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Thomas L. Stockard

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INTRODUCTION

Many statutes passed by Congress are passed with a particular policy objective. When statutes with differing policy objectives conflict, the judicial system is left with the difficult task of sifting through the competing policy objectives to decide which should take priority. The conflict between the Bankruptcy Code and the Comprehensive Environmental Response Compensation Liability Act (CERCLA) is an example. The Bankruptcy Code's principal policy objective is to provide the bankrupt debtor with protection from its creditors — giving the debtor a "fresh start" free from past encumbrances. CERCLA's main policy objective is to prevent the release or threatened release of hazardous substances into the environment and to allocate the financial burden of cleaning up such releases to the responsible parties. The conflict between these policy objectives arises when a party who has been allocated the financial burden of cleaning up a piece of property under CERCLA files for bankruptcy, and seeks the protection from claims by potential creditors. This protection against claims by potential creditors may include cleanup claims brought under CERCLA.

Recently, in In re Chateaugay Corp., the United States Court of Appeals for the Second Circuit was faced with the dilemma of sorting through the conflict in these two statutes to determine which of the conflicting policy objectives will be applied. This note examines the Second Circuit's analysis in In re Chateaugay Corp. Part I of this note discusses the facts

5. 944 F.2d 997 (2d Cir. 1991).
6. Id.
involved, and the procedural history of the Chateaugay case, including an overview of the district court's holding. Part II of this note discusses the holding of the Second Circuit in Chateaugay, on four main issues: A) the dischargeability of CERCLA claims in a bankruptcy proceeding; B) the dischargeability of claims for injunctive relief brought under CERCLA; C) whether the policy objectives of CERCLA override the "fresh start" policy of the Bankruptcy Code; and D) the priority CERCLA claims will take in a bankruptcy proceeding. Part III of this note discusses and analyzes the Second Circuit's reasoning in deciding each issue in this case.

I. FACTS AND PROCEDURE OF DISTRICT COURTS DECISION

A. Facts

In Chateaugay, the Environmental Protection Agency (EPA) brought claims for violations of environmental regulations, including CERCLA, against the LTV corporation. LTV is a diversified steel, aerospace, and energy corporation, with operations in several states, including New York. In July of 1986, LTV sought protection from its creditors under Chapter 11 of the Bankruptcy Code. In the process of reorganization, LTV submitted 24 pages of environmental claims it considered contingent within the meaning of the bankruptcy code. If the court found the claims to be contingent, the Bankruptcy Code would discharge them. The EPA opposed the discharge of the claims, stating that the contingent "claims" were not claims within the meaning of the Bankruptcy code. The EPA had previously sought to collect $32 million in response costs that it had incurred prior to the filing of the bankruptcy petition.

7. Id.
8. Id. at 999.
9. Id.; see 11 U.S.C. §§ 1101-1174 (1988) (providing the relevant provisions of the Bankruptcy Code that relate to Chapter 11 proceedings). A Chapter 11 proceeding is more commonly known as a reorganization proceeding, and commonly involves an ongoing entity that is seeking temporary relief from its debts to reorganize itself. The purpose of a Chapter 11 proceeding is to substantially relieve the corporation of substantially all of its obligations which have arisen prior to and during the commencement of the Chapter 11 proceeding See generally JACKSON, supra note 3, at 209-24.
10. Chateaugay, 944 F.2d at 999.
11. Id. at 1000.
12. Id
13. Id. at 999.
Additionally, of the sites listed on the 24 pages of claims, only one had been treated to the point where no more costs would be incurred in cleanup. Due to future response costs that may be incurred, the EPA claimed that it could assert claims that greatly exceeded the $32 million claim for which they had already filed.14

