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Environmental Impediments to Bankruptcy Reorganizations

JAMES K. McBAIN*

[It is not a question of which statute should be accorded primacy over the other, but rather what interaction between [the Bankruptcy Code and CERCLA] serves most faithfully the policy objectives embodied in the two separate enactments of Congress.]

INTRODUCTION

Only a decade ago, Congress resolved to combat those businesses which threaten the public health and safety with hazardous wastes, by forcing them to pay the costs of massive cleanups. Congress enacted the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA) and established the Superfund to begin the task of environmental reclamation and cost recovery. With the costs of reclamation running extremely high, many corporations are now seeking to avoid the burdens of cleanup by using bankruptcy as a shield from mounting environmental obligations.

The application of the Bankruptcy Code to CERCLA obligations raises sharp policy conflicts between these powerful federal statutes. The

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3. CERCLA empowers the Environmental Protection Agency (EPA) with funding and enforcement authority for hazardous waste sites. The EPA may either use funds from the Superfund, the trust funded by a tax on chemical and petroleum manufacturers and other corporate polluters, toward cleanup, or subsequently assess such costs against potentially responsible parties (PRPs). If the site creates an “imminent and substantial endangerment to the public health or welfare or the environment,” the EPA has the more extensive power to compel liable parties to perform the cleanup themselves. CERCLA § 106(a).

An especially thorny problem resulting from CERCLA involves liability for lending institutions that may “own or operate” sites in violation of CERCLA. CERCLA § 101(20)(A). For a recent discussion of lender liability for environmental obligations, see Bruce P. Howard & Melissa K. Gerard, Lender Liability Under CERCLA: Sorting Out the Mixed Signals, 64 S. Cal. L. Rev. 1187 (1991).

4. The costs associated with this effort may reach as high as $750 billion by some estimates, although so far only $11 billion has been used to clean up 84 sites. Peter Hong & Michele Galen, The Toxic Mess Called Superfund, Bus. Wk., May 11, 1992, at 32.


bankruptcy process provides for equality of distribution and an opportunity to reorganize and save potentially viable businesses. The Code reaches the equality principle by cumulating the debtor's available assets for distribution in the bankruptcy estate and creating a process for creditors to file claims against the estate for amounts owed. The reorganizing debtor files a plan under which claims or portions thereof are satisfied. The portion of the claim impaired (or left unsatisfied) by the distribution is discharged and the debtor is relieved of the obligation. As a result of this procedure, debtors have the potential to reorganize their obligations without liquidating and dissolving.

The policies of CERCLA conflict with the goals of bankruptcy, creating problematic results for petitioning debtors and often resulting in the "sudden death" of otherwise viable firms under the burden of environmental liabilities. Environmental statutes, such as CERCLA, seek to protect the environment and the public health and safety by restraining polluters from further damaging the environment and by assessing the costs of cleanup to the responsible parties.

Two substantial problems arise from the current conflict between bankruptcy and environmental law. Presently, the Code makes no provision for environmental obligations, which had not reached the public's consciousness when the Code was drafted. Courts are therefore left to determine whether environmental obligations are "claims" in bankruptcy, and if so, what kind of priority they should have. To solve this problem, Congress should refine the definition of "claim" to include environmental obligations owed to federal and state environmental authorities and accord these claims the same status as claims of other governmental units.

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8. Id. § 501.
9. Id. §§ 1101-1174.
10. Id. § 1141(d).
11. Chapter 11 of the Code establishes a detailed procedure for troubled corporations to reorganize and liquidate debts in order to maximize the going concern value of the corporation. However, the rationale for reorganization does not mean that every financially troubled business should be revived in Chapter 11, since many corporations do not have sufficient going concern value to warrant reorganization.
13. EPA Administrator William K. Reilly claimed that this liability scheme was intended to create "a new environmental ethic [for] industrial America." Hong & Galen, supra note 4, at 33.
15. An important recent article similarly proposes such treatment, but prioritizes environmental claims ahead of other governmental units. See id. Arguably, no distinction is warranted between claims by environmental authorities and other governmental units, all of which receive distributions from the estate after secured creditors. See infra Appendix B.
The general policies of bankruptcy and environmental law create the other
problematic situation: the use of assets of the bankruptcy estate (which
includes encumbered property)\(^6\) to satisfy environmental obligations at the
expense of a creditor's security. Congress could alleviate this problem by
specifically recognizing the special status of environmental obligations as
claims of governmental units, thereby rejecting the argument that CERCLA
claims are administrative expenses to be paid ahead of secured creditors.
Such a move would protect the interests of secured creditors during pendency
of the case and reject proposals for using security to finance cleanups.\(^7\)

This Note proposes a framework for handling environmental obligations
in bankruptcy. Part I outlines the cleanup scheme established by CERCLA,
including the settlement process under the 1986 amendments. Part II focuses
on whether environmental obligations are claims in the bankruptcy process,
and the related problem of the priority such obligations should receive. Part
III discusses the impact of environmental obligations on secured creditors
by considering what property of the bankruptcy estate may be used to
finance reclamation. Part IV concludes with a proposal for reconciling the
conflict between the policies underlying bankruptcy and environmental laws
by amending the Bankruptcy Rules and Code to recognize the importance
of environmental claims. While this approach accepts the importance of
environmental reclamation, it does so without abusing the procedures guid-
ing bankruptcy.

I. ENVIRONMENTAL RECLAMATION UNDER CERCLA

To cope with the growing problem of hazardous wastes, Congress, in
1980, enacted the Comprehensive Environmental Response, Compensation,
and Liability Act (CERCLA) and empowered the EPA with funding and
enforcement authority for hazardous waste sites.\(^8\) Congress also created the

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16. “Property of the estate” in bankruptcy includes assets encumbered by liens of secured
17. Some secured lenders suffer due to the expanding notion of lender liability for cleanups
because the EPA had not defined the scope of the secured creditor exemption, which provides
that creditors, in merely protecting their security, will not be held as owners or operators.
note 3. The EPA recently clarified the area by issuing a rule interpreting the scope of the
secured creditor exemption to give lenders more latitude in foreclosing and selling contaminated
rule departs from United States v. Fleet Factors Corp., 901 F.2d 1550 (11th Cir. 1990), cert.
denied, 111 S. Ct. 752 (1991), where a federal court imposed liability based on the secured
creditor's "capacity" to influence the environmental policies of the debtor. Id. at 1557.
18. Although this Note will focus almost exclusively on CERCLA, other environmental
regulatory and reclamation statutes may impose some measure of liability that could be
important in bankruptcy.

Congress approached the "last remaining loophole in environmental law, that of unregulated
Hazardous Waste Response Trust Fund, or Superfund, to facilitate expedited cleanup of the nation's hazardous waste sites by the EPA.

CERCLA provides substantial liability for polluters. Liability may arise from one of two routes: the EPA may order a party to clean up a site, or the EPA may undertake the cleanup itself and utilize the Superfund. Response costs expended from the Superfund give rise to liability under CERCLA, which permits the EPA to bring an action to recover the costs of cleanup from the potentially responsible parties (PRPs). Liability under CERCLA is strict, and PRPs may be held jointly and severally liable. This statute empowers the EPA with the authority to impose enormous liability on responsible parties.

Before undertaking an actual cleanup, site studies must be prepared to determine the scope of the contamination. These studies include a Remedial Investigation (RI), focusing on the nature and threat of the contamination,
and a Feasibility Study (FS), which details possible remedies. These studies may take years to prepare, even when complying with the timetables added by Congress in the Superfund Amendments and Reauthorization Act of 1986 (SARA). The EPA has estimated the average cost of the RI/FS to be $800,000, with complex studies rising far beyond this figure. Together, the RI/FS provides the roadmap for the site cleanup.

II. ENVIRONMENTAL OBLIGATIONS: CLAIMS AND PRIORITY

The Bankruptcy Code offers little guidance to courts approaching the exigencies of environmental impediments to reorganization. The Code preceded CERCLA, which was the first environmental statute to impose liability directly on polluters. Nevertheless, courts have attempted to apply traditional methods of claim and priority classification to environmental obligations, often resulting in inconsistent results that favor one statute at the expense of the other.

A. Environmental Obligations and "Claims" in Bankruptcy

The Code defines a "claim" broadly to include a "right to payment" or a "right to an equitable remedy for breach of performance if such breach gives rise to a right to payment." The legislative history recognizes the breadth of such a definition, proclaiming that "the [Code] contemplates that all legal obligations of the debtor, no matter how remote or contingent, will be able to be dealt with in the bankruptcy case. It permits the broadest possible relief in the bankruptcy court." The broad definition of "claim" furthers the goals of bankruptcy reorganizations by permitting claim holders to participate in the reorganization process to the extent of the allowed

29. A common practice is the preparation of a "work plan" that commences before an RI/FS to guide the cost outlay for the studies and provide the appropriate sampling procedures for the site. Id. at 132-33.
claim\textsuperscript{33} and by providing debtors with a plan that utilizes the existing pool of assets while not entirely crippling future operations.

