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The Competing Goals Of Environmental And Bankruptcy Laws

By **Andrew Gallo and Duke McCall** (January 23, 2024, 4:30 PM EST)


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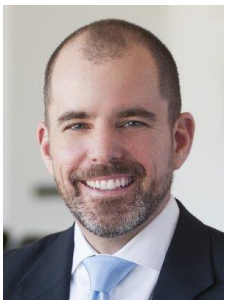
Duke McCall

U.S. bankruptcy filings surged nearly 20% in 2023,[1] and economic volatility is expected to continue in 2024, with the potential for negative gross domestic product growth in the second and third quarters that would be felt broadly across the U.S. economy.[2]

At the same time, many U.S. companies face new and increasing environmental exposures as a result of climate change, emerging contaminants, evolving regulatory standards and other factors. Such economic pressures combined with environmental liabilities have led to some of the largest bankruptcy filings in U.S. history, such as Pacific Gas and Electric's 2019 bankruptcy.[3]

Because of the competing goals of U.S. bankruptcy and environmental laws, such cases also present unique challenges for debtors, creditors, purchasers and their counsel.

This article examines some of the core issues that arise at the intersection of bankruptcy and environmental laws, discusses how courts have sought to address the inherent conflicts, and identifies issues on which the law remains unsettled.

The Competing Goals of Environmental and Bankruptcy Laws

One of the primary goals of bankruptcy law is to provide debtors with a fresh start by imposing an automatic stay and allowing for claims of reorganizing debtors to be discharged.

In environmental law, a primary goal is to ensure that the polluter pays for environmental harms.

These two goals collide when an entity with environmental liabilities enters bankruptcy. The result is often outcomes that are the exception, rather than the rule, with many unsettled areas of law that can be dealt with by bankruptcy courts in varying ways.

With a close eye on current economic conditions and an increasing focus on bankruptcy and restructuring efforts, debtors, creditors and purchasers should keep in mind the following key issues when dealing with environmental liabilities in bankruptcy.

The Automatic Stay

The commencement of a bankruptcy case triggers an automatic stay that generally prohibits creditors

from starting or continuing an action to enforce claims against a debtor or its property.[4]

The automatic stay does not extend to a government's exercise of its police powers.[5] This police power exception can be applied to efforts by a governmental entity to enforce environmental cleanup obligations.[6]

It should be noted, however, that environmental enforcement actions are generally stayed when they are pecuniary in nature — i.e., when the government is seeking damages or remuneration for past cleanup efforts.

Dischargeability of Claims

A key aspect of the bankruptcy fresh start is a debtor's ability to discharge certain claims upon approval of a reorganization plan.

Generally, only claims that arise prior to the bankruptcy filing can be discharged.[7]

Accordingly, a key issue for environmental liabilities is determining whether the claim arose before or after the bankruptcy filing. Certain courts have held that environmental claims arise when the release occurs, whereas other courts hold that the claim arises only when it is foreseeable or fairly contemplated.[8]

Where a debtor is subject to remediation obligations pursuant to an injunction, such performance obligations are generally not dischargeable if they relate to ongoing pollution or where remediation is necessary to prevent an imminent harm to human health or the environment.[9] Where obligations relate to past pollution that does not pose an ongoing threat, they are likely dischargeable.[10]

Treatment of fines and penalties imposed by the government can vary. Generally, they are nondischargeable, but practitioners need to look at relevant precedent from the jurisdiction where the bankruptcy is pending to determine ultimate treatment — including priority — of these claims.[11]

Contaminated Property

The Comprehensive Environmental Response, Compensation and Liability Act imposes liability for environmental cleanup on the owner of a contaminated property regardless of fault and, as noted above, ongoing cleanup obligations generally cannot be discharged in bankruptcy.

The debtor's options for the contaminated property include the following:

- Retain the property, in which case the debtor will retain the cleanup obligations;
- Sell the property with the purchaser assuming cleanup obligations, which requires a willing purchaser;
- Settle with applicable government authorities, which typically requires transferring the contaminated property into a trust that has the financial ability to satisfy future cleanup obligations; and
- Abandonment, discussed below.

