



WITH POLLUTED PROPERTY, THERE ARE FEW CLEAN ANSWERS

Goals of Bankruptcy Code and environment laws can be at odds

By **DIANE W. WHITNEY**

What happens when the owner of contaminated real estate files for bankruptcy? Is the owner's remediation obligation a debt that can be discharged? If it is, who retains that obligation? Can the property be abandoned or sold? What if you buy contaminated property from a bankrupt estate?

The answers to these questions can be found in a handful of cases and sometimes hinge on what look like technicalities of timing and procedure. This article outlines the very basic court decisions dealing with these issues.

Definitions

First some basic definitions from the Bankruptcy Code:

A "claim" is (A) 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 (B) a 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. 11 USCA § 101(5) and (12).

Fundamental Tension

When is a clean-up obligation a dischargeable debt and when can contaminated property be abandoned?

The fundamental tension is between the goals of bankruptcy, which are to discharge debts in order to give the debtor a fresh start, and the goals of environmental laws, which generally are to remediate contaminated property at the expense of those who caused the contamination. In various circumstances, one or the other of those goals is realized.

In *Ohio v. Kovacs*, 469 U.S. 274 (1985), the problem was a hazardous waste site that the owner, though subject to an injunction brought by the state, had not remediated. The state had a receiver appointed whose job was to collect as much of Mr. Kovacs' assets as were necessary to pay for the remediation, but he had not achieved that goal when Mr. Kovacs filed for bankruptcy.

To the state's dismay, the remediation debt was found by the Supreme Court to be a dischargeable debt because in going after the debtor's assets, the state had conceded that what it wanted was money. Moreover, by taking the debtor's money, the state made it virtually impossible for the debtor to perform the remediation himself. Had the state chosen instead to pursue Mr. Kovacs through civil or criminal environmental laws, the debt probably would not have been dischargeable.

And the property? Whoever is left in control of it has to remediate it. If its value exceeds the cost of the remediation, it is most likely that the trustee will sell it and the buyer will clean it up. On the other hand, if the cost of the remediation exceeds the value of the property, the trustee probably

will try to abandon it and the debtor will still bear that cost.

But more about abandonment. When can contaminated property be abandoned? In *Midlantic National Bank v. N.J. Dept. of Environmental Protection*, 474

U.S. 494 (1986), the Supreme Court decided that the property cannot be abandoned if its condition poses a risk to the public. Bankruptcy law does not preempt all other laws, particularly if the property presents an imminent and identifiable harm to human safety.

If property cannot be abandoned and costs must be incurred by the trustee to prevent harm to the public, those costs should qualify as administrative costs, with priority determined on a case-by-case basis. However, if the condition of the property does not pose a risk to the public, the trustee can abandon the property and, having been abandoned, the property is no longer in the estate, so any remediation performed does not benefit the estate and does not receive administrative priority. In *re McCrory Corporation*, 188 B.R. 763 (S.D.N.Y. 1995).

In *re Chateaugay Corp. v. LTV Corp.*, 944 F.2d 997 (2d Cir. 1991) tells us that most environmental injunctions to remedy ongoing pollution will not give rise to claims in bankruptcy, because an order that ends pollution is not an order for breach of an obligation that gives rise to a right of payment.



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The same result was reached in *Torwico Electronics, et al. v. N.J. Dept. of Environmental Protection*, 8 F.3d 146 (1993), in which the Chapter 11 debtor wanted to avoid liability for environmental remediation by making the state's efforts to enforce clean-up obligations into dischargeable claims under 11 U.S.C. § 101(5). However, the state filed no claim with the bankruptcy court and demanded that Torwico rectify an ongoing situation that constituted a hazard. Torwico lost and had to clean up the property.

Very recently, the same conclusion was reached as to an order under RCRA – *United States v. Apex Oil Co.*, (No. 08-3433, 7th Circuit, Aug. 25, 2009).

Lessons Learned

To the extent generalizations can be

pulled from these cases, they are:

- 1) If a remediation obligation is reduced to a monetary amount, it can be discharged as a debt. This does not answer who remains responsible for the remediation of the property.
- 2) If the value of the property exceeds its clean-up cost, the trustee can sell the property and the buyer must remediate.
- 3) If the cost of remediation exceeds the value of the property, and the property does not pose a risk to the public, the trustee can abandon the property, leaving the debtor with the property and the remediation obligation.
- 4) If the property presents a risk, the trustee may not abandon it without making it safe. Presumably the costs of that action are administrative expenses.
- 5) If the state cleans up the property, it will

probably put a lien on it to recover its costs.

The best a debtor who owns contaminated property can do is to have the remediation costs discharged, in that case most likely losing both the property and the debt. The worst the debtor can do is to be left with both the property and a remediation cost greater than the value of the property. A middle ground can be reached when concern that an environmental debt could be discharged leads to settlement discussions among all those involved in the contamination, allowing the debtor to resolve its obligation for a negotiated figure outside bankruptcy.

Bankruptcy does not solve all problems. The case of contaminated property is just one example where none of the possible solutions satisfies everyone. ■