Treatment of CERCLA Claims for Hazardous Waste Cleanup Costs in Bankruptcy

by Christopher Dow

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I. Recession's Impact on Cleanup Litigation

According to a September 2010 report of the Business Cycle Dating Committee of the National Bureau of Economic Research, the nationwide recession that began in December 2007 ended in June 2009, although this fact does not mean that economic conditions since that time "have been favorable or that the economy has returned to operating at normal capacity."[1] In this challenging economic climate, it is not uncommon for some companies who are potentially responsible parties (PRPs) involved in hazardous substances cleanup litigation under the federal Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA)[2] to file for bankruptcy protection. Where government authorities propose to spend millions of dollars to clean up hazardous substances at a site, and where one or more of the PRPs potentially liable for these costs files for bankruptcy protection, the following question necessarily arises: What steps can the remaining solvent PRPs involved in the litigation take to try to ensure that funds of the insolvent PRP (debtor-PRP) are preserved for cleanup? The answer can depend in part on what CERCLA claims for relief a solvent PRP is asserting, i.e., a CERCLA §107 claim for cleanup costs that the PRP has itself expended to clean up a site, or a CERCLA §113 claim for contribution for any costs that the PRP may have to pay over to another PRP, or the state or federal government, who has incurred costs in cleaning up hazardous substances at a site.

II. Cost Recovery and Contribution Claims in Bankruptcy

The "principal purpose" of the federal Bankruptcy Code (the Code) is to preserve the assets of the "honest but unfortunate debtor," so that these may be distributed among creditors in a final satisfaction, or "discharge," of these debts, and to enable the creditor to get an economic "fresh start."[3] The Code defines "debt" as a "liability on a claim."[4] A "claim" is broadly defined by the Code to include virtually any right to payment, even if the right is not certain, but is "disputed," "unliquidated," "unmatured," or "contingent."[5] The U.S. Supreme Court has determined that a debtor's state-law environmental liability can be a "claim" subject to discharge under the Code if the creditor's claim for relief amounts to a suit for the payment of money.[6] More specifically, other courts have determined that a claim for incurred response costs brought under CERCLA §107 is a "claim" that can be discharged under the Code, even if that claim is brought by the government or a state government.[7] As a general rule, a PRP who holds a claim participates in the debtor-PRP's bankruptcy case and in the bankruptcy distribution.[8] However, there are exceptions to this rule.

Many courts have "disallowed" a creditor-PRP's CERCLA §113 claims from proceeding in bankruptcy.[9] That is, CERCLA contribution claims are generally not included in the debtor's bankruptcy estate, and therefore, unlike allowed claims, do not have a chance to be partially or fully satisfied by any monies from the bankruptcy estate. This is because the Code provides that a bankruptcy court

1. *See* http://www.nber.org/cycles/sept2010.html.
2. 42 U.S.C. §§9601-9675, ELR Stat. CERCLA §§101-405.
3. Marrama v. Citizens Bank of Massachusetts, 549 U.S. 365, 367 (2007); 11 U.S.C. §§101-1532.
4. 11 U.S.C. §101(12).
5. 11 U.S.C. §101(5).
6. Ohio v. Kovacs, 469 U.S. 274, 282-83, 15 ELR 20121 (1985).
7. *See, e.g.*, In re Chateaugay Corp., 944 F.2d 997, 1005, 21 ELR 21466 (2d Cir. 1991); In re Jensen, 127 B.R. 27, 33 (B.A.P. 9th Cir. 1991), *aff'd*, 995 F.2d 925, 23 ELR 20991 (9th Cir. 1993).
8. *See* 11 U.S.C. §§726, 1129.
9. *See, e.g.*, In re Eagle-Picher Industries, Inc., 131 F.3d 1185, 1190, 28 ELR 20492 (6th Cir. 1997); In re Hemingway Transport, Inc., 993 F.2d 915, 923, 23 ELR 20953 (1st Cir. 1993); In re Charter Co., 862 F.2d 1500, 1503 (11th Cir. 1989); In re Eagle-Picher Industries, Inc., 144 B.R. 765, 770 (Bankr. S.D. Ohio 1992), *aff'd*, 164 B.R. 265 (S.D. Ohio 1994); In re Eagle-Picher Industries, Inc., 197 B.R. 260, 277 (Bankr. S.D. Ohio 1996); In re Cottonwood Canyon Land Co., 146 B.R. 992, 997 (Bankr. D. Colo. 1992).