B. Procedural History

The EPA originally brought the case in the United States District Court for the Southern District of New York.15 LTV had informed the Government that it expected confirmation of a reorganization plan to discharge all obligations concerning environmental liabilities that were traceable to their pre-petition conduct. LTV expressed to the Government that they sought to include in the discharge, obligations for response costs that were incurred after the filing of the bankruptcy petition as long as they related to pre-petition conduct.16 The EPA sought the following declaratory judgements from the district court: A) response costs incurred post-confirmation pursuant to CERCLA are not dischargeable claims under the Bankruptcy Code; B) environmental injunctive complaints obtained under CERCLA are not efforts to collect money judgments and therefore are not dischargeable in a bankruptcy proceeding; and C) environmental claims obtained pursuant to CERCLA and New York environmental claims that are incurred after the filing of the bankruptcy petition are expenses necessary to preserve the estate and are therefore entitled to an administrative priority17 in the bankruptcy settlement.18

C. Overview Of The District Court’s Decision

The district court in Chateaugay found that certain CERCLA claims were dischargeable in a bankruptcy proceeding.19 They reasoned that in order for an environmental claim

14. Id.
15. In re Chateaugay Corp., 112 B.R. 513 (S.D.N.Y. 1990), aff’d, 944 F.2d 997 (2d Cir. 1991). Any citations to the district courts decision will be denoted as such to prevent confusion.
16. Chateaugay, 944 F.2d at 1000.
17. See infra note 38 for a discussion of administrative priority in the Bankruptcy Code.
19. Id. at 521.
brought under CERCLA to be dischargeable in a bankruptcy proceeding, the claim must arise prior to the filing of a bankruptcy petition. With respect to injunctions, the court found that certain injunctions brought under CERCLA were dischargeable. In their analysis, the district court reasoned that injunctions which contain an optional right to payment fit within the definition of dischargeable claims within the Bankruptcy Code.

In deciding the priority of dischargeable CERCLA claims in a bankruptcy proceeding, the district court found that cleanup costs incurred post-petition were entitled to an administrative priority. The administrative priority classification gives CERCLA claims priority over the claims of unsecured creditors. The EPA appealed the district court’s decision to the Second Circuit, and LTV filed a cross appeal. The Second Circuit upheld the district court’s decision, clarifying which injunctions are dischargeable and which are not.

II. HOLDING OF THE SECOND CIRCUIT IN CHATEAUGAY

The court in Chateaugay answered some difficult questions that other courts addressing the conflict between the Bankruptcy Code and CERCLA have avoided. The Chateaugay decision addressed the following issues: A) when is a CERCLA claim dischargeable in a bankruptcy proceeding; B) when is a claim for injunctive relief dischargeable; C) do the policies behind CERCLA override the policies of the Bankruptcy Code, and therefore provide an exception to the application of the Bankruptcy Code’s policies; and D) what priority will environmental claims be given in a bankruptcy proceeding?

20. Id. at 521-22.
21. Id. at 522-23.
22. Id. at 522.
23. Id. at 522-23.
24. Id. at 525.
25. See infra note 38 for a discussion of administrative priority in the Bankruptcy Code.
27. Id. at 999.
28. See In re Combustion Equip. Assoc., 838 F.2d 35 (2d Cir. 1988) (refusing to issue declaratory judgment that CERCLA liability is discharged in a bankruptcy proceeding); In re Peerless Plating Co., 70 B.R. 943, 948 (W.D. Mich. 1987) (refusing to decide when a CERCLA claim arises under the bankruptcy code).
A. When is a CERCLA Claim Dischargeable?

In Chateaugay the Second Circuit determined that a bankruptcy proceeding will only discharge CERCLA claims that arise prior to the filing of the bankruptcy petition. The Chateaugay court also found that a CERCLA claim arises at the time when the acts giving rise to the alleged liability were performed. Putting these findings together, the court determined that in order for a CERCLA claim to be dischargeable, the claim must be linked to an actual release or threatened release of hazardous substances which occurred prior to the filing of the bankruptcy petition.

