

A Congressional Choice: The Question of Environmental Priority in Bankrupt Estates

I.

INTRODUCTION

The Federal Bankruptcy Code (the "Code") creates a list of priorities for the payment of creditors' claims. It does not, however, specifically address the priority to be given federal and state claims resulting from environmental cleanups. The possible alternatives for such cleanup claims range from a priority higher than that for any secured creditor to a priority equivalent to that of an unsecured creditor. If such cleanups are given high priority, creditors may not receive any compensation upon the disposition of the bankrupt estate. If cleanups are given a lower priority, creditors will recover but taxpayers will foot the bill for a debtor's negligence.

Strong policy considerations underlie each possible alternative priority for environmental cleanup costs in bankruptcy. Yet neither environmental nor bankruptcy statutes provide a clear answer to the question of priority. The courts have attempted to interpret the laws and identify a priority for environmental cleanups, but decisions have run the spectrum of alternatives. Clearly, Congress must address the issue of priority if a consistent result is to be reached.

This article provides an objective, in-depth analysis of the alternative priorities available to Congress when it addresses environmental cleanups in the future, and suggests which alternatives Congress is likely to choose.

A. *Bankruptcy Law: An Overview*

Bankruptcy affords an insolvent debtor the opportunity of a "fresh start."¹ The debtor is relieved of her financial obligations² and her creditors are paid to the extent possible with the assets in the debtor's estate.³ This system allows for an equitable and efficient distribution of assets so that individual creditors need not pur-

1. R. AARON, *BANKRUPTCY LAW FUNDAMENTALS* § 1.03 (1989).

2. 11 U.S.C. § 727 (1988).

3. 11 U.S.C. § 507 (1988).

sue their claims independently.⁴

Upon filing a petition in bankruptcy⁵ a debtor is protected from her creditors through the automatic stay provision,⁶ which stops all proceedings,⁷ enforcement actions,⁸ and other efforts to claim the debtor's assets.⁹ The automatic stay is limited by specific exceptions¹⁰ such as the police and regulatory power of the government.¹¹ Creditors obtain payment from the bankrupt estate because they have a claim against the debtor. The Code defines "claim" as a "right to payment" or a "right to an equitable remedy."¹² This broad definition permits the bankruptcy courts to consider a wide range of claims under the Code. House and Senate Reports on the draft versions of the Code confirm that Congress intended to give the Bankruptcy Courts jurisdiction over a wide range of "claims."¹³

The Code dictates an organized system of priorities¹⁴ that determines which claims receive payment. Secured claims¹⁵ are paid first

4. Heidt, *Cleaning Up Your Act: Efficiency Considerations in the Battle for the Debtor's Assets in Toxic Waste Bankruptcies*, 40 RUTGERS L. REV. 819, 831 (1988).

5. Filing in bankruptcy usually takes on one of two very distinct forms—Chapter 7 or Chapter 11. Under Chapter 7 the bankrupt's estate is liquidated and distributed to the creditors. The debtor's property is reduced to liquid assets as quickly as practicable. If the estate consists of a business that is valuable as a going concern, bankruptcy provides a means of selling the business as a going concern to maximize the value of the estate for the creditors. The estate is administered by a trustee. R. AARON, *supra* note 1, § 1.03.

Under Chapter 11, the debtor acts as the trustee (known as the debtor-in-possession) and develops a plan to continue the operations of the business. This plan must be approved by the creditors prior to any discharge. Upon discharge, the business is relieved of its past financial obligations so that it can regain its position in the business community. *Id.* § 1.04.

6. 11 U.S.C. § 362 (1988).

7. 11 U.S.C. § 362(a)(1) & (a)(8) (1988).

8. 11 U.S.C. § 362(a)(2), (a)(4), (a)(5) (1988).

9. 11 U.S.C. § 362(a)(3), (a)(6), (a)(7) (1988).

10. 11 U.S.C. § 362(b) (1988).

11. The police power provisions create exceptions to the automatic stay:

(4) under subsection (a)(1) of this section, of the commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power;

(5) under subsection (a)(2) of this section, of the enforcement of a judgment, other than a money judgment, obtained in an action of unit's police or regulatory power;

...

11 U.S.C. § 362(b)(4), (b)(5) (1988).

12. 11 U.S.C. § 101(4) (1988).

13. H.R. REP. No. 595, 95th Cong., 1st Sess. 309 (1977); S. REP. No. 989, 95th Cong., 2d Sess. 21-22 (1978). See also *Ohio v. Kovacs*, 469 U.S. 274, 279 (1985).

14. 11 U.S.C. § 507 (1988).

15. A security interest exists when a "lien [is] created by an agreement." 11 U.S.C. § 101(45) (1988). A lien is an "interest in property to secure payment of a debt or performance of an obligation." 11 U.S.C. § 101(33) (1988). This circular scheme of

and become post-bankruptcy claims if not paid during the distribution of the estate.¹⁶ Administrative claims, which are the "actual, necessary costs and expenses of preserving the estate,"¹⁷ are next in line for payment.¹⁸ Finally, unsecured claims are paid with the remaining assets. The total amount of secured and administrative claims against the estate dictates whether an unsecured creditor gets paid fully, partially or not at all.¹⁹

B. *Environmental Law: An Overview*

The original source of the environmental regulatory program was

definitions means that when property becomes collateral for a debt, a lien is created against that property and a security interest exists.

A lien is perfected by filing a financing statement. U.C.C. § 9-302 (1978). This recording "perfects" the right of the creditor against others who may claim a security interest in the same property.

16. A claim is secured only to the extent of the value of the property it represents. 11 U.S.C. § 506 (1988). For example, if a creditor's security is a house valued at \$50,000 but her claim is for \$75,000, then the creditor has a secured claim for \$50,000. The remainder of her claim is unsecured.

The Code also expressly allows the trustee in bankruptcy to abandon burdensome property. 11 U.S.C. § 554 (1988). The property is abandoned to anyone with a possessory interest. At that point the secured creditor with a lien on the property can proceed against the property under the laws of the state in which the property is located.

17. 11 U.S.C. § 503(b)(1)(A) (1988).

18. Actually, administrative expenses are part of a list of seven priorities that are paid prior to general, unsecured creditors. 11 U.S.C. § 507 (1988). Each priority on the list is a class of claims and all claims in a class must be paid before the next class receives payment. If funds are not available to pay the whole class, then the claims in the class are paid pro rata and subordinate classes are not paid. The section 507 priorities are listed below.