Courts have applied this broad definition to environmental claims with little consistency, finding that in some cases a “right to payment”\textsuperscript{34} reducible to money springs from an environmental obligation while in others it does not.\textsuperscript{34} For example, in \textit{In re Chateaugay Corp.},\textsuperscript{35} the Second Circuit gave an expansive reading to “contingent claim,” holding that claims for response costs arising under CERCLA\textsuperscript{36} related to pre-petition releases or threatened releases of hazardous wastes by the debtor constitute claims that may be discharged in bankruptcy.\textsuperscript{37}

\begin{itemize}
\item \textsuperscript{33} See 11 U.S.C. § 1124.
\item \textsuperscript{34} The legislative statements accompanying the Code recognize this problem but do nothing to alleviate it. See \textit{Bankruptcy Code, Rules and Forms, Legislative Statements to § 101} (West 1991).
\item \textsuperscript{35} United States v. LTV Corp. (\textit{In re Chateaugay Corp.}), 944 F.2d 997 (2d Cir. 1991).
\item \textsuperscript{36} These are response costs within § 107 of CERCLA. CERCLA § 107, 42 U.S.C. § 9607 (1988).
\item \textsuperscript{37} \textit{In re Chateaugay}, 944 F.2d at 1004-05. Chateaugay, a subsidiary of the conglomerate LTV Corporation, had listed numerous “contingent claims” held by the EPA and enforcement officials of all fifty states and the District of Columbia. Chateaugay informed the regulatory authorities that it expected to confirm a plan discharging all listed obligations traceable to Chateaugay’s pre-petition conduct, including obligations for response costs incurred post-petition. The government brought an action for a declaratory judgment that response costs incurred post-petition are not dischargeable as pre-petition claims within the meaning of the Code. The district court held that where “there has been a pre-petition release or threatened release of hazardous waste, there does exist an event that would render any claims arising from that circumstance dischargeable pursuant to the broad definition of ‘claim’ set forth in the Bankruptcy Code.” United States v. Chateaugay Corp. (\textit{In re Chateaugay Corp.}), 112 B.R. 513, 522 (S.D.N.Y. 1990), aff’d sub nom. United States v. LTV Corp. (\textit{In re Chateaugay Corp.}), 944 F.2d 997 (2d Cir. 1991). This decision attempted to limit the number of non-dischargeable environmental injunctions for pre-petition releases to those where the EPA could not reduce the order to a payment of money. Kenneth E. Aaron, Chateaugay Appeal—The Crash at the Intersection of Bankruptcy and Environmental Law, \textit{Bankr. L. Daily} (BNA), Oct. 2, 1991, at 24-25. The court permitted only pre-petition actions of the debtor to fall within the definition of “claim.”

After presenting the broad definition of a claim, the Second Circuit affirmed, formulating a nexus requirement for determining when the claim arose. \textit{In re Chateaugay}, 944 F.2d at 1005. Finding that the EPA was “acutely aware” of the debtor and others subject to regulation, the court stated that this relationship provided “sufficient ‘contemplation’ of contingencies” that the EPA could bring suit under CERCLA for response costs, creating a “contingent claim” under the Code. \textit{Id}. While holding that the pre-petition release was a dischargeable claim, the court nevertheless created an opportunity for the EPA to use post-petition orders for pre-petition releases that would fall outside the broad scope of dischargeable claims. See Aaron, supra, at 25. The Second Circuit’s nexus requirement is unfortunate, for agency awareness as the basis of a claim is a difficult subjective requirement. The nexus test provides little hope for consistency in judicial resolution of environmental liabilities in bankruptcy.

While this requirement may define limits for the financial community, the Second Circuit’s opinion creates incentives for mischief in the claim filing process. Daniel Wise, \textit{Courts Rule on Cleanup Costs}, \textit{Nat’l L.J.}, Oct. 14, 1991, at 38 (quoting environmental specialist Martin Baker). Orders issued by the EPA could survive bankruptcy if framed with the dual objectives of removing waste and stopping pollution in mind, leading to an incentive for the EPA to alter its enforcement process to avoid bankruptcy classification. Almost all pre-petition releases
Instead of relying on the district court’s determination of the timing of the release, the Second Circuit focused on the effect of the injunction involved. If the injunction was only to clean up pre-petition waste, it was a dischargeable claim since the order “does no more than impose an obligation entirely as an alternative to a payment right.” But an injunction imposing obligations to “end[,] or ameliorate[,] current pollution . . . is not a claim.” An injunction accomplishing the “dual objectives” of removing wastes and halting continued pollution is also not a dischargeable claim. By focusing on the EPA’s option to accept payment as the requirement of a claim, the court recognized that “most environmental injunctions will fall on the non-‘claim’ side of the line.” The court believed this position to be most faithful to previous Supreme Court rulings on matters in this area. On the heels of *In re Chateaugay*, another case provided evidence of judicial difficulty with environmental obligations. In *In re Dant & Russell*, the Ninth Circuit upheld the district court’s allowance of a claim for expenses already incurred for cleanup under CERCLA, but the court reversed the lower court’s allowance of response costs not yet incurred for cleanup. By could be subject to a nonclaim injunction that would continue after confirmation of a reorganization plan, thereby jeopardizing the feasibility of the plan. See Aaron, *supra*, at 25. The concern with feasibility did not go unheeded by the Second Circuit in *In re Chateaugay*, which noted that reorganizations may not be possible if all CERCLA response costs are exempted from the bankruptcy process. *In re Chateaugay*, 944 F.2d at 1005. This court, however, conditioned the claim on the future operations of the debtor instead of future existence of the waste. By disregarding the district court’s careful balance of when a claim occurs, the Second Circuit has created a procedure that may lead to the failure of future reorganization plans.

38. *In re Chateaugay*, 944 F.2d at 1007.
39. Id. at 1008.
40. Id. (emphasis added).
41. Id.
42. See Ohio v. Kovacs, 469 U.S. 274 (1985) (holding that since obligation could only be satisfied by payment of money, obligation was a claim); Midlantic Nat’l Bank v. New Jersey Dept. of Envtl. Protection, 474 U.S. 494 (1986) (holding that property could not be abandoned by the debtor under 11 U.S.C. § 554(a) in violation of state environmental laws).
44. Id. at 250. The debtor had leased property from Burlington Northern Railroad (BN) to operate its wood treatment plant. The debtor renewed its lease during the bankruptcy case in the ordinary course of business as permitted under 11 U.S.C. § 363(c)(1) (1988). During the lease period, the debtor dumped toxic wastes on the property, which BN cleaned up. BN filed a claim in the debtor’s bankruptcy case for costs incurred and future response costs, which the lower court allowed.

In reversing the allowance of future response costs, the Ninth Circuit stressed CERCLA’s provision that costs must be incurred in order to be recovered, part of the policy of encouraging immediate actual cleanup. The Ninth Circuit focused on the term “incurred” in discussing whether costs should be allowed, a path not previously taken by courts in determining when a claim arises, holding that since BN had not yet incurred much of its claimed amount, it
concentrating on whether costs were incurred, the court created yet another approach for environmental claims.

Another recent case takes a different approach to the claim question. In re National Gypsum Co. held that all liabilities, whether listed by the debtor or not, "based on pre-petition conduct that can be fairly contemplated by the parties at the time of Debtors' bankruptcy are claims under the Code." Judge Sanders departed from the In re Chateaugay court's use of contingent claims, stating instead that "the only meaningful distinction is one that distinguishes between costs associated with pre-petition conduct resulting in a release or threat of release that could have been 'fairly' contemplated by the parties; and those that could not have been 'fairly' contemplated by the parties."

With each decision approaching the very existence of environmental claims differently, courts provide parties with little guidance for future actions, which may lead to the failure of many reorganization attempts.

B. Estimating the Amount of the Claim

The Code gives courts wide discretion to estimate contingent or unliquidated claims under section 502(c). While the procedure for estimating claims is less than clear, the provision nevertheless permits courts handling bankruptcies to determine the amount of a contingent or unliquidated claim.

Courts have utilized the claim estimation procedure in fixing the claim amount most notably in product liability and shareholder actions. For example, a court estimated the future recovery of victims of the Dalkon

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46. Id. at 409.
47. Id. at 407-08 (footnotes omitted). Judge Sanders went on to provide a list of factors for "fair contemplation": knowledge of a site in which a PRP may be liable, listing on the National Priorities List (NPL), notification by the EPA of potential liability, commencement of the EPA investigation, and incurrence of response costs. Id. at 408. These factors would apply specifically to response costs under § 107 of CERCLA and not § 106 orders. For a discussion of the differences between §§ 106 and 107, see In re CMC Heartland Partners, 966 F.2d 1143 (7th Cir. 1992).
48. 11 U.S.C. § 502(c) states:
   (c) There shall be estimated for purposes of allowance under this section—
   (1) any contingent or unliquidated claim, the fixing or liquidation of which, as the case may be, would unduly delay the administration of the case; or
   (2) any right to payment arising from a right to an equitable remedy for breach of performance.
Id.
49. BROUDE, supra note 30, at 6A-27.
50. The EPA may contend that the bankruptcy court, as an Article I court, does not have
Shield, eventually setting the liability at $1.4 billion for injury claimants. Another court approached estimation by assessing the claimants' chances of prevailing on their claims in state court, fixing at zero the amount of the claim for reorganization because the court believed that the shareholders could not establish their claim by a "preponderance of the evidence." Claim estimation has been applied to environmental liabilities only recently, in a further proceeding in the National Gypsum bankruptcy. That court estimated the amount of the response costs and natural resource damages under CERCLA after hearing testimony from expert witnesses of the debtor and the EPA.

Claim estimation could be effective for environmental claims for response costs. While future cleanup costs will be uncertain, as future tort recoveries are in product liability claims, the court may still be able to estimate cleanup expenses so as not to "unduly delay the administration of the case." The balance struck by courts in product liability cases could apply to environmental claims, especially after the In re National Gypsum ruling, although court estimation may require a more structured procedure.

C. Priority of Environmental Obligations

If the obligation is a claim, the Code requires that it fit within one of five categories: secured claims, administrative expenses, priority claims (such as tax claims held by governmental units), unsecured claims, or equity interests. Classification within the Code is critical to reorganizations, for jurisdiction to estimate an environmental claim. Courts have not reached this issue, but decisions in other matters may permit discretion. See Broude, supra note 30, at 2-36 to -50.


52. Bittner v. Borne Chemical, 691 F.2d 134 (3d Cir. 1982). This decision sparked much criticism, for it was seen as a return to the cumbersome method of the old 1898 Bankruptcy Act. See Benjamin Weintrab & Alan N. Resnick, Bankruptcy Law Manual 5-18 to -24 (1986). "Congress in Section 502(c) must have intended that if the claims are estimated in the bankruptcy court, the proceeding in state court is rendered moot and, absent some extraordinary circumstance, should not be permitted to go forward." Broude, supra note 30, at 6A-28.


