

Midlantic National Bank v. New Jersey Department of Environmental Protection: Has the Supreme Court “Abandoned” Section 554¹ of the Bankruptcy Code?

Since its codification in 1898, the federal Bankruptcy Code has allowed those unfortunate victims of financial woes to discharge their debts and to start afresh.² The primary purpose³ of the Code, which has been improved through judicial and legislative modifica-

1. The right of abandonment, under 11 U.S.C. § 554, empowers the trustee or the debtor-in-possession to rid

the estate of burdensome property [that is, property that is overencumbered or that cannot otherwise be administered or sold for the benefit of the creditors] or property that is not worth administering because of its inconsequential value. . . . The legal effect of abandonment is to revert the debtor with the property interest as of the date of the petition. Technically, the trustee does not abandon property to a secured creditor, although he may physically deliver the collateral to that person. The debtor's reverted property interest that results from the abandonment must still be foreclosed by the secured creditor in accordance with applicable law.

G. TREISTER, F. TRUST, L. FORMAN, K. KLEE & R. LEVIN, *FUNDAMENTALS OF BANKRUPTCY LAW* 179-81 (1986).

2. The “fresh start” policy reflects the contemporary notion that indebtedness is not a crime as it was historically.

The earliest involvement of the legal system in the affairs of a financially distressed debtor unable or unwilling to pay his debts was punitive in nature and represented moralistic condemnation of the failure to pay. The traditional remedies devised were akin to punishment for a crime. Thus, for example, curing the period just prior to the late 1700's, the practice of debt slavery was widespread. Similarly, imprisonment was a common response to the failure to pay debts. A sense of the character of the law existing at that time and the harsh attitude prevalent was conveyed by an English court discussing the situation of a person who had been imprisoned for debt: “[N]either the plaintiff at whose suit he is arrested, nor the sheriff who took him is bound to find him meat, drink or clothes; but he must live on his own, or on the charity of others; and if no man will relieve him, let him die in the name of God. . . .” *Manby v. Scott*, 86 Eng. Rep. 781, 786 (1659).

NORTON BANKRUPTCY LAW AND PRACTICE § 1.01 (1981). See also, Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 HARV. L. REV. 1393 (1985).

3. The Bankruptcy Code seeks “to convert the assets of the bankrupt into cash for distribution among creditors and then to relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes.” *Williams v. United States Fidelity & Guar. Co.*, 236 U.S. 549, 554-55 (1915).

tions, is to grant relief⁴ to debtors and provide ratable distribution to creditors⁵ through bankruptcies⁶ tailored to fit every debtor's financial situation, although sometimes involuntarily.⁷

In achieving these goals, one inevitably encounters conflicts between the federal Bankruptcy Code and state environmental laws,⁸ both of which may further public interests that are equally important, e.g., debtor protection and environmental protection. The recent influx of litigation involving ailing debtors engaged in the hazardous waste management business seeking protection⁹ under the auspices of the federal Bankruptcy Code illustrates one way in which the underlying tensions between the federal bankruptcy law and state environmental laws may surface. The most recent confrontation, *Midlantic National Bank v. New Jersey Department of Environmental Protection*, (hereinafter "*Midlantic*"),¹⁰ focused on the struggle between, on the one hand, the bankruptcy trustee's

4. Relief is granted by discharging old debts. However, liens, unlike debts, are not dischargeable in bankruptcy. While the corporate debtor gets "discharged" from debts via the limited liability laws under state law, the individual debtor may discharge his debts only through bankruptcy.

5. *In re McGoldrick*, 121 F.2d 746, 751 (9th Cir. 1941), *cert. denied*, 314 U.S. 675 (1941). However, the attempt, if successful, to give priority to state governments who clean up after hazardous waste debtors via Superlien statutes and to give priority to tort victims of hazardous or toxic waste generators may render the commercial creditor's share de minimis. See Comment, *State "Superlien" Statutes: An Attempt to Resolve the Conflict Between the Bankruptcy Code and Environmental Law*, 59 TEMP. L.Q. 981 (1986); Comment, *Bankruptcy, Hazardous Waste and Mass Tort: A Top Priority Review*, 23 HOUS. L. REV. 1243 (1986).

6. See, e.g., 11 U.S.C. §§ 701-766 (liquidation); §§ 901-946 (adjustment of debts of a municipality); §§ 1101-1174 (reorganization); §§ 1201-1231 (farmer bankruptcies); §§ 1301-1330 (adjustment of debts of an individual with regular income).

7. The Bankruptcy Code also provides for the commencement of involuntary bankruptcies under Chapters 7 or 11. See *id.* § 303.

8. Because most federal environmental laws are not invoked until after there is an "imminent and substantial threat to the public health or safety," the Bankruptcy Code usually conflicts with state environmental laws, which normally become applicable before the health threat is imminent. See Note, *The Bankruptcy Code and Hazardous Waste Cleanup: An Examination of the Policy Conflict*, 27 WM. & MARY L. REV. 165, 175 (1985); *United States v. Reilly Tar & Chem. Corp.*, 546 F. Supp. 1100, 1108-10 (D. Minn. 1982); *United States v. Price*, 523 F. Supp. 1055, 1070 (D.N.J. 1981), *aff'd*, 688 F.2d 204 (3d Cir. 1982).

9. A corporate debtor may dispose of its obligation owed to the state to clean up its hazardous wastes independent of the Bankruptcy Code simply by dissolving under state limited liability laws. The viability of the dissolution option depends on the extent to which the state imposes liability on the corporation, shareholders, officers and directors; the extent to which the state is successful in piercing the corporate veil; and the extent to which the state has imposed licensing or insurance obligations. See Baird & Jackson, *Kovacs and Toxic Wastes in Bankruptcy*, 36 STAN. L. REV. 1199, 1202 n.9 (1984).

10. 474 U.S. 494, 106 S.Ct. 755, *reh'g denied*, 106 S.Ct. 1482 (1986).

right under § 554¹¹ to abandon polluted property that is burdensome or of inconsequential value to the estate and, on the other hand, a claim by state governments¹² that abandonment should not be allowed until the trustee has complied with state environmental laws.¹³

This comment seeks to analyze the *Midlantic* decision. Part I dissects the opinion. Part II evaluates how the Supreme Court may have violated various constitutional provisions and several rules of statutory construction. Part III evaluates the possible effect *Midlantic* may have on bankruptcy proceedings involving state environmental regulations. Part IV concludes that the ideal solution is legislation since the ultimate decision—whether we ought to abandon debtor relief to fund environmental clean up—remains a political one.¹⁴

I.

MIDLANTIC NATIONAL BANK V. NEW JERSEY DEPARTMENT OF ENVIRONMENTAL PROTECTION

In *Midlantic*, the Supreme Court held that the trustee could not abandon worthless property under § 554 when the property was in violation of state environmental laws. The Court's apparent refusal to recognize the statutory right to abandon any property burdensome to a Chapter 7 estate indicates a shift in the Court's perception of the paramount purpose of the Bankruptcy Code, especially given the statement made by an unanimous Court regarding the abandon-

11. 11 U.S.C. § 554 on the abandonment of property of the estate provides:

- (a) After 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.
- (b) On request of a party in interest and after notice and a hearing, the court may order the trustee to abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate.
- (c) Unless the court orders otherwise, any property scheduled under section 521(1) of this title not otherwise administered at the time of the closing of a case is abandoned to the debtor and administered for purposes of section 350 of this title.
- (d) Unless the court orders otherwise, property of the estate that is not abandoned under this section and that is not administered in the case remains property of the estate.

12. See Morris, *State Enforcement of Environmental Laws Against Bankrupt Entities*, 16 ENVTL. L. REP. (Envtl. L. Inst.) 10143, 10146 (1986).

13. See R. AARON, *BANKRUPTCY LAW FUNDAMENTALS* § 6.06 (1985).

14. An alternative source of funding may be in the form of excess liability insurance coverage for polluters. See L.A. Times, Feb. 9, 1987, § 1, at 1.

ment right in *Ohio v. Kovacs*,¹⁵ decided less than 12 months earlier: "If the property were worth less than the cost of clean up, the trustee would likely *abandon* it to the prior owner, who would have to comply with the state environmental law to the extent of his or its liability."¹⁶ In the dicta quoted above, the Supreme Court not only refused to question the trustee's right to abandon polluted property but also held that state environmental laws applied *after* abandonment, not *before*, as *Midlantic* apparently requires.¹⁷

A. Facts

Quanta Resources, Inc., ("Quanta") was incorporated in Delaware in March of 1980 and maintained a storage facility for waste oil in Long Island City, New York. In July of 1980, Quanta purchased Edgewater Terminals, Inc. and obtained by assignment both the lease for the property located at Edgewater, New Jersey and the Temporary Operating Authorization ("TOA") issued by the New Jersey Department of Environmental Protection ("NJDEP") to operate a waste oil recovery business at the Edgewater site. Thus, as of July 1980, Quanta conducted business at two sites, storing waste oil in New York and processing waste and sludge oil for resale in New Jersey.

