

## Comment

# Environmental Claims in Bankruptcy: It's a Question of Priorities\*

*Conflicting case law exists regarding the proper treatment of environmental claims in bankruptcy—primarily in the contexts of a trustee's power to abandon contaminated property, a debtor's ability to receive a discharge of environmental liability, and a creditor's request for administrative priority. This Comment evaluates criteria courts have established for characterizing environmental claims and for determining their priority in bankruptcy. It examines the relationships between the trustee's abandonment power, the priority of environmental claims, and the determination of when a claim arises. Criteria are suggested for characterizing environmental claims and for determining their priority in bankruptcy which resolve the conflicting case law and result in a uniform and consistent application of the Bankruptcy Code, environmental law, and Supreme Court precedent.*

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## I. INTRODUCTION

Over the past two decades, hazardous substances have become a great national concern due to their severe impact on the environment and public health and safety. Both Congress and state legislatures have enacted comprehensive environmental laws to address existing and future problems associated with hazardous waste. Under these laws, businesses or individuals may find themselves liable for the substantial costs of identification, removal, and disposal of hazardous waste. Faced with such liability, a party may choose or be forced to seek protection from the financial burden in bankruptcy.

The goal of the bankruptcy law is to rehabilitate the debtor by allowing the debtor to discharge prepetition debts, abandon property, and make pro rata payoffs to creditors.<sup>1</sup> The goal of environmental law is to protect the environment and preserve public health and safety by imposing liability for hazardous waste cleanup. The goals of bankruptcy and environmental law come into conflict when individuals or business-

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1. There is serious disagreement among scholars regarding the policies behind bankruptcy law and the source of the rights which are administered in bankruptcy. Some scholars view loss distribution as the central policy concern of bankruptcy. They believe that creditors' state-defined rights are *redefined* in bankruptcy through the process of loss distribution. Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775 (1987). Other scholars view bankruptcy as administration of the collection efforts of creditors with state-defined rights. Douglas G. Baird, *Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren*, 54 U. CHI. L. REV. 815 (1987).

es, subject to environmental liability they are financially unable or unwilling to satisfy, seek protection in bankruptcy. This conflict has been the subject of much discussion in recent years.

The fundamental issue in resolving this conflict is under what circumstances and to what extent is a bankruptcy estate liable for an environmental claim—for example, the cleanup costs of contaminated estate property. Conflicting case law exists regarding this issue because courts disagree on whether to prioritize environmental policy or bankruptcy policy ahead of the other. Additionally, courts often fail to give proper consideration to either the “priority” of environmental claims *outside of bankruptcy* or the lack of “priority” of environmental claims *in bankruptcy*.

Determining the proper treatment of environmental claims in bankruptcy requires consideration of the priority of claims in three legal contexts. First, the priority of environmental claims relative to other claims *outside of bankruptcy* must be understood by looking at state law and federal nonbankruptcy law. Second, the priority of environmental claims relative to other claims *in bankruptcy* must be understood by looking at the Bankruptcy Code.<sup>2</sup> Third, the priority of environmental objectives relative to bankruptcy objectives must be considered by looking at the competing policies behind bankruptcy law and environmental law.

This Comment evaluates criteria courts have established for characterizing environmental claims and for determining their priority in bankruptcy. Part II provides a brief summary of relevant environmental and bankruptcy law. Part III analyzes criteria for determining when an environmental claim arises and the consequences of that determination. Part IV discusses the trustee’s power to abandon property subject to environmental liability and the consequences of abandonment. Part V addresses the bankruptcy estate’s liability for environmental claims and the prioritization of those claims. Finally, part VI suggests criteria for characterizing environmental claims and for determining their proper priority in bankruptcy. These criteria resolve the conflicting case law and result in a uniform and consistent application of the Bankruptcy Code and Supreme Court precedent.

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2. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codified as amended at 11 U.S.C. §§ 101-1330 (1988)).

## II. LEGISLATION

### A. *Environmental Law*

An increasing amount of environmental legislation and litigation evince the heightened importance of environmental responsibility in our society. The handling and disposal of hazardous waste as well as the remediation of contaminated property have become tremendous concerns. Substantial numbers of properties contaminated with toxic substances caused by improper hazardous waste handling and disposal procedures threaten public health and safety. Traditionally, environmental legislation has served to prevent future environmental damage by regulating the conduct of potential polluters. However, some more recent environmental legislation serves to remedy preexisting environmental damage by authorizing the government to respond immediately to hazards which threaten the public. Environmental liability can arise in various forms, including an obligation to pay for environmental cleanup expenses incurred by the government or others, an obligation to perform a cleanup directly, or an obligation to refrain from polluting in the future.

One of the most extensive environmental laws governing liability for hazardous waste is the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA).<sup>3</sup> Under CERCLA, the President, who has delegated his power to the Environmental Protection Agency (EPA), is authorized to dispose of hazardous waste and to remediate contaminated property when there is an imminent and substantial danger to the public health or welfare.<sup>4</sup> After the EPA has discovered a hazardous release, it assesses the site and determines the degree of risk to human health and the environment. The EPA

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3. Comprehensive Environmental Response, Compensation, and Liability Act of 1980, Pub. L. No. 96-510, 94 Stat. 2767 (codified as amended at 42 U.S.C. §§ 9601-9675 (1988)).

4. CERCLA provides that:  
Whenever (A) any hazardous substance is released or there is a substantial threat of such a release into the environment, or (B) there is a release or substantial threat of release into the environment of any pollutant or contaminant which may present an imminent and substantial danger to the public health or welfare, the President is authorized to act . . . to remove . . . and provide for remedial action . . . or take any other response measure . . . necessary to protect the public health or welfare or the environment.  
42 U.S.C. § 9604(a)(1) (1988).

places those sites with a sufficiently high degree of risk on the National Priorities List (NPL).<sup>5</sup>

Congress has established a "Superfund" which provides a source of immediate funding to the EPA for hazardous waste cleanup operations. Under CERCLA, the EPA may undertake a cleanup, using funds from the Superfund, and recoup its response costs by bringing an action against potentially responsible parties (PRPs).<sup>6</sup> Liability for the EPA's response costs is sorted out after the cleanup. Alternatively, the EPA may order the present owner of contaminated property to take cleanup action<sup>7</sup> and thus bear the financial burden.<sup>8</sup> Either way, liability of PRPs is broad and can be substantial. The PRPs are held jointly and severally liable for the hazardous waste cleanup and disposal costs.<sup>9</sup> CERCLA liability is imposed not only on those parties responsible for hazardous waste releases but also on those parties currently in possession of contaminated property.<sup>10</sup> CERCLA also has provisions permitting private parties to bring civil actions against PRPs for the recovery of their expenses in cleaning up contaminated property.<sup>11</sup>

Other federal statutes impose liability for different types of environmental harm or impose liability on other parties. For example, the Resource Conservation and Recovery Act of 1976 (RCRA)<sup>12</sup> imposes liability for toxic waste cleanup not only on property owners, regardless of fault, but also on all those involved, from the generation of the hazardous waste through the disposal of it. Many state legislatures have enacted similar types of environmental legislation.

Although environmental legislation is in place that imposes liability on responsible parties for cleanup and hazardous waste disposal, such

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5. *Id.* § 9605(c).

6. Potentially responsible parties, those "covered persons" upon whom liability is imposed by CERCLA, include: (1) the current owner or operator of the site, (2) the owner or operator of the site at the time of the contamination, (3) the person who arranged for the disposal of the waste, and (4) the person who transported the waste to the site. *Id.* § 9607(a)(1)-(4).

7. *Id.* § 9606(a).

8. However, the owner may seek contribution from other PRPs. *Id.* § 9613(f)(1).

9. *United States v. Chem-Dyne*, 572 F. Supp. 802, 810-11 (S.D. Ohio 1983).

10. *Id.* § 9607(a)(1).

11. *Id.* § 9607(a)(4)(B). The Superfund Amendments and Reauthorization Act in 1986 explicitly created a right of contribution. Any person may seek contribution from any other person who is liable or potentially liable under section 9607(a). *Id.* § 9613(f).

12. Resource Conservation and Recovery Act of 1976, Pub. L. No. 94-580, 90 Stat. 2795 (codified as amended at 42 U.S.C. §§ 6901-6992k (1988)).

legislation often fails to establish a priority for the liability imposed, making enforcement difficult. A legislature may choose to create a superpriority lien, a secured lien subordinate to all existing perfected liens, or an unsecured interest in remediated property based on environmental liability. The power and authority to prioritize environmental liability is in the hands of the legislatures, *not* federal bankruptcy courts.

Some environmental laws establish a priority by creating a lien on the remediated property, junior to any existing and perfected security interests, to secure the repayment of response costs incurred by the government.<sup>13</sup> Unfortunately, when environmental liability exists on an encumbered property, a junior lien often provides the government with little, if any, protection at all. A few states have environmental legislation that creates a *superpriority* lien on remediated property to secure repayment of response costs. A superpriority lien receives priority ahead of all other secured creditors. Superpriority liens are uncommon and the consequences are somewhat unsatisfying because they simply *shift* the burden of insuring against environmental liability from the government to lenders.

Part of the reason for the substantial conflict in case law regarding the treatment of environmental claims in bankruptcy is the failure of state and federal law to establish a priority for environmental claims outside of bankruptcy. Legislatures have the power to establish priorities by creating liens on property to secure the payment of environmental liabilities. Those priorities, established under state or federal law, are respected in bankruptcy. However, when state or federal legislatures fail to prioritize environmental claims above others, should a bankruptcy court create such a priority? This Comment carefully considers this issue and concludes that although important environmental policies may support such a proposition, a bankruptcy court is not free to create rights and priorities which do not exist under nonbankruptcy law. Such powers must remain in the capable hands of the legislatures.

### B. Bankruptcy Law

Bankruptcy provides debtors an opportunity to satisfy creditors by liquidating assets or reorganizing their affairs under the protection of the Bankruptcy Code.<sup>14</sup> Bankruptcy, by imposing a collective, compulsory

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13. For example, CERCLA includes a provision giving the government a lien on remediated property which arises when cleanup costs have been incurred, but the lien is subject to existing perfected liens. 42 U.S.C. § 9607(D) (1988).

14. An individual liquidates under chapter 7 and reorganizes under chapter 13. 11 U.S.C. §§ 701-766, 1301-1330 (1988). A corporation usually liquidates under chapter

proceeding, forces all of the creditors to act as one for the benefit of the whole group.<sup>15</sup> One objective of bankruptcy is to assure equal and identical treatment of all creditors with the same type of claim, thus preventing any creditor from receiving preferential treatment. A second objective is to provide the debtor with a fresh start by allowing the debtor to discharge debts incurred before bankruptcy.<sup>16</sup>

A debtor seeks relief by filing a petition with the bankruptcy court.<sup>17</sup> When the debtor files, a bankruptcy "estate" is created which contains all of the debtor's assets and liabilities. The fundamental purpose of a chapter 7 bankruptcy is to liquidate the estate assets while maximizing the size of the estate for the benefit of the creditors. Under chapter 7 a trustee will take control of the debtor's assets and liabilities and liquidate the estate to satisfy the demands of the creditors to the greatest extent possible. The fundamental purpose of a chapter 11 bankruptcy is the rehabilitation of the debtor's business. Chapter 11 is useful for businesses which might be successfully rehabilitated rather than being subjected to an economically wasteful liquidation. The debtor often administers a chapter 11 bankruptcy estate, acting in the fiduciary role of "debtor in possession," while continuing to operate the business during the reorganization.

Creditors may assert "claims" against the bankruptcy estate for liabilities incurred by the debtor before bankruptcy or by the trustee during the bankruptcy. A "claim" is a "right to payment" or a "right to an equitable remedy for breach of performance if such breach gives rise to a right to payment."<sup>18</sup> A claim may be contingent or actual and may

7, but may liquidate all or part of a business under chapter 11. A corporation reorganizes under chapter 11. *Id.* §§ 701-766, 1101-1174.

15. Thomas H. Jackson, *Who Pays? Toxic Wastes in Bankruptcy*, STAN. LAW., Fall 1985, at 8, 10.

16. H.R. REP. NO. 595, 95th Cong., 1st Sess. 309 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6266-67; S. REP. NO. 989, 95th Cong., 2d Sess. 21-22 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5807-08; *see also* Williams v. United States Fidelity & Guar. Co., 236 U.S. 549, 554-55 (1915) (recognizing the bankruptcy objective of providing a debtor with a "fresh start").

17. 11 U.S.C. §§ 301, 302(a) (1988).

18. *Id.* § 101(5). This provision states:

'[C]laim' means —

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

be unliquidated, unmatured, or disputed. A “debt” is liability on a claim.<sup>19</sup> A “creditor” is an entity that has a claim against the debtor that arose before the bankruptcy.<sup>20</sup> Claims are classified as either prepetition or postpetition. Prepetition environmental claims arise from liability incurred by the debtor before the filing of the bankruptcy. Postpetition claims arise from liability incurred by the bankruptcy estate after the bankruptcy was filed. The bankruptcy is intended to preserve and distribute the debtor’s assets to creditors who assert claims against a debtor for liabilities incurred prepetition. The bankruptcy is also intended to discharge the debtor’s liability for those debts.<sup>21</sup>

The distinction between prepetition and postpetition claims is very important. In general, a debtor is discharged and no longer personally liable for prepetition obligations unless the obligation is outside the Code’s definition of “claim” and “debt” or the obligation falls within an exception to discharge under section 523(a).<sup>22</sup> Bankruptcy Code section 727<sup>23</sup> governs the discharge of a chapter 7 debtor while section 1141(d)<sup>24</sup> governs the discharge of a chapter 11 debtor. Section 523 identifies claims which cannot be discharged by individual debtors. Although a debtor’s prepetition debts are discharged in bankruptcy, the debtor is *not* discharged of liability incurred *postpetition*, even if the debtor is operating under the protection of the Bankruptcy Code.

Claims asserted by creditors against a debtor typically arise under nonbankruptcy law—usually state law. Nonbankruptcy law categorizes creditors as either secured or unsecured. Bankruptcy law honors the

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

*Id.*

19. *Id.* § 101(12).

20. *Id.* § 101(10).

21. *United States v. LTV Corp. (In re Chateaugay Corp.)*, 112 B.R. 513, 524 (S.D.N.Y. 1990), *aff’d* 944 F.2d 997 (2d Cir. 1991) (“[T]he Bankruptcy Code manifests a strong and clearly expressed congressional intent that a debtor be discharged from all claims, both actual and contingent, which arise out of pre-petition conduct.”).

22. Kathryn R. Heidt, *Environmental Obligations in Bankruptcy: A Fundamental Framework*, 44 FLA. L. REV. 153, 158 (1992).

23. The court shall grant an individual debtor a discharge, unless the debtor falls into one of the exceptions to discharge. 11 U.S.C. § 727(a) (1988). Most exceptions to discharge are based on the debtor’s fraud or misconduct or the fact that the debtor has previously been discharged. A discharge under section 727(a) discharges the debtor from all debts that arose prepetition. *Id.* §§ 523(a), 727(a), (b).

24. The confirmation of a plan discharges the debtor from any debt that arose before the confirmation. *Id.* § 1141(d)(1)(A). The confirmation of a plan does not discharge an individual debtor from any debt excepted under section 523. *Id.* § 1141(d)(2).

valid and perfected liens of secured creditors. A secured creditor receives the proceeds from the sale of the collateral which secured the debt.<sup>25</sup> In addition, the secured creditor may make a claim against the debtor's bankruptcy estate for any deficiency.<sup>26</sup> Thus, the "priority" of a creditor's lien on the debtor's property established under nonbankruptcy law is respected in bankruptcy and is unaltered.

Creditors who have allowed,<sup>27</sup> unsecured claims may share in the distribution of estate assets in a chapter 7 or 11 liquidation or participate in the debtor's chapter 11 reorganization plan. The distribution of estate assets to unsecured creditors is made according to a priority established in the Bankruptcy Code.<sup>28</sup> Pursuant to the Code, administrative expenses incurred during the bankruptcy receive first priority and are paid in full, to the extent funds are available to do so.<sup>29</sup> Priority unsecured claims are paid next, and general unsecured claims are paid last.<sup>30</sup> Typically, funds are insufficient to satisfy all claims, and distribution is made on a pro rata basis in proportion to the amount of claims relative to the total estate assets.

The bankruptcy court may authorize priority payment of administrative expenses incurred by the bankruptcy estate postpetition.<sup>31</sup> Administrative expenses include "the actual, necessary costs and expenses of preserving the estate."<sup>32</sup> A postpetition claim may or may not be entitled to administrative expense priority. Not all postpetition claims are administrative expenses. If a postpetition claim does not qualify as an administrative expense, it is treated as a postpetition general unsecured claim.

25. The Bankruptcy Code provides that a claim is secured to the extent of the value of the creditor's interest in its collateral. *Id.* § 506(a). The Code also provides that the trustee shall dispose of property in which a secured creditor (or any other entity other than the estate) has an interest. *Id.* § 725.

26. The Bankruptcy Code provides that the secured creditor's allowed claim is an unsecured claim to the extent that the value of such creditor's interest in its collateral is less than the amount of such allowed claim. *Id.* § 506(a).

27. The Bankruptcy Code requires creditors who seek payment in bankruptcy to file a proof of claim or interest. *Id.* § 501. The Code also provides procedures for the allowance of such claims or interests in bankruptcy. *Id.* § 502.

28. *Id.* § 507(a).

29. *Id.* §§ 503(b), 507(a)(1).

30. *Id.* §§ 507(a)(2), 502(f).

31. *Id.* § 503.

32. *Id.* § 503(b)(1)(A).

The Bankruptcy Code defines a “claim” and establishes the priority for payment of various classes of claims. Although bankruptcy law establishes the priority for payment of various classes of claims, it does not determine the class into which a particular claim falls. That is determined by nonbankruptcy law. For example, state law establishes the priority of a lender’s recorded deed of trust; that priority is respected in bankruptcy.

### III. DISCHARGEABILITY OF ENVIRONMENTAL CLAIMS IN BANKRUPTCY

The issue of the proper treatment of environmental claims in bankruptcy arises in two common, yet opposing, contexts: (1) the *dischargeability* of environmental claims and (2) the *prioritization* of environmental claims for the purpose of sharing in the distribution of estate assets. In either context, a court’s analysis must begin with a determination of whether the environmental liability constitutes a “claim” within the meaning of the Bankruptcy Code, and if so, when the claim arose—prepetition or postpetition. A distinction must be made between the *existence* of a claim pursuant to section 101(5) and the *dischargeability* of a claim pursuant to sections 727 and 1141(d)(1)(A). The existence of a claim does not assure the dischargeability of that claim. Few courts distinguish between the issue of when a claim *arises* and when a claim is *dischargeable* in bankruptcy. This section identifies difficulties in making these determinations and suggests criteria for doing so that are consistent with both environmental and bankruptcy law objectives.

