Strange Things Are Afoot at the Circle K: Agency Action Against Leased Sites in Environmental Bankruptcy

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Strange Things Are Afoot at the Circle K: AGENCY ACTION AGAINST LEASED SITES IN ENVIRONMENTAL BANKRUPTCY

Buckmaster de Wolf*

I believe that the need to quickly resolve this health hazard transcended monetary considerations.1

The interaction of bankruptcy and environmental law is like sitting in a room with a guy holding a hand grenade, saying, 'If you come any closer, I'll blow us all up.'2

I. INTRODUCTION

Responding to the growing problem of environmental contamination, federal and state agencies charged with environmental law enforcement (Agencies) have been given substantial statutory authority to ensure cleanup of contaminated sites and to punish illegal dumpers.3 Agency enforcement of environmental laws is often fruitless, however, if a party that is potentially responsible for cleanup of contamination files for bankruptcy protection under the United States

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Bankruptcy Code (Code). An Agency's action is usually stayed by the bankruptcy court and then, after receiving little compensation in the court's distribution of the debtor's assets, an Agency's claim is generally discharged by the court at the completion of the proceeding.

By filing bankruptcy, potentially responsible parties (PRPs) force Agencies to make creative use of various Code provisions to achieve higher priority for their claims in order to ensure payment from the debtor. Although the results have been inconsistent, this creativity has found some success, particularly in the form of state "superliens" and administrative expense priority.

The debtors, however, easily frustrate the Agencies' creative efforts to gain higher priority by merely leasing the contaminated site, rather than owning the site. The existence of a lease defeats the Agencies' opportunities for a superlien or administrative expense priority, putting the Agencies' claims back in a bleak low priority position.

Corporate leasing of sites is a common practice because of the low cost, tax savings, and increased flexibility. Many of these leased sites are home to potential polluters such as coal mines, gas stations, and hazardous waste sites. The opportunity to avoid environmental liability may encourage corporations that are at risk of contaminating their sites to lease those sites in an effort to avoid clean-up liability through an improper attempt at bankruptcy planning. If a company is found responsible for contaminating a leased site, a bankruptcy proceeding provides an opportunity to simply walk away from liability for site cleanup. This opportunity frustrates the deterrent purpose of environmental laws and potentially burdens the general public with financial responsibility for cleanup.

This Comment will discuss the interaction between environmental and bankruptcy laws, particularly focusing on the effect of corporate leasing. Section II discusses the deleterious effects of bankruptcy law on environmental law enforcement against corporations. Section III explores the various tools Agencies use to work within the Code to ensure payment from corporate debtors. Section IV discusses the

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6 See infra Section III.
7 For a discussion of leases under the Code, see Don Fogel, Executory Contracts and Unexpired Leases in the Bankruptcy Code, 64 MINN. L. REV. 341 (1980).
8 See infra Section IV.
specific effect the debtor's leasing a contaminated site has on these otherwise useful methods. Section V details the case of In re Circle K, a prime example of the treatment of contaminated leases in bankruptcy. Finally, Section VI provides some possible solutions, including amending the Code to provide environmental claims with higher priority.

II. THE UNSTOPPABLE FORCE OF ENVIRONMENTAL LAW MEETS THE IMMOVABLE OBJECT OF BANKRUPTCY

A. Environmental Law

The primary policy goals of federal and state environmental laws, particularly the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA)\(^9\) and similarly constructed state statutes,\(^10\) are to ensure timely cleanup of hazardous waste and to allocate the financial burden of cleanup to the responsible parties as a deterrent against future contamination.\(^11\)

To that end, Agencies have been given extraordinary power to effect cleanup.\(^12\) Agencies have the power to order PRPs to clean up significantly contaminated sites.\(^13\) The group of PRPs under these statutes is potentially very large, usually including current owners

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The provisions of CERCLA serve two goals. First, the federal government should be given the tools necessary for a prompt and effective response to problems of a national magnitude and resulting from hazardous waste disposal. Second, those responsible for problems caused by the disposal of chemical poisons should bear the costs and responsibility for remedying the harmful conditions they created. United States v. Reilly Tar & Chems., 546 F. Supp. 1100, 1112 (D. Minn. 1982).

and operators of a contaminated facility, those who owned or operated when the contamination occurred, transporters of the hazardous materials, and generators of the hazardous materials.\textsuperscript{14} Furthermore, in order to encourage timely compliance with remediation orders,\textsuperscript{15} many federal and state environmental laws allow Agencies to levy civil or criminal fines against PRPs for noncompliance.\textsuperscript{16} These non-compensatory, punitive penalties accrue for each day the violation remains uncorrected.\textsuperscript{17} If the PRPs fail to comply with the order, an Agency may undertake the cleanup itself and then seek reimbursement from the PRPs, who are jointly and severally liable.\textsuperscript{18} In order to ensure reimbursement, many statutes provide for a lien that arises to secure the cost of cleanup.\textsuperscript{19}

Finally, in order to encourage third party participation in clean-up

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The agency can sue the PRPs for statutorily permitted costs incurred in response actions taken with respect to releases or threatened releases of hazardous substances.


\textsuperscript{15} In other words, clean-up orders.


\textsuperscript{19} CERCLA does not provide for joint and several liability. Congress expressly left to the courts the determination of what standard of liability to impose under CERCLA, based on a case by case basis. See H. REP. NO. 258(I), 99th Cong., 2d Sess. 74, \textit{reprinted in} 1986 U.S.C.C.A.N. 2835, 2856 ("Explicit mention of joint and several liability was deleted from CERCLA in 1980 to allow courts to establish the scope of liability through a case-by-case application of 'traditional and evolving principles of common law' and pre-existing statutory law"). Subsequently, however, in enacting the Superfund Amendments and Reauthorization Act of 1986 (SARA), Congress endorsed the standard of joint and several liability imposed by the seminal case of United States v. Chern-Dyne, 572 F. Supp. 802 (S.D. Ohio 1983). See also United States v. Monsanto Co., 858 F.2d 160, 171 n.23 (4th Cir. 1988), \textit{cert. denied}, 490 U.S. 1106 (1989); \textit{In re Nat'l Gypsum}, 139 B.R. 397, 414 (N.D. Tex. 1992).


\textsuperscript{19} For a complete discussion of lien provisions, see \textit{infra} Section III. A.
efforts, environmental laws also allow for equitable contribution between PRPs to reimburse third parties that undertake voluntary cleanup of contaminated sites. 20 Under these statutes, any party, whether or not a PRP, who undertakes clean-up efforts consistent with an Agency’s contingency plan is entitled to sue other PRPs for equitable contribution. 21

B. Bankruptcy Law

If one of the PRPs involved with the contaminated site files for federal bankruptcy protection, the involved Agency’s response scheme for cleanup of hazardous waste is greatly affected. 22 The Bankruptcy Code’s principal policy of protecting the debtor from its creditors is in direct conflict with the protection of human health and welfare goals of environmental law. 23 The Code does not mention environmental clean-up obligations expressly, providing no special guidance as to how environmental claims should be treated in bankruptcy. 24 Due to this lack of direction, the treatment of environmental claims is most commonly resolved in favor of debtor and creditor protection, with federal bankruptcy law trumping state and federal environmental law. 25 The case law, however, is very inconsistent. 26

Commercial bankruptcy filings have increased dramatically since


22 See In re Chateaugay Corp., 944 F.2d 997, 1002 (2d Cir. 1991); In re Combustion Equip. Assoc., 838 F.2d 35, 37 (2d Cir. 1988); In re Nat’l Gypsum, 139 B.R. at 404.

23 The conflict begins at a basic level, since the goal of CERCLA—cleaning up toxic waste sites promptly and holding liable those responsible for the pollution—is at odds with the premise of bankruptcy, which is to allow debtors a fresh start by freeing them of liability. The two statutes also differ in their timing. To foster rapid cleanup, Congress embraced a policy of delaying litigation about clean-up costs until after the cleanup. Thus, under CERCLA, liability is not assessed until after the EPA has investigated a site, decided what remedial measures are necessary, and determined which PRPs will bear the costs. In re Combustion Equip. Assoc., 838 F.2d at 37.


25 See Claar, supra note 5, at 30; Stockard, supra note 23, at 443.

1981, with bankruptcy becoming a particularly common refuge of the environmental polluter. Indeed, with the average cost of a single Superfund cleanup soaring to between $30 and $40 million, many PRPs are being driven into bankruptcy by environmental liability alone.

The origins and process of bankruptcy have been explained briefly by one commentator as follows:

Although bankruptcy proceedings can take many forms, they generally arise from a similar situation: the debtor's assets are inadequate to satisfy all its debts. Some of the debtor's creditors will have to suffer a financial loss. The federal bankruptcy system provides a forum to equitably distribute the loss among all of the debtor's creditors.

Bankruptcy law serves three fundamental purposes when dealing with the debtor's bleak financial situation. The first principal goal of bankruptcy is to give the debtor a fresh start in business and commercial life by relieving him or her from the weight of indebtedness that may have resulted from business misfortune. This goal is accomplished primarily by discharging the debtor's unpaid debts, essentially elevating the debtor's inability to pay to a legal right not to pay his or her debts. Another purpose of bankruptcy is to provide a set of equitable rules for the division of the debtor's property among his or her various creditors. Finally, bankruptcy law provides a mechanism for the rehabilitation or reorganization of a business debtor who has the capacity to stay in business.

The debtor's reorganization is addressed under chapter 11 of the Bankruptcy Code and is designed to reduce the net loss of the creditors. If the corporate debtor has no feasible chance of reorganization, then the debtor's assets are simply liquidated under chapter 7 of the Code and the proceeds are equitably distributed to the creditors.

In order to fulfill these three goals during the bankruptcy proceeding, the creditors' claims against the debtor are handled in three distinct stages. First, at the filing of the bankruptcy petition, the Code stays collection efforts by most creditors. Second, during the proceeding, the creditors' claims are ranked by priority and paid accordingly.

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30 Id.
Third, at the completion of the proceeding, the Code discharges most unpaid claims against the debtor. At each one of these stages, the bankruptcy proceeding dramatically affects environmental actions against the debtor.

1. The Bankruptcy Petition: The Automatic Stay and the Debtor's Estate

When a corporation validly files for federal bankruptcy protection two Code provisions are immediately activated. First, under § 541 of the Code, a "bankruptcy estate" arises, which assumes ownership of all the debtor's legal and equitable property interests at the time of filing. The bankruptcy estate, under the control of either the trustee or the debtor in possession, holds the debtor's unencumbered assets for orderly and equitable distribution to the debtor's creditors.

Second, under § 362(a), an "automatic stay" freezes almost all actions against the debtor, including most new and continuing judicial and administrative proceedings and judgments. The protection afforded by the automatic stay is intended to be quite broad, stopping virtually all collection efforts by creditors with claims arising before the debtor filed for bankruptcy protection (prepetition). Before a creditor may attempt to collect payment from the debtor, the court

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32 The participation of the trustee and the debtor in possession (the debtor) is different in chapter 7 from chapter 11. In a chapter 7 case, a trustee is always appointed to manage the liquidation of the debtor's assets and is given certain powers under the Code to facilitate this goal. 11 U.S.C. § 701 (1988). In contrast, in a chapter 11 case, the trustee is only appointed for cause or at the request of an interested party. 11 U.S.C. § 1104 (1988). Furthermore, in a chapter 11 case, the presumption is that the debtor will continue to run the business after the bankruptcy petition is filed (postpetition) as the debtor in possession. Accordingly, the debtor in possession is given the same powers as the trustee. 11 U.S.C. §§ 1104 & 1107 (1988).


35 Id. The stay prevents all collection efforts including all acts to obtain possession of property or payment from the debtor, the property of the debtor and property of the estate. Id.; 28 U.S.C. § 1334(d) ("The district court in which a case under title 11 is commenced or is pending shall have exclusive jurisdiction over all the property, wherever located, of the debtor as of the commencement of such case, and of property of the estate.").

must approve the creditor's action.\textsuperscript{36} The stay gives the debtor a "breathing spell"\textsuperscript{37} to effect repayment or reorganization and thus, an opportunity for a "fresh start."\textsuperscript{38}

The stay is not meant, however, to be an absolute refuge for the debtor. Section 362(a) is subject to a series of exceptions set forth in § 362(b) and § 105 of the Code.\textsuperscript{39} In relevant part, § 362(b) provides government police power and criminal exceptions,\textsuperscript{40} and § 105 provides the court discretionary injunction power.\textsuperscript{41}

\textit{a. Civil Police Power Exception under § 362(b)(4) & (5)}

The civil police power exception to the automatic stay allows governmental units to pursue actions to judgment after the debtor has filed for bankruptcy (postpetition) in order to fix damages but does not allow enforcement of any judgment requiring expenditure of funds.\textsuperscript{42} Under § 362(b)(4), governmental civil actions against the debtor, commenced by entities pursuant to police or regulatory power, that arose or were commenced prepetition are exempt from the stay.\textsuperscript{43} In applying the stay exception to governmental actions, the courts reason that filing for bankruptcy protection was not meant as a shield against government actions designed to protect the public's health, safety, and welfare.\textsuperscript{44}


\textsuperscript{37} See RAYMOND T. NIMMER & INGRID M. HILLINGER, COMMERCIAL TRANSACTIONS: SECURED FINANCING 263 (1992). The Code's legislative history states that "[t]he automatic stay is one of the fundamental debtor protections provided by the bankruptcy laws. It gives the debtor a breathing spell from his creditors. It stops all collection efforts, all harassment, and all foreclosure actions. It permits the debtor to attempt a repayment or reorganization plan, or simply to be relieved of the financial pressures that drove him into bankruptcy." H.R. REP. No. 95-595, 95th Cong., 1st Sess. 340-44 (1977), \textit{reprinted in} 1978 U.S.C.C.A.N. 5963, 6296-97.

\textsuperscript{38} Wetmore v. Markoe, 196 U.S. 68, 77 (1902) ("Systems of bankruptcy are designed to relieve the honest debtor from the weight of indebtedness which has become oppressive and to permit him to have a fresh start in business or commercial life, freed from the obligation and responsibilities which may have resulted from business misfortunes.").


\textsuperscript{44} See National Labor Relations Bd. v. Continental Hagen Corp., 932 F.2d 828 (9th Cir. 1991) (NLRB actions to fix award in action to enforce back pay provision are not affected by automatic
The § 362(b)(4) exception, however, only allows a governmental action to be brought to judgment to fix damages. Under § 362(b)(5) of the Code, a governmental unit may only enforce a judgment against the debtor or the property of the estate to the extent the judgment is not deemed a “money judgment.” This “exception to the exception” is intended to prevent governmental abuse of police or regulatory power to gain an economic advantage over other creditors in the bankruptcy proceeding.

Because the Code does not define money judgment, the courts generally look at “legal custom and practice to determine what was traditionally understood to be a recovery for money damages.”