54. Id. The judge also denied administrative expense priority for the estimated amount, stating that such priority would only be available if the government was abating an "imminent and identifiable threat" under CERCLA § 106, 42 U.S.C. § 9606 (1988). Id.


56. For the proposed procedure, see infra Appendix A.

57. Torwico Electronics, Inc. v. New Jersey Dep't of Envtl. Protection (In re Torwico Electronics, Inc.), 131 B.R. 561 (Bankr. D.N.J. 1991). While administrative expenses are a type of priority claim, many courts view "priority claim" as a term of art to refer to claims under CERCLA § 507(a)(2)-(8). Id. at 565. Some commentators argue that administrative expenses are just a subset of priority claims. The distinction is made here so that the later discussion of priority claims will be clearer.
status determines payment priority. Courts have taken the position that environmental obligations are either administrative expenses or unsecured claims.58

The Code grants administrative expense priority for the “actual, necessary costs and expenses of preserving the estate”59 in order to allow businesses to continue functioning during the bankruptcy proceeding. These expenses are paid first after secured claims.60

Environmental authorities will typically submit that response costs under CERCLA section 107 are administrative expenses of the estate, and a number of courts have agreed with this characterization.61 Granting administrative expense priority to environmental cleanup obligations jeopardizes any potential reorganization, since administrative expenses must be paid in cash before the plan may be confirmed.62 Reorganizing firms typically will be

58. Courts have almost uniformly taken the position that orders under CERCLA § 106(a) are administrative expenses because these actions involve the government acting pre-petition “to abate an ‘imminent and identifiable threat.’” In re National Gypsum II, supra note 53.

60. Id. § 507(a)(1).
61. The leading example of administrative expense priority for CERCLA § 107 claims is In re Wall Tube & Metal Products Co., 831 F.2d 118 (6th Cir. 1987). Persuaded that permitting the obligations to be treated as general unsecured claims would favor a business in bankruptcy over other similar businesses, the court stated that such costs were part of the “actual, necessary costs of preserving the estate” under § 503(b) and as such were entitled to the priority. Id. at 124. The court refused to allow Chapter 7 to supplant 28 U.S.C. § 959(b), which states in part that the debtor in possession “shall manage and operate the property in his possession . . . according to the valid laws of the State in which such property is situated.” The court applied the Supreme Court’s test from Reading Co. v. Brown, 391 U.S. 471 (1968), for determining priority status, stating that while the existing creditors were not in a dilemma of their own making, there was no reason to relieve them from liability while imposing the costs on others equally innocent. In re Wall Tube, 831 F.2d at 123 (quoting Reading, 391 U.S. at 482-83).

In re Wall Tube imposes the costs of cleanup on the general unsecured creditors who are faced with the prospect of no return at all after satisfying the environmental obligations. The case creates an unusual incentive on the regulatory body to force the business into bankruptcy. Such an incentive is completely at odds with the Code’s equal distribution mechanism and provides environmental authorities with priority even over other governmental entities.

But the decision is misleading, for the “others equally innocent” are not other businesses as creditors, but rather the taxpayers through the conduit of the environmental authorities. In re Wall Tube preferred the readily available deep pocket of creditors over the environmental agency with enforcement responsibility. Granting administrative expense priority to environmental authorities merely forces unsecured creditors instead of the government to bear the costs of cleanup.

Other courts apparently have found the environmental policies compelling. See In re Stevens, 68 B.R. 774 (D. Me. 1987); In re T.P. Long Chemical, 45 B.R. 278 (Bankr. N.D. Ohio 1985). Still others permit administrative expense priority only upon an “imminent and identifiable harm” to the public health and safety. Midlantic Nat’l Bank v. New Jersey Dep’t of Envtl. Protection, 474 U.S. 494, 507 n.9 (1986); see also In re National Gypsum Co., 139 B.R. 397, 413 (Bankr. N.D. Tex. 1992) (permitting priority for pre-petition costs so long as the costs “were necessitated by conditions that posed an imminent and identifiable harm to the environment and public health”).

unable to pay out a massive expenditure such as an environmental obligation, and hence the reorganization will fail. By classifying environmental obligations as administrative expenses, many reorganizing debtors are doomed to "sudden death" from the crippling blow of this immediate cash payment.

Conversely, some courts have held that environmental obligations arise before the filing of the petition and are general unsecured claims. This classification facilitates reorganizations by permitting debtors to pay small dividends to environmental authorities to discharge cleanup claims. This action is likely objectionable, for this classification grants no deference to the environmental policies undergirding a comprehensive federal statute such as CERCLA. Furthermore, debtors with environmental obligations could declare bankruptcy simply to avoid the claims and gain a competitive advantage in bankruptcy, a prospect at odds with the general policy of substantive consistency in and out of bankruptcy.

Faced with the all-or-nothing decision of whether environmental obligations are "the actual, necessary costs of preserving the estate" or general unsecured claims, courts have responded with little consistency. "Preserving the estate" has become an elusive, fact-specific determination that provides little guidance for potential litigants.

The priority issue is also quite difficult when further releases of hazardous waste or improvements to an existing treatment system or site occur after the debtor files the bankruptcy petition. In one such case, the Ninth Circuit affirmed the lower court and bankruptcy court holdings that there was "insufficient evidence establishing that [debtor] added any significant contamination to the site after the filing of Chapter 11." In addition, the debtor had improved its waste containment system and had modified its operations to prevent further contamination. The findings led the district court to refuse administrative expense priority, a conclusion upheld by the Ninth Circuit.

Consideration of ameliorative efforts against continuing pollution in determining priority is beyond the scope of the bankruptcy courts (and maybe other bodies, because segregating and tracing waste is nearly impossible),

64. See generally THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW (1986).
67. Id. at 250 (emphasis added).
68. Id.
69. Id.
although many courts are attempting similar calculations. This monumental problem further begs for a simplified approach to environmental obligations. Classifying environmental obligations as administrative expenses would doom many reorganizations. Few debtors with environmental liabilities would be able to pay off the obligations in cash at the time of confirmation as required under the Code for administrative expenses. The result would be "sudden death" for otherwise viable debtors with environmental liabilities. But classification of CERCLA obligations as general unsecured claims fails to recognize the important policies guiding the environmental laws. The current approach is confused and provides little guidance for parties to a reorganization.

III. SECURED CREDITORS AND FINANCING THE CLEANUP

While the current application of bankruptcy to environmental obligations may supply the death blow to the debtor's chances of reorganization, secured creditors may suffer substantial injury at the same time. Courts in their rush to solve environmental problems have in effect taken security interests from creditors in order to finance cleanup obligations. This judicial move may upset the balance explicit in the Code by failing to adequately protect the interests of secured creditors during the pendency of the bankruptcy case.

A. The Automatic Stay

Creditors holding claims against the debtor may not immediately move to liquidate these claims in bankruptcy. Reorganizations require ample time for the debtor to restructure its assets and liabilities before reemergence. To provide this time, all entities (including governmental entities such as environmental authorities) are stayed from taking action against property of the debtor upon the filing of the bankruptcy petition. The automatic stay provision of the Code provides the debtor with a breathing spell and prevents creditors or governmental units from acting to collect against the debtor or interfering with property of the estate until the bankruptcy proceeding has run its course. The automatic stay is, however, limited to only those actions which could have been commenced pre-petition or attempt

71. Section 362(a) provides in part:
   [A] petition filed under section 301, 302, or 303 of this title ... operates as a stay, applicable to all entities, of the commencement or continuation of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title
to collect on pre-petition claims. Claims arising post-petition are not affected by the automatic stay.

The Code recognizes two specific exceptions applicable to governmental authorities with claims against the debtor. The first is found in section 362(b)(4), which exempts commencement of actions within the police power of the state from the automatic stay. This section permits the state to obtain an injunction to protect the public health and safety, such as to prevent the debtor from violating environmental laws. But the legislative history suggests that the police power exception is to be given a narrow construction and should not apply to "actions by a governmental unit to protect a pecuniary interest in property of the debtor or property of the estate." This thin distinction between the pecuniary interest and public safety exists to prevent governmental units from enjoying priority over other creditors and from using assets of the estate absent danger to public health and safety.

The other provision that environmental authorities have used to avoid the stay is section 362(b)(5), which exempts from the automatic stay enforcement of nonmonetary judgments against the debtor. This section carves out a narrow exception to the stay, permitting enforcement of judgments obtained before the commencement of the case. Courts have wrestled with whether enforcement of cleanup orders is permitted under this exception or whether it would be barred as an attempt to enforce a monetary judgment against the debtor, an action precluded by the stay.

Courts have walked a tightrope between the competing policies of the automatic stay and the environmental laws. For example, in Penn Terra v. Department of Environmental Resources, the Third Circuit construed section 362(b)(4) broadly, permitting the state to retain its police power while limiting the scope of "enforcement of a monetary judgment."

72. Id. § 362(b)(4).
73. See, e.g., Walsh v. West Virginia (In re Security Gas & Oil, Inc.), 70 B.R. 786, 795 (Bankr. N.D. Cal. 1987) (holding that order to cease activities violating state law fell within § 362(b)(4)).
75. 11 U.S.C. § 362(b)(5).
76. Id. § 362(a)(2).
77. 733 F.2d 267 (3d Cir. 1984). Penn Terra had been violating environmental laws in operating coal mines. The Pennsylvania Department of Environmental Resources (DER) cited Penn Terra for the violation, and the two entered a consent decree. Penn Terra never complied with the consent decree, and it later filed for a Chapter 7 liquidation. The DER sought a preliminary injunction to force the debtor to comply with the consent decree and to correct environmental violations, which the state court granted.
78. Id. at 273. Since the remedy sought did not compensate for "past wrongful acts" but instead would protect against "potential future harm," the injunction fell within the police power exemption to the stay. Id. (emphasis added).

The court buttressed its decision by stating that the "injunction was, neither in form nor
This decision leaves debtors with little solace, especially since most cleanup orders force action regardless of cost. Most courts confronting this problem, however, have followed Penn Terra and its functional approach to the automatic stay. But the result of such an expansive police power exemption would be to doom reorganizing businesses by granting priority to environmental authorities over other creditors affected by the stay. Reorganizing businesses would see the existing pool quickly depleted by environmental obligations, often forcing complete liquidation.