Classification of an environmental claim as either prepetition or postpetition can be complicated because prepetition acts or occurrences frequently have postpetition consequences. An environmental claim may arise when the debtor first acts (for example, by placing hazardous waste in a disposal site), when the hazardous waste is released, when the release is discovered, or when the cost of hazardous waste cleanup is incurred. This classification problem, however, is not unique to environmental liability. Other forms of liability present equally difficult classification problems. For example, tort claims are difficult to classify because a tortious act may occur prepetition but the consequences may not develop for many years or may only be discovered postpetition.

The characterization of a claim as prepetition or postpetition is significant because it affects the determinations of whether the claim is dischargeable, and if it is not, whether the claim should be treated as a

general unsecured claim or a claim entitled to administrative priority.<sup>33</sup> If a creditor has a prepetition environmental claim, it is subject to discharge and the creditor is one of many unsecured creditors paid on a pro rata basis after payment of administrative expenses and higher priority unsecured claims. If a creditor has a postpetition environmental claim, it may qualify as an administrative expense.

The question of whether an environmental "claim" is dischargeable was addressed by the Supreme Court in *Ohio v. Kovacs*.<sup>34</sup> The Court held that prepetition environmental claims which could be properly characterized as *demands for money* were dischargeable.<sup>35</sup> However, the decision did not alter the duty of the debtor to obey an injunction which prohibited the debtor from creating any further pollution.<sup>36</sup> The *injunction* was not dischargeable. The *Kovacs* case raised the fundamental questions: (1) what type of environmental liability will be considered a "claim" for purposes of discharge in bankruptcy and (2) when does an environmental claim arise. Several tests have been developed by the courts to determine when an environmental claim arises and whether it is dischargeable.

#### A. *The Legal Relationship Test*

The Court of Appeals for the Third Circuit<sup>37</sup> and a few other

33. See *supra* part II.B.

34. 469 U.S. 274 (1985).

35. *Id.* at 275, 281.

36. *Id.* at 284-85.

37. *In re Penn Cent. Transp. Co.*, 944 F.2d 164 (3d Cir. 1991) (holding that hazardous waste cleanup costs arising from debtor's prepetition activities could be asserted against the reorganized debtor because no legal relationship existed to establish a prepetition contingent CERCLA claim and that a CERCLA claim could not arise before CERCLA was created), *cert. denied*, *Penn Cent. Corp. v. United States*, 503 U.S. 906 (1992); *Schweitzer v. Consolidated Rail Corp.*, 758 F.2d 936 (3d Cir.) (explaining that tort "claims" did not arise until plaintiffs suffered identifiable and compensable injuries from exposure to asbestos, at which time a legal relationship arose simultaneously with the plaintiffs' cause of action), *cert. denied*, 474 U.S. 864 (1985); *Avellino & Bienes v. M. Frenville Co. (In re M. Frenville Co.)*, 744 F.2d 332 (3d Cir. 1984) (deciding that when debtor's accountant sought indemnification from the debtor after several banks brought suit against the accountant postpetition, a "claim" did not arise until the accountant filed an answer in the underlying lawsuit), *cert. denied*, 469 U.S. 1160 (1985).

courts<sup>38</sup> have considered the legal relationship between parties in making the determination of when a claim arises. A legal relationship must exist between the creditor and debtor which gives rise to the claim. Strictly construed, the legal relationship test requires that a claimant have an existing cause of action in order to establish a claim in bankruptcy. For example, applying this criterion to a tort, a negligent act does not give rise to a claim until the tort victim suffers identifiable, compensable injury, as required for a cause of action to accrue under state law.<sup>39</sup> Courts, in applying this criterion to environmental liability, have refused to recognize a contingent prepetition CERCLA claim when the government has not incurred any response costs prepetition because the government has no cause of action against the debtor under CERCLA until it incurs response costs.<sup>40</sup> CERCLA does not give rise to a cognizable legal claim until funds have been expended or remedial measures have been taken to address environmental hazards. To foster rapid cleanups, Congress has adopted a policy of delaying litigation to determine environmental liability until after the investigation and cleanup.

One problem with the legal relationship test is that it fails to differentiate between a claim in bankruptcy and a cause of action under nonbankruptcy law. Although nonbankruptcy law governs the *existence* of a claim in bankruptcy, it is not dispositive of *when* a claim arises.<sup>41</sup> Under the current Bankruptcy Code, the definition of “claim” includes contingent, unliquidated, and unmaturing claims.<sup>42</sup> Under the former Code, the Bankruptcy Act of 1898,<sup>43</sup> creditors could only assert

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38. *Al Tech Specialty Steel Corp. v. Allegheny Int'l, Inc. (In re Allegheny Int'l, Inc.)*, 126 B.R. 919 (Bankr. W.D. Pa. 1991) (stating that a “claim” arises when a cause of action is established under CERCLA, which occurs only after the claimant has incurred *some* response costs); *United States v. Union Scrap Iron & Metal*, 123 B.R. 831 (D. Minn. 1990) (arguing that nonbankruptcy substantive law defines when a particular relationship between a debtor and a third party amounts to a legal obligation giving rise to a bankruptcy “claim” and that under CERCLA the government must incur response costs to establish a legal obligation); *In re Forty-Eight Insulations, Inc.*, 58 B.R. 476 (Bankr. N.D. Ill. 1986) (finding that future unknown claimants who have been exposed to asbestos but have not yet manifested injuries do not have bankruptcy “claims”).

39. *Schweitzer v. Consolidated Rail Corp.*, 758 F.2d 936 (3d Cir.), *cert. denied*, 474 U.S. 864 (1985); *In re Forty-Eight Insulations, Inc.*, 58 B.R. 476 (Bankr. N.D. Ill. 1986). *But see In re UNR Indus., Inc.*, 725 F.2d 1111 (7th Cir. 1984) (holding that a “claim” for bankruptcy purposes *may* include liability to tort victims exposed to asbestos who have not yet manifested asbestos-related injuries and therefore have not accrued a cause of action under state law).

40. *Allegheny*, 126 B.R. at 925; *Union Scrap*, 123 B.R. at 835.

41. *In re National Gypsum Co.*, 139 B.R. 397, 405 (N.D. Tex. 1992).

42. *See supra* note 18.

43. The Bankruptcy Act of July 1, 1898, ch. 541, 30 Stat. 544 (codified as amended at 11 U.S.C. §§ 1-1103 (1976) (repealed 1978)).

“provable” claims. Parties holding contingent or unliquidated claims were excluded from the distribution of estate assets. As a result, the debtor’s fresh start was impaired because such claims were not discharged and creditors were able to pursue the debtor after bankruptcy. Congress has abolished the provability requirement. The current Code includes procedures for courts to estimate contingent or unliquidated claims<sup>44</sup> so that the claims may be paid and the debtor discharged. However, the legal relationship test excludes contingent and unmatured claims from bankruptcy. Consequently, adhering to the legal relationship test adds the concept of provability into the meaning of “claim,” which the drafters of the Code specifically intended to abolish.<sup>45</sup> Thus, the legal relationship test is in direct conflict with the existing Code as well as with congressional intent.<sup>46</sup>

A second problem with the legal relationship test is that it precludes creditors with contingent or unmatured claims from sharing in the distribution of estate assets in a chapter 7 liquidation. If unincurred response costs for cleanup of prepetition releases are not valid contingent claims, then environmental agencies will be uncompensated by a corporation in a chapter 7 liquidation.<sup>47</sup> In addition, preventing a claim from arising until a cause of action accrues inhibits the debtor’s ability to discharge prepetition liability and start anew.<sup>48</sup>

A related problem with the legal relationship test is that a debtor may be precluded from effectuating a reorganization under chapter 11. Although unincurred response costs may not constitute a claim, that contingent liability may be substantial nonetheless and may impair the

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44. 11 U.S.C. § 502(c) (1988). The legislative history explains that “contingent or unmatured claims are to be liquidated by the bankruptcy court in order to afford the debtor complete bankruptcy relief.” H.R. REP. NO. 595, 95th Cong., 1st Sess. 352 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6308; S. REP. NO. 989, 95th Cong., 2d Sess. 62 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5848.

45. *In re Johns-Manville Corp.*, 57 B.R. 680, 690 (Bankr. S.D.N.Y. 1986).

46. The 1978 Bankruptcy Code’s legislative history states that “[a]ll claims against the debtor, whether or not contingent or unliquidated, will be dealt with in the bankruptcy case . . . . The proposed law will permit a complete settlement of the affairs of a bankrupt debtor, and a complete discharge and fresh start.” H.R. REP. NO. 595, 95th Cong., 1st Sess. 180 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6141.

47. *Ohio v. Kovacs*, 469 U.S. 274, 285-86 (1985) (O’Connor, J., concurring); *United States v. LTV Corp. (In re Chateaugay Corp.)*, 944 F.2d 997, 1005 (2d Cir. 1991).

48. *Roach v. Edge (In re Edge)*, 60 B.R. 690, 699 (Bankr. M.D. Tenn. 1986).

debtor's prospects of achieving a viable reorganization. Unable to reorganize, some corporations may be forced to liquidate in bankruptcy or dissolve under state law. As a result, the debtor's assets will be unavailable for environmental cleanup because the liability is not yet a claim entitled to pro rata payment.<sup>49</sup>

A third problem with the legal relationship test is that creditors may manipulate the timing of their claims to obtain the most desirable treatment of their claim. In a chapter 7 liquidation, a creditor will not delay because only creditors with prepetition claims will share in the distribution of estate assets. In a chapter 11 reorganization, however, a creditor may choose to delay in order to obtain a postpetition claim which is not discharged in the bankruptcy and which may be pursued against the reorganized company. Allowing creditors to manipulate the classification of their environmental claims by delaying cleanup or investigation is in contravention of congressional intent in enacting CERCLA, which was to allow the government to remedy environmental hazards speedily.

Many courts and commentators have criticized the legal relationship reasoning.<sup>50</sup> The Court of Appeals for the Third Circuit,<sup>51</sup> retreating from a strict interpretation of the "legal relationship" test, recognized that "a party may have a bankruptcy claim and not possess a cause of action on that claim."<sup>52</sup> However, the court maintained that any interest cognizable under the Code must stem from "a legal relationship relevant to the purported interest from which that interest may flow."<sup>53</sup>

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49. *Chateaugay*, 944 F.2d at 1002, 1005.

50. *E.g.*, *Erti v. Paine Webber Jackson & Curtis, Inc.* (*In re Baldwin-United Corp. Litig.*), 765 F.2d 343, 348 n.4 (2d. Cir. 1985); *In re National Gypsum Co.*, 139 B.R. 397, 405 (N.D. Tex. 1992) (holding that it is immaterial in bankruptcy whether a claim is ripe for adjudication under nonbankruptcy law as long as all the elements that give rise to liability under nonbankruptcy law have occurred); *Danzig Claimants v. Grynberg* (*In re Grynberg*), 113 B.R. 709 (Bankr. D. Colo. 1990) (finding that the bankruptcy definition of "claim" is not inextricably linked to the accrual of a cause of action under state law); *In re Johns-Manville Corp.*, 57 B.R. 680, 690 (Bankr. S.D.N.Y. 1986) (concluding that a prepetition claim may encompass a cause of action that is not cognizable under nonbankruptcy law until after the bankruptcy has commenced). *Contra* Philippe J. Kahn, Comment, *Bankruptcy Versus Environmental Protection: Discharging Future CERCLA Liability in Chapter 11*, 14 CARDOZO L. REV. 1999, 2054 (1993) (recommending that a CERCLA "claim" arises at the time the CERCLA cause of action fully accrues and that the CERCLA "claim" be handled through settlement provisions in CERCLA rather than through a bankruptcy reorganization).

51. *Kilbarr Corp. v. General Servs. Admin.* (*In re Remington Rand Corp.*), 836 F.2d 825 (3d Cir. 1988).

52. *Id.* at 832.

53. *Id.*

### B. *The Debtor's Conduct Test*

The Court of Appeals for the Second Circuit<sup>54</sup> and other courts<sup>55</sup> have considered the debtor's conduct in making the determination of when a claim arises. Under the debtor's conduct test, the determination of when a claim arises is based on the timing of the debtor's actions that gave rise to the claim. The debtor's conduct, rather than the legal relationship between parties, can transform a nondischargeable postpetition claim under the legal relationship test into a dischargeable prepetition claim under the debtor's conduct test.

In the case of *In re Chateaugay Corp.*,<sup>56</sup> the EPA sought their post-confirmation costs for cleanup of the debtor's prepetition releases of hazardous waste to be considered outside the Code's definition of "claim" so that the claim would not be discharged in the chapter 11 bankruptcy and the EPA could pursue the reorganized company. The court affirmed the district court's decision that "an obligation to reimburse [the] EPA for response costs is a dischargeable claim whenever based upon a pre-petition release or threatened release of hazardous substances . . . even though [prepetition releases] have not then been discovered by [the] EPA (or anyone else)."<sup>57</sup> The Second Circuit affirmed the district court's finding that "before a contingent claim can be discharged, it must result from pre-petition conduct [resulting in a release or threatened release] *fairly giving rise to that*

54. *United States v. LTV Corp. (In re Chateaugay Corp.)*, 944 F.2d 997 (2d Cir. 1991).

55. *Grady v. A.H. Robins Co.*, 839 F.2d 198, 203 (4th Cir.) (holding that a claim arises when a tortious act or breach of warranty occurs prepetition), *cert. dismissed sub nom. Joynes v. A.H. Robins Co.*, 487 U.S. 1260 (1988); *Danzig Claimants v. Grynberg (In re Grynberg)*, 113 B.R. 709, 713 (Bankr. D. Colo. 1990) (explaining that the triggering act which constitutes the basis for the cause of action must have occurred prepetition); *In re Johns-Manville Corp.*, 57 B.R. 680, 690 (Bankr. S.D.N.Y. 1986) (stating that in determining when a claim arises the focus should be on the timing of the debtor's acts which give rise to the claim); *Roach v. Edge (In re Edge)*, 60 B.R. 690, 699 (Bankr. M.D. Tenn. 1986) (recognizing an unmatured and contingent claim even though the injury was undiscovered by the victim because a relationship existed between tortfeasor and victim based on contact at the time of the tortious act and the consequential potential tort liability).

56. 944 F.2d 997 (2d Cir. 1991).

57. *Id.* at 1000.

*contingent claim.*<sup>58</sup> The court explained that the “relationship between environmental regulating agencies and those subject to regulation provides sufficient ‘contemplation’ of contingencies to bring most ultimately maturing payment obligations based on pre-petition conduct within the definition of ‘claims.’”<sup>59</sup> The court characterized the EPA’s claim as contingent rather than determining it to be outside the Code’s definition of claim. All prepetition environmental liability was discharged in the debtor’s bankruptcy.

Many courts and commentators agree that a “relationship” must exist between a creditor and a debtor in order to lay a foundation for a claim in bankruptcy.<sup>60</sup> The *Chateaugay* decision has been criticized because it broadens the concept of relationship to a point which undermines the rationale for considering whether a relationship exists, namely that a creditor with a relationship may anticipate its potential claim.<sup>61</sup> One commentator has argued: “Despite Congress’s repeal of the ‘provability’ requirement and its broad definition of ‘claim,’ nothing in the legislative history or the Code suggests that Congress intended to discharge a creditor’s rights before the creditor knew or should have known that its rights existed.”<sup>62</sup>

The creditor’s knowledge of the potential claim is an important factor to consider in applying the debtor’s conduct test. Some courts considering the debtor’s conduct test are presented with the issue of whether a creditor is precluded from pursuing a claim against a debtor because the debtor is protected by the automatic stay provision of the Bankruptcy Code.<sup>63</sup> In these cases, the creditor is well aware of its rights against the debtor and is seeking redress. However, other courts, presented with the issue of the dischargeability of contingent claims, encounter difficult issues regarding to what extent, if any, a creditor must have knowledge or notice of contingent liability for the debtor to be discharged from that liability.<sup>64</sup> In *Chateaugay*, the court discharged

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58. *United States v. LTV Corp. (In re Chateaugay Corp.)*, 112 B.R. 513, 521 (S.D.N.Y. 1990) (emphasis added), *aff’d*, 944 F.2d 997 (2d Cir. 1991).

59. *Chateaugay*, 944 F.2d at 1005.

60. *E.g.*, *Pettibone Corp. v. Ramirez (In re Pettibone Corp.)*, 90 B.R. 918, 931-33 (Bankr. N.D. Ill. 1988); *Roach v. Edge (In re Edge)*, 60 B.R. 690, 699 (Bankr. M.D. Tenn. 1986).

61. *E.g.*, Kevin J. Saville, Note, *Discharging CERCLA Liability in Bankruptcy: When Does a Claim Arise?*, 76 MINN. L. REV. 327, 353 (1991).

62. *Id.* at 349.

63. 11 U.S.C. § 362(a) (1988).

64. Shawn F. Sullivan, Note, *Discharge of CERCLA Liability in Bankruptcy: The Necessity for a Uniform Position*, 17 HARV. ENVTL. L. REV. 445 (1993) (discussing the due process requirements associated with discharging CERCLA claims in a chapter 11 reorganization). See *infra* part III.D for a discussion of dischargeability.

the debtor because the debtor and creditor were well aware of each other. The debtor was aware of its contingent environmental liability and scheduled the government agency as a creditor; the creditor received notice of the bankruptcy and filed a proof of claim. The creditor had an opportunity to anticipate its potential claims based on its prepetition regulatory relationship with the debtor.<sup>65</sup>

### C. *The Fair Contemplation Test*

The Court of Appeals for the Ninth Circuit<sup>66</sup> and other courts<sup>67</sup> have considered whether liability resulting from the debtor's conduct was or could have been fairly contemplated by the parties in determining whether a claim is dischargeable. If liability was, or should have been, fairly contemplated by the parties prepetition, it gives rise to a prepetition claim which may be discharged in bankruptcy. These courts combine the separate issues of when a claim arises and whether the claim may be discharged into a single inquiry.

In *In re Jensen*, the Ninth Circuit held that where the state had sufficient knowledge of the debtors' potential liability for cleanup costs before the debtors filed their bankruptcy petition, the state's contingent claim was discharged.<sup>68</sup> The Court of Appeals for the Seventh Circuit, in *In re Chicago, Milwaukee, St. Paul & Pacific Railroad Co.*,<sup>69</sup> although not expressly adopting the fair contemplation test, explained:

[W]hen a potential CERCLA claimant can tie the bankruptcy debtor to a known release of a hazardous substance which this potential claimant knows will lead

65. *United States v. LTV Corp. (In re Chateaugay Corp.)*, 944 F.2d 997, 1005 (2d Cir. 1991).