B. When is a Claim for Injunctive Relief Dischargeable?

The Second Circuit in Chateaugay found that orders for injunctive relief under CERCLA are dischargeable in a bankruptcy proceeding if the injunction includes an optional right to payment or is an attempt to collect a money judgment. However, this finding was limited by the court. The Second Circuit found that where there is no optional right to payment and the bankrupt entity still has the ability to comply with the injunction, the injunction is not dischargeable.

C. Policies Behind CERCLA

The Second Circuit determined that the Bankruptcy Code and CERCLA were in conflict with one another or at least pointed toward competing objectives on this issue. However, the court noted that the Bankruptcy Code is intended to be a piece of broad sweeping legislation. The Chateaugay court further noted that because of this broad sweeping characteristic, the purpose of the Bankruptcy Code is to supersede other statutes, which would apply, had the debtor not filed for bankruptcy. Therefore, the Second Circuit determined that any limits which the Bankruptcy Code imposes on environmental

29. Chateaugay, 944 F.2d at 1005.
30. Id. at 1005 (citation omitted).
31. Id.
32. Id. at 1008.
33. Id.
34. Id.
35. Id.
36. Id.
cleanup efforts under CERCLA, is a problem for Congress, not the courts to remedy. 37

D. Administrative Priority of an Environmental Claim

Finally, the Second Circuit determined the priority which environmental claims will take in a bankruptcy proceeding. 38 The Chateaugay court found that monies spent to comply with environmental laws such as CERCLA that were incurred post-petition would be "actual and necessary costs and expenses of preserving the estate" 39 provided the damage was the result of a pre-petition release or threatened release. 40 Because the monies spent to comply with CERCLA were "necessary costs to preserve the estate" the Second Circuit determined that these expenses were entitled to an administrative priority. 41

III. ANALYSIS OF THE SECOND CIRCUIT'S REASONING

A. Dischargeability of CERCLA Claims

In coming to the decision that CERCLA claims that arise due to a pre-petition release or threatened release of hazardous substances are dischargeable 42, the Second Circuit focused on the broad definition of the word "claim" in the Bankruptcy Code. 43 A key factor in the court's reasoning was the Congres-

37. Id.
38. In a Bankruptcy proceeding, the trustee in bankruptcy has the responsibility to marshal the debtor's assets, to either liquidate or reorganize them, and to distribute the secured asset funds to secured creditors. The balance of any funds left over are distributed to unsecured creditors. Distribution among the unsecured creditors is done according to certain priorities set forth in the Bankruptcy Code. See 11 U.S.C. § 503 (1988). Among the unsecured creditors, the Code gives first priority to "administrative expenses." See 11 U.S.C. § 503(b)(1)(A) (1988), in which the Bankruptcy Code accords an administrative priority to "actual, necessary costs and expenses of preserving the estate.

However, because of the enormous costs of environmental cleanup, the reality is that even with this priority over other unsecured creditors, the cleanup costs usually will not be paid in full. The significance of this priority depends upon the financial situation of the debtor and the cost of the cleanup. See infra note 75 for a discussion regarding the high cost of cleanup under CERCLA liability.
41. See supra note 38 for a discussion of administrative priority in the Bankruptcy Code.
42. Chateaugay, 944 F.2d at 1005.
43. A "claim" is defined in the Bankruptcy Code as: "[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
sional intent that "all legal obligations of the debtor, no matter how remote or contingent, be dealt with in the bankruptcy case." The court found that CERCLA claims fit within the Bankruptcy Code's broad definition of "claims", and that dismissal of this type of claim was consistent with Congressional intent.

Thus, for the court in Chateaugay, the key issue was: When does a claim arise for CERCLA purposes? Perhaps the district court put it best, when they stated: "[a] claim, even a contingent claim, arises under the Bankruptcy Code at the time when the acts giving rise to the alleged liability were performed." The Second Circuit applied this definition to CERCLA claims by focusing on the event which triggers CERCLA liability, i.e. the release or threatened release of hazardous substances. The Second Circuit found that the triggering event, the release or threatened release of a hazardous substance, must occur prior to the filing of the bankruptcy petition. The district court explained this relationship very clearly:

So long as there is a pre-petition triggering event, i.e., the release or threatened release of hazardous waste, the claim is dischargeable, regardless of when the claim for relief may be in all respects ripe for adjudication. Very frequently, only one part of a tort occurs pre-petition, with the injury occurring post-petition. Such claims are nonetheless dischargeable.

