104</sup> The Court limited its holding, however, in a footnote which explained:

This exception to the abandonment power vested in the trustee by § 554 is a narrow one. It does not encompass a speculative or indeterminate future violation of such laws that may stem from abandonment. The abandonment power is not to be fettered by laws or regulations not reasonably calculated to protect the public health or safety from imminent and identifiable harm.<sup>105</sup>

Because of this footnote, analysis in subsequent cases has focused on the issue of whether the harm is an imminent threat to public safety or health. Such analysis represents the balance struck by the Supreme Court between bankruptcy and environmental concerns.<sup>106</sup>

The bankruptcy court in *In re Franklin Signal Corp.*,<sup>107</sup> held that *Midlantic* did not preclude abandonment in all instances, and the court fashioned a test to determine when abandonment should be permitted. The test consisted of five factors: (1) the imminence of the danger; (2) the extent of probable harm; (3) the amount of hazardous substance; (4) the cost of compliance with environmental law; and (5) the funds available for cleanup.<sup>108</sup> The court concluded that "[t]he trustee only needs to take adequate precautionary measures to ensure that there is no imminent danger to the public as

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104. *Id.* at 507.

105. *Id.* at 507 n.9.

106. Smillie, *supra* note 28, at 86; see, e.g., *In re Smith-Douglass, Inc.*, 856 F.2d 12, 16 (4th Cir. 1988) (Chapter 11 debtor allowed to abandon property on which violation of state law existed because abandonment posed no imminent threat to public health).

107. 65 Bankr. 268 (Bankr. D. Minn. 1986).

108. *Id.* at 272.

a result of abandonment."<sup>109</sup> If such measures are taken, then the court may permit abandonment of the property.

Another bankruptcy court also applied *Midlantic* in a less restrictive manner, noting the "quandary" of the trustee who has "[o]n one hand, . . . no funds which are not cash collateral but, under a strict reading of *Midlantic* could be required to comply with state laws and regulations which is impossible because of 363(c)(2)."<sup>110</sup> The court resolved this predicament by interpreting *Midlantic* as putting the issue within the court's discretion. The court explained: "We do not believe the Supreme Court intended to place bankruptcy trustees in such a predicament but rather that *Midlantic* requires the bankruptcy court, in determining whether to permit abandonment, take state environmental laws and regulations into consideration."<sup>111</sup>

The Bankruptcy Court for the Western District of Pennsylvania cited *Franklin* and *Oklahoma Refining* to support its less restrictive analysis of *Midlantic* in *In re Purco*.<sup>112</sup> The court found support for this interpretation in *Midlantic* itself: "wherein the Court instructed that the trustee's petition to abandon will be denied *unless* the trustee has 'formulat[ed] conditions that will adequately protect the public's health and safety.'<sup>113</sup> The court allowed abandonment and concluded that the Pennsylvania Department of Environmental Resources had

109. *Id.* at 272.

110. *In re Oklahoma Refining Co.*, 63 Bankr. 562, 565 (Bankr. W.D. Okla. 1986). Section 363(c)(2) prohibits the trustee from using, selling or leasing cash collateral unless:

(A) each entity that has an interest in such cash collateral consents; or

(B) the court, after notice and a hearing, authorizes such use, sale, or lease in accordance with the provisions of the section.

11 U.S.C. § 363(c)(2).

111. *In re Oklahoma Refining Co.*, 63 Bankr. at 565.

112. 76 Bankr. 523 (Bankr. W.D. Pa. 1987).

113. *Id.* at 533 (quoting *Midlantic Nat'l Bank v. New Jersey Dep't of Env'tl. Protection*, 474 U.S. 494, 507 (1986) (emphasis added)).

not shown that a clear and imminent danger to public health existed or that the public was inadequately protected,<sup>114</sup> even assuming the solid waste on the site was hazardous.<sup>115</sup> The court in *Purco* took the expansive reading of *Midlantic* one step further by placing the burden of proving that the waste constituted an imminent threat to the public on the environmental agency.

Some bankruptcy courts have interpreted *Midlantic* to preclude abandonment unless total compliance with the violated environmental laws is possible. In *In re Peerless Plating Co.*,<sup>116</sup> the bankrupt company filed a petition under Chapter 7 of the Code and thereafter the EPA found that the company had violated CERCLA. The EPA incurred the cleanup costs and sought reimbursement from the bankruptcy trustee. The court began its analysis by discussing *Midlantic* and noting its disagreement with the interpretation given *Midlantic* by the court in *Franklin*. The court found that the "clear impact of the *Midlantic* language," disallowed abandonment unless: (1) the environmental law was so onerous as to interfere with bankruptcy adjudication; (2) the environmental law was not created to protect the public; or (3) the violation caused by abandonment was merely speculative.<sup>117</sup> The court did not believe that complete depletion of the estate due to compliance with CERCLA was the type of onerous condition allowing abandonment that the Supreme Court had in mind. Since Congress clearly intended CERCLA to protect the public, and the ongoing violation of the law was not merely speculative, the court precluded the bankruptcy trustee from abandoning the property.<sup>118</sup>

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114. *Id.*

115. *Id.*

116. 70 Bankr. 943 (Bankr. W.D. Mich. 1987).

117. *Id.* at 947.

118. *Id.* at 947-48.

## CONCLUSION

In *Penn Terra Limited v. Pennsylvania Department of Environmental Resources*,<sup>119</sup> the Third Circuit enunciated a rule which prevented litigation from going forward when the government sought to obtain a money judgment from a debtor, but permitted the government to maintain suit under the police and regulatory power exception when the government was legitimately trying to force the debtor to comply with environmental laws. Some courts have expanded the *Penn Terra* rule to allow the government to proceed to establish debtor's liability for environmental damage. In those cases, the government was not allowed to enforce the judgment, but it was then granted a perfected claim in the bankruptcy proceedings.

In *Midlantic National Bank v. New Jersey Department of Environmental Protection*,<sup>120</sup> the Supreme Court enunciated a rule which, unlike *Penn Terra*, has become more compatible with the needs of bankrupt businesses that face potential environmental liability. *Midlantic* prohibited the bankruptcy trustee from abandoning environmentally damaged property in contravention of state law when abandonment would create an imminent danger to the public. More recent cases have interpreted *Midlantic* in a less restrictive manner so as to allow abandonment as long as the trustee has taken adequate steps to safeguard the property, and the state cannot prove that imminent harm is likely to result from the abandonment.

Finally, *Ohio v. Kovacs*<sup>121</sup> established that an environmental obligation was dischargeable in bankruptcy when it was a claim for a monetary judgment. The ruling was fact-specific and held that since a receiver had been appointed for the debtor's assets, the equitable claim had been converted to an action seeking purely monetary relief. Courts have expanded the *Kovacs* rule to allow

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119. 733 F.2d 267 (3d Cir. 1984).

120. 474 U.S. 494 (1985).

121. 469 U.S. 274 (1985).

discharge when the claimant requests compliance with an environmental law that would require the expenditure of money. Both the *Midlantic* and *Kovacs* lines of cases are similar in that subsequent rulings generally show greater concern for protecting the debtor, while the *Penn Terra* line of cases is more concerned with protecting the environment.

As the number of bankruptcy filings grows, the tension increases between the policies of bankruptcy and environmental legislation. Courts are increasingly faced with balancing the health and safety goals of environmental legislation against a corporation's right to a fresh start under the Bankruptcy Code. To maintain the integrity of both areas of the law, courts should not allow bankruptcy to become a shield protecting corporations from all environmental responsibility. The mechanisms of the Bankruptcy Code should be interpreted to complement environmental policies and legislation wherever possible.