The automatic stay is a critical tool of bankruptcy that temporarily shields debtors from their creditors. But while it is a powerful protection, the automatic stay does not grant debtors unbridled discretion to use encumbered property of the estate at the expense of their creditors.

B. Adequate Protection and the Use of Estate Property

Closely tied to the stay is the concept of "adequate protection," which preserves the secured creditor's benefit of the bargain by protecting her security while the debtor is in bankruptcy. Regardless of the nature of the debtor's business, a secured creditor may petition to lift the stay "for cause, including the lack of adequate protection ...." Methods of adequate protection include periodic cash payments, additional liens, or the "indubitable equivalent." Adequate protection is the trade off for the debtor's use of encumbered property during the bankruptcy proceeding. Without the inclusion of encumbered property in the estate, reorganizations would almost certainly fail; without compensation for decline in value of the

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79. See Mirsky et al., supra note 12, at 637.
84. Id. § 363. Recall that encumbered property is included in property of the estate under § 541(a)(1).
collateral, the creditor would lose the benefit of her bargain. The need for adequate protection is particularly compelling when the security is cash collateral, and as a result, courts have closely scrutinized the use of cash collateral.85

Some courts seem willing to relax the adequate protection requirement in order to finance an environmental cleanup. An indication of the relaxed approach is In re Environmental Waste Control,86 in which the district court ordered a debtor to use estate property to comply with a cleanup order.87 A secured creditor claimed that such a holding both violated its right to adequate protection within bankruptcy and deprived it of property without just compensation.88 The court rejected these arguments, stating that "[the secured creditor's] position regarding its priority over the estate's assets must yield in light of the competing environmental harms."89

The same secured creditor argued that the debtor could not draw on the cash collateral without creditor consent or court authorization "in accordance with the provisions of this section,"90 which required adequate protection. But the court authorized the EPA and the state environmental authority to use the cash collateral toward cleanup.91

In order to use cash collateral, the debtor must move for court authorization.92 Upon such a motion, the court will hold a hearing at which it

86. 125 B.R. 546 (N.D. Ind. 1991).
87. Id. Environmental Waste Control (EWC), a landfill operator, filed for reorganization after a consent decree was entered against it in a RCRA case. United States v. Environmental Waste Control, 710 F Supp. 1172 (N.D. Ind. 1989), aff'd, 917 F.2d 327 (7th Cir. 1990), cert. denied, 111 S. Ct. 1621 (1991). All of EWC's liquid assets were cash collateral subject to the secured claims of Resources Unlimited, Inc. (RUI). EWC had slightly over two million dollars in cash, which had been decreasing rapidly due to the prohibition on incoming shipments under the RCRA decree. Since the cleanup would cost far more than the remaining value of the estate, EWC sought to defer the environmental authorities until the bankruptcy court could determine the relative rights of creditors. In re Environmental Waste Control, 125 B.R. at 549. But the court denied EWC's request, ordering EWC to comply with the cleanup order, regardless of a total cost that would greatly exceed EWC's remaining assets.
88. The constitutional argument is discussed infra notes 94-104 and accompanying text.
89. In re Environmental Waste Control, 125 B.R. at 552. The court stated that "the matter of adequate protection is outside [the district court's] current scope" and within that of the bankruptcy court, although the court's dictum may encourage a future holding in line with environmental ends. Id.
91. In re Environmental Waste Control, 125 B.R. at 552.
may "authorize the use of only that amount of cash collateral necessary to avoid immediate and irreparable harm to the estate."93

Avoidance of immediate harm to the estate is the sole apparent justification for releasing a portion of the cash collateral. Such a stringent requirement is the only way to protect the property interests of creditors in cash collateral.

C. Constitutional Problems for Secured Creditors: The Loss of Adequate Protection as a Taking

While the constitutional impact of CERCLA in bankruptcy has never been litigated, other laws altering the position of secured creditors in bankruptcy have generated constitutional concerns under the Fifth Amendment Takings Clause.94

Conflicts between the Code and CERCLA raise important constitutional issues which few courts have yet to examine. Environmental obligations

93. FED. R. BANKR. P 4001(b)(2) (emphasis added). The court never mentioned this requirement in its opinion.

94. The Takings Clause states that "private property shall not be taken for public use without just compensation." U.S. CONST. amend. V

The constitutional concerns generated by bankruptcy procedures have a long history. Under President Franklin D. Roosevelt's New Deal, Congress attempted to stem the tide of farm bankruptcies. One such action, the Frazier-Lemke Act, amended the Bankruptcy Act to permit debtors to remain on their property, provided a five-year moratorium on state-law foreclosure rights, and allowed for repurchase at a below-debt price. Pub. L. No. 73-486, 48 Stat. 1289 (1934). In Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555 (1935), the United States Supreme Court held that retroactive enactment of this act deprived the secured creditor of property rights in violation of the Fifth Amendment. Justice Brandeis, writing for the Court, stated that no matter how grave the economic climate, "private property shall not be thus taken even for a wholly public use without just compensation." Id. at 602. Shortly after this decision, the Court distinguished the descendent of Frazier-Lemke and upheld it as a less violative provision in Wright v. Union Central Life Ins. Co., 311 U.S. 273 (1940).

The Court later decided a case regarding mechanic liens that also involved a taking challenge. In Armstrong v. United States, 364 U.S. 40 (1960), the Court held that the government's action in confiscating unfinished ships under contract with the U.S. Navy constituted a taking of private property by nullifying mechanic liens on the work in progress. The Court stated that "the total destruction by the Government of all value of these liens, which constitute compensable property, has every possible element of a Fifth Amendment 'taking' and is not a mere 'consequential incidence' of a valid regulatory measure." Id. at 48.

United States v. Security Industrial Bank, 459 U.S. 70 (1982), affirmed the Court's position in Radford and Armstrong. The case involved § 522(f) of the Code and its retroactive application to the bank. This section allows the debtor to invalidate nonpossessory, nonpurchase-money liens on personal property, including household goods. The Court unanimously agreed that the section could not be applied retroactively, but avoided the apparent constitutional issue arising from the destruction of the bank's liens. For the majority, Justice Rehnquist held that § 522(f) did not apply retroactively to liens perfected before passage of the Bankruptcy Reform Act. He explicitly recognized that "the bankruptcy power is subject to the Fifth Amendment's prohibition against taking private property without compensation," and for this proposition he cited Radford. Id. at 75.

For an extremely thorough discussion of this line of cases, see John Ayer, Rethinking Absolute Priority After Ahlers, 87 Mich. L. Rev. 963 (1989).
create new problems that courts must address to protect the constitutional rights of secured creditors in the bankruptcy process. Creditors may lose constitutionally protected property rights as a result of the combination of these powerful federal statutes.95

Bankruptcy alone does not effectuate a taking; the automatic stay and its complementary provision of adequate protection for the secured party satisfy Fifth Amendment due process requirements.96 Since a security interest is a property right protected by the Takings Clause of the Fifth Amendment,97 a creditor receives protection within the bankruptcy proceeding from reduction in value or total loss of her collateral through the concept of "adequate protection."98 A creditor may get relief from the stay upon motion by showing that her collateral is not adequately protected.99 So long as adequate protection accompanies the stay, the creditor's constitutional rights are preserved.

Few courts have addressed the constitutional argument in an environmental case. In In re Heldor Industries,100 the bankruptcy court held that the New Jersey Department of Environmental Protection could not use the collateral of a secured creditor to finance a cleanup under the state's Environmental Cleanup Responsibility Act (ECRA).101 The court refused to

95. Outside bankruptcy, creditors holding properly perfected security interests against a debtor are entitled to recover the collateral and sell it to recover the proceeds. U.C.C. §§ 9-503, -504. CERCLA permits the EPA to take a lien on real property to secure costs incurred by the federal government for cleanup of that property, 42 U.S.C. § 9607(l) (1988), but these liens are subordinate to previously perfected security interests.

96. See, e.g., Chrysler Credit Corp. v. Ruggiere (In re George Ruggiere Chrysler-Plymouth, Inc.), 727 F.2d 1017 (11th Cir. 1984).


101. Id. In an attempt to balance the interests of debtors and creditors with the interest in public health, many states have responded to local environmental problems with legislation similar to CERCLA or RCRA. The best known of the state counterparts is New Jersey's ECRA, which imposes a notification requirement on owners before they close or transfer certain businesses or property. See N.J. STAT. ANN. §§ 13:1K-6 to -13 (West 1991 & Supp. 1992). A few states have enacted "superliens," which afford priority to claims of state environmental authorities over all previously perfected liens. See, e.g., Douglas Ballantine, Note, Recovering Costs for Cleaning Up Hazardous Waste Sites: An Examination of State Superlien Statutes, 63 Ind. L.J. 571 (1988). These statutes attempt to resolve the conflict between bankruptcy and environmental law by ensuring that state agencies can recover costs under priority liens against the debtor's property ahead of even secured creditors. These state statutes are not to be confused with CERCLA's lien provision, which grants the federal government a lien over real property subordinate to perfected security interests.

If these statutes attempt to alter the bankruptcy baseline, they run afield of the Constitution. For example, Torwico Electronics, Inc. v. New Jersey Department of Environmental Protection (In re Torwico Electronics, Inc.), 131 B.R. 561 (Bankr. D.N.J. 1991), held that portions of ECRA which attempt to limit the effect of the Code on cleanup obligations and create new
allow the state to “simply . . . take the Bank’s money to pay for a cleanup merely because the Bank [had] the misfortune to be in the same case.”

From the premise that security interests are property within the Fifth Amendment, the court stressed that

there is no satisfactory basis for arguing that although Code sections 361, 362(d)(1), 363(e), 364(d) and 507(b) provide that a secured creditor must be compensated if the bankruptcy case causes a reduction in the value of collateral, the creditor does not have to be compensated if the state takes the creditor’s money to pay for an environmental cleanup.

