

Environmental Issues in Bankruptcy Cases

A Collier Monograph

by Adam P. Strochak, Jennifer L. Wine and Erin K. Yates
Weil, Gotshal & Manges LLP

Published by LexisNexis Matthew Bender July 2009

Excerpt from Section 3

There is a natural tension between the rehabilitative purpose of bankruptcy and the “polluter pays principle” underpinning environmental law. Whereas chapter 11 bankruptcy protection is intended to give debtors a “fresh start” and ensure equality of treatment of creditors, major environmental cleanup statutes attach strict, joint and several liability to responsible parties to ensure that the persons receiving the benefits of polluting pay for remedying it, not taxpayers or future generations. CERCLA and RCRA contain sweeping liability schemes with the general objective of imposing the burden of paying for pollution on those who caused or contributed to it. The protections afforded to debtors and creditors under the Bankruptcy Code may at times conflict with the fundamental goals of the environmental laws.

Policy Conflicts and Environmental Claims

The idea behind a bankruptcy reorganization is that a debtor is entitled to a “fresh start” on grounds that a reorganized company is more socially useful than a liquidated one. Bankruptcy law also seeks to treat all creditors fairly. Environmental laws, on the other hand, are premised on the notion that a polluter should pay for the historic costs of its endeavors. As a matter of public policy, environmental agencies are understandably eager to place environmental obligations ahead of other creditors’ claims against a reorganizing debtor.

Determining whether environmental claims concerning a reorganizing company are discharged, paid in part or in full, or passed through to the surviving entity can be a complicated evaluation. The first part of the process is to de-

to determine whether environmental obligations are “claims” for purposes of bankruptcy law. Prepetition claims, as defined in the Bankruptcy Code, cannot be enforced during the reorganization and can be discharged when the plan of reorganization is confirmed. If an environmental obligation is not a “claim,” however, it may have to be paid or it may survive the reorganization. Liabilities under environmental law can include affirmative legal obligations to refrain from polluting the environment, requirements to remediate contaminated sites owned or operated (either currently or in the past) by the debtor, obligations to reimburse other parties (including the government) for the incurrence of costs in remediating contamination caused in whole or in part by the debtor, and fines and penalties imposed by courts and government agencies. Various courts have reached different conclusions about whether each type of environmental liability is a “claim.”

Once an obligation is classified as a “claim” for bankruptcy purposes, the second part of the analysis is determining when the claim arose. For example, do environmental claims arise when the debtor first placed hazardous substances at the site, or do they arise when the contamination is discovered? Similarly, does a claim accrue when the government or a third party begins to investigate and incur costs, or not until the cleanup is completed, a process which may take years or even decades? Establishing when an environmental claim accrued is critical to deciding whether the claim is subject to the Bankruptcy Code’s automatic stay provision, whether it can receive the priority treatment accorded administrative expenses during the reorganization, whether it must compete equally with other unsecured claims and whether it is discharged.

An important factor in evaluating environmental claims in the bankruptcy context is whether the claim involves debtor-controlled property or third-party sites, including the debtor’s former facilities. As discussed more fully below,¹ during a reorganization a debtor must continue to comply with environmental laws and regulations. This obligation may entail costs that cannot be clas-

¹ See Section 6[2][c] *infra*.

sified readily as either prepetition or postpetition claims. Just because debtors enjoy the protection of bankruptcy does not mean that debtors may operate their facilities without regard for environmental obligations. Similarly, debtors emerging from bankruptcy may not be free to ignore contamination caused by prepetition activities, notwithstanding the bankruptcy principle of a fresh start. Thus, because some types of environmental obligations can pass through the reorganization and can impose a significant burden on the reorganized company, the classification of environmental obligations can play a key role in determining whether to proceed under a chapter 11 reorganization or a chapter 7 liquidation.

Jurisdictional Conflicts

When debtors have pending environmental cases or liabilities, jurisdictional conflicts may arise between the bankruptcy courts and the forum granted jurisdiction over the environmental claims. For example, which court may approve settlement agreements when an environmental case is pending in one federal district court and a bankruptcy is then commenced in another district? CERCLA requires that remedial action settlements be lodged as consent decrees before the “appropriate district court” and the federal district courts have “exclusive original jurisdiction” over all CERCLA controversies.² On the other hand, the bankruptcy courts have original, but not exclusive, jurisdiction over all civil proceedings “arising in or related to cases under the Bankruptcy Code.”³

These issues were presented to the Court of Appeals for the Second Circuit in *In re Cuyahoga Equipment Co.*⁴ There, the court concluded that a federal district court in New York, exercising bankruptcy jurisdiction, could approve the settlement of CERCLA claims relating to a site in Philadelphia that was the subject of a lawsuit in the Eastern District of Pennsylvania. The Second Circuit rea-

² 42 U.S.C. §§ 9622(d)(1)(A), 9613(b).

³ 28 U.S.C. § 1334(b).