In need of more working capital, Quanta obtained a \$600,000 loan from Midlantic National Bank ("Bank") in June of 1981. In exchange, the Bank received a note and security agreement which it perfected pursuant to New Jersey commercial laws. The security agreement gave the Bank a security interest in Quanta's inventory, accounts receivable and equipment in New Jersey. Days after Quanta received the loan from the Bank, the NJDEP found unlawful quantities (400,000 gallons) of polychlorinated biphenyls ("PCB's") at the Edgewater facility, in direct violation of the terms

15. In *Ohio v. Kovacs*, 469 U.S. 274, 105 S.Ct. 705 (1985), the Court held that the debtor's obligation imposed by the injunction to clean up its hazardous waste disposal site was a "debt" or "liability on a claim" under § 362 and therefore subject to discharge under the Bankruptcy Code.

16. 469 U.S. 274 n.12 (1985) (emphasis added). While one may argue that this statement was incorporated into the dicta by the author of the *Kovacs* opinion, Justice White, who was also one of the four dissenting voters in *Midlantic*, the significance of this coincidence becomes de minimis since *Kovacs* was an unanimous decision.

17. In requiring compliance with state environmental regulations before abandonment, the majority in *Midlantic* placed more weight on cases addressing the pre-Code (referring to the bankruptcy law before the 1978 amendments) abandonment right than on a statement, albeit part of the dicta, addressing the § 554 abandonment right in an unanimous opinion rendered by the same Court less than a year before the *Midlantic* case.

of the TOA. In compliance with a formal request issued by NJDEP, Quanta ceased all operations at the Edgewater site on July 2, 1981. In the midst of negotiations between Quanta and NJDEP regarding clean up of the Edgewater facility, Quanta filed a petition¹⁸ for bankruptcy under Chapter 11. This was converted¹⁹ to a Chapter 7²⁰ bankruptcy when NJDEP issued its clean up order.²¹ On the same day that Quanta converted to Chapter 7, a trustee was appointed²² to the estate. Shortly thereafter, Quanta's waste oil storage facilities in New York were also found to contain unlawful levels (70,000 gallons) of PCB's. The trustee commenced to liquidate the estate and distribute the assets to Quanta's creditors.

After unsuccessful attempts to sell the property,²³ the trustee, in compliance with the standard duties²⁴ imposed by the Bankruptcy

18. 11 U.S.C. § 301.

19. 11 U.S.C. § 1112 (conversion from Chapter 11 to 7).

20. "In a Chapter 7 proceeding the debtor surrenders nonexempt property to a trustee appointed by the court [§ 701]. The trustee liquidates the property through bankruptcy sales and distributes the proceeds to the creditors in accordance with their bankruptcy priorities. . . ." L. LOPUCKI, STRATEGIES FOR CREDITORS IN BANKRUPTCY PROCEEDINGS 22 (1985).

21. Had the NJDEP then obtained an injunction to compel compliance with the clean up order, the injunction may have constituted a "claim" under a *Kovacs* analysis and could have been deemed dischargeable under 11 U.S.C. § 362.

22. See generally 11 U.S.C. §§ 321-331; §§ 701-766.

23. Quanta's property consisted of hazardous waste drenched land in New York and oil barrels containing hazardous materials in New Jersey.

Long Island City, New York: On March 18, 1982, the trustee filed with the bankruptcy court a notice to creditors of "sale by public auction or abandonment" of the New York property. The notice indicated that the trustee would abandon the property if he did not receive an offer in excess of liens on the property. Although Greenpoint Oil Corp. made an offer to purchase the Long Island facility subject to mortgages and certain liens for \$300,000.00, this offer was revoked when Greenpoint became aware of the hazardous conditions and violations at the site.

Edgewater, New Jersey: On April 23, 1983, the trustee petitioned to abandon only the waste oil in the tanks at the New Jersey site since Quanta only leased but did not own the New Jersey site. The notice excluded the uncontaminated oil which was later sold to third parties.

24. Section 704 which governs the general duties of the trustee provides:

The trustee shall—

- (1) collect and reduce to money the property of the estate for which such trustee serves, and close such estate as expeditiously as is compatible with the best interests of parties in interest;
- (2) be accountable for all property received;
- (3) ensure that the debtor shall perform his intention as specified in section 521(2)(B) of this title;
- (4) investigate the financial affairs of the debtor;
- (5) if a purpose would be served, examine proofs of claims and object to the allowance of any claim that is improper;
- (6) if advisable, oppose the discharge of the debtor;

Code,²⁵ petitioned to abandon the property under 11 U.S.C. § 554. Section 554 authorizes abandonment as long as the trustee or debtor-in-possession notifies all the creditors and presents proof that the property in question is either burdensome or of inconsequential value or benefit to the estate. Without dispute, the clean-up costs for the New York and New Jersey facilities exceeded their fair market values.²⁶

Both the city and state of New York and the Department of Environmental Protection of New Jersey opposed the trustee's abandonment petition. Since the property, upon abandonment, reverts back to the debtor or lienholders²⁷ "as if the bankruptcy case [had] never commenced,"²⁸ they argued that allowing abandonment of the property to an insolvent debtor (Quanta) with no financial resources to clean up the polluted properties in effect violates state environmental laws²⁹ against disposal of hazardous wastes.³⁰ In-

-
- (7) unless the court orders otherwise, furnish such information concerning the estate and the estate's administration as is requested by a party in interest;
 - (8) if the business of the debtor is authorized to be operated, file with the court and with any governmental unit charged with responsibility for collection or determination of any tax arising out of such operation, periodic reports and summaries of the operation of such business, including a statement of receipts and disbursements, and such other information as the court requires; and
 - (9) make a final report and file a final account of the administration of the estate with the court.

With regard to the disposition of certain property, § 725 states:

After the commencement of a case under this chapter, but before final distribution of property of the estate under section 726 of this title, the trustee, after notice and a hearing, shall dispose of any property in which an entity other than the estate has an interest such as a lien, and that has not been disposed of under another section of this title.

25. Although the trustee "is the representative of the estate" [11 U.S.C. § 323(a)] and "has capacity to sue and be sued" [11 U.S.C. § 323(b)], he "is not liable personally . . . for any penalty or forfeiture incurred by the debtor [11 U.S.C. § 322(c)]." Thus, the threat of criminal sanctions imposed against the trustee in *In re Charles* seems inconsistent with the Bankruptcy Code.

26. 739 F.2d 912, 914 n.4 (1984). In addition to the clean up and repair costs, the "attendant costs associated with its upkeep includ[ed] 24 hour guard service for the property at a cost exceeding \$1,100 per week paid by the trustee. . . ." Bankruptcy Court Transcript.

27. This burdensome property may be abandoned to any party with a possessory interest in the property abandoned. (H.R. Rep. No. 595 to accompany H.R. 8200, 95th Cong., 1st Sess. 377 (1977). Thus, the property may be abandoned to lienholders who wish to foreclose as well as to the debtor. See H.R. Rep. No. 595 at 377 ("abandonment may be to any party with a possessory interest in the property abandoned").

28. Weintraub & Resnick, Bankruptcy Law Manual ¶ 4.06, 4-22 (1980).

29. When the trustee filed the notice of intent to abandon, 70,000 of the 500,000 gallons of waste oil stored at the waste oil storage and processing facility in Long Island City, New York, were contaminated with PCB's. The New York laws governing the storage and disposal of PCB's were N.Y. ENVTL. CONSERV. LAW §§ 27-0900 to 27-

stead, New York insisted that before the trustee could abandon the burdensome property, the trustee must use all the available assets of the estate to clean up the property in compliance with state environmental laws. In addition, New York petitioned the court for a lien on the estate to cover any clean up costs expended by the state should it be forced to clean up the waste.

However, because the trustee had complied with all of the requirements of § 554 by giving notice to all the creditors and presenting proof that the property was "burdensome and of inconsequential value and benefit to the estate,"³¹ the bankruptcy court approved the abandonment petition.³² In his ruling, the bankruptcy judge not only refused to stay the abandonment order pending New York's appeal but also refused to grant New York's requested first lien on the property to cover any possible expenses incurred to bring the abandoned property into compliance with state laws.

