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ENVIRONMENTAL LAW

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Bankruptcy Law, Meet Environmental Law

Resolution of the tension between abandonment under the Bankruptcy Code and environmental protection under ISRA remains a work in progress

A battle has waged in the federal courts concerning a bankruptcy trustee's substantively unlimited statutory power of abandonment and the state's power and right to protect the public's health and safety.

The U.S. Bankruptcy Code states that "[a]fter notice and a hearing, the trustee may abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate." 11 U.S.C. §554(a).

The New Jersey Industrial Site Recovery Act, N.J.S.A. 13:1K-6 et seq., and its implementing regulations, N.J.A.C. 7:26B-1 et seq., on the other hand, are designed to ensure against unnecessary risks to public health and the environment.

The U.S. Supreme Court imposed a limitation on the trustee's abandonment power in *Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection,* 474 U.S. 494 (1986). There, Quanta Resources Corporation processed waste oil at facilities in New York and New Jersey. The facilities were polluted.

During negotiations with the New Jersey Department of Environmental Protection for the remediation of the New Jersey site, Quanta filed a petition for reorganization under Chapter 11 of the United States Bankruptcy Code. The next day, the DEP issued an administrative order requiring Quanta to clean up the New Jersey site.

Subsequently, Quanta converted its reorganization proceeding to a liquidation proceeding under Chapter 7. In Chapter 7, the bankruptcy trustee determined the property was suited for abandonment pursuant to §554(a) of the Bankruptcy Code. The DEP objected on the grounds that abandonment would place the public health and safety at risk due to the large number of drums of hazardous substances stored onsite and the proposed termination of security and fire suppression systems. The Bankruptcy Court ruled in favor of the bankruptcy trustee and the DEP appealed.

The Third U.S. Circuit Court of Appeals reversed, holding that the Bankruptcy Court erred in permitting abandonment. See *In re Quanta Resources Corp.*, 739 F.2d 912 (3d Cir. 1984). The Court of Appeals concluded that it was the intent of Congress in enacting the Code to codify the common law abandonment practice developed under the Bankruptcy Act, the predecessor of the Code.

Under the act, certain public interests protected by state law or principles of equity overrode the common law abandonment power. The Court of Appeals remanded for further proceedings. Midlantic National Bank appealed.

The U.S. Supreme Court affirmed the decision of the Third Circuit holding that, in enacting §554(a), Congress did not intend to pre-empt all state and local laws. Thus, a trustee may not abandon property if such abandonment would contravene a state statute or regulation that is reasonably designed to protect the public health or safety from known hazards.

The Court was not persuaded by the trustee's argument that if Congress had intended to limit the abandonment power, Congress would have expressly included such language in §554(a). The Court stated, "When Congress enacted §554, there were well-recognized restrictions on a trustee's abandonment power. In codifying the judicially developed rule of abandonment, Congress also presumably included the established corollary that a trustee could not

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exercise his abandonment power in violation of certain state and federal laws."

The Court reasoned that the Bankruptcy Court, which had overruled the DEP's objection to the trustee's abandonment decision, did not have the power to authorize abandonment without formulating appropriate conditions that will adequately protect the public's health and safety.

In *Midlantic*, the Court did not specifically address the trustee's abandonment power in contravention of ISRA. However, in *In re: St. Lawrence Corp.*, 248 B.R. 734 (Bankr. D.N.J. 2000), the U.S. District Court for the District of New Jersey addressed that very issue. There, the district court affirmed the Bankruptcy Court's denial of the DEP's objection to the bankruptcy trustee's abandonment decision. This affirmation was founded on the *St. Lawrence* court's determination that (1) an identified hazard did not exist and (2) ISRA is not reasonably designed to protect human health and safety from imminent and identifiable harm.

The DEP did not base its objection in *St. Lawrence* on any known environmental condition, but rather on the fact that the trustee did not comply with ISRA. No evidence was offered by the NJDEP that the property was contaminated.

Moreover, the *St. Lawrence* court stated that, based on its reading of the legislative findings contained in ISRA, the purpose of that statute included goals other than protecting public health and safety. The court reasoned that ISRA, as it was specifically being applied by the DEP in the *St. Lawrence* case, was not applied in a way that was "reasonably calculated to protect public health and safety from imminent and identifiable harm caused by identified hazards."

One could argue that the *Midlantic* Court's holding does not require that the only purpose of a given statute be to protect public health and safety and, thus, ISRA does satisfy the *Midlantic* exception. However, the *St. Lawrence* court astutely observed that ISRA itself recognizes that the harm it addresses may not be imminent because it permits remediation to be deferred under certain circumstances, for example, by execution of a remediation agreement.