"shall disallow any claim for reimbursement or contribution of an entity *that is liable with the debtor* . . . to the extent such claim . . . is contingent as of the time of allowance or disallowance of such claim for reimbursement or contribution."[10] In other words, in a situation where the creditor-PRP and the debtor-PRP are both potentially liable to a third party, such as the government or another PRP, for the same cleanup costs at a site, the bankruptcy courts will not allow the creditor-PRP to collect from the debtor-PRP via the creditor-PRP's claim for contribution under CERCLA §113. The rationale is that the Code discourages two parties from competing to collect the same debt from the debtor-PRP where the purpose of the Code "is to preclude redundant recoveries on identical claims against insolvent estates in violation of the fundamental Code policy fostering equitable distribution among all creditors of the same class."[11] A CERCLA §113 claim is therefore disallowed unless the creditor-PRP's CERCLA liability is determined and it has paid monies over to the third party to satisfy this liability, thereby negating the possibility that the third party will also pursue the debtor-PRP for these monies.[12]

Given the often slow pace of multiparty CERCLA litigation, as compared to the relatively speedy bankruptcy process, in the vast majority of cases, it is unlikely that a creditor-PRP's CERCLA liability will be determined, and monies paid over, before the "bar date"—the deadline for creditors of the insolvent PRP to file their proofs of claim with the bankruptcy court. In fact, it appears that all courts that have addressed the treatment of CERCLA §113 actions in bankruptcy have found that these claims must be disallowed. Therefore, it is more than likely that a PRP's pending CERCLA contribution suit will amount to a claim that has no chance to receive payment from the debtor-PRP's bankruptcy estate under the Code.

Meanwhile, a creditor-PRP's claims based on a CERCLA §107 suit for cost recovery are allowed to proceed in bankruptcy and to potentially share in any distribution from the debtor's bankruptcy estate.[13] This is because, unlike a CERCLA §113 contribution claim, a CERCLA §107 claim does not involve shared liability to a third party that could result in the creditor-PRP and the third party competing for the same funds in the debtor-PRPs bankruptcy estate.[14] Thus, allowing a creditor-PRP with a CERCLA §107 claim the opportunity to collect from the bankruptcy estate does not run afoul of Code policy.

III. "Piggy-Backing" Onto the Government's Good Claim

A case can arise where the PRP filing for bankruptcy is potentially responsible for a significant portion of the cleanup at a site, but the remaining solvent PRPs have only asserted CERCLA §113 contribution claims, either because they have not incurred their own costs of response at the site, or are otherwise precluded from bringing CERCLA §107 cost-recovery claims. For instance, if the remaining PRPs were compelled to clean up the site by government authorities, they may have no claim for relief for CERCLA cost recovery, and may only bring CERCLA contribution claims.[15] Further, the government may decide not to pursue the insolvent PRP in bankruptcy, or may simply neglect to file a proof of claim before the bar date.[16] In these circumstances, a creditor-PRP can be left in a situation where it has no chance to recover from the debtor-PRP in bankruptcy, and could potentially get stuck with all or some of the debtor-PRP's cleanup share.

In some circumstances, the situation discussed above can be avoided. A creditor-PRP that does not have a viable bankruptcy claim against the debtor-PRP can essentially "piggy back" onto the federal or state government's CERCLA §107 or other bankruptcy-viable claim by filing a proof of claim on the government's behalf under Code §501(b). Code §501(b) provides: "If a creditor does not timely file a proof of such creditor's claim, *an entity that is liable to such creditor with the debtor* . . . may file a proof of such claim."[17] A solvent PRP who shares CERCLA liability to the government with the debtor-PRP is an entity who is liable to a creditor, i.e., the government, with the debtor-PRP. In the context of a CERCLA case where several PRPs may have liability to the government for the same contaminated site, the policy underlying Code §501(b) is to avoid a situation where the government decides to pursue only the solvent PRPs and ignore the insolvent PRP, collects monies from the solvent PRPs over and above their equitable share of cleanup costs, and leaves the solvent PRPs unable to collect in contribution from the insolvent PRP where the debtor-PRP's bankruptcy estate is now fully administered and all debts are discharged.[18] Using this "surrogate claim" procedure, a creditor-PRP can maximize the chances that at least some of the debtor-PRP's bankruptcy estate will be set aside for site cleanup.

10. 11 U.S.C. §502(e)(1)(B) (emphasis added).
11. In re APCO Liquidating Trust, 370 B.R. 625, 634 (Bankr. D. Del. 2007).
12. *Id.* at 636 (citing authority from bankruptcy courts in the U.S. Court of Appeals for the Second, Third, and Sixth Circuits).
13. *See, e.g.*, In re Dant & Russell, Inc., 951 F.2d 246, 248-49, 22 ELR 20239 (9th Cir. 1991); In the Matter of Harvard Industries, Inc., 153 B.R. 668, 672 (Bankr. D. Del. 1993).
14. *See id.*
15. *See, e.g.,* Appleton Papers Inc. v. George A. Whiting Paper Co., 572 F. Supp. 2d 1034, 1042-43, 38 ELR 20231 (E.D. Wis. 2008); W.R. Grace & Co.-Conn. v. Zotos Int'l Inc., 559 F.3d 85, 9439 ELR 20066 (2d Cir. 2009); Ashland Inc. v. GAR Electroforming, 729 F. Supp. 2d 526, 544 (D.R.I. 2010).
16. This was the circumstance in *In re Hemingway Transport*, as the U.S. Environmental Protection Agency claimed it did not have notice of the debtor-PRP's bankruptcy filing. 993 F.2d 915, 923 n.14, 23 ELR 20953 (1st Cir. 1993).
17. 11 U.S.C. §501(b) (emphasis added); In re Hemingway Transport, Inc., 993 F.2d at 927 (referring to such a filing as the "surrogate-claim procedure" and pointing out that this procedure is unnecessary if the government files its own proof of claim).
18. *In re Hemingway Transport*, 993 F.2d at 927 n.14.