⁴ 980 F.2d 110 (2d Cir. 1992). *But see* Halvajian v. Bank of New York, 191 B.R. 56 (Bankr. D.N.J. 1995) (holding no supplemental jurisdiction for bankruptcy courts).

soned that the New York district court had the authority to approve the settlement of environmental claims under the federal supplemental jurisdiction statute.⁵ As an alternative ground for its decision, the *Cuyahoga* court held that CERCLA itself does not mandate the conclusion that a CERCLA settlement may be approved only by a court exercising original CERCLA jurisdiction. Rather, the statute simply provides that a CERCLA claim must be heard in a *federal* district court and does not require it to be heard in any *specific* federal district court.⁶

Another area of potential tension is the bankruptcy court's removal jurisdiction and its power to join pending environmental lawsuits with the bankruptcy proceeding. Under the Judicial Code⁷ and Rule 9027 of the Federal Rules of Bankruptcy Procedure, certain civil suits involving the debtor and pending in either state or federal courts may be removed to the bankruptcy court. However, the Judicial Code prohibits removal of pending state court actions which represent enforcement of a governmental unit's police or regulatory powers.⁸ Accordingly, it is often impermissible to remove state actions alleging environmental violations to the bankruptcy court because they are exercises of the state's police and regulatory powers.⁹ Bankruptcy courts also have discretionary authority to decline jurisdiction over a removed lawsuit on equitable grounds.¹⁰ Thus, where

⁵ 28 U.S.C. § 1367(a). Section 1367(a) gives a federal court "supplemental jurisdiction over all other claims that are so related to claims in [an] action within [a court's] original jurisdiction that they form part of the same case." See *In re Cuyahoga Equip. Co.*, 980 F.2d 110, 115 (2d Cir. 1992).

⁶ 980 F.2d 110, 115.

⁷ 28 U.S.C. § 1452(a).

⁸ *Id.*

⁹ See, e.g., *State ex rel. Fisher v. Forster*, 27 C.B.C.2d 1538, 146 BR. 383, 384 (Bankr. N.D. Ohio 1992) (suits seeking to enforce certain environmental procedures and seeking reimbursement of costs resulting from violations thereof removed to state court); *In re Rabzak*, 79 BR. 966 (Bankr. E.D. Pa. 1987) (state court prosecution for violations of rubbish ordinance was exercise of police power and could not be removed to bankruptcy court).

¹⁰ 28 U.S.C. § 1452(b). The equitable factors to be considered include: (1) the possibility of duplicative litigation in two forums; (2) prejudice to the involuntarily removed parties; (3) forum non conveniens; (4) the state court's better ability to resolve state law issues; (5)

a pending environmental claim involves questions of state law unfamiliar to the bankruptcy judge, the bankruptcy court may decline to take jurisdiction over an environmental dispute, even if that suit does not fall within the police power exemption.¹¹ Finally, a bankruptcy court may be required to abstain from hearing a pending state law claim that could not originally have been brought in federal court in the absence of bankruptcy jurisdiction and that could be timely adjudicated in state court. The court also has discretion to abstain from hearing other matters¹²

About the Lead Author


ADAM P. STROCHAK is a partner in the Washington, D.C., office of Weil, Gotshal & Manges LLP, where he has practiced since 1993. He concentrates his practice on corporate restructuring, representing both debtors and creditors in restructuring matters in and out of court. Mr. Stochak also has represented clients in a wide variety of industries on environmental, insurance coverage, and commercial litigation matters, focusing particularly on the intersection of these disciplines with the bankruptcy laws.

In chapter 11 cases, Mr. Stochak has represented debtors from diverse industries, including telecommunications, steel, healthcare, building products and re-

considerations of comity; (6) the lessened possibility of inconsistent results and (7) the expertise of the state court in which the matter was pending. *In re Revco D.C., Inc.*, 99 BR. 768, 776 (N.D. Ohio 1989).

¹¹ State ex rel. Fisher v. Forster, 27 C.B.C.2d 1538, 146BR. 383, 384-85 (Bankr. N.D. Ohio 1992).

¹² 28 U.S.C. § 1334(c)(2) (mandatory abstention); 28 U.S.C. § 1334(c)(1) (discretionary abstention); see also State ex rel. Fisher v. Forster, 27 C.B.C.2d 1538, 146BR. 383, 385-86 (Bankr. N.D. Ohio 1992) (abstaining on both mandatory and discretionary grounds); *In re Commercial Oil Serv., Inc.*, 58BR. 311, 315-16 (Bankr. N.D. Ohio 1986), *aff'd*, 88BR. 126 (N.D. Ohio 1987).



tail sales. Major debtor representations include World Com, Inc., Silicon Graphics, Inc., Genesis Health Ventures, Inc., Sun Healthcare Group, Inc., Enron Corporation, G-I Holdings Inc. (former known as GAF Corporation), Eagle-Picher Industries, Inc., Republic Technologies International, LLC, Brothers' Gourmet Coffee and Metallurg Inc. Mr. Stochak also regularly represents creditors in both out-of-court workouts and court-supervised restructurings. Creditor representations include the Official Committee of Asbestos Property Damage Claimants in the Federal-Mogul bankruptcy, the Senior Lenders of Owens Corning, General Electric Capital Corporation in the Kmart Corporation Chapter 11 case, GE Capital Aviation Services, Inc. in the Fairchild Dornier Corporation bankruptcy, and ChevronTexaco Corporation in the American Western Refining bankruptcy.

Mr. Stochak is a co-author, with David R. Berz and Stanley M. Spracker, of the three-volume treatise *Environmental Law in Real Estate and Business Transactions* (Matthew Bender), which focuses on the implications of environmental law in transactional and restructuring matters. He also has written for a variety of publications on current topics in restructuring, environmental law and insurance coverage.

Mr. Stochak is a graduate of the University of Vermont (B.A.) and George Washington University (J.D.).