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45 National Labor Relations Bd. v. Continental Hagen Corp., 932 F.2d 828 (9th Cir. 1991); United States v. Nicolet, Inc., 857 F.2d 202, 207 (3d Cir. 1988); National Labor Relations Bd. v. Edward Cooper Painting, 804 F.2d 834, 942-43 (6th Cir. 1986); United States v. Mattiace Indus., 733 F.2d 267, 272 (3d Cir. 1984) (state’s action to compel debtor to correct violations of anti-pollution laws was exempt from automatic stay); Ahrens Aircraft v. NLRB, 703 F.2d 23 (1st Cir. 1983) (enforcement of NLRB order awarding back pay was not subject to automatic stay); National Labor Relations Bd. v. Evans Plumbing, 639 F.2d 291 (5th Cir. 1981) (NLRB proceeding for entry of judgment for back pay was exempt from automatic stay).

46 11 U.S.C. § 362(b)(5) (1988 & Supp. III 1991). Technically, § 362(b)(5) should be applied only to judgments entered prepetition. The (b)(5) exception applies specifically to § 362(a)(2) which stays only “the enforcement, against the debtor or against the property of the estate, of a judgment obtained before commencement of the case...” Id. (emphasis added). Few courts have noted this distinction. Compare Brock v. Morysville Body Works, 829 F.2d 383, 388 (3d Cir. 1987) (court noted that because judgment was brought postpetition § 362(b)(5) was not implicated) with Commonwealth Oil Ref. v. United States Envtl. Protection Agency (In re Commonwealth Oil Ref.), 805 F.2d 1175 (5th Cir. 1986) (not noting distinction in similar circumstance), cert. denied, 105 S. Ct. 585 (1987). Courts rely instead on the legislative history, which states that “paragraph (5) makes clear that the exception extends to permit an injunction and enforcement of an injunction, and to permit the entry of a money judgment, but does not permit enforcement of a money judgment.” H.R. REP. No. 95-595, 95th Cong., 1st Sess. 343 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6299. For a discussion of this issue, see William A. Shirley, The Precedence of Environmental Protection over Chapter 11 Bankruptcy Protection: Commonwealth v. United States Environmental Protection Agency, 35 WASH. U. J. URB. & CONTEMP. L. 189, 199 (1989).

47 National Labor Relations Bd. v. Continental Hagen Corp., 932 F.2d 828, 834 (9th Cir. 1991); In re Sam Daily Realty, 57 B.R. 83, 85 (Bankr. D. Haw. 1985) (Hawaii postpetition order suspending debtor’s real estate license for prepetition violations not stayed, but concomitant civil penalty was stayed).

judgment the Agency is impermissibly attempting to gain a pecuniary advantage in the proceeding through the government exception.\textsuperscript{49}

Governmental action pursuant to environmental laws consistently has been held by the courts to be within the § 362(b)(4) \& (5) governmental exception to the stay, thus allowing Agencies to pursue actions to determine a debtor's environmental liability but not to receive any compensation.\textsuperscript{50} Relying on the legislative history of the provision,\textsuperscript{51} the courts reason that, among other purposes, the § 362(b)(4) exemption was designed to combat the risk that bankruptcy court would become a sanctuary for environmental wrongdoers.\textsuperscript{52} Courts, how-

\textsuperscript{49} See City of New York v. Exxon, 932 F.2d 1020, 1024 (2d Cir. 1991) (noting collection of a money judgment would be stayed); Word v. Commerce Oil (In re Commerce Oil), 847 F.2d 291, 296 (6th Cir. 1988) (Tennessee Water Quality Control Board may only fix civil liability against debtor not enforce judgment); United States v. Nicolet, 857 F.2d at 207 (EPA action to recover hazardous waste clean-up costs are exempt from automatic stay only up to and including entry of a monetary judgment); Brock v. Morysville Body Works, 829 F.2d 383, 389 (3d Cir. 1987) (OSHA citation could not be enforced against debtor to the extent it required debtor to pay penalty for past safety and health violations); United States v. Standard Metals, 49 B.R. 623 (D. Colo. 1985) (noting action seeking enforcement of money judgment for violations of Clean Water Act would be stayed); United States v. ILCO, 48 B.R. 1016, 1024 (N.D. Ala. 1985) (noting civil penalties would be stayed).

\textsuperscript{50} See City of New York v. Exxon, 932 F.2d at 1024 (governmental actions to recover costs expended in response to completed environmental violations are not stayed by the violator's filing for bankruptcy); In re Commerce Oil, 847 F.2d at 296 (Tennessee Water Quality Control Board proceeding to fix civil liability against debtor was within police power exception to automatic stay in bankruptcy); United States v. Nicolet, Inc., 857 F.2d at 299--10 (EPA action to recover hazardous waste clean-up costs was exempt from automatic stay up to and including entry of a monetary judgment); In re Commonwealth Oil Ref., 805 F.2d at 1184--86 (EPA actions to require debtor hazardous waste facility to comply with federal and state environmental laws was exempted from stay by § 362(b)(4)); Penn Terra Ltd. v. Dep't of Envtl. Resources, 738 F.2d 267, 274 (3d Cir. 1984) (actions taken by commonwealth to obtain an injuction against debtor to correct environmental violation was within governmental exception to automatic stay); Cournoyer v. Town of Lincoln, 790 F.2d 971, 977 (1st Cir. 1986) (town's proposed removal of automotive parts and scrap metal from salvage yard maintained by debtor in violation of local zoning law would not be stayed); United States v. ILCO, 48 B.R. 1016, 1023 (N.D. Ala. 1985) (automatic stay does not apply to actions by state to fix liability for debtor's civil violations of state and federal environmental laws); United States v. Standard Metals, 49 B.R. 623, 624 (D. Colo. 1985) (action seeking entry of money judgment for violations of Clean Water Act not stayed).

\textsuperscript{51} "Thus where a governmental unit is suing a debtor to prevent or stop violation of fraud, \textit{environmental protection}, consumer protection, safety, or similar police or regulatory laws, or attempting to fix damages for violation of such law, the action or proceeding is not stayed under the automatic stay." H.R. REP. No. 595, 95th Cong., 1st Sess. 343 (1977), \textit{reprinted} in 1978 U.S.C.C.A.N. 5963, 6290 (emphasis added).

\textsuperscript{52} United States v. Nicolet, Inc., 857 F.2d at 207 (EPA action to recover hazardous waste clean-up costs was exempt from automatic stay up to and including entry of a monetary judgment). \textit{See} City of New York v. Exxon, 932 F.2d at 1024 (governmental actions to recover costs expended in response to completed environmental violations was not stayed by the violator's filing for bankruptcy); In re Commerce Oil, 847 F.2d at 296 (Tennessee Water Quality
ever, also have held that enforcement of civil environmental actions, including reimbursement actions, remediation orders, and fines, are stayed as money judgments under § 362(b)(5).

Fines and cost reimbursement actions are clearly money judgments, but it is less clear whether remediation orders qualify as money judgments as well. The Code is silent on whether affirmative injunctive-type orders qualify as money judgments and the legislative history is unclear on the issue. Courts holding that remediation orders should not be stayed as money judgments rely on standards established by the United States Court of Appeals for the Third Circuit in *Penn Terra Limited v. Department of Environmental Resources*. In *Penn Terra*, the Pennsylvania Department of Environmental Resources (DER) obtained a consent decree requiring Penn

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53 See City of New York v. Exxon, 932 F.2d at 1024 (noting collection of money judgment would be stayed); *In re Commonwealth Oil Ref.*, 806 F.2d at 1184–86 (EPA actions to require debtor hazardous waste facility to comply with federal and state environmental laws was exempted from stay by § 362(b)(4)); *Penn Terra*, 733 F.2d at 274 (actions taken by commonwealth to obtain an injunction against debtor to correct environmental violation was within governmental exception to automatic stay); *In re Lenz Oil Serv.*, 65 B.R. 292, 294 (Bankr. N.D. Ill. 1986) (automatic stay does not prohibit regulatory action seeking injunctions and fixing of fines and penalties); *United States v. ILCO*, 48 B.R. at 1023 (automatic stay does not apply to actions by state to fix liability for debtor's civil violations of state and federal environmental laws); *United States v. Standard Metals*, 49 B.R. at 625 (action seeking entry of money judgment for violations of Clean Water Act was not stayed).

54 See City of New York v. Exxon, 932 F.2d at 1024 (noting collection of money judgment would be stayed); *In re Commonwealth Oil Ref.*, 806 F.2d at 1184–86 (EPA actions to require debtor hazardous waste facility to comply with federal and state environmental laws was exempted from stay by § 362(b)(4)); *Penn Terra*, 733 F.2d at 274 (actions taken by commonwealth to obtain an injunction against debtor to correct environmental violation was within governmental exception to automatic stay); *In re Lenz Oil Serv.*, 65 B.R. 292, 294 (Bankr. N.D. Ill. 1986) (automatic stay does not prohibit regulatory action seeking injunctions and fixing of fines and penalties); *United States v. ILCO*, 48 B.R. at 1023 (automatic stay does not apply to actions by state to fix liability for debtor's civil violations of state and federal environmental laws); *United States v. Standard Metals*, 49 B.R. at 625 (action seeking entry of money judgment for violations of Clean Water Act was not stayed).

55 The legislative history states that "[p]aragraph (5) makes clear that the exception extends to permit an injunction and enforcement of an injunction, and to permit the entry of a money judgment, but does not permit enforcement of a money judgment." H.R. REP. No. 95-595, 95th Cong., 1st Sess. 343 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6299.

56 733 F.2d at 274. See Brock v. Morysville Body Works, 829 F.2d at 388 (prospective orders to abate future violations of OSHA not stayed); United States v. Wheeling-Pittsburgh Steel, 818 F.2d 1077, 1086–87 (3d Cir.) (bankruptcy no bar to prospective enforcement of Clean Water Act), cert. denied, 483 U.S. 1005 (1987); *In re Commonwealth Oil Ref.*, 805 F.2d at 1186 (EPA's postpetition administrative order directing debtor to obtain permit and submit closure plans for its land disposal facilities in compliance with state and federal environmental law not stayed); Walsh v. West Virginia (*In re Security Gas & Oil*), 70 B.R. 786, 790–91 (Bankr. N.D. Cal. 1987) (W.Va postpetition order directing debtor to plug and regrade oil and gas wells abandoned prepetition not stayed); United States v. Gregory & Sons, 58 B.R. 590, 592 (W.D. Pa. 1986) (state postpetition order directing debtor to perform reclamation work at leased mine site abandoned
Terra to reclaim certain subsurface coal mines pursuant to state law. Before Penn Terra complied with the consent decree, the mining company filed a petition under chapter 7 of the Code. The DER then sought to obtain a preliminary injunction against Penn Terra forcing the company to comply with the previous reclamation order, which required backfilling, controlling erosion, and sealing of a mine.

Stating that the exceptions to the automatic stay in § 362(b)(4) & (5) should be read broadly, and thus the term “money judgment” construed narrowly, the Third Circuit held that the injunction was not a money judgment and thus was enforceable as an exception to the stay. The court reasoned whether or not an injunction requires payment or expenditure of money is not dispositive of whether an injunction is a money judgment. Rather, the court stated, a money judgment generally specifies only the parties and a definite and certain sum that the defendant is obligated to pay; neither of which was present in this case. In fact, the court noted that the mere payment of money would not satisfy DER’s order. Moreover, there was evidence that the debtor could comply with the order by performing the mine reclamation work itself. The court further noted that the purpose of DER’s order was to prevent future harm, and not to compensate for past injuries, the type of remedy traditionally associated with a money judgment. To hold that the injunction was stayed as a money judgment, the court opined, would narrow the police and regulatory power exception to the automatic stay into “virtual nonex-

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57 738 F.2d at 269.
58 Id. at 270.
59 Id. at 270 n.3.
60 Id. at 273.
61 Id. at 272.
62 Id. at 277–78.
63 Id. at 275.
64 Id. at 278.
65 Id. at 277–78.
because compliance with almost any type of injunction costs money.66

b. Criminal Exception under § 362(b)(1)

Another exception to the automatic stay available to Agencies under § 362(b) is the criminal exception under § 362(b)(1).67 Similar to the government’s civil exception to the stay under § 362(b)(4) & (5), this section provides that the automatic stay does not prevent “the commencement or continuation of a criminal action or proceeding against the debtor.”68 Unlike the civil exception, however, which is limited by the money judgment restriction under § 362(b)(5), the criminal exception is subject to no such restriction. Hence, the courts have interpreted § 362(b)(1) more broadly to mean that the automatic stay does not bar any criminal proceedings, including enforcement of a criminal judgment.69 The court’s reasoning is supported by the legislative history of § 362(b)(1): “[t]he bankruptcy laws are not a haven for criminal offenders, but are designed to give relief from financial over-extension. Thus, criminal actions and proceedings may proceed in spite of bankruptcy.”70

The seminal case on the scope of the criminal exception to the stay is United States v. Troxler Hosiery.71 In Troxler, criminal contempt proceedings were brought against the defendant company as a result of an unlawful sale of sleepwear garments that had been treated with

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66 Id. Other courts addressing this issue have noted that, technically, even if the remediation order is not stayed by § 362(a)(1) or (2), any payment necessary to comply with the order would still need to be approved by the bankruptcy court under § 362(a)(3) of the Code, which enjoins “any act to obtain possession of property of the estate or to exercise control over property of the estate.” 11 U.S.C. § 362(a)(3) (1988). See, e.g., In re Professional Sales, 56 B.R. 753, 763 n.6 (N.D. Ill. 1985) (noting that sections 362(b)(4) & (5) do not provide an exception to § 362(a)(3)). But see Cournoyer v. Town of Lincoln, 790 F.2d 971, 977 (1st Cir. 1986) (town’s removal and sale of debtor’s scrap metal stored in violation of local zoning law not stayed under § 362(a)(3) where town had no pecuniary interest in debtor’s property and no alternative measure was available to abate debtor’s long-standing violation); In re Beker, 57 B.R. 611, 626 (Bankr. S.D.N.Y. 1986) (holding 362(b)(4) exception to the stay applies to 362(a)(3) as well). See also Mirsky, supra note 35, at 638–39.


68 Id.


hazardous substances. The court entered a judgment for a criminal fine and costs totalling $82,733.48. The defendant company later filed a chapter 11 bankruptcy petition. In an effort to collect the criminal judgment claim, the government made a motion for relief from the automatic stay based on § 362(b)(1) that was denied by the bankruptcy court. The District Court for the District of North Carolina, however, reversed the bankruptcy court's decision on appeal, reasoning that criminal contempt proceedings differ from actions by governmental units enforcing police or regulatory powers pertaining to the public health, safety, and welfare. The court stated that prosecution of a criminal case is not aimed at obtaining a pecuniary advantage; it is designed to punish offenders of the criminal law and to deter others. The court reasoned that if Congress intended the civil police power exception in § 362(b)(4) & (5) to include enforcement of criminal laws, then § 362(b)(1) would be surplusage. The court went on to hold that § 362(b)(1) applies to all stays enumerated in § 362(a) and is broad enough to include governmental suits to enforce criminal judgments through pecuniary collection means.

As with the civil enforcement exception, the fact that the proceeding is criminal does not indicate immediately that the exception is applicable. If the court determines that the criminal proceeding is actually an attempt to collect a prepetition claim unrelated to criminal penalties, such as a restitution action, the court may enjoin the action. These disguised collection actions have arisen most often in "bad check" prosecutions where the state will dismiss the criminal prosecution upon payment of the check.