- (a) The following expenses and claims have priority in the following order:
 - (1) First, administrative expenses . . . and any fees and charges assessed against the estate
 - (2) Second, unsecured claims allowed under section 502(f) of this title (claims in an involuntary case arising after commencement of the case but prior to appointment of a trustee if allowed).
 - (3) Third, allowed unsecured claims for wages, salaries, or commissions
 - (4) Fourth, allowed unsecured claims for contributions to an employee benefit plan
 - (5) Fifth, allowed unsecured claims of [farmers and fisherman as specified]
 - (6) Sixth, allowed unsecured claims of individuals, to the extent of \$900 for each such individual, arising from the deposit . . . of money in connection with the purchase . . . of property
 - (7) Seventh, allowed unsecured claims for [taxes]

19. Cistulli, *Striking a Balance Between Competing Policies: The Administrative Claim as an Alternative to Enforce State Clean-up Orders in Bankruptcy Proceedings*, 16 B.C. ENVTL. AFF. L. REV. 581, 585 (1989). If an unsecured creditor is not paid during distribution of a bankrupt's estate because there are a large number of secured and administrative claims, this creditor may demand security prior to extending credit in the future to ensure payment when a debtor becomes insolvent.

the Resource Conservation and Recovery Act (RCRA) of 1976.²⁰ RCRA regulates the permitting, transportation, treatment and disposal of hazardous wastes.²¹ This comprehensive, far-reaching approach allows the EPA to regulate hazardous wastes from "the point of generation to the site of ultimate disposal"²²

In 1980, Congress enacted the Comprehensive Environmental Response, Compensation, and Liabilities Act (CERCLA).²³ CERCLA and its 1986 amendments have extended liability for toxic waste sites to any party who contributed to a hazardous condition in any manner. Better known as Superfund, the act allows entities such as the EPA and state agencies to take immediate action to clean up or at least stabilize a hazardous condition and then recover from any responsible party the costs expended in such an effort.²⁴ CERCLA created a fund comprised of revenues from taxes on petroleum- and chemical-manufacturing industries to be used to pay for these cleanup actions. The government can then sue the responsible parties to recover the money expended on such cleanups. Likewise, a private party can bring a cost-recovery action under CERCLA for damages caused by hazardous substance releases. Finally, the federal government can issue an administrative order to force cleanup efforts by responsible parties.²⁵

CERCLA is very broad in scope, expanding liability to spread the cost of cleanup to all "potentially responsible parties" (PRP's).²⁶ This cost-spreading theory is even more effective because of the nature of the liability, which is strict in that it is not based on fault or causation, and retroactive in that it applies to environmental damage that occurred before CERCLA was enacted.²⁷ The act provides for joint and several liability and the power to reach personal assets, facilitating recovery by the state.²⁸

20. 42 U.S.C. §§ 6901-6991 (1988).

21. Cosetti & Friendman, *Midlantic National Bank, Kovacs and Penn Terra: The Bankruptcy Code and State Environmental Law—Perceived Conflicts and Options for the Trustee and State Environmental Agencies*, 7 J.L. & COM. 65, 68 n.8 (1987).

22. *Id.*

23. 42 U.S.C. §§ 9601-9657 (1988).

24. 42 U.S.C. § 9607 (1988).

25. 42 U.S.C. § 9601 (1988); see also L. CHERKIS, *COLLIER REAL ESTATE TRANSACTIONS AND THE BANKRUPTCY CODE* 6-26 (1984).

26. Funsten and Hernandez, *The Toxic Waste Generator in Bankruptcy: Should Environmental Clean-up Costs be Given a Priority?*, 6 STAN. ENVTL. L.J. 108, 114-15 (1986-1987). "Not only is CERCLA liability a large net, but also the EPA has successfully cast that net widely across the sea of parties potentially liable for response costs." *Id.* at 115.

27. L. CHERKIS, *supra* note 25, § 6.07, at 6-26—6-27.

28. *Id.*

CERCLA was amended in 1986 by the Superfund Amendments and Reauthorization Act (SARA).²⁹ The most significant change resulting from SARA is the creation of a federal lien on all property that is subject to a cleanup action.³⁰ Once the government spends money to clean up a piece of property and notifies the owner, a security interest arises. However, the federal lien is subordinate to previously perfected liens on the property.³¹

RCRA, CERCLA and SARA are the key acts addressing hazardous waste at the federal level. State superfund statutes have also created additional liability for hazardous waste.³² Additional regulatory measures³³ at the federal level have addressed water and air pollution,³⁴ chemical substances such as pesticides,³⁵ safety issues³⁶ and endangered species.³⁷ Other regulatory measures involve Environmental Impact Statements,³⁸ freedom of information³⁹ and coastal protection.⁴⁰ Environmental laws have expanded to affect all aspects of business and personal life.

C. *Alternative Priorities for the Environmental Claim*

EPA has estimated that cleanup costs under RCRA "will range between \$2 million to \$4 million per land disposal facility."⁴¹ Approximately seventy-four hazardous waste facilities had filed for

29. 42 U.S.C. §§ 9601-9675 (1988).

30. 42 U.S.C. § 9607(l) (1988).

31. See L. CHERKIS, *supra* note 25, § 6.07, at 6-27.

32. California's hazardous waste cleanup provision is the Carpenter-Presley-Tanner Hazardous Substance Account Act, CAL. HEALTH & SAFETY CODE §§ 25300-25395 (Deering 1988 & Supp. 1990). Other state Superfund statutes can be found in STATE SUPERFUND STATUTES 1984, (1983).

33. See Morgan, Lewis & Bockius, *Environmental Deskbook* (1989).

34. 33 U.S.C. §§ 1251-1387 (1988) (Clean Water Act); 42 U.S.C. §§ (300f-j 11) (1988) (Safe Drinking Water Act); 42 U.S.C. §§ 7401-7626 (1988) (Clean Air Act).

35. 7 U.S.C. §§ 136-136y (1988) (Federal Insecticide, Fungicide and Rodenticide Act); 15 U.S.C. §§ 2601-2671 (1988) (Toxic Substances Control Act); 21 U.S.C. §§ 301-393 (1988) (Federal Food, Drug & Cosmetic Act).

36. 29 U.S.C. §§ 651-678 (1988) (Occupational Safety and Health Act); 42 U.S.C. §§ 11001-11050 (1988) (Emergency Planning and Community Right-to-Know Act).

37. 16 U.S.C. §§ 1531-1544 (1988) (Endangered Species Act).

38. 42 U.S.C. §§ 4321-4347 (1988) (National Environmental Policy Act).

39. 5 U.S.C. § 552 (1988) (Freedom of Information Act).

40. 16 U.S.C. §§ 1451-1464 (1988) (Coastal Zone Management Act); 16 U.S.C. §§ 3501-3510 (1988) (Coastal Barrier Resources Act).

41. Cosetti & Friedman, *supra* note 21, at 68 (citing U.S. GENERAL ACCOUNTING OFFICE, HAZARDOUS WASTE ENVIRONMENTAL SAFEGUARDS JEOPARDIZED WHEN FACILITIES CEASE OPERATING 18 (1986)).

The disposal of waste in California is regulated in Title 23 of the California Code of Regulations. Each landfill, or land disposal facility, is classified by the state based on its ability to contain particular types of wastes. CAL. CODE REG. tit. 23, § 2530 (1990).

bankruptcy by August 1985 and many more are expected to follow.⁴² EPA estimates that "twenty-five to thirty percent of the firms owning land disposal facilities will petition for bankruptcy" over the next fifty years.⁴³ From these numbers it is clear that environmental liabilities are often a concern in bankruptcy.

