

After Apex, Debtors Must Clean Up After Themselves

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The Supreme Court recently denied *certiorari* in *U.S. v. Apex Oil Company, Inc.*,¹ which dealt with the issue of whether an injunction requiring a debtor to clean up contaminated property, which would cost \$150 million, creates a “right to payment” qualifying as a “claim” subject to discharge under § 101(5)(B) of the Bankruptcy Code.² From a debtor’s perspective, an order compelling it to spend money on an environmental cleanup has the same effect as an order compelling it to pay damages on a contract or tort claim. In each scenario, the debtor has incurred a monetary obligation based on pre-petition events.



Ji Hun Kim

Although many hoped that the Court would grant *certiorari* and clarify a confusing area within bankruptcy law, the consequence of the Court’s refusal reinforces the argument that the government’s right to compel a debtor to perform an environmental cleanup is not dischargeable in bankruptcy. This article covers the concepts invoked by the *Apex* decision by analyzing the definition of a “claim” under the Code, deconstructing the *Ohio v. Kovacs*³ and *Apex* decisions, and finally anticipating the consequences of the Supreme Court’s denial of *certiorari*.

What Is a “Claim”?

The Code provides for the discharge of “debts,” which are defined as a “liability on a claim.”⁴ Congress assigned two definitions to the term “claim.” A claim means a “right to payment,”⁵ whether the right is “reduced to judgment, liquidated,

¹ *U.S. v. Apex Oil Co. Inc.*, 579 F.3d 734, 735 (7th Cir. 2009), cert. denied, 2010 WL 752322, *1 (U.S.).

² 11 U.S.C. § 101(5)(B).

³ *Ohio v. Kovacs*, 469 U.S. 274 (1985).

⁴ 11 U.S.C. § 101(12).

⁵ 11 U.S.C. § 101(5)(A).

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unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal equitable, secured or unsecured.”⁶ It also means a “right to an equitable remedy for breach of performance,” such as the right to compel a debtor to do something other than pay money, so long as “such breach gives rise to a right to payment.”⁷

The key for determining whether an environmental obligation is dischargeable in bankruptcy is whether the obligation creates a “right to payment.” Courts take different approaches to assess whether an injunction meets this

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standard.⁸ The confusion likely stems from the fact that the definition under § 101(5)(B) does not articulate the meaning of “gives rise to a right to payment.”

An environmental claim is usually one of three types: an obligation to (1) pay money, (2) perform a cleanup or (3) refrain from polluting in the future.⁹ As a general matter, environmental claims requiring a payment of money are dischargeable. Furthermore, an obligation to clean up a site is dischargeable if the creditor can recover cleanup costs in lieu of performance, since that makes it an equitable claim dischargeable through the payment of money.¹⁰

However, much of the confusion regarding environmental claims comes from those claims that cannot be read-

ily converted into money damages. For example, an obligation to refrain from polluting in the future is not dischargeable, since payment is usually not acceptable in lieu of continuing to pollute.¹¹ The more difficult question is whether an obligation to perform a cleanup pursuant to an injunction, which does not allow for payment in lieu of performance (despite significant costs to the debtor), constitutes a dischargeable claim.

The Kovacs Decision



Nicholas M. McGrath

A discussion on the dischargeability of environmental injunctions must begin with *Ohio v. Kovacs*.¹² In *Kovacs*, the Supreme Court decided that an injunction obligating a debtor to clean up hazardous waste constituted “a ‘debt’ or ‘liability on a claim’ subject to discharge under the Bankruptcy Code.”¹³ A “discharge in

bankruptcy discharges the debtor from all debts that arose before bankruptcy.”¹⁴ The state of Ohio argued that the obligation was not dischargeable because it was not a “debt” or “liability on a claim” as it had no “right to payment” from the debtor.¹⁵ An assertion of an equitable remedy against a debtor is a claim if “breach of performance [under the injunction]...gives rise to a right of payment.”¹⁶ The Court analyzed whether Ohio’s injunction requiring cleanup was an equitable remedy that gave rise to a right of payment.¹⁷

Prior to bankruptcy, Ohio obtained an injunction against William Kovacs and his company, which operated an industrial and waste disposal site.¹⁸ The injunction affirmatively required the defendants to remove the specified waste and pay \$75,000 to Ohio to compensate for injury to wildlife. Furthermore, it enjoined the defendants from bringing

¹¹ *Id.*

¹² See *Kovacs*, 469 U.S. 274 (1985).