Interestingly, there are no environmental cases testing the

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72 Id. at 458.
73 Id. at 459.
74 Id.
75 Id.
76 Id.
77 Id.
78 Id. at 461.
79 Id. at 461. See Patten & Puetz, supra note 35, at 237.
80 For an excellent discussion of the criminal exception, see Patten & Puetz, supra note 35, at 238.
81 See, e.g., In re Van Riper, 25 B.R. 972, 978 (Bankr. W.D. Wis. 1982). See also Patten & Puetz, supra note 35, at 238.
82 See, e.g., In re Butler, 74 B.R. 106, 107 (W.D. Mo. 1985). See also Patten & Puetz, supra note 35, at 236 (arguing that even if reimbursement for response costs is viewed as a form of restitution, the breach of the public order by the parties responsible for the contamination is a matter which is independent of such restitution and will probably not be stayed by a bankruptcy filing).
§ 362(b)(1) criminal exception to the stay. This lack of case law is most likely due to the reluctance of Agencies to pursue criminal claims. Although most environmental statutes include criminal penalty provisions, Agencies are reluctant to pursue criminal claims due to the higher burden of proof required for criminal actions versus civil actions.


Even if a civil or criminal Agency proceeding is exempted from the automatic stay under § 362(b) of the Code, a bankruptcy court still has the discretion to enjoin the action pursuant to § 105(a) of the Code. This provision allows the bankruptcy court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Code]." Although § 105(a) provides the courts with broad injunction power, courts have exercised this power cautiously, particularly in the area of environmental law. Section 105(a) has been described as a last resort available to a debtor to halt a governmental proceeding that otherwise has a valid purpose. The courts reason that § 105 should only be used in extraordinary circumstances to prevent injury or correct errors and not to create rights not otherwise stipulated under applicable laws.

In determining whether to enjoin an environmental clean-up order

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83 Id.; Salerno, supra note 27, at 271.
The authors argue that the major difficulty with criminal actions in environmental law is the higher burden of proof. As a criminal cause of action, the agency must prove the defendant's guilt beyond a reasonable doubt, which can require substantial evidence in environmental cases. In addition, many of the criminal provisions require proof of some sort of criminal intent or knowledge on the part of the defendant. In contrast, the civil burden of proof requires only a preponderance of the evidence and any showing of knowledge is far less stringent. Furthermore, civil penalties, including remediation orders, response cost reimbursement actions and civil fines, usually prove amply severe. Given this difficulty with environmental criminal law, its usefulness has been argued to be largely symbolic, primarily used as a leverage tool by the prosecution to encourage defendants to plead guilty to civil charges so as to avoid possible jail time. Id.
under § 105, the bankruptcy courts weigh the state's interest in protecting the public health and welfare against the policies of the Code.\textsuperscript{90} While the legislative history of § 105 makes it clear that the stay should be granted only under the usual rules for the issuance of an injunction,\textsuperscript{91} courts have considered a myriad of issues in their balancing efforts.\textsuperscript{92}

So, while the Code provides government exceptions set forth in § 362(b) and discretionary power in § 105, the automatic stay under § 362(a) usually acts to stay all Agency enforcement efforts. Agencies are thus forced to pursue payment of their claims against debtors in bankruptcy's distribution process.

2. Payment of Claims

\textit{a. Unsecured Claims}

One of the primary objectives of the bankruptcy proceeding is to distribute equitably the property of the estate, comprised of the debtor's unencumbered assets, to the debtor's prepetition unsecured creditors based on a priority distribution scheme.\textsuperscript{93} The Code's distribution scheme divides holders of unsecured claims, claims not guaranteed by any lien in the debtor's property, into priority classes.\textsuperscript{94} The vast majority of unsecured claimants are classified as general unsecured creditors, the lowest priority level.\textsuperscript{95} Unless otherwise agreed to by the unsecured creditors, each priority level must be paid in full before moving down to pay the next priority level.\textsuperscript{96} This priority payment process continues until the estate's unencumbered assets are exhausted, with the remaining funds distributed on a pro-rata basis to the lowest priority level reached.\textsuperscript{97}


\textsuperscript{91} Tabb, supra note 88, at 195–96.

\textsuperscript{92} In re Security Gas & Oil, 70 B.R. at 796.


\textsuperscript{95} Id.


\textsuperscript{97} 11 U.S.C. §§ 507, 726, 1123, 1129 (1988). Unless otherwise agreed to, in order to be confirmed, a chapter 11 reorganization plan must provide the creditors with satisfaction equivalent to at least what the creditor would have received under a chapter 7 liquidation. § 1129(a)(9). This requirement means that all of the priority claims listed in § 507(a)(1)–(6) must be paid in cash in full at the date of the confirmation of the plan or on a deferred basis. Otherwise the reorganization will be converted to a chapter 7 liquidation.
b. Secured Claims

The debtor’s secured creditors, holders of valid security interests in the debtor’s property,98 are not subject to this priority distribution scheme.99 Rather, the secured creditors are entitled to the value of their interest in property or adequate protection100 of that interest before the unsecured creditors are paid.101 The creditors’ secured claims, however, are limited to the value of their interest in the secured property, with the remaining unsatisfied portion of the creditors’ claims becoming unsecured and subject to the Code’s distribution scheme.102

c. Environmental Claims

The Code’s priority scheme is silent regarding government environmental claims.103 An Agency claim arising from prepetition actions—once stayed as a money judgment—is usually relegated to general unsecured priority status, the lowest priority position in the Code’s priority scheme.104 Generally, there are insufficient funds to satisfy claims so low on the priority list.105 Moreover, even if there are sufficient funds to pay some amount to the general unsecured claims,

98 A secured creditor’s loan is secured by a valid lien on the debtor’s property of a value equal to the debtor’s interest in the property. 11 U.S.C. § 506(a). The lien creditor’s property interest can arise upon the debtor’s default pursuant to a contractual agreement between the creditor and the debtor. Otherwise, the lien creditor can acquire its property interest upon default by means of the judicial process and without the debtor’s consent. In most states, such secured transactions are governed by Article 9 of the U.C.C. See NIMMER & HILLINGER, supra note 37, at 10–18.


101 Secured interests are subject to the article 9 priority system. U.C.C. §§ 9–201 & 301(1)(b).


105 See, e.g., In re T.P. Long Chems., 45 B.R. 278, 281 n.4 (Bankr. N.D. Ohio 1985) (“EPA’s argument for reimbursement as a general unsecured creditor for costs attributable to the . . . spill is academic; there are no funds in the estate to pay general unsecured creditors) (emphasis added); Ohio v. Kovacs, 469 U.S. at 284; In re Chateauagay Corp., 944 F.2d at 1005 (2d Cir. 1991); In re Nat’l Gypsum, 139 B.R. 397, 409 (N.D. Tex. 1992); In re Hudson Oil, 100 B.R. 72, 77 (Bankr. D. Kan. 1989); In re Kaiser Steel, 87 B.R. 662, 665 (Bankr. D. Colo. 1988); In re Security Gas & Oil, 70 B.R. at 795 n.6.
the pro-rata distribution often results in an Agency receiving only a few cents on the dollar.\textsuperscript{106} Furthermore, Agency claims are limited to incurred costs. Under the Code, unincurred clean-up costs may be disallowed altogether as contingent claims.\textsuperscript{107} Thus, Agency reimbursement claims for prepetition remediation costs have little probability of receiving sufficient payment from the distribution of the debtor's available assets.\textsuperscript{108}

d. Tax Claims

Some governmental claims do receive priority treatment under the Code, particularly tax claims.\textsuperscript{109} Tax claims are given seventh priority in the Code's distribution scheme.\textsuperscript{110} Moreover, a chapter 11 reorganization plan must provide for the full payment of tax claims in deferred cash payments within six years.\textsuperscript{111} Environmental claims, however, do not qualify for tax priority.\textsuperscript{112}

3. Discharge

The remaining unsecured claims not satisfied under the Code's priority distribution scheme are usually discharged upon completion of the bankruptcy proceeding.\textsuperscript{113} The discharge voids all debts\textsuperscript{114} that arose prepetition\textsuperscript{115} without regard to whether the debts were filed with the bankruptcy court as claims.\textsuperscript{116} Furthermore, the discharge

\textsuperscript{106} See In re Charles George Land Reclamation Trust, 30 B.R. 918, 924 n.9 (Bankr. D. Mass. 1983) ("The costs of environmental study and resultant cleanup would, and I so found, have been entitled to unsecured status on the bankruptcy proceeding. Those astronomical costs as well as the ever-present administration expenses, would have resulted in a few pennies on a dollar."); Claar, supra note 5, at 33.

\textsuperscript{107} 11 U.S.C. § 502(e)(1)(B) (1988); In re Charter Co., 862 F.2d 1500, 1504 (11th Cir. 1989). The court disallowed contingent claims, stating that § 502(e)(1) encourages expeditious cleanup and liquidation of contingent claims because only non-contingent claims are eligible to seek contribution from a debtor's estate. Id.

\textsuperscript{108} Id.

\textsuperscript{109} For a full discussion of tax claims in bankruptcy, see Claar, supra note 5.


\textsuperscript{112} Claar, supra note 5.


\textsuperscript{115} 11 U.S.C. §§ 727 & 1141 (1988). Technically, the chapter 11 discharge also discharges any claim that arose during the pendency period, the postpetition period before the confirmation of the plan. 11 U.S.C. § 1141(d) (1988).

\textsuperscript{116} 11 U.S.C. §§ 727 & 1141 (1988). The only significant exception is under § 525(a)(3) of the Code, which provides that debts of unlisted or unscheduled creditors are not discharged unless the creditor has notice or actual knowledge of the bankruptcy case in time to file a timely proof of claim. 11 U.S.C. § 525(a)(3).
acts as an injunction against the commencement or continuation of any action by any creditor with an unsatisfied claim that arose prior to the conclusion of the bankruptcy proceedings. The discharge fulfills the "fresh start" goal of bankruptcy. The courts interpret claims subject to discharge broadly, applying the discharge provision to most creditors' claims, including government claims.

Significantly, the fresh start is not absolute. A corporate debtor is only entitled to the discharge of its debts if it is reorganizing under chapter 11, rather than liquidating under chapter 7 of the Code. However, the absence of a discharge under chapter 7 for corporate debtors does not have a significant impact on the creditors' ability to collect from the liquidating corporate debtor because, typically, any further attempts at collection from a liquidated, defunct corporation are fruitless.

Another exception to the fresh start resulting from the discharge is that only the personal liability of the debtor is discharged. Thus, claims secured by property of the debtor survive the bankruptcy proceeding. Consequently, the debtor's bankruptcy proceeding does not threaten secured claims against the debtor.

Finally, the discharge is also subject to certain public policy exceptions, listed in § 523(a) of the Code. The § 523(a) public policy exceptions, however, only apply to individual debtors and not corporations. Thus, the exception would have little relevance to corporate debtors facing environmental claims.

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118 See Wetmore v. Markoe, 196 U.S. 68, 77 (1902); Claar, supra note 5, at 30.
125 Yamaha Motor Corp. v. Shadco, Inc., 762 F.2d 668, 670 (8th Cir. 1985) (holding § 523(a) only applies to individual debtors).
a. Environmental Cost Reimbursement and Fines

Courts have held that environmental claims arising prepetition, including reimbursement actions and fines, are subject to the discharge. The most important question in this context is when does the environmental claim arise. In order to maximize the scope of the discharge and to provide the "broadest possible relief," courts look to the earliest reasonable date upon which an environmental claim may arise. Courts reason that while non-bankruptcy law governs the existence of a claim under the Code, it is not dispositive of the time at which a claim arises in bankruptcy. Thus, for purposes of bankruptcy law, environmental claims arise at the time when the contamination or violation occurred, despite the fact that there might be a continuing violation or substantial unincurred costs.

128 See, e.g., Ohio v. Kovacs, 469 U.S. 274, 284 (1985); In re Chateaugay Corp., 944 F.2d 997, 1006 (2d Cir. 1991) (EPA's response cost claims were prepetition "claims" dischargeable in bankruptcy, regardless of when such costs were incurred, so long as such costs concerned release or threatened release of hazardous waste that occurred prepetition); In re Nat'l Gypsum, 139 B.R. 397, 409 (N.D. Tex. 1992) (future response and natural resource damage costs based on prepetition conduct that can be fairly contemplated by the parties at time of debtor's bankruptcy are discharged as claims under the Code); In re Hudson Oil, 100 B.R. 72, 77 (Bankr. D. Kan. 1989) (indemnification claim arising from debtor-lessee's violation of state environmental law prior to bankruptcy filing was "prepetition claim" notwithstanding that lessor did not learn of contamination to property until post-petition); In re Kaiser Steel, 87 B.R. 662, 665 (Bankr. D. Colo. 1988) (debtor's prepetition activities in violation of environmental laws including failure to reclaim site were dischargeable as claims).


129 See In re Nat'l Gypsum, 139 B.R. at 405.

130 See In re Chateaugay Corp., 944 F.2d at 1005 (EPA's response cost claims were prepetition "claims" dischargeable in bankruptcy, regardless of when such costs were incurred, so long as such costs concerned release or threatened release of hazardous waste that occurred prepeti-
Some courts have slightly limited this broad interpretation of when an environmental claim arises, staying only claims that the parties could have fairly contemplated at the time of the debtor's bankruptcy. The courts reason that the Agencies should not be penalized for not acting sooner when they had no knowledge of the contamination.

b. Environmental Remediation Orders

While fines and cost reimbursement claims are clearly dischargeable under the Code, it is not as clear whether injunction remedies, such as clean-up orders, are dischargeable as well. Generally, these injunctions are discharged as claims to the extent the debtor would be required to spend funds to fulfill the obligation.

131 See, e.g., In re Nat'l Gypsum, 139 B.R. at 407 (debtor could discharge potential liability for future CERCLA response costs only to extent such claims could be fairly contemplated by parties as of the commencement of the case); American Intern, Inc. v. Datacard Corp., 146 B.R. 391, 394 (N.D. Ill. 1992) (prepetition release of hazardous waste alone does not give rise to CERCLA claim; disposition of this issue rests on determination of when CERCLA claimant had sufficient knowledge of claim); Sylvester Bros. Dev. v. Burlington N.R.R., 133 B.R. 648, 652-53 (D. Minn. 1991) (debtor's CERCLA liability not discharged even though state failed to file claim and was on notice that it was a creditor in case, because state did not know that debtor was PRP in time to file); In re Allegheny Int., 126 B.R. 919, 926 (W.D. Pa. 1991) (CERCLA cost recovery claim does not arise until claimant incurs costs, however, once costs are incurred, a claim exists for all costs, future and past, incurred at the site); United States v. Union Scrap Iron & Metal, 123 B.R. 831, 834-37 (D. Minn. 1990) (court refused to discharge environmental claims arising post-bankruptcy based on post-petition conduct because EPA was unaware that debtor was PRP at site not owned by debtor). See also In re Frenville, 774 F.2d at 337 (holding that a claim arises when the claimant's cause of action has accrued under state law).

