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# *Non-Claim Status of Environmental Clean-Up Injunctions Limited to States*

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## INTRODUCTION

Does the equitable right of an *individual*, whose property has been damaged by the debtor's pollution, to injunctive clean-up relief constitute a "claim" that may be discharged in the debtor's Chapter 11 bankruptcy? This was the issue of first impression which the Pennsylvania Bankruptcy Court dealt with in Krafczek v. Exide Corp., No. 00-1965, 2007 WL 1199530, at *1 (E.D. Pa. Apr. 19, 2007). The Krafczek court answered the question in the affirmative, 2007 WL 1199530 at *3, setting new precedent in an already narrow area of Bankruptcy Law upon which other courts had trodden carefully.

This article has four parts. The first part provides a brief overview of the Bankruptcy Code's definition of the term "claim." The second part examines the leading cases dealing with injunctive environmental clean-up orders, with particular focus on how these cases helped carve out an exception to the Code's "claim" definition for certain injunctive clean-up orders. The third part discusses Krafczek (citations omitted), its decision to restrict individuals from being able to access the injunctive clean-up order remedy, as well as the court's rationale behind that decision. The article concludes with a few brief thoughts on how Krafczek could have been similarly decided without reaching as far as it did, as well as on the burden that its holding places on individuals.

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## I. THE DEFINITION OF "CLAIM" UNDER 11 U.S.C. § 101(5)

With a few narrow exceptions, none of which bears upon injunctive environmental clean-up orders, a discharge in Bankruptcy Law discharges the debtor from all debts that arose before bankruptcy. 11 U.S.C. § 727(b) (2006). Specifically, Section 727(b) states that "a discharge . . . discharges the debtor from all debts that arose before the date of the order for relief under this chapter, and any liability on a claim . . . if such claim had arisen before the commencement of the case". Id. For purposes of bankruptcy law, the term "debt" is defined as "liability on a claim". 11 U.S.C. § 101(12) (2006). Therefore, the definition of the term "claim" is central to our discussion.

The Bankruptcy Code defines the term "claim" as:

> A) "[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) "[A] right to an equitable remedy for breach of performance if such breach ***gives rise to a right to payment*** … ."

11 U.S.C. § 101(5) (2006). Courts have interpreted the above definition as reflective of Congress's intent to make the coverage of the term "claim" as broad as possible, so as to include, and thus discharge upon bankruptcy, a large variety of debtor obligations. See Pa. Dep't of Public Welfare v. Davenport, 495 U.S. 552, 558 (1990) (*rev'd on other grounds*).

The first part of the definition, part (A), is the most straightforward. Essentially, any right to payment that a party has against the debtor (pre-bankruptcy) will be considered a claim

against the debtor. The modifying words that follow simply help expand the diverse forms that such a right to payment might appear in. Id.

The second part of the definition, however, is more complex, and it is also the most relevant for the purposes of this discussion. Section 101(5)(B)'s phrase "right to an equitable remedy . . . [giving] rise to a right to payment," was concisely explained by the Seventh Circuit in In re Udell. 18 F.3d 403 (7th Cir. 1995). In that case, an employer was seeking to enforce a covenant not to compete against a former employee who had in the meantime filed for bankruptcy. The employer argued that its right to an injunction against the employee was not a "claim" and therefore was not discharged. Id. at 405. In holding that the injunctive relief sought was indeed not a claim, and thus not dischargeable, Id. at 410, the Seventh Circuit explained that Section 101(5)(B) could be interpreted as referring to "a right to an equitable remedy that can be satisfied by an 'alternative' right to payment." Id. at 407. The court went on to note that, "[i]f the right to payment is not an alternative remedy, it must at least arise 'with respect to' the equitable remedy, not apart from it." Id. Thus, under the Udell court's interpretation, the key issue becomes "whether [plaintiff's] right to an injunction 'gives rise' to an alternative or other corollary right to payment of liquidated damages." Id. In Udell, the court held that the answer was no. Id. at 410. However, as the cases in the next section demonstrate, the Udell formulation became a central tenet in the area of state-issued injunctive environmental clean-up orders.

