Column, Code to Code, Resource Conservation and Recovery Act vs. Chapter 11: When Is a "Discharge" Not Discharged?

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Text

[*26] Editor's Note: *Please see the Toxins-Are-Us column on page 42, which also discusses the Apex case. The authors of these two articles provide different details and analysis of this significant ruling.*

In a rare outcome regarding the treatment of environmental obligations under the Bankruptcy Code, Judge Richard Posner, writing for a three-judge panel of the U.S. Court of Appeals for the Seventh Circuit, recently affirmed a district court decision compelling Apex Oil Company Inc. to perform a massive environmental cleanup of property formerly owned by a corporate predecessor, an entity that had previously emerged from protection under chapter 11.

The key issue addressed in *United States v. Apex Oil Co. Inc.* [1] was whether a federally-mandated cleanup obligation constituted a "claim" under § 101(5) of the Code. [2] While the holding in *Apex Oil* may be somewhat unique because of the federal environmental law relied upon, other specific circumstances and applicable state and federal law could lead to a similar outcome and must be considered when evaluating the potential scope of discharge for environmental obligations.

Facts and Case Summary

The U.S. Environmental Protection Agency (EPA) sought and received an injunction requiring Apex to clean up a contaminated site in Hartford, Ill., among other things. [3] Although Apex no longer owned this site, it was named in the

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[1] F.3d , 2009 WL 2591545 (7th Cir. Aug. 25, 2009).

[2] Pursuant to***§ 101(5) of the Bankruptcy Code***, the term "claim" means: (1) 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 (2) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured or unsecured.

[3] U.S. v. Apex Oil Co. Inc., 2008 WL 2945402, *1 (S.D. Ill. July 28, 2008).

action as a successor-by-merger to the site's previous owner (the debtor). [4] Critical facts implied in the appellate court's holding and gleaned from the district court's decision were that the debtor--Apex's predecessor from an apparent post-confirmation merger--emerged from chapter 11 following the confirmation of a plan of reorganization and after shedding the site pursuant to a § 363 sale approved by the bankruptcy court. [5]

The debtor's oil refinery operations at the site allegedly released millions of gallons of oil into the ground. [6] The oil was contaminating groundwater and emitting noxious fumes that entered homes in the surrounding community. [7] Apex was no longer performing oil refining and had no in-house capabilities to clean up the site. [8] The cost of the environmental remediation was estimated at $ 150 million. [9]

The principal issue addressed by the appeals court was whether the EPA's injunction, which compelled Apex to clean up the site, was a "claim" that was previously discharged at the time the bankruptcy court confirmed the debtor's reorganization plan. [10] The appeals court first reviewed the Code's definition of "claim," noting that it may be based on either a "right to payment" under § 101(5)(A) or a "right to an equitable remedy for breach of performance if such breach gives rise to a right to payment" under § 101(5)(B). [11] Based on this broad definition, the appeals court surmised that if the EPA could have obtained a money judgment against the debtor instead of forcing the site's cleanup, then the equitable remedy would have constituted a claim that was dischargeable upon plan confirmation. [12] The appeals court noted that the federal law relied upon by the EPA in *Apex Oil* did not authorize monetary relief. Specifically, the EPA's injunction was asserted under the Resource Conservation and Recovery Act (RCRA), [13] which requires certain operational standards for the management of hazardous waste and petroleum storage. The RCRA also imposes closure or corrective-action requirements when the use of certain management units is terminated or environmental impacts are identified. Cleanup requirements may be enforced by the government under § 6973(a) of title 42, or by a private party under § 6972(a)(2) of title 42.

The appeals court relied on the Supreme Court's decision in *Meghrig v. KFC Western Inc.*, [14] which held that the RCRA's citizen-suit provision did not authorize monetary relief. [15] As such, the appellate court believed that the EPA's equitable action against Apex precluded monetary relief inasmuch as the language authorizing the relief in both §§ 6973(a) and 6972(a)(2) were identical. According to Judge Posner, the right to seek an award of costs on the basis of general equitable principles was "dead after *Meghrig*." Therefore, **[*86]** [EDITOR'S NOTE: The page numbers of this document may appear to be out of sequence; however, this pagination accurately reflects the pagination of the original published documents.] the

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[4] Apex Oil, 2008 WL 2945402. *1.