When a debtor does not have enough assets both to pay his creditors and to effectuate a cleanup, the courts must determine who will be paid—the creditors or the state.⁴⁴ The Code does not specify the priority to be given a cleanup claim, and the policies underlying the two laws in issue, environmental and bankruptcy, conflict. Environmental laws are concerned with cleaning up the environment, while bankruptcy laws are designed to ensure an orderly distribution of funds to the creditors. These conflicting policies must be balanced to determine what priority should be given to cleanup claims.⁴⁵

Courts have been faced with numerous cases that require a decision regarding the priority of environmental claims. Some courts have questioned whether the environmental obligation should be given any priority at all,⁴⁶ while others have looked to the police power exceptions to the automatic stay to provide for government creditor relief.⁴⁷ The Supreme Court has offered little guidance in this area, and what guidance it has given has been vague and inconsistent.⁴⁸

Wastes must be disposed of in facilities that are classified to accept the particular type of waste.

42. Cosetti & Friendman, *supra* note 21, at 68.

43. *Id.* The federal government has estimated that EPA spends approximately \$12 million per Superfund site on clean-up expenses. Drabkin, Moorman & Kirsch, *Bankruptcy and the Cleanup of Hazardous Waste: Caveat Creditor*, 15 *Envtl. L. Rep. (Envtl. L. Inst.)* 1016869 (1985) (citing 49 *FED. REG.* 40320, 40325 (1984)).

44. Note that the state is usually the party to effectuate a cleanup.

45. Cistulli, *supra* note 19, at 607.

46. See *In re Wall Tube and Metal Prod.*, 56 *Bankr.* 918 (*Bankr. E.D. Tenn.* 1986), *rev'd*, 831 *F.2d* 118 (6th *Cir.* 1987).

47. See *Penn Terra Ltd. v. Department of Env'tl. Resources*, 733 *F.2d* 267 (3d *Cir.* 1984).

48. See *Ohio v. Kovacs*, 469 *U.S.* 274 (1985); *Midlantic Nat'l Bank v. New Jersey Dep't of Env'tl. Protection*, 474 *U.S.* 494, *reh'g denied*, 475 *U.S.* 1090 (1986). These two cases represent the only Supreme Court decisions regarding bankruptcy/environmental issues in the past six years. The inadequate and confusing nature of the decisions is most apparent when focusing on the issue of abandoning a hazardous site under the Code. In a footnote in *Kovacs*, the Court explained that property that is not of value to the estate may be abandoned and the prior owner would then be liable for the cleanup costs incurred by bringing the site into compliance with state and federal laws. 469 *U.S.* at 284 n.12. In *Midlantic National Bank*, the Court appears to have reversed its view, holding that the "trustee may not abandon property in contravention of a state statute or regulation . . ." 474 *U.S.* at 507. The *Midlantic National Bank* holding may be

While many commentators have criticized the courts' solutions to this problem and have suggested solutions of their own,⁴⁹ most agree that Congress must make the ultimate decision as to the priority of environmental claims in a bankruptcy proceeding. Congress must weigh the policies and decide which is dominant—the “fresh start” behind the Bankruptcy Code or the funding of cleanups promoted by environmental laws.

II.

THE ALTERNATIVES

There are four possible alternatives for state environmental cleanups in the bankruptcy priority scheme: 1) environmental superlien, 2) administrative claim, 3) unsecured claim or 4) no claim. The case law supporting each alternative, and the underlying policy arguments, are outlined below.

A. *Environmental Superliens*

Environmental cleanup costs may be given the highest priority under the bankruptcy code—priority as a secured creditor. The value of one creditor's secured interest depends on the secured interests of other creditors.⁵⁰ If the secured cleanup claim is inferior to all other secured claims, only property that is not current collateral for another creditor's claim will be available to cover cleanup costs. This would limit recovery to the value of residual collateral and would in many cases result in a claim that is primarily unsecured.⁵¹ Alternatively, the cleanup can be given priority over all claims so that all secured interests are subordinate to the environmental claim. This is the true “environmental superlien”⁵² that

limited in the future to cases where public health and safety is at risk or to situations where no initial safety measures have been taken to secure the property, but the court did not clearly limit its holding. 474 U.S. at 498 n.2. A thorough review of the implications of the *Midlantic National Bank* case is beyond the scope of this article. However, the disarray of the law must be noted.

49. Compare Heidt, *supra* note 4, at 863 (stating that the “best method of achieving [efficiency] is for each state to enact a superlien law”) with Funsten & Hernandez, *supra* note 26, at 144 (suggesting the use of criminal and civil penalties to punish those who abuse environmental laws and promoting the protection of the “innocent creditors”).

50. If two creditors hold security interests in the same piece of property, the one who first perfects his interest is the senior lienholder. The other lienholder is paid only if residual value remains after payment of the senior lienholder's claim.

51. In most cases, most of a debtor's valuable assets, such as real property, are security for various claims. See *supra* note 16.

52. Several states have passed statutes modifying the priority of a state's claim for environmental liabilities. New Jersey's statute, probably the closest to the “superlien,” creates a lien on the contaminated property that is superior to all other liens against that

would give environmental claims the highest possible priority.

This secured/superlien alternative provides an economically efficient solution to the question of the appropriate priority for a state environmental claim.⁵³

To achieve an efficient level of production in a free market the price of a product must equal the cost of producing it . . . includ[ing] not only the private costs such as the costs of raw materials, but the less obvious social costs such as the harm to potential victims or, as here, the cost of clean-up. Should the price of a product or service not include all of the costs of production, [too much] of that product will be produced, sold and consumed.⁵⁴

If costs are internalized so that the cost of cleanup is part of the cost of credit, the most efficient amount of the product will be produced, the consumers will bear all the costs of the product, and the demand for such a product will be reduced to an efficient level because of the higher price. This "[c]ost internalization will cause consumers to substitute safer and cheaper alternatives if they are available."⁵⁵ This cost internalization also encourages research and development efforts to lower costs to the level of environmentally safer products.⁵⁶

The remaining question is how to internalize the cost of cleanup so that the cost is borne by the producer and then, ultimately, passed on to the consumer.⁵⁷ The cost of production must be increased to reflect the environmental risk created by the producer.

This solution may be achieved by affording cleanup costs the

property. If the value of the property is not sufficient to cover the costs, then a lien attaches to the debtor's other property, both real and personal, but this lien is subordinate to existing liens. N.J. STAT. ANN. § 58:10-23.11f (West Supp. 1990). Connecticut's statute is similar to that of New Jersey except the Connecticut statute does not extend to personal property of the debtor and does not apply retroactively to environmental liabilities existing before the legislation. CONN. GEN. STAT. ANN. § 22a-452a (West Supp. 1990). Arkansas, Massachusetts and New Hampshire also have statutes creating a superpriority. ARK. STAT. ANN. §§ 8-7-417, 8-7-516 (Supp. 1989), MASS. ANN. LAWS ch. 21E, § 13 (Law Co-op. 1988), N.H. REV. STAT. ANN. § 147-B:10-b (Supp. 1990). While all of these statutes increase the priority of the environmental claim and thus the likelihood of payment, none create a true superlien as discussed in the text of this article.