132 See In re Nat'l Gypsum, 139 B.R. at 407.

134 See, e.g., In re Chateaugay Corp., 944 F.2d at 1009 (EPA's injunction remedy constituted dischargeable claim to extent it did "no more than impose an obligation entirely as an alternative to a payment right"); United States v. Whizco, 841 F.2d 147, 150-51 (6th Cir. 1988) (chapter 7
Courts which allow the discharge of environmental claims base their decision on the Supreme Court holding in *Ohio v. Kovacs*, where the Court held that environmental orders are claims under § 101(5) of the Code and thus are dischargeable. In *Kovacs*, the state of Ohio obtained an injunction ordering William Kovacs, chief executive officer of Chem-Dyne Corporation, to clean up a hazardous waste disposal site. When Kovacs failed to comply with the injunction, the state court appointed a receiver to take control of the site and to seize his assets to pay for the site cleanup. Kovacs subsequently filed for personal bankruptcy before the state completed the cleanup. The state sought to have Kovacs’ obligation to clean up the site declared non-dischargeable in bankruptcy and to enjoin the bankruptcy trustee from obtaining any assets in Kovacs’ estate from the state receiver.

The bankruptcy court ruled against the state, as did the District Court for the Southern District of Ohio. The United States Court of Appeals for the Sixth Circuit affirmed, holding that the state essentially sought from the respondent only a monetary payment and that such a required payment was a liability on a claim that was dischargeable under the Code. The Supreme Court affirmed the Appellate Court decision, holding that the clean-up injunction had been converted into a monetary obligation and, as such, was dischargeable as a claim. The Court reasoned that when the state had appointed the receiver, it had dispossessed Kovacs of his authority over the site and its assets. Therefore, the only performance sought from Kovacs was the payment of money.

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*debtor’s obligation to reclaim mine discharged to the extent it required debtor to spend money, but debtor must comply with portion of order not requiring expenditure of funds); In re Microfab, 106 B.R. 161, 167 (Bankr. D. Mass. 1989) (where chapter 7 trustee may only fulfill remediation order on inoperative site contaminated prepetition by paying contractor, order would be dischargeable as money judgment); United States v. Robinson (In re Robinson), 46 B.R. 130, 139 (Bankr. M.D. Fla.) (injunction ordering debtor that illegally filled in wetland area to restore the wetland to its prior condition held to be dischargeable because the restoration would require expenditure of money), rev’d on other grounds, 55 B.R. 355 (M.D. Fla. 1985)*.

137 *Id.* at 276.
138 *Id.*
139 *Id.* at 277.
140 In re Kovacs, 29 B.R. 816 (S.D. Ohio 1982).
141 In re Kovacs, 717 F.2d 984 (6th Cir. 1983).
142 Ohio v. Kovacs, 469 U.S. at 283.
143 *Id.*
In a footnote, the Court in *Kovacs* distinguished *Penn Terra*\(^{144}\) as an action to enforce regulatory statutes rather than enforcement of a money judgment against the debtor.\(^{145}\) Courts that rely on *Kovacs* to discharge injunctions conclude that, although under *Penn Terra* the injunction action would not be stayed during the proceeding, under *Kovacs* the clean-up obligation would be dischargeable at the end of the proceeding.\(^{146}\)

Other courts, however, have distinguished *Kovacs* on its facts. These courts draw a distinction between affirmative orders to clean up, such as the order stayed in *Kovacs*, and negative orders to cease polluting.\(^{147}\) The courts reason that the appointment of a receiver in *Kovacs* left the debtor no alternative method of compliance other than payment, thus the clean-up order was rightly dischargeable.\(^{148}\) The courts distinguish the situation in *Kovacs*, however, from one where no alternative right to payment exists, such as an order to stop or ameliorate ongoing pollution.\(^{149}\) In holding these negative orders non-dischargeable, the courts rely on the *Kovacs* Court's statement that the owner "may not maintain a nuisance, pollute the waters of the State, or refuse to remove the source of such conditions."\(^{150}\)

\(^{144}\) *Penn Terra Ltd. v. Dep't. of Env'tl. Resources*, 733 F.2d 267 (3d Cir. 1984).

\(^{145}\) Id. at 288 n.11. Previously, the court in *Penn Terra* had distinguished the Sixth Circuit opinion affirmed by the Supreme Court in *Kovacs* on similar grounds, stating that the cases dealt with "different sections of the Code." *Penn Terra Ltd.*, 733 F.2d at 277 n.11.


\(^{147}\) See, e.g., *In re CMC Heartland Partners*, 966 F.2d 1143, 1147 (7th Cir. 1992) (CERCLA liability based on chapter 11 debtor's current ownership of hazardous waste site created claim running with land, not dependent on debtor's actions before or during reorganization, and liability survived reorganization); *In re Chateaugay Corp.*, 944 F.2d 997, 1009 (2d Cir. 1991) (order obtained by EPA against debtor, that to any extent ends or ameliorates continued pollution, was not dischargeable claim); United States v. Whizco, 841 F.2d 147, 150–51 (6th Cir. 1988) (debtor must comply with portion of order not requiring expenditure of funds); Torwico Elec., Inc. v. N.J. Dept. of Env'tl. Protection & Energy, 1992 U.S. Dist. LEXIS 20465 at 7 (D.N.J. 1992) (debtor's clean-up obligation was not dischargeable unsecured claim because intended to remedy both past and ongoing pollution, *rev'd in part and vacating in part*, *In re Torwico Elec.*, 131 B.R. 561 (Bankr. D.N.J. 1991); United States v. Hubler, 117 B.R. 160, 164 (W.D. Pa. 1990) (obligations under cessation order, requiring operator of surface mine to obtain permit or to regrade and re-seed area were not discharged because order demanded performance not payment, and thus obligations were not claims), *aff'd without opinion*, 928 F.2d 1131 (3d Cir. 1991).

\(^{148}\) See, e.g., *In re Chateaugay Corp.*, 944 F.2d at 1008–09 (court agreed that where injunction does no more than impose obligation entirely as alternative to right to payment then that order is dischargeable as claim).

\(^{149}\) Id.

\(^{150}\) *Ohio v. Kovacs*, 469 U.S. at 285.
c. Summary

In short, the Code severely limits Agency opportunities to satisfy environmental claims against bankrupt corporate debtors, including fines, cost reimbursement claims, and remediation orders. The Code stays Agency collection efforts when the debtor files a bankruptcy petition. Then, it classifies Agency claims as general unsecured priority claims, and Agencies receive insufficient compensation. Finally, the Code authorizes the discharge of the unsatisfied Agency claims upon completion of the proceeding.

III. THE AGENCIES GET TOUGH

In response to the inconsistent and rather unsympathetic treatment of environmental claims in bankruptcy, Agencies grew more creative and sophisticated in their approach to the Code. The Agencies devised ingenious strategies to shoehorn environmental claims into higher priority classes in order to ensure compensation from debtors’ assets. Agencies found particular success with state superlien statutes and some additional success with administrative expense priority.151

A. Superlien Statutes

In an effort to counter Agency claims that the Court’s holding in Kovacs was hostile to enforcement of environmental law, Justice O’Connor noted, in her concurrence, that “... a state may protect its interests in the enforcement of its environmental laws by giving clean-up judgments the status of statutory liens. . . .”152

Over twenty states’ statutes currently contain such environmental

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152 469 U.S. at 286. Similar reasoning has been used in other cases to justify holdings adverse to environmental laws. See Midlantic Nat. Bank v. N.J. Dept. of Envtl. Protection, 474 U.S. 494, 517 (Renquist, J., dissenting) (states retain considerable latitude to ensure priority status of their clean-up claims), reh’g denied, 475 U.S. 1090 (1986); Burlington N.R.R. Co. v. Dant & Russell, Inc. (In re Dant & Russell), 853 F.2d 700, 709 (9th Cir. 1988) (quoting Kovacs, court held that it was not free to formulate its own rules of super- or sub-priorities within specifically enumerated class); In re Microfab, 105 B.R. at 168 n.21 (quoting Kovacs, court noted that denying administrative priority “does not necessarily set environmental authorities at a disadvantage”).
lien provisions, as does CERCLA. Under these statutes, a lien generally arises to secure the costs that the Agency incurred cleaning up the debtor's contaminated land. Once the Agency files the lien, it usually attaches to the contaminated site being remediated, placing the state claim in the secured claimant group and thereby giving the Agency's claim priority over all unsecured claims. Furthermore, as a secured claim, the Agency lien may survive the debtor's bankruptcy unaffected by the discharge.

Statutory liens, however, are not a perfect solution for Agency collection woes resulting from bankrupt PRPs. Most lien statutes give the Agency's claim priority only over subsequent secured creditors but not over creditors with prior perfected security interests in the debtor's property. The Agency lien, as a subordinate secured claim, will receive compensation only after the prior secured claims are fully satisfied by the proceeds of the secured property. A bankrupt debtor, in the course of its business, is likely to have granted many security liens in its property prior to the filing of the Agency lien. Therefore, the Agency claim will often receive insufficient compensation from the lien on the property. Upon liquidation of the property, the unsatisfied

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154 42 U.S.C. § 9607(d) (1988). Note that the status of the current CERCLA lien provision is unclear following the First Circuit Court of Appeals decision in Reardon v. United States, 947 F.2d 1509, 1523–24 (1st Cir. 1991), where the court held that the CERCLA lien provision violates the Due Process Clause of the Fifth Amendment, requiring the EPA to provide notice and a hearing before imposing the lien. See Note, Environmental Law—Due Process—First Circuit Finds That CERCLA Lien Provision Violates Due Process, 105 HARV. L. REV. 1420 (1992).

155 Id.


158 If another financier already had a prior perfected security interest in the particular property, the state would only collect from secured property the value remaining after the prior financier had completely satisfied its debt. See U.C.C. §§ 9–201 & 9–301(1)(b).
remainder of the Agency’s secured claim is relegated to general unsecured status, which often results in little or no payment.

In response to the lack of certain higher priority status under traditional statutory liens, some states currently authorize “super priority” environmental liens, referred to as superliens. These liens have super priority, meaning that upon filing by the Agency, the superlien becomes a first priority charge upon the debtor’s property, superior even to prior perfected, consensual and nonconsensual liens and security interests. Superliens represent an attempt by states to place the Agencies’ claims ahead of other secured claims in the Code’s orderly presentation and prioritization of those claims.

Superliens, however, are not the ultimate solution for Agency collection troubles arising out of bankruptcy either because, to be effective in bankruptcy, all statutory liens must adhere to certain restrictive requirements. First, the liens must be levied prepetition or risk avoidance by the trustee. Under § 545(2), the trustee may avoid any statutory lien that is not perfected under the state law requirements before the bankruptcy petition is filed. If the lien is avoided under § 545, it is relegated by the Code to general unsecured status, possibly precluding recovery. Second, not all costs are recoverable under the

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162 Douglas C. Ballantine, Note, Recovering Costs for Cleaning Up Hazardous Waste Sites: An Examination of State Superlien Statutes, 63 IND. L.J. 571, 581 (1988); Epling, supra note 160, at 87. See generally Lockett, supra note 18; Smith, supra note 35.

A constitutional challenge to the broad reach of a superlien statute was rejected by the New Jersey Appellate Court in Kessler v. Tarrats, 476 A.2d 326, 331 (Super. Ct. App. Div. 1984), where the court held that New Jersey’s superlien statute was not in violation of the contracts or due process clauses of the Constitution, as long as the lien served a legitimate public purpose and was reasonable. See Epling, supra note 160, at 88–89.

163 See Ballantine, supra note 162, at 581.

164 11 U.S.C. § 545(2) (1988). Note, however, that there is no risk of violating the automatic stay. Section 362(b)(3) provides an exception to the stay for actions taken under § 546(b), which allows recording of liens taken pursuant to applicable law. See In re Microfab, 105 B.R. 152, 153 (Bankr. D. Mass. 1989) (court held automatic stay did not apply to recording of environmental liens provided by state law).

165 See Ballantine, supra note 162, at 581. Under § 546(b), however, a state could allow for retroactive filing, which might defeat the trustee’s avoidance power. Epling, supra note 160, at 92.

super priority lien. Most lien statutes cover only remediation costs, which excludes interest and penalties arising from the debtor's recalcitrance.\footnote{See Cheryl K. Clark, Due Process and the Environmental Lien: The Need for Legislative Reform, 20 B.C. ENVT. AFF. L. REV. 203, 205 (1993); Ballantine, supra note 162, at 581.}

Finally, the type of property to which the lien attaches may determine whether an Agency actually will recover its remediation expenses.\footnote{See Developments in the Law—Toxic Waste Litigation, 99 HARV. L. REV. 1458, 1599 (1986).} Most lien statutes attach only to the contaminated property.\footnote{See, e.g., CONN. GEN. STAT. ANN. § 22a-452a (West Supp. 1992); ME. REV. STAT. ANN. tit. 38, § 1371 (West 1989 & Supp. 1992).} This may present a problem for an Agency because clean-up costs often exceed the value of the contaminated property.\footnote{See Clark, supra note 167, at 205.} An Agency's remaining unsecured costs will languish on the bottom of the chain of priority, often resulting in no payment.

Recognizing that the clean-up cost might exceed the waste site's value, some states have extended the reach of their superlien statutes beyond the contaminated site to all the PRPs real and personal property and revenues.\footnote{See LA. REV. STAT. ANN. § 30:2281 (West Supp. 1993); MASS. GEN. L. ch. 21E, § 13 (Supp. 1992); N.H. REV. STAT. ANN. §§ 147-B:2, :10-b (1990); N.J. STAT. ANN. § 58:10–23.11(1) (West 1991). See Clark, supra note 167, at 205.} The liens have super priority, however, only as they apply to the realty, personalty, and business revenues of the contaminated site itself and not to the debtors' other assets that are unrelated to the site.\footnote{See Clark, supra note 167, at 205.} As to all the other attachable property or revenues, the liens have priority only over subsequent encumbrances.\footnote{See Clark, supra note 167, at 205.}

Therefore, while some superlien statutes allow Agencies to place a lien on other property of the debtor unrelated to the contaminated site, the superliens may not ultimately give Agency claims any more priority than if their claims were filed simply as general unsecured claims.

\section*{B. Administrative Expense Priority}

Some Agencies with environmental claims against bankrupt PRPs have found tremendous success filing for administrative expense pri-
ority under § 503 of the Code. Administrative expense priority provides the highest possible priority available under the Code for unsecured creditors, qualifying claims to be paid in full, ahead of all other unsecured creditors. The rationale behind elevating certain expenses to this high priority is to encourage third parties to continue to conduct business with the estate, in an effort to rehabilitate the debtor's business and preserve the estate's assets. Without a guarantee of first priority, third parties, such as goods and service suppliers, would not deal with a business in chapter 11 reorganization or chapter 7 liquidation, thereby greatly hindering administration of the estate.