IV. Priority for Government Cleanup Cost Claims

A potential advantage of filing a claim on behalf of the government is that government CERCLA claims have been granted payment priority over other competing bankruptcy claims by the courts, and are therefore more likely to receive payment from the bankruptcy estate than environmental claims by private PRPs. Because the Code creates no payment priority for environmental claims, the general rule is that environmental claims have only general unsecured status.[19] However, some courts have elevated a general unsecured environmental claim of the federal or state government to an administrative expense.[20] Administrative expenses are entitled to payment priority over general unsecured claims,[21] and are defined as "the actual, necessary costs and expenses of preserving the estate."[22] One court has opined that a surrogate claim filed by a private PRP on behalf of the government would compel a bankruptcy estate to set aside monies for the government's cleanup efforts regardless of the government's decision to not file a claim on its own behalf.[23] That a surrogate claim would be treated the same as a claim filed by the government itself leads to the conclusion that a surrogate claim could also be treated as an administrative expense, and receive priority over general unsecured claims.

In the majority of cases, the government's or a state's CERCLA cleanup costs are given administrative expense priority where the contaminated site at issue is actually owned by the debtor and therefore part of the assets of the bankruptcy estate.[24] The rationale is that the cleanup of the debtor's property preserves the value of the bankruptcy estate as allowed by the Code.[25] On the other hand, the priority is denied where the contaminated property is not owned by the debtor, but only leased.[26] This is likely due to the fact that efforts to clean up property not owned by the estate do not preserve the assets of the estate.[27]

There is also the possibility that a government's CERCLA cleanup costs are entitled to an even higher payment priority under the Code that takes precedence over creditors' claims that are secured by collateral, or secured claims. This higher payment priority, or "super-priority" lien, is authorized by §506(c) of the Code, which provides that the bankruptcy trustee "may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim."[28] While the one bankruptcy court decision that granted super-priority status to a state government's CERCLA claim was ultimately vacated,[29] another court has suggested that there are circumstances when a party with a secured claim will benefit from the grant of super-priority status to a government CERCLA claim for cleanup costs, such as when the cleanup costs expended would restore the value of a secured creditor's collateral.[30] For example, a bank that holds a mortgage collateralized with real property belonging to the debtor-PRP may benefit where the cleanup would preserve the value or facilitate the sale of the property.[31] How courts will rule on this remains an open question at this time, but the preservation of the value of the bankruptcy estate may favor the granting of a "super-priority" lien in some circumstances.

V. Collecting Cleanup Monies From an Insolvent PRP

Many factors need to be considered in order to determine a PRP's chances of collecting cleanup monies from an insolvent PRP. These factors include, among others, the types of environmental claims that have been asserted in an action, the extent of government involvement in the case, and whether any CERCLA claims asserted against the debtor's estate have priority. Therefore, when guiding a client through the often messy intersection of CERCLA and the Code, it is essential for environmental counsel to have familiarity with fundamental principles of bankruptcy law in addition to CERCLA.

19. 11 U.S.C. §507; In re Virginia Builders, Inc., 153 B.R. 729, 733, 24 ELR 20147 (Bankr. E.D. Va. 1993).
20. *See, e.g.,* In re Chateaugay Corp., 944 F.2d 997, 1009, 21 ELR 21466 (2d Cir. 1991); In re Wall Tube & Metal Prod. Co., 831 F.2d 118, 124, 18 ELR 20013 (6th Cir. 1987); In re Distrigas Corp., 66 B.R. 382, 386 (Bankr. D. Mass. 1986); In re Stevens**,** 68 B.R. 774, 783, 17 ELR 20491 (D. Me. 1987).
21. 11 U.S.C. §507(a)(1).
22. 11 U.S.C. §503(b)(1)(A).
23. *In re Hemingway Transport*, 993 F.2d at 928.
24. *See, e.g., In re Chateaugay Corp.*, 944 F.2d at 1009; *In re Wall Tube & Metal Prod. Co.*, 831 F.2d at 124; *In re Distrigas Corp.*, 66 B.R. at 386; *In re Stevens*, 68 B.R. at 783.
25. *See, e.g.*, In re Dant & Russell, Inc., 853 F.2d 700, 709, 18 ELR 21312 (9th Cir. 1988).
26. *Id.* (debtor-PRP was lessee). *See also* Southern Ry. Co. v. Johnson Bronze Co., 758 F.2d 137, 141 (3d Cir. 1985) (debtor-PRP was sublessee).
27. *See In re Dant & Russell*, 853 F.2d at 709.
28. 11 U.S.C. §506(c).
29. In re Better-Brite Plating, Inc., 105 B.R. 912 (Bankr. E.D. Wis. 1989), *vacated by* 136 B.R. 526 (Bankr. E.D. Wis. 1990).
30. In re T.P. Long Chemical, Inc., 45 B.R. 278, 288, 15 ELR 20635 (Bankr. N.D. Ohio 1985).
31. *See id.*