Addressing Environmentally Contaminated Property: A Primer

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<u>Abandonment of Properties Subject to Environmental Liabilities</u>

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I. Introduction to Abandonment Under Section 554 of the Bankruptcy Code

A. 11 U.S.C. § 554(a) provides:

> 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. In *In re Ames Department Stores, Inc.*, 306 B.R. 43 (Bankr. S.D.N.Y. 2004), the court discussed the power of abandonment.

1. In *Ames*, the debtor, a discount department store chain, was party to a number of commercial leases. These leases contained provisions requiring "that at the termination of the lease, the premises were to be left by the tenant clean and/or free of goods and effects." *Ames*, 306 B.R. at 49. However, the debtor sought to reject these leases under section 365 and abandon the personal property (*e.g.* shelves, racks, and other trade fixtures) contained therewithin. The landlords objected, claiming that the debtors failed to deliver the premises free of debris pursuant to provisions of the leases requiring the debtors to remove all goods.

2. The bankruptcy court rejected the landlords' claims. The court first noted that section 365 of the Code permits a debtor to reject a burdensome contract, and cannot be "qualified by requirements not in the Bankruptcy Code itself, and especially by an implied requirement of compliance with lease covenants that are burdensome to the debtor, and that may form part of the rationale for rejection in the first place." *Id.*, at 51.

3. Moreover, in rejecting the landlords' claims that the debtors were liable for holdover rent, the court noted that "it would be the maintenance of the personal property on the premises for the estate's *continuing benefit* that would trigger the duty to compensate the landlord, as compared and contrasted to leaving 'remaining property' on the premises that is 'abandoned.'" *Id.*, at 62. Accordingly, because the debtors abandoned the property and were therefore not benefitting from it, the landlords were not entitled to holdover rent.

II. Overview of *Midlantic National Bank v. New Jersey Dept. of Env. Protection*, 474 U.S. 494 (1986)

A. Factual and Procedural Background

1. Quanta, a waste oil processing company with two facilities, filed for bankruptcy in New Jersey. After filing, an investigation revealed that Quanta had accepted and stored massive amounts of contaminated oil in leaking containers in its NY facility. The estimated cost of disposing the waste oil rendered that property a burden to the estate.

2. Accordingly, the chapter 7 trustee notified of his intention to abandon the NY facility pursuant to § 554(a) of the Code. The City and State of NY objected on public policies embodied in local laws through reliance on 28 U.S.C. § 959(b), which states that a trustee must "manage and operate" estate property "according to the requirements of the valid laws of the State in which such property is situated."

3. The Bankruptcy Court approved the abandonment of the NY facility.[1] The District Court affirmed.

4. The Third Circuit Court of Appeals reversed, concluding that Congress intended to codify pre-Code practice under which state law and general equitable principles protecting the public interest could not be overridden by the judge-made abandonment power.

B. Holding

1. The Supreme Court affirmed the Third Circuit, finding that "Congress did not intend for § 554(a) to pre-empt all state and local laws . . . Accordingly, without reaching the question whether certain state laws imposing conditions on abandonment may be so onerous as to interfere with the bankruptcy adjudication itself, **we hold 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**." *Midlantic*, 474 U.S. at 506-07 (footnote omitted).

2. Bases for Holding

a. Prior to enacting the Bankruptcy Code (and section 554), judge-made law allowed a trustee to abandon estate

[1] After this favorable ruling, the trustee also requested and was granted the ability to abandon the NJ facility, and the appeals were consolidated at the Circuit Court of Appeals.

property, subject to the limitation that such abandonment could not contravene non-bankruptcy state and federal laws. The Supreme Court found that "when Congress enacted § 554 . . . Congress also presumably included the established corollary that a trustee could not exercise his abandonment power in violation of certain state and federal laws." *Midlantic*, 474 U.S. at 501.

b. The Supreme Court further stated that neither it nor Congress has stated that a trustee may "abandon property in contravention of state or local laws designed to protect public health or safety." *Midlantic*, 474 U.S. at 502. In fact, the Court noted that Congress has repeatedly expressed its intent that a bankruptcy trustee may not ignore nonbankruptcy law.

c. Finally, the Supreme Court noted that Congress has repeatedly emphasized its intention to protect the environment against pollution.