[5] Apex Oil, 2009 WL 2591545, *1 ("The bankruptcy judge's confirmation (approval) of a claim in a Chapter 11 proceeding discharges the debtor from 'any debt that arose before the date of confirmation."); Apex Oil, 2008 WL 2945402, *1 ("[The debtor] sold the Hartford [Ill., site] in a sale approved by the Bankruptcy Court...[Thereafter, Apex Oil] was incorporated...and [the debtor] was merged into Apex Oil. Apex Oil is a successor-by-merger to [the debtor], who...owned the Hartford [Ill site] between Sept. 29, 1967, and Nov. 20, 1988.").

[6] Apex Oil, 2009 WL 2591545, at *1.

[7] *Id.*

[8] *Id.*

[9] *Id.*

[10] Pursuant to§ 1141(d)(1)(A) of the Bankruptcy Code, the confirmation of a plan, unless otherwise specified in the plan or the Code, "discharges the debtor from any debt that arose before the date of such confirmation." "Debt" is defined as "liability on a claim." *See **11 U.S.C. § 101***(12).

[11] Apex Oil, 2009 WL 2591545, at *1.

[12] *Id.*

[13] 42 U.S.C. § 6901, *et seq.*

[14] 516 U.S. 479, 483-87 (1996).

[15] Apex, 2009 WL 2591545, at *1 (citing Meghrig v. KFC Western Inc., 516 U.S. 479, 483-87 (1996)).

EPA was precluded from obtaining a money judgment under the RCRA against Apex. [16] In reaching its decision, the appellate court rejected Apex's assertion that the cost of complying with an equitable decree should be deemed a claim dischargeable under § 1141(1)(a):

> Almost every equitable decree imposes a cost on the defendant, whether the decree requires him to do something, as in this case, or, as is more common, to refrain from doing something. The logic of Apex's position is thus that every equitable claim is dischargeable in bankruptcy unless there is a specific exception in the Code. This is inconsistent with the Code's creation in *11 U.S.C. § 101*(5) (B) of only a limited right to the discharge of equitable claims. And if "any order requiring the debtor to expend money creates a dischargeable claim, it is unlikely that the state could effectively enforce its laws: virtually all enforcement actions impose some cost on the violator." [17]

In reaching its decision, Judge Posner distinguished the Supreme Court's holding in *Ohio v. Kovacs*. [18] In *Kovacs*, "[t]he receiver...was seeking money rather than an order that the debtor clean up the contaminated site. That was a claim to a right to payment." [19] In contrast, the EPA did not seek a money judgment from Apex, and EPA's injunction under the RCRA did not entitle it to the payment of money in lieu of performance. [20]

The appeals court acknowledged that the Sixth Circuit's decision in *United States v. Whizco Inc.* [21] was factually similar to those in the present case and favored Apex's arguments. In the end, the appellate court concluded that *Whizco* could not be reconciled with other cases, holding that "cost incurred" was not equivalent to a "right to payment." [22] Furthermore, *Whizco* provided "no limiting principle" to distinguish cases under the RCRA, where there is no right to a money judgment, from other statutory and decisional law where complying with an equitable decree would require expenditures by the defendant. [23]

In discarding Apex Oil's assertion that the EPA's injunction was overly vague, Judge Posner considered the massive scope of the required cleanup and determined that to "specify the details of the project in the decree [advanced by Apex] would either impose impossible rigidity on the performance of the clean up or, more likely, require constant recourse to the district judge for interpretation or modification of the decree," [24] and in any event would fail to comply with *Rule 65(d) of the Federal Rules of Civil Procedure.* [25] Judge Posner, with little substantive analysis, also rejected Apex's assertion that denying discharge in such cases would damage environmental quality by minimizing a polluter's ability to reorganize under chapter 11. [26]

Discussion

At the outset, it is critical to outline some distinctions between the RCRA and a more frequently encountered (and perhaps more notorious) environmental law, the Comprehensive Environmental Response, Compensation and Liability Act [27]

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[16] *Id.* at *2.

[17] *Id.* at *2-3, (quoting In re Torwico Electronics Inc., 8 F.3d 146, 150 n. 4 (3d Cir. 1993)).

[18] 469 U.S. 274 (1985).

[19] Apex Oil, 2009 WL 2591545, at *3 (internal citations omitted)

[20] *Id.* at *3.

[21] 841 F.2d 147, 150-51 (6th Cir. 1988).

[22] *Id.*

[23] *Id.*

[24] *Id.* at *4-5.

[25] *Id.*

[26] *Id.* at *4.