The court refused to permit the bank’s security to be used to pay for the cleanup when the bank had only the misfortune to lend to a polluter.

The In re Heldor court clearly expressed hostility to the State’s attempt to fall back on the bank as an insurer for the environmental obligations of the debtor, since this draconian result seemed beyond even the broad reach of ECRA. This ruling would seem to apply with equal force to CERCLA, which also does not require lenders to act as environmental insurers.

The impact of environmental laws in bankruptcy creates a constitutional problem that can only be avoided by ensuring adequate protection for secured lenders. Using cash collateral for environmental cleanups removes this protection and deprives secured lenders of vested property rights in violation of the Fifth Amendment.

obligations when the bankruptcy case is filed violate the supremacy clause of the Constitution.

In re Torwico Electronics involved a manufacturer of electronic transformers who leased property that was found to be contaminated. When the debtor filed under Chapter 11, it listed the state Department of Environmental Protection (DEP) and attorney general as unsecured creditors holding disputed claims. But ECRA states, “[n]o obligations imposed by this act shall constitute a lien or claim which may be limited or discharged in a bankruptcy proceeding. All obligations imposed by this act shall constitute continuing regulations imposed by the State.” Id. at 573. ECRA altered bankruptcy’s baseline and provided the state with a right of payment outside of bankruptcy. Redefining terms in case of bankruptcy violates bankruptcy’s equality principle and threatens any administration of the bankruptcy case.

Courts have typically disfavored such alterations to the federal scheme, and this case was no exception. Relying on the Supremacy Clause of the U.S. Constitution, the court held that ECRA’s definition of “claim” conflicted with that of the Code and was therefore void on its face. The court went on to say that “[i]f the extent that they require expenditure of a bankruptcy estate’s money, even ‘continuing regulatory obligations’ are either secured claims, administrative expenses, priority claims or unsecured claims as defined by Congress, and are subject to the provisions of the Bankruptcy Code regarding payment.” Id. at 575. The court found that the other provisions of ECRA providing for the treatment of cleanup obligations also violated the supremacy clause. Id.

State statutes often respond more clearly to state environmental problems, but their coverage must be limited so as to remain within legitimate constitutional boundaries. Although they may define the nonbankruptcy terms, states may not alter the bankruptcy process by reshaping the system’s complex network of priorities and procedures. Only Congress has the authority to redefine terms in bankruptcy.

102. In re Heldor, 131 B.R. at 586.
104. In re Heldor, 131 B.R. at 586.
IV. A Proposed Process for Handling Environmental Obligations in Bankruptcy

Environmental obligations by their nature complicate the bankruptcy process. Reducing the obligation to money, deciding who is responsible for what share, and fixing the total cost of the cleanup are all intractable problems that lack the exactness desired in bankruptcy. Congress must provide courts with guidance in this area, for resolving these issues based on the current Bankruptcy Code and Rules will only result in greater inconsistency.

Congress should act to resolve the confusion surrounding CERCLA obligations in bankruptcy by amending the Code and Rules to create a process for dealing with the problem. The process must conform to general bankruptcy procedures, such as claim classification and priority, in order to fulfill bankruptcy’s promise. But the unique nature of environmental obligations calls for a unique process to recognize the important federal objectives of the environmental laws.

The following proposals reconcile the federal policies and provide a framework for the treatment of environmental obligations in bankruptcy. First, obligations for response costs to federal and state environmental authorities should be classified as claims in bankruptcy in order to respond to the needs of both the reorganizing debtor and the environmental authorities. The amount of the claim would then be fixed either through settlement with the EPA or estimation by the bankruptcy court in accordance with the proposed process. Next, the claims should receive priority status, like tax claims, in recognition of the special policies behind the environmental laws. This treatment promotes equality among government entities, while at the same time providing guidance to courts and avoiding the “sudden death” problem of corporate reorganizations. Finally, resolution of the quandary of creditor protection requires judicial deference to the rights of secured creditors by fortifying the Bankruptcy Rules relating to adequate protection.

A. Claims

Environmental obligations for response costs should be classified as claims for the reorganization. They resemble other obligations of the debtor that may be satisfied by the expenditure of money. As claims, the obligations would entitle environmental authorities to participate in the reorganization,

105. This is not true for costs under CERCLA § 106. “Liability under section 106 in conjunction with section 107(a)(1) is a different matter,” since a cleanup order under CERCLA § 106 creates a “claim running with the land.” In re CMC Heartland Partners, 966 F.2d 1143, 1146 (7th Cir. 1992).
thus ensuring future payment to the appropriate agency. This treatment recognizes the interest that environmental authorities have in present and future actions of the debtor.

Courts have approached the issue of whether the Code’s definition of “claim” includes environmental liabilities for response costs in many different ways. The approach that could provide the most useful guidance for all parties involved in environmental controversies involving bankruptcy may be derived from In re National Gypsum.\(^{106}\)

The court in In re National Gypsum held that only those response costs based on pre-petition conduct by the debtor that are “fairly contemplated” by the parties at the time of filing are claims within the Code.\(^{107}\) This court pronounced as factors to be considered in determining fair contemplation: knowledge by the parties of a site of potential liability, listing on the National Priorities List, notification by the EPA of liability, commencement of investigation and cleanup activities, and incurrence of response costs.\(^{108}\) This standard, more so than the broader and less clear standard from In re Chateaugay,\(^{109}\) will provide parties with substantial guidance as to what constitutes a claim under the Code.

The In re National Gypsum approach to when a claim exists is more practical for all parties than In re Chateaugay. While In re Chateaugay requires that a claim would only arise upon “release or threatened release of hazardous waste,”\(^{110}\) In re National Gypsum focuses on the relationship between the parties and whether the liability would be fairly contemplated by the parties at the filing of the petition.\(^{111}\) The effect of In re National Gypsum is to avoid the scientific dilemma of discerning which releases occurred before the petition for bankruptcy was filed.\(^{112}\) This approach requires courts to determine whether the elements creating liability under the Code arose pre-petition and thus were fairly contemplated by the parties, not whether the EPA’s claims under CERCLA were ripe for adjudication. In re National Gypsum’s practical approach provides a rule based on discernible legal factors for “fair contemplation”\(^{113}\) which should become

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107. Id. at 407-08.
108. Id. at 408 (footnote omitted). While an NPL listing has “no direct legal consequence,” it “signifies the EPA’s belief that the site is releasing or likely to release hazardous substances.” In re CMC Heartland Partners, 966 F.2d at 1145.
109. United States v. LTV Corp. (In re Chateaugay Corp.), 944 F.2d 997 (2d Cir. 1991); see also supra notes 35-42 and accompanying text.
110. In re Chateaugay, 944 F.2d at 1005; see also supra notes 35-42 and accompanying text.
111. In re National Gypsum, 139 B.R. at 409.
112. Waste migration tracking techniques currently do not permit authorities to determine on what date a release occurred. Waste migration simply does not respect the filing of a bankruptcy petition.
113. See supra note 47.
the preferred approach to allowing environmental claims in the bankruptcy process.

B. Determining the Amount of the Claim

Fixing the amount of the claim would involve a choice for the debtor: settle with the EPA for an amount determined through a limited Remedial Investigation and Feasibility Study (RI/FS) or estimate the claim under the Code. The settlement procedure would require a shortened RI/FS process and increased cooperation between the debtor and the EPA.

Estimation of the environmental claim under Code section 502(c) would fix the amount of the liability. Estimation settles the problem of "incurred costs" from *In re Dant & Russell II* without constant reconsideration whenever new costs are incurred. These two procedures would resolve the amount of the environmental claim in order to better facilitate the Chapter 11 reorganization while still involving the environmental authorities in the reorganization process. Cost estimation may have its limits, but it may also create a workable solution for balancing the interests of environmental reclamation and corporate reorganization.

1. Settlement with the EPA

As an initial move to facilitate the claims process in bankruptcy, debtors and environmental regulators could settle the existing dispute over cleanup obligations. Debtors who settle early with the EPA benefit from the certainty of resolution and potential protection from further suits that CERCLA provides. Settling debtors also move closer to plan confirmation, since the amount of their environmental claims will be determined quickly.

Section 122 of CERCLA, added by the SARA amendments in 1986, authorizes the federal government to settle with PRPs for some or all of the potential costs of cleanup "[w]henever practicable and in the public interest." The EPA, in determining how to proceed with the cleanup, may prepare a nonbinding preliminary allocation of responsibility (NBAR),

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114. 11 U.S.C. § 502(j) permits reconsideration for cause, a prospect that would severely jeopardize the confirmation of a plan. For a discussion of *In re Dant & Russell II*, see supra notes 43-44 and accompanying text.

115. For instance, determining the amount of a claim for response costs may involve calculations and speculation beyond the typical product liability suit. Furthermore, the EPA contends that estimation amounts to pre-enforcement judicial review in violation of CERCLA § 113(f). CERCLA § 113(f), 42 U.S.C. § 9613(f) (1988); see, e.g., United States v. LTV Corp. (*In re Chateaugay Corp.*), 944 F.2d 997, 1005-06; *In re National Gypsum II*, supra note 53.


117. CERCLA § 122(a).
which "allocates percentages of the total cost of response among potentially responsible parties at the facility." This section even permits the EPA to bar further contribution claims from settled matters or grant covenants not to sue. The purpose behind this carrot-and-stick approach to resolving CERCLA liability is the desire for parties to settle quickly, thereby commencing cleanup sooner rather than later.

These settlement procedures apply to cost recovery actions, but Congress could create an analogous procedure to be undertaken at a preliminary stage in the cleanup process. The first stage of a cleanup involves the preparation of an RI/FS to determine the scope of the contamination and the potential costs of reclamation. While such a study would be a useful tool for early stage settlement, a typical RI/FS takes as long as three years to prepare. Since this period would probably doom most reorganizations of debtors with environmental liabilities, a new limited RI/FS could be created to expedite the process. This study would not involve the thorough analysis found in the current RI/FS but instead would summarize preliminary estimates of liability. The schedule for completion of the limited RI/FS would be far shorter (for instance, 90 days) in order to facilitate the reorganization process. The limited RI/FS would no doubt lack the extensive analysis of the current study, but this expedited procedure would involve the EPA in the reorganization at an earlier stage and increase the possibility of facilitating a feasible plan which would provide for the polluter's participation in the cleanup.