C. "Footnote 9"

1. The Supreme Court's holding, quoted above, was followed by Footnote 9, which reads as follows:

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.

III. Subsequent Cases Interpreting *Midlantic*

A. Some courts have allowed abandonment of encumbered property notwithstanding *Midlantic* if the estate has no assets or if all estate assets are encumbered.

1. In *In re Smith-Douglass, Inc.*, 856 F.2d 12 (4th Cir. 1988), the debtor, who owned a fertilizer plant, had no unencumbered estate assets, and thus decided to liquidate. After liquidating all other assets, the debtor sought to abandon the fertilizer plant, which was opposed by the state government because the property was in violation of state environmental law. The Fourth Circuit found that the debtor's financial condition was relevant in the *Midlantic* analysis, finding that "where the estate has unencumbered assets, the bankruptcy court should require

stricter compliance with state environmental law before abandonment is permitted" because, in that situation, a debtor is more financially able to undertake the expense of environmental remediation. *Smith-Douglass*, 856 F.2d at 17.

2. *See also In re Microfab, Inc.*, 105 B.R. 161, 169 (Bankr. D. Mass. 1989) ("[T]he trustee cannot be ordered to comply with a cleanup obligation that he does not have the financial resources to satisfy.").

B. Subsequent to *Midlantic*, lower courts have split as to the breadth of the Supreme Court's holding, specifically focusing on Footnote 9.

1. Majority View: *Midlantic* is narrow ("imminent and identifiable harm")

a. The majority of courts have held that the *Midlantic* exception to a trustee's statutory abandonment power is narrow, and limited to situations where there is an "imminent and identifiable harm" to public safety.

b. In *Smith-Douglass*, the Fourth Circuit discussed the doctrine of preemption in the context of *Midlantic*, stating that Congress must not have intended that "where conditions on property pose a danger of imminent death or illness" a trustee can abandon estate property, and therefore the Bankruptcy Code does not preempt state laws designed to protect against such situations. *Smith-Douglass*, 856 F.2d at 16. The Court, importantly, did note that "this narrow exception applies where there is a serious health risk, not where the hazards are speculative or may await appropriate action by an environmental agency." *Id.* However, the court "does not have the power to substitute its judgment for that of the state as to what constitutes a serious public health or safety risk." *Id.*

c. In *In re Anthony Ferrante & Sons, Inc.*, 119 B.R. 45 (D.N.J. 1990), the debtor owned and operated a water-supply system that was subject to a state-issued "boil order," informing consumers to boil water before consumption due to contamination. After filing for bankruptcy, the debtor sought to abandon the system, which was opposed by the state on *Midlantic* grounds. In permitting the abandonment, the court found that "[s]ince the residents served by the System have been repeatedly warned of the contamination, and operation of the System

has ceased, abandonment will not threaten the health of those residents." *Anthony Ferrante*, 119 B.R. at 50.

d. In *Matter of MCI, Inc.*, 151 B.R. 103 (E.D. Mich. 1992), the debtor sought to abandon certain contaminated property to the EPA and Michigan Department of Natural Resources. In holding such abandonment permissible under *Midlantic*, the court found that the abandonment to the government agencies completely protected the public health and safety because the contaminated properties were abandoned to the custody of "governmental agencies which protect the public from environmental harms" that would remediate any such problems. *MCI*, 151 B.R. at 109.

e. The court in *In re St. Lawrence Corp.*, 248 B.R. 734 (D. N.J. 2000) interpreted *Midlantic* as creating a four-part test for when abandonment may be restricted under the Code. Under this test, the *Midlantic* restrictions do not apply unless: "(1) an identified hazard exists that poses a risk of imminent and identifiable harm to the public health or safety; (2) abandonment of the property will violate a state statute or regulation; (3) the state or regulation being violated is reasonably designed to protect the public health and safety from imminent and identifiable harm caused by identified hazards; and (4) compliance with the statute or regulation would not be so onerous as to interfere with the bankruptcy administration itself." *St. Lawrence*, 248 B.R. at 739.