After the property was abandoned, New York, pursuant to its state law,³³ proceeded to clean up the Long Island facility, except the subsoil, at a cost of 2.5 million dollars. Upon appeal to the United States District Court for the District of New Jersey, New York did not assert its right to a first lien but confined itself to the validity of the abandonment order. Judge Lacey of the district court affirmed the abandonment order and stressed that the clear language of the abandonment right as provided by § 554 required nothing more than notice and proof of the worthlessness of the property.³⁴

New York then appealed to the Third Circuit Court of Appeals.³⁵ With the consent of the parties, New Jersey was able to take a direct appeal to the Third Circuit under Bankruptcy Code § 405(c)(1)(B).

0923 (McKinney Supp. 1982), N.Y. COMP. CODES R. & REGS. tit. 6, § 366.4(e) (1982) and New York, N.Y. ADMIN. CODE § C19-50.0. See *In re Quanta Resources Corp.*, 739 F.2d 912, 913 (3d Cir. 1984).

In New Jersey, the temporary operating authorities (TOA's) issued by the New Jersey Department of Environmental Protection (NJDEP) prohibited Quanta from accepting PCB-contaminated oil. See *In re Quanta Resources Corp.*, 739 F.2d at 928.

30. In addition to the local laws, New York relied on public policy considerations and 28 U.S.C. § 959(b).

31. 11 U.S.C. § 554.

32. *In re Quanta Resources Corp.*, No. 81-05967 (Honorable D. Joseph DeVito, presiding) (June 22, 1982).

33. See N.Y. ENVTL. CONSERV. LAW § 27-0916 (McKinney Supp. 1982).

34. *In re Quanta Resources Corp.*, No. 82-3524 (D.N.J. 1983) (Honorable Frederick B. Lacey).

35. *In re Quanta Resources Corp.*, 739 F.2d 912 (3d Cir. 1984), *aff'd sub nom.* Midlantic National Bank v. New Jersey Dept. of Env'tl. Protection, 106 S.Ct. 755, *reh'g denied*, 106 S.Ct. 1482 (1986).

The appellate court, framing the issue as whether 11 U.S.C. § 554 permitted the abandonment of property of the bankrupt estate in contravention of state and local environmental protection laws, reversed both abandonment orders.³⁶ Upon certiorari,³⁷ the United States Supreme Court, by a 5 to 4 vote, affirmed the appellate court's holding that 11 U.S.C. § 554 was subject to state environmental regulations.

B. *The Opinion*

The majority, per Justice Powell, disallowed abandonment, holding that the trustees "may not abandon property in contravention of a state statute or regulation that is *reasonably* designed to protect health or safety from identified hazards."³⁸ The majority stressed the narrowness³⁹ of the restriction imposed on the trustee's right to abandon.

This exception to the abandonment power vested in the trustee by § 554 is a narrow one. It does not encompass a speculative or indeterminate future violation of such laws that may stem from abandonment. The abandonment power is not to be fettered by laws or regulations not reasonably calculated to protect the public health or safety from imminent and identifiable harm.⁴⁰

36. Because New York and NJDEP appealed separately, the appellate court rendered two opinions, 739 F.2d 912 and 739 F.2d 927 (3d Cir. 1984). For a discussion of the appellate court opinion of *In re Quanta Resources Corp.*, see Paige, *In Re Quanta Resources Corp.: Bankruptcy Policy v. Environmental Interests; A Polluted Judicial Theory*, 59 AM. BANKR. L.J. 357 (1985); Note, *Belly Up Down in the Dumps: Bankruptcy and Hazardous Waste Cleanup*, 38 VAND. L. REV. 1037, 1054 (1985); Note, *Cleaning Up in Bankruptcy: Curbing Abuse of The Federal Bankruptcy Code By Industrial Polluters*, 85 COLUM. L. REV. 870, 874 (1985); Note, *The Bankruptcy Code and Hazardous Waste Cleanup: An Examination of the Policy Conflict*, 27 WM. & MARY L. REV. 165, 184 (1985); *Right of Trustee to Abandon Polluted Property*, N.Y.L.J., March 21, 1985, at 1, col.1.

37. Conflicting conclusions by lower courts made it necessary for the Supreme Court to consider the issue. *E.g.*, *In re National Smelting of New Jersey, Inc.*, 49 Bankr. 1012 (Bankr. D. Colo. 1985) (can't abandon property in contravention of state environmental laws); *In re Union Scrap Iron & Metal Co.*, 49 Bankr. 477 (Bankr. D. Minn. 1985) (public policy grounds should not be added as a factor to the express statutory prerequisite for abandonment under § 554(a)); *In re A & T Trailer Park, Inc.*, 53 Bankr. 144 (Bankr. D. Wyo. 1985) (trustee for corporate Chapter 7 debtor in a no-asset case may abandon a mobile home park whose waste water treatment plant is in a state of non-compliance with state environmental quality laws); *In re T.P. Long Chem., Inc.*, 45 Bankr. 278 (Bankr. N.D. Ohio 1985) (police power overrides any right to abandon).

38. 106 S.Ct. 755 (1986) (emphasis added).

39. In doing so, the Court may have inadvertently created an escape hatch for bankruptcy courts to avoid strict compliance with the *Midlantic* decision mandating the application of state environmental laws before allowing abandonment.

40. 106 S.Ct. at 762-3 n.9.

Furthermore, the Court held that before the bankruptcy court may authorize abandonment, it must formulate "conditions that will adequately protect the public's health and safety."⁴¹ To reach its conclusion, the majority relied on three sources: pre-Code cases, rules of statutory construction, and § 959 of the Bankruptcy Code.

1. Case Law

Since neither § 554 nor its legislative history indicated any intent to create exceptions to the trustee's statutory abandonment right, the majority was forced to rely on three pre-Code⁴² cases which it characterized as constituting a "judicially developed doctrine . . . that a trustee could not exercise his abandonment power in violation of certain state and federal laws."⁴³ In order to invoke the applicability of those cases, the majority concluded that since § 554 codified the judicially developed rule of abandonment at common law, § 554 must have also incorporated⁴⁴ the judicially developed restrictions to the abandonment right applicable before the 1978 Bankruptcy Amendments. Working under the presumption that Congress intended to codify a right of abandonment identical to the

41. *Id.* at 762.

42. "Pre-Code" refers to those cases decided under the 1898 Bankruptcy Act, before the enactment of the 1978 Bankruptcy Amendment, commonly referred to as the Bankruptcy Code.

43. 106 S.Ct. at 759.

44. The majority in *Midlantic* contends that "[i]n codifying the judicially developed rule of abandonment, Congress also presumably included the established corollary that a trustee could not exercise his abandonment power in violation of certain state and federal laws." 106 S.Ct. at 759. However, the abandonment right under § 554 is distinguishable from the judge-made abandonment right in respect to title of the property.

Under the former Bankruptcy Act, title to the debtor's property vested in the trustee. Abandonment divested the trustee of title and revested it in the debtor. 4 Collier ¶ 554.02[2]. [On the other hand], [u]nder the Code, the trustee no longer takes title to the debtor's property, and he is simply divested of control over the property by the abandonment. *Ibid.* Although § 554 does not specify to whom the property is abandoned, the legislative history suggests that it is to the person having possessory interest in the property. S. Rep. No. 95-989, p. 92 (1978); *Ohio v. Kovacs*, 469 U.S.—, —, n.12, 105 S.Ct. 705, 711-12, n.12, 83 L.Ed.2d 649, 659 (1985).