A limited RI/FS, however, would bring with it the problems of inaccuracy resulting from the shortened time frame. Response costs, unlike other corporate claims, are difficult to estimate due to technological inaccuracies, and the public health and safety would seem to demand an even greater concern with accuracy in order to restore the environment and protect the public.

But the delays associated with preparing the studies may actually disserve the public health more than the potential for inaccuracy. The typical RI/FS takes years to complete, time which could be spent cleaning up the site. Undertaking an early cleanup may substantially reduce the end costs of the

118. *Id.* § 122(e)(3)(A).
119. *Id.* § 122(h)(4). For broader contribution protection, see also *id.* § 113(f)(2).
120. *Id.* § 122(f).
122. For a discussion of the limited RI/FS, see *infra* note 123 and accompanying text.
project while also protecting the public health and safety from the outset. The snail's pace at which current CERCLA cleanups progress is so time-consuming and so administratively expensive that the delays only exacerbate existing problems. For example, under the current procedure, a cleanup originally estimated at one million dollars may grow to five or ten million dollars by the time the RI/FS is completed and the cleanup actually begins, due only to the time delay. For this reason, a quick response action is preferable to a wait-and-see approach dependent upon the drawn-out RI/FS process.\(^1\)

CERCLA currently forces companies, which would have a reasonable chance of reorganization if the cleanup were undertaken early, to liquidate rather than wait in bankruptcy for the RI/FS. Subjecting reorganizing debtors to long delays while the CERCLA clock ticks during the RI/FS period severely threatens any chance of reorganization.

Permitting the debtor to settle with the EPA would also serve the goal of quick response action. For reorganizing debtors, the settlement procedure could be undertaken as quickly as possible to expedite the reorganization.\(^2\) The settlement amount would then become a claim in the debtor's reorganization.\(^2\) Although response costs often result in multimillion dollar liabilities, actual settlements are routinely far less than the Agency's claim, thereby resulting in a claim that could be potentially reorganized.\(^3\) The EPA recognizes the potential damage that CERCLA liabilities may have on reorganization prospects and on the EPA's own potential for cost recovery. Thus the agency will often settle with a debtor for an amount that would not render the plan infeasible.\(^4\) The EPA is also aware of the expense and

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1. Such a quick response would not prevent the EPA from including a "reopener" clause in any consent decree, which permits the EPA to institute new proceedings against the debtor or the reorganized corporation based on "previously unknown conditions or new information" concerning the sites. See, e.g., Lodging of Proposed Consent Decree Pursuant to the Comprehensive Environmental Response, Compensation, and Liability Act, 55 Fed. Reg. 46,110 (1990).

2. Debtors should attempt to liquidate liabilities into damages only, for responsive actions would most likely cause undue delay to the bankruptcy proceeding.

3. For the priority that the proposed claim would receive, see infra notes 144-47 and accompanying text.

4. For example, the Department of Justice and the Bellamah Community Development Company settled a two million dollar claim for response costs for $150,000 and an irrevocable right of access to the site. Lodging of Stipulation and Agreement Pursuant to the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, as Amended ("CERCLA"), 56 Fed. Reg. 65,507 (1991).

5. The EPA noted this consideration in a consent decree with Atlantic Richfield (ARCO) that stated "consideration and approval of the ARCO decree, with its resulting impact on ARCO's cross claims against Sharon Steel, will significantly enhance the prospects for confirmation of the Sharon Steel Plan of Reorganization, pursuant to which Sharon Steel may be able to emerge from bankruptcy." Lodging of Proposed Consent Decree Pursuant to the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, as Amended ("CERCLA"), 55 Fed. Reg. 46,110 (1991). The debtor was a PRP as the current owner or operator of the site and was subject to cross claims from ARCO. The recognition of the impact on Sharon Steel's reorganization shows the EPA's increasing awareness of bankruptcy problems.
length of CERCLA litigation, and quick settlements avoid these costs and delays. This recognition is an important step toward settling CERCLA suits with reorganizing debtors.\textsuperscript{128}

Facing the possibility that the environmental claim would be classified as a cost of preserving the estate (an administrative expense) and not a general unsecured claim, debtors would be wise to reach a consensual settlement with the environmental authorities.\textsuperscript{129} Debtors with ongoing environmental obligations would have liability fixed by settlement and would avoid machinations over how much of the contamination occurred post-petition. For CERCLA section 107 response costs, the EPA would probably receive a greater amount of the debtor's estate than it would have received under the current structure.\textsuperscript{130} Parties that elect not to settle risk the potential failure of the reorganization because of the overwhelming contingent claim of the environmental authorities. By settling with the environmental authorities, the debtor fixes a claim amount that may permit a feasible plan of reorganization.\textsuperscript{131}

There are two principle ways in which the EPA benefits from a settlement with a reorganizing debtor. First, the settlement permits the EPA to avoid costly and protracted litigation. Second, and more importantly, by settling with a reorganizing debtor, the EPA has a stake in the reorganization and can vote on proposed reorganization plans. This voting power grants the Agency some discretion in accepting the plan, for if the settlement amount seems too small in relation to the claims of other creditors, the EPA can vote against the plan and encourage the debtor to negotiate further.\textsuperscript{132} The stake in the reorganization process allows the EPA to maintain some measure of influence over the debtor which may include direction in the cleanup itself.

2. Estimation under the Code

If the debtor is unable or unwilling to settle with the EPA, the bankruptcy court could estimate the amount of the allowable environmental claim.

\textsuperscript{128} The bankruptcy court also becomes involved if the debtor decides to settle with the EPA while the bankruptcy case is pending. A debtor must obtain court approval to settle with a class of creditors (and presumably the environmental authorities would be their own class in the reorganization). \textit{Fed. R. Bankr. P} 9019(a)-(b). This approval should be immediately granted so long as the settlement would not destroy the feasibility of the plan.

\textsuperscript{129} For a discussion of administrative expense or general unsecured priority, see \textit{supra} notes 57-70 and accompanying text.

\textsuperscript{130} \textit{CERCLA} § 107(c), 42 U.S.C. § 9607(c) (1988). The same does not hold true for \textit{CERCLA} § 106 abatement actions, under which the EPA probably would receive administrative expense priority. \textit{CERCLA} § 106(b). \textit{See supra} note 58 and accompanying text.

\textsuperscript{131} If the settlement amount still renders the plan infeasible, the debtor should reassess the possibility of any reorganization.

While settlement has typically been recognized as the preferable approach to resolving disputes with the EPA, the agency may be unwilling to settle on terms that would permit plan confirmation. Bankruptcy should therefore provide a mechanism for handling these unsettled claims for reorganizing debtors.

The bankruptcy court has the discretion to estimate claims for allowance under section 502(c), including contingent or unliquidated claims or other rights to payment. Many courts have exercised wide discretion in applying this section, using it as a requisite crutch toward reorganization.

The estimation procedure could be readily applied to environmental claims. The bankruptcy court would use the limited RI/FS to determine the total cost of cleanup and the allocation of the debtor's share of the cleanup from an NBAR to estimate the debtor's total potential future liability. Based on the limited RI/FS and the NBAR, the court could estimate the EPA's contingent future claim against the debtor for unsettled cleanup costs and include the estimated claim in the reorganization plan. Estimation can be as useful for environmental claims as it is for other unliquidated claims or payment rights. Since the liquidation of environmental claims could otherwise "unduly delay the administration of the case," the bankruptcy court should be encouraged to estimate such claims for allowance in the bankruptcy proceeding.

Greater urgency for estimation is provided by In re Dant & Russell II, in which the Ninth Circuit held that a party may recover incurred costs but not projected future cleanup costs from a reorganizing debtor under CERCLA. The court focused on which costs were actually incurred at the time of the bankruptcy filing instead of costs that would flow from the releases. Besides further complicating the definition of "claim" and when

133. Although settlements establish a working relationship with the EPA and may permit cost scheduling, onerous terms may doom an entire reorganization. For instance, absent a broad covenant not to sue for future unanticipated costs, debtors would still face future liability for environmental damages after settlement (and often the EPA is loath to grant broad covenants not to sue due to the highly speculative nature of cleanup costs). For a discussion of when to settle, see Stephen L. Kass & Michael B. Gerard, CERCLA Settlements with the EPA, N.Y. L.J., Apr. 24, 1992, at 3.

134. 11 U.S.C. § 502(c).

135. For example, in Menard-Sanford v. Mabey (In re A.H. Robins, Inc.), 880 F.2d 694 (4th Cir. 1989), cert. denied 493 U.S. 959 (1989), after considering widely differing estimates from interested parties, the Fourth Circuit accepted the bankruptcy court's estimation of A.H. Robins' liability resulting from the Dalkon Shield claims.

136. One court has already taken this step, estimating both response costs and natural resource damages to allow for reorganization. In re National Gypsum II, supra note 53.

137. See infra notes 144-56 and accompanying text for a discussion of the priority this claim would receive in the reorganization.


139. 951 F.2d 246 (9th Cir. 1991).

140. Id. at 250.
it arises,\textsuperscript{141} the court created an opportunity for ongoing recoveries from the debtor as cleanup costs are incurred. Such a "temporary disallowance" is not unique to environmental claims,\textsuperscript{142} but it is potentially crippling to any future reorganization. Providing a mechanism to consistently assess new damages against a reorganized debtor for pre-petition releases jeopardizes future reorganizations.