66. *California Dep't of Health Servs. v. Jensen (In re Jensen)*, 995 F.2d 925 (9th Cir. 1993).

67. *In re Chicago, Milwaukee, St. Paul & Pac. R.R.*, 974 F.2d 775 (7th Cir. 1992) (holding that a prepetition claim existed where the claimant knew there had been a release, response costs were imminent, and liability was tied to the debtor); *Am Int'l, Inc. v. Datacard Corp.*, 146 B.R. 391 (N.D. Ill. 1992) (although not adopting the fair contemplation test per se, following the magistrate judge's recommended holding that a contingent claim arises when a release occurs and is dischargeable if it was within the fair contemplation of the parties at the time of the bankruptcy filing); *In re National Gypsum Co.*, 139 B.R. 397 (N.D. Tex. 1992) (finding that the debtor's liability or response costs associated with prepetition activity gave rise to a dischargeable claim to the extent that such claims could fairly be contemplated by the parties at the time of commencement of the case).

68. *Jensen*, 995 F.2d at 931.

69. 974 F.2d 775 (7th Cir. 1992)

to CERCLA response costs, and when this potential claimant has, in fact, conducted tests with regard to this contamination problem, then this potential claimant has, at least, a contingent CERCLA claim . . . .<sup>70</sup>

In that case the prepetition claim was discharged and the claimant was not allowed to pursue the reorganized debtor.

The *In re National Gypsum Co.*<sup>71</sup> court identified factors relevant to the inquiry of fair contemplation by the parties. These factors are “knowledge by the parties of a site in which a PRP may be liable, [a National Priorities List] listing, notification by [the] EPA of PRP liability, commencement of investigation and cleanup activities, and incurrence of response costs.”<sup>72</sup> That court considered the debtor’s conduct test applied in *Chateaugay* so broad a definition of claim as to encompass costs that could not fairly have been contemplated by the EPA or the debtor prepetition.<sup>73</sup> Those claims not fairly contemplated by the parties should not be discharged.

The fair contemplation test is inconsistent with the language of both the Bankruptcy Code and CERCLA. A claim is based on a right to payment. In order to establish a claim, there is no requirement in the Code that the parties have fairly contemplated liability at the time of the bankruptcy. Although Congress has not defined “contingent” in the Code, some courts and commentators have found that a contingent claim for bankruptcy purposes exists when the liability-triggering event is “reasonably contemplated by the debtor and creditor at the time the event giving rise to the claim occurred.”<sup>74</sup> However, the dictionary definition of “contingent liability” is a liability which “is not now fixed and absolute, but which will become so in case of the occurrence of some future and uncertain event.”<sup>75</sup> Using this definition, fair contemplation, or foreseeability, is not necessary to establish a contingent claim. A contingent claim arises under CERCLA if the acts giving rise to a need for environmental cleanup occur prepetition. Under these circumstances, the government has a prepetition right to relief which carries with it an alternative right to payment, even though it is contingent on the government expending money. Neither

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70. *Id.* at 786.

71. 139 B.R. 397 (N.D. Tex. 1992).

72. *Id.* at 408.

73. *Id.*

74. *In re All Media Properties, Inc.*, 5 B.R. 126, 133 (Bankr. S.D. Tex. 1980), *aff’d sub nom.* *All Media Properties, Inc. v. Best (In re All Media Properties, Inc.)*, 646 F.2d 193 (5th Cir. 1981); *see also* *United States v. LTV Corp. (In re Chateaugay Corp.)*, 944 F.2d 997, 1004 (2d Cir. 1991); Saville, *supra* note 61, at 362 (arguing that if environmental liability is “foreseeable,” it should be discharged; if it is not, it should remain with the debtor).

75. BLACK’S LAW DICTIONARY 321 (6th ed. 1990).

the timing nor the foreseeability of the government's cleanup expenditures should be a factor in determining whether there is a claim. Nothing in either CERCLA or the Bankruptcy Code supports such a proposition.<sup>76</sup>

CERCLA imposes liability on property owners when there is a release of a hazardous substance on their property—whether or not the owner is at fault or is even aware of the release. The debtor's liability for repayment of the EPA's remediation costs does not depend on whether or not the EPA or the property owner fairly contemplated, at any time, that the EPA would need to take action to remediate the property in the future. A contingent claim arises in bankruptcy when contingent liability arises under nonbankruptcy law. Contingent liability under CERCLA arises when the debtor's conduct results in the release or threatened release of a hazardous substance. At that time the property owner's liability is contingent only upon the EPA taking steps to remedy the environmental hazard. The debtor need not take any further action for a cause of action to accrue under CERCLA in the future.

Although foreseeability is not a factor in establishing a contingent claim in bankruptcy, one must consider separately the issue of whether foreseeability is a factor in the *dischargeability* of a contingent claim in bankruptcy. No provision in the Code explicitly requires that a prepetition liability be "fairly contemplated" by the parties in order to be discharged. No explicit exception to discharge exists in the Bankruptcy Code for prepetition contingent environmental claims. Unless prepetition environmental claims fall within an exception to discharge, they should be discharged.

Only one exception to discharge, section 523(a)(3)(A),<sup>77</sup> may be applicable. If an individual debtor fails to list or schedule a claim in time for the creditor to file a proof of claim, the creditor's claim will not be discharged unless the creditor had notice or actual knowledge of the case in time to file a claim. This exception assures that creditors will have an opportunity to share in the distribution of the estate assets. If the debt is neither listed nor scheduled and the creditor has no notice,

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76. Heidt, *supra* note 22, at 179.

77. "A discharge . . . does not discharge an individual debtor from any debt . . . (3) neither listed nor scheduled . . . in time to permit — (A) . . . timely filing of a proof of claim, unless such creditor had notice or actual knowledge of the case in time for such timely filing . . ." 11 U.S.C. § 523(a)(3)(A) (1988).

the creditor cannot file a claim and share in the distribution of estate assets.

In general, if notice and participation cannot be provided to a creditor holding an unknown future claim, that creditor's due process rights *may* limit the court's ability to discharge a debtor's prepetition claims.<sup>78</sup> One court has required that the claimant have had notice of the debtor's potential liability in time to file a proof of claim in order for the environmental claim to be discharged.<sup>79</sup> The Seventh Circuit recognized this problem in *In re UNR Industries, Inc.*<sup>80</sup> The court stated that "[t]he practical difficulties of identifying, giving constitutionally adequate notice to, and attempting to estimate the damages of [unknown future claimants] are formidable, and possibly insurmountable."<sup>81</sup> However, this potential limitation on the dischargeability of prepetition contingent claims is not based on the concept of "claim" or of "dischargeability," but instead on the claimant's due process rights.

Even if a claimant is given notice, the notice may not be constitutionally sufficient if it does not provide sufficient details regarding the claim.<sup>82</sup> On the other hand, due process may require no more than the best possible notice under the circumstances.<sup>83</sup> One problem with the fair contemplation test, which requires that contingent liability be fairly contemplated by the parties, is that it is more stringent than the requirements imposed by due process. Providing a creditor with proper notice may satisfy due process requirements, but such notice cannot substitute for the parties' fair contemplation of contingent liability prepetition. Bankruptcy, environmental, and constitutional laws do not justify imposing the stricter requirement of the fair contemplation test.

Another problem with the fair contemplation test, like the legal relationship test, is that it encourages "dilatatory tactics" on the part of the creditor. The incentive is for the creditor to strategize on when to act in order to avoid dischargeability of environmental claims in bankruptcy. If the creditor acts after the bankruptcy is filed rather than before, the claim may not be considered "in the fair contemplation" of the parties.

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78. *Roach v. Edge (In re Edge)*, 60 B.R. 690, 692 (Bankr. M.D. Tenn. 1986). See generally Sullivan, *supra* note 64; Kahn, *supra* note 50, at 2034.

79. *Sylvester Bros. Dev. Co. v. Burlington N. R.R.*, 133 B.R. 648, 653 (D. Minn. 1991) (holding that "[w]hen the debtor has not disclosed its potential CERCLA . . . liabilities in long-since closed bankruptcy proceedings, and the governmental agency has not had actual knowledge of the potential claim in sufficient time to file a claim in those proceedings, the potential CERCLA . . . liability is not discharged").

80. 725 F.2d 1111, 1119 (7th Cir. 1984).

81. *Id.*

82. Saville, *supra* note 61, at 350.

83. *Roach v. Edge (In re Edge)*, 60 B.R. 690, 692 (Bankr. M.D. Tenn. 1986) (citing *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306 (1950)).

Similarly, the debtor may simply notify the creditor of potential liability prior to filing bankruptcy in order to assure the creditor's prepetition "fair contemplation." This is inapposite to the congressional intent of CERCLA to facilitate immediate cleanup because it will unduly burden the government with unnecessary investigations which will delay environmental cleanups of the most seriously contaminated properties.

*D. Picking the "Right" Test: When a Claim Arises and When a Claim is Discharged*

The Bankruptcy Code has no separate provision defining an "environmental claim." The intent of section 101(5) is that "claim" be interpreted broadly, encompassing contingent, unmatured, unliquidated and disputed claims based on state or federal nonbankruptcy law resulting from the debtor's prepetition conduct.<sup>84</sup> When Congress enacted this revision of the Bankruptcy Code, it broadened the definition of "claim" to encompass all types of liability incurred by the debtor within the bankruptcy case. Therefore, an "environmental claim" should fall within the general definition of "claim" provided in section 101(5) of the Code<sup>85</sup> and should not be treated separately or specially.

The Bankruptcy Code does not specify when a claim arises and courts have struggled with this determination. The legal relationship test cannot be supported because it excludes contingent and unmatured claims from bankruptcy, in direct conflict with the Bankruptcy Code and congressional intent, and encourages creditors to exercise dilatory tactics to achieve preferential treatment of their claims. The fact that cleanup takes place after the date of relief should have no effect on the classification of the claim to recover cleanup expenses. Similarly, the fair contemplation test cannot be supported. The fair contemplation test can be viewed either as narrowing the definition of "claim" to include only environmental liability fairly contemplated by the parties or as excepting from discharge any environmental claim not fairly contemplated by the parties. Either view is inconsistent with the Bankruptcy Code and environmental law.

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84. The legislative history indicates that Congress intended a broad definition of "claim." H.R. REP. NO. 595, 95th Cong., 1st Sess. 309 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6266; S. REP. NO. 989, 95th Cong., 2d Sess. 21 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5807-08.

85. 11 U.S.C. § 101(5) (1988).

The debtor's conduct test is consistent with both bankruptcy and environmental law. A claim arises when prepetition conduct by the debtor results in the release or threatened release of a hazardous substance into the environment.<sup>86</sup> Under CERCLA, contingent liability exists when a hazardous environmental condition exists, regardless of fault, knowledge, or fair contemplation of such liability, until the government takes some form of cleanup action.<sup>87</sup> The bankruptcy court should not exclude contingent claims because they are not fairly contemplated by the parties when this contingent liability exists outside of bankruptcy.

The National Bankruptcy Conference (NBC), an organization devoted to defining what reforms should be made to the Bankruptcy Code, has proposed a rule that considers the debtor's conduct in determining when an environmental claim arises.<sup>88</sup> According to the NBC, environmental claims should be treated just as any other claim. A prepetition environmental claim, like any other prepetition claim, should be discharged unless it falls within an exception to discharge provided in the Code.

The conflict between environmental policies and bankruptcy policies is particularly clear when considering the discharge of a debtor's environmental liability. Although no exception to discharge of environmental liability exists in the Code, expeditious and effective cleanup of hazardous substances is an important environmental objective which may justify the creation of a new exception. Congress bears the burden of weighing competing policies and establishing this exception to discharge through legislation. If an exception to discharge is desirable based on environmental policies, Congress should modify the Bankruptcy Code to incorporate such an exception. Bankruptcy courts confronted with environmental claims should not modify existing priorities, established both inside and outside of bankruptcy law, by redefining the meaning of "claim" and by creating nonstatutory exceptions to discharge, in order to satisfy environmental objectives.

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86. *See id.*

87. *See* 42 U.S.C. § 9605(c) (1988).

88. "A claim against a debtor for environmental harm should be regarded as arising (A) When the debtor first (1) acts, resulting in, (2) fails to act, resulting in, or (3) otherwise becomes legally responsible for the harm, (B) irrespective of when the harm (1) occurs, (2) is manifested, (3) is fully known or knowable, or (4) is remediated." ALI-ABA Conference, Bankruptcy Reform Circa 1993, A Presentation of the NBC's Bankruptcy Code Review Project, June 10-12, 1993 at Atlanta, GA, at 4-5 [hereinafter Bankruptcy Reform].

## IV. ABANDONMENT

The treatment of environmental claims in bankruptcy is controversial because of the competing policies of environmental and bankruptcy law. When a party responsible for environmental damage seeks relief in bankruptcy, the question is *who* must bear the cost of environmental remediation. If the environmental liability gives rise to a prepetition claim, the government will bear the burden of a majority of the cleanup costs because the bankruptcy estate will only pay the EPA on a pro rata basis with other unsecured creditors. However, if the environmental claim arose postpetition and qualifies as an administrative expense, the bankruptcy estate will bear the burden of paying the cleanup costs to the extent funds are available because the claim will be paid from estate assets, in full, ahead of unsecured creditors.

In determining whether an environmental claim should be entitled to administrative priority, some courts consider the trustee's power to abandon<sup>89</sup> the property relevant. The *abandonment* of property subject to environmental liability is interpreted as a question of environmental claim *priority* cast in a slightly different form. These courts hold that a bankruptcy court cannot authorize a trustee to abandon property without requiring the trustee to first clean up the property or reimburse others for the cleanup costs.<sup>90</sup> The result of denying abandonment is the prioritization of the environmental claim ahead of all other unsecured claims because the funds used to satisfy the environmental claim would otherwise be available to pay unsecured creditors. Thus, the decisions of these courts regarding abandonment of property are in fact decisions establishing environmental claim priority.<sup>91</sup>

These courts do not adequately distinguish between the issues of abandonment and environmental claim priority. Abandonment and environmental claim priority are distinct issues. The abandonment issue requires a determination of the conditions under which a trustee may avoid the future liability associated with continued ownership or

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89. The Bankruptcy Code provides: "After notice and a hearing, the trustee may abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate." 11 U.S.C. § 554(a) (1988).

90. See part V.A for a discussion of the role of abandonment in determining administrative priority and an analysis of the conflicting case law.

91. Jackson, *supra* note 15, at 12.

operation of property in the bankruptcy estate. The claim priority issue requires a determination of whether a creditor's environmental claim is secured or unsecured, prepetition or postpetition, and necessary to preserve the estate. Based on these factors, the bankruptcy court decides the portion of estate assets to which the creditor is entitled. Treatment of environmental claims is discussed in part V.

Section 554 of the Bankruptcy Code authorizes a trustee to abandon property that is "burdensome" or of "inconsequential value and benefit" to the bankruptcy estate.<sup>92</sup> By abandoning burdensome property, the trustee may expend estate resources in liquidating only those assets which have a net value to the estate. Abandonment benefits the estate by freeing the estate from obligations that have not yet arisen but might arise if the trustee remains the property owner during bankruptcy.<sup>93</sup> A trustee who abandons burdensome property prevents the bankruptcy estate from incurring postpetition liability associated with ownership of the property.

Courts disagree on the conditions under which a trustee may abandon property subject to environmental liability.<sup>94</sup> Part of the reason for disagreement is due to the misperception that when a trustee abandons burdensome property, the trustee also abandons the debtor's liability for environmental cleanup of the property. The trustee may abandon the property, but not the debtor's prepetition liability incurred as a consequence of owning the property prepetition. The trustee's decision to keep or abandon burdensome property does not affect that liability and abandonment does not relieve the trustee from responsibility for the debtor's prepetition liabilities.

#### A. *The Midlantic Decision*

Although the trustee's abandonment power is unconditional as defined in section 554 of the Code, the Supreme Court has restricted that power when the property in question is subject to environmental liability. In the landmark case of *Midlantic National Bank v. New Jersey Department of Environmental Protection*,<sup>95</sup> the Supreme Court considered a trustee's power to abandon property containing toxic waste. In that case, Quanta Resources Corporation (Quanta) processed waste oil at two

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92. 11 U.S.C. § 554(a), (b) (1988).

93. Douglas G. Baird, *A World Without Bankruptcy*, LAW & CONTEMP. PROBS., Spring 1987, at 173.

94. See *infra* notes 111-12 and accompanying text.

95. 474 U.S. 494 (1986).

facilities located in New York and New Jersey.<sup>96</sup> Investigations revealed that Quanta accepted more than 470,000 gallons of oil contaminated with PCB, a toxic carcinogen, at the two sites.<sup>97</sup> Quanta filed a chapter 11 petition for reorganization during negotiations for cleanup of the New Jersey site and converted to chapter 7 liquidation after receiving a cleanup order.<sup>98</sup>

The bankruptcy court approved the trustee's abandonment of the New York facility and the contaminated oil at the New Jersey site.<sup>99</sup> The trustee removed the guard service and shut down the fire-suppression system. The bankruptcy court did not require the trustee to take steps to reduce imminent danger although 470,000 gallons of highly toxic waste oil in unguarded, deteriorating containers presented risks of explosion, fire, contamination of water supplies, destruction of natural resources, and injury, genetic damage, or death through personal contact.<sup>100</sup> The Court of Appeals for the Third Circuit reversed the bankruptcy court's decisions.<sup>101</sup>

The Supreme Court affirmed the court of appeals' decisions and refused to allow the trustee to abandon the contaminated properties. The Supreme Court found the trustee's abandonment "aggravated already existing dangers by halting security measures that prevented public entry, vandalism, and fire."<sup>102</sup> Although section 554(a) allows a trustee to abandon property which is burdensome or of inconsequential value, the Supreme Court created a *narrow* exception and refused to allow abandonment. The Supreme Court concluded:

Congress did not intend for § 554(a) to pre-empt all state and local laws. 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. Accordingly, without reaching the question whether certain state laws imposing conditions on abandonment may be so onerous as to interfere with the bankruptcy adjudication itself, [the Court] hold[s] that a trustee may not abandon property in contravention of a state statute or regulation that is

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96. *Id.* at 494.

97. *Id.* at 496-97.

98. *Id.* at 497.

99. *Id.*

100. *Id.* at 499 n.3.

101. *City of New York v. Quanta Resources Corp. (In re Quanta Resources Corp.)*, 739 F.2d 912 (3d Cir. 1984); *In re Quanta Resources Corp.*, 739 F.2d 927 (3d Cir. 1984).