Payment of administrative expense claims, however, can quickly deplete the debtor's assets reserved for prepetition unsecured credi-

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Section 506(c) of the Code represents the only exception to the traditional rule that the costs of administering the bankruptcy estate may not be charged against secured creditors. 11 U.S.C. § 506(c) (1988). Section 506 provides that the trustee may recover the reasonable and necessary costs of preserving collateral to the extent the lien holding secured creditor benefits from such actions. These claims have secured status and therefore payment is a super priority under the Code. Although the issue of standing is far from clear, a court has held that along with the trustee and the debtor in possession, the EPA has standing to seek a surcharge for clean-up costs. In re T.P. Long Chems., 45 B.R. at 288–89. Section 506(c) also requires, however, that costs incurred directly benefit the lien holder. Courts have consistently held that environmental clean-up costs do not qualify for surcharge priority because the secured lien holder is not properly benefitted in a direct and tangible way. See In re Cascade Hydraulics & Utility Serv., 815 F.2d at 548 (lacking specific findings as to how administrative expense benefitted secured creditor, there was no basis in record for allowing payment of administrative expenses from proceeds of sale of secured creditor's collateral); In re Paris Ind., 80 B.R. 2, 5 (Bankr. D. Me. 1987) (no basis existed to grant state of New York super priority lien for cost of cleaning up hazardous waste on debtor's real property, and thus, New York's claim did not displace bank's first security interest in proceeds of sale of debtor's personal property); In re T.P. Long Chems., 45 B.R. at 287 (denied EPA's claim to proceeds of sale of property securing claim because no benefit to secured creditor). But see In re Better-Brite Plastics, 105 B.R. 912, 916 (Bankr. E.D. Wis. 1989), vacated on other grounds, 136 B.R. 526 (E.D. Wis. 1990) (granting EPA and state administrative priority for clean-up claims over secured creditors). For a discussion of this issue, see Salerno, supra note 27, at 305.

178 See In re N.P. Mining, 963 F.2d 1449, 1452–54 (11th Cir. 1992); Burlington N.R.R. Co. v. Dant & Russell, Inc. (In re Dant & Russell), 853 F.2d 700, 707 (9th Cir. 1988); Trustees of Amalgamated Ins. Fund v. McFarlin's, 789 F.2d 98, 101 (2d Cir. 1986); In re Jartran Inc., 732 F.2d 584, 586 (7th Cir. 1984); In re Mammoth Mart, 536 F.2d 950, 953 (1st Cir. 1976). See also Lawlor, supra note 151, at 837.
tors. Accordingly, under § 503(b), claimants must show that their claims are "actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case. . . ."\(^{178}\)

Some courts have granted environmental clean-up costs administrative expense priority under § 503, but limit the opportunity generally to costs and concomitant fines incurred postpetition to clean up postpetition contamination.\(^{179}\) Courts have broad discretion to determine what qualifies as administrative expense priority,\(^{180}\) and the decisions in this area are inconsistent.\(^{181}\)

Generally, most courts require environmental claims to have a distinct postpetition character, allowing administrative priority only for the environmental costs both incurred postpetition and arising from postpetition contamination or violation.\(^{182}\) Other courts, however, are


\(^{180}\) See In re Dant & Russell, 853 F.2d at 707; In re N.P. Mining, 963 F.2d at 1452; In re Verco Indus., 20 B.R. 664 (Bankr. 9th Cir. 1982).

\(^{181}\) See LAWRENCE P. KING, 3 COLLIER ON BANKRUPTCY 503.03, at 503-17 - 503-18 (15th Ed. 1991) ("A court might well conclude that there are to be allowed as administrative expenses claims not necessarily precisely covered by the provisions of section 503(b)... Further, what constitute actual and necessary costs and expenses of preserving an estate might well be open to judicial construction."); Lawlor, supra note 151, at 837.

\(^{182}\) See In re N.P. Mining, 963 F.2d at 1461 (punitive and civil penalties assessed postpetition against chapter 11 debtor as punishment for environmental violations qualified as administrative expense priority only to the extent they were assessed as a consequence of postpetition operations); In re Dant & Russell, 853 F.2d at 709 (lessor not entitled to administrative priority for clean-up cost where conduct giving rise to clean-up costs occurred prepetition); Southern Ry. v. Johnson Bronze Co., 758 F.2d 137, 142 (3d Cir. 1985) (bankruptcy court has no authority to elevate prepetition unsecured claim to administrative priority claim); In re Bill's Coal Co., 124 B.R. at 830 (only penalties assessed for postpetition misconduct or for misconduct that continued into postpetition, as opposed to continuing effects of prepetition misconduct, should be treated as administrative expense); In re Kent Holland Die Casting & Plating, 125 B.R. at 504 (allowed administrative priority only for damage caused by postpetition operation); In re Pierce Coal and Constr., 65 B.R. at 531 (damages caused by chapter 7 trustee operating bankruptcy estate postpetition were entitled to administrative priority).
less strict on this issue, holding that environmental claims have a sufficient postpetition character if the clean-up costs simply were incurred postpetition.\textsuperscript{183}

In order to be considered actual costs, courts usually require the Agency to bring a reimbursement action only after incurring the clean-up costs.\textsuperscript{184} The courts reason that allowing administrative priority without actual costs would be premature and speculative.\textsuperscript{185} This reasoning is consistent with CERCLA requirements that clean-up costs must be incurred before PRPs can bring reimbursement claims.\textsuperscript{186} Other courts, however, have accorded administrative priority to contingent future costs.\textsuperscript{187}

Most importantly, environmental cost reimbursement claims must also be "necessary" to "preserve" the estate in order to qualify for administrative expense priority under § 503.\textsuperscript{188} The Code is silent on whether environmental clean-up costs should qualify as necessary to preserve the estate, and the courts are divided.\textsuperscript{189}

\textsuperscript{183} See \textit{In re} Chateaugay Corp., 944 F.2d at 1009–10 (all clean-up costs assessed postpetition with respect to sites currently owned by debtor where there had been prepetition release or threatened release of hazardous wastes were entitled to administrative priority); \textit{In re} Nat'l Gypsum, 139 B.R. at 413 (response costs incurred postpetition as a result of debtor's prepetition activity were entitled to administrative priority); \textit{In re} Hemingway Transp., 126 B.R. at 659 (private action under CERCLA for reimbursement of postpetition costs arising from prepetition conduct awarded administrative priority, noting that cause of action under CERCLA did not arise until postpetition); \textit{In re} Stevens, 68 B.R. at 783 (postpetition cleanup of prepetition environmental hazard by state agency constituted first priority expenditure); \textit{In re} Distrigas Corp., 66 B.R. 382, 386 (Bankr. D. Mass. 1986) (allowed administrative priority for reimbursement of postpetition efforts to remedy toxic waste problems stemming from prepetition activity). See also \textit{supra} note 5, at 48.

\textsuperscript{184} See, \textit{e.g.}, \textit{In re} Shore Co., 134 B.R. 572, 580 (Bankr. E.D. Tex. 1991) (until expense is incurred in furtherance of a cleanup, award of administrative priority was premature); \textit{In re} Kent Holland Die Casting & Plating, 125 B.R. at 497 (administrative priority for contribution claim by lessor for incurred clean-up costs disallowed where EPA action against lessor was still pending); \textit{In re} Microfab, 105 B.R. 161, 169–70 (Bankr. D. Mass. 1989) (commonwealth request for administrative status was premature where no funds had been expended and no reliable estimate was available).

\textsuperscript{185} See \textit{In re} Shore Co., 134 B.R. at 580; \textit{In re} Kent Holland Die Casting & Plating, 125 B.R. at 497; \textit{In re} Microfab, 105 B.R. at 169–70.


\textsuperscript{187} See \textit{In re} Hemingway Transp., 126 B.R. at 659 (D. Mass. 1991) (past and future response costs incurred by entity that purchased real property from debtor in cleaning up hazardous waste on the property were entitled to administrative priority); \textit{In re} FCX, 96 B.R. at 55 (administrative priority granted to state's requested future clean-up costs where alleviating imminent and immediate threat to public safety; all other clean-up expenses were treated as general unsecured claims); \textit{In re} Distrigas Corp., 66 B.R. 382, 387 (Bankr. D. Mass. 1986) (noting in dicta that although state claim was contingent until funds expended, post bankruptcy cleanup was entitled to administrative priority).


\textsuperscript{189} \textit{Compare In re} Wall Metal Prods. & Metal Prods., 831 F.2d 118, 122 (6th Cir. 1987) (awarded administrative priority for clean-up claims) \textit{with} Borden, Inc. v. Wells-Fargo Bus. Credit (\textit{In re}
1. Necessary Costs

In holding that clean-up costs and concomitant fines are necessary costs for preserving the estate, many courts rely on Midlantic National Bank v. New Jersey Department of Environmental Protection. In Midlantic, the Supreme Court affirmed the decision of the United States Court of Appeals for the Third Circuit, holding that a bankruptcy trustee could not abandon a debtor's contaminated property in contravention of a state statute reasonably designed to protect the public health or safety from an imminent and identified hazard. The Court's ruling directly conflicted with the trustee's explicit statutory power under § 554 of the Code to abandon any burdensome property of the estate.

The effect of abandonment of property under § 554 is that ownership and control are reinstated in the debtor with all rights and obligations the debtor had prepetition. The Midlantic Court reasoned that by abandoning the contaminated property, the trustee was imprudently releasing the property back to the insolvent debtor, who would be unable to facilitate cleanup. Thus, the Court concluded allowing abandonment would ultimately burden the state agency with the responsibility for cleaning up the site.

Accordingly, the Midlantic Court held that the trustee could not abandon property to preserve the estate.

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190 Smith-Douglas, Inc.), 856 F.2d 12, 16-17 (4th Cir. 1988) (denied administrative priority for clean-up claims).
192 New York v. Quanta Resources (In re Quanta Resources), 739 F.2d 912 (3d Cir. 1984).
193 474 U.S. at 507.
195 It is not clear under § 554 what the beneficial effect would be of abandoning contaminated property in a chapter 11 case. Apparently, the abandoned property that reverts to the debtor during the pendency period would become part of the reorganized debtor's postconfirmation property, along with the environmental liability. Moreover, due to successor liability, any attempt to sell the property would not reduce the debtor's postconfirmation liability. See Ohio v. Kovacs, 469 U.S. at 285; In re CMC Heartland Partners, 966 F.2d 1143, 1147–48 (7th Cir. 1992) (notwithstanding discharge of preconfirmation environmental clean-up claim as to the debtor, the reorganized debtor could be held liable for all clean-up costs as current owner or operator of toxic waste site pursuant to CERCLA).
196 Midlantic, 474 U.S. at 507.
abandon property without first complying with environmental laws "reasonably designed to protect the public health and safety from identified hazards." In creating this "narrow" public policy exception to the trustee's abandonment power, the Court opined that "the Bankruptcy Court does not have the power to authorize an abandonment without formulating conditions that will adequately protect the public's health and safety." Significantly, the Court qualified its holding in a footnote, stating that the exception to abandonment was to be construed narrowly and only applied in cases in which there had been a showing of an "imminent and identifiable harm."

The Midlantic Court supported its decision with 28 U.S.C. § 959(b), although recognizing that the provision does not directly apply to abandonment. Section 959(b) requires that the trustee or debtor in possession manage and operate the property in accordance with state law. The purpose behind the § 959(b) requirement to comply with state law is to prevent a debtor from using federal bankruptcy protection to maintain its economic viability through violations of state laws, including environmental laws. The Court reasoned that § 959(b) was not directly applicable in this case, however, because the provision applies only where the trustee is actually oper-
ating the business of the debtor, and not where the trustee is liquidating the business (as was the case in *Midlantic*). Nonetheless, the Court used the provision to support its conclusion.

Although *Midlantic* expressly reserved the question of what priority the clean-up costs deserved, some courts have held that the Supreme Court’s decision supports the theory that payment of actual postpetition environmental response costs and fines is sufficiently necessary to be entitled to administrative expense priority. These courts reason that if, under *Midlantic*, the trustee cannot abandon contaminated property in contravention of a state’s environmental laws, then, under § 959(b), the trustee cannot maintain or possess contaminated property in continuous violation of that same state environmental law. Therefore, costs incurred by the state to satisfy remediation requirements are necessary expenses to fulfill legal obligations of the estate.

Other courts reject the idea that any violation of environmental law is a necessary expense of the estate under § 503. These courts grant administrative priority for environmental claims only where the contamination represents what the court determines to be an “imminent and identifiable hazard to public health and welfare.” These courts

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203 *Midlantic*, 474 U.S. at 505.

204 *Id.*

205 *Id.* at 498 n.2.


207 See *In re N.P. Mining*, 963 F.2d at 1458–59; *In re Chateaugay Corp.*, 944 F.2d at 1010; *In re Wall Tube & Metal Prods.*, 831 F.2d at 122.


209 See, e.g., Borden, Inc. v. Wells-Fargo Bus. Credit (*In re Smith-Douglass, Inc.*), 856 F.2d 12, 16–17 (4th Cir. 1988) (disallowed administrative priority where no serious health risk, and where the hazards were speculative or could await appropriate action by environmental agency, noting fact that Agency had taken no enforcement action); *In re Nat’l Gypsum*, 139 B.R. at 413 (allowed administrative priority only for costs necessitated by conditions that posed imminent and identifiable harm to environment and public health); *In re Shore*, 134 B.R. 572, 580 (Bankr. D. Tex. 1991) (denied administrative priority where no showing of imminent and identifiable harm);
rely on decisions that interpret the *Midlantic* exception to abandonment very narrowly, holding that a trustee's right to abandon environmentally impacted property is limited only by the precondition that the trustee remediate an “imminent and identifiable” danger present on the property proposed to be abandoned.\(^{210}\) Applying this narrow interpretation of *Midlantic* to administrative expense motions, courts reason that if a simple violation of state law is not enough to justify limiting the trustee's abandonment power, then it should not be enough to justify awarding administrative priority for reimbursement claims.\(^{211}\)

\(^{210}\) See, e.g., *In re Smith-Douglass*, 856 F.2d at 16 (trustee only required to “take adequate precautionary measures to ensure that the public is not threatened” before abandonment); *Leavell v. Karnes*, 143 B.R. 212 (S.D. Ill. 1990) (lack of imminent danger, rather than trustee's compliance with environmental laws, is requisite to abandonment); *In re Shore Co.*, 134 B.R. 572, 578–79 (Bankr. E.D. Tex. 1991) (allowed abandonment in contravention of environmental laws where no showing of imminent and identifiable harm, citing lack of urgency by state agency and EPA); *In re Anthony Ferrante & Sons*, 119 B.R. 45, 49–50 (D.N.J. 1990) (trustee allowed to abandon contaminated public water system in contravention of state environmental regulations absent showing of “imminent and identifiable harm” to public from such abandonment, citing lack of enforcement by Agency); *White v. Coon* (*In re Purco*), 76 B.R. 523, 533–34 (Bankr. W.D. Pa. 1987) (allowed abandonment in contravention of state law where there was no showing that public health or safety were not protected adequately, citing lack of interest of Agency); *In re FCX*, 96 B.R. at 55 (polluted property may be abandoned from debtor's estate in contravention of state and federal environmental laws as long as debtor's violations posed no immediate threat to public health and safety and no imminent danger of death or illness); *In re Franklin Signal Corp.*, 65 B.R. 268, 269 (Bankr. D. Minn. 1986) (trustee permitted to abandon drums of hazardous waste in violation of state environmental law where trustee took at least minimal steps to protect public, citing lack of state enforcement); *In re Oklahoma Ref.*, 63 B.R. 562, 565–66 (Bankr. W.D. Okl. 1986) (trustee allowed to abandon real estate surrounding oil refinery in contravention of Oklahoma environmental law where pollution at site did not present immediate and menacing harm to public health and safety).

\(^{211}\) See *In re Smith-Douglass*, 856 F.2d at 16; *In re Nat'l Gypsum*, 139 B.R. at 413; *In re Shore*, 134 B.R. at 580; *In re FCX*, 96 B.R. at 55; *In re Microfab*, 105 B.R. at 163; *In re Stevens*, 68 B.R. at 781.