106 S.Ct. 755, 763 n.1 (1986) (Rehnquist, J., dissenting). Because title vested in the trustee under pre-Code law, it is understandable why the trustee should not be allowed to abandon property where doing so would enable him to escape the application of local laws affecting "his" property. However, since the trustee no longer takes title to the debtor's property under the Code, the reason for denying abandonment no longer exists. In fact, allowing the trustee to abandon worthless property of the estate ensures compliance with the local laws since the property is now abandoned to the debtor, or holder of title to the properties, to whom the state environmental laws undeniably apply. See generally Annotation, *What Constitutes Abandonment or Rejection of Property or Assets of Bankrupt Estate by Trustee so as to Revest Title Thereto in Bankrupt*, 19 A.L.R. 2d 890 (1951).

one existing under common law,⁴⁵ the majority relied on the following three pre-Code cases: *Ottenheimer v. Whitaker*,⁴⁶ *In re Chicago Rapid Transit Co.*,⁴⁷ and *In re Lewis Jones, Inc.*⁴⁸

a. *Ottenheimer v. Whitaker*

In *Ottenheimer v. Whitaker* ("Ottenheimer"),⁴⁹ the trustee, in liquidating a barge company, sought to abandon four worthless barges docked at the local harbor since the cost of removal exceeded the value of the barges.⁵⁰ However, if the dilapidated barges were abandoned, they would sink in the harbor, in violation of 33 U.S.C. §§ 409 and 411 which prohibited obstruction of navigable channels.⁵¹ The appellate court disallowed abandonment of the barges because, in its opinion, the judge-made rule of abandonment, while widely accepted, "must give way when it comes into conflict with a statute enacted . . . by an Act of Congress in the public interest."⁵²

Although the court disallowed abandonment and therefore arguably made the abandonment right subordinate to a conflicting statute, the *Ottenheimer* decision does not support the majority's contention in *Midlantic* that the statutory federal abandonment right must yield to a conflicting state law. Rather, the court, confronted by "the need to reconcile a conflict between a judicial gloss⁵³ on the Bankruptcy Act and the commands of another fed-

45. The majority proceeded to impose this "judicially developed doctrine intended to protect legitimate state and federal interests" on § 554, thus allowing a state environmental law to regulate the Federal Bankruptcy Code, 106 S.Ct. at 759.

46. 198 F.2d 289 (4th Cir. 1952).

47. 129 F.2d 1 (7th Cir.), *cert. denied*, 317 U.S. 683 (1942).

48. 1 Bankr. Ct. Dec. (CRR) 277 (Bankr. E.D. Pa. 1974).

49. 198 F.2d 289 (4th Cir. 1952).

50. *See id.* at 289.

51. 33 U.S.C. § 409 made it unlawful "to anchor vessels in navigable channels in such a manner as to prevent or obstruct the passage of other vessels or craft, or to voluntarily or carelessly sink or permit or cause to be sunk vessels or other craft in navigable channels." 198 F.2d at 290. 33 U.S.C. § 411 provided that "every person who shall violate or knowingly aid or abet the violation of the provisions of § 409 shall be guilty of a misdemeanor and on conviction, shall be punished by a fine not exceeding \$2,500 nor less than \$500, or by imprisonment, in the case of a natural person, for not less than 30 days nor more than one year or both such fine and imprisonment, in the discretion of the court." 198 F.2d at 290.

52. *Id.*

53. Prior to enactment of the Bankruptcy Code in 1978, there was no statutory provision specifically authorizing abandonment in liquidation cases. By analogy to the trustee's statutory power to reject executory contracts, courts had developed a rule permitting the trustee to abandon property that was worthless or not expected to sell for a price sufficiently in excess of encumbrances to offset the costs of administration.

eral statute,"⁵⁴ held that federal legislation preempted judicial doctrines.⁵⁵ That is, the *Ottenheimer* court limited the abandonment right only when it conflicted with an explicit federal statute. Thus *Ottenheimer* is persuasive authority for subjecting the *federal* Bankruptcy Code to a *federal* environmental regulation but not as authority that the *federal* Bankruptcy Code is preempted whenever it conflicts with a *state* environmental law. If such were the case, the Supremacy Clause would be superfluous.⁵⁶

Ottenheimer is thus distinguishable from *Midlantic* in several respects. First, *Ottenheimer* was interpreting the judge-made abandonment rule,⁵⁷ while *Midlantic* dealt with the statutory abandonment rule. Second, *Ottenheimer* involved a conflict between "a rule which is not provided by statute but built up by the courts" and "an Act⁵⁸ of Congress in the public interest."⁵⁹ *Midlantic*, on the other hand, involved a conflict between a provision⁶⁰ of the Federal Bankruptcy Code and state environmental regulations.⁶¹ Given the different sources upon which the respective abandonment rights were based, *Ottenheimer* and *Midlantic* should render different results.⁶²

Ottenheimer followed rather than violated the Supremacy Clause when it allowed the judicially created abandonment right to be preempted by a federal statute. However, the majority in *Midlantic* arguably ignored the Supremacy Clause when it subordinated the statutory right of abandonment provided by the Federal Bank-

106 S.Ct. at 763 (Rehnquist, J., dissenting) (citing 4 L. KING, COLLIER ON BANKRUPTCY ¶ 554.01 (15th ed. 1985)).

54. 106 S.Ct. at 764 (Rehnquist, J., dissenting).

55. The Supreme Court "implicitly confirmed the validity of such an approach . . . in *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 523-24, 104 S.Ct. 1188, —, 79 L.Ed.2d 482 (1984)." 106 S.Ct. at 764 (Rehnquist, J., dissenting).

56. See *infra* text accompanying notes 97-101.

57. *American File Co. v. Garrett*, 110 U.S. 288 (1884); *Dushane v. Beall*, 161 U.S. 513, 515, 16 S.Ct. 637, 40 L.Ed. 791 (1896); *Quinn v. Gardner*, 32 F.2d 772, 773 (8th Cir. 1929); *Lincoln Nat. Life Ins. Co. v. Scales*, 62 F.2d 582, 585 (5th Cir. Tex. 1933). See 4A L. KING, COLLIER ON BANKRUPTCY ¶ 70.42, at 502-504 & n.4 (14th ed. 1978) (citing cases).

58. 33 U.S.C. §§ 409 & 411.

59. 198 F.2d at 290.

60. 11 U.S.C. § 554.

61. N.Y. ENVTL. CONSERV. LAW §§ 27-0900 to 27-0923 (McKinney Supp. 1982); N.Y. COMP. CODES R. & REGS. tit. 6, § 366.4(e) (1982); N.Y. ADMIN. CODE § C19-50.0; NJDEP's TOA.

62. *Ottenheimer* and *Midlantic* involved identical concerns: that upon abandonment, the title to the worthless property would revert to the bankrupt, who more often than not is "left without the means to care for or dispose of them in the manner prescribed by the statute." 198 F.2d at 290.

ruptcy Code to state environmental regulations. Because the court in *Ottenheimer* relied so "heavily on the fact that the pre-Code law of abandonment was judge-made," it is unclear "whether that court would have decided the case the same way under the present Code."⁶³

b. In re Lewis Jones, Inc.

The bankruptcy court in *In re Lewis Jones, Inc.* ("Lewis"),⁶⁴ operating under the judge-made abandonment rule, would not allow the trustee of the bankrupt utility companies to abandon the man-holes, vents, and steam pipes until they were all filled or foam sealed. With no actual statute compelling such remedial measures,⁶⁵ the bankruptcy court could not rely on the conflict of law principles established by *Ottenheimer*.⁶⁶ Instead, the bankruptcy court fell back on its equitable powers to "safeguard the public interest."⁶⁷ Since the unsealed vents and lines posed possible health hazards,⁶⁸ the bankruptcy court used its equitable powers to condition approval of abandonment ". . . upon performance of a condition [sealing all the vents and steam lines] which will safeguard the public interest."⁶⁹

Once again, *Lewis* is unpersuasive and inapplicable in determining the scope of the abandonment right under § 554 of the Bankruptcy Code. First, like *Ottenheimer*, *Lewis* turned "on the judge-made nature of the abandonment power."⁷⁰ As such, it seemed appropriate for the judges to mold and alter those judge-made rules initially created to promote equity. However, even the pre-Code *Lewis* opinion acknowledged that the bankruptcy court, as a court of equity, "is guided by equitable doctrines and principles *except* as they are inconsistent with the [Bankruptcy] Act."⁷¹ Since the

63. 106 S.Ct. at 765 (Rehnquist, J., dissenting).

64. 1 Bankr. Ct. Dec. (CRR) 277 (Bankr. E.D. Pa. 1974).

65. 1 Bankr. Ct. Dec. (CRR) at 278-79.

66. The notion "that the trustee in the exercise of the power to abandon is subject to the application of general regulations of a police nature (citations omitted)." 1 Bankr. Ct. Dec. (CRR) at 279.

67. 1 Bankr. Ct. Dec. (CRR) at 280 (quoting Securities and Exchange Commission v. United States Realty and Improvement Co., 310 U.S. 434, 455 (1940)).

68. 1 Bankr. Ct. Dec. (CRR) at 279.

69. 1 Bankr. Ct. Dec. (CRR) at 280 (citing Securities and Exchange Commission v. United States Realty and Improvement Co., 310 U.S. 434, 455 (1940)).

70. 106 S.Ct. at 765.

71. 1 Bankr. Ct. Dec. (CRR) at 280 (quoting Securities and Exchange Commission v. United States Realty and Improvement Co., 310 U.S. 434, 455 (1940)) (citations omitted) (emphasis added).