¹³ *Id.* at *279.

¹⁴ *Id.* at *278 (citing 11 U.S.C. §§ 523(a), 727(b)).

¹⁵ *Id.* at *279.

¹⁶ 11 U.S.C. § 101(4)(B) (predecessor to 11 U.S.C. § 101(5)(B)).

¹⁷ *Kovacs*, 469 U.S. at *275.

¹⁸ *Id.* at *276.

additional waste onto the sites and from polluting in the future.¹⁹

The defendants, including Kovacs, failed to perform as required under the injunction, and Ohio appointed a receiver to take possession of all the defendants' assets in an effort to comply with the injunction.²⁰ However, Kovacs filed for bankruptcy before the receiver completed its task.²¹ As a result, Ohio sought to levy Kovacs' future earnings on account of his affirmative obligation under the injunction to clean up the sites.²²

The Supreme Court granted *certiorari* and subsequently affirmed the decisions of the lower courts, ruling that Kovacs' obligation under the injunction was a claim that was dischargeable in bankruptcy.²³ The Court dismissed the state's contention that only breaches of contract—not breaches of statutes—can give rise to a right of payment.²⁴ It held that Congress broadly defined "claim" and knew how to limit the application of Bankruptcy Code provisions to contracts, but chose not to do so here.²⁵ Further, the Court found comfort in the legislative history:

Section 101(4)(B)...is intended to cause the liquidation or estimation of contingent rights of payment for which there may be an alternative equitable remedy with the result that the equitable remedy will be susceptible to being discharged in bankruptcy. For example, in some States, a judgment for specific performance may be satisfied by an alternative right to payment in the event performance is refused; in that event, the creditor entitled to specific performance would have a claim for purposes of a proceeding under title 11.²⁶

Moreover, the state conceded that the injunction requiring Kovacs to pay \$75,000 was a dischargeable claim, and that liability was also based upon a breach of statute.²⁷ The Court further rejected Ohio's contentions that it had no right to payment,²⁸ and found that Kovacs was precluded from personally performing the clean-up, because Ohio had divested him of the property and all

his assets when a receiver was appointed.²⁹ Therefore, Kovacs' ability to satisfy his obligation could only be achieved by "paying money or transferring over his own financial resources."³⁰ In fact, the only type of performance that Ohio was interested in was a money payment,³¹ and conceded this based on its "steadfast pursuit of payment as an alternative to personal performance."³² It was the state that chose to appoint a receiver and effectively remove Kovacs' authority over the hazardous waste site, rather than prosecute him "under the environmental laws or bring civil or criminal contempt proceedings."³³ It was clear to the Court that Ohio would have been satisfied if Kovacs had produced the requisite funds.³⁴ As such, the Court held that the "cleanup order had been converted into an obligation to pay money, an obligation that was dischargeable in bankruptcy."³⁵

Interestingly, the Court took great care to limit its holding,³⁶ and Kovacs was not discharged from prosecution under environmental laws, or from criminal contempt.³⁷ It also expressed that its ruling does "not address what the legal consequences would have been" had Kovacs gone into bankruptcy "before a receiver had been appointed and a trustee had been designated."³⁸ The Court held that the injunctions forbidding Kovacs from bringing further wastes on the premises or further polluting were not dischargeable in bankruptcy,³⁹ while his obligation to pay \$75,000 under the injunction was dischargeable.⁴⁰

The Apex Decision

A hydrocarbon plume composed of millions of gallons of oil contaminating the groundwater and emitting toxic fumes near residential homes compelled a district judge to issue a treatise-length opinion demanding that Apex Oil Co. rectify the nuisance created by one of its corporate predecessors.⁴¹ Unfortunately, when the court issued its decision, Apex was no longer in the refining business and had no means with which to clean the contaminated site.⁴² Apex's only remedy was to hire an outside company for \$150 mil-

lion.⁴³ Apex appealed to the Seventh Circuit, challenging the injunction requiring it to clean up the contaminated site.⁴⁴ On appeal, the principal question was whether the "government's claim to an injunction was discharged in bankruptcy and therefore [could not] be renewed in a subsequent lawsuit."⁴⁵