In addition, where the cost of remediation vastly exceeds the available assets of the estate, courts have further refused administrative priority where the environmental law is so onerous as to interfere with the bankruptcy adjudication itself. The courts reason that the trustee or debtor in possession cannot be ordered to satisfy a clean-up obligation that he does not have financial resources to satisfy. See *In re Smith-Douglass*, 856 F.2d at 17 (held that only where
2. Preservation of the Estate

Even if the cost is considered to be necessary, environmental clean-up costs must also "preserve" the estate to qualify for administrative expense priority under § 503.\(^{212}\) In upholding administrative expense priority for Agency clean-up reimbursement claims and fines, courts have employed the theory that the estate is "preserved" by expenditures that keep the estate in compliance with the law.\(^{213}\) In other words, by discharging the trustee's responsibility to remediate the environmental impact of the hazards, the Agency has shouldered a burden of the trustee and is thus entitled to administrative expense priority.\(^{214}\)


\(^{213}\) See, e.g., *In re Chateaugay Corp.*, 944 F.2d at 1009-10 (administrative priority granted where response costs incurred by EPA enabled estate to maintain itself in compliance with applicable laws); *In re Wall Tube & Metal Prods.*, 831 F.2d at 123 (hazardous waste site response costs incurred by state were granted administrative expense priority where costs were necessary to preserve estate in required compliance with state law); *In re Nu'l Gypsum*, 139 B.R. at 413 (held that estate was preserved by protecting environment and public health); *In re Better-Brite Plating*, 105 B.R. 912, 917 (Bankr. E.D. Wis. 1989) (held that because trustee is required to comply with state laws concerning hazardous waste sites, it follows that costs of cleanup must be treated as administrative expenses), vacated on other grounds, 136 B.R. 526 (E.D. Wis. 1990); *In re Vernon Sand & Gravel*, 93 B.R. 580, 582 (Bankr. N.D. Ohio 1988) (expenses sought by state agency were granted administrative priority where such costs were necessary both to preserve estate in compliance with Ohio laws, and to protect safety of public); *In re Peerless Plating*, 70 B.R. at 948-49 (administrative priority granted where EPA discharged CERCLA obligation of estate that could not be avoided by abandonment per Midlantic); *In re Stevens*, 68 B.R. at 782-83 (administrative priority granted where estate liable for costs state incurred removing waste oil in accordance with Maine law); *In re Mowbray Engineering*, 67 B.R. 34, 35 (Bankr. M.D. Ala. 1986) (administrative priority granted for costs incurred by EPA to decontaminate property abandoned by trustee, stating that EPA stood in shoes of trustee in preserving estate); *In re Pierce Coal and Constr.*, 65 B.R. 521, 531 (Bankr. N.D. W. Va. 1986) (cost of reclaiming area disturbed by debtor in possession was entitled to administrative priority); *In re T.P. Long Chems.*, 45 B.R. 278, 286-87 (Bankr. N.D. Ohio 1985) (costs EPA incurred in discharging CERCLA liability that estate could not avoid were actual, necessary cost of preserving estate entitled to administrative priority); *In re Laurinburg Oil*, 49 B.R. 652, 654 (Bankr. M.D.N.C. 1984) (expenses debtor incurred in abating public nuisance awarded administrative priority); *In re Vermont Real Estate Inv. Trust*, 25 B.R. 804, 806 (Bankr. D. Vt. 1982) (administrative priority granted to expenses incurred to remove dangerous building from debtor's leasehold premises in accordance with city order and to protect public). See also *Claar*, *supra* note 5, at 46-47.

\(^{214}\) See *In re Wall Tube & Metal Prods.*, 831 F.2d at 123.
Some courts, focussing less on preservation of the estate, have further relied on the Supreme Court's decision in *Reading v. Brown*. In *Reading*, a fire, caused by the negligence of the receiver acting within the scope of his employment, destroyed property in the adjoining premises. The Court held that damages resulting from the negligence of a receiver, acting within the scope of his or her authority as a receiver, give rise to actual and necessary costs of operation for the debtor's business and are thereby entitled to priority status. In following *Reading*, courts reason that "actual and necessary costs" should include costs ordinarily incident to operations of a business, such as fines, and should not be limited to costs without which rehabilitation would be impossible.

Other courts have rejected this analysis of preservation under § 503. These courts instead interpret administrative priority to be limited exclusively to costs that preserve the estate for the benefit of creditors. Accordingly, these courts would grant administrative priority only to expenses that directly and substantially benefit the estate, reasoning that this limitation is necessary to protect the

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215 See, e.g., *In re N.P. Mining*, 963 F.2d 1449, 1453–56 (11th Cir. 1992) (punitive civil fines for debtor's violation of injunction qualified for administrative priority); *In re Wall Tube & Metal Prods.*, 831 F.2d at 123; *In re Charlesbank Laundry*, 755 F.2d 200, 202 (1st Cir. 1985) (although lack of benefit to estate, civil compensatory fine for debtor's violation of injunction qualified for administrative priority); *In re Bill's Coal Co.*, 124 B.R. 827, 830 (D. Kan. 1991) (fine for violation of strip mining regulation was cost ordinarily incident to operation of business, and thus, was administrative expense); *In re Kent Holland Die Casting & Plating*, 125 B.R. at 504 (environmental damages arising from lessee's negligence were entitled to administrative priority); *In re Hemingway Transp.*, 126 B.R. 656, 659 (D. Mass. 1991), aff'd, 964 F.2d 1 (1st Cir. 1992); *In re Pierce Coal and Constr.*, 65 B.R. 521, 525 (Bankr. N.D. W. Va. 1986). But see Burlington N.R.R. Co. v. Dant & Russell, Inc. (*In re Dant & Russell*), 853 F.2d 700, 706 (9th Cir. 1988) (interpreting § 503(b)(1)(A) narrowly to apply only to those costs that benefit debtor's creditors by either helping to rehabilitate the business or preserve estate assets); *In re Jartran Inc.*, 732 F.2d 584, 587 (7th Cir. 1984) (same). See also Claar, supra note 5, at 48–49.

217 *Id.* at 473.
218 *Id.* at 483. The damages were entitled to administrative priority under the Bankruptcy Act of 1898.

219 See *In re N.P. Mining*, 963 F.2d at 1453–56 (punitive civil fines for debtor's violation of an injunction qualified for administrative priority); *In re Wall Tube & Metal Prods.*, 831 F.2d at 123; *In re Charlesbank Laundry*, 755 F.2d at 202 (civil compensatory fine for debtor's violation of an injunction qualified for administrative priority); *In re Bill's Coal Co.*, 124 B.R. at 830 (fine for violation of strip mining regulation was cost ordinarily incident to operation of business, and thus, was administrative expense); *In re Hemingway Transp.*, 126 B.R. at 659; *In re Pierce Coal and Constr.*, 65 B.R. 521, 525 (Bankr. N.D. W. Va. 1986).

220 See, e.g., *In re Dant & Russell*, 853 F.2d at 706; *In re White Motor Corp.*, 831 F.2d 106, 110 (6th Cir. 1987); *In re Jartran Inc.*, 732 F.2d 584, 587 (7th Cir. 1984); *In re Mammoth Mart*, 536 F.2d 950, 954 (1st Cir. 1976); *In re Great N. Forest Prods.*, 135 B.R. 46, 59 (Bankr. W.D. Mich. 1991).
ted assets of the estate for the benefit of the unsecured creditors’ interests.\textsuperscript{221}

Therefore, Agencies may have success securing compensation from bankrupt PRPs using superlien statutes and administrative priority. The opportunity to use these strategies is narrow, however, and success is limited. These enforcement strategies are frustrated even further by debtors leasing sites they contaminate.

IV. THE LOOPHOLE IN BANKRUPTCY: A NEW LEASE ON LIFE

The superlien and administrative expense priority strategies are easily frustrated if the debtor leases the contaminated site, rather than acting as an owner-operator. A leased site impedes Agency use of a superlien because placing a lien on a lease is virtually worthless. A lease also obstructs Agency use of administrative expense priority because courts have held that a leasehold is not a sufficient ownership interest of the estate for administrative expense priority.

As a lessee, the debtor may be liable, under CERCLA and similar state statutes, as an “operator” of a leased site or as an “owner” of a “facility” situated on a leased site.\textsuperscript{222} The term facility may include buildings or personal property such as tanks and drums.\textsuperscript{223} Furthermore, some courts have held that, although only a lessee, the debtor is also liable as an “owner” of the contaminated real estate.\textsuperscript{224}

A. Superliens and the Lease

There is no bankruptcy case law on the issue of the effectiveness of liens against debtors with contaminated leased sites, but logically, lien statutes would be ineffective.\textsuperscript{225} Superlien statutes that are limited in scope to attachment of a contaminated site provide little or no opportunity to satisfy an Agency’s claim against a debtor if a site is

\begin{itemize}
  \item \textsuperscript{221} See \textit{In re} Dant \& Russell, 853 F.2d at 706; \textit{In re} White Motor Corp., 831 F.2d 106, 110 (6th Cir. 1987).
  \item \textsuperscript{223} See \textit{In re} Hemingway Transp., 126 B.R. at 659; \textit{In re} T.P. Long Chems., 45 B.R. 278, 285 (Bankr. N.D. Ohio 1985).
  \item \textsuperscript{225} See Southern Ry. v. Johnson Bronze Co., 758 F.2d 137, 140 (3d Cir. 1985) (noted lack of North Carolina statute allowing a lien on a leasehold). See \textit{also} Ballantine, \textit{supra} note 162, at 584; Epling, \textit{supra} note 160, at 88; Fogel, \textit{supra} note 7, at 372–77.
\end{itemize}
leased. A debtor's property interest is limited to its leasehold interest. While it is possible to put a lien on a lease interest, the lien would only attach to a debtor's limited leasehold interest in the contaminated site, rather than the more valuable ownership interest. In most cases this lease interest would be virtually worthless relative to the cost of cleanup. The value of this leasehold right would depend on the desirability of the site to other potential lessees. The desirability of leaseholds could be particularly low if the site were contaminated.

Broader reaching superlien statutes that attach to all the PRP's real and personal property and its revenue unrelated to the leased site would prove only slightly more useful. Superlien statutes provide super priority status only to revenue and property connected to the contaminated site itself. Therefore, a super priority lien on personal property and revenue from the contaminated site would provide significant value only if the personal property on the site had substantial value and the site generated attachable income. There is no guarantee, however, of such income being generated, particularly if the debtor discontinues operations at the contaminated site. Without such income, collection efforts would be limited to any personal property abandoned on the site, which could be worthless.

Looking for value beyond the contaminated site to a debtor's other property also provides little satisfaction. Statutory liens lack super priority for a lien on a debtor's other property unrelated to the contaminated site. Agency lien claims would be subordinated to prior encumbrances, which are bound to exist with a bankrupt party. Consequently, an Agency lien on unrelated property, subordinated to prior creditors, likely will not be satisfied. Therefore, despite the superlien, an Agency reimbursement claim for cleanup of a leased site is likely to become a general unsecured claim and risk discharge.

With contaminated leased sites, super priority liens serve only to raise the liability of land owners who lease to debtors. While the owner of a contaminated site is jointly and severally liable for any contamination under state and federal environmental law, Agency action against land owners presents some policy concerns and practical problems. From a policy perspective, land owners in many cases play no role in the environmental damage. In such situations, moving

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226 Interview with Margaret Malek, Assistant Attorney General, Envtl. Protection Division, Massachusetts Office of the Attorney General, in Boston, Mass. (July 15, 1992). For a discussion of statutory lien provisions, see infra Section III. A.
227 For a discussion of statutory lien provisions, see infra Section III. A.
228 Malek, supra note 226.
against a land owner provides none of the intended deterrent effect against a responsible debtor. Furthermore, from a practical perspective, land owners often lack sufficient funds or income to clean up the contaminated site, and the site value is too low to cover remediation costs.

In order to obtain sufficient funds for cleanup, a landowner may sue other jointly and severally liable PRPs, including the debtor, for equitable contribution.\textsuperscript{229} The Code, however, does not guarantee payment from a debtor's estate. The drafters of the Code envisioned a lessor's damage claims against a bankrupt lessee to be primarily rent delinquencies, as evidenced by § 502(b)(6) restricting a lessor's damage recovery to a certain percentage of the unpaid rent.\textsuperscript{230} Moreover, land owners may only seek reimbursement for costs incurred. The court may disallow any portion of a land owner's contribution claim for costs that are unincurred as a contingent claim under § 502(e) of the Code.\textsuperscript{231} Finally, any attempt by a land owner to protect against potential environmental contamination by a lessee in the lease contract—requiring the lessee/debtor to remediate a contaminated leasehold, for example—would be ineffective because § 365(e) of the Code invalidates bankruptcy clauses and limitations that might impose on the trustee's power to assume or reject a lease.\textsuperscript{232}

B. Administrative Expense Priority and the Lease

A leased site also greatly complicates the issue of administrative expense priority for postpetition clean-up costs.\textsuperscript{233} While there are few cases on the issue of leased sites in bankruptcy, courts ruling against administrative expense priority for environmental claims look closely at whether the clean-up costs in question truly preserved the estate.\textsuperscript{234} Some courts deny priority for cost reimbursement claims for cleanup

\textsuperscript{229} See infra notes 20–21 and accompanying text.
\textsuperscript{232} 11 U.S.C. § 365(e) (1988). See Fogel, supra note 7, at 348. Only if the debtor assumes the lease may the lessor put conditions on the lease relationship. One of the only possible remedies for the landlord would be to require a substantial security deposit. Under § 506(a), the lessor has the right to secured status for setoffs. These funds may be put toward clean-up costs. This approach could be considered impractical, however, given the tremendous cost associated with these cleanups. Few lessors would willingly provide the sufficient security deposit. See Fogel, supra note 7.
\textsuperscript{234} Claar, supra note 5, at 48.
of leased sites under the rationale that the site is not sufficiently part of the estate. The decisions in this area are inconsistent, however, depending greatly on whether the lease has been rejected or has expired, and on whether the contamination was caused by personal property present on the site.

1. Rejection of Leases: The Business Judgment Test

The postpetition treatment of a debtor's unexpired leases is addressed, along with executory contracts, by § 365 of the Code. When the debtor files a bankruptcy petition, an unexpired leasehold, as a legal and equitable interest of the debtor, is considered property of the estate under § 541(a)(1). Under § 365(a) of the Code, however, the trustee, subject to the court's approval, may assume or reject any burdensome unexpired lease of the debtor during the bankruptcy proceeding. The trustee's power to reject a lease or executory contract under § 365 is an extension of the power to abandon burdensome property under § 554.

The Code does not provide a standard for rejection of a lease. The only restriction under § 365(a) refers to the trustee's ability to assume a lease, rather than reject one. Therefore, to determine if rejection of a lease is appropriate, most courts employ the business judgment test, which closely resembles the standard for abandonment of property under § 554. The primary issue under the business judgment test is whether rejection of the lease would benefit general unsecured creditors.