2. <u>Minority View</u>: *Midlantic* is broad

a. A minority of courts, however, have broadly interpreted *Midlantic* notwithstanding Footnote 9, holding that a trustee may not abandon property in violation of state environmental laws even if no "imminent and identifiable" threat exists.

b. In *In re Am. Coastal Energy, Inc.*, 399 B.R. 805 (Bankr. S.D. Tex. 2009), the debtor was an oil and gas exploration company that owned and operated oil and gas wells in Texas. Texas law provided that a well operator must plug and abandon a well that was inactive for over one year. The debtor was notified by the state that it was in violation of this law on eight wells it operated, and subsequently filed bankruptcy. Relying on 28 U.S.C. § 959(b), the bankruptcy court stated that "a trustee cannot abandon contaminated estate property if state health or safety law

prohibits such abandonment." *ACE*, 399 B.R. at 810. The bankruptcy court continued to discuss *Midlantic* in the context of whether claims by state environmental agencies may be afforded administrative priority under section 503 of the Bankruptcy Code. In so doing, it referenced *In re Natl. Gypsum Co.*, 139 B.R. 397 (N.D. Tex. 1992), which held that post-petition expenditures by an environmental agency for a debtor's pre-petition liability is an administrative expense, but limited such treatment (referencing *Midlantic*) to environmental hazards presenting imminent and identifiable harms. In disagreeing with this limitation, the *ACE* court stated:

"The Court reads the Supreme Court's *Midlantic* opinion to require the Court to determine whether the debtor is violating a statute 'reasonably designed to protect the public health or safety from identified hazards,' not the extent to which particular conduct imposes actual and imminent threats . . . It is enough that [a] claim arises from a state law designed to protect the public from an identified hazard. It is not the Court's prerogative to replace the legislature's judgment with its own judgment as to what constitutes a sufficient threat to the public."

c. In *In re Peerless Plating Co.*, 70 B.R. 943 (Bankr. W.D. Mich. 1987), the bankruptcy court, noting that some courts read Footnote 9 "as permitting abandonment of hazardous waste sites with less than full compliance with the applicable environmental law," disagreed, stating that "such a narrow reading is [in]consistent with the intent of *Midlantic*." *Peerless*, 70 B.R. at 946-47.

d. *See, e.g., Lancaster v. State of Tenn.* (*In re Wall Tube & Metal Prods. Co.*), 831 F.2d 118, 122 (6th Cir. 1987) (stating that a debtor "could not have abandoned the estate in contravention of the State's environmental law," without discussion of any limitations on such a rule); *In re 82 Milbar Blvd., Inc.*, 91 B.R. 213, 219 (Bankr. E.D.N.Y. 1988); *In re Stevens*, 68 B.R. 774 (D. Me. 1987).

IV. Recent Cases Concerning Abandonment

A. In 2015, another Fifth Circuit bankruptcy court referenced and disagreed with *American Coastal Energy* in *In re Howard*, 533 B.R. 532 (Bankr. S.D. Miss. 2015). The *Howard* court reviewed both the majority and minority interpretations of Footnote 9 and adopted the majority view, holding "that the exception to a trustee's abandonment power set forth in

Midlantic is limited to situations where an imminent and identified harm to the public health and safety exists." *Howard*, 533 B.R. at 547.

In *Howard*, the debtor's father acquired certain real property in Mississippi. Subsequently, he filed multiple lawsuits against various parties, seeking damages related to alleged contamination of the property. The debtor filed for bankruptcy, and subsequently, the debtor's father died, with the debtor coming into possession of the property. Years later, the chapter 7 trustee sought to abandon the property because the trustee believed it to be burdened by lawsuits and of inconsequential value to the estate, much to the chagrin of the debtor himself. Accordingly, the debtor opposed the trustee's proposed abandonment, claiming that the property could not be abandoned because they were an "imminent harm to the public health and safety." *Howard*, 533 B.R. at 547. The bankruptcy court disagreed, finding that the record reflected no evidence of a threat to public health or safety, and moreover found persuasive the state government's inaction as to the property for about a decade as demonstrative of a lack of such threat.