A workable resolution to \textit{In re Dant & Russell II} would have been to estimate future costs to be incurred by the debtor, Burlington Northern, for cleanup of the site. Estimation of future liability would provide the debtor with the opportunity to consider all claims arising from pre-petition acts in its reorganization, a critical element of bankruptcy policy. The resulting allowance would constitute the environmental claim for consideration in the reorganization.\textsuperscript{143}

Claim estimation serves both the debtor and the environmental agencies. For the debtor, estimation of the environmental claim guides later reorganization plans by fixing an amount of the claim owed to the environmental authorities. For the environmental authorities, estimation of liability supplies the agency with a financial stake and a vote in the potential reorganization, assuring it of some payment in the future. Estimation serves the policies of notice to other parties and avoidance of "sudden death" for otherwise viable businesses. What this procedure lacks in exactness it makes up in timeliness: reorganizing debtors may be able to reorganize the estimated amount and environmental authorities will recover an amount toward cleanup upon confirmation of the plan. The next step is determining what status the environmental claim should receive in the reorganization.

\textbf{C. Governmental Unit Priority for Environmental Claims}

The Code provides that "allowed unsecured claims of governmental units" receive a special priority for distribution.\textsuperscript{144} Satisfaction of these claims may be extended for up to six years after the date of assessment of such a claim.\textsuperscript{145} Since assessment is the important date, debtors must determine exactly when the tax, duty, or similar claim was assessed to determine the

\begin{itemize}
  \item \textsuperscript{141} For a discussion of the effect of this case on claims in reorganizations, see \textit{supra} notes 66-69 and accompanying text.
  \item \textsuperscript{142} See also Bittner v. Borne Chem. Co., 691 F.2d 134 (3d Cir. 1982).
  \item \textsuperscript{143} A recent case may establish the availability of such a solution. In the National Gypsum bankruptcy proceedings, \textit{supra} note 53, a court has determined that the amount of the EPA's claim for response costs and natural resource damages could be estimated consistently with both CERCLA and the Bankruptcy Code.
  \item \textsuperscript{144} See 11 U.S.C. § 507(a)(7) (1988). This section also includes claims by individuals, placing them ahead of the government, which can more easily bear losses resulting from bankruptcy. See also Claar, \textit{supra} note 14, at 55.
  \item \textsuperscript{145} 11 U.S.C. § 1129(a)(9)(C).
\end{itemize}
maximum extension period. The Code also requires the debtor to pay the present value of the obligation in order to use the extended payment period.

By providing debtors with the option to extend or stretch out payment for these priority claims over a six year period, the Code creates a mechanism to encourage reorganization plans. If these priority claims had to be paid in full immediately following confirmation, many plans would fail the confirmation requirement of feasibility. Instead, the Code delineates these priority claims from administrative expenses, permitting deferred cash payments equal to the value of the claim.

A similar extension period is critical for satisfaction of environmental claims. Stretching out the period for payment lifts debtors out from under the immediate crippling pressure of environmental obligations while still providing environmental regulators with a guarantee of repayment over time. The time of assessment, which starts the six year payment clock, should be the time at which the authority cited the debtor for the environmental violation.

A vexing problem for courts approaching tax claims that would also affect environmental claims is the appropriate interest rate to use for the extension period. The Code indicates that the relevant standard for confirmation is the current value of deferred cash payments. The rate must be "reasonable in light of the risks involved" and should include consideration of the security itself and the risk of default. Courts have struggled to determine an applicable standard, applying the market rate, the Treasury bill rate, or the rate assessed by the Internal Revenue Service for delinquent taxes. The determination of which rate to apply is within the court's discretion.

In setting the interest rate for environmental claims, the court must also consider two major factors: risk of default and available collateral. The risks of default, while also a problem for tax claims, may be far higher

146. Id. § 1129(a)(11).
147. 11 U.S.C. § 1129(a)(9)(C) provides that:
   with respect to a claim of a kind specified in section 507(a)(7) of this title, the holder of such claim will receive on account of such claim deferred cash payments, over a period not exceeding six years after the date of assessment of such claim, of a value, as of the effective date of the plan, equal to the allowed amount of such claim.
Id. § 1129(a)(9)(C). Administrative expenses enjoy no such deferral mechanism. Id. § 1129(a)(9)(A).
148. Id. (emphasis added).
149. Prudential Ins. Co. of Am. v. Monmer (In re Monmer Bros.), 755 F.2d 1336, 1339 (8th Cir. 1985) (citation omitted).
with a large environmental claim. Therefore, the interest rate must include this risk. The other factor is the lack of collateral to secure the environmental claim. Secured claims may bear a relatively low rate of interest because of the option of foreclosure. But this option is unavailable for an environmental claim. CERCLA already creates a lien on contaminated property. Another environmental lien would have little effect. Although bankruptcy courts have not settled the interest rate question for tax claims, the options utilized provide appropriate parameters for applying an interest rate to environmental claims.

Creating a deferred payment plan for environmental obligations requires amending the Code to recognize these new priority claims. Cleanup obligations should be added to section 507(a)(7)'s litany of allowed unsecured claims of governmental units.153 "Governmental unit," as defined in the Code, covers all types of federal and state governmental authorities, a term presumably broad enough to include state and federal environmental regulatory bodies.154 While section 507(a)(7) currently refers only to taxes, customs duties, and penalties, the provision could tolerate an amendment to include environmental authorities.155

Amending section 507(a)(7) to include cleanup obligations would provide a mechanism for consistently handling the recurrent problem of how to treat environmental orders in bankruptcy.156 The new section would provide notice to parties, reduce the number of "sudden death" results due to environmental claims, and create equal treatment for another governmental unit.

D. Preserving Adequate Protection

The interests of debtors and environmental authorities would be better served by predictable treatment of environmental claims than by the current inconsistencies. Creditors must also enjoy increased protection over their security in the face of increasing environmental demands. Although environmental claims may be conveniently funded by using estate property for cleanup,157 use of estate property without adequate protection violates bankruptcy's equality procedures that protect creditors. The Code requires that property may be used only on condition of adequate protection to the

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153. 11 U.S.C. § 507(a)(7) (1988); see infra Appendix B.
155. Another commentator makes a persuasive argument that cleanup claims should receive higher priority because "[c]leanup liabilities supply funds to only one government program while taxes supply funds to most of the others." Claar, supra note 14, at 55.
156. For the proposed amendment to 11 U.S.C. § 507(a)(7), see infra Appendix B.
secured creditor. Amending the Code would be unnecessary to solve this problem, especially in light of governmental unit priority for environmental authorities, but the Bankruptcy Rules should be amended to protect creditors in the environmental claims process.

Debtors receive protection from creditors with the automatic stay and the use of encumbered property while in bankruptcy; creditors are protected by the concept of "adequate protection," a term defined in the Code only by example. Adequate protection is a fundamental requirement of bankruptcy's collective process, for it does not allow debtors to abrogate the rights of creditors by filing the petition.

The court in In re Environmental Waste Control came dangerously close to ignoring the right to adequate protection entirely. The court stated that adequate protection was not a matter for its consideration, yet it permitted the use of estate property for cleanup in the meantime. The decision is more problematic in light of the security at issue, cash collateral, which may only be used with creditor consent or court authorization. Since the district court refused to reach the issue of adequate protection, leaving it to the bankruptcy court on remand, the bankruptcy court must find a way for the debtor to supply periodic cash payments, an additional or replacement lien, or other such relief constituting an "indubitable equivalent" for adequate protection. Some commentators posit that the cash collateral should not be used without consent "absent very special circumstances." This concern is justified since the secured creditor will be enjoying no direct benefit based on the use of her cash collateral. While environmental harms are compelling, forcing a secured creditor to bear massive cleanup costs is manifestly unjust and removes adequate protection of the creditor's security.

The specific facts of In re Environmental Waste Control may seem compelling for preferring environmental policy over bankruptcy. The court recognized that the secured creditor's claim of priority would have been stronger absent the "imminent danger" to the environment under the Resource Conservation and Recovery Act order and absent the "circumstances of this case," which may be a passing reference to the secured creditor's involvement with the debtor.

158. 11 U.S.C. § 363(e).
159. See infra Appendix B.
160. 125 B.R. 546.
161. Id. at 552.
162. Id. at 546.
165. Mirsky et al., supra note 12, at 667.
166. See supra notes 86-91 and accompanying text.
167. In re Environmental Waste Control, 125 B.R. at 552.
168. Id. at 550. Supporters to Oppose Pollution (STOP) argued that the secured creditor
But should imminent danger resulting from actions of the debtor force a secured creditor to act as an environmental insurer? "Imminent danger" may justify elevation to administrative expense priority, as in most "imminent and identifiable threat" situations under CERCLA section 106, but that standard should not create a new priority above secured status. Unless the creditor herself has acted in violation of environmental laws, her exposure should not be so extreme. The site will be cleaned up; the real issue is simply who shoulders the cost. While forcing a deep-pocket lender to pay the cost of a cleanup may be attractive as a matter of policy, neither the environmental statutes nor any other legislation mandates such cost spreading. Absent involvement at the site by the secured creditor, the secured creditor's position should be neither bolstered nor weakened by the existence of an imminent danger or other acts of the debtor.

Adjusting the positions of secured creditors based on imminent dangers or other potential harms undermines the position of federal bankruptcy law by removing adequate protection when an attractive environmental policy presents itself. Broad extensions of environmental policy pollute the bankruptcy process and lead to uncertainty for lenders in an already uncertain business climate. Lenders will be forced to condition loans to businesses—not just landfills, but all businesses—on satisfaction of costly environmental assessments and agreements for future monitoring. This requirement alone was itself a PRP at the site. If this were proven (and the court did not mention this), the secured creditor's argument would indeed pale in comparison.

169. See, e.g., United States v. LTV Corp. (In re Chateaugay Corp.), 944 F.2d 997, 1004 (2d Cir. 1991); In re National Gypsum II, supra note 53.

170. The EPA has the option to compel a responsible party to clean up the property or to perform the cleanup itself and impose costs. Under either situation, the site will be restored. It may be relevant to note, however, that in bankruptcy innocent taxpayers may bear at least a portion of the cost allocated to the debtor.