102. *Midlantic*, 474 U.S. at 499 n.3.

reasonably designed to protect the public health or safety from identified hazards.<sup>103</sup>

The Court further stated:

This exception to the abandonment power vested in the trustee by § 554 is a narrow one. It does not encompass a speculative or indeterminate future violation of such laws that may stem from abandonment. The abandonment power is not to be fettered by laws or regulations not reasonably calculated to protect the public health or safety from imminent and identifiable harm.<sup>104</sup>

The Court has carved out a narrow exception to abandonment with the *Midlantic* decision. However, several problems cloud the *Midlantic* decision, making it difficult for trial courts to interpret and apply.<sup>105</sup> One commentator explains:

First, [*Midlantic*] was endorsed by only a bare majority of justices.<sup>106</sup> Second, the Court expressly declined to attach a priority to claims for cleanup expenses.<sup>107</sup> Thus, while [*Midlantic*] precludes a trustee from abandoning property without first bringing it into compliance with state environmental laws, *Midlantic* gives no guidance concerning the source of the cleanup funds. Third, the limitations placed on abandonment power are uncertain;<sup>108</sup> the Court stated that the limitation is too narrow to include instances in which contamination is merely speculative or where no “imminent and identifiable” harm to the public is present.<sup>109</sup>

Furthermore, the *Midlantic* exception does not apply to environmental laws not reasonably calculated to protect the public health and safety.<sup>110</sup> The Court did not provide guidance regarding what circumstances constitute “imminent danger” or what laws “reasonably” protect the public from that danger.

### B. Application of the *Midlantic* Decision

The *Midlantic* decision presents trial courts with the difficult task of formulating a test to determine whether a trustee’s act of abandonment is in contravention of state or federal law. Some courts, interpreting the *Midlantic* decision narrowly, find that a trustee may abandon contami-

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103. *Id.* at 506-07.

104. *Id.* at 507 n.9.

105. Paula T. Perkins, Comment, *Abandonment in the Face of Possible Toxic Contamination: What’s a Lender To Do?*, 44 SW. L.J. 1563, 1575-76 (1991); Richard A. Marshack, *The Toxic Claim: Using Bankruptcy Law To Limit Environmental Liabilities*, 19 CAL. BANKR. J. 193, 199 (1991).

106. The *Midlantic* opinion was a 5-4 decision.

107. *Midlantic*, 474 U.S. at 498 n.2.

108. *Id.* at 507 n.9.

109. Perkins, *supra* note 105, at 1575-76 (quoting *Midlantic*, 474 U.S. 494, 507 n.9).

110. *Midlantic*, 474 U.S. at 507.

nated property if the trustee takes adequate precautions to ensure that there is no imminent danger to the public.<sup>111</sup> These courts focus on the act of abandonment and rely on the plain language of both the statute and the opinion. Other courts, interpreting the *Midlantic* decision broadly, find that a trustee is barred from abandoning any property if the act of abandonment would violate a state or federal law designed to protect the public health and safety.<sup>112</sup> These courts hold that the trustee must comply with environmental law and the costs of compliance are entitled to administrative priority. This interpretation of the *Midlantic* decision prevents abandonment of property which is not in full compliance with state and federal environmental law. These courts focus on the condition of the property and emphasize the greater importance of environmental policies over bankruptcy objectives.

The Supreme Court's dicta in *Ohio v. Kovacs*,<sup>113</sup> which was decided one year before *Midlantic*, provides some guidance in understanding the Court's *Midlantic* decision. *Kovacs* involved a debtor who filed a chapter 11 bankruptcy which was later converted to chapter 7. A receiver had been put in charge of the debtor's property. The Court provided dicta regarding the requirements for the debtor to abandon the property had he been in control of the property instead of the receiver. The Court stated:

If the site at issue were [the debtor's] property, the trustee would shortly determine whether it was of value to the estate. If the property was worth more than the cost of bringing it into compliance with state [environmental] law, the trustee would undoubtedly sell it for its net value, and the buyer would clean up the property, in which event whatever obligation [the debtor] might have had to clean up the property would have been satisfied. If the property were worth less than the cost of cleanup, the trustee would likely abandon it to its prior owner, who would have to comply with the state environmental law to the extent of his or its ability.<sup>114</sup>

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111. *E.g.*, *Borden, Inc. v. Wells-Fargo Business Credit (In re Smith-Douglass, Inc.)*, 856 F.2d 12 (4th Cir. 1988); *In re Shore Co.*, 134 B.R. 572 (Bankr. E.D. Tex. 1991); *In re Anthony Ferrante & Sons*, 119 B.R. 45 (D.N.J. 1990); *In re FCX, Inc.*, 96 B.R. 49 (Bankr. E.D.N.C. 1989); *In re Franklin Signal Corp.*, 65 B.R. 268 (Bankr. D. Minn. 1986); *In re Oklahoma Ref. Co.*, 63 B.R. 562 (Bankr. W.D. Okla. 1986).

112. *E.g.*, *United States v. LTV Corp. (In re Chateaugay Corp.)*, 944 F.2d 997 (2d Cir. 1991); *Lancaster v. Tennessee (In re Wall Tube & Metal Prods. Co.)*, 831 F.2d 118 (6th Cir. 1987); *In re Stevens*, 68 B.R. 774 (D. Me. 1987); *In re Microfab, Inc.*, 105 B.R. 161 (Bankr. D. Mass. 1989); *In re Peerless Plating Co.*, 70 B.R. 943 (Bankr. W.D. Mich. 1987).

113. 469 U.S. 274 (1985).

114. *Id.* at 284 n.12.

From this passage it appears that a trustee may abandon property subject to environmental liability in violation of state environmental law. The Court indicated that the estate may avoid liability by abandoning the property and that the party receiving the property must comply with environmental law only to the extent of his or its ability.

### 1. Interpretation of *Midlantic* in Abandonment Cases

Some courts considering environmental liability in bankruptcy have been presented with the issue of whether a trustee may abandon property subject to environmental liability.<sup>115</sup> These courts interpret *Midlantic* narrowly. Most of them authorize abandonment. They distinguish the facts in each particular case from *Midlantic's* facts and hold that the narrow exception carved out by the Supreme Court does not apply.

For example, in the case of *In re Oklahoma Refining Co.*,<sup>116</sup> the trustee sought court approval to abandon the property. State laws required that before a contaminated site may be abandoned the owner must clean up the property, commit to monitor the site for up to thirty years, and provide financial assurances. The trustee had no estate funds available to comply. The bankruptcy court allowed the trustee to abandon the property even though abandonment would not be in strict compliance with state environmental laws. The court, factually distinguishing the case from *Midlantic*, found that there was no imminent harm to the public, that abandonment would not aggravate the existing situation, that the refinery was largely in compliance with state

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115. *E.g.*, *Borden, Inc. v. Wells-Fargo Business Credit (In re Smith-Douglass, Inc.)*, 856 F.2d 12 (4th Cir. 1988); *In re Anthony Ferrante & Sons*, 119 B.R. 45 (D.N.J. 1990); *In re Shore Co.*, 134 B.R. 572 (Bankr. E.D. Tex. 1991); *In re Better-Brite Plating, Inc.*, 105 B.R. 912 (Bankr. E.D. Wis. 1989); *In re FCX, Inc.*, 96 B.R. 49 (Bankr. E.D.N.C. 1989); *In re 82 Milbar Boulevard, Inc.*, 91 B.R. 213 (Bankr. E.D.N.Y. 1988); *In re Franklin Signal Corp.*, 65 B.R. 268 (Bankr. D. Minn. 1986); *In re Mowbray Eng'g Co.*, 67 B.R. 34 (Bankr. M.D. Ala. 1986); *In re Oklahoma Ref. Co.*, 63 B.R. 562 (Bankr. W.D. Okla. 1986).

116. 63 B.R. 562 (Bankr. W.D. Okla. 1986). After the debtor filed bankruptcy, the chapter 11 trustee ceased all operations at the debtor's oil refinery site. *Id.* at 563. During prepetition refinery operations hazardous substances had been dumped on the property. *Id.* Although toxic substances were found on the site, none were found in the public water supply. There was no imminent harm to the public health although it was likely that at some indeterminable time, toxic substances would pollute the public water supply. *Id.* at 563-64. The trustee took substantial steps to minimize hazards by drilling monitoring wells, removing hazardous waste, draining tanks, maintaining fencing, and commissioning an environmental report. *Id.* at 564. The cost of cleanup was estimated at \$2.5 million and the property would then be worth only \$100,000. *Id.*

agency directives, and that there were no estate funds available to comply fully.<sup>117</sup>

In the case of *In re Franklin Signal Corp.*,<sup>118</sup> the bankruptcy court held that a trustee may abandon contaminated property if the trustee takes adequate precautionary measures to ensure that there is no imminent danger to the public.<sup>119</sup> Specifically, the court stated that at a minimum the trustee must conduct an investigation to determine what hazardous substances, if any, burden the property and the trustee must inform state and federal agencies of the situation, including the trustee's intent to abandon.<sup>120</sup>

The court proposed five factors<sup>121</sup> to be considered in determining whether a bankruptcy court may approve of abandonment of contaminated property. Applying this test, the court approved abandonment, even though abandonment by the trustee would be in violation of state laws designed to protect the public health and safety, because there was no evidence of any imminent danger to the public, the amount of waste was relatively small, and the estate did not have sufficient funds to dispose of the waste.<sup>122</sup>

In the case of *In re Smith-Douglass, Inc.*,<sup>123</sup> a chapter 11 corporate debtor desired to abandon a fertilizer plant, which was the only piece of property left in the estate. The bankruptcy court found that the property was in violation of state law but that the violations did not present any imminent harm or danger to the public. The court authorized unconditional abandonment because there were no unencumbered assets to fund

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117. *Id.* at 565.

118. 65 B.R. 268 (Bankr. D. Minn. 1986). Franklin Signal Corporation leased property for manufacturing purposes. Fourteen drums, totalling 400 gallons, of contaminated waste were generated and stored on the property before the debtor filed bankruptcy under chapter 11. *Id.* at 269, 274. The case was converted to chapter 7 five months later. The trustee filed a motion to abandon the waste or, in the alternative, to determine how the cleanup would be funded. *Id.*

119. *Id.* at 272.

120. *Id.* at 273.

121. The factors considered were: "(1) the imminence of danger to the public health and safety, (2) the extent of probable harm, (3) the amount and type of hazardous waste, (4) the cost to bring the property into compliance with environmental laws, and (5) the amount and type of funds available for cleanup." *Id.* at 272.

122. *Id.* at 273.

123. *Borden, Inc. v. Wells-Fargo Business Credit (In re Smith-Douglass, Inc.)*, 856 F.2d 12 (4th Cir. 1988).

the cleanup and the environmental violations posed no imminent harm or danger to the public. The Court of Appeals for the Fourth Circuit affirmed unconditional abandonment based on the estate's lack of unencumbered assets and the absence of imminent public harm.<sup>124</sup> While it was not an issue in this case because the estate had no unencumbered funds, the court stated in dicta that "where the estate has unencumbered assets, the bankruptcy court should require stricter compliance with state environmental law before abandonment is permitted."<sup>125</sup>

In the case of *In re Anthony Ferrante & Sons*,<sup>126</sup> the district court distinguished the facts before it from those in *Midlantic* and allowed abandonment.<sup>127</sup> In *Ferrante*, no funds were available to correct environmental hazards.<sup>128</sup> The debtor in *Ferrante* filed a chapter 7 liquidation, while in *Midlantic* the debtor filed a chapter 11 reorganization and converted to chapter 7 only after the state sought compliance with environmental laws.<sup>129</sup> In *Ferrante*, the public was adequately protected, and abandonment of the system would not aggravate already existing dangers.<sup>130</sup> The customers had been warned of the contamination and were able to refrain from using the water and the debtor's operations had ceased long before the bankruptcy.<sup>131</sup> Further, the state agency waited nearly eight years before seeking to enforce orders issued against the debtor and pursued judicial remedies only after learning of the trustee's intended abandonment.<sup>132</sup> The system did not pose an imminent threat of harm to the public, and the state agency's interest was in protecting the public fisc.<sup>133</sup>

In the case of *In re Shore Co.*,<sup>134</sup> the district court affirmed the

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124. *Id.* at 16.

125. *Id.* at 17.

126. 119 B.R. 45 (D.N.J. 1990). The debtor owned a public water supply system. The system was contaminated and a state agency issued a series of orders directing the debtor to correct system deficiencies. Most were unremedied. *Id.* at 46. In April of 1986 the debtor abandoned the system. *Id.* In April of 1987, the debtor filed a petition to liquidate under chapter 7. The trustee sought authorization to abandon the system and a state agency sought a court order compelling the trustee to operate the system in compliance with state law. *Id.*

127. *Id.* at 50.

128. *Id.* at 49 n.8.

129. *Id.* at 48.

130. *Id.* at 50.

131. *Id.* at 49, 50.

132. *Id.* at 50.

133. *Id.*

134. 134 B.R. 572 (Bankr. E.D. Tex. 1991). The Shore Corporation operated an oil refinery, discharging waste into the ground water and storing harmful materials in pits on refinery property. *Id.* at 575. Shore filed a chapter 11 petition but six months later, after an unsuccessful attempt to reorganize, the case was converted to chapter 7. *Id.* at

bankruptcy court's decision and authorized abandonment, holding that a trustee's right to abandon environmentally impacted property is limited only by the precondition that the trustee remediate any imminent and identifiable danger.<sup>135</sup> The court found that, unlike the *Midlantic* case, abandonment would not aggravate potential harm to the public because the property had in fact been abandoned for almost a decade.<sup>136</sup> The court explained that although "in all likelihood" the property was in violation of environmental law, violation of environmental laws is not enough to limit the trustee's power of abandonment, nor is the recognition that a site probably contains some hazardous substances sufficient.<sup>137</sup> The violation must constitute an imminent and identifiable harm.<sup>138</sup> The court determined that there was no imminent and identifiable harm.<sup>139</sup>

In the case of *In re FCX, Inc.*,<sup>140</sup> the court found that the presence of five tons of buried pesticide in an uncontrolled condition on the debtor's property constituted an imminent and identifiable harm to those living in the area.<sup>141</sup> The court granted administrative expense status to "only those costs reasonably required to remove the immediate threat."<sup>142</sup> The court authorized abandonment "on the condition that

573. The trustee attempted to sell the refinery and commissioned a closure study to determine the cost of cleanup for the purpose of making the property more attractive to buyers. *Id.* at 573-74. However, funds to clean up were not allocated and efforts to sell the property were unsuccessful. *Id.* at 574. After four years in chapter 7, a newly-appointed chapter 7 trustee decided to abandon the property. *Id.*

135. *Id.* at 578.

136. *Id.* at 579.

137. *Id.* at 578.

138. *Id.*

139. *Id.*

140. 96 B.R. 49 (Bankr. E.D.N.C. 1989). FCX, Inc. operated a pesticide blending plant from 1940 to 1969. *Id.* at 51. In 1969, FCX buried five tons of "off spec" pesticides in a pit at an indeterminate location on the plant site. *Id.* In addition, FCX buried 50 to 100 gallons of liquid DDT in glass bottles. *Id.* at 52. FCX also routinely disposed of another chemical, Lindane, by pouring it directly on ground soil. *Id.* FCX filed bankruptcy under chapter 11 in 1985 for the purpose of liquidating its assets and distributing them to creditors. *Id.* at 50. In May 1986, FCX notified the EPA of its recently discovered hazardous waste problem. *Id.* at 51. The estimated remediation costs were greater than the value of the property in an uncontaminated condition. *Id.* FCX attempted to abandon the property. *Id.*

141. *Id.* at 55.

142. *Id.*

[the debtor] set aside the sum of \$250,000 for the payment of clean up costs incurred by [the] EPA or the State."<sup>143</sup>

In each of these cases, the court, when presented with the issue of a trustee's power to abandon property subject to environmental liability, applied *Midlantic* narrowly and determined that the trustee who takes adequate precautions to protect the public health and safety may abandon environmentally impacted property. The costs associated with taking precautionary measures to protect the public against imminent harm are incurred postpetition by the bankruptcy estate and therefore qualify for treatment as administrative expenses. The National Bankruptcy Conference (NBC), has proposed rules for abandonment based on the Bankruptcy Code and a narrow interpretation of the *Midlantic* decision.<sup>144</sup>

## 2. Consequences of Abandonment

When property is abandoned, control of the asset is reinstated in the debtor with all rights and obligations as before the filing of the bankruptcy.<sup>145</sup> Title to property abandoned by the estate reverts in the debtor retroactively to the date of commencement of the case. The result is as if the estate never owned the property.<sup>146</sup> However, the

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143. *Id.*

144. Rules for Abandonment:

1. A trustee or debtor in possession should have the right to abandon property "that is burdensome to the estate or that is of inconsequential value and benefit to the estate."
2. The abandonee of property under section 554 should have a prepetition claim for damages, that is, for the net cost of remediation (full cost less residual value of the property).
3. Property is subject to being abandoned only if as of the date of relief the property was legally identifiable as separate from other property of the debtor (and had not been previously set off by a transfer subject to any avoiding power under the Code).
4. A trustee or debtor in possession who intends to abandon or sell property subject to environmental regulation should be required to protect the public from immediate danger by (1) promptly giving to a public authority or authorities responsible for the regulation notice of the immediate danger and (2) taking steps to forestall immediate environmental harm until a public authority or other responsible entity can assume control of the site.

Bankruptcy Reform, *supra* note 88, at 24.

145. 11 U.S.C. § 554 (1988). Abandonment divests the property from the estate. Legislative history suggests that the property is abandoned to the person having a possessory interest in the property. S. Rep. No. 989, 95th Cong., 2d Sess. 92, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5878; *Ohio v. Kovacs*, 469 U.S. 274, 285 n.12 (1985).

146. *Dewsnup v. Timm* (*In re Dewsnup*), 908 F.2d 588, 590 (10th Cir. 1990) (stating that "[p]roperty abandoned under [section 554] ceases to be part of the estate[,] . . . reverts to the debtor[,] and stands as if no bankruptcy petition was filed"), *aff'd*, 502 U.S. 410 (1992); *see also In re Peerless Plating Co.*, 70 B.R. 943, 948 (Bankr. W.D.

debtor's assets, if any, are in the bankruptcy estate. The debtor thus is in no position to cure environmental violations or reimburse anyone for cleanup expenses.