B. In *dicta*, the court in *In re Old Carco LLC*, 424 B.R. 633 (Bankr. S.D.N.Y. 2010) appeared to adopt the majority view of Footnote 9. In *Old Carco*, a group of Chrysler dealers sought to prevent the debtor's rejection of their dealership agreements by pointing to state dealer laws. The court, however, rejected this argument, stating that the dealer laws "constitute primarily commercial and economic regulation as applied to the dealers and are not intended to protect the health and safety of the general public." *Old Carco*, 424 B.R. at 647. The court continued, stating that even if state dealer laws included a public health and safety concern as in *Midlantic*, "there is no allegation of an imminent and identifiable hazard [and] declined to apply a heightened standard for the rejection of dealer agreements in the absence of an imminent identifiable harm." *Id.*

ENVIRONMENTAL LIABILITIES IN § 363 SALES AND THE PRIORITY OF ENVIRONMENTAL CLAIMS

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In a certain sense, bankruptcy law and environmental law share a common purpose: to render assets free and clear of liabilities. Bankruptcy law aims to give a debtor a fresh start and disfavors idle assets. It therefore allows a debtor to sell property free and clear of third-party interests under 11 U.S.C. § 363. Environmental law aims to free property of contamination, and to do so in a manner that leaves taxpayers clear of remediation costs.

More accurately, though, bankruptcy law and environmental law stand in near-constant tension. Because bankruptcy law cleans a debtor's slate, it generally cuts off liability for claims that antedate the filing of its bankruptcy petition. Environmental law, on the other hand, generally seeks to hold a polluter strictly liable for its actions—even if the polluter no longer owns or controls the contaminated property.

That the goals of bankruptcy law and environmental law oppose each other is especially apparent in the context of successor liability. In that context, for example, courts must determine whether a debtor's sale of assets under § 363 sheds environmental liabilities, imputes them to the purchaser, or prohibits the transfer altogether.

I. SALES OF ASSETS UNDER SECTION 363 OF THE BANKRUPTCY CODE

A. Section 363 Authorizes Sales of Assets "Free and Clear" of Interests

Section 363 of the Bankruptcy Code authorizes a debtor to sell its assets in or outside the ordinary course of business. 11 U.S.C. § 363(b)–(c). In certain circumstances, the assets can be sold "free and clear of any interest in such property of an entity other than the estate[.]" *Id.* § 363(f). Specifically, a debtor can sell an asset free and clear of a third-party's interest if:

> (1) applicable non-bankruptcy law permits sale of such property free and clear of such interest;
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> (2) such entity consents;
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> (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
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> (4) such interest is in bona fide dispute; or
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> (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

Id.

In 2003, the Third Circuit Court of Appeals issued an opinion that surveyed other courts' construction of § 363 and the kinds of interests in property that it affects. *In re Trans World Airlines*, 322 F.3d 283 (3d Cir. 2003). Though not an environmental case, the *Trans World Airlines* decision is instructive. There, the court noted the trend toward "a more expansive reading of 'interests in property' which 'encompasses [] obligations'"—other than *in rem* interests such as liens—"'that may flow from ownership of [] property.'" *Id.* at 289 (quoting 3 Collier on Bankruptcy ¶ 363.06[1]).

B. The Treatment of Environmental Obligations in § 363 Sales

Just as courts are not unified in their treatment of what constitutes an "interest" that can be avoided by a debtor selling assets under § 363, courts also lack unity in their treatment of environmental obligations under § 363.

Three examples follow: one finds that prepetition environmental obligations could be avoided in a § 363 sale, but that postpetition environmental obligations could not; one finds that a transfer of property could be made free and clear of a third-party creditor's *in personam* rights; and one forbids a state environmental protection agency from using for reclamation costs cash owed to a creditor because the value of its collateral decreased.

1. *Ninth Avenue Remedial Grp. v. Allis-Chalmers Corp.*, 195 B.R. 716 (N.D. Ind. 1996).

The *Ninth Avenue* court considered cross motions to dismiss or, alternatively, for summary judgment in a lawsuit that alleged CERCLA liability against a number of "potentially responsible parties." 195 B.R. at 720. One of the defendants had previously filed for bankruptcy and proposed a sale of its assets to a co-defendant free and clear of third-party interests in the property. *Id.* The bankruptcy court approved the sale and required any creditors with liens against the conveyed assets to attach their claims against the purchase price. *Id.* at 721.