## II. NON-CLAIM STATUS OF INJUNCTIVE ENVIRONMENTAL CLEAN-UP ORDERS

The first Supreme Court case that considered state-issued injunctive environmental clean-up orders was Ohio v. Kovacs. 469 U.S. 274 (1985). That case, however, left a lot of unanswered questions which the Court meticulously listed as issues which it was not deciding.

Later cases, such as In re Chateaugay, 944 F.2d 997 (2d Cir. 1991), expanded upon Kovacs, and actually helped establish the non-claim status of such orders issued by states, provided that certain circumstances were present. Then came In re Torwico Electronics, Inc., 8 F.3d 146 (3rd Cir. 1993), which drawing upon the previous cases, firmly solidified the non-claim status of state-issued injunctive clean-up orders. Finally, with the above case law already in place, came Krafczek (citations omitted), which set new precedent on the applicability of this doctrine to individuals, by essentially excluding them from being able to utilize such injunctive clean-up orders after a polluter has filed for bankruptcy protection. The purpose of this section is to examine these important decisions with a view towards outlining how injunctive clean-up orders gained their present non-claim status.

The issue of whether obligations to remove toxic waste were dischargeable upon bankruptcy, as well as the foundational considerations surrounding this issue, had their genesis in the landmark Supreme Court case of Ohio v. Kovacs. 469 U.S. 274. In Kovacs, the state of Ohio procured an injunctive order against the plaintiff, the CEO of a corporation which utilized an industrial waste disposal site, requiring him to clean up the pollution at the site. Id. at 276. When Kovacs failed to comply with his obligations, the state obtained a court order appointing a receiver to take possession of the property and perform the clean-up. Id. After the receiver was appointed, but before he could complete the clean-up task, Kovacs filed for personal bankruptcy. Id. The state sought to obtain some of Kovacs' post-bankruptcy income for use in completing the clean-up, and it argued that Kovacs's obligation under the injunctive order to clean up the site was not dischargeable in bankruptcy for it was not a "claim." Id. at 276-77.

The Supreme Court disagreed with the state's position. In holding that the state indeed possessed a right to payment, and thus a claim dischargeable in bankruptcy, the court noted that

once the receiver took over, Kovacs had lost possession of the waste site and could no longer control its clean-up. Id. at 283. Therefore, he had effectively been dispossessed. Additionally, the court noted that all that the state was seeking from Kovacs was money to complete the clean-up. Id. In conclusion then, the injunctive clean-up order "had been converted into an obligation to pay money, an obligation that was dischargeable in bankruptcy". Id.

The Court in Kovacs refused to decide some very important issues, however, leaving them open to future cases. Specifically, the court did not decide "what the legal consequences would have been had Kovacs taken bankruptcy before a receiver had been appointed." Id. at 284. Also, the Court did not hold that "an injunction against bringing further toxic wastes on the premises or against any [continuing] pollution of the site or the State's waters" is dischargeable. Id. Finally, the court reiterated that no one may maintain an ongoing nuisance, pollute state waters, or refuse to remedy the source of such conditions. Id.

A subsequent case from the Seventh Circuit helped answer some of the questions which Kovacs left unanswered. In In re CMC Heartland Partners, 966 F.2d 1143 (7th Cir. 1992), the debtor owned a harmful waste site and filed for bankruptcy. Id. at 1144. Subsequently, the Environmental Protection Agency issued a clean-up order to the debtor, who was still in possession of the hazardous site, requiring it to clean and recondition the property. Id. at 1145. The debtor protested on the grounds that this was a claim which did not survive bankruptcy. In holding that the injunctive clean-up order did indeed survive bankruptcy, Judge Easterbrook explained that "a statutory obligation attached to current ownership of the land survives bankruptcy." Id. at 1147. However, and this is where the holding surpasses that of Kovacs, the EPA was required to show that the contamination by the site of surrounding areas was

"threatened or ongoing" so as to "avoid the conclusion that it is repackaging a forfeited claim for damages." Id.