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235 See, e.g., Southern Ry. v. Johnson Bronze Co., 758 F.2d at 142.
237 11 U.S.C. § 541 (1988). See In re Arizona Appetito Stores, 893 F.2d 216, 218 (9th Cir. 1990); In re Computer Communication, 824 F.2d 725, 730 (9th Cir. 1987). But see In re Lovitt, 757 F.2d 1035, 1041 (Bankr. 9th Cir.) (leasehold was not property of the estate until assumed), cert. denied sub nom. Cheadle v. Appleatchee Riders Assoc., 474 U.S. 849 (1986). There is an exception for a nonresidential lease that has expired pre or postpetition. See 11 U.S.C. § 541(c)(2) (1988).
238 11 U.S.C. § 365(a) (1988). If the trustee doesn't assume or reject an unexpired lease within 60 days of the bankruptcy filing, it is assumed rejected and must be surrendered to the lessor. 11 U.S.C. § 365(d)(4) (1988).
239 See In re Lovitt, 757 F.2d at 1041.
creditors by maximizing the value of the debtor’s estate.\textsuperscript{243} In order to maximize the trustee’s responsibility for administering the estate and to expedite the proceedings, courts accord great deference to the trustee’s or the debtor in possession’s decision to reject a lease, refusing approval only where the decision is clearly erroneous, too speculative, or contrary to Code provisions.\textsuperscript{244}

Despite this great deference given to the trustee’s judgment, some courts employ a balancing of interests when applying the business judgment test.\textsuperscript{245} Courts have noted that they should be flexible, exercising discretion fairly in the interest of all who have had the misfortune of dealing with the debtor.\textsuperscript{246} It is not clear whether the business judgment test should also include consideration of the \textit{Midlantic} Court’s environmental hazard restriction on a trustee’s ability to abandon property under § 554.\textsuperscript{247} The \textit{Midlantic} Court, however,

\textsuperscript{243} See, e.g., Lubrizol Ent., 756 F.2d at 1048 (impact to nondebtor of rejection of executory contract is irrelevant); In re Meehan, 59 B.R. 380, 385–86 (E.D.N.Y. 1986) (declining to authorize rejection where unsecured creditors would receive 100% satisfaction with or without rejection); In re Hawaii Dimensions, 47 B.R. 425, 426 (D. Haw. 1985) (hardship on nondebtor is not a factor to be weighed in determining whether to approve rejection); In re Florence Chi-Feng Huang, 23 B.R. 798, 801 (Bankr. 9th Cir. 1982) (primary issue to be determined with business judgment test is whether rejection would benefit general unsecured creditors); In re Yellow Limousine Serv., 22 B.R. 807, 808 (Bankr. D. Mass. 1982) (business judgment test involves determination of whether rejection benefits estate); In re Flying Airways, 328 F. Supp. 1256, 1257 (E.D. Pa. 1971) (determination to permit rejection of lease is based on benefit of lease to estate). But see In re Federated Dep’t Stores, 131 B.R. 808, 812–13 (S.D. Ohio 1991) (permitting rejection of lease to benefit of debtor, despite no obvious benefit to creditors); Borman’s, Inc. v. Allied Supermarkets, 706 F.2d 187, 189 (6th Cir.) (noting in dicta that burden or hardship to parties beyond debtor, including creditors, of lease rejection is not factor), \textit{cert. denied}, 464 U.S. 908 (1983).

\textsuperscript{244} See, e.g., Lubrizol Ent., 756 F.2d at 1047 (court reviewed debtor’s decision to reject executory contract under clearly erroneous standard); In re Wheeling-Pittsburg Steel Corp., 59 B.R. at 136 (only extraordinary circumstances would prompt court to second guess the debtor’s presumptively sound business judgment); In re By-Rite Distrib., 47 B.R. 660, 668 n.10 (Bankr. D. Utah) (judgment of debtor in possession should be given great deference), \textit{rev’d on other grounds}, 55 B.R. 740 (D. Utah 1985); Allied Technology v. R.B. Brunneman & Sons, 25 B.R. 484, 495 (Bankr. S.D. Ohio 1982) (rejection should only be restricted if decision is clearly erroneous, too speculative or contrary to Code provisions).

\textsuperscript{245} See, e.g., National Labor Relations Bd. v. Bildisco & Bildisco, 465 U.S. 513, 527 (1984); Group of Investors v. Chicago, Milwaukee, St. Paul & Pacific R.R., 318 U.S. at 549 (before allowing rejection of collective bargaining agreement under § 365(a), court must consider impact on debtor, creditors and employees); In re Minges, 602 F.2d 38, 43 (2d. Cir. 1979) (trustee and ultimately court must exercise their discretion fairly in interest of all who have had misfortune of dealing with debtor); In re Petur U.S.A. Instrument Co., 35 B.R. 561, 563–64 (Bankr. W.D. Wash. 1983) (held that equity would not permit approval of rejection that would force nondebtor out of business).


\textsuperscript{247} Compare United States v. F.E. Gregory & Sons, Inc., 58 B.R. 590, 592 (Bankr. W.D. Pa. 1986) (held \textit{Midlantic} makes clear that defendant is treated no differently as lessee than as
did support its holding with a decision by one court to condition approval of a lease rejection on compliance with state law.\textsuperscript{248} In \textit{In re Chicago Rapid Transit Company}, the Second Circuit Court of Appeals conditioned the rejection of a real estate lease by the debtor, a railroad company, on continued operation of its railroad line until the state could grant leave to abandon the operation, as required by state law.\textsuperscript{249}

Under § 365(g) of the Code, the lease rejection is treated as a breach of contract occurring immediately before the date of the bankruptcy filing.\textsuperscript{250} While the lease rejection does not necessarily terminate the lease, requiring immediate vacation of the leasehold by the debtor, it does remove the leasehold from the property of the estate.\textsuperscript{251} Furthermore, similar to a lease that expires postpetition,\textsuperscript{252} a lease that is rejected postpetition is treated retroactively, as though the leasehold never became part of the estate.\textsuperscript{253} Therefore, once the lease expires or has been rejected, the trustee no longer has any right, title, or legal responsibility over the leased property, and the bankruptcy court has no jurisdiction over the property.\textsuperscript{254} Consequently, damage claims related to postpetition leasehold rejection are treated retroactively, under § 502, as though the claims arose prepetition.\textsuperscript{255} These prepetition claims are then relegated to general unsecured status.\textsuperscript{256}
2. Rejected or Expired Contaminated Leaseholds

If the lease of a contaminated site is rejected or has expired, courts have held that claims for clean-up costs will not be awarded administrative expense priority. The courts reason that these costs do not preserve the estate because the rejected or expired leasehold has never legally been part of the estate. Therefore, any clean-up work done on the property would not preserve the estate for the benefit of creditors. Moreover, these courts reason, it would arguably be beyond the court's discretion to approve administrative priority for expenses on property that was never part of the estate because the court has no authority over such property.

Courts refusing administrative priority further rely on the Ninth Circuit Court of Appeals decision in In re Dant & Russell. In Dant & Russell, the debtor leased certain real property from Burlington Northern and operated a treatment and storage facility on the site. The site had "massive contamination." The landlord sought administrative priority for contribution claims for CERCLA remediation costs of $25,000 incurred postpetition on the debtor's rejected leasehold, claiming the debtor was jointly liable. The court denied the landlord's motion for administrative expense priority, holding that the breach of an unexpired lease, and any consequent damages, occurred prepetition and therefore the environmental claims should be regarded as arising prepetition and could not qualify for administrative priority.

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258 See In re Wheeling-Pittsburgh Steel Corp., 59 B.R. at 135–37 (held that even if it could be shown that lease agreement imposed liability for cost of cleanup on debtor, with court approval debtor could reject lease, leaving lessor with prepetition general unsecured claim, citing 365(g)); Southern Ry. v. Johnson Bronze Co., 758 F.2d at 142-43 (rejecting landlord's claim for administrative priority for costs of cleanup of leasehold occupied by debtor as sublessee); In re T.P. Long Chems., 45 B.R. 278, 281 (Bankr. N.D. Ohio 1985) (EPA did not claim it was entitled to administrative priority for cleanup of ruptured tank sold by trustee because tank was no longer property of estate at time of release).
260 See 28 U.S.C. § 1334(d); In re Wheeling-Pittsburgh Steel Corp., 59 B.R. at 135.
261 In re Dant & Russell, 853 F.2d 700 (9th Cir. 1988).
262 Id. at 702.
263 Id.
264 Id.
265 Id. at 709.
3. Negligence Claims on Leased Sites

Other courts have awarded administrative priority in lease situations based on the Reading rationale that administrative expenses should go beyond costs that simply preserve the estate to include costs ordinarily incident to running the business. These courts reason that estate liability arising from negligent postpetition operations does not depend on the estate’s property interest in the facility and may not be abandoned with the property. Therefore, negligence awards assessed as a consequence of postpetition activities are “actual, necessary expenses of preserving the estate.” Most of these cases arise out of private landlord negligence actions against a debtor/lessee for contribution for clean-up costs. In In re N.P. Mining Co., however, the United States Court of Appeals for the Eleventh Circuit applied the same rationale to award administrative priority for punitive civil fines assessed by an Agency as a consequence of postpetition business operations on a leased site.
4. Personal Property

Other courts have avoided the lease issue altogether by limiting the administrative expense analysis to the existence of personal property remaining on the leased site, such as leaking tanks and buried drums. These courts allow administrative priority for expenses incurred in removing tanks and buried drums and in cleaning up the contaminated surrounding soil. Under CERCLA and similar state environmental statutes, the tanks and drums qualify under the broad definition of "facilities," creating liability. The courts reason that, under § 541(a), a debtor's personal property at filing of the bankruptcy petition, including tanks and drums, becomes property of the estate. Furthermore, the contaminated tanks and drums must remain property of the estate because under Midlantic, they may not be abandoned postpetition, including tanks and drums, becomes property of the estate. Moreover, under 28 U.S.C. § 959(b), the estate may not hold them in violation of state law. Therefore, the courts conclude that costs incurred by an Agency to discharge liability with regard to the abandoned personal property are "actual, necessary costs of preserving the estate" and entitled to administrative priority.


273 See, e.g., In re Wall Tube & Metal Prods., 831 F.2d 118, 120 (6th Cir. 1987) (costs awarded administrative priority were those state incurred in connection with tanks and drums containing hazardous waste that remained in debtor's estate after rest of property was conveyed back to lessor); In re Kent Holland Die Casting & Plating, 125 B.R. at 504 (barrels left on leased property where lease expired postpetition before conversion to chapter 7 were property of estate and could not be abandoned, so incurred removal costs were entitled to administrative priority); In re T.P. Long Chems., 45 B.R. at 285 (court awarded administrative priority for response costs incurred postpetition by EPA to remove drums buried on debtor's leased site); In re Vermont Real Estate Inv. Trust, 25 B.R. 804, 806 (Bankr. D. Vt. 1982) (expenses incurred in removing dangerous building from debtor's leasehold awarded administrative expense priority).

274 See 42 U.S.C. § 9601(9) (1988) defining "facility" as follows: "Facility" means (A) any building, structure, installation, equipment, pipe or pipeline (including any pipe into a sewer or publicly owned treatment works), well, pit, pond, lagoon, impoundment, ditch, landfill, storage container, motor vehicle, rolling stock, or aircraft, or (B) any site or area where a hazardous substance has been deposited, stored, disposed of, or placed, or otherwise come to be located; but does not include any consumer product in consumer use or any vessel. See also In re T.P. Long Chems., 45 B.R. at 284.


276 See In re Wall Tube & Metal Prods., 831 F.2d at 121; In re Kent Holland Die Casting & Plating, 125 B.R. at 504.

277 See In re Wall Tube & Metal Prods., 831 F.2d at 121; In re Kent Holland Die Casting & Plating, 125 B.R. at 504.

278 See In re Wall Tube & Metal Prods., 831 F.2d at 121; In re Kent Holland Die Casting & Plating, 125 B.R. at 504.
V. CIRCLE K: A JOURNEY THROUGH THE LOOPHOLE

The *In re Circle K*\(^{279}\) case provides a vivid example of the treatment of contaminated leases in bankruptcy. The bankruptcy court and district court permitted the bankrupt Circle K corporation to avoid environmental liability by rejecting leases for its gas station sites located throughout the country.

A. Background

Circle K operates thousands of convenience stores in over 30 states nationwide.\(^{280}\) These convenience stores typically include a small grocery store and self-service gasoline pumps.\(^{281}\) The majority of these stores are located on leased sites and include underground storage tanks (USTs) to store gasoline and diesel fuel that is transferred through pipes to above-ground dispensers.\(^{282}\) Leaks were discovered in numerous USTs across the country.\(^{283}\) The leaks have resulted in varying degrees of contamination of air, soil, and ground water at many of these locations.\(^{284}\) State and federal statutes require owners and/or operators of USTs to remove those tanks after they are taken out of use and to assess and to remediate any contamination of soil and ground water the leaking USTs caused.\(^{285}\)

On May 15, 1990, Circle K filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code.\(^{286}\) Circle K’s reorganization effort included a lease rejection program intended to pare down the company’s size, to reduce costs, to eliminate unprofitable locations, and to redirect cash for operations and capital improvements at the remaining stores.\(^{287}\) Accordingly, Circle K filed numerous petitions after the filing date to reject leases, subleases, and attendant contracts covering over 1,000 stores.\(^{288}\) Prior to vacating the rejected leaseholds, Circle K ceased operations; made preliminary estimates of leakage based on site inspection and its inventory records; and then drained,
sealed, and vented the USTs.289 Under the terms of its leases, Circle K then left the USTs on the property.290 These steps comport with the requirements for temporary tank closure under applicable state law.291

State environmental agencies and the land owners/lessors objected to Circle K's motions for an order approving rejection of closed store leases, claiming that Circle K failed to comply with the state laws governing abandonment of USTs.292 The plaintiffs argued that Circle K failed to assess and to remediate soil and groundwater contamination adequately at numerous leased sites nationwide.293 The plaintiffs demanded that the court enjoin Circle K from rejecting the leases until the sites were adequately investigated and remediated.294

Specifically, the plaintiffs argued that Circle K was abandoning impermissibly USTs and contaminated soil by using lease rejection under § 365 to sidestep the Midlantic restriction on abandonment under § 554, which would not permit abandonment in contravention of state law.295 The plaintiffs insisted that there is no logical reason to distinguish between the effects of unremediated contamination resulting from abandonment of property versus lease rejection.296 Plaintiffs argued that Midlantic applies wherever there is an existing danger and a bankruptcy estate fails to comply with applicable state laws that are reasonably designed to protect the public health and safety.297

The plaintiffs further argued that 28 U.S.C. § 959(b) should apply to Circle K because it continued to operate the convenience store business.298 Under that provision, Circle K should be required to comply fully with all applicable state laws at all sites, those where it currently operates, as well as those where it rejected leases.299 Finally, citing In re Chicago Rapid Transit Company, the plaintiffs urged the court to condition Circle K's lease rejections on compliance with the state law, requiring the debtor to prove the absence of contamination and full compliance with applicable UST laws.300 Allowing the rejection of these leases in their present condition would impermissi-

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289 Id.
290 Id.
291 Id.
293 Id.
294 Id.
295 Id.
296 Id.
297 Id. at 6.
298 Id. at 5–7.
299 Id.
300 Id.
bly shift the burden of assessment and cleanup onto the Agencies and the innocent land owners.301