53. Heidt, *supra* note 4, at 833. A majority of the analysis in this section is taken from this article.

54. *Id.*

55. *Id.*

56. *Id.*

57. A general income tax will not achieve such internalization because it would not specifically impose a burden on only those who have created the costs. If such costs are spread throughout society by a general income tax, then all taxpayers pay and there is even less internalization than exists under present environmental laws. *Id.* at 841-43.

highest priority—priority over all creditors. Under such a priority system, the state would be paid for its cleanup claims before other creditors. Creditors would increase interest rates charged to debtors in proportion to the risk each debtor represents. The higher the probability that a creditor will lose her collateral, the higher the interest rate charged. The resulting increased cost of credit, an input of production, would be imposed on producers that represent a higher risk due to their toxic activities. This increased cost would be passed along to consumers in the form of higher prices, resulting in more complete cost internalization.

To ensure the recovery of their investment, creditors will restrict the types of activities debtors may pursue and monitor debtors' activities to ensure compliance.⁵⁸ Such monitoring is an added benefit of this cost internalization scheme. Monitoring will also increase the cost of credit as the creditor takes on the role of a regulator in the case of a high risk debtor. However, as the monitoring cost is reflected in the debtor's cost of credit, further cost internalization is realized.⁵⁹

One commentator claims that this solution places the responsibility of cost internalization on the party who can most cheaply enter into transactions with the debtor. The secured creditor is such a party because she has established a bargaining relationship with the debtor and may coerce the debtor to comply with environmental laws through increased interest rates.⁶⁰ These higher interest rates will help compensate the creditor whose claims are subordinated to environmental cleanup claims when a debtor files in bankruptcy. However, only debtors who can afford the higher interest rates will be able to acquire capital for production. Debtors who cannot afford the capital are probably also those who would become insol-

58. If environmental claims were paid out of residual property not part of any secured claim, secured creditors would only monitor to ensure that assets subject to their security interests were not contaminated. Creditors would have no incentive to monitor a debtor's entire business to ensure compliance because their payment would only depend on their specific security interest. See Schwartz, *Security Interests and Bankruptcy Priorities: A Review of Current Theories*, 10 J. LEGAL STUD. 1 (1981).

59. The problem with this analysis is that it ignores the initial inefficiency during the transition to this type of system. If this new priority scheme is implemented to apply retroactively, the solution does not result in true internalization. Secured creditors were charging an interest rate that was too low in the past so that the product produced was underpriced and overproduced. Interest rates will be increased significantly at first to cover not only the cost of future cleanups due to current credit but also to cover the cost of cleanups due to past, unmonitored credit. This will result in temporary overpricing of risky products and underproduction. This inefficiency will be corrected over time but it should not be ignored when analyzing the alternatives. Heidt, *supra* note 4, at 849-51.

60. *Id.* at 848.

vent if an environmental cleanup is necessary.⁶¹

The market solution does not always assure that funds will be available for cleanup. If a debtor does not have enough property to cover the cost of cleanup, taxpayers will foot the bill. For this reason, the state must still regulate debtors to ensure compliance with environmental laws. Sometimes these state regulations duplicate efforts by creditors. While such duplication may be the only way to ensure that environmental laws are not violated,⁶² this problem reduces the economic efficiency of this solution.

In *In re T. P. Long Chemical, Inc.*,⁶³ the bankruptcy court rejected the superlien analysis. Although the court agreed that cleanup obligations deserved a high priority, it reasoned that the state should not be entitled to recover its costs out of the secured creditors' collateral. The court referred to section 506(c) of the Code, which provides: "The trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim."⁶⁴ However, even though the cost of cleanup was "reasonable" and "necessary,"⁶⁵ the creditor had to receive a benefit before this cost could be imposed on her security interest. Since the "creditor is under no obligation to assume possession of the collateral,"⁶⁶ the expenditure "by the EPA did not discharge a liability of, and did not confer a benefit on," the creditor.⁶⁷

In addition to the court's concern regarding the benefit conferred upon the estate, a second concern is that responsibility for cleanup costs may be misplaced. If creditors are forced to bear the costs associated with the toxics industry, they may decide to curb investment in these types of businesses rather than expose themselves to the risk of environmental liability.⁶⁸ While one may argue that market forces will cause creditors to invest if the expected rate of return is sufficient even considering the risk of environmental liabil-

61. *Id.* at 836. Many debtors may choose to self-insure to avoid bankruptcy if a cleanup becomes necessary. In this case, the insurance company will probably do the monitoring. Creditors should then provide capital at a lower interest rate that reflects a lower risk.

62. *Id.* at 846-47.

63. 45 Bankr. 278 (Bankr. N.D. Ohio 1985).

64. 11 U.S.C. § 506(c) (1988).

65. *In re T.P. Long Chemical, Inc.*, 45 Bankr. at 287.

66. *Id.* at 288.

67. *Id.* at 289.

68. Funsten & Hernandez, *supra* note 26, at 143-44.

ity, this argument ignores the fact that creditors may not be willing to take such risks given the uncertainty with which a creditor can determine her risk in an environmentally sensitive situation. It also ignores the fact that the cost of such credit may actually prohibit some industries from existing in the market.

A second problem with this priority scheme is that it places the blame, which belongs on the polluter, on the estate and the innocent creditors. The estate is a morally neutral party that did not create the environmental liability that burdens the estate. Creditor liability for environmental costs runs counter to the policies underlying the Code—the efficient payment of creditors' claims.⁶⁹ Congress had the opportunity to place the cost of cleanup liability on creditors under CERCLA but chose not to do so, determining that such an imposition would run counter to the spirit of CERCLA.⁷⁰ Congress did create a federal lien under SARA, but this lien is subordinate to previously perfected liens and does not affect state claims. To impose cleanup costs on the estate and creditors is "contrary to accepted notions of fair play and . . . cost-spreading which underlie general [b]ankruptcy policy."⁷¹

B. *Environmental Claims as Administrative Claims*

The second alternative in prioritizing environmental claims is to award them the status of administrative expenses. Claims are usually awarded this status so that suppliers will deal with the bankrupt estate.⁷² If a supplier were not given some priority status, she would refuse to continue to supply goods or services necessary for the efficient disposition of the estate. In the words of section 503 of the Code, these are the "actual, necessary costs" of preserving the estate.

69. There has also been some commentary on the idea that retroactive application of a superlien statute that is a superior claim on all assets of the bankrupt is a taking of property in violation of the fifth amendment. A discussion of this topic is beyond the scope of this article. See K. Heidt, *supra* note 4, at 854-59; see also M. Zarín, *State Recovery of Hazardous Waste Cleanup Costs and Bankruptcy: The Constitutionality of Retroactive State Superpriority Lien Statutes*, 90 COM. L.J. 346 (1985). But see Kessler v. Tarrats, 194 N.J. Super. 136, 476 A.2d 326 (App. Div. 1984).

70. Funsten & Hernandez, *supra* note 26, at 120-21.

71. *Id.* at 121.

72. When a supplier, for example, provides goods to an estate so that a business can continue to operate under Chapter 11, the supplier's claim is considered an administrative claim if the goods are "necessary" for the continued operation of the business. However, the supplier would not provide the goods if she were not assured payment. The higher priority given to administrative expenses allows the estate to continue to receive these "necessary" goods. Cistulli, *supra* note 19, at 586-87.