Thus, the Second Circuit found that claims that arose prior to the filing of the bankruptcy petition were dischargeable. Additionally, the Second Circuit determined for purposes of CERCLA, a claim arises at the time of the release or threatened release.

B. Dischargeability of Claims for Injunctive Relief.

The Second Circuit determined claims for injunctive relief

unsecured . . . [or] a right to an equitable remedy for breach of performance if such breach gives rise to a right to payment. 11 U.S.C. § 101 (4) (1988).

44. Chateaugay, 944 F.2d at 1003 (citing H.R. REP. No. 595, 95th Cong., 2d Sess. 309 (1978)).

45. Id. at 1003-04.


47. Id.

48. Id. at 522 (footnotes omitted).
which have an optional right are dischargeable. The Second Circuit's analysis focused on the broad question of whether claims for injunctive relief are ever dischargeable. The court first focused on the broad definition of "claim" within the Bankruptcy Code.\textsuperscript{49} They noted that the Bankruptcy Code's definition of dischargeable claims includes the "right to an equitable remedy".\textsuperscript{50} They found that a claim for injunctive relief clearly fell within this definition and should therefore be discharged.\textsuperscript{51} The court noted the EPA's claim that any right to payment that existed was only an optional right, and had not yet exercised that right, and therefore any claim that may exist should not be discharged.\textsuperscript{52} In response to this claim, the Second Circuit quoted the district court's finding which stated: 

"[e]ven an optional right to payment is nonetheless a right to payment and the fact that EPA may not choose to exercise that option in no way negates the existence of that right."\textsuperscript{53}

The Second Circuit did however, limit its holding to the above stated rule. It stated: "where there is no right to such payment for cleanup or other remedial costs, claims for injunctive relief do not fall within the Bankruptcy [Code] and are not dischargeable."\textsuperscript{54} This was the most troubling issue for the Second Circuit in this case. Although they upheld the district court's ruling on injunctions, they expounded on the parameters of the above stated exception. With regards to the district court's holding in this case, the Second Circuit stated: "This deceptively simple statement perhaps obscures difficult questions of application because it is not clear which forms of injunctive relief [the district court] regards as being an option to EPA's right of response cost reimbursement and which entail 'no right to payment'."\textsuperscript{55}

In seeking to shed light on the district court's ambiguous holding, the Second Circuit distinguished between injunctive claims that are dischargeable in bankruptcy proceedings and those that are not. The Second Circuit drew the distinction in

\textsuperscript{49} Chateaugay, 944 F.2d at 1006.
\textsuperscript{50} Id. (citing to 11 U.S.C. § 101(4) (1988)).
\textsuperscript{51} Id. at 1007-08.
\textsuperscript{52} Id.
\textsuperscript{53} Id. at 1001 (quoting In re Chateaugay Corp., 112 B.R. 513, 522 (S.D.N.Y. 1990), aff'd, 944 F.2d 997 (2d Cir. 1991)).
\textsuperscript{54} Id. (citing In re Chateaugay Corp., 512 B.R. 513, 523 (S.D.N.Y. 1990), aff'd, 944 F.2d 997 (2d Cir. 1991)).
\textsuperscript{55} Id.
the following manner:

[any order that to any extent ends or ameliorates continued pollution is not an order for breach of an obligation that gives rise to a right of payment and is for that reason not a 'claim'. But an order to clean up a site, to the extent that it imposes obligations distinct from any obligation to stop or ameliorate ongoing pollution, is a 'claim' if the creditor obtaining the order had the option, which CERCLA confers, to do the cleanup work itself and sue for response costs, thereby converting the injunction into a monetary obligation.]

