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Environmental LAW

Environmental claims against debtors hard to discharge

The recession and the difficult economic times that have persisted have pushed many companies, large and small, to seek protection from liabilities and attempt reorganization through bankruptcy. The goal of reorganization under Chapter 11 of the Bankruptcy Code is to give a debtor saddled with liabilities that are burdensome, but not yet fatal, an opportunity for a fresh start.

One of the many tensions the courts must resolve in this situation is how to treat the debtor's environmental obligations. Our state and federal environmental laws rest in large part on the guiding principle that the polluter should pay for the remediation of environmental contamination. Discharging those liabilities in bankruptcy inevitably increases the burden on other responsible parties or on the public, while failing to protect the debtor from its environmental past may doom the attempt to reorganize and emerge from bankruptcy, resulting in liquidation.

By RONALD G. HULL
Daily Record Columnist

The U.S. Supreme Court and the Second Circuit Court of Appeals laid down basic principles for reconciling these tensions more than 20 years ago in *Ohio v. Kovacs*, 469 U. S. 274 (1985) and *In re Chateaugay Corp.*, 944 F.2d 997 (2d Cir. 1991), which allowed environmental liabilities to be discharged in bankruptcy if the government was effectively seeking a money judgment or if the government had the option of conducting the cleanup itself and seeking reimbursement.

In *Chateaugay*, the Second Circuit also distinguished between orders to clean up past contamination, which may be discharged, from orders to abate ongoing pollution, which are not discharged and remain enforceable against the reorganized debtor.

The leading cases left significant questions unresolved. One of the most troublesome issues involved the government's choice of remedy and whether, if the government selectively orders injunctive relief under a statute that does not include a right to do the work and seek reimbursement, but could also issue an order under a statute that does, the order can be discharged in bankruptcy? Second, how should the courts determine whether pollution is ongoing?

In September, in *In re Mark IV Industries, Inc.*, Civil Action No. 11-CIV-648 (S.D.N.Y. Sept. 28, 2011), the district court affirmed a ruling of the bankruptcy court that attempted to clarify the law by articulating a three-part test for determining whether an environmental order can be discharged as a "claim" under Chapter 11:

1. Is the debtor capable of executing the equitable decree, or can he only comply by paying someone else to do it?
2. Is the pollution ongoing?
3. Does the environmental agency have the option under the statute giving rise to the equitable obligation to remove the waste and seek reimbursement from the debtor?

The first factor restates the holding in *Kovacs* and may be limited to the peculiar facts of that case. In most cases, the debtor will have access to the contaminated site and will be capable of executing the remedy. The second factor is drawn from *Chateaugay*. The third factor is new and attempts to clarify how to determine whether the government has a right to reimbursement.

The bankruptcy court and the district court on appeal articulated a framework for applying the second and third factors, which maximize the prosecutional discretion of the government and severely restrict the ability of debtors to discharge environmental obligations in bankruptcy.

In *Mark IV*, the debtor argued that the literal definition of "claim" in the Bankruptcy Code required the court to consider whether the government could step-in and perform the work and then seek reimbursement under any environmental statute in addition to the law originally invoked as the basis for the equitable remedy. The court perceived that the government would always have residual authority somewhere to abate contamination and that the debtor's interpretation could potentially render all environmental obligations dischargeable.

It rejected this approach as "oversimplified", but then went to

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the other extreme, holding that the Bankruptcy Code should not consider any hypothetical remedies that the enforcing agency could have invoked under other statutory authorities, and should only consider the statute pursuant to which the enforcing agency had obtained its injunction.

The district court also applied the ongoing pollution test in a way that may significantly limit the number of sites where environmental obligations may be discharged in bankruptcy. The principle from *Chateaugay* is that an environmental obligation to remedy ongoing pollution cannot be converted to a monetary sum and, therefore, cannot be discharged as a "claim." This begs the question of when pollution is "ongoing."

In *Mark IV*, the debtor argued that all operational sources of pollutants had been removed and all that remained was residual contamination that had already been discharged into the environment; i.e., that there was no "ongoing" operation that was a source of additional pollution. The enforcing agency did not dispute this, but argued that as long as contamination continued to migrate through the groundwater, the pollution was not past, but remained ongoing.

The district court agreed with the agency that "residual" waste, even if source areas have already been cleaned up, can cause "ongoing pollution," which makes the obligation non-dischargeable. Although the district court held that the dispute over ongoing pollution raised issues of fact and could not be determined as a matter of law, the determination that passive migration of contaminants from past disposal constitutes ongoing pollution may disqualify most environmental obligations from being considered as claims that can be discharged in bankruptcy.

While the district court's decision is less than a month old, and it is too early to evaluate the full impact, it is clear that the court's decision has the potential to significantly reduce the likelihood of discharging environmental obligations in bankruptcy. In some circumstances this may undercut the use of Chapter 11 altogether, and in all such cases will affect the amount of assets available to other creditors.

Companies facing environmental obligations and considering bankruptcy as a means of dealing with these liabilities should examine the decision in *Mark IV* closely as part of the overall evaluation of filing under Chapter 11 to reorganize.

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