A rule of law prohibiting abandonment of environmentally burdened property does not resolve the problem of environmental cleanup when the responsible party has no resources to fund or reimburse the cleanup.<sup>147</sup> Although ownership of abandoned property is reinstated in the debtor, with respect to continuing violations of state environmental laws several parties have an interest in disposing of the waste or cleaning up the site, including the debtor, the property owner (if the debtor is not the owner), the secured creditors, the state and federal governments, the corporate officers and directors, and other PRPs.<sup>148</sup> If the estate lacks the resources necessary to clean up the contaminated property, there are likely third parties (who often oppose the abandonment) who are better situated than the bankruptcy estate to prevent potential "imminent and identifiable" harm. In some circumstances abandonment may be the only means of achieving the Supreme Court's goal of protecting the public from "imminent and identifiable" harm.<sup>149</sup> For example, in one unusual case, *In re 82 Milbar Boulevard, Inc.*,<sup>150</sup> the bankruptcy court authorized the conveyance of a possessory interest in the contaminated property to the EPA for environmental remediation.<sup>151</sup>

Often in cases of abandonment, the court focuses not on the issue of public health and safety, but instead on the public fisc, with an interest in preventing the government from bearing the cost of environmental cleanups. The *Ferrante* court considered these issues and aptly noted:

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Mich. 1987); *In re Franklin Signal Corp.*, 65 B.R. 268, 274 (Bankr. D. Minn. 1986); *LaRoche v. Tarpley (In re Tarpley)*, 4 B.R. 145, 146 (Bankr. M.D. Tenn. 1980).

147. *Franklin Signal*, 65 B.R. at 272 n.5. A broad interpretation of *Midlantic* creates a troublesome dilemma in a chapter 7 no asset bankruptcy. There are no estate funds available for the trustee to comply with environmental law. Yet, a bankruptcy court will prevent the trustee from abandoning the property without full compliance with environmental law. Thus, the trustee is unable to administer burdensome property in the estate. However, ultimately the property will be abandoned by default pursuant to § 554(c) which provides for abandonment of all property remaining in the estate when the case is closed. 11 U.S.C. § 554(c) (1988). A rule preventing abandonment accomplishes nothing under these circumstances.

148. *Franklin Signal*, 65 B.R. at 274; Marshack, *supra* note 105, at 200.

149. Marshack, *supra* note 105, at 200.

150. 91 B.R. 213 (Bankr. E.D.N.Y. 1988).

151. *Id.* at 219.

“That the State may be forced to bear the expense of remedial measures, when that expense should have been borne by [the debtor] before it filed for bankruptcy, is perhaps unfair but nonetheless [is] not a basis for restriction of the powers given a trustee under the Bankruptcy Code.”<sup>152</sup> The courts should focus on the issue of public health and safety as *Midlantic* explains. In matters concerning the public fisc, it is Congress, and not the bankruptcy courts, that has the power to restrict the actions of a bankruptcy trustee. This must be done by Congress’ careful revision of the Bankruptcy Code, not by judicial fiat.

In the *Midlantic* dissent Justice Rehnquist noted that

[w]hat the [majority] fails to appreciate is that respondents’ interest in these cases lies not just in protecting public health and safety but also in protecting the public fisc . . . . But barring abandonment and forcing a cleanup would effectively place respondents’ interest in protecting the public fisc ahead of the claims of other creditors. Congress simply did not intend that § 554 abandonment hearings would be used to establish the priority of particular claims in bankruptcy.<sup>153</sup>

This led Justice Rehnquist to conclude that “[t]he bankruptcy court may not, in the exercise of its equitable powers, enforce its view of sound public policy at the expense of the interests the [Bankruptcy] Code is designed to protect.”<sup>154</sup> This reasoning leads to the conclusion that public policy grounds should not be used by a bankruptcy court to justify establishing its own set of priorities to further an environmental agenda when the Bankruptcy Code and nonbankruptcy law together define the priorities to be followed in bankruptcy.

## V. TREATMENT OF ENVIRONMENTAL CLAIMS

Whether or not the trustee chooses to abandon burdensome estate property, the bankruptcy estate remains liable for prepetition environmental claims incurred by the debtor. Furthermore, the estate may incur additional environmental liability based on postpetition ownership or operation of the property. The Bankruptcy Code does not distinguish environmental claims from other claims. An environmental claim, like most other unsecured claims, should be treated as a general unsecured claim unless it is entitled to priority treatment as an administrative expense. To maximize the distribution of estate assets to creditors, administrative expense claims must be kept to a minimum. Under the Bankruptcy Code, to qualify as an administrative expense the expense

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152. *In re Anthony Ferrante & Sons*, 119 B.R. 45, 50 (D.N.J. 1990).

153. *Midlantic Nat’l Bank v. New Jersey Dep’t of Env’tl. Protection*, 474 U.S. 494, 516-17 (1986) (Rehnquist, J., dissenting).

154. *Id.* at 514 (Rehnquist, J., dissenting).

must arise postpetition and must either rehabilitate or preserve the estate, providing a benefit to the estate.<sup>155</sup> The requirement of an actual benefit is necessary to protect the limited assets of the estate for the benefit of unsecured creditors.<sup>156</sup> The expense must not be incurred primarily in the interest of an individual claimant; it must, in fact, benefit the estate and the creditors as a whole.<sup>157</sup> In a liquidation case, where there is no reorganization effort, benefit to the estate is particularly important because the emphasis of the bankruptcy is on maximizing the size of the estate to be distributed to creditors rather than assuring continuing business operations.<sup>158</sup>

Although environmental cleanup may be a benefit to society, it may not preserve or benefit the bankruptcy estate. When environmental

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155. The Bankruptcy Code provides: "After notice and a hearing, there shall be allowed administrative expenses . . . including . . . the actual, necessary costs and expenses of *preserving the estate*, including wages, salaries, or commissions for services rendered *after the commencement of the case*["] 11 U.S.C. § 503(b)(1)(A) (1988) (emphasis added).

Many courts have interpreted this language. *E.g.*, *In re Jartran, Inc.*, 732 F.2d 584 (7th Cir. 1984) (denying administrative expense priority to an advertiser because the claim was based on an irrevocable contract with the debtor which was executed prepetition, even though benefits of the contract accrued to the estate postpetition); *Cramer v. Mammoth Mart, Inc.* (*In re Mammoth Mart, Inc.*), 536 F.2d 950 (1st Cir. 1976) (holding that to establish administrative expense status, the claimant must show that the claim is based on a transaction with the debtor in possession and that the transaction resulted in a direct benefit to the estate); *St. Paul Fire & Marine Ins. Co. v. Rea Express, Inc.* (*In re Rea Express, Inc.*), 442 F. Supp. 71 (S.D.N.Y. 1977) (finding, in a chapter 11 case, that workmen's compensation payments to employees injured prepetition were not entitled to priority as an administrative expense and that sums due to employees postpetition were entitled to priority only to the extent that they were attributable to events during the pendency of the proceedings); *In re CIS Corp.*, 142 B.R. 640 (S.D.N.Y. 1992) (holding that a lessor of computer equipment to a chapter 11 debtor was not entitled to administrative priority for postpetition rent because the debtor subleased the equipment to a third party which had prepaid the entire amount owed under the sublease to the debtor prepetition and as a result the sublease conferred no postpetition benefit on the debtor's bankruptcy estate); *In re Coastal Carriers Corp.*, 128 B.R. 400 (Bankr. D. Md. 1991) (stating that owners of a tug which towed the debtor's barge three quarters of the way across the Atlantic Ocean before it sank were entitled to an administrative expense for payment of a postpetition towage contract and finding that the debtor's estate benefited because it was able to function as a going concern and to enter into a commercial shipping contract which gave rise to certain rights and liabilities).

156. *Burlington N. R.R. v. Dant & Russell, Inc.* (*In re Dant & Russell, Inc.*), 853 F.2d 700, 706 (9th Cir. 1988).

157. *Coastal Carriers*, 128 B.R. at 403.

158. *Dant & Russell*, 853 F.2d at 706.

cleanup costs exceed the value of the property after cleanup, there is clearly no economic benefit to the estate in incurring the cleanup cost. Furthermore, treating environmental claims as administrative expenses may substantially deplete estate resources and significantly reduce unsecured creditors' compensation. The courts have arrived at conflicting treatments of environmental claims due to competing environmental and bankruptcy policies and the failure of either bankruptcy law or environmental law to authorize expressly priority treatment of environmental claims.

In one case, the Court of Appeals for the Seventh Circuit considered the priority of a nuisance claim in *In re Chicago, Rock Island & Pacific Railroad Co.*<sup>159</sup> In that case, the debtor was reorganizing but had ceased operating its railroad and was liquidating that portion of its business. The state sought a court order to compel the debtor to remove the debtor's abandoned highway crossings from state property in an effort to prevent prospective nuisances. The court held that the state would not be entitled to administrative expense priority for costs incurred in removing the crossings in the absence of any evidence that the removal was necessary to avoid imminent danger.<sup>160</sup> The court refused to grant administrative priority to the nuisance claims because the benefits to creditors of avoiding potential future liability were too slight and conjectural.<sup>161</sup>

In sorting out the conflict between environmental law and bankruptcy law, some courts have found *Kovacs* controlling and have refused to rely on *Midlantic* to determine the proper treatment of environmental claims because *Midlantic* addressed the issue of abandonment and declined to consider the proper treatment of environmental claims.<sup>162</sup> In *Kovacs*, the Supreme Court found that a state injunction directing the cleanup of a hazardous waste site was a prepetition "claim" dischargeable against the debtor.<sup>163</sup>

For example, the Ninth Circuit found *Kovacs* controlling in the case of *In re Dant & Russell, Inc.*<sup>164</sup> and determined that the lessor's claim

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159. 756 F.2d 517 (7th Cir. 1985).

160. *Id.* at 520, 523.

161. *Id.* at 520.

162. *Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection*, 474 U.S. 494, 498 n.2 (1986).

163. *Ohio v. Kovacs*, 469 U.S. 274 (1985).

164. *Burlington N. R.R. v. Dant & Russell, Inc. (In re Dant & Russell, Inc.)*, 853 F.2d 700, 706 (9th Cir. 1988). *Dant & Russell, Inc.* operated a wood treatment plant on leased property. *Id.* at 701-02. The corporation filed chapter 11 and continued operations for over a year to facilitate liquidation. *Id.* at 702. A state agency discovered massive toxic waste contamination at the site resulting primarily from prepetition operations by the debtor and debtor's predecessor. Cleanup costs were estimated

for environmental cleanup costs was a prepetition claim.<sup>165</sup> The court properly refused to prioritize the *prepetition* environmental claim as an administrative expense and instead treated it as a general unsecured claim. The court explained:

Congress alone fixes priorities. Courts are not free to formulate their own rules of super or sub-priorities within a specifically enumerated class. . . . [U]ntil the [state] legislature enacts such protective provision or until Congress amends sections 503 and 507 to give priority to claims for [environmental] cleanup costs, [the court is] without authority to create such a priority.<sup>166</sup>

Similarly, the Court of Appeals for the Third Circuit found *Kovacs* controlling in the case of *Southern Railway Co. v. Johnson Bronze Co.*<sup>167</sup> The Third Circuit held that a prepetition contractual indemnification claim was properly treated as a general unsecured claim not entitled to administrative priority.<sup>168</sup> The bankruptcy court had granted Southern a lien against the proceeds of the sale of Johnson's manufacturing plant for the cost of cleanup.<sup>169</sup> The Third Circuit explained that, in exercising its equitable powers, the bankruptcy court is not free to create rights otherwise unavailable under applicable law.<sup>170</sup> State law provided no means for placing a lien on the property based on a contract indemnification claim and the bankruptcy court refused to create such a lien.

Both *Dant & Russell* and *Southern Railway* involved lessees whose prepetition conduct resulted in prepetition claims against the bankruptcy

between \$10 and \$30 million. *Id.* The lessor sought administrative expense priority for the cleanup costs at the site. *Id.* at 703.

165. *Id.* at 709. The court decided that consequential damages arising out of the breach of an unexpired lease should be regarded as prepetition. *Id.*

166. *Id.* at 709 (citation omitted).

167. 758 F.2d 137 (3d Cir. 1985). Johnson Bronze Co. (Johnson) conducted manufacturing operations and disposed of sewage on an adjacent site owned by Southern Railway Co. (Southern) pursuant to a license agreement which provided that Johnson would indemnify Southern for any liability arising from its use. *Id.* at 139. Johnson disposed of hazardous waste on Southern's site. *Id.* A cleanup order was issued, but Johnson ceased operations and filed chapter 11 prior to compliance. *Id.*

168. *Id.* at 141. The Third Circuit cited *Kovacs* which held that Ohio's injunction directing the cleanup of hazardous waste was no more than an unsecured claim and noted that *Midlantic* was not controlling because that decision expressly declined to reach the issue of what priority, if any, ought to be afforded a claim for the cost of cleanup. *Id.*

169. *Id.* at 138.

170. *Id.* at 142.

estate. In each case, the court properly refused to prioritize the prepetition general unsecured claim as an administrative expense without express authority from state or federal law.

#### A. *The Role of Midlantic In Determining Administrative Priority*

In sorting out the proper treatment of environmental claims in light of the competing policies of environmental law and bankruptcy law, most courts look to *Midlantic* for guidance. Abandonment is considered relevant based on the premise that if a trustee cannot abandon property without satisfying certain conditions, he can neither maintain nor possess that property without satisfying the same conditions.<sup>171</sup> The cost incurred in satisfying those conditions is entitled to priority as an administrative expense of the estate.<sup>172</sup> Courts recognize that the real issue in abandonment is not disposing of the property but determining who is liable for environmental cleanup.<sup>173</sup> As a result, most courts presented with the *issue of abandonment* interpret *Midlantic* narrowly, whereas most courts presented with the *issue of reimbursement* of environmental cleanup costs rely on a broad interpretation of *Midlantic*.

Interestingly, *Midlantic* expressly declined to address the treatment of environmental claims in bankruptcy.<sup>174</sup> Nevertheless, varying interpretations of *Midlantic's* exception have resulted in conflicting case law regarding when environmental claims are entitled to treatment as administrative expenses. The conflict is based on the fact that courts do not agree on the conditions under which *Midlantic* authorizes abandonment. Courts relying on a narrow interpretation of *Midlantic* have denied payment of environmental claims as administrative expenses absent imminent and identifiable harm.<sup>175</sup> Courts relying on a broad interpretation of *Midlantic* have granted administrative priority to environmental claims resulting from noncompliance with laws intended to protect the public health and safety.<sup>176</sup> Arguably, the narrow interpretation of *Midlantic* is the proper interpretation based on the express language of the opinion.<sup>177</sup>

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171. *In re Microfab, Inc.*, 105 B.R. 161, 168 (Bankr. D. Mass. 1989).

172. *Id.*

173. *In re Franklin Signal Corp.*, 65 B.R. 268, 274 n.9 (Bankr. D. Minn. 1986); *In re Oklahoma Ref. Co.*, 63 B.R. 562, 565 (Bankr. W.D. Okla. 1986).

174. *Midlantic Nat'l Bank v. New Jersey Dep't of Env'tl. Protection*, 474 U.S. 494, 498 n.2 (1986).

175. *In re FCX, Inc.*, 96 B.R. 49 (Bankr. E.D.N.C. 1989).

176. *Franklin Signal*, 65 B.R. at 270.

177. *See supra* notes 103-04 and accompanying text.

### 1. *The Narrow Interpretation of Midlantic*

Courts interpreting *Midlantic* narrowly find an exception to the general rule that prepetition environmental claims should be treated as general unsecured claims when environmental liability causes imminent and identifiable harm to the public health and safety. For example, in the case of *In re Pierce Coal & Construction, Inc.*,<sup>178</sup> the court recognized an implied exception<sup>179</sup> to the classification of prepetition environmental claims as general unsecured claims based on its interpretation of the *Midlantic* decision. The exception is triggered when "imminent and identifiable harm" is present.<sup>180</sup> *Midlantic* provides the rationale for the exception: where imminent and identifiable harm is present, the priorities of the Bankruptcy Code become subservient to environmental laws designed to protect the public safety.<sup>181</sup> Consequently, the *Pierce Coal* court reasoned that if the exception applies, then "the necessary costs of protecting the public health or safety from imminent and identifiable harm may be elevated to administrative [expense] priority."<sup>182</sup> However, although the court recognized the exception, it found that it did not apply in this case.<sup>183</sup>

*Pierce Coal* involved both prepetition and postpetition claims. In *Pierce Coal*, the bankruptcy court held that the cost of reclamation of land damaged prepetition could not be accorded administrative expense priority and should be treated as a general unsecured claim because *Midlantic's* narrow exception did not apply.<sup>184</sup> However, the court also held that the cost of reclamation of land damaged during

178. 65 B.R. 521 (Bankr. N.D. W. Va. 1986). The debtor operated a surface mining business for a year under chapter 11 before conversion of the case to chapter 7. *Id.* at 522-23. The court considered the priority of the state's claim against the estate for the cost of reclaiming property mined by the debtor both prepetition and postpetition. *Id.* at 530-31.

179. *Id.* at 531. The court recognized an implied exception to the general rule that prepetition environmental claims are general unsecured claims where imminent and identifiable harm is present, but the court refused to apply the exception because no such harm was present based on the evidence presented.

180. *Id.*

181. *Midlantic Nat'l Bank v. New Jersey Dep't of Env'tl. Protection*, 474 U.S. 494, 506-07 (1986).

182. *Pierce Coal*, 65 B.R. at 531.

183. *Id.*

184. *Id.* at 531.

postpetition operations would be entitled to administrative priority because the cost was necessary to preserve the estate.<sup>185</sup> The court explained that a bankruptcy court has no authority to elevate a prepetition unsecured claim to an administrative expense.<sup>186</sup> The court noted that although “[c]ongressional intent to allow enforcement of environmental regulations is clear,”<sup>187</sup> congressional intent to preclude governmental agencies from gaining favored priority as creditors while acting under the umbrella of their governmental enforcement powers is explicit.<sup>188</sup>

The exception was also recognized in the case of *In re Stevens*.<sup>189</sup> In that case, the court decided that the costs incurred by a state agency in protecting the public from imminent and identifiable danger due to improper and illegal storage of hazardous waste were entitled to treatment as administrative expenses.<sup>190</sup> The court explained that under these circumstances, *Midlantic* altered the criteria for determining the allowance of administrative expenses set forth in the Bankruptcy Code.<sup>191</sup> The *Stevens* court noted *Midlantic*'s rationale for the exception, namely that “public health and safety take precedence over the longstanding, but more parochial, concerns of efficient bankruptcy administration.”<sup>192</sup>

The costs of taking precautions necessary to protect the public from imminent harm should be treated as administrative expenses, whether or not the trustee chooses to abandon the property and whether or not the claim is prepetition or postpetition. Although the *Midlantic* decision did not address the source of funding for precautionary measures, the costs are actual and necessary to effectuate abandonment of the property for the benefit of the estate and therefore qualify as an administrative expense pursuant to section 503.<sup>193</sup> Theoretically, the trustee will only abandon property and incur the administrative expense if the cost of taking precautions is less than the cost of keeping the property. However, if the trustee is precluded from abandoning property without

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185. *Id.* at 530.