Circle K responded, citing Dant & Russell, that as a matter of law Midlantic is not applicable to lease rejections.302 Moreover, even if Midlantic were to apply as a matter of law, the facts in the case did not support a sufficient finding of imminent and identifiable harm to justify restricting the lease rejection.303 Furthermore, Circle K argued that, as a matter of public policy, extending Midlantic to this case would frustrate Congress's intent to encourage corporate reorganizations by forcing debtors to retain unprofitable leases.304 Finally, the unsecured creditor committee argued in an amicus curiae brief that extending Midlantic to this case would create inequitable non-statutory priority claims in favor of the land owners and states.305

The bankruptcy court did not conduct a full evidentiary hearing to determine exactly the nature and type of contamination at each site on which the debtor sought to reject a lease.306 Although the bankruptcy court twice offered to convene an evidentiary hearing if a party of interest was prepared to establish that an imminent danger existed on one or more of the leaseholds, there was insufficient response.307 The state Agencies argued that providing sufficient evidence for the over 1000 sites represented a substantial financial and administrative burden.308 The parties agreed that leaking USTs posed several potential health hazards, including contamination of groundwater and soil; escape of fumes; and release of several carcinogens including benzene, toluene, ethylene, and xylene.309 Ultimately, however, the parties agreed that the precise amount of contamination was unknown, the degree of environmental damage was unknown, the danger to the public health and safety was unknown, and the costs of site remediation were also unknown.310 Therefore, despite the indica-

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301 Id.
303 Id.
304 Id.
305 Id.
306 Id. at 3–4.
307 Id.
310 Id.
tion of extensive contamination, the bankruptcy court proceeded on
the assumption that none of the leaseholds constituted an imminent
danger to the public health.\textsuperscript{311}

\textbf{B. The Bankruptcy Court Holding}

After considering the parties' pleadings and hearing oral argument,
the bankruptcy court determined that the environmental concerns
implicated in the lease rejections were of such a nature as to be
addressed adequately within the provisions of \$ 365, which permits
postpetition lease rejections.\textsuperscript{312} The court concluded that there was no
need to rewrite \$ 365 in these particular factual circumstances in
order to impose additional requirements on Circle K, the debtor in
possession.\textsuperscript{313}

1. The Business Judgment Test

In determining whether Circle K's lease rejection motions were
proper under \$ 365, the bankruptcy court applied the business judg­
ment test.\textsuperscript{314} Under the test, the court weighed the benefit to creditors
of rejection of the contaminated leaseholds against the harm to the
lessors and the state environmental agencies.\textsuperscript{315} Deferring to the wis­
dom of Circle K, the court determined that the rejection of the con­
taminated leaseholds provided a clear benefit to Circle K's unsecured
creditors.\textsuperscript{316} If the leases were not rejected, the estate would be
obligated to make substantial payment for environmental cleanup, in
addition to rent payments at unprofitable store locations.\textsuperscript{317}

The bankruptcy court then examined the corresponding damage to
the lessors and the states caused by the lease rejections, holding that
the damage was insufficient to outweigh the benefits to the estate.\textsuperscript{318}
First, because the lessors were jointly and severally liable with Circle
K under environmental statutes, rejection of the lease would not
affect the lessors' liability.\textsuperscript{319} Secondly, the court noted that environ­
mental laws and the Code provide lessors opportunities to sue the

\textsuperscript{311} Id.
\textsuperscript{312} Id. at 34–5.
\textsuperscript{313} Id.
\textsuperscript{314} Id. at 23.
\textsuperscript{315} Id. at 24.
\textsuperscript{316} Id. at 39.
\textsuperscript{317} Id.
\textsuperscript{318} Id. at 36–8.
\textsuperscript{319} Id. at 36.
debtor for contribution. The Agencies, according to the court, would also suffer little harm due to the rejection because the Agencies would still have the option of filing claims against the lessor for clean-up costs. Furthermore, the Agencies were free to enforce their police power under § 362(b) of the Code.

2. Midlantic and Lease Rejection

Having determined that the lease rejections were proper under the business judgment test, the Circle K court turned to consider the petitioners' arguments concerning Midlantic. The court rejected the petitioners' argument that the public policy restriction on the trustee's abandonment power created under Midlantic should prevent lease rejections under § 365 of the Code. The court reasoned that in Midlantic the Supreme Court created the narrow exception to the abandonment power under § 554 because the result of literal application of the statute would have been demonstrably at odds with the intent of its drafters. The bankruptcy court concluded that, unlike Midlantic, it did not appear necessary in this case to rewrite the lease rejection statute by judicial fiat.

The court explained that in Midlantic, by abandoning the property, the trustee was releasing the property imprudently back to the insolvent debtor, who would be unable to facilitate cleanup, thus ultimately burdening the state Agency. In contrast, the bankruptcy court concluded that there were no similar concerns in this case because the property leased by Circle K was being conveyed back to the lessors, who had a myriad of remedies available under § 365 of the Code. The court held that § 365 as drafted by Congress appeared well able to handle the environmental issue presented in the case. The court supported its holding with Kovacs, where the Supreme Court noted it would be sufficient to release property back to the original owner.

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320 Id. at 37.
321 Id. at 38.
322 Id. For a discussion of § 362(b), see infra Section II.B.1.a–b.
323 Id. at 32–6.
324 Id.
329 Id.
who would have to comply with the state environmental law to the extent of his or her ability. ³³⁰

The bankruptcy court did note that Midlantic might apply where there was evidence of a debtor abandoning a UST under the guise of a lease rejection. ³³¹ Following cases that interpret the Midlantic exception narrowly, ³³² however, the court added that the abandoned UST would also have to represent an imminent and identifiable public harm for the public policy restriction to apply to a lease rejection. ³³³ The court concluded that the facts of this case did not indicate such a serious threat. ³³⁴

3. 28 U.S.C. § 959(b) and Lease Rejection

Finally, the bankruptcy court also dismissed the petitioners’ argument that Circle K’s lease rejections would violate § 959(b), holding that the trustee or debtor in possession need not comply with laws under § 959(b) before rejection of leases. ³³⁵ The court reasoned that § 959(b) applies to the trustee or debtor in possession only if they are managing or operating the site, not if they are liquidating the site. ³³⁶ The court supported its decision by citing decisions that have refused priority to state claims where the trustee is merely liquidating the property of the estate. ³³⁷

The court noted, however, that the facts of this case were slightly different from traditional liquidation cases. ³³⁸ By rejecting its leases, Circle K was liquidating only part of its business but was continuing to operate the remainder. ³³⁹ Nevertheless, the court concluded that even in a partial liquidation situation, § 959(b) would not apply to specific sites where Circle K was no longer operating the business but was simply rejecting the lease. ³⁴⁰ The court reasoned that once the lease is rejected, the former tenant no longer has any authority over the property, so it would be impractical to hold the former tenant responsible for compliance with state law. ³⁴¹ The court stated: “Al-

³³⁰ Id.
³³¹ Id. at 32–33.
³³² See infra notes 209–11 and accompanying text.
³³⁴ Id.
³³⁵ Id. at 25–9.
³³⁶ Id. at 26.
³³⁷ Id. See infra notes 210–11.
³³⁹ Id.
³⁴⁰ Id. at 29 (citing the Ninth Circuit Court of Appeals decision in Dant & Russell).
³⁴¹ Id.
though a debtor may be liable to the landlord or a third party for damages arising out of an event which occurred during the tenancy, he does not have any ongoing obligation to operate or manage the property. And accordingly, § 959(b) is not applicable."\footnote{Id. at 28.}

C. The District Court Opinion

The United States District Court for the District of Arizona affirmed the bankruptcy court decision on appeal.\footnote{Id. at 22 (also citing Dant & Russell).} Addressing the issue of the applicability of the Midlantic restriction on the abandonment power to lease rejections, the district court concluded that some sort of threshold fact-finding was necessary before consideration of this restriction was appropriate.\footnote{In re Circle K, CIV-91-1000-PHX-RGS at 1 (D. Ariz. Dec. 29, 1992). The District Court reviewed the factual findings of the Bankruptcy Court under the clearly erroneous standard and the findings of law under the de novo standard of review, citing In re Daniels-Head and Assoc., 819 F.2d 914, 917 (9th Cir. 1987). Id. at 5.} The district court supported this reasoning by citing courts that have interpreted the applicability of the Midlantic restriction more narrowly.\footnote{Id. at 18.} Accordingly, the district court stated that applying the Midlantic restriction required a factual showing of an imminent and identifiable threat to public safety.\footnote{Id. See infra notes 209–11 and accompanying text.} The court concluded that the fact finding by the bankruptcy court did not indicate any such threat of public harm.\footnote{Id. at 10.} Finding that the facts of this case would not preclude lease rejection even if Midlantic were applied, the court declined to reach the question of whether Midlantic applies to lease rejections.\footnote{Id. at 18.}

Addressing the applicability of § 959(b), the district court agreed with the bankruptcy court's conclusion that, similar to Midlantic, the provision was not applicable in this case because Circle K was not managing the leased property, rather it was rejecting the leased property in a liquidation situation.\footnote{Id. at 12.} The district court followed the bankruptcy court's reasoning insofar as where a partial liquidation is necessary to facilitate reorganization, that portion of a case resembles a chapter 7 liquidation case to which § 959(b) would not apply.\footnote{Id. at 17.} Therefore, the district court concurred with the bankruptcy court
decision that Circle K's lease rejections constituted just such a partial liquidation to which § 959(b) would not be applicable. 351

The district court concluded that the burden to clean up the sites should fall fairly and appropriately on the owners/lessors of the sites and the states. 352 The court affirmed the bankruptcy court decision that Circle K could not be made to clean up these sites either before or after the leases were rejected. 353 The district court reasoned that the land owners had ample remedies available under §§ 365 & 502 of the Code. The court also noted that the lessors had benefited from the lease, assuming certain risks of contamination. 354 The district court further noted that the states also had sufficient remedies, including the option of giving clean-up judgments the status of statutory liens. 355

VI. AFTER CIRCLE K

"Bill?" "Yeah?" "Strange things are afoot at the Circle K." 356 Strange, indeed. Circle K's chapter 11 bankruptcy reorganization provides the most recent installment of the strange and terrible saga of the conflict between environmental law and the Code. An apparent liability loophole exists in the Code for debtors leasing contaminated sites. By merely leasing a site the debtor can successfully frustrate the remaining two cost recovery opportunities available to Agencies under the Code to enforce environmental laws against a bankrupt PRP—superliens and administrative expense priority.

Essentially, with a leased contaminated site, the Agencies are back in the bleak position of lowly general unsecured creditors with little hope of sufficient compensation. The existence of this loophole may encourage more corporations, in an improper attempt at bankruptcy planning, to lease sites that risk being contaminated in order to avoid the associated liability. If a company is found responsible for contaminating a site, it has a much greater ability to simply walk away from liability for site cleanup via the bankruptcy proceeding if the site is leased rather than owned. This frustrates the deterrent intent of

351 Id. at 21–2. Specifically, the district court stated the following reasons for agreeing with the Bankruptcy Court's conclusion that § 959(b) should not be applied to this case: Circle K did not own any of these sites; the leases on these sites had been properly rejected under § 365 of the Code; while Circle K still engaged in the convenience store business nationally, it did not do so at the site on which it rejected leases. Id.
352 Id. at 16, 20–1.
353 Id. at 16–20 (citing Dant & Russell for support).
354 Id. at 16, 20.
355 Id. at 21.
356 Bill & Ted's Excellent Adventure, Nelson Entertainment.
environmental laws, potentially burdening the general public with financial responsibility for cleanup.

The basic issue is one of priority within the Code's distribution scheme. The Code is silent on the priority of environmental claims, giving these claims no special treatment. The Supreme Court has twice addressed the issue of environmental law enforcement against bankrupt PRPs: first in

Ohio v. Kovacs

and then again in

Midlantic.

Unfortunately, in both these cases, the Court expressly reserved judgment on the issue of what priority environmental clean-up costs should receive, leaving the lower courts to grapple with the issue themselves.357 The developing case law is extremely inconsistent, with environmental claims discharged with no payment in some cases and in other cases, paid in full ahead of all other unsecured creditors as first priority administrative expenses.358

Courts have justified denying administrative priority to Agency environmental claims based on the state's opportunity to gain secured status through statutory liens. Where that option is not available, as with a leased site, the courts should be more willing to award administrative priority, notwithstanding the arguments that the property is not part of the estate. Otherwise, the Agency environmental claim has little hope of compensation.

The most sensible long-term solution to this conflict is the proposal by one commentator to amend the Code to treat environmental claims similar to tax claims, which are given seventh priority in the Code's distribution scheme.359 The rationale for this special treatment of tax claims in bankruptcy is that allowing the debtor to avoid tax liability through bankruptcy would unfairly punish the innocent taxpaying community. Unlike the debtor's creditors who made a conscious choice to deal with the debtor because of potential financial benefits, the taxpayers made no such conscious decision. Moreover, the taxpayers are excluded from enjoying the financial benefits. Therefore, the taxpayers should not share in the debtor's losses.

The argument to treat environmental claims similarly to tax claims is that environmental clean-up costs incurred by the government, like unpaid taxes, represent a burden on the community at large. If left unreimbursed, environmental clean-up costs incurred by the Agen-


358 Compare In re Dant & Russell, 853 F.2d at 709 (discharging claims) with In re Wall Tube & Metal Prods., 831 F.2d 118 (6th Cir. 1987) (allowing administrative priority).

359 For a full discussion of this issue and possible amendment language, see Claar, supra note 5.
cies represent punishment equal to unpaid taxes for the innocent taxpayers. Furthermore, from a policy perspective, priority treatment for environmental claims would provide increased certainty of reimbursement for Agencies. This greater certainty of reimbursement would encourage Agencies to clean up contaminated sites in a more timely fashion, rather than delay in hopes of receiving administrative expense priority. Accordingly, Agencies would be able to effectuate more fully the quick response and deterrent intent of environmental statutes.

Finally, giving environmental claims tax claim status would also address the lease issue. If the environmental claims were given a higher priority, there would be less need to use statutory liens or to file for administrative expense priority. Therefore, it would be unimportant that cleanup on leased sites cannot qualify for either of these higher priority options. The claims on the site, whether leased or not, would receive the same priority treatment in the debtor's bankruptcy proceeding.

VII. CONCLUSION

Despite the tremendous statutory authority available to Agencies to ensure remediation of contaminated sites, many PRPs are able to avoid punishment through federal bankruptcy protection. If a PRP files bankruptcy, the bankruptcy court usually stays any Agency enforcement action against the PRP, and then after providing little compensation to the low priority Agency claims, the court discharges the Agency claims at the end of the bankruptcy proceeding.

The interference resulting when a PRP files for bankruptcy forces Agencies to make creative use of the Code to ensure greater access to a PRP's assets. The most successful efforts involve the use of superliens and administrative expense priority. While Agencies have found some success with these creative efforts, they may be frustrated easily by a debtor leasing rather than owning a contaminated site. In many cases when the contaminated site is leased the assets of the bankrupt PRP are unavailable to satisfy Agency enforcement claims.

Without any compensation from the bankrupt PRP, the financial responsibility for cleaning up the site usually falls to the federal or state government and so, ultimately, to the taxpayers. This is an unfair burden to put on innocent taxpayers. The Code should be amended to address this situation.