After a thorough discussion of successor liability principles, *id.* at 722–29, the district court considered sales of assets under the Bankruptcy Code. In relevant part, it wrote that, "while the bankruptcy courts might have the power to sell assets free and clear of any interest that could be brought against the bankruptcy estate

during bankruptcy, either through section 363(f) or through the powers of the bankruptcy court under other sections of the Code, a sale free and clear does not include future claims that did not arise until after the bankruptcy proceedings concluded." *Id.* at 732. Thus, to the *Ninth Avenue* court, the point at which an interest in the property conveyed arises is dispositive: if pre-petition, it can be avoided through a § 363 sale; if post-petition, it cannot. *Id.*

The court ultimately denied the cross motions to dismiss and alternative motions for summary judgment for two related reasons: first, that a company "becomes a successor through a bankruptcy sale does not preclude liability as a matter of law." And second, determining successor liability is a matter of fact for which the record did not provide sufficient guidance. *Id.* at 735.

2. *In re Pintlar Corp.*, 187 B.R. 680 (Bankr. D. Idaho 1995).

In *Pintlar*, the bankruptcy court had before it the debtor's motion to transfer real property to environmental creditors as a condition of the parties' settlement. A third-party creditor alleged that it possessed a lien on the property that allowed it to dump mining tailings into the Coeur d'Alene River. The creditor argued that, unless its lien transferred with the property, § 363(f) prohibited the conveyance. *Id.* at 680–81.

Upon review, the bankruptcy court noted that CERCLA would have forbid the environmental creditor from accepting the property subject to the third-party creditor's purported lien. That is because doing so would give rise to future damages for pollution—an acceptance of liability by a governmental unit that

CERCLA forbids. *Id.* at 682. And though environmental law prohibited the dumping for which the creditor had a purported right, the court could not identify non-bankruptcy law that would have allowed transfer of the property without that burden.

No matter: the court found the illegal dumping lien to be a right personal to the creditor—not one that ran with the land—and therefore inapplicable for § 363 purposes. *Id.* Accordingly, the court approved the transfer of property from the debtor to environmental creditors free and clear of the third-party creditor's purported interest in such. *Id.*

3. ***In re Heldor Indus., Inc.*, 131 B.R. 578 (Bankr. B.N.J. 1991) *rev'd and vacated on other grounds sub nom. N.J. Dept. of Envt'l Protection & Energy v. Heldor Indus., Inc.*, 989 F.2d 702 (3d Cir. 1993).**

In *Heldor*, the debtor sold a number of assets on which a creditor held liens. The debtor proposed settling the creditor's claims by distributing to it substantially all of the proceeds from the sale. The New Jersey Department of Environmental Protection objected to the settlement because it did not set aside any funds for pollution cleanup, in violation of state environmental law. 131 B.R. at 580. (The New Jersey Department of Environmental Protection later withdrew its objection. The Third Circuit found that this action deprived the bankruptcy court of jurisdiction. For that reason, the Third Circuit reversed the bankruptcy court and vacated its decision. 989 F.2d at 708–09.

In rejecting the objection of the New Jersey Department of Environmental Protection, the bankruptcy court made three broad points relevant to § 363

analysis. Initially, though, the court noted that state environmental law must yield to an order authorizing the debtor's sale of assets under § 363. The inverse would violate the Supremacy Clause, it reasoned. 131 B.R. at 585.

As to its relevant substantive points, the *Heldor* court first wrote that the state environmental law at issue did not apply to the assets sold. The state environmental law governed industrial establishments and real property. But the assets sold by were inventory, accounts receivable, and similar items. *Id.* at 585–86.