186. *Id.* at 531.

187. *Id.* at 530 (citing 11 U.S.C. § 362(b)(4)). This section of the Bankruptcy Code provides that an exception to the automatic stay exists to allow governmental agencies to exercise police powers, including enforcement of environmental regulations. *Id.*

188. *Id.* (citing 11 U.S.C. § 362(b)(5)). This section provides that enforcement of a money judgment is an exception to the police power exception; enforcement of a money judgment is an act which *is* subject to the automatic stay. *Id.*

189. 68 B.R. 774 (D. Me. 1987).

190. *Id.* at 783.

191. *Id.* at 780-81.

192. *Id.* at 781.

193. *In re Shore Co.*, 134 B.R. 572, 580 (Bankr. E.D. Tex. 1991).

taking adequate precautions to protect the public from imminent harm, there is a strong argument that the trustee should be required to take those same precautions even if he chooses to keep the property. *Midlantic's* policy of protecting the public health and safety from imminent harm supports this proposition. Therefore, the precautions necessary to protect the public from imminent harm must be taken whether or not the trustee seeks to abandon, and the associated costs should be treated as administrative expenses.

Several other courts, acting in concert with these principles, have denied administrative priority to environmental claims absent a showing of imminent and identifiable harm. For example, in the case of *In re Jr. Food Mart of Arkansas, Inc.*, the bankruptcy court denied administrative expense priority for the costs of removing underground gas tanks because the cost was neither necessary to preserve nor beneficial to the bankruptcy estate.<sup>194</sup> There was no evidence that the tanks created an environmental hazard or posed a threat to the public health and safety or that cleanup was required.<sup>195</sup>

The *Shore* court also denied administrative priority to environmental claims absent a showing of imminent and identifiable harm.<sup>196</sup> The *Shore* court allowed the trustee to abandon the contaminated property and, finding no imminent harm, refused to authorize use of the unencumbered assets of the bankruptcy estate for cleanup purposes to satisfy the prepetition environmental claim.<sup>197</sup> The court found the depletion of estate assets a relevant though not an overriding concern to be considered by the court.<sup>198</sup> Finally, the court decided that administrative expenditures to clean up the property would only deplete the estate without yielding any contemporaneous benefit to the estate.<sup>199</sup>

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194. 144 B.R. 423 (Bankr. E.D. Ark. 1992). The owners of property leased by the debtor to operate a gasoline station requested payment for the cost of removing underground storage tanks after the debtor vacated the premises. *Id.* at 424.

195. *Id.* at 425.

196. *Shore*, 134 B.R. at 578. See *supra* notes 134-39 and accompanying text.

197. *Shore*, 134 B.R. at 579-80.

198. *Id.* at 580 n.4; see also *In re Microfab, Inc.*, 105 B.R. 161, 170 (Bankr. D. Mass. 1989); *In re Franklin Signal Corp.*, 65 B.R. 268, 274 (Bankr. D. Minn. 1986). *Contra In re Peerless Plating Co.*, 70 B.R. 943, 947 (Bankr. W.D. Mich. 1987).

199. *Shore*, 134 B.R. at 580.

## 2. *The Broad Interpretation of Midlantic*

Courts interpreting the *Midlantic* decision broadly find an exception to the trustee's power of abandonment when abandonment is in contravention of any law designed to protect the public health and safety.<sup>200</sup> Most courts interpreting *Midlantic* broadly are presented not with the issue of *abandonment* but with the issue of the *priority* of environmental claims. These courts begin their analysis by referring to the Supreme Court's *Midlantic* decision—a case which addressed the question of abandonment, not administrative priority. They find that the condition for abandonment is full compliance with laws designed to protect the public health and safety. Thus, if a trustee cannot abandon property because of noncompliance with an environmental law, then the cost incurred in complying with the environmental law is entitled to priority as an administrative expense.<sup>201</sup> Courts interpreting the *Midlantic* decision broadly focus on the condition of the property, rather than on the act of abandonment, and emphasize the greater importance of environmental policies over bankruptcy policies.

For example, in the case of *In re Peerless Plating Co.*,<sup>202</sup> the EPA sought reimbursement of CERCLA response costs as administrative expenses. Construing *Midlantic*, the *Peerless* court found three conditions under which a trustee may abandon a hazardous waste site in contravention of environmental law. The court determined that a trustee may not abandon a hazardous waste site unless:

1. the environmental law in question is so onerous as to interfere with the bankruptcy adjudication itself; or
2. the environmental law in question is not reasonably designed to protect the public health or safety from identified hazards [imminent and identifiable harm]; or
3. the violation caused by abandonment would merely be speculative or indeterminate.<sup>203</sup>

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200. *Franklin Signal*, 65 B.R. at 270. This position is based on the premise that a violation of an environmental law which is intended to protect the public health and safety creates a *threat* of imminent harm to the public health and safety.

201. *United States v. LTV Corp. (In re Chateaugay Corp.)*, 944 F.2d 997, 1009-10 (2d Cir. 1991); *Lancaster v. Tennessee (In re Wall Tube & Metal Prods. Co.)*, 831 F.2d 118, 123-24 (6th Cir. 1987); *Microfab*, 105 B.R. at 168; *Peerless*, 70 B.R. at 948-49.

202. 70 B.R. 943 (Bankr. W.D. Mich. 1987). *Peerless Plating Co.*, due to regulatory and labor difficulties, ceased operations of its metal plating shop and filed bankruptcy under chapter 7. *Id.* at 945. Two months later, the EPA was informed that gas had been detected in the plant. The EPA determined an immediate cleanup was necessary. *Id.* After the debtor and trustee declined to clean up, the EPA proceeded to clean up the property. The EPA demanded reimbursement from the trustee. *Id.*

203. *Id.* at 947.

After considering these conditions, the court concluded that the trustee could not abandon the site in violation of CERCLA.<sup>204</sup> Furthermore, the court decided that the EPA's cleanup costs were entitled to priority as administrative expenses because the EPA's cleanup discharged the bankruptcy estate's liability for the cleanup.<sup>205</sup>

Although the court granted administrative priority based on a violation of CERCLA, the facts of the case arguably fall within *Midlantic's* narrow exception. The EPA, after learning that gas had been detected in the Peerless plant, undertook an immediate cleanup to protect public health and safety.<sup>206</sup> The actual and necessary costs of the EPA's precautionary measures to protect the public health and safety from imminent and identifiable harm should be entitled to treatment as an administrative expense. This falls within *Midlantic's* narrow exception.

In the case of *In re Stevens*,<sup>207</sup> a state agency sought administrative expense priority for the reimbursement costs incurred in disposing of drums containing hazardous waste. The court determined that a trustee could not abandon the drums because abandonment posed a threat to public safety and was in contravention of state laws reasonably designed to protect the public.<sup>208</sup> The *Stevens* court found that abandonment required full compliance with "relevant" state and local laws.<sup>209</sup> Since the chapter 7 trustee could not abandon the hazardous waste without fully complying with relevant state and local laws, the estate was liable for the cleanup costs and the state agency was entitled to administrative

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204. *Id.* at 947-48.

205. *Id.* at 948.

206. *Id.* at 945.

207. 68 B.R. 774 (D. Me. 1987). The debtors owned a scrap metal business. While operating the business, the debtors acquired drums of oil containing dangerous levels of PCBs (prepetition). *Id.* at 775. In 1981, the debtors were instructed by the EPA to properly store the drums and dispose of them by January 1, 1984. *Id.* at 775-76. The debtors stored the material in a locked trailer lined with plastic but their precautions were not in compliance with EPA requirements. *Id.* at 776. The debtors failed to dispose of the drums prior to filing a chapter 7 petition for liquidation on April 26, 1984. The debtors subsequently ceased operation of their business. *Id.* The state agency directed the trustee or debtor to dispose of the drums. *Id.* Neither the debtor nor the trustee undertook the cleanup. The state sought reimbursement for removal costs as an administrative expense. *Id.*

208. *Id.* at 780. The court noted that abandonment to a debtor violates state law and the express policy of controlling hazardous waste to assure no threat to public health and safety. *Id.*

209. *Id.* at 782 n.7.

expense priority.<sup>210</sup> In this case, however, the debtor had taken precautions prepetition to protect the public health and safety by storing the drums in a locked trailer.<sup>211</sup> The trustee maintained the precautions postpetition.<sup>212</sup> The property was not abandoned without the estate adhering to conditions designed to protect the public's health and safety. Therefore, the facts in this case do not appear to fall within *Midlantic's* narrow exception and *Midlantic* does not support the court's holding.<sup>213</sup>

In the case of *In re Wall Tube & Metal Products Co.*,<sup>214</sup> the state sought reimbursement for environmental cleanup costs associated with drums containing hazardous waste which belonged to the bankruptcy estate and which were stored on the debtor's leased manufacturing site. The court determined that the chapter 7 trustee could not have abandoned the property because the debtor violated state law intended to protect the public health and safety prepetition and the violations continued postpetition.<sup>215</sup> The court found that because the trustee could not abandon the property, the expenses incurred to comply with state law were "actual and necessary, both to preserve the estate in required compliance with state law and to protect the health and safety of a potentially endangered public."<sup>216</sup> Because the state discharged the estate's cleanup obligation, the state was entitled to reimbursement of cleanup costs as administrative expenses.<sup>217</sup>

The rationale of the *Wall Tube* court is irreconcilable with the facts of the case. In order to qualify for administrative expense priority under *Midlantic*, expenses must be incurred to protect the public from an imminent and identifiable harm.<sup>218</sup> Although the court explained that abandonment would have subjected the public to the "same threat the

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210. *Id.* at 783.

211. *Id.* at 776.

212. *Id.*

213. See *supra* notes 189-92 and accompanying text for a discussion of the *Stevens* court's recognition of an exception to the general rule that prepetition environmental claims should be treated as general unsecured claims even when environmental liability causes

imminent and identifiable harm to the public health and safety.

214. *Lancaster v. Tennessee (In re Wall Tube & Metal Prods. Co.)*, 831 F.2d 118 (6th Cir. 1987). The debtor operated a metal product manufacturing business on leased property, generating hazardous waste which was stored in drums on the site. *Id.* at 119-20. The state undertook the cleanup and sought reimbursement as an administrative expense. *Id.* at 121.

215. *Id.* at 122.

216. *Id.* at 124.

217. *Id.*

218. *Midlantic Nat'l Bank v. New Jersey Dep't of Env'tl. Protection*, 474 U.S. 494, 507 n.9 (1986).

court in *Midlantic* sought to avoid—a continuing, potentially disastrous environmental health hazard,<sup>219</sup> the facts of the case do not support the conclusion that there was an imminent and identifiable threat. In fact, the drums of hazardous waste were not actually disposed of for over two years after being discovered.<sup>220</sup>

In the case of *Chateaugay*, the district court held that all environmental cleanup costs assessed postpetition with respect to sites currently owned by debtor where there had been a prepetition release or threatened release of hazardous wastes were entitled to administrative priority.<sup>221</sup> The issue on appeal was whether this was an attempt to convert prepetition contingent claims to priority status by simply liquidating them. The Court of Appeals for the Second Circuit agreed with the district court and held that “[i]f property on which toxic substances pose a significant hazard to public health cannot be abandoned, it must the [sic] follow . . . that expenses to remove the threat posed by such substances are necessary to preserve the estate.”<sup>222</sup> The court appeared to rely on a broad interpretation of *Midlantic* to support granting administrative priority to the prepetition environmental claims. In fact, the determinative factors in the court’s decision were the debtor’s continued operations *postpetition* under chapter 11 and the CERCLA liability incurred by the estate *postpetition*, not the presence of an imminent and identifiable threat to the public.<sup>223</sup> The *Chateaugay* court explained that the “EPA is doing more than fixing the amount of its [contingent] claim; it is acting, during administration of the [chapter

219. *Wall Tube*, 831 F.2d at 122.

220. *Id.* at 120 & n.5.

221. *United States v. LTV Corp. (In re Chateaugay Corp.)*, 944 F.2d 997, 1009-10 (2d Cir. 1991). LTV, a diversified steel, aerospace, and energy corporation, filed chapter 11 and scheduled 24 pages of contingent environmental claims held by the EPA. *Id.* at 999. The EPA asserted \$32 million in prepetition response costs at 14 identified sites. There were potentially more sites at which LTV might have been a PRP and the \$32 million may have been only a small fraction of the total response costs required to clean up all of the sites. *Id.*

222. *Id.* at 1010.

223. *Id.* at 999. The court explained that the debtor’s obligation to assure that facilities it operates postpetition comply with environmental laws is not dischargeable and that CERCLA response costs incurred during the bankruptcy at sites owned or operated by the debtor are entitled to administrative expense priority. *Id.*

Courts have granted administrative expense status to environmental claims based on liability incurred not by the debtor prepetition, but by the bankruptcy estate postpetition as an owner of contaminated property.

11] estate, to remedy the ongoing effects of a release of hazardous substances.<sup>224</sup>

In the case of *In re Microfab, Inc.*,<sup>225</sup> the Commonwealth of Massachusetts sought to compel a chapter 7 trustee to clean up the debtor's industrial site. The court relied on *Midlantic*, even though the trustee did not seek to abandon the site, reasoning that "if the Trustee cannot abandon property without satisfying certain conditions, neither can he maintain or possess it without satisfying them."<sup>226</sup> The court determined that abandonment requires full compliance with state environmental laws subject to four conditions.<sup>227</sup> Three of the conditions rarely are in issue.<sup>228</sup> However, the fourth condition, lack of estate assets to comply with environmental law, is common. According to condition four, if the trustee does not have sufficient funds to comply with environmental law, then the trustee does not have to comply with state law in order to abandon property. In *Microfab*, the fourth condition was in issue.<sup>229</sup> Even after the court found "imminent and identifiable harm" to the public, the court refused to order the trustee to clean up the property because no significant improvement in the condition of the property would result from exhaustion of the estate's funds.<sup>230</sup> Although *Midlantic* requires a chapter 7 trustee to bring contaminated

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224. *Id.* at 1010.

225. 105 B.R. 161 (Bankr. D. Mass. 1989). The debtor's bankruptcy estate contained real property which had been contaminated with hazardous substances before the debtor filed a petition under chapter 7. *Id.* at 161-62. The trustee did not seek to abandon the site. *Id.* at 163. Instead, a state agency wanted the trustee to remediate the contamination at the estate's expense or to pay the state agency's cleanup costs as an administrative expense. *Id.* at 162. The estate contained approximately \$750,000 of unencumbered cash. The state's estimate to clean up the site was two million dollars. *Id.* at 164.

226. *Id.* at 168.

227. The four conditions are:

1. The laws must be reasonably calculated to protect the public health or safety from imminent and identifiable harm.
2. The violation resulting from abandonment may not be speculative or indeterminate.
3. The law must not be so onerous as to interfere with the bankruptcy adjudication itself.
4. The trustee cannot be ordered to clean up when he does not have financial resources to do so.

*Id.* at 169.

228. First, environmental laws are typically intended to protect public health and safety. Second, rarely are violations of an environmental law speculative or indeterminate. Third, the Supreme Court provided no standard for determining whether a law is so "onerous" as to interfere with bankruptcy adjudication, so this is difficult to prove. The EPA often has already taken action based on a thorough investigation.

229. *Id.* at 169.

230. *Id.*

property into compliance with state environmental laws on an administrative expense basis, that requirement is subject to the limitation of estate assets necessary to achieve appreciable results.

The *Peerless*, *Stevens*, *Wall Tube*, *Chateaugay*, and *Microfab* courts, each presented with the issue of liability for environmental cleanup costs, interpreted *Midlantic* broadly, requiring full compliance with state and federal laws intended to protect the public health and safety.<sup>231</sup> These courts found that the costs incurred in complying with state law were entitled to treatment as administrative expenses. However, the *Midlantic* opinion expressly stated that the exception to the trustee's power of abandonment was a *narrow* one requiring the existence of an imminent and identifiable harm to the public health and safety.<sup>232</sup> These courts failed to recognize the express language of the *Midlantic* decision. Their decisions are inconsistent with the decisions of other courts<sup>233</sup> that have applied *Midlantic* to *abandonment* cases and with the Supreme Court's *Kovacs* decision, which acknowledged that a trustee may abandon property in violation of environmental law but that a party who subsequently receives and possesses the property must comply with environmental laws.<sup>234</sup>

Although *Midlantic* may stand for the proposition that costs incurred in taking precautionary measures to protect the public from imminent harm are entitled to treatment as administrative expenses, nothing in the Bankruptcy Code nor in state law provides that *any* environmental claim arising from a violation of environmental law is to be accorded administrative expense priority.<sup>235</sup> The narrow exception carved out in *Midlantic* does not authorize administrative expense priority for costs incurred in complying with environmental laws absent a showing of imminent harm to the public, and then only to the extent necessary to protect the public. Violations of state or federal environmental laws are not to be treated lightly, but a violation is not conclusive evidence of the existence of an imminent and identifiable harm. The particular

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231. Although subject to exceptions in several cases.

232. *Midlantic Nat'l Bank v. New Jersey Dep't of Env'tl. Protection*, 474 U.S. 494, 507 n.9 (1986).

233. *In re Anthony Ferrante & Sons*, 119 B.R. 45 (D.N.J. 1990); *In re Shore Co.*, 134 B.R. 572 (Bankr. E.D. Tex. 1991); *In re Franklin Signal Corp.*, 65 B.R. 268 (Bankr. D. Minn. 1986); *In re Oklahoma Ref. Co.*, 63 B.R. 562 (Bankr. W.D. Okla. 1986).

234. *Ohio v. Kovacs*, 469 U.S. 274, 285 (1985).

235. *In re Shore Co.*, 134 B.R. 572, 580 (Bankr. E.D. Tex. 1991).

circumstances surrounding a violation must be examined to determine whether such harm is present. The *Midlantic* exception does not justify prioritizing reimbursement of CERCLA response costs absent a showing of imminent and identifiable harm to the public health and safety.

The *Peerless*, *Stevens*, *Wall Tube*, and *Chateaugay* courts granted administrative priority for costs incurred in complying with environmental law. However, *Midlantic* did not even address administrative priority and, to the extent administrative priority was implied, it was limited to the narrow exception carved out in the opinion. Nothing in the Bankruptcy Code creates administrative expense priority for claims to cure violations of any law designed to protect the public health and safety. Under nonbankruptcy law, environmental liability is “prioritized” ahead of unsecured creditors only by creating and perfecting a security interest in real or personal property.<sup>236</sup> Absent such an interest, nothing in nonbankruptcy law establishes a priority that can be applied in bankruptcy.