Bankruptcy Code now contains a specific statutory provision permitting trustees to abandon property as long as that property is burdensome or of inconsequential value or benefit to the estate, bankruptcy courts must follow the express terms of the Bankruptcy Code in analyzing abandonment petitions, and not rely on nebulous equity doctrines which they may find appealing.⁷²

Second, *Lewis* is factually distinguishable from *Midlantic* as the total equity in the estate of the utility companies far exceeded the cost of the remedial actions.⁷³ Here, although the majority refuses to acknowledge it,⁷⁴ the State of New York is seeking reimbursement from the estate for the 2.5 million dollars it spent to clean up Quanta's property in Long Island City. From the facts, it appears that this amount far exceeded the available equity of the estate at any time.⁷⁵

c. *In re Chicago Rapid Transit Co.*

In *In re Chicago Rapid Transit Co.* ("CRT"),⁷⁶ the trustee of the bankrupt public transportation utility company petitioned the bankruptcy court for approval to abandon a lease of a railroad right of way. The bankruptcy court approved abandonment but only if the debtor complied with certain conditions. Upon appeal to the Third Circuit Court of Appeal on only the issue of the propriety of allowing abandonment and not on the validity of the conditions imposed, the appellate court affirmed. While the court in *CRT*

72. Equity does not appear to have been done when the Court imposed the substantial clean up bill (\$2.5 million) on the creditors of Quanta as opposed to the State of New York when, although both are innocent, the latter is not only directly benefited by the cleanup but under New York statute is obligated to clean up the mess.

73. The equity of the bankrupt utility companies' estates totaled \$328,240.89. 1 Bankr. Ct. Dec. (CRR) at 280. The estimated cost of the remedial measures was at least \$82,000 (plus \$500 to fill in each vent). Thus while the creditor's claims (\$4,478,000) also exceeded the equity available in *Lewis*, the remedial costs were far lower than the available equity.

This practical consideration, while ignored in *Midlantic*, has been a substantial factor in post-*Midlantic* abandonment determinations.

74. The sole issue presented by these petitions is whether a trustee may abandon property under § 554 in contravention of local laws designed to protect the public's health and safety. New York is claiming reimbursement for its expenditures as an administrative expense. That question, however, like the question of the ultimate disposition of the property, is not before us.

106 S.Ct. at 758 n.2.

75. This raises another question, that is, by denying abandonment before compliance with New York's clean up order, is the Supreme Court in effect giving special preference to New York's claim over other creditors and thereby violating other sections of the Bankruptcy Code regarding priorities and preference of payment (especially, since New York did not again assert its right to a lien upon appeal)?

76. 129 F.2d 1 (7th Cir.), *cert. denied*, 317 U.S. 683 (1942).

proclaimed restrictions on the judge-made abandonment right in dicta, it is unclear whether these "general principles" are likewise applicable to the statutory right of abandonment since neither § 554 nor its legislative history states any exceptions to the right of the trustee to abandon property that is burdensome or inconsequential to the estate.

2. Statutory Construction

In addition to pre-Code case law, the Court in *Midlantic* relied on rules of statutory construction in denying abandonment. In particular, the rule that "if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific."⁷⁷ Acknowledging the judicial origin of the pre-Code abandonment right, the Supreme Court interpreted the lack of any restrictions on the statutory abandonment right as an implicit adoption of the entire abandonment right as it existed before the 1978 Amendments.

In applying that rule, the Supreme Court ignored another equally important caveat of statutory construction. According to *United States v. Security Industrial Bank*,⁷⁸ if one construction of a statute will result in a possible violation of the Takings Clause under the Fifth Amendment, and an alternative construction is available which avoids such an issue, the Supreme Court *should* opt for the alternative interpretation. Since disallowing abandonment arguably deprives secured creditors of their priority status to the assets of the estate,⁷⁹ the Supreme Court should have allowed abandonment.

However, the "specific intent" rule may likewise be applied to allow abandonment. Since Congress has not established any specific exceptions to the abandonment right as it has with several other bankruptcy code provisions,⁸⁰ the express terms of § 554 should control and no exception should be created where none was apparently intended.⁸¹

77. 106 S.Ct. at 760 (citing *Edmonds v. Compagnie Generale Transatlantique*, 443 U.S. 256, *reh'g denied*, 444 U.S. 889 (1979)).

78. 459 U.S. 70 (1982) (applying the cardinal rule to the bankruptcy context).

79. No court has dealt with this question and the majority in *Midlantic* sidetracked the issue.

80. The express inclusion of environmental laws in other sections of the Bankruptcy Code could be interpreted to indicate that "when Congress *was* so concerned it expressed itself clearly, specifically exempting some environmental injunctions from the automatic stay provisions of § 362 of the Code" [106 S.Ct. at 764] and mandating reorganization trustees to "manage and operate the property in his possession . . . in compliance to valid state laws." 28 U.S.C. § 959(b).

81. As the Court suggested in *Kovacs*, "If the property were worth less than the cost

3. Section 959

Finally, the *Midlantic* majority contends that § 959⁸² evidences the intent of Congress to have the trustee “manage and operate the property in his possession . . . according to the requirements of the valued laws of the State.”⁸³ Such an application ignores the difference between the function of the trustee in a Chapter 11 bankruptcy which § 959 specifically addresses and a Chapter 7 bankruptcy to which § 959 neither literally nor functionally applies.⁸⁴ Under Chapter 7, trustees neither manage nor operate the property but merely dissolve the business as quickly as possible. Even the majority in *Midlantic* admitted that “§ 959(b) does not directly apply to an abandonment under § 554(a) of the Bankruptcy Code—and therefore does not de-limit the precise conditions on an abandonment. . . .”⁸⁵ Yet, the majority asserts that the existence of a section like § 959 evidences Congress’ general and pervasive intent to subject the Bankruptcy Code to environmental laws, whether state or federal. The majority was so “liberal” in locating authority to support the imposition of state environmental restrictions on the federal abandonment right that it also referred to RCRA and CERCLA⁸⁶ to support its contention that § 554 codified not only the right of the trustee to abandon worthless property but also the restrictions on that power.

II.

CONSTITUTIONAL IMPLICATIONS

Midlantic also raises serious constitutional issues. By conditioning the right of abandonment on compliance with state environmental laws, did not the Supreme Court violate both the Fifth Amendment Just Compensation Clause when it altered the creditor’s rights to the liquidated proceeds of the estate, and the

of clean up, the trustee would likely abandon it to its prior owner, who would have to comply with the state environmental laws to the extent of his or its liability.” 469 U.S. 274, 285 n.12.

82. 28 U.S.C. § 959(b): “a debtor in possession shall manage and operate the property in his possession . . . according to the requirement of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof, would be bound to do if in possession thereof.”

83. 11 U.S.C. § 959(b).

84. *In re* Catamount Dyers, Inc., 13 Bankr. Ct. Dec. (CRR) 321, 50 Bankr. 790 (Bankr. Vt. 1985).

85. 106 S.Ct. at 762.

86. *See* Governmental Recovery of Cost of Hazardous Waste Removal Under Comprehensive Environmental Response, Compensation and Liability Act, 42 U.S.C. §§ 9601-9657 (1982).

Supremacy Clause of Article VI, Section 2 when it preempted federal law by state regulations? Because *Midlantic* may have infringed upon several rights guaranteed by the Constitution, the Court arguably violated the “ ‘cardinal principle that this Court will first ascertain whether a construction of the statute is fairly possible by which the constitutional question[s] may be avoided.’ ”⁸⁷

A. *Takings Clause of the Fifth Amendment*

Although the takings issue was posed by the trustee's brief as well as by several amicus briefs, neither the Supreme Court's majority opinion nor the majority opinion of the appellate court adequately addressed the takings issue. Other than giving lip service to the contention that prohibiting a § 554 abandonment would raise “substantial questions under the Takings Clause by potentially destroying the interest of secured creditors. . .”,⁸⁸ the majority opinion ignored the possibility of a takings violation. This may account for its failure to follow the rule of statutory construction⁸⁹ established by *United States v. Security Industrial Bank* (“*Industrial Bank*”).⁹⁰

Industrial Bank established that “in the absence of a clear expression of Congress' intent ... [the Supreme Court will] decline to construe the Act in a manner that could in turn call upon the Court to resolve difficult and sensitive questions arising out of the guarantees of the Takings Clause.”⁹¹ By conditioning abandonment upon compliance with state environmental laws, the Supreme Court is requiring the depletion of the estate not for the benefit of the creditors, as mandated by the Bankruptcy Code, but for the benefit of New York, which, in effect, obtains a Superlien.⁹² Under the Fifth Amendment of the U.S. Constitution, “private property [shall not] be taken for public use without just compensation.” Consequently,

87. *Lorillard v. Pons*, 434 U.S. 575 (1978) (quoting *Crowell v. Benson*, 285 U.S. 22, 62 (1932)).

