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Sweeping Environmental Liability Under the Bankruptcy Carpet: Fresh Start Is Not Guaranteed

Businesses considering filing Chapter 11 for bankruptcy protection may not necessarily be able to avoid certain environmental cleanup obligations. The underlying policy goals of bankruptcy and environmental laws are in direct conflict in that bankruptcy law seeks to promote financial rehabilitation by discharging a debtor's past obligations in order to promote financial rehabilitation while environmental law seeks to ensure that the government can order responsible parties to clean up contamination, including historical pollution caused by business predecessors.

In the latest judicial attempt to reconcile this conflict, the Seventh Circuit ruled that a company, which had long since emerged from a Chapter 11 bankruptcy, was required to undertake a $150 million cleanup ordered by the U.S. Environmental Protection Agency ("EPA") under the Resource Conservation and Recovery Act ("RCRA") for contamination caused by its pre-bankruptcy predecessor.

Background

The fresh start objectives of bankruptcy law are counterposed against the goals of environmental law. Specifically, Superfund law (CERCLA) seeks to impose joint and several liability on responsible parties, including past owners and operators and upon successors. Under RCRA, the federal law establishing "cradle to grave" liability for the generation, handling, storage and disposal of solid and hazardous waste, the government is empowered to order responsible parties to remediate contaminated property. These broad powers clash with the bankruptcy goal of discharging an entity's debts in order to allow the entity to reorganize and start with a "clean slate."

Generally, a Chapter 11 bankruptcy will discharge a debtor from any claims that arose before the date of the confirmation of the plan of reorganization. The definition of the term "claim" is key when evaluating whether an environmental obligation may be properly discharged. The Bankruptcy Code defines "claim" as a right to payment and a "right to an equitable remedy for breach of performance if such breach gives rise to a right to payment." For companies with latent environmental liabilities, including RCRA and CERCLA cleanup obligations, the dispositive issue is whether the government's right to issue a cleanup order or obtain an injunction requiring a responsible party to clean up constitutes a "claim" for purposes of discharge under the bankruptcy code.

The *Apex* Decision

In *United States* v. *Apex Oil Co*., 579 F.3d 734 (7th Cir. 2009), the federal government was seeking an injunction under RCRA to require Apex Oil to clean up petroleum contamination at a property it did not own or operate. The EPA's claim arose from an oil plume at a refinery which was previously operated from the 1960s until 1987 by Apex's predecessor, Clark Oil and Refining Corporation. In 1987, Clark Oil filed for Chapter 11 bankruptcy and sold the refinery as part of the bankruptcy proceedings. In 1990, the company emerged from bankruptcy as Apex Oil following the Bankruptcy Court's confirmation of its Plan of Reorganization.

The EPA did not initiate its environmental law suit until 15 years after Apex had emerged from its Chapter 11 bankruptcy. The district court ruled that Apex was not protected by the confirmation order and granted the EPA's request for an injunction, ordering Apex to clean up a contaminated site pursuant to RCRA. On appeal, the Seventh Circuit addressed the issue of whether the EPA's right and claim to an injunction was discharged in bankruptcy.

A U.S. Supreme Court case is the controlling authority on this issue. In *Ohio* v. *Kovacs*, 469 U.S. 274 (1985), the Supreme Court held that an individual's Superfund cleanup obligation was discharged following Chapter 11 in specific circumstances.[1] The *Apex* court limited its application of *Kovacs* to situations in which the government actively seeks payment of money from the debtor rather than seeking an order or injunction to clean up the contaminated property. The Seventh Circuit held that RCRA Section 7003 provides the government a right to injunctive relief only and not a monetary damage. The court rejected Apex's argument that the government could have sued for restitution of cleanup costs or sought a money judgment against Apex and therefore, the government's suit was a "claim" that could be discharged through bankruptcy. The Seventh Circuit upheld the district court's ruling that Apex was required to undertake the $150 million cleanup because it was not a cognizable "claim" that could be discharged in a bankruptcy proceeding.

Business Implications and Considerations

Entities contemplating a Chapter 11 filing should evaluate carefully the potential business implications relative to environmental obligations against the prevailing court decisions. The Seventh Circuit court weighed in favor of environmental policy by ruling that certain cleanup obligations owed to the government are not "claims" which may be discharged through a bankruptcy proceeding. Other federal courts have ruled on this issue in different manners depending on the specific facts at issue. Potentially responsible parties should assess the possibility that after they emerge from Chapter 11 they may still be required to undertake certain cleanup obligations depending on the circumstances. Also, an entity considering purchasing an asset or business which has emerged from a bankruptcy proceeding should appreciate the potential impact of the various court decisions given that a successor to a post-bankruptcy entity may be held responsible for cleanup obligations associated with potential divestitures and acquisitions of pre-bankruptcy entities and assets.

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[1] In *Kovacs*, the Supreme Court reasoned that the government had converted its cleanup order into a monetary obligation when it sought to enforce an injunction by appointing a receiver and divest assets necessary to comply with the injunction ordering the debtor to clean up a property.