On the other hand, all remediation projects take time, and the ability to defer such obligations under ISRA only defers the completion of the project, not commencement of the cleanup activities.

Discharge of General ISRA Obligations in Bankruptcy

Pursuant to *Midlantic* and *St. Lawrence*, noncompliance with ISRA is not an absolute bar to a trustee's abandonment power. Nevertheless, one question that remains is whether a party responsible for conducting a remediation pursuant to ISRA (or pursuant to its predecessor, the Environmental Cleanup and Recovery Act), may discharge its liability in a bankruptcy proceeding. This specific issue was addressed in *In re: Torwico Electronics, Inc.*, 8 F.3d 146 (3d Cir. 1993).

Torwico involved a company that operated on leased property and, shortly after termination of the lease, executed an agreement with the property owner to share the costs of ECRA compliance. Some four years later, Torwico filed a Chapter 11 bankruptcy petition listing the DEP as a creditor with a disputed and unliquidated claim.

A subsequent DEP site inspection discovered an illegal seepage pit containing hazardous wastes that were allegedly migrating into local waters. Although the DEP issued notices of violation for the seepage pit, it filed no proof of claim prior to the deadline established by the Bankruptcy Court. Almost one year later, the DEP issued to both Torwico and to the property owner an additional notice of violation for failure to comply with ECRA.

Because debts may be discharged upon confirmation of a plan of reorganization under Chapter 11, the issue addressed by the Third Circuit in *Torwico* was whether the debtor's ECRA obligations are a "debt." Section 101(12) of the code defines a "debt" as a "liability on a claim." A claim is defined under §101(5) as, among other things:

> (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or
>
> (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

The Third Circuit stated that the state, in enforcing its environmental regulatory powers, may force a debtor to comply with such laws even if the debtor must thereby expend money. The state cannot, however, force a debtor to pay money to the state. Such an order would convert the state from a regulator to a creditor and thereby make the state's claim a dischargeable debt under the code.

Under ECRA, the state had no right to payment but rather a right to force the debtor to comply with ECRA by remedying an existing hazard. In such a case, the court ruled, the debtor's obligations are not a claim and are therefore not dischargeable.

As to the issue of the priority assigned to a responsible party's ISRA obligations in a bankruptcy proceeding, the U.S. Bankruptcy Court for the District of New Jersey has held that ECRA obligations are unsecured claims and, thus, do not take priority over secured claims of a financing creditor. See *In re Corona Plastics, Inc.*, 99 B.R. 231 (Bankr. D.N.J. 1989).

Corona Plastics involved a motion by the Chapter 11 trustee seeking a determination that it need not comply with ECRA prior to surrendering a vacating debtor tenant's collateral to a secured creditor. The trustee had already obtained court approval to retain an environmental consultant to investigate the subject property in anticipation of ECRA compliance. The consultant, however, determined that soil borings and tank investigations would be necessary prior to submitting the requisite documentation to the NJDEP. The debtor's secured creditor refused to supply the funds necessary for such investigation

The *Corona Plastics* court refused

to apply the *Midlantic* exception to the trustee's abandonment power because (1) the case at bar involved the turnover of the debtor's collateral by the trustee and not abandonment of real estate and (2) there was no proof of any environmental threat.

In supporting the trustee's position, the court held that "even if it were inclined to grant administrative status for cleanup costs, these [ECRA] claims would be general unsecured claims and would not take priority over the secured claim of" the financier. See also *In re Synfax Manufacturing, Inc.,* 126 B.R. 30 (1990), where the court held that a landlord's claim for ECRA costs were subordinate to that of the secured creditor.

The court further refused to hold the secured creditor liable for the debtor's ECRA compliance under the asserted theory that its supervision of the day-to-day operations of the facility rose to the level of site operation.

Because no higher court has addressed the issue, the *Corona Plastics* court's ruling may still leave open the issue of whether the ISRA (or ECRA) obligations of a site operator take priority over claims of a secured creditor. See *In re KAR Development Associates, L.P.*, 180 B.R. 629 (1995), where the court stated that a district court's bankruptcy decisions do not bind other district judges within the same district or the bankruptcy courts.

Noncompliance with ISRA does not bar abandonment under §554(a) of the code. The state can, on the other hand, compel an owner (or prior owner) of a site who is responsible for ISRA compliance to satisfy the requirements of the statute. The state cannot, however, mandate that the debtor pay money in lieu of complying with ISRA.

Finally, because no higher court has addressed the issue, it is unclear whether an operator's ISRA liability may take priority over claims made by a secured creditor. As a result, resolution of the tension between abandonment under the Bankruptcy Code and environmental protection under ISRA remains a work in progress. ■