88. — U.S. —, 106 S.Ct. at 759 n.4 (1986).

89. See discussion on rules of statutory construction *supra* notes 77-81 & accompanying text.

90. 459 U.S. 70 (1982) (deciding that § 522(f) cannot be retroactively applied because doing so would violate the Takings Clause of the Fifth Amendment).

91. 459 U.S. at 82 (quoting *NLRB v. Catholic Bishop of Chicago*, 440 U.S. 490, 507 (1979)).

92. Congress so far has not affirmatively granted first priority to environmental claims. The 97th Congress refused to pass a bill introduced by Rep. James J. Florio on Sept. 23, 1982 (H.R. 1972) “giving priority in bankruptcy proceedings to federal and state government claims to recover the costs of cleaning up hazardous substances under the Superfund law and the Resource Conservation and Recovery Act.” *In re Charles George Land Reclamation Trust*, 30 Bankr. 918, 922 n.6 (Bankr. D. Mass. 1983).

the secured creditor, given priority by the Bankruptcy Code if he perfects his security interest pursuant to the applicable commercial code provisions,⁹³ should not have that interest or priority position taken away without just compensation as the Court in *Midlantic* purports to do. Because “[t]he bankruptcy power is subject to the Fifth Amendment’s prohibition against taking private property without compensation,⁹⁴ . . . however ‘rational’ the exercise of the bankruptcy power may be, that inquiry is quite separate from the question whether the enactment takes property within the prohibition of the Fifth Amendment.”⁹⁵

B. *Supremacy Clause of Article VI, Section 2*

Under the Supremacy Clause, federal laws preempt state regulations unless otherwise provided in the federal law. When two federal laws conflict, as they may in the bankruptcy - environmental law arena, the only issue is which goal of the federal government overrides the other. But when a state law clashes with a federal statute, the Supremacy Clause dictates that the federal law should govern.⁹⁶

The Supremacy Clause of section 2 of Article VI provides that “to whatever extent Congress has exercised its powers, any ‘inconsistent’ state laws are prohibited.” Thus, “state laws will be held void under the Supremacy Clause if it would retard, impede, burden, or otherwise stand as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress in enacting the federal law.”⁹⁷ Consequently, the federal bankruptcy law preempts any inconsistent state regulations.⁹⁸

Federal preemption applies even where the state law is enacted for some valid purpose, such as keeping irresponsible drivers off the road, but at the same time impedes the purpose of the federal bankruptcy act, e.g., giving discharged debtors a new start by forcing persons to pay off discharged judgments if they want to drive a

93. See generally Schwartz, *Security Interests and Bankruptcy Priorities: A Review of Current Theories*, 10 J. LEGAL STUD. 1 (1981); Jackson & Kronman, *Secured Financing and Priorities Among Creditors*, 88 YALE L.J. 1143 (1979).

94. *Louisville Joint Stock Bank v. Radford*, 295 U.S. 555 (1935), *reh'g. denied*, 296 U.S. 661 (1936).

95. *Security Industrial Bank*, 459 U.S. at 75.

96. *Fidelity Fed. Sav. & Loan Ass'n v. De La Cuesta*, 458 U.S. 141, 153 (1982).

97. *McCulloch v. Maryland*, 14 U.S. (4 Wheat.) 316 (1819) (state law that sought to impose tax on Bank of U.S., created by Congress, held void as burdensome on federal power to regulate currency, under Article I, section 8, clause 5).

98. *Perez v. Campbell*, 402 U.S. 637 (1971).

car.⁹⁹ By analogy, although the New York environmental law was enacted for some valid purpose (protecting the environment), it is void because it impedes the purpose of Chapter 7 bankruptcies under the Bankruptcy Code (summary liquidation of the estate for distribution to creditors) by forcing the trustee to satisfy all the state environmental clean up claims before distributing any of the liquidated assets to any other creditor.¹⁰⁰

III. CONSEQUENCES

Not only may *Midlantic* be at odds with both the takings and Supremacy Clauses, it may also violate equitable principles, perpetuate impractical legal doctrines, and reduce the utility of the Bankruptcy Code. Furthermore, the Supreme Court left too many questions unanswered,¹⁰¹ thereby imposing the ominous burden of complying with the *Midlantic* holding on the lower courts, which have neither the expertise nor the resources to reconcile the Bankruptcy Code with state environmental laws.

A. *Equitable*

Under *Midlantic*, innocent creditors, who are not responsible for the violations and have no direct relationship with the debtor other than as third party commercial lenders, must clean up the guilty debtor's mess.¹⁰² Although both the creditors and the government are innocent parties, disallowing abandonment disproportionately imposes the burden on the creditors, who are not directly benefitted by the clean up. However, the residents of New York¹⁰³ receive a direct benefit since they now have a cleaner state. In choosing between innocent parties, the court should weigh all the factors and not operate under the false delusion that by denying the trustee the

99. *Id.*

100. As discussed earlier, compelling the trustee to satisfy clean up claims seems inconsistent with the holding in *Kovacs* that clean up injunctions were dischargeable under 11 U.S.C. § 362.

101. What happens if there is not enough money in the estate to cover the clean up costs? What is the priority of the government claim for clean up?

102. New York seeks to transfer "the cost of cleanup to secured and unsecured creditors of the debtor, in this instance outside New York, who have no interest whatever in the Long Island City property, and who, on the record before us, were in no way responsible for placing the contaminated oil on the site." *In re Quanta Resources, Corp.*, 739 F.2d 912, 925 (3d Cir. 1984).

103. New York residents also gain since if the state had to pay for the entire clean up cost, the funding would come from the taxes of the residents.

exercise of his abandonment right guaranteed by § 554 of the Bankruptcy Code, it is indirectly punishing the debtor.

B. *Legal*

Because *Midlantic* was decided by a 5-4 split, similar facts before the court may render different results in the future. In fact, the majority of post-*Midlantic* cases have allowed abandonment even though the abandoned properties were in clear violation of state environmental laws. As illustrated in two recent post-*Midlantic* cases discussed below, the bankruptcy courts tend to stress the good faith efforts of the trustee and the inadequacy of the available funds to comply with the clean up order in approving abandonment.

1. *In Re Oklahoma Refining Company*

The corporate debtor, unable to prosper with a 1919 refinery which it purchased in 1978, filed for Chapter 11¹⁰⁴ in 1984. Because the total claims against the estate exceeded the total value of the assets,¹⁰⁵ the trustee sought to abandon the property on which the refinery was located. The State of Oklahoma opposed abandonment, arguing that, given the potential public health risks presented by the subsoil and aquifer contamination caused by the 65 year-old refinery,¹⁰⁶ abandonment would violate several state environmental laws.¹⁰⁷ Further, the Oklahoma agencies, "without reference to any

104. The trustee proposed to abandon the land "pursuant either to a liquidating plan of reorganization or conversion to a case under Chapter 7." 63 Bankr. 562, 563 (Bankr. W.D. Okla. 1986).

105. The \$4 million estate was subject to approximately \$40 million in secured claims and \$8 million in unsecured claims. Testimony indicated that the polluted land would be worth \$100,000 after the clean up, which was estimated to cost at least \$2.5 million and would require "up to 30 years of monitoring and additional clean up operations." *Id.* at 564.

106. The State claims that abandonment would violate the following statutes:

- 1) Rule 1020.2(a) of the Oklahoma Water Resources Board Rules, Regulations and Modes of Procedure 1985. OKLA. STAT. tit. 82, § 926.4(B) (1981);
- 2) OKLA. STAT. tit. 50, § 5 (1981);
- 3) 1982 Oklahoma Water Quality Standards, § 4.10(a), (d), (e);
- 4) OKLA. STAT. tit. 63, § 1-2009 (Supp. 1985);
- 5) Oklahoma State Department of Health Regulations for Industrial Waste Management, Rules 7.1.6, 7.1.13.

63 Bankr. at 564.

107. While the refinery, since termination of operations, has not generated nor introduced any new contaminants, "[t]he obvious concern, however, is that those substances in the ground will continue to migrate towards the fresh water supplies until, at some indeterminable time, they will pollute public drinking supplies." 63 Bankr. at 563.

specific authority . . . argue that the funds¹⁰⁸ necessary for compliance with state law should be used for those purposes before distribution to the holders of secured claims."¹⁰⁹

Recognizing the "formidable dilemma" confronting the trustee who had no funds by which to comply with the environmental laws, the bankruptcy court approved abandonment. The court interpreted *Midlantic* as requiring bankruptcy courts, in the determination of a trustee's petition to abandon, merely "to take state environmental laws and regulations into *consideration*"¹¹⁰ but not making strict compliance a prerequisite to any approval order.