Because of the priority status acquired when a claim is cast as administrative, states are attempting to expand the definition of this type of claim to include compliance with state environmental laws. The courts may be expanding this category of claims by broadening the definition of "necessary" to create an environmental administrative claim. "Payment of such claims neither rehabilitates the estate nor preserves its assets, yet based on the public policy of protecting the environment, courts are broadening the meaning of 'necessary' to enforce environmental cleanup orders."⁷³

The administrative status may not be available to all environmental claims. Instead, some factors⁷⁴ to be considered in determining if an administrative claim is appropriate under section 503 are as follows:

1. Was the claim a post-petition claim?⁷⁵
2. Did the expenditure benefit the estate?
3. Was the claim necessary to prevent imminent harm?
4. Is the claim non-monetary in nature?

The first two factors represent the policy that administrative claims are for the benefit of the estate and not for the benefit of a specific creditor. Since the estate does not exist until the bankruptcy petition has been filed, a claim is not administrative unless it provides a post-petition benefit.

The third factor comes from the "actual and necessary" language in the Code.⁷⁶ Classifying all environmental claims as administrative expenses may be beyond the scope of the Code. Each environmental claim differs in its severity and certainty of danger to the public. When the threat is imminent, the claim may be "necessary" and allowable under section 503(b)(1)(A).⁷⁷ This analysis illustrates a problem that would result if all environmental claims were given administrative status—namely, that all claims may not represent imminent harm and require this higher priority. Administrative proponents will argue that the administrative priority addresses this need for case-by-case analysis, because a claim is not granted administrative status until a hearing has been held to determine that

73. *Id.*

74. *Id.* at 588-90.

75. To begin a bankruptcy proceeding, the debtor files a petition. Claims that arose prior to the petition are claims in bankruptcy. Post-petition claims are those that arise while the estate is being administered or after disposition of the estate.

76. 11 U.S.C. § 503(b)(1)(A) (1988).

77. Cistulli, *supra* note 19, at 608-10.

the claim deserves a priority status.⁷⁸ This hearing assures that the courts look at the circumstances of each environmental claim to determine whether an "imminent" threat of harm existed when the expenditures were made.

The final factor derives from the police power exceptions to the automatic stay and is partially defined by a recent Supreme Court decision, *Ohio v. Kovacs*.⁷⁹ The police power provisions of the Code are exceptions to the automatic stay. The first⁸⁰ excepts the commencement or continuation of actions or proceedings by a governmental unit to enforce police or regulatory power. This exception to the automatic stay was meant to give the government the right to continue to act to enforce environmental laws despite the stay provision in the code.⁸¹ The second exception⁸² limits the enforcement of the judgments allowed in the first provision to non-monetary judgments to enforce the police or regulatory power. The purpose of such a provision is to limit the government's ability to obtain a preferred status over creditors.⁸³

Kovacs involved the operation of a hazardous waste disposal site that was not in compliance with state environmental laws. The site owners were enjoined⁸⁴ from, among other things, further polluting the site and were ordered to pay \$75,000 to compensate for injury to wildlife. When the owners did not comply, the state seized all property and assets "to implement the judgment entry by cleaning up the Chem-Dyne site."⁸⁵ One of the owners filed in bankruptcy. The state claimed the liability for cleaning up the site was not dischargeable in bankruptcy because it was not a "debt" within the meaning of the Bankruptcy Code. The Court disagreed, emphasizing that a debt is a "liability on a claim"⁸⁶ and "Congress desired a broad definition of a 'claim.'"⁸⁷ Even though the judgment was an injunction, it required the owner to clean up the site. Since the

78. *Id.*

79. 11 U.S.C. §§ 362(b)(4) & (5) (1988); *Ohio v. Kovacs*, 469 U.S. 274 (1985).

80. 11 U.S.C. § 362(b)(4) (1988).

81. L. CHERKIS, *supra* note 25, at 6-4.

82. 11 U.S.C. § 362(b)(5) (1988).

83. L. CHERKIS, *supra* note 25, at 6-4.

84. *Kovacs* was the Chief Executive Officer and stockholder of Chem-Dyne Corporation. Chem-Dyne operated the disposal site in question with other business entities. These business entities and *Kovacs* were the defendants in the injunctive action. *Kovacs*, 469 U.S. at 276.

85. *Id.*

86. *Id.*, 469 U.S. 274 at 278 (citing 11 U.S.C. § 101(1)).

87. *Id.* at 279. See *supra* note 13 and accompanying text.

owner was relieved of any means to clean up the site himself, the receiver could only have wanted money to cover the cleanup costs.

Under the *Kovacs* analysis, courts must analyze each claim to determine whether the injunction is actually a monetary claim. The problem with this analysis is that almost any injunction will require monetary expenditures in one form or another. Thus the *Kovacs* court may have overly limited the fourth factor to be considered under section 503.

Penn Terra Ltd. v. Department of Env'tl. Resources is the leading case that broadens the term "non-money judgment" and limits the use of the automatic stay in environmental cases.⁸⁸ *Penn Terra* operated coal mines that were in violation of certain environmental laws. The company had agreed to a consent order but filed in bankruptcy shortly thereafter. The state sued to force compliance with the order. The Third Circuit saw the required cleanup not as a money judgment but as a valid exercise of the police powers under section 362(b)(4). The court narrowly interpreted the term "money judgment" as involving a certain sum owed by one party to another with specific parties identified against whom and for whom the judgment is entered. Injunctions, on the other hand, protect the public from potential future harm. The court refused to view the required expenditure of money as a "money judgment" because such a finding would narrow the police power exception "into virtual nonexistence."⁸⁹ The court went on to state that "in contemporary times, almost everything costs something. An injunction which does not compel some expenditure or loss of monies may often be an effective nullity."⁹⁰

This broader definition of "non-money judgment" may expand the availability of the administrative status for environmental claims.⁹¹ Courts will look to the nature of the enforcement action rather than the expenditure or non-expenditure of money as the factor determining the status of the claim. The result is that environ-

88. 733 F.2d 267 (1984).

89. *Id.* at 277-78.

90. *Id.* at 278.

91. Numerous cases have followed the *Penn Terra* analysis. *See, e.g.*, *United States v. Mattiace Indus., Inc.*, 73 Bankr. 816 (E.D.N.Y. 1987); *Walsh v. West Virginia (In re Security Gas & Oil, Inc.)*, 70 Bankr. 786 (Bankr. N.D. Cal. 1987); *Cournoyer v. Town of Lincoln*, 790 F.2d 971 (1st Cir. 1986); *United States v. F.E. Gregory & Sons, Inc.*, 24 Env'tl. Rep. Cas. (BNA) 1110 (D.W.D. Pa. 1986); *United States v. ILCO, Inc.*, 48 Bankr. 1016 (D.N.D. Ala. 1985); *In re Laurinburg Oil Co., Inc.*, 49 Bankr. 652 (Bankr. M.D.N.C. 1984).

mental costs may be recoverable as an administrative expense, even if monetary expenditures are required.

Two commentators have developed a test to distinguish between injunctive and monetary claims.⁹² Claims that result from pre-petition activities and whose consequences continue to exist even after the debtor goes out of business are claims on the estate or monetary claims. On the other hand, obligations that would cease to exist if the debtor were no longer in business result in injunctions to cease polluting and are non-monetary, administrative claims. This is a narrow view of the administrative status that would not cover the majority of environmental claims.