Although environmental policies are important, courts should not ignore the priorities established by Congress under the Bankruptcy Code and the priorities established by state legislatures under state law. As Justice O’Connor pointed out in her concurring opinion in *Kovacs*, state and federal legislatures have the freedom to establish their own priorities for environmental claims.<sup>237</sup> Alternatively, Congress is free to change the priorities established in the Bankruptcy Code to specially prioritize environmental claims. The courts should not compromise existing law by relying on a broad interpretation of *Midlantic* to prioritize environmental claims.

If one claimant is to be preferred over others, the purpose should be clear from the statute.<sup>238</sup> Giving priority to a claimant not clearly entitled to priority is inconsistent with the policy of equality of distribution and dilutes the value of the priority for those creditors Congress intended to prefer.

### *B. The Role of Environmental Law in Determining Administrative Priority*

The treatment of environmental claims in bankruptcy is particularly complex because the proper treatment depends on the type of bankruptcy

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236. See *supra* note 13 and accompanying text.

237. *Kovacs*, 469 U.S. at 285-86 (O’Connor, J., concurring).

238. *Nathanson v. NLRB*, 344 U.S. 25, 29 (1952); *Cramer v. Mammoth Mart, Inc. (In re Mammoth Mart, Inc.)*, 536 F.2d 950, 953 (1st Cir. 1976) (quoting *Nathanson v. NLRB*, 344 U.S. 25, 29 (1952)).

(reorganization or liquidation), the type of claim (prepetition or postpetition), and the law from which the claim is derived (e.g., CERCLA, RCRA, etc.). In determining administrative priority issues, a distinction must be drawn between prepetition claims asserted against the debtor and postpetition claims asserted against the bankruptcy estate.

The general rule is that prepetition environmental claims should be treated as general unsecured claims. *Midlantic* established a narrow exception to the general rule when prepetition environmental liability causes imminent and identifiable harm to the public health and safety. The costs incurred by the bankruptcy trustee in protecting the public from such imminent and identifiable harm are entitled to priority as administrative expenses.<sup>239</sup> In addition, postpetition environmental claims incurred during the bankruptcy may be entitled to priority as administrative expenses.<sup>240</sup>

When a debtor files bankruptcy, the assets of the debtor become property of the bankruptcy "estate." If environmentally impacted property owned by the debtor becomes part of the bankruptcy estate, the question arises: To what extent does the estate incur liability as an owner or operator of the property? If a trustee is allowed to abandon the property, the abandonment is retroactive to the petition date; the result is that the estate incurs no liability as an owner because the effect of abandonment is the same as if the estate never owned the property.<sup>241</sup> However, the estate does remain liable for prepetition environmental claims incurred by the debtor.<sup>242</sup>

Some environmental statutes, like CERCLA, impose liability on the current owner or operator of the property, regardless of fault. Since the trustee cannot abandon environmentally burdened property because there exists an imminent and identifiable harm to public health or safety, the costs incurred in taking precautions to protect the public from that harm are treated as an administrative expense.<sup>243</sup> If the trustee takes the necessary precautions and then abandons, the estate should be able to avoid liability as an owner or operator.

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239. See *supra* notes 178-92 and accompanying text.

240. See *supra* notes 29-31 and accompanying text.

241. See *supra* note 146 and accompanying text.

242. Although the estate remains liable, the debtor may be discharged from prepetition debts. See *supra* note 16 and accompanying text.

243. See, e.g., *In re FCX, Inc.*, 96 B.R. 49, 55 (Bankr. E.D.N.C. 1989).

If the trustee chooses to keep the property or to continue to operate its business on the property, the question arises whether the estate incurs *postpetition* liability under CERCLA as an “owner or operator.” In the case of *In re T.P. Long Chemical, Inc.*,<sup>244</sup> the court considered this issue. The EPA asserted a *postpetition* CERCLA claim against the bankruptcy estate based on *postpetition* operations, not on the debtor’s *prepetition* operations.<sup>245</sup>

The court, apparently unclear about the effective date of abandonment, offered two alternative outcomes. First, assuming the trustee was permitted to abandon the drums, the court found that the estate would nevertheless incur CERCLA liability as an operator of the site.<sup>246</sup> This position was based on the premise that abandonment was not retroactive to the petition date. According to this premise, abandonment would not free the estate from liability incurred as an operator from the petition date to the date of abandonment. However, most courts hold that the effective date of abandonment is retroactive to the petition date.<sup>247</sup>

As an alternative holding, the court decided that if abandonment is *retroactive* to the petition date, thus relieving the estate of liability under CERCLA, then the trustee would not be permitted to abandon the property based on public policy considerations requiring compliance with state and local laws regulating the abandonment of hazardous waste.<sup>248</sup> Thus, under this alternative, the court required (as a condition of abandonment) that the trustee comply with CERCLA. In order to abandon, the estate would have to satisfy the existing CERCLA liability as an administrative expense.<sup>249</sup> In either case, the court refused to allow the estate to avoid CERCLA liability.<sup>250</sup> The court found that the costs incurred in satisfying the estate’s CERCLA liability were

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244. 45 B.R. 278 (Bankr. N.D. Ohio 1985). This decision was prior to the *Midlantic* decision. The corporation operated a rubber recycling plant on property leased from the corporation’s owner. *Id.* at 280. The debtor in possession operated under chapter 11 for eight months before the case was converted to chapter 7. *Id.* The EPA discovered drums containing hazardous materials which had been buried on leased property *prepetition*. *Id.* at 281. The EPA undertook a cleanup effort and sought reimbursement of its CERCLA claim against the estate as an administrative expense based on the estate’s *postpetition* ownership and operation of the property. *Id.*

245. *Id.*

246. *Id.* at 284.

247. *E.g., In re Peerless Plating Co.*, 70 B.R. 943 (Bankr. W.D. Mich. 1987). “Of course, title to property abandoned by the estate reverts, usually in the debtor, retroactively to the date of commencement of the case. Therefore, if the estate could abandon under *Midlantic*, . . . the estate could avoid [CERCLA] liability [for owning the site].” *Id.* at 948 (citation omitted). *See supra* note 146 and accompanying text.

248. *T.P. Long Chem.*, 45 B.R. at 284.

249. *Id.* at 286.

250. *Id.*

actual, necessary costs of preserving the estate and were entitled to administrative priority.<sup>251</sup>

Keeping in mind that under CERCLA a bankruptcy estate is liable for owning or operating a hazardous waste site, one can conclude from the foregoing discussion that if the trustee or debtor in possession can abandon the property, the estate can avoid *postpetition* CERCLA liability. However, if the trustee or debtor in possession cannot abandon the property, the estate, as the owner or operator of the property, is subject to *postpetition* CERCLA liability. This is true notwithstanding the fact that the EPA may have a valid *prepetition* claim against the estate based on the debtor's *prepetition* ownership or operation.

Although a bankruptcy estate may incur *postpetition* CERCLA liability based on ownership or operation of estate property, CERCLA does not establish what priority such a claim should receive in bankruptcy. A bankruptcy court faithfully applying the Bankruptcy Code will treat a *prepetition* CERCLA claim as a "general unsecured claim."<sup>252</sup> Similarly, the court will treat a *postpetition* CERCLA claim as a "general unsecured claim" *unless* the court finds that the *postpetition* claim is entitled to administrative priority because the requirements of section 503 are satisfied.<sup>253</sup>

As we have seen, inside of bankruptcy, some courts "prioritize" environmental claims ahead of other *unsecured* creditors, even though such prioritization would not be available outside of bankruptcy and notwithstanding the fact that the requirements for such prioritization are not met. An unsecured environmental claim should not be entitled to priority ahead of other unsecured creditors merely because it arises out of the violation of an environmental law. The court should prioritize an environmental claim only if the statutory requirements set forth in section 503(b)(1)(A) are met.<sup>254</sup> One court has explained that prioritization of claims under section 503(b) "begins with the *premise* that all the

251. *Id.*

252. *See supra* part II.B.

253. 11 U.S.C. § 503(b)(1)(A) (1988). The section provides: "After notice and a hearing, there shall be allowed administrative expenses . . . including . . . the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case . . ." *Id.* *See supra* part II.B.

254. Although CERCLA provides for the creation of a federal lien on property to secure the payment of response costs, 42 U.S.C. § 9607(l) (1988), a lien on property of the estate perfected *postpetition* may be avoided, 11 U.S.C. § 545 (1988).

costs to be considered are postpetition and *some* of them will receive administrative-expense priority.”<sup>255</sup> Nevertheless, bankruptcy courts continue to grant administrative priority to the EPA for unsecured environmental claims.

Some courts have taken one step further and granted environmental claims priority ahead of *secured* creditors. One example is the case of *In re Better-Brite Plating, Inc.*<sup>256</sup> The bankruptcy court, interpreting *Midlantic* narrowly, held that because the trustee had no unencumbered assets to finance a cleanup and there was no imminent danger to the public, the trustee could abandon the property even though violations of environmental laws existed.<sup>257</sup> However, the court also granted the EPA a *superpriority lien* on the property to secure repayment of the EPA’s cleanup costs.<sup>258</sup> Ironically, CERCLA provided a statutory basis for establishing only a *junior* lien on the property.<sup>259</sup> Thus, outside of bankruptcy the EPA would not be able to attain this superpriority lien. Nevertheless, the court found that the EPA was entitled, as the trustee would be under section 506(c),<sup>260</sup> to recover cleanup costs, ahead of any secured creditors, because the cleanup provided a benefit to the secured creditor.<sup>261</sup> Without reimbursement of the EPA’s costs, the secured creditor would have received an unfair windfall at the taxpayers’ expense.<sup>262</sup>

The case of *In re Mowbray Engineering Co.*<sup>263</sup> presented the bankruptcy court with a similar situation. In that case the trustee could not abandon the property without cleaning it up, but the estate had no assets available for cleanup.<sup>264</sup> The court allowed abandonment but

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255. *Alabama Surface Mining Comm’n v. N.P. Mining Co. (In re N.P. Mining Co.)*, 963 F.2d 1449, 1460 (11th Cir. 1992).

256. 105 B.R. 912 (Bankr. E.D. Wis. 1989). The chapter 7 trustee moved to abandon the debtor’s real property and leases. The EPA did not oppose abandonment provided it received priority liens on the properties ahead of the secured lenders. *Id.* at 915. The EPA would then be first in line to collect the proceeds of the sale of the property subsequent to decontamination.

257. *Id.* at 917.

258. *Id.* at 919.

259. “42 U.S.C. § 9607(a) imposes liability on the owner or operator of any facility for ‘all costs of removal or remedial action incurred by the United States Government.’ Section 9607(l) creates a federal lien for such costs, but the lien is subject to prior valid liens.” *Id.* at 917.

260. Section 506(c) of the Bankruptcy Code provides: “The trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim.” 11 U.S.C. § 506(c) (1988).

261. *Better-Brite*, 105 B.R. at 917-18.

262. *Id.* at 918.

263. 67 B.R. 34 (Bankr. M.D. Ala. 1986).

264. *Id.* at 35.

prioritized the EPA's claim for cleanup costs ahead of the secured creditors.<sup>265</sup> The court explained that the "EPA stands in the shoes of the trustee in preserving the estate and is entitled, as the trustee would be but for abandonment, to recover costs upon sale of the property prior to satisfying any secured claims against the property."<sup>266</sup> It is important to note that outside of bankruptcy the EPA would not have been able to attain this priority ahead of secured creditors.

### C. *The Role of "Reorganization" in Determining Administrative Priority*

One purpose of administrative priority is to facilitate rehabilitation of a debtor-business by encouraging third parties to provide goods and services. Congress has recognized that if a business is to be reorganized, third parties must be willing to provide the goods and services necessary to continue the operation.<sup>267</sup> Because third parties will be unwilling to do so without assurance of payment, section 503 provides a priority for expenses incurred by the trustee or debtor in possession in order to continue business operations. Costs "ordinarily incident" to the postpetition operation of a reorganizing business are entitled to administrative priority because continued operation benefits the creditors of the estate.<sup>268</sup>

It should be noted that Congress did intend that administrative expenses *include* claims *other than* those that preserve the assets of the bankruptcy estate.<sup>269</sup> The language of section 503 indicates that administrative expenses *include* those that preserve the assets of the bankruptcy estate but are *not restricted to* only those that preserve the assets of the bankruptcy estate. For example, expenditures that deplete the estate's assets but rehabilitate the debtor's business are entitled to administrative priority.

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265. *Id.* at 35-36.

266. *Id.* at 35.

267. *Cramer v. Mammoth Mart, Inc. (In re Mammoth Mart, Inc.)*, 536 F.2d 950, 954 (1st Cir. 1976).

268. Creditors are entitled to be treated under a chapter 11 plan at least as well as they would be treated under a chapter 7 liquidation. 11 U.S.C. § 1129(a)(7) (1988).

269. *Alabama Surface Mining Comm'n v. N.P. Mining Co. (In re N.P. Mining Co.)*, 963 F.2d 1449, 1456 (11th Cir. 1992).

Controversy has arisen regarding whether the bankruptcy estate must actually *benefit* from an administrative expenditure. The question is how broadly should the term “administrative expenses” be interpreted. Many courts grant administrative priority only if the costs either help rehabilitate the business or preserve the estates assets, thus providing a benefit in some way to the estate.<sup>270</sup> These courts rely on the overriding concern in bankruptcy of “keeping fees and administrative expenses at a minimum so as to preserve as much of the estate as possible for the creditors.”<sup>271</sup>

The Supreme Court has *not* construed the term “administrative expenses” narrowly.<sup>272</sup> Consequently, neither have many lower courts. For example, one court found that “costs that form ‘an integral and essential element of the continuation of the business’ are necessary expenses even though priority is not necessary to the continuation of the business.”<sup>273</sup> In *Reading Co. v. Brown*, the Supreme Court held that those injured by the negligence of a bankruptcy trustee operating the debtor’s business during reorganization were entitled to recover damages as administrative expenses.<sup>274</sup> The Court reasoned that “[e]xisting creditors are, to be sure, in a dilemma not of their own making, but there is no obvious reason why they should be allowed to attempt to escape that dilemma at the risk of imposing it on others equally innocent.”<sup>275</sup> The Court was concerned with fairness and policies of compensating innocent tort victims for injury suffered and encouraging trustees to adequately insure the businesses they operate.<sup>276</sup> These policies form the basis for the longstanding general rule of imposing a receiver’s tort liability on the receivership.

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270. *E.g.*, *Burlington N. R.R. v. Dant & Russell, Inc.* (*In re Dant & Russell, Inc.*), 853 F.2d 700 (9th Cir. 1988); *In re Pierce Coal & Constr., Inc.* 65 B.R. 521 (Bankr. N.D. W. Va. 1986) (holding that the cost of reclamation of land damaged during postpetition operations was entitled to administrative priority because the cost was necessary to preserve the estate and that the estate benefited by postpetition mining operations); *In re O.P.M. Leasing Servs., Inc.*, 23 B.R. 104, 121 (Bankr. S.D.N.Y. 1982) (cited in *N.P. Mining*, 963 F.2d at 1454); *In re Vermont Real Estate Inv. Trust*, 25 B.R. 804, 806 (Bankr. D. Vt. 1982) (finding that the expenses incurred in removing a dangerous building which had collapsed postpetition on the debtor’s leased premises were entitled to treatment as an administrative expense because removal was necessary for preservation of the leasehold as part of the chapter 11 bankruptcy estate and was necessary for the public’s safety).

271. *N.P. Mining*, 963 F.2d at 1454 (quoting *Otte v. United States*, 419 U.S. 43, 53 (1947)).

272. *Id.*

273. *Id.* (quoting *Reading Co. v. Brown*, 391 U.S. 471, 484 (1968)).

274. 391 U.S. 471, 484-85 (1968).

275. *Id.* at 482-83.

276. *N.P. Mining*, 963 F.2d at 1456.

Based on the principles of “fairness” expressed in *Reading*, some courts have granted administrative priority to the actual, necessary costs of preserving the estate even though there was *no actual benefit* to the estate. Courts focusing on fairness to innocent persons injured by the estate’s actions may be inclined to expand the meaning of administrative expense to claims that do not aid the rehabilitation of the business or preserve a maximum of assets for distribution. But if the “fairness to innocent victims” argument is determinative in deciding administrative expense status, *any* postpetition act which violates the law and damages another should be treated as an administrative expense entitled to priority ahead of prepetition creditors. Such a broad interpretation of administrative priority would discourage creditors from supporting a chapter 11 reorganization and force distressed businesses into liquidation.<sup>277</sup> Creditors of a chapter 11 bankruptcy estate would be unwilling to become insurers against liability which would not be insurable by traditional means.<sup>278</sup>

#### *D. The Role of 28 U.S.C. § 959 in Determining Administrative Priority*

When the trustee continues to own or operate the property, does the trustee or debtor in possession have a duty to operate the property in compliance with state laws? Are costs of compliance entitled to administrative expense priority? Must prepetition claims be satisfied and violations be corrected postpetition as administrative expenses? Should the trustee’s liability for noncompliance postpetition be entitled to administrative expense priority when the same liability for noncompliance incurred by the debtor prepetition is only treated as a general unsecured claim?

These questions cannot be answered without first considering the duties of the bankruptcy trustee. It is well recognized that an owner or operator of property outside of bankruptcy must abide by state law. Similarly, Congress has mandated that a trustee managing and operating estate property must abide by state law.<sup>279</sup> Thus, section 959(b)

277. *Reading*, 391 U.S. at 487 (Warren, C.J., dissenting).

278. *Id.* at 489.

279. Section 959 provides:

[A] trustee . . . appointed in any cause pending in any court of the United States, including a debtor in possession, shall manage and operate the property

requires that liability incurred postpetition by a trustee or debtor in possession be paid from the assets of the estate. However, controversy arises regarding the priority of such liability incurred by the trustee on behalf of the estate. The resolution of this controversy depends on whether the bankruptcy is a reorganization or liquidation.

### 1. Reorganization

When a trustee or debtor in possession operates the debtor's business postpetition, section 959 applies.<sup>280</sup> Compliance with state law is required and the associated costs should be treated as administrative expenses necessary to preserve the estate. When a business is in reorganization, it is attempting to start anew as a viable, going concern. During the reorganization the business must abide by the same laws and regulations as its competitors. Otherwise, the bankruptcy estate would have an unfair advantage over nonbankrupt competitors. Businesses under the protection of chapter 11 should not be allowed to cut costs and to benefit by ignoring safety, environmental, or any other laws.<sup>281</sup> To assure that the estate will receive no advantage over other competitors, penalties and fines imposed on the bankruptcy estate resulting from violations of nonbankruptcy law by the trustee should be given administrative priority. The estate creditors would obtain the benefits associated with the debtor's business operating as a going concern but would incur the liability associated with trustee's violation of state or federal nonbankruptcy law.