Second, the court believed that using the creditor's funds to pay for remediation would violate the Fifth Amendment. A security interest is property protected by the Takings Clause, it noted. The government cannot take such property without compensating the creditor, which has a "constitutional right to preserve the value of its secured claim on the petition date." *Id.* The latter point obligated the debtor to compensate the creditor for any decrease in the value of its collateral, the court found. And the former point prohibited the New Jersey Department of Environmental Protection from applying any portion of those funds to the remediation of property neither owned nor controlled by the creditor. *Id.*

Finally, the court concluded that "an obligation of the debtor to clean up environmental contamination is a 'claim' as defined in" 11 U.S.C. § 101(4). *Id.* at 586. If fulfilling that obligation can be accomplished only by "the payment or spending of money," it is an expenditure of funds under § 362 and thus subject to the automatic stay. *Id.* at 586–87. Accordingly, for these reasons, the court overruled the objection and approved the debtor's proposed settlement. *Id.* at 588.

II. ENVIRONMENTAL CLAIMS AND THEIR PRIORITY

As noted above, the determination of whether an environmental obligation is a "claim" under the bankruptcy code is often dispositive. Yet, courts have not arrived at uniform distinctions for what constitutes a claim and what does not.

Environmental obligations manifest in a number of ways: reclamation work, monetary damages, and injunctions all appear as remedies in environmental laws and regulations. As a general matter, actions for cleanup costs or monetary penalties have been found to be claims, *see, e.g.*, *Boston & Me. Corp. v. Mass. Bay Transp. Auth.*, 587 F.3d 89, 100 (1st Cir. 2009), whereas mandatory or prohibitory injunctions have not (if they cannot be reduced to monetary damages), *see, e.g.*, *In re Chateaugay Corp.*, 944 F.2d 997, 1008 (2d Cir. 1991).

Once an environmental obligation is determined to be a claim, analysis shifts to its priority. If the claim arises from an order by the Environmental Protection Agency, for example, it will supersede other uses of the debtor's assets. *See, e.g.*, *In re Envt'l Water Control, Inc.*, 125 B.R. 546 (N.D. Ind. 1991). Moreover, under CERCLA and many state law equivalents, liens that secure a debtor's environmental obligations are entitled to priority or super-priority status. *Compare* Del. Code Ann., tit. 7 § 9117 (basic lien statute) *with* Mass. Gen. Laws Ann. ch. 21E, § 13 (super-lien statute). And, of course, an environmental claim that is secured has priority over unsecured claims.

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DISCHARGING ENVIRONMENTAL LIABILITIES IN BANKRUPTCY: QUESTIONS, PROBLEMS, ANSWERS, AND MORE QUESTIONS

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INTRODUCTION

Bankruptcy law in the United States allows certain debtors to receive a discharge of their debts, often in order to reemerge as viable businesses.[2] This affords the debtor a "fresh start" and also facilitates equal treatment of creditors. Environmental laws, on the other hand, seek to promote timely cleanup of environmental contamination and remedy past or current contamination.[3] It is easy to see how these two groups of laws conflict: discharging environmental claims in bankruptcy shortchanges environmental cleanup goals because environmental remedies are erased, while barring the discharge of such claims shortchanges the goal of providing the debtor a fresh start and providing an equal playing field among all of a debtor's various creditors.

Reconciling the conflicts between bankruptcy law and environmental law adds many other hurdles for courts and lawyers to overcome. Environmental liabilities usually stem from the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA) or the Resource Conservation Recovery Act of 1976 (RCRA), or a similar state law.[4] CERCLA, also known as Superfund, imposes strict liability on certain potentially responsible parties ("PRPs") with the goal of promptly cleaning up hazardous waste and imposing the costs on the responsible parties.[5] While RCRA often issues injunctions and orders similar to those issued via CERCLA, its goal is different than CERLA's in that RCRA seeks to reduce the creation of waste and regulate its proper disposal, treatment, and storage.[6] CERCLA and RCRA often overlap in authority, and when faced with an environmental hazard, EPA may act under either of these laws to remedy the hazard.[7] Whether injunctions and other remedies imposed under the authority of these statutes and others are dischargeable as "claims" under the Bankruptcy Code's definition of "claim" has led many courts to conclude different things and adopt different tests for answering this question. Additionally, when courts *do* consider such liabilities to be "claims" and thus