The court began its analysis by explaining that when a bankruptcy judge confirms a claim in a chapter 11 proceeding, it discharges the debtor from "any debt that arose before the date of" confirmation.⁴⁶ To understand exactly what debts are included in this phrase, the court looked at the definitions of "debt" and "claim" provided in §§ 101(12) and 101(5)(A) and (B).⁴⁷ The court discerned that the natural reading of these statutory provisions suggests that "if the holder of an equitable claim can, in the event that the equitable remedy turns out to be unobtainable, obtain a money judgment instead, the claim is dischargeable."⁴⁸ Such a reading dispels the myth that "equitable remedies are always orders to act or not to act, rather than to pay."⁴⁹

The court pointed out that the Environmental Protection Agency's (EPA) equitable claim based on the Resource Conservation and Recovery Act of 1976 (RCRA), 42 U.S.C. §§ 6901, which it was relying on to require Apex to clean the contaminated site, did not entitle the government to demand payment in lieu of Apex cleaning up the site.⁵⁰ As a result, the RCRA only empowered the EPA to require Apex to clean up the contaminated site rather than receive payments instead, and was therefore nondischargeable.⁵¹

In response to the court's interpretation of §§ 6973(a) and 6972(a)(2), Apex argued that the cost of complying with the provision should be considered a monetary claim, and therefore dischargeable.⁵² The court rejected this argument, stating that the cost to Apex is "not a 'right [of the plaintiff] to payment.'"⁵³ The court reasoned that adopting Apex's position would allow every equitable claim to be discharged unless there was a specific exception in the Code, which is clearly inconsistent with § 101(5)(B).⁵⁴

19 *Id.*

20 *Id.*

21 *Id.*

22 *Id.* at *282 (citing *Ohio v. Kovacs (In re Kovacs)*, 717 F.2d 984, 987-88 (6th Cir. 1983)).

23 *Id.* at *280.

24 *Id.* at *279.

25 *Id.*

26 *Id.* at *280 (citing 124 Cong. Rec. 32393, 33992 (1978); Sen. DeConcini and Rep. Edwards).

27 *Id.*

28 *Id.* at *279.

29 *Id.* at *282-83.

30 *Id.* at *282 (citing *Kovacs*, 717 F.2d at *987-88).

31 *Id.* at *283.

32 *Id.* at *282-83 (citing *Kovacs*, 717 F.2d at *988).

33 *Id.* at *282.

34 *Id.* at *283.

35 *Id.*

36 *Id.* at *284.

37 *Id.*

38 *Id.*

39 *Id.* at *285.

40 *Id.* at *280.

41 *U.S. v. Apex Oil Co. Inc.*, 579 F.3d 734, *735 (7th Cir. 2009).

42 *Id.* at *737.

43 *Id.*

44 *Id.* at *735.

45 *Id.*

46 *Id.* (citing 11 U.S.C. § 1141(d)(1)(A)).

47 *Id.* at *736.

48 *Id.*

49 *Id.*

50 *Id.*

51 *Id.* at *737.

52 *Id.*

53 *Id.*

54 *Id.*

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The court stressed that Apex's position would "discourage polluters from developing an internal capability of cleaning up their pollution, even if hiring third parties...would be more expensive."⁵⁵

To support its decision, the Seventh Circuit distinguished the case from *Ohio v. Kovacs* and *U.S. v. Whizco*. In *Kovacs*, the debtor failed to comply with an injunction ordering it to clean up a contaminated site, so a receiver was appointed to take possession of his assets in order to obtain money to effectuate the clean-up.⁵⁶ Ultimately, the Supreme Court allowed the discharge of the debtor's equitable obligation to clean up the contaminated site.⁵⁷ The Seventh Circuit explained that *Kovacs* was inconsistent with the case facts because the authority that the receiver was relying on permitted him to seek money in lieu of a specific act from the debtor, and therefore the claim was dischargeable.⁵⁸

Turning to *U.S. v. Whizco*, the court acknowledged that the case supported Apex's position. However, it could not square the decision with others that held "cost incurred is not equivalent to 'right of payment.'"⁵⁹ Furthermore, the court expressed concern that *Whizco* failed to set forth a limiting principle to distinguish cases under the RCRA from other cases where compliance with an equitable decree required the defendant to spend money.⁶⁰ Due to the sparse and distinguishable case law dealing with the discharge of claims like Apex's, the court determined that the discharge of such claims must be limited to claims that permit a right to payment if the equitable decree cannot be executed, and exclude those claims that merely impose a cost on a defendant.⁶¹