Some courts have looked to section 503(b)(1)(A) of the Code for "a statutory basis for elevating general, unsecured claims to the level of an administrative claim."⁹³ These courts base their reasoning on policy considerations rather than directly on the language in the code.

Prioritizing claims based on policy considerations is nowhere more evident than in the area of toxic waste cleanup orders. Courts frequently cite the "actual and necessary" language of section 503(b)(1)(A) but in reality go beyond the plain meaning of the statute to allow administrative claim status for hazardous waste clean-up orders.⁹⁴

Congress could grant environmental claims the status of administrative priority. The flexibility of this alternative would require some definitive measures by the legislature. All environmental claims could be classified as post-petition because they require expenditures to keep the estate in compliance with environmental laws.⁹⁵ This argument somewhat subsumes the idea that the expen-

92. Baird & Jackson, *Kovacs and Toxic Wastes in Bankruptcy*, 36 STAN. L. REV. 1199, 1204-05 (1984).

93. Cistulli, *supra* note 19, at 581-82.

94. *Id.* In *In re Quanta Resources Corp.*, 739 F.2d 912, 923 (3d Cir. 1984), the Third Circuit stated in dicta that such cleanup costs might qualify as an administrative expense under section 503(b)(1)(A) of the Code as the "actual, necessary costs of preserving the estate." The Supreme Court in *Midlantic National Bank* did not address this issue. 106 S. Ct. 755. However, Justice Powell stated in *Midlantic National Bank* that the proper measure of determining whether a court should allow an administrative priority is whether the public will be adequately protected. *Id.* at 762.

Note that *Midlantic National Bank* "restricts abandonment power when it would threaten public health and safety. If trustees cannot abandon the real estate, then they must comply with state environmental laws. . . . [C]ost then becomes an 'actual and necessary' administrative cost under section 503(b)(1)(A)." Cistulli, *supra* note 19, at 596 (citing *Midlantic National Bank*, 106 S. Ct. at 760).

95. 28 U.S.C. § 959(b) (1988) (Requires that a trustee "manage and operate the property in his possession . . . according to the requirements of the valid laws of the

diture must be for the benefit of the estate. The imminent harm factor could be used to restrict the administrative expense status to certain types of environmental claims. Congress could adopt a narrow definition of imminent harm and require that only preliminary remedial steps be taken to secure the immediate safety of the public.⁹⁶ Alternatively, a broader definition of imminent harm may allow the requirement of site assessments, remedial action plans and even plan implementation where the contamination is severe. Congress could define the meaning of imminent harm consistent with its determination as to the extent of the cleanup that should be handled by the estate. The courts would then interpret this definition on a case by case basis, providing the flexibility required because of the variable nature of environmental claims.⁹⁷

Elevating environmental cleanups to the status of administrative claims may thwart the Code's underlying policy goals in several ways. Governmental agencies may try to enforce a money judgment under the police power exception by requesting a type of injunction to disguise a money judgment. "The legislative history clearly indicates that the police power exception should not be used by a governmental unit to obtain preferential treatment over other creditors."⁹⁸ If pre-filing cleanup orders are given a preferred status, the funds available to satisfy unsecured creditors' claims are reduced. As a result, general creditors would be discouraged from extending credit, and only secured credit would be available in any situation with environmental risks. This status also limits the "breathing space" necessary for a debtor to reorganize. Affording non-statutory claims preferred status may initiate a "destructive race" that destroys the going concern value of a business because

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.").

96. See *Midlantic National Bank*, 106 S. Ct. at 766-67 (Rehnquist, J., dissenting).

97. A claim must be adjudicated administrative. 11 U.S.C. § 503(b) (1988). In *In re Peerless Plating Co.*, 70 Bankr. 943 (Bankr. W.D. Mich. 1987) an administrative claim was allowed for a cleanup order issued under CERCLA. The court saw adjudication of administrative expenses as a means of deciding each cleanup case based on the record as a whole. But see *In re Wall Tube & Metal Products Co.*, 56 Bankr. 918, 927 (Bankr. E.D. Tenn. 1986), *rev'd* 831 F.2d 118 (6th Cir. 1987) ("[P]otential for unwittingly creating an incentive for governmental authorities to postpone environmental cleanup activities for financially strategic reasons in order to gain the advantage of priority treatment in a bankruptcy context.") See also *In re Pierce Coal & Constr., Inc.*, 65 Bankr. 521, 531 (Bankr. N.D.W. Va. 1986) (The court would not elevate pre-petition claims to administrative priority status, but if imminent and identifiable harm is present claims "may be elevated to administrative priority and, perhaps, even to a type of secured priority.").

98. Cosetti & Friendman, *supra* note 21, at 86.

creditors will push to assure collection of at least part of their own interest rather than try to maximize the return on their investment by keeping the business whole.⁹⁹ This race would discourage current creditors from dealing with an insolvent business because their status as administrative would be diluted by the new administrative priority.

The environmental claim as an administrative claim severely limits the realizable cost internalization and resulting economic efficiency that would occur under the superlien alternative.¹⁰⁰ The new environmental administrative claim would be given a priority under section 507 of the Code. Since administrative claims are the highest priority under section 507 and must be paid before any other priority can be paid, most environmental claims would destroy any chance of payment to lower priority claimants or unsecured creditors. Administrative expenses would deplete the remaining assets in the estate and some administrative claimants would not receive any payment. Some suppliers might refuse to do business with the bankrupt estate because of the added uncertainty in receiving full payment for goods supplied.¹⁰¹ Unsecured creditors might decide not to offer credit to the debtor because of this new priority. However, because unsecured creditors receive little or no compensation for their claims in bankruptcy anyway, this new priority would have little impact on the unsecured creditor. The

99. Cistulli, *supra* note 19, at 608. Representative Edwards and Senator DeConcini sponsored the Bankruptcy Code legislation. In a specific discussion of section 362(b)(4), the two made it clear in their remarks that the police power exception, from which the environmental claims may get their status as administrative expenses, "is intended to be given a *narrow* construction in order to permit governmental units to pursue actions to protect the public health and safety and not to apply to actions by a governmental unit to protect a pecuniary interest in property of the debtor or property of the estate." Cosetti & Friedman, *supra* note 21, at 88 (citing 1979 U.S. CODE CONG. & ADMIN. NEWS 6444-45 (remarks of Rep. Edwards), 6513 (remarks of Sen. DeConcini)) (emphasis added).

100. See *supra* notes 52-61 and accompanying text. An economic analysis involves only one variable with all other factors held constant. It is difficult to analyze the economic efficiency of this alternative because more than one variable exists. For this alternative, assumptions must be made concerning the value of the estate, the value of secured and unsecured creditors' claims and the existence of other priority claims. For this reason, the economic analysis offered for this alternative is not as comprehensive as for the other alternatives.

101. Administrative claims usually result from the continuing business of the estate. Administrative claimants chose to do business because of the higher priority of their claims. If their claims will not be paid because of an environmental liability that will deplete the assets in the estate, some suppliers will probably choose not to subject themselves to doing any business with the bankrupt estate. This priority *will* result in fewer people willing to provide the necessary goods needed to reorganize a bankrupt estate under Chapter 11. See also *supra* note 71 and accompanying text.

new priority would thus not result in any significant cost internalization or economic efficiency.