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[2] *See* 11 U.S.C. § 1141(d).
[3] Murray, Melissa & Franco, Sandra, *Treatment of Environmental Liabilities in Bankruptcy*, in *Environmental Aspects of Real Estate and Commercial Transactions* at 341 (James B. Witkin, ed., 1995).
[4] Newton, James, *Searching for A 'Right to Payment': Defining the Scope of Bankruptcy Code §101(5)(B) Under RCRA and Other Statutes Not Providing Express Rights to Payment*, 19 Penn St. Envtl. L. Rev. 55, 59-60 (2011).
[5] *See* Murray & Franco, *supra* note 1 at 342 (citing Meghrig v. KFC W., Inc., 516 U.S. 479, 483 (1996)).
[6] *See id.*
[7] *See id.* at 60-62, 71-73 (citing http:// www.epa.gov/osw/inforesources/pubs/orientat/rom62.pdf (last visited Nov. 12, 2010)).

dischargeable, courts' views on when exactly such claims arise are far from uniform. This Note examines the differences and trends in case law regarding these two important questions.

I. Are Injunctions (and Other Environmental Liabilities) "Claims" Under the Bankruptcy Code and Thus Dischargeable?

A. The Basics: The Statutes

Whether environmental liabilities are "claims" under the Bankruptcy Code is of paramount importance to both debtors and creditors. Debtors may discharge their debts in bankruptcy, and "debt" is defined by the Bankruptcy Code as "liability on a claim."[8] "Thus, if an obligation is not a 'claim', then it is not a 'debt' and it is not discharged in bankruptcy."[9] The Bankruptcy Code defines "claim" very broadly as:

> [R]ight to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or
>
> [R]ight to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.[10]

Both the plain language of this statute-which includes unmatured and contingent rights to payment and equitable remedies[11]- as well as its legislative history make clear that the Bankruptcy Code's definition of 'claim' is very broad.[12] The purpose of this broadness is to allow all issues and claims to come under the bankruptcy umbrella in order to ensure the finality of bankruptcy cases and increase the chances of the debtor's successful reorganization.[13] What constitutes a 'right to payment' under § 101(5)(B) is a controversial topic for courts and is a source of ambiguity explored later in this Note.

B. The Ambiguities: The Case Law

There is no bright-line rule for whether an environmental liability is a "claim" under the Bankruptcy Code. This section of the Note follows the precedential journey of relevant case law in chronological order, starting with the only Supreme Court case addressing the issue and

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[8] § 101(12).
[9] Koks, Mary J. & Million, Tim, *Environmental Issues in Bankruptcy*, 40 Texas Envtl. L.J., 43, 46 (2009-2010).
[10] § 101(5).
[11] *Id.*
[12] Newton, *supra* note 3, at 63-64 (citing Johnson v. Home State Bank, 501 U.S. 78, 83 (1991); S. Rep. No. 95-989 at 21-22 (1978); H.R. Rep. No 95-595 at 309 (1977)).
[13] Brimmer, Jannette, *Environmental Issues in Bankruptcy*, 3 Wis. Envtl. L.J. 159,175 (1996) (citing H.R. Rep. No. 95-595 at 309; United States v. LTV Corp. (In re Chateaugay Corp.), 944 F.2d 997, 1003 (2d. Cir. 1991)).

ending with an examination of current trends in the case law marking an apparent departure from its starting point.

There are generally three types of environmental liabilities: (1) an order to pay money to the government or another entity for the cleanup or the investigation of a contaminated site; (2) an order forcing the cessation of the release of hazardous substances on a property; and (3) an order to remediate (or clean up) property.[14] The first of these scenarios is generally easily handled: such an order is clearly a 'right to payment' and falls within the definition of a claim, and is thus generally dischargeable.[15] But the analysis of the second and third above scenarios, which involve an order to clean up the contaminated property, is much less straightforward.[16]