[27] 42 U.S.C. § 9601, *et seq.*

(CERCLA, or commonly referred to as the "Superfund"). Typical CERCLA sites may include an abandoned manufacturing site or a disposal facility where multiple parties directed wastes. The CERCLA allows the government to order certain "responsible parties," including site owners and operators and those who arranged for disposal, to perform a cleanup of hazardous substances. [28] CERCLA explicitly provides for cost recovery by the EPA and private parties. [29] Most states also have laws similar to CERCLA with respect to liability and cost recovery. Under certain circumstances, environmental obligations arising under CERCLA and analogous state law will be dischargeable claims because of the statutory right to payment. [30]

It is also important to consider some other scenarios that were not addressed in *Apex Oil*. First, environmental obligations arising under state-specific law may produce a similar result. For example, in *In re Torwico Electronics Inc.* [31] (cited by *Apex Oil*), the defendant had operated a hidden seepage pit from which hazardous wastes were continuing to migrate and threaten groundwater. At the time of the filing, the defendant did not own the property and had since moved its operations to another location. [32] Compliance with the clean-up order was held not to be a dischargeable claim because the state law under which the order was issued was based on the defendant's liability "running with the waste" and did not authorize cost recovery in lieu of performance. [33]

Apex Oil also did not address how a cleanup obligation may nonetheless be a dischargeable claim if the EPA could have sought a right to payment under an alternative environmental law but did not do so for strategic or other reasons. This outcome is based on the broad definition of "claim" under § 101(5) and further supported by the Code's legislative history. [34]

Other decisional law suggests that such a further application of the definition of a "claim" may be limited to the extent a cleanup order requires a party to cease ongoing pollution. For example, in *In re Chateaugay*, [35] the court held that the EPA "has no authority to accept a payment from a responsible party as an alternative to continued pollution," and an order that seeks to both remove accumulated wastes and prevent ongoing pollution is not a dischargeable claim. [36] Even if the EPA could have performed a cleanup of all such pollution and then sought cost recovery, "any order that to any extent ends or ameliorates continued pollution is not an order for breach of an obligation that gives rise **[*87]** to a right to payment and is for that reason not a 'claim.'" [37]

A party may also retain environmental obligations based on property ownership. Strictly liable parties under CERCLA include, among others, current property owners. [38] Therefore, an enforceable clean-up order may be issued after the conclusion of a bankruptcy proceeding if a party continues to own polluted property subject to the CERCLA or analogous state law.

Conclusion

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[28] 42 U.S.C. § 9607.

[29] 42 U.S.C. §§ 9607, 9613.

[30] *See, e.g.,* In re Chateaugay, 944 F.2d 997, 1008 (2d Cir. 1991).

[31] 8 F.3d 146,150 n. 4 (3d Cir. 1993)).

[32] *Id.* at 147.

[33] *Id.* at 151, *See also* The Connecticut Property Transfer Act, C.G.S. § 22a-134, *et seq.*, under which the state does not have cost recovery authority arising from the failure of a "certifying party" to perform a full investigation and remediation of a hazardous waste "establishment" (although certain private parties might).

[34] *See, e.g., Kovacs*, at 280; In re Kilpatrick, 160 B.R. 560, 567 (Bankr. E.D. Mich. 1993).

[35] In re Chateaugay, 944 F.2d at 1008.

[36] *Id.*

[37] *Id. See also* In re CMC Heartland Partners, 966 F.2d 1143, 1146-47 (7th Cir. 1992); *In re Torwico*, at n. 6.

[38] *See, e.g., In re CMC Heartland Partners*, at 1147 (claim "runs with the land" and "statutory obligation attached to current ownership of the land survives bankruptcy").

The outcome in*Apex Oil*, and related case law based on similar facts addressed here, suggests that certain key factors in determining whether an environmental obligation may or may not be discharged following the confirmation of a debtor's chapter 11 plan. First, the claim will be discharged if the creditor has a right to payment in lieu of performance, while discharge may not occur if such a right does not exist. Second, both state and federal environmental law must be considered in evaluating these issues and potential outcomes. Third, a creditor's ability to secure a right to payment under an alternative law, even if not asserted, may result in a dischargeable claim, at least to the extent the obligation is not required to address ongoing pollution. Fourth, a party's ownership of real property post-confirmation may provide the basis at that time for strict liability for existing pollution. Finally, caution is urged in attempting to draw or rely on certain bright lines applicable to all cases; the outcome and rationale in any one case may be strongly affected by the specific legal authority, facts and issues presented.