Apex made two additional arguments in support of its position. First, it argued that denying it a discharge "disserves the government's long-term interest in envi-

ronmental quality" by precluding reorganization in bankruptcy.⁶² Specifically, Apex claimed that had it known it would have been liable for the clean-up costs when it filed for bankruptcy, it would have liquidated rather than reorganized.⁶³ Second, Apex argued that the injunction was vague and that Rule 65(d) requires an injunction to "state its terms specifically" and "describe in reasonable detail...the act...required."⁶⁴

The Seventh Circuit dispensed with Apex's first argument, stating that the EPA took the position that it would be better off if the cost of clean-up was not dischargeable, rather than risking some businesses liquidating rather than reorganizing.⁶⁵ Addressing Apex's second argument, the court agreed that the injunction was not so much vague as it was open-ended, since it did not specify the criteria for the EPA's approval of Apex's efforts in cleaning up the contaminated site.⁶⁶ The court acknowledged that "a degree of ambiguity is unavoidable" in an order such as this, and if Apex wished to resolve any ambiguity, it could always seek clarification or modification.⁶⁷ Thus, the Seventh Circuit held that the EPA's claim was not discharged, and that the injunction was specific enough to satisfy the requirements of Rule 65(d).

The Aftermath of Apex

As the case history suggests, courts do not have a strong grasp on how to address the issue of whether environmental claims are dischargeable in bankruptcy. While it is true that the Supreme Court's denial of *certiorari* in *Apex* reinforces the thought that the government's right to compel a debtor to perform a cleanup might not be dischargeable in bankruptcy, there are still several unanswered questions.

One issue left unanswered is how to treat injunctions that arise under a statute that provides the government with an

alternative right to cost recovery, such as the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA).⁶⁸ The analysis in *Apex* relies on the fact that the Supreme Court previously concluded that the RCRA does create a cause of action for recovery of clean-up costs.⁶⁹ Therefore, the *Apex* decision suggests that CERCLA injunctions may be treated as "claims" and subject to discharge in bankruptcy because the statute expressly gives the government the right to sue for recovery of cleanup costs.⁷⁰

However, the Seventh Circuit also based its decision on the determination that the definition of "claim" only includes those equitable remedies, which gives "rise to a right to payment because the equitable decree cannot be executed."⁷¹ This seems to suggest that a CERCLA injunction would not be treated as a "claim" if it is capable of execution.⁷² While *Apex* provides further clarity on the issue of whether an RCRA cleanup injunction may be discharged in bankruptcy, the law remains unclear with respect to obligations under other environmental laws.

Practically, the Supreme Court's decision not to review the Seventh Circuit's ruling may encourage federal and state governments to rely more on the RCRA and other environmental statutes that do not permit the recovery of money, rather than CERCLA. Furthermore, *Apex* reminds reorganizing debtors that its discharge is not going to protect it from injunctions to perform environmental clean-ups in the future. This will force a reorganizing debtor to either settle its environmental obligations with the state or federal governments, or emerge as a new entity with sufficient financial resources to meet any clean-up obligations. Either way, you are going to have to clean up after yourself. ■

⁵⁵ *Id.* at *738.

⁵⁶ *Id.* at *737 (citing *Ohio v. Kovacs*, 469 U.S. 274 (1985)).

⁵⁷ *Id.*

⁵⁸ *Id.*

⁵⁹ *Id.* at *738 (citing *United States v. Whizco Inc.*, 841 F.2d 147, *150-51 (6th Cir. 1988)).

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² *Id.*

⁶³ *Id.*

⁶⁴ *Id.* at *739.

⁶⁵ *Id.*

⁶⁶ *Id.*

⁶⁷ *Id.* at *740.

⁶⁸ 42 U.S.C. §§ 9601-9675.

⁶⁹ Adam Stochak and Erin Yates, "Seventh Circuit Holds that Reorganized Debtors Must Comply with a RCRA Cleanup Order Because the Mandatory Cleanup Injunction Is Not a 'Claim' Discharged in a Prior Chapter 11 Bankruptcy," LEXSEE 2009 Emerging Issues 4637 (November 2009).

⁷⁰ See *id.*

⁷¹ *Id.*

⁷² *Id.*

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