The administrative claim status for environmental cleanups may be a good middle position between the two priority extremes: secured and unsecured. Such a position may provide the best balance and compromise between the "fresh start" policy of the Code and the need to clean up hazardous waste. "Use of an administrative priority allows *ad hoc* adjudication of the issues which is fair and yet preserves the priorities in the Code."¹⁰² This placement for environmental claims can be accomplished if Congress looks beyond the language of the Code to adapt the Code to address growing environmental concerns.

C. *Environmental Claims as Unsecured Claims*

The third alternative status for state environmental claims is that of an unsecured creditor. The environmental claim would be a claim in bankruptcy but would not be given any priority. The secured and administrative creditors would be satisfied first, with residual property being distributed *pro rata* to all unsecured claimants.¹⁰³

This solution is justified by the argument that the bankrupt's estate is not the culpable party when environmental liability exists. One commentator claims that resentment toward the concept of limited shareholder liability causes the misperception that the debtor is "getting away with something."¹⁰⁴ A review of the result in bankruptcy illustrates the problem with this misperception. In Chapter 7, the corporation is never discharged. The corporation's assets are distributed and the corporate shell remains.¹⁰⁵ In Chapter 11, all creditors must be satisfied or the stockholders get nothing.¹⁰⁶ The corporate debtor never "gets away with anything" because, regardless of the priority the creditor receives, her claims are paid before the debtor corporation receives anything.

Several courts have implied that a state environmental claim in a bankruptcy situation is an unsecured claim. In *In re Wall Tube and Metal Products*,¹⁰⁷ the court refused to allow priority status to the

102. Cistulli, *supra* note 19, at 613.

103. See *supra* notes 14-19 and accompanying text.

104. Heidt, *supra* note 4, at 820-21 n.9. If the shareholder did not have limited liability, his assets would be used to pay the claims in bankruptcy, including environmental cleanup claims.

105. 11 U.S.C. § 727(a)(1) (1988).

106. See 11 U.S.C. §§ 1129(a)(8), 1129(b)(1), 1129(b)(2)(B)(i)-(ii) (1988).

107. 56 Bankr. 918 (Bankr. E.D. Tenn. 1986), *rev'd*, 831 F.2d 118 (1987).

post-petition costs of sampling and analyzing of hazardous wastes where the debtor had filed in Chapter 7. The court stated that the trustee did not have to manage the business in compliance with state laws; the trustee was not operating the business as in a Chapter 11 case but was merely disposing of the estate. The court did not see any benefit conferred on the estate or its creditors from such expenditures and denied priority as an administrative expense. Rather, the costs were given an unsecured status.

The Third Circuit also denied administrative status for cleanup costs in *Southern Railway Co. v. Johnson Bronze Co.*¹⁰⁸ The lessee in that case had expended funds to clean up a hazardous waste site but the lessor had indemnified the lessee for these types of costs. The lessee claimed to have a priority status because of the indemnification agreement. The court assumed that the lessee's rights against the bankrupt were identical to the rights of the state for any such claim. The court concluded that the lessee would not have any priority under the Code but would be a general, unsecured creditor.

*Midlantic National Bank*¹⁰⁹ is the most recent Supreme Court decision addressing environmental liability in a bankruptcy situation. The case has forced courts to consider all environmental liabilities as having a high priority because of the estate's inability to abandon hazardous property. *Midlantic National Bank* concerned the bankruptcy of a debtor who operated two waste oil facilities. After unsuccessfully attempting to sell the facilities, the trustee sought to abandon the property under section 554(a) of the Code. The Court recognized that the property was "burdensome" and "of inconsequential value to the estate" as required for abandonment under section 554(a). The Supreme Court looked beyond this language to deny abandonment of the property. The Court held that "[t]he Bankruptcy Court does not have the power to authorize an abandonment without formulating conditions that will adequately protect the public's health and safety."¹¹⁰ The Court stated that "a trustee may not abandon property in contravention of a state statute or regulation that is reasonably designed to protect the public health or safety from identified hazards."¹¹¹

Lower courts have interpreted this new limitation on abandonment rights as a factor creating an allowable administrative claim, raising most environmental claims from their unsecured status. If

108. 758 F.2d 137 (3d Cir. 1985).

109. 474 U.S. 494 (1986).

110. *Id.* at 506-07.

111. *Id.* at 507.

the environmental conditions of a site are such that the court will not allow abandonment, the property will remain with the estate. The trustee must then maintain the property in compliance with all laws under section 959 of Title 28. The trustee's only choice will be to provide for cleanup of the site to the extent possible with the assets of the estate. The result is the elevation of environmental claims to administrative status.

In *In re Pierce Coal & Construction, Inc.*,¹¹² the court considered expenses incurred during operation of mines while in Chapter 11 as administrative costs. The court went on to discuss the creation of this new means to elevate pre-petition unsecured claims to an administrative priority using the *Midlantic National Bank* exception:

The United States Supreme Court has indicated . . . that where imminent and identifiable harm is present, the priorities of the Bankruptcy Code may be subservient to the environmental laws designed to protect the public safety. It is reasonable to expect that under a given set of circumstances, the necessary costs of protecting the public health or safety from imminent and identifiable harm may be elevated to administrative priority and, perhaps, even to a type of secured priority.¹¹³

The court in *In re Stevens*¹¹⁴ agreed with this reasoning in a case concerning the abandonment of waste oil drums. The state Department of Environmental Protection disposed of the drums after the debtor filed in bankruptcy and claimed a priority status for its claim. The District Court held that because the trustee could not abandon the hazardous waste, it remained the property of the estate. Since the estate must comply with environmental laws under section 959 of Title 28, the costs of disposing of the hazardous waste are necessary for the disposition of the estate and thus are administrative expenses under the Code.

Economic inefficiency also adds to the downfall of this alternative. Costs must be internalized and reflected in the product price so that an efficient amount of the product is consumed. If environmental costs are not part of the cost of production, these costs will be borne by the state. Under this alternative, the state would be an unsecured creditor. Since a majority of a debtor's assets are consumed by the claims of the secured and administrative status claimants, unsecured creditors receive very little when an estate is distributed. Without cost internalization, debtors and creditors are

112. 65 Bankr. 521 (Bankr. N.D.W. Va. 1986).

113. *Id.* at 531.

114. 68 Bankr. 774 (Bankr. D. Me. 1987).

not given any economic incentive to minimize environmental liabilities because the state pays for the environmental costs in the case of a bankruptcy.

Although nothing in the Code or in the original environmental statutes specifically provided for a priority status for environmental claims, the courts have increasingly awarded a higher status to these claims. With the enactment of SARA, the government created a federal lien on all property not already encumbered by a security interest; this may have been the first step in creating a statutorily based priority for environmental claims in bankruptcy. While the environmental priority question has not been specifically resolved in the Code, the case law coupled with SARA may have already limited the possibility that the unsecured status will be the alternative chosen for environmental claims in the future.