An even clearer formulation of the requirements that a state-issued injunctive clean-up order must satisfy, so as to be considered a non-dischargeable non-claim, was given by the Second Circuit in In re Chateaugay. 944 F.2d 997 (2d Cir. 1991). In that case, LTV Corporation owned and operated many hazardous waste sites. Id. at 999. The EPA obtained injunctive orders requiring LTV, which in the meantime had filed for bankruptcy, to clean up one of the waste sites. Id. LTV contended that the orders constituted a claim which was discharged upon bankruptcy. Id. at 1001. The court, in holding that the injunctive clean-up orders were not claims under § 101(5)(B), explained that while "EPA is entitled to seek payment if it elects to incur cleanup costs itself," it had "no authority to accept a payment from a responsible party as an alternative to continued pollution". Id. at 1008. The court went on to state that since there is no option on the part of a state entity to accept payment in lieu of continued contamination, any injunctive environmental clean-up order issued by that state entity, which "to any extent ends or ameliorates continued pollution is not an order for breach of an obligation that gives rise to a right of payment" and is thus not a claim pursuant to § 101(5)(B). Id. (emphasis added).

However, the Chateaugay court made an additional observation of major importance to our discussion. It specifically pointed out that where pollution is not ongoing, and a "creditor obtaining the order ha[s] the option . . . to do the cleanup work itself and sue for response costs, thereby converting the injunction into a monetary obligation," the order is a claim pursuant to 101(5)(B) and thus discharged upon bankruptcy. Id. Therefore, to summarize the court's view, where the injunctive order seeks to end or ameliorate ongoing pollution, it is not a claim, even if

the state had the option of cleaning the site itself and only suing subsequently for the cost.[1] But where the pollution is not ongoing, and the state's injunctive order is issued despite the state having the option to do the cleanup itself and sue for the cost, the order is a dischargeable claim.

In 1993, the Third Circuit was faced with precisely the same dilemma as the other two circuits above. In In re Torwico Electronics, Inc., 8 F.3d 146 (3d Cir. 1993), the debtor was an electronics manufacturer whose manufacturing plant included an illegal seepage pit containing hazardous waste – waste which was migrating into surrounding bodies of water. Id. at 147. The manufacturing property, along with the area of the seepage pit, was leased by the debtor from its actual owners, and when that lease expired the debtor moved its business elsewhere. Subsequently, the debtor filed for bankruptcy. Id. The New Jersey Dep't. of Environmental Protection and Energy, upon an inspection of the site, discovered the leaking pit and issued a notice requiring the debtor to clean it up. When the debtor failed to comply, the state issued an order levying a $22,500 penalty for non-compliance, in addition to requiring the submission of a closure plan by the debtor. Id. at 147-48. Debtor immediately contested the order as constituting a claim which was barred, since the state failed to file it within the claim-filing deadline. The state, on the other hand, claimed that this was simply an injunctive order issued pursuant to state law, and that it survived bankruptcy. Id. at 148.

The Third Circuit agreed with the state's position. Holding that the state's injunctive clean-up order was not a claim, and thus survived bankruptcy, id. at 151, the court stated that "[t]he state can exercise its regulatory powers and force compliance with its laws, even if the debtor must expend money to comply". Id. at 150 (emphasis added). It went on to note that under Kovacs, "what the state cannot do is force the debtor to pay money to the state," a request

[1] Unless, of course, it actually did so, in which case Kovacs says that the clean-up order is converted into an obligation to pay money and is thus a claim.

which would turn the state from a regulator to a creditor. Id. However, this did not mean that the state could not assert a non-compliance penalty against the debtor, which is simply an enforcement of its laws. "Were we to adopt the . . . position that any order requiring the debtor to expend money creates a dischargeable claim", the court noted, "it is unlikely that a state could effectively enforce its laws". Id. at 150, n. 4.