In defining the parameters of *Midlantic*, the bankruptcy court emphasized that the Supreme Court did "not address how a trustee might pay for environmental clean up of a hazardous waste site," and even ". . . did not reach the question of the ultimate disposition of the property."¹¹¹ In an additional effort to avoid the application of *Midlantic*, the bankruptcy court distinguished factually the amount of hazardous waste involved and the good faith efforts of this trustee. Further, the court rejected the contention made by the state agencies "that section 959(b) of the United States Code requires the trustee to strictly comply with State environmental laws,"¹¹² noting that while the Supreme Court "referenced section 959(b) as additional evidence that Congress did not intend for the Bankruptcy Code to pre-empt all state laws,"¹¹³ it also admitted that § 959 "does not directly apply to an abandonment under Sec. 554(a). . . ." ¹¹⁴

Taking the state environmental laws into consideration in its determination of a trustee's motion for abandonment, the bankruptcy court allowed abandonment, stating that "[for] all purposes the difference between denying and allowing abandonment produces the same result [since] [u]nder either scenario there are no funds available to finance the closure plan or post closure monitoring."¹¹⁵ Since the estate possesses no funds,¹¹⁶ "[t]o require strict compli-

108. The only funds available were cash collateral, defined in § 363(a), which, under § 363 (c)(2), the trustee cannot utilize without approval of the secured creditors. *Id.*

109. *Id.* at 564-5.

110. *Id.* at 565 (emphasis added). See *In re Purco*, 76 Bankr. 523 (Bankr. W.D. Pa. 1987) and *In re Smith-Douglas, Inc.*, 75 Bankr. 994 (Bankr. E.D.N.C. 1987).

111. 63 Bankr. at 565 (referring to discussion in *Midlantic*, 106 S.Ct. at 758 n.2).

112. *Id.*

113. *Id.*

114. 14 Bankr. Ct. Dec. (CRR) at 878 (quoting 106 S.Ct. at 762).

115. *Id.*

116. As noted earlier, § 363(c)(2) prohibits the trustee from using cash collateral without secured creditors' approval.

ance with state environmental laws under the facts of this case would create a bankruptcy case in perpetuity and fetter the estate to a situation without resolve."¹¹⁷ Allowing the state environmental laws "to preempt the administration of this estate would derogate the spirit and purpose of the bankruptcy laws requiring prompt and effective administration within a limited time period."¹¹⁸ The bankruptcy court felt compelled by the Supremacy Clause to approve abandonment. While the "Oklahoma laws regarding environmental protection are not unreasonable . . . , juxtaposed to the Bankruptcy Code, [they] cannot be reconciled to satisfy the strict compliance sought by the State agencies."¹¹⁹

Relying on the Supreme Court's own characterization of its holding in *Midlantic* as "narrow," the bankruptcy court proceeded to whittle away at the requirements of *Midlantic*. In giving mere consideration to state environmental laws, the bankruptcy court in *Oklahoma* examined such relevant factors as the good faith of the trustee, the availability of funds to comply with the clean up order, and the imminence of the danger. Since bankruptcy by definition means that there are insufficient funds for clean up, abandonment will be allowed as long as the trustee acts in "good faith" and the danger is not "imminent."¹²⁰

To this bankruptcy court, good faith of the trustee is inextricably tied to the imminence of the danger. The less imminent the danger, the fewer the remedial steps that need to be taken by the trustee to constitute good faith. However, the real question is whether abandonment will still be approved where the polluted property is clearly in violation of state environmental laws and is presenting an imminent public danger but where the trustee has undoubtedly acted in good faith; that is, he has notified the relevant state agencies, assessed the environmental hazards present, and maintained the necessary security pending the court's order.¹²¹ In addition, did not the bankruptcy court further limit the scope of *Midlantic* when it delayed the application of state environmental laws, which usually apply before the health threat is imminent, by invoking their application only when the situation presented imminent danger to the public? According to the bankruptcy court in *Oklahoma*, only

117. 14 Bankr. Ct. Dec. (CRR) at 878.

118. *Id.* (citation omitted).

119. *Id.*

120. The precise definition of these two terms remains unclear.

121. Arguably, the trustee in *Midlantic* acted in good faith since he maintained 24-hour security around the plants until the issuance of the abandonment order.

when the danger is imminent does *Midlantic* require that environmental laws be given consideration in the determination of whether to grant the abandonment order.

2. *In Re Franklin Signal Corporation*¹²²

The corporate debtor had leased lands in Clear Lake, Wisconsin, and manufactured and sold burglary alarms. In the course of its business it had produced fourteen drums of wastes. Debtor filed for Chapter 11 in 1985 but converted to Chapter 7 a few months later. Upon appointment, the trustee spent \$500 of estate funds to investigate the contents of the drums, discovering that among the chemicals stored in the drums were several deemed hazardous under Wisconsin law. The clean up cost was estimated at \$20,000. Confronted with \$10,000 in unencumbered cash and claims well in excess of that amount against the estate, among them \$17,652 in administrative expenses,¹²³ the trustee petitioned the court for abandonment of the fourteen drums of wastes.

While the bankruptcy court believed that the *Midlantic* decision requires more than mere consideration of state law, but something less than complete compliance, the standard established is practically indistinguishable from that formulated in *In re Oklahoma Refining Company*. The bankruptcy court read *Midlantic* as requiring at minimum two conditions to be met by the trustee in order to abandon burdensome property that "contravene[s] a state law designed to protect the public health and safety."¹²⁴

First, the trustee must conduct an investigation to determine what hazardous substances, if any, burden the property. Second, the trustee must inform the appropriate state and federal agencies of the situation including the trustee's intent to abandon.¹²⁵

If the trustee has met the above conditions, then abandonment will be allowed unless the facts of the case "warrant other restrictions be placed on the trustee's abandonment."¹²⁶

Conditions under which the bankruptcy court may "approve abandonment of hazardous waste . . . must be formulated on a case-by-case basis." The court must consider the following five factors in

122. *In re Franklin Signal Corp.*, 65 Bankr. 268 (Bankr. D. Minn. 1986).

123. Administrative expenses receive first priority under the Bankruptcy Code. 11 U.S.C. § 507(a)(1) (1982).

124. *Id.* at 272.

125. *Id.* at 273.

126. *Id.*

“effectively balanc[ing] the competing interest[s]”:¹²⁷

- (1) the imminence of danger to the public health and safety,
- (2) the extent of probable harm,
- (3) the amount and type of hazardous waste,
- (4) the cost to bring the property into compliance with environmental laws, and
- (5) the amount and type of funds available for clean up.¹²⁸

The court felt that “this case-by-case approach provides a more feasible solution to the underlying problem, as opposed to applying a strict reading of *Midlantic* [and] . . . [e]ven if *Midlantic* dictates complete compliance with state law, the trustee would not have the requisite funds.”¹²⁹ In approving abandonment, the court opted for a “wait and see” approach and stated that it would not address the issue of whether the person deemed ultimately liable would have a valid claim against the estate.¹³⁰ However, the court failed to clarify the relative importance of the five factors. Is the good faith of the trustee sufficient to permit abandonment even though the polluted property may present “imminent” danger? What is the result if there is imminent public threat and the estate does not have the funds to remove the wastes?

C. *Practical*

The trademark of a Chapter 7 bankruptcy is the summary fashion by which it liquidates the debtor’s assets for distribution to the creditors. Attaching additional conditions to the procedural right of abandonment under § 554 will delay bankruptcy proceedings, increase the administrative costs which must be paid before any other claims, and leave less cash to distribute to the creditors. All this appears to violate the underlying purpose of the Chapter 7 bankruptcy under the Code: expeditious dissolution of bankrupt’s estate for distribution to creditors.¹³¹

Furthermore, *Midlantic* subjects the estate to environmental injunctions and other environmental regulations of which the trustee may be held in violation if the trustee is unable to comply because of

127. *Id.* at 272.

128. *Id.*

129. *Id.* at 274.

130. “The determination of who may be ultimately liable and whether that individual or entity has a claim against the estate present interesting questions; however, these issues need not be addressed until presented.” *Id.* at 274.