The district court and the Second Circuit rejected LTV's argument that any injunction resulting from a pre-petition release or threatened release that requires the expenditure of money is dischargeable. In so doing, they noted that to accept LTV's position would effectively render all injunctive claims dischargeable except those that sought the cessation of some activity.

The Second Circuit distinguished the facts of Chateaugay from those of the United States Supreme Court case of Ohio v. Kovacs. In Kovacs, the State obtained an injunction ordering an individual to clean up a hazardous waste site. After he failed to comply, a receiver was appointed to take possession of the property. Under these facts, where the debtor was no longer able to comply with the injunction, and where the state conceded that it could no longer obtain injunctive relief, the Supreme Court found that the claim for injunctive relief had been transformed into a dischargeable money judgment. With regards to this type of situation as it applies to the facts in Chateaugay, the Second Circuit stated:

To the extent that CERCLA affords EPA and others a right to payment in lieu of an order directed solely at cleanup, Kovacs indicates that such an order is a "claim." And to the extent that an order is obtained under CERCLA or any other environmental statute that seeks to end or ameliorate pollution, we are satisfied that nothing in Kovacs permits a discharge of such obligation.

In coming to its decision, the Chateaugay court focused on

56. Id. at 1008.
57. Id.
59. Chateaugay, 944 F.2d at 1009.
the ability to comply with the injunction. Under this analysis, in a situation brought under CERCLA where the EPA does not have a contingent right to payment, and the bankrupt party still has the ability to comply with the injunction, the liability is not dischargeable. In coming to this conclusion, *Chateaugay* implicitly rejects the Sixth Circuit's bright line holding that an injunction is dischargeable if compliance with the injunctive order requires the bankrupt debtor to expend money. 60

The Sixth Circuit took a very bright line approach in *United States v. Whizco* 61. In *Whizco*, the United States sought to obtain an injunction against a coal company to compel them to reclaim an abandoned mine pursuant to statutory obligations. 62 The Sixth Circuit found that an injunction which compels the bankrupt debtor to expend money in order to fulfill its obligation is a claim as defined in the Bankruptcy Code, and as such is dischargeable. The Sixth Circuit did, however, narrow its opinion by adding: "to the extent that the defendant can comply with the orders without spending money, his bankruptcy did not discharge his obligation to comply with the orders." 63

C. Policy Considerations Behind CERCLA

The Second Circuit determined that CERCLA policy does not override the Bankruptcy Code's broad sweeping policy objectives. 64 To begin their analysis, the Second Circuit pointed out that the conflict which exists between the Bankruptcy Code and CERCLA is not a direct conflict in the statutes, but rather two statutes that have different destinations which conflict in this specific application. 65

The court's analysis focused on the Bankruptcy Code's important "fresh start" objective. The court focused on the fact that the Bankruptcy Code was intended to supersede other statutes. The Bankruptcy Code is used to override statutes that would clearly apply and provide a creditor with full payment in

60. See *United States v. Whizco*, 841 F.2d 147 (6th Cir. 1988).
61. 841 F.2d 147 (6th Cir. 1988).
62. The statute under which the coal company was obliged to reclaim the mine was the Surface Mining Control and Reclamation Act of 1977. 18 U.S.C. § 1201 (1988). An in depth discussion of this act and its requirements is beyond the scope of this note.
63. *Whizco*, 841 F.2d at 151.
64. *Chateaugay*, 944 F.2d at 1002.
65. Id.
the absence of bankruptcy. The Second Circuit accepted the district court's very broad interpretation of the term "claim." This broad interpretation creates a situation where any exceptions to dischargeability are construed very narrowly by the courts.

The Second Circuit also pointed out that Congress has failed to clearly manifest an intent that CERCLA claims not be discharged. The court continued by stating: "If the Bankruptcy Code, fairly construed, creates limits on the extent of environmental cleanup efforts, the remedy is for Congress to make exceptions to the Code to achieve other objectives that Congress chooses to reach, rather than for courts to restrict the meaning of across the board legislation like the Bankruptcy Code, in order to promote objectives evident in more focused statutes."