There were two additional elements which the Torwico court examined in reaching its conclusion. First, it found that the pollution involved was ongoing, thus precluding any claims that the state was simply trying to repackage a forfeited claim for damages. Id. at 150. Additionally, the court disregarded the debtor's argument that since its lease had expired on the old property, just like the debtor in Kovacs, it was now not in possession of the property. The court stated that unlike the debtor in Kovacs, the debtor here had access to the site, and the state had not performed any clean-up of its own. Id. at 151. Ultimately, the court noted, while perhaps the debtor's clean-up obligations in the present case did not run with ownership of the land, they did run with ownership of the waste which it threw upon the land. Id. Therefore, the state's order survived bankruptcy.

## III. KRAFCZEK LIMITS THE NON-CLAIM STATUS OF INJUNCTIVE CLEAN-UP ORDERS TO STATES.

The scenario presented in Krafczek v. Exide Corp., No. 00-1965, 2007 WL 1199530, at *1 (E.D. Pa. Apr. 19, 2007), was dissimilar to any of the scenarios presented in the above cases dealing with injunctive clean-up orders. In Krafczek, the plaintiffs were a couple whose residence was located near the defendant's battery recycling plant. Id. They sued Exide, alleging that contaminants from its factory were polluting the surrounding areas, including causing substantial pollution of their property. Id. They requested equitable relief to compel

Exide to decontaminate their property. A few months later, in a related case, the EPA obtained a Consent Decree requiring Exide to clean up all of the surrounding areas, including plaintiff's property, but Exide failed in that effort and only partially cleaned up the plaintiff's property. Subsequently, Exide filed for bankruptcy, and its confirmed plan included an injunction and discharge of all claims against it. Id. The Krafczeks filed a timely proof of claim, requesting monetary relief for damages already caused, but not for the cost of remediation, since remediation of the property was supposed to be carried out by Exide pursuant to the Consent Decree. Plaintiffs asserted that under Torwico, their right to injunctive clean-up relief survived bankruptcy because it did not constitute a claim. Krafczek, 2007 WL 1199530, at *2. The debtor, on the other hand, contended that the plaintiffs' right constituted a claim under § 101(5)(B), and was thus discharged. Id.

The court's holding came as a surprise to the parties involved, for neither side appeared to have anticipated the grounds upon which the court's decision rested. Without citing any precedent to this effect, the Krafczek court read Torwico, and by implication all the cases preceding it, as allowing for injunctive clean-up orders to survive bankruptcy only when such actions were brought against a debtor by states. Id. at *3. A state, the court noted, "can exercise its regulatory powers and force compliance with its laws; but individual plaintiffs may not". Id. Therefore, the court concluded, the Krafczeks' request for an injunctive order compelling Exide to decontaminate their property was a dischargeable claim under § 101(5)(B). Id. Thus, dismissal of their complaint was warranted. Id.

## IV. CONCLUDING THOUGHTS

By limiting the availability of non-claim injunctive clean-up orders to states, the Krafczek court's holding places a severe limitation on the ability of individual plaintiffs to force polluters to decontaminate the plaintiff's properties, if those polluters subsequently file for bankruptcy. This result, appears to be contrary to the Supreme Court's warning in Kovacs, that no "person or firm may . . . maintain a nuisance, pollute the waters of the State, or refuse to remove the source of such conditions". 469 U.S. at 285. Clearly, Exide was maintaining a nuisance by its failure to decontaminate the plaintiffs' property.

However, even if we assume that the request of the Krafzceks for injunctive relief was a dischargeable claim, the court could have probably reached that result without severely limiting the options of individual plaintiffs in general. For example, the court could have interpreted the pollution on the Krafczek property as not being "ongoing" in the same way that a leaking seepage pit is. It would have been a stretch, but it would not have had the adverse effect that the court's current holding has. Alternatively, the court could have considered whether Krafczeks' request for injunctive relief was really a repackaged claim for damages. Whether this latter analysis would have reached the same result as that actually reached by the court is questionable, but it would have been a more cautious approach to take than simply refusing to make that consideration by holding that Torwico was inapplicable to individuals. See Krafczek, 2007 WL 1199530, at *3 n. 4. It remains to be seen whether Krafczek will be affirmed on appeal to the Third Circuit, the very court that decided Torwico. (citations omitted).