D. *The Government & Other PRP's Pay*

In a bankruptcy situation, any recovery by a government entity for environmental cleanup costs is at the expense of another creditor. Some commentators have questioned whether Congress intended creditors to pay for any part of a debtor's cleanup liability.¹¹⁵ The definition of owner/operator in CERCLA has been restricted to a creditor who does more than act merely to protect his security interest.¹¹⁶ Creditors will be held liable if they contribute to the mismanagement of the site but usually not when their only actions are to protect their financial interests.¹¹⁷

In many cases when hazardous waste sites are an issue in a bankrupt's estate, there are numerous responsible parties from whom

115. Funsten & Hernandez, *supra* note 26, at 113-14.

116. *United States v. Mirabile*, 15 Env'tl. L. Rep. 20994 (E.D. Pa. 1985). However, when lenders foreclose on contaminated property, they become "owners" and thus potentially responsible parties under CERCLA. *United States v. Maryland Bank & Trust Co.*, 632 F. Supp. 573 (D. Md. 1986). Lenders may not know about the environmental liability when foreclosing on a piece of property. The 1986 amendments to CERCLA added an "innocent landowners defense" to protect parties who become landowners without knowledge of the environmental liabilities, but this defense has not established the level of protection that landowners need. 42 U.S.C. § 9601(35)(A) (1988). See L. CHERKIS, *supra* note 25, at 6-27 for a list of the criteria to be met before qualifying for the defense. *But see EPA Refuses to Support Bill Exempting Lenders as 'Owners,'* 1 BANKR. L. REP. 88 (BNA) (1989). Despite this inadequacy in CERCLA, EPA has tried to block efforts by the House to clarify the lender liability portion of CERCLA. *See EPA Refuses to Support Bill Exempting Lenders as 'Owners.'*

117. *Mirabile*, 15 Env'tl. L. Rep. 20994. *But see United States v. Fleet Factors Corp.*, 901 F.2d 1550 (11th Cir. 1990), *petition for cert. filed*, 59 U.S.L.W. 3278 (U.S. Sept. 21, 1990) (No. 90-504).

EPA can recover.¹¹⁸ This shifts costs to the other generators of hazardous wastes rather than onto creditors. EPA can always go after another PRP and may be inclined to settle with the debtor for whatever she is able to give.¹¹⁹ “[G]enerally, the EPA will ignore marginal operator/defendants and go after the ‘deep pocket’ waste generator/defendants irrespective of blame.”¹²⁰ While this may not appear to be an effective solution, this may result in self-regulation.¹²¹ Large companies will monitor sites and exercise caution in choosing locations for waste disposal. Site operators would be forced to become environmentally sound before big companies, the bread and butter for the little companies, would continue to use their facilities.

Cost spreading requires considering a number of factors when assigning the first level of liability. “The larger the number of entities that will be called upon to bear the risk, the lower the cost of bearing that risk becomes to each of the entities.”¹²² However, spreading the cost of cleanup to the PRP’s will increase the number of “victims” because the secured creditor and debtor would not have the incentive to internalize the cost of cleanup. A balance must be drawn “between the need to lessen the initial burden of cost recovery per accident and [the need to] prevent[] polluters from shifting the risks and costs to the communities.”¹²³ Large industrial-waste generators may be the most efficient entities to absorb the cleanup costs and prevent further contamination because of their technical expertise and economic resourcefulness. Because these large generators create a large portion of the problems that lead to response cost liability, “they are the cheapest and most efficient parties to

118. Funsten, *supra* note 26, at 113. If EPA does not pursue the debtor, other PRP’s may be able to pursue the debtor in EPA’s name. Section 501(b) of the Code allows an entity that owes money to a creditor to file a claim in the creditor’s name if the creditor does not file the claim herself. The claim is filed against a debtor whose payment would reduce the entity’s debt to the creditor. The EPA is the creditor in this case while the PRP is the entity who owes money to the creditor but whose debt will be reduced if the debtor is forced to pay. The PRP gains considerably from this tactic if the government’s claim is given higher priority than their own claim would be given. J. Singer & R. Havel, Meeting of the Environmental Law Section of the Los Angeles County Bar, *Evolving Interaction Between Bankruptcy and Environmental Law*, September 6, 1989.

119. If EPA settles with the debtor this may foreclose the PRP filing under 501(b) discussed *supra* in note 118.

120. Funsten & Hernandez, *supra* note 26, at 134.

121. *Id.*

122. *Id.* at 119.

123. *Id.* at 120.

remedy hazardous waste problems"¹²⁴

Imposing costs on a bankrupt's creditors appears to disregard bankruptcy procedure and reward the debtor/generator who is in the best position to prevent the toxic waste problem. "When the government, and thus the PRP's, pay for the cleanup, some may believe that the guilty go free.¹²⁵ But the guilty do not pay when the creditors pay. Wage earners or suppliers who dealt with the business prior to bankruptcy pay for the environmental liabilities.¹²⁶ Payment by the government and the PRP's does not promote the false sense of justice that arises when the innocent creditors pay—but the guilty still go free as they do under every solution.

The government may be the party best able to pay for the cleanup costs because the bankruptcy policy remains intact. The government has the power to establish financial responsibility requirements for hazardous waste facilities that must be in place prior to such a facility obtaining the necessary licensing. The government can then use these licensing fees to closely regulate and vigorously enforce environmental regulations.¹²⁷ This solution avoids imposing cleanup costs on the innocent creditors.

III. CONCLUSION

The priority for environmental liabilities must be established by the legislature. Courts, on a case by case basis, have continued to interpret the existing environmental and bankruptcy statutes but such interpretations have been inconsistent and confusing. The reason the higher courts cannot develop a body of precedent that can guide the lower courts is that the courts themselves are torn between strong, competing policy interests.¹²⁸ Congress must balance the policies underlying bankruptcy and environmental laws and develop a framework for the courts to use in developing future decisions.

A bankruptcy code revision will not be a flawless answer. Such revisions involve political struggles that may result in compromises influenced by special interest groups. Such legislation may pigeon-hole claims into vague or overly specific categories, resulting in in-

124. *Id.*

125. *See id.* at 141 (Courts can enforce criminal sanctions against culpable parties, regardless of the outcome of the civil liability's question).

126. *Id.* at 143.

127. *Id.* at 134-35.

128. *See supra* note 48 and accompanying text.

equitable results that were not considered during the legislative process. However, all of these concerns are not new to the bankruptcy/environmental law dilemma. Rather, they are part of the passage of every law or revision within our system of government.

While all of the priority alternatives are supported by strong policy considerations, public awareness and concern regarding environmental problems may tip the balance in favor of a higher priority solution such as that provided if environmental claims receive an administrative or secured claim status.¹²⁹ While special interests may strongly oppose such a solution because creditors will resist this costly new responsibility, the public interest in supporting environmental policies will probably be stronger and more consistent with the recent revisions seen in the environmental statutes, namely SARA. Congress is likely to sense the public concern for the environment and respond by supporting a high priority for cleanup costs. Presidential candidates felt this public concern during the 1988 presidential election and were forced to address environmental issues during their campaigns. It is only a matter of time until Congress will be forced to confront this controversial policy balance.

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129. Cistulli, *supra* note 19, at 582.

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