D. Priority of Environmental Claims.

In Chateaugay, the Second Circuit found that costs associated with CERCLA claims incurred post-petition are entitled to administrative priority under Section 503(b)(1)(A) of the Bankruptcy Code. Because the defendant in Chateaugay continued to own and operate the contaminated site post-petition, the court also found that the defendant was under a continuing obligation to comply with environmental laws. For that reason, the Chateaugay court held that the money spent for compliance, and even the civil penalties for post-petition violations, would be treated as administrative expenses as long as they were the result of a pre-petition release or threatened release. In supporting this finding, the Second Circuit noted that this holding does not eliminate the Bankruptcy Code's requirement that notice be given to creditors before an administrative priority is granted.

Although this decision makes the clear determination that CERCLA claims that arise post-petition are entitled to an administrative priority, it does not change the Bankruptcy Code's

66. Id.
67. Id.
68. Id.
69. Id.
70. Id. at 1010.
71. Id. at 1009.
72. Id.
73. Id. at 1010 (citing 11 U.S.C. § 503(b)(1)(A) (1988)).
requirements that notice be given, and a hearing held. These requirements serve as a check on this ruling, allowing each claim for administrative priority to be considered on an individual basis.

IV. CONCLUSION

The high cost of environmental claims makes bankruptcy an option an individual, business or corporation must consider when faced with the enormous financial costs that CERCLA cleanup requires. In fact, bankruptcy under the current laws is often more attractive than facing potential environmental liability.

The Chateaugay case illustrates a situation where the policies behind the Bankruptcy Code and CERCLA conflict with each other. Because Congress has failed to provide any specific guidance with respect to this conflict, the courts have been left to sort through the issues raised by this conflict. The Second Circuit’s decision in In re Chateaugay Corp. has addressed and presented some possible answers to some of these issues.

The Chateaugay decision determined that a claim under CERCLA which arises due to a release or threatened release of hazardous substances that occurs prior to the filing of a bankruptcy petition, is a dischargeable claim within the Bankruptcy Code.

The Chateaugay court also decided that claims for injunctive relief are also dischargeable if the injunctive claim is accompanied with an optional right to payment. The court limited this holding however, by stating that if there was no optional right to payment, then the claim is not dischargeable, even if compliance requires the bankrupt defendant to spend money.

The Chateaugay court also decided that the policies behind CERCLA do not override those of the Bankruptcy Code. The court determined that the Bankruptcy Code is a broad-sweeping statute that was passed with the intention to override other provisions of the law that otherwise would apply in the absence of bankruptcy. They found that restricting across the board

75. It is estimated that the average cleanup site will require $10 million to rehabilitate. In addition, it is estimated that the cleanup of all contaminated cites would require the expenditure of $100-700 billion. FREDERICK R. ANDERSON, ET AL., ENVIRONMENTAL PROTECTION: LAW AND POLICY 614, 617 (2d ed. 1990).
76. 944 F.2d 997 (2d Cir. 1991).
legislation such as the Bankruptcy Code was a task for Congress and not the courts.

The last issue that the Chateaugay court decided was that CERCLA claims which arise after the filing of the bankruptcy petition would be given an administrative priority. This gives CERCLA claims in this category priority over unsecured creditors. To qualify for this priority, a claim must arise post-petition. In addition, any claims that are given administrative priority are required to be necessary expenses for the preservation of the estate.

As a result of the conflict between the Bankruptcy Code and CERCLA, a body of case-law is slowly emerging regarding the important issues that result from this conflict. However, the case-law that has emerged thus far is new and untested in many ways. Some conflicts now exist, and in the coming years, some new conflicts may arise. Some of these conflicts will be resolved by the Judiciary, and others will be left to be resolved by the Congress.

Thomas L. Stockard