Abandonment

The U.S. Bankruptcy Code generally allows debtors to abandon property that is burdensome to maintain or has no value.

In Midlantic National Bank v. New Jersey Department of Environmental Protection in 1986, the U.S. Supreme Court held that a bankrupt debtor's ability to abandon contaminated property is limited if the property poses an imminent and identifiable risk to public health and safety.

More recently, in the case of In re: Exide Holdings Inc. in 2021, the U.S. District Court for the District of Delaware pushed the boundaries of the doctrine established by Midlantic by allowing a debtor to abandon contaminated property to state regulators where necessary to complete a comprehensive settlement.

The courts found that the property, although contaminated, did not pose an imminent danger due to ongoing remediation efforts that could be funded with surety funds.[12]

Allowance

Where multiple parties are jointly and severally responsible for cleanup costs, can parties assert claims for contribution or reimbursement against a co-liable party that is in bankruptcy?

The answer is generally "yes" where costs were incurred prior to the bankruptcy case or are future costs that are not contingent on the occurrence of a subsequent event.[13]

However, contingent claims relating to costs that may be incurred in the future can be disallowed under Section 502 of the Bankruptcy Code.[14]

Sales of Assets

Section 363 of the Bankruptcy Code provides for asset sales free and clear of liabilities of the debtor.[15]

Environmental claims against a debtor based upon prior conduct associated with a specific property should not follow the property in any bankruptcy sale if there is no ongoing contamination. However, contaminated real property cannot be purchased free and clear of CERCLA liability.

Accordingly, buyers need to perform adequate environmental due diligence when purchasing property out of bankruptcy, as there are likely to be limited or no indemnities from a seller in bankruptcy.

Conclusion

As evident from this overview, environmental liabilities in bankruptcy present unique challenges because of the conflicts inherent in the underlying goals of our bankruptcy and environmental laws.

The efforts of courts to resolve those conflicts have produced conflicting precedents and decisions driven by the specific facts presented. The resulting ambiguity creates uncertainty for debtors, creditors, purchasers and their counsel, and requires careful consideration of the potential outcomes.

This ambiguity also presents opportunities, however, for creative solutions in the treatment of environmental liabilities in bankruptcy.

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[1] https://www.reuters.com/markets/us/us-bankruptcies-surged-18-2023-seen-rising-again-2024-report-2024-01-03/#:~:text=Jan%203%20(Reuters)%20%2D%20U.S.,the%20outbreak%20of%20COVID%2D19.

[2] https://www.conference-board.org/research/us-forecast.

[3] See, e.g., https://www.newyorker.com/business/currency/the-pg-and-e-bankruptcy-and-the-coming-climate-related-business-failures.

[4] 11 U.S.C. § 362(a).

[5] City of New York v. Exxon Corp., 932 F.2d 1020 (2d Cir. 1991).

[6] But see U.S. Johns-Manville Corp., 13 Envtl. L. Rep. 20310 (D.N.H. 1982) (holding that an environmental cleanup obligation was the equivalent of a monetary judgment subject to the automatic stay).

[7] See Ohio v. Kovacs, 469 U.S. 274, 278 (1985).

[8] Compare In re Chateaugay Corp., 944 F.2d 997 (2d Cir. 1991) and In re Nat'l Gypsum, 139 B.R. 397 (N.D. Tex. 1992).

[9] In re Chateaugay Corp., 944 F.2d 997, 1008 (2d Cir. 1991).

[10] See In re IT Group, Inc., 339 B.R. 338 (D. Del. 2006).

[11] E.g., In re Jones, 311 B.R. 647, 652 (Bankr. M.D. Ga. 2004).

[12] In re Exide Holdings, Inc., 2021 WL 3145612 (D. Del. 2021).

[13] See In re G-I Holdings, Inc., 308 B.R. 196 (Bankr. D.N.J. 20024).

[14] In re Lyondell Chem C., 442 B.R. 236 (Bankr. S.D.N.Y. 2011).

[15] 11 U.S.C. § 363.