The Supreme Court addressed this issue in *Reading*. In that case, the Court decided that tort liability incurred by the receiver during postpetition operation of the debtor's business was a cost of doing business entitled to administrative priority.<sup>282</sup> The Court justified its holding based in part upon the fact that the injury was one which might have been insured against. The Court sought to encourage receivers to insure adequately the businesses they operate. Insuring against tort liability is a common practice and the costs would clearly qualify for administrative priority because they are necessary to preserve the assets

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in his possession as such trustee, according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof.

28 U.S.C. § 959(b) (1988).

280. *Id.*

281. *Alabama Surface Mining Comm'n v. N.P. Mining Co. (In re N.P. Mining Co.)*, 963 F.2d 1449, 1456 (11th Cir. 1992).

282. *Reading Co. v. Brown*, 391 U.S. 471 (1968). See *supra* notes 274-78 and accompanying text.

of the estate. In the *Reading* case, however, the damage was so great that insurance coverage likely would have been inadequate to compensate for the loss.<sup>283</sup> Nevertheless, the risk and resulting liability was a consequence of the trustee's continued operation of the debtor's business. The estate obtained the benefit of the ongoing business subject to the risks and liability associated with continued operations that any other similar business might incur.

In the case of *In re Charlesbank Laundry, Inc.* the Court of Appeals for the First Circuit extended the *Reading* decision by granting administrative priority to a compensatory civil fine imposed against the debtor in possession for a postpetition violation of an injunction to abate a nuisance.<sup>284</sup> The court found that a postpetition "intentional act which violates the law and damages others" should be treated as an administrative expense.<sup>285</sup>

Another example of the treatment of this issue is presented in the case of *In re Laurinburg Oil Co.*<sup>286</sup> In that case, the debtor maintained and operated a waste disposal facility postpetition. The state sought injunctive relief to abate postpetition violations of water pollution laws which were creating a threatened release of hazardous waste. The bankruptcy court, relying only on section 959, found that the reasonable and necessary expenses incurred to abate violations of the state water pollution laws were administrative expenses necessary to preserve the estate.<sup>287</sup>

Based on section 959 and these decisions, it is reasonable to conclude that penalties for violations of state and federal law are entitled to administrative expense priority as necessary costs of the continuing operation of the chapter 11 debtor's business. Arguably such penalties are not entitled to administrative priority because they provide no benefit to the bankruptcy estate, even though they are properly considered part of the cost of the debtor's continued business operations. But neither logic nor legal precedent support this position. First, the estate will benefit if allowed to operate postpetition without making the expenditures necessary to comply with state environmental laws. Second, the

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283. *Reading*, 391 U.S. at 483.

284. *Spunt v. Charlesbank Laundry, Inc. (In re Charlesbank Laundry, Inc.)*, 755 F.2d 200 (1st Cir. 1985).

285. *Id.* at 203.

286. 49 B.R. 652 (Bankr. M.D.N.C. 1984).

287. *Id.* at 654.

Supreme Court has found postpetition penalties incurred by a trustee while operating the debtor's business postpetition were entitled to administrative priority under the Bankruptcy Act.<sup>288</sup>

Similarly, the Court of Appeals for the Fourth Circuit, convinced that the bankruptcy estate was liable for *all* penalties arising out of the trustee's postpetition operation of the debtor's business, regardless of their type, granted the postpetition penalties priority as administrative expenses.<sup>289</sup> The court reasoned that although *prepetition* penalties should not reduce the distribution to the creditors because the creditors could not have prevented accrual of penalties, *postpetition* penalties could be granted priority as administrative expenses because during bankruptcy business operations are subject to court supervision and the creditors, having a voice in its operation, can prevent violations of the law and the accrual of penalties.<sup>290</sup> Creditors benefiting from the postpetition operation of the debtor's business cannot object to the liabilities which arise under nonbankruptcy law as a result of the ongoing business.

In another case, *In re N.P. Mining Co.*, the Court of Appeals for the Eleventh Circuit granted administrative priority status to a punitive civil penalty for environmental violations resulting from the operation of the debtor's business postpetition.<sup>291</sup> The priority status served the federal policy of requiring trustees to operate bankruptcy estates in compliance with state law.<sup>292</sup> The court granted priority even though the penalties were not used to repair environmental damage,<sup>293</sup> there was no evidence of an imminent health hazard,<sup>294</sup> and the estate was no longer in a position to abate violations and avoid fines.<sup>295</sup> The court, citing

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288. *Nicholas v. United States*, 384 U.S. 678 (1966); *Boteler v. Ingels*, 308 U.S. 57 (1939); see also *In re Samuel Chapman, Inc.*, 394 F.2d 340 (2d Cir. 1968) (holding that creditors should not benefit from the debtor in possession's postpetition tax delinquencies and holding that the estate remains liable). In *Boteler*, the Supreme Court explained: "Subdivision 57(j) prohibits allowance of a tax penalty against the bankrupt estate only if incurred by the bankrupt before bankruptcy by reason of his own delinquency. After bankruptcy, it does not purport to exempt the trustee from the operation of state laws, or to relieve the estate from liability for the trustee's delinquencies." *Boteler*, 308 U.S. at 59-60.

289. *United States Dep't of Interior v. Elliott (In re Elkins Energy Corp.)*, 761 F.2d 168, 171 (4th Cir. 1985) (granting administrative-expense status to postpetition penalties assessed against the debtor mining company for postpetition misconduct).

290. *Id.*

291. *Alabama Surface Mining Comm'n v. N.P. Mining Co. (In re N.P. Mining Co.)*, 963 F.2d 1449 (11th Cir. 1992).

292. *Id.* at 1458.

293. *Id.* at 1452.

294. *Id.*

295. *Id.* at 1450.

*Elliott*, explained that creditors, who receive the benefit of the ongoing business and have influence over the debtor's business operations postpetition, must prevent violations of the law or bear financial responsibility for the consequences.<sup>296</sup> To the court, the "punitive civil penalties assessed as a consequence of the operation of a bankruptcy estate's business [were] 'actual, necessary costs and expenses of preserving the estate' under section 503(b)(1)(A)."<sup>297</sup>

So far, these decisions have involved penalties incurred as a result of postpetition operation of the debtor's business, and the courts have held that such penalties are entitled to administrative priority. However, a different issue regarding the proper classification and treatment of environmental penalties arose in the case of *In re Bill's Coal Co.*<sup>298</sup> In that case, the debtor attempted reorganization under chapter 11 but ceased all mining operations on the date of filing bankruptcy.<sup>299</sup> A year later the case was converted to a chapter 7 liquidation.<sup>300</sup> During the chapter 11 case, the state brought forty-two enforcement actions against the debtor for noncompensatory penalties resulting from violations of surface mining laws.<sup>301</sup> The court had to classify these claims as prepetition or postpetition. The court found the claims were postpetition<sup>302</sup> even though all mining operations had ceased *prepetition*. Having found the claims were postpetition, the court had no difficulty granting them priority as administrative expenses, despite the lack of benefit to the estate, because the payment of a fine for the violation of environmental regulations should be considered a cost ordinarily incident to the operation of the business.<sup>303</sup> The court saw

296. *Id.* at 1460.

297. *Id.* at 1459.

298. 124 B.R. 827 (D. Kan. 1991).

299. *Id.* at 828.

300. *Id.*

301. *Id.* at 828-29.

302. The district court reversed the bankruptcy court's decision reasoning that the fact that the "debtor ceased strip mining when it filed for bankruptcy does not force the conclusion that the violations were pre-petition, since obligations to reclaim land or maintain certain land practices could continue regardless of whether [the] debtor was actively strip mining." *Id.* at 829. The bankruptcy court had previously (and seemingly correctly) found that the violations were *prepetition* claims based on the fact that the debtor ceased all mining operations *prepetition*. *Id.* at 828.

303. *Id.* at 830 (relying on *Lancaster v. Tennessee (In re Wall Tube & Metal Prods. Co.)*, 831 F.2d 118, 123-34 (6th Cir. 1987); *Borden, Inc. v. Wells-Fargo Business Credit (In re Smith-Douglass, Inc.)*, 856 F.2d 12, 17 (4th Cir. 1988); *Burlington N. R.R. v.*

no reason to distinguish between compensatory and noncompensatory penalties<sup>304</sup> and held that the penalties for the debtor's postpetition misconduct were to be treated as an administrative expense<sup>305</sup> despite the lack of benefit to the estate.<sup>306</sup>

The *Bill's Coal* decision is difficult to reconcile with other cases for several reasons. First, the penalties were a result of the debtor's prepetition conduct. Although the debtor was reorganizing in an attempt to continue as a viable business enterprise, the mining operations had ceased. The debt was not related to the ongoing business of the debtor. Second, the creditors had no control over the estate's liability for the penalties assessed postpetition. Because the claims were a result of the debtor's prepetition mining, neither the creditors nor the court had any control over the debtor to prevent the estate from incurring the liability. Third, the debt was not a consequence of the debtor's postpetition operations. The estate did not benefit from any postpetition mining operations and therefore the penalties should not have been treated as an administrative expense.

## 2. Liquidation

Although it is well recognized that section 959 applies to trustees in a bankruptcy reorganization, some controversy has arisen regarding the applicability of section 959 in a bankruptcy liquidation. A broad interpretation of section 959 leads to the conclusion that section 959 applies both to liquidating and to reorganizing trustees. Several courts have taken this view. For example, the *Stevens* court reasoned that "[s]ince the [liquidating] trustee cannot abandon hazardous waste and 28 U.S.C. § 959(b) requires that the trustee comply with valid state laws affecting such property, . . . the cleanup . . . remains the responsibility of the estate."<sup>307</sup> The *Wall Tube* court also found that section 959(b) requires a chapter 7 trustee to comply with state environmental law.<sup>308</sup> That court found no consequential difference between the duties of a liquidating or reorganizing trustee with respect to compliance with section 959 because "[i]n either case, an environmental hazard . . . is

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Dant & Russell, Inc. (*In re Dant & Russell, Inc.*), 853 F.2d 700, 709 (9th Cir. 1988).

304. *Id.* at 830.

305. *Id.*

306. *Id.*

307. *In re Stevens*, 68 B.R. 774, 781 (D. Me. 1987).

308. *Lancaster v. Tennessee (In re Wall Tube & Metal Prods. Co.)*, 831 F.2d 118, 122 (6th Cir. 1987).

within the control of the trustee.”<sup>309</sup> Although the Supreme Court has not answered the question directly, the Court stated in *Kovacs*:

[A]nyone in possession of the site — whether it is [the debtor] . . . or the bankruptcy trustee — must comply with the environmental laws of the State of Ohio. Plainly, that person or firm may not maintain a nuisance, pollute the waters of the State, or refuse to remove the source of such conditions.<sup>310</sup>

On the other hand, a *narrow* interpretation of section 959 leads to the conclusion that section 959 only applies to reorganizing debtors. Several courts have also taken this view. For example, the *N.P. Mining* court found that section 959 only applies when the property is managed or operated for the purpose of continuing operations.<sup>311</sup> Similarly, the *Microfab* court found that section 959 “does not require a Chapter 7 trustee to clean contaminated real estate” when the trustee neither managed nor operated the property.<sup>312</sup> The *Stevens* court found that the fairer literal reading of section 959 was that it did not apply to a liquidating trustee.<sup>313</sup> The *narrow* interpretation is preferable because it takes into consideration that a liquidating trustee does not have the same interests as an owner, operator, or even a reorganizing trustee. The liquidating trustee will not pursue the long-term benefits and address the long-term concerns that are the focus of attention for an owner, operator, or reorganizing trustee. Assuming the narrow interpretation, section 959 cannot be used to create a postpetition claim against a bankruptcy estate arising out of prepetition conduct or environmental violations. Because there is no postpetition claim under these circumstances, the claim cannot be prioritized and the question of priority is not an issue.

However, even if one were to adopt the *broad* interpretation, and decide that section 959 is applicable to liquidating trustees, there is nothing in the section or elsewhere that establishes the *priority* of a claim against the estate based on section 959. As the *Reading* court noted, section 959 establishes only the principle of liability under state law and does not define from whom or with what priority the claim

309. *Id.*

310. *Ohio v. Kovacs*, 469 U.S. 274, 285 (1985).

311. *Alabama Surface Mining Comm'n v. N.P. Mining Co. (In re N.P. Mining Co.)*, 963 F.2d 1449, 1460 (11th Cir. 1992).

312. *In re Microfab, Inc.*, 105 B.R. 161, 168 (Bankr. D. Mass. 1989).

313. *In re Stevens*, 68 B.R. 774, 781 (D. Me. 1987).

ought to be collected.<sup>314</sup> In order for such a claim to qualify for administrative priority, the claim must satisfy the requirements of section 503 of the Bankruptcy Code. In a chapter 7 liquidation, a section 959 claim will not satisfy the requirements of section 503 because such a claim is not a necessary expense to preserve the assets of the estate for the benefit of the creditors.

The case of *In re Bio-Med Laboratories* provides an example illustrating the problems with the broad interpretation of section 959. In that case, the lessor sought reimbursement for the fair rental value of property occupied by the chapter 7 trustee for five months postpetition while the debtor undertook environmental cleanup.<sup>315</sup> The bankruptcy court determined that the trustee could not abandon the property in contravention of state environmental protection law<sup>316</sup> and, as a result, the debtor was a holdover tenant obligated to pay rent.<sup>317</sup> In deciding to grant administrative priority for the lessor's claim, the court, apparently agreeing with the *Wall Tube* court, found it irrelevant whether the trustee was liquidating, managing, or reorganizing.<sup>318</sup> The court found the lessor was entitled to rent as an administrative expense because allowing the debtor to remain on the premises as a holdover tenant to clean up the property "effectively preserved the estate."<sup>319</sup> Although the court found that the holdover tenancy benefited the estate, it appears that the estate benefited only to the extent that the estate discharged a CERCLA claim. However, only if the claim was the result of postpetition operations under chapter 11, should the claim have been treated as an administrative expense. If the claim arose prepetition, the postpetition expense provided no benefit to the estate and should not have received priority because the occupancy of the property during the cleanup did not serve to preserve the chapter 7 estate for the benefit of the creditors.

The case of *In re Kent Holland Die Casting & Plating, Inc.*<sup>320</sup>

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314. *Reading Co. v. Brown*, 391 U.S. 471, 477-78 n.7 (1968).

315. *In re Bio-Med Lab.*, 131 B.R. 72 (Bankr. N.D. Ohio 1991). The debtor conducted business on leased premises. *Id.* at 73. The debtor operated under chapter 11 for a year before conversion of the case to chapter 7. *Id.* After conversion, the trustee discovered hazardous waste on the property and the EPA required disposal in compliance with environmental laws. *Id.* at 74. The chapter 7 trustee occupied the property for five months for the purpose of carrying out the hazardous waste disposal. *Id.*

316. *Id.* at 75.

317. *Id.*

318. *Id.*

319. *Id.*

320. *Windolph Trust v. Leitch (In re Kent Holland Die Casting & Plating, Inc.)*, 125 B.R. 493 (Bankr. W.D. Mich. 1991). The chapter 11 debtor assumed a lease

illustrates the proper treatment of postpetition environmental claims asserted against a chapter 7 and chapter 11 bankruptcy estate. The environmental liability which arose during the chapter 11 case resulting from the debtor's breach of a lease agreement was accorded administrative priority. The liability which arose under the lease was incurred so that the debtor could receive the benefits of the lease during the ongoing operations of the debtor's business postpetition. The environmental liability which arose during the chapter 7 case, resulting from the debtor's breach of the lease agreement, was also entitled to administrative priority but was limited to the actual value conferred on the estate as a result of the breach. Rental value was the very most to which the lessor would be entitled as an administrative expense. The National Bankruptcy Conference (NBC) has proposed a similar, though slightly different, rule for granting administrative expense status to environmental claims.<sup>321</sup>

## VI. CONCLUSION

Determining the proper treatment of environmental claims in bankruptcy requires recognizing established priorities in three areas of law—the priority of bankruptcy law relative to environmental law, the priority of environmental claims relative to other claims outside of bankruptcy law, and the priority of environmental claims relative to other claims within bankruptcy law. These priorities have been considered in the analysis of when an environmental claim arises, the

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postpetition which included an indemnification agreement for environmental liability. *Id.* at 496. Two and a half years later, the debtor's case was converted to chapter 7. *Id.* at 495.

321. The rules governing administrative expense priority:

1. Costs expended postpetition to clean up prepetition contamination of property owned but not operated by the debtor postpetition should be entitled to administrative expense priority only to the extent that the costs (1) actually enhance the value of the property or (2) are necessary to carry out the trustee's or debtor in possession's duty to protect the public from immediate danger from environmental harm prior to abandonment or sale. The amount of any other cleanup costs should be treated as a general unsecured claim.

2. Costs expended to clean up contamination of property operated postpetition or to prevent postpetition pollution should be entitled to administrative expense priority.

Bankruptcy Reform, *supra* note 88, at 30.

extent and consequences of a trustee's abandonment power, and environmental claim priority in order to define and evaluate criteria for characterizing environmental claims and for determining their proper priority in bankruptcy.

An environmental claim against a debtor should arise when the debtor's conduct results in liability under environmental law, irrespective of when environmental harm actually occurs, is manifested, is fully known or knowable, or is remediated. The environmental liability may be contingent, unmatured, or unliquidated. For example, a contingent CERCLA claim will arise when there is a release or threatened release of a hazardous substance.

The bankruptcy estate should be liable for prepetition environmental claims incurred by the debtor. Since the Bankruptcy Code does not distinguish environmental claims from other claims, environmental claims should be treated just as any other claims. A prepetition environmental claim, like any other prepetition claim, should be discharged unless it falls within an exception to discharge provided in the Bankruptcy Code.

An environmental claim, like most unsecured claims, should be treated as a general unsecured claim unless it is entitled to priority treatment as an administrative expense. Administrative priority should be granted for postpetition costs incurred in satisfying a prepetition environmental claim only if the expenditure is necessary to protect the public from immediate danger from the environmental harm. Any other expenditures made to satisfy a prepetition environmental claim should be treated as a general unsecured claim.

The bankruptcy estate may incur postpetition liability under environmental law because of postpetition ownership or operation of property. In addition, the estate may incur postpetition liability based on the trustee's duty to abide by state law pursuant to 28 U.S.C. section 959. Nevertheless, postpetition environmental claims should not *automatically* be entitled to administrative expense priority simply because of their "environmental" nature. In a reorganization case, only those expenditures made to satisfy postpetition environmental claims resulting from the continued operations of the debtor's business during reorganization should be treated as an administrative expense. In a liquidation case, expenditures made to satisfy postpetition environmental claims should be treated as an administrative expense only to the extent they provide an actual benefit to the bankruptcy estate.

DEBORAH E. PARKER