171. "[T]he ultimate issue in cases such as this is not whether contamination should be cleaned up, but who must pay for it. By attempting to compel bankruptcy estates to clean up contamination, as opposed to having the state do so the [New Jersey Department of Environmental Protection] is at least as concerned with the public fisc as with the public health." Torwico Electronics, Inc. v. New Jersey Dep't of Envtl. Protection (In re Torwico Electronics, Inc.), 131 B.R. 561, 577 (Bankr. D.N.J. 1991) (quoting Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection, 474 U.S. 494, 507 (1986) (Rehnquist, J., dissenting)). "The DEP admits as much: 'Public money is scarce; necessary cleanups abound.'" Id. (quoting Brief of DEP filed March 8, 1991, at 32).

172. For the regulation providing the level of involvement for liability, see 57 Fed. Reg. 18,344 (1992).

173. This is not to say that the evolving doctrine of lender liability for environmental claims is misplaced. Quite the contrary, lenders who act as owners or operators are already subject to liability under the federal environmental statutes. See In re Bergsoe Metal Corp., 910 F.2d 668 (9th Cir. 1990) (holding the lender not liable unless it actually exercised the right of control); but see United States v. Fleet Factors Corp., 901 F.2d 1550, 1557 (11th Cir. 1990) (holding the lender liable simply by having the "capacity to influence the corporation's treatment of hazardous wastes"), cert. denied, 111 S. Ct. 752 (1991).

174. These steps may be the effect of New Jersey's ECRA, which provides other measures to ensure financial security for cleanup obligations. See N.J. STAT. ANN. §§ 13:1K-6 to -12 (West 1991).
would drive up the costs of borrowing for businesses and individuals alike.\textsuperscript{175}

Courts must adhere to the mandate of adequate protection to comply with due process requirements imposed by the takings clause of the Fifth Amendment, which protects creditors from destruction of their security.\textsuperscript{176} As security interests are property, "a secured creditor has a constitutional right to preserve the value of its secured claim on the petition date."\textsuperscript{177} The court in \textit{In re Heldor} stated that use of a secured creditor's collateral violated the Fifth Amendment, holding that "[t]he only expenses which can be charged against a creditor's collateral are those for preserving or disposing of the collateral" under section 506(c).\textsuperscript{178} As environmental cleanup costs only preserve the value of \textit{real property}, the use of cash collateral for cleanups without consent violates the Fifth Amendment.

The judicial approach to adequate protection should utilize the \textit{Heldor} court's strict reading of the Code. That decision protects the rights of the secured creditor in her cash collateral and requires that the "estate compensate a secured creditor for any decrease in the value of its collateral resulting from the bankruptcy case."\textsuperscript{179} Adequate protection must be provided to secured creditors, notwithstanding judicial exuberance to environmental policies.

Encouraging adherence to a single bankruptcy court is insufficient, since the appropriate means of directing courts is through amendment to the Code or Rules. For CERCLA claims, an amendment to the Rules to provide for a specific authorization requirement will protect creditors who have the misfortune to lend to polluters.\textsuperscript{180}

\textbf{CONCLUSION}

Bankruptcy policy is suffering at the hands of compelling environmental policies. Congress, increasingly attuned to hazardous waste problems, has forced businesses to shoulder more of the burden for cleaning up the environment. But courts are gutting bankruptcy's most important provisions

\textsuperscript{175} The chief economist for the American Association of Bankers already claims that lender liability is part of the cause of the current credit crunch. \textit{Environmental Liability Contributing to Credit Crunch, Banking Official Says}, Bankr. L. Daily (BNA) at 4 (Oct. 29, 1991).


\textsuperscript{178} \textit{Id.} at 586. The \textit{In re Environmental Waste Control} court gave little notice to this constitutional challenge by the secured creditor, dismissing the argument as inextricably intertwined with the adequate protection claim that it had remanded. \textit{In re Environmental Waste Control}, 125 B.R. 546, 552 (Bankr. N.D. Ind. 1991).

\textsuperscript{179} \textit{In re Heldor}, 131 B.R. at 586.

\textsuperscript{180} For the specific amendment to reinforce the primacy of adequate protection, see \textit{infra} Appendix C.
by preferring vague environmental policies at the expense of secured lenders. The solution to environmental problems in reorganizations lies not in creating involuntary insurers for polluting debtors but in refining the Bankruptcy Code and Rules to cope with shifting American concerns and establishing a predictable process for resolving thorny environmental issues in bankruptcy.

Bankruptcy attempts to avoid inconsistency by providing debtors with an opportunity to reorganize and creditors with a uniform, predictable system of equal distribution of available assets. Courts that meddle with the Code to further competing policies disserve the debtor/creditor relationship and usurp the job of Congress to enact federal statutes. If Congress wishes to prefer environmental policies at the expense of bankruptcy or other laws, it may enact legislation to do so. Courts, however, enjoy no such legislative power. Their role is to interpret the laws, including the Code and Rules, and respect the compromises made by Congress. By upsetting these compromises, they create inconsistent results, force reorganizing debtors into "sudden death," and prefer environmental authorities over other governmental entities, results which are detrimental to the working of the bankruptcy process.

Congress should amend the Code and Rules to create a unique process for environmental claims for response costs. By establishing a process for determining the amount of the claim, granting governmental unit priority to environmental authorities, and preserving adequate protection, Congress will serve the policies of both bankruptcy and environmental law.
APPENDIX A

Proposed amendments to 11 U.S.C. § 502(c) and Bankruptcy Rule 3003(c) to create a method for determining the amount of environmental claims

Section 502(c) of the Bankruptcy Code provides the court with the broad discretion to estimate contingent or unliquidated claims to avoid undue delay in the administration of the bankruptcy case. In order to direct courts to consider the necessity of estimating environmental claims in the bankruptcy process, the section should be amended to provide for environmental estimations.

Instead of attempting to locate response costs within the existing framework of this provision, a new subsection should be appended to the estimation provision for environmental claims. New section 502(c)(3) would read as follows:

(c) There shall be estimated for purpose of allowance under this section—
   ...(3) any response costs under 42 U.S.C. § 9607 [CERCLA], or any similar federal or state environmental provision.

To provide further procedural guidance in the claim filing process, the Bankruptcy Rules would be amended to require the environmental agencies to file a proof of claim for consideration in the estimation process. Such a requirement would simplify the estimation process, for the environmental authorities would be forced to file their own approximations of the cleanup costs. New Rule 3003(c) would read as follows:

(c) Filing Proof of Claim.
   ... (2) Who Must File. Any creditor or equity security holder whose claim or interest is not scheduled, scheduled as disputed, contingent, or unliquidated, or scheduled as a right to payment by the environmental authorities for response costs shall file a proof of claim . . .

This amendment to Rule 3003(c) would expedite the claims process and serve the interests of both the debtor and the environmental agency by requiring an estimate of the costs of cleanup. Only by requiring a proof of claim to be filed by the agency can the court hope to make a sound estimation.

Proposed amendment to 11 U.S.C. § 507 providing priority status to environmental claims

This section establishes that certain claims are entitled to priority status. Congress determined that these special claims should be treated before all other unsecured claims in order to facilitate the reorganization process.

Section 507(a)(7) applies specifically to "allowed unsecured claims of governmental units," and includes taxes or customs duties and accompanying penalties. The Code defines "governmental unit" broadly so as not to include only taxing and customs authorities. Governmental units typically hold claims with no listed security, such as a tax claim or a customs duty. Since the definition has such breadth, environmental authorities fall within "governmental unit" for bankruptcy purposes. Furthermore, environmental claims for response costs should fall within this section as priority claims.

Amending section 507(a)(7) requires only an additional section with no change to the introduction. This new section would become a part of existing section 507(a)(7) since Congress, to remain consistent, should treat environmental obligations on a par with other claims of governmental units. This new section would precede current section 507(a)(7)(G), which provides priority for penalties related to these claims (section 507(a)(7)(G) would then become section 507(a)(7)(H)). The penalty would apply with equal force to environmental violations and therefore should remain the final provision within the section.

New section 507(a)(7)(G) would read as follows:

(a) The following expenses and claims have priority in the following order:

(7) Seventh, allowed unsecured claims of governmental units, only to the extent that such claims are for—

. (G) response costs under 42 U.S.C. § 9607 [CERCLA], or any similar federal or state environmental provision, including—

(i) any amount of settlement between the debtor and the EPA or the state equivalent, or

(ii) an estimation under 502(c)(3) of this title for environmental response costs.

182. Id. § 507(a)(7).
183. Id. § 101(26).
184. Another commentator argues that environmental obligations should receive a higher priority than the tax claims within § 507(a)(7). Claar, supra note 14, at 55. Consistency will be better served by merely including environmental claims within the existing framework of § 507(a)(7), which is intended to apply to governmental units generally, such as the Internal Revenue Service and the U.S. Customs Service.
This amendment would include claims by the EPA and state departments of environmental management against the reorganizing debtor. The provision would allow debtors to reorganize with consideration of all pre-petition environmental claims, avoiding "sudden death" for the debtor while treating governmental units consistently. Other provisions throughout the Code that reference section 507(a)(7), such as section 1129(a)(9)(C), would remain unaffected textually by the change, but these provisions would apply with equal force to environmental obligations.

APPENDIX C

Proposed amendment to Bankruptcy Rule 4001 to preserve adequate protection for secured creditors

By amending Rule 4001, Congress would protect creditors from having their collateral depleted to finance environmental reclamation projects. An amendment would specifically condition the use of estate property on court authorization and provision of adequate protection. Interposing the judicial process before applying estate property for an environmental reclamation would guide the parties and protect creditors in the environmental claims process.

New Rule 4001(e) would read as follows:

(e) ADEQUATE PROTECTION. The court shall authorize the use of any estate property for environmental reclamation only upon the provision of adequate protection to the secured party.

This amendment merely states in the environmental context what is observed in other situations: that adequate protection is a constitutionally mandated requirement in bankruptcy. The amendment would recognize the unique nature of environmental claims and would provide explicit guidance in a difficult process.