131. See Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors’ Bargain*, 91 YALE L.J. 57 (1982).

lack of funds in the bankrupt estate.¹³² Imposing sanctions on the trustee, who under the Code cannot be held in contempt, may create two practical problems both of which may result in the dismissal of the bankruptcy petition. First, there is the possibility that the debtor may not be able to find a trustee,¹³³ which may mean that the bankruptcy court must resort to a United States trustee.¹³⁴ Second, even if the debtor finds a willing trustee, the petition may still be dismissed because of the trustee's inexperience in cleaning up hazardous wastes.¹³⁵

Not only may debtors encounter difficulty in finding bankruptcy trustees once they file their petitions, but debtors involved in the business of recycling hazardous wastes will encounter more difficulty in finding willing lenders.¹³⁶ Making financial assistance less accessible creates more bankruptcies in the waste management industry. The short term effect of this result is that those creditors who have already lent money to debtors involved in the hazardous waste business are placed in a "no-win" situation. The long term effect will be less development and enthusiasm in the new waste management industry.

The general rule is that unless the debtor is acting in bad faith, the bankruptcy petition should not be rejected.¹³⁷ But disallowing abandonment is equivalent to dismissing the Chapter 7 petition

132. This is similar to the possible personal liability imposed upon a trustee under the Federal and State Superfund statutes. See *In re Charles George Land Reclamation Trust*, 30 Bankr. 918, 923 (Bankr. D. Mass. 1983).

133. See *In re Chicago Rapid Transit Co.*, 129 F.2d 1 (7th Cir. 1942), cert. denied, 317 U.S. 683 (1942).

134. 11 U.S.C. § 15701(b) provides that the U.S. Trustee "shall serve if no member of the private panel is willing to serve."

135. See *In re Commercial Oil Service, Inc.*, 58 Bankr. 311 (Bankr. N.D. Ohio 1986).

136. "With environmental sensitivity at a peak, the nation is committed to resource recovery and recycling of waste, financing is needed for environmental business that will substitute technology for the callous waste disposal practices of the past. However, the risk associated with the Third Circuit's interpretation of 11 U.S.C. § 554(a) will discourage such lending." Midlantic Briefs, 6 of 11.

137. See *Ordin, The Good Faith Principle in the Bankruptcy Code*. 38 BUS. LAW. 1795 (1983); 11 U.S.C. § 1129(a)(3); *In re Madison Hotel Associates*, 749 F.2d 410 (7th Cir. 1984); *In re Little Creek Development, Co.*, 54 Bankr. 510 (Bankr. N.D. Tex. 1985) rev'd, 779 F.2d 1068 (5th Cir. 1986); *In re Harvey Probbler, Inc.*, 44 Bankr. 647 (Bankr. D. Mass. 1984); *In re Johns Manville Corp.*, 36 Bankr. 727 (Bankr. S.D.N.Y. 1984); *Matter of Port Richey Service Co., Inc.*, 44 Bankr. 634 (Bankr. M.D. Fla. 1984); *Matter of Winn*, 43 Bankr. 634 (Bankr. M.D. Fla. 1984); *Matter of Levinsky*, 23 Bankr. 210 (Bankr. E.D.N.Y. 1982); *In re 299 Jack-Hemp Associates*, 20 Bankr. 785 (Bankr. S.D.N.Y. 1982); *In re Victory Construction Co., Inc.*, 9 Bankr. 549 (Bankr. C.D. Cal. 1981) vacated 37 Bankr. 222 (Bankr. 9th Cir. 1984); *In re G-2 Realty Trust*, 6 Bankr. 549 (Bankr. D. Mass. 1980).

since "by abandoning the contaminated waste oil the trustee may be guilty of a felony under New York law."¹³⁸ Clearly, no one would accept such a perilous responsibility, and the bankruptcy system would grind to a halt in any case involving potential environmental violations. However, "the Supreme Court has indicated that creditors cannot be forced to operate a business, no matter how vital to the public interest, at a loss."¹³⁹ Maybe the debtor could get rid of polluted property without actually abandoning it, e.g., through indirect abandonment.¹⁴⁰

IV. CONCLUSION

On a theoretical basis,¹⁴¹ the Supreme Court may have achieved a desirable result by emphasizing the importance of environmental protection on our national agenda in the recent decision of *Midlantic National Bank v. New Jersey Department of Environmental Protection*. Unfortunately, by partaking in such "judicial legislating," the Court was compelled to rely on unpersuasive authorities, to infringe upon constitutional guarantees, to violate rules of statutory construction, and to ignore the spirit and purpose of the Bankruptcy Code. In addition, what appeared on its face to be an attempt to prevent the Bankruptcy Code from being "a refuge for wrongdoers" ended up as the Spanish inquisition of the bankruptcy

138. 739 F.2d at 921.

139. 739 F.2d at 924 (Gibbons, J., dissenting).

140. "[S]ection 554 was amended by § 468 of the Bankr. Amendments Act of 1984 to provide that property not otherwise administered at the close of the case is not only considered 'abandoned' but is also considered 'administered' for purposes of § 350." 4 Norton Bankr. L. & Prac. Legis. Hist. (Callaghan) § 554, at 164 (cum. supp. 1986). This was also acknowledged by the bankruptcy court in *In re Franklin Signal*:

In some cases, a strict application of the *Midlantic* holding is not practical, or even possible. For example, in a Chapter 7 no-asset case the trustee is rendered helpless. On the one hand, the trustee has no funds—secured or unsecured—to pay for the hazardous waste cleanup. On the other hand, the court cannot authorize an abandonment under § 554(a) if it would contravene state environmental laws. The ironic quirk in a strict application of *Midlantic* is that the property would ultimately be abandoned by default pursuant to 11 U.S.C. § 554(c). That section provides: 'any property scheduled under section 521(a)(1) of this title not otherwise administered at the time of the closing of a case is abandoned to the debtor and administered for purposes of section 350 of this title.' *Id.* Because a strict application of *Midlantic* would simply side-step the problem, it is entirely logical to conclude that the majority did not intend such a result.

65 Bankr. 268, 272 n.5 (Bankr. D. Minn. 1986).

141. The attractiveness of the *Midlantic* facts (e.g., the financial resources were available to fund the clean up, New York had already cleaned up the site at a cost of \$2.5 million, etc.) may have also contributed to the outcome of *Midlantic*.

trustee's "good faith." In effect, the Supreme Court vented its frustration with the current increase of bankruptcies filed by "hazardous wasters" by imposing more stringent requirements on the trustee, who is usually an innocent third party brought on the scene only *after* the state environmental laws have been violated and who, under the Bankruptcy Code, cannot be subject to criminal penalties.

Congress, and not the courts, is the appropriate arena for the resolution of this conflict between federal bankruptcy laws and state environmental laws. First, the ultimate decision is political in nature as it requires a choice between two equally important public interests: debtor protection and environmental protection. Second, Congress possesses all the requisite means of gathering information regarding the possible impact of the choices on society. This is important as bankruptcy policies should not be made in a vacuum but only after an in-depth analysis of all the possible ramifications.¹⁴² Third, congressional action may be the most effective as well as the most efficient way to clear up any and all ambiguities regarding Congress' intent when it created § 554 without any reference, in either § 554 or its legislative history, to the pre-Code judicial restriction on the abandonment right. This may be done by either (1) amending § 554 to require satisfaction of state environmental laws before allowing abandonment, (2) amending § 554 to exclude compliance with state environmental laws as a prerequisite to the exercise of the abandonment right, or (3) amending the Bankruptcy Code to preclude the bankruptcy option for those who have violated any state or federal environmental laws.¹⁴³

While these three options neither exhaust the ambit of possible solutions nor lead to similar results, they all provide a measure of certainty for the debtors, the creditors, the state agencies, and the bankruptcy judges involved in the disposition of a bankrupt estate burdened with hazardous wastes. This certainty will expedite and ensure the proper application of both the federal Bankruptcy Code and state environmental laws. Congress is best suited to bring about this certainty as it possesses the resources to reflect the public atti-

142. In his article *The Bankruptcy of Bankruptcy Policy*, 17 STAN. L. REV. 10 (1982), Professor Jackson advises that in formulating bankruptcy rules, the question asked *should be* "does this bankruptcy rule make sense in light of the larger legal, social, and economic picture?" and *not* "is there any reason that we should let these non-bankruptcy legal rules affect the bankruptcy system?" *Id.* at 10.

143. This third alternative, while harsh, may be desirable as it would preclude those involved in the nuclear energy industry from utilizing the bankruptcy option as a way to dump nuclear wastes.

tudes in deciding whether we should abandon debtor relief to fund environmental clean up.

*Grace C. Yeh**

* J.D. 1987, UCLA; B.A. 1984, University of California, Berkeley.