i. The Pro-Debtor Beginnings

Legal analysis of the dischargeability of environmental claims in bankruptcy begins with the 1985 *Ohio v. Kovacs* Supreme Court decision.[17] In this case, the state of Ohio filed a lawsuit against Kovacs, the CEO of a company which, along with other companies, operated a hazardous waste disposal site.[18] Kovacs settled with the state both as an individual and in his capacity as CEO of the company regarding the waste on the company's property.[19] This settlement required that the company clean up the contaminated site and required the company to compensate the state for injury to wildlife.[20] After filing for bankruptcy, Kovacs, then a debtor to the state, did not comply with the settlement order, so the state appointed a receiver to liquidate his assets to use them to fund the cleanup operation.[21] When the state initiated the collection proceedings of Kovacs' post-bankruptcy earnings by first trying to discover his assets, the Bankruptcy Court stayed these proceedings. [22] The District Court as well as the Sixth Circuit Court of Appeals affirmed this stay, finding such a collection attempt tantamount to enforcing a judgment obtained before filing of the bankruptcy petition, a violation of the automatic stay.[23] The Supreme Court agreed with the District Court and the Sixth Circuit, holding that by appointing such a receiver to collect money from the debtor, the state had converted the cleanup order into an obligation to pay money and thus, the state held a 'right to payment', which was a dischargeable claim.[24] But the Court was careful to limit its holding to the particular facts of the case,[25] which are so unique

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[14] Koks & Million*, supra* note 8, at 47-48.
[15] *Id.* at 48.
[16] *Id.*
[17] *Ohio v. Kovacs*, 469 U.S. 274 (1985).
[18] *Id.* at 276.
[19] *Id.*
[20] *Id.*
[21] *Id.*
[22] *Id.* at 276-77 (citing In re Kovacs, 29 B.R. 816 (Bankr. S.D. Ohio 1982)).
[23] *Id.* at 277 (citing In re Kovacs, 717 F.2d 984 (1983)).
[24] *Id.* at 283.
[25] *See id.*

that one commentator labeled them "legendary."[26] Furthermore, "courts and commentators have recognized *Kovacs*' limited application in light of the strange facts of that case."[27]

Kovacs was only the beginning of the case law's varied journey on this issue. In 1998, the Sixth Circuit took a clear pro-debtor and anti-green approach in *U.S. v. Whizco* that some commentators have called "extreme."[28] This case centered on the Surface Mining Control and Reclamation Act of 1977, which required Whizco, Inc., a mining company, and its director to reclaim the land it contaminated in the course of its mining operations.[29] Whizco declared bankruptcy and abandoned the mine without reclaiming it.[30] Pursuant to the Act, the Department of the Interior entered orders demanding Whizco reclaim the site, and when the director did not comply, the United States sued for injunctive relief pursuant to the Act.[31] The director of Whizco later converted his Chapter 11 claim into a Chapter 7 claim, but still did not comply with the orders or the injunction.[32] After noting that the debtor had sold all of his mining equipment, the District Court held that the only way the debtor could reclaim the land was to spend money, which rendered the orders a "claim" dischargeable in bankruptcy.[33] In accepting this rationale, the Sixth Circuit further pointed out that the debtor director was not only without mining equipment but also 63 years old, and thus completely helpless to comply with the injunction unless he spent money.[34]

The *Whizco* Court relied on the following statement from *Kovacs*, which it quoted directly: "He [the debtor] cannot perform the affirmative obligation properly imposed upon him by the State court except by paying money or transferring over his own financial resources."[35] The Sixth Circuit court then reasoned that the government was seeking money from the debtor because there was no other way that he could comply with the order- thus, the order was a "right to payment" and dischargeable.[36] While this ruling undoubtedly helps debtors by providing a standard from a court allowing even injunctions to be considered "claims" (sometimes called

[26] Belzil, Daniel, *Why Congress Should Clean up the Bankruptcy Code to Render Environmental Cleanup Orders Into Claims*, Vt. J. Envtl. L. 101, 104 (2012).
[27] Newton, *supra* note 3, at 87. *See also id.* at 87-88 ("The *Kovacs* decision should be read as the exception, not the rule").
[28] *Id.* at 58.
[29] *U.S v. Whizco*, *Inc.* 841 F.2d, 147, 147-48 (6th Cir. 1998).
[30] *Id.* at 148.
[31] *Id.* (citing 30 U.S.C. § 1271).
[32] *Id.*
[33] *Id.*
[34] *Whizco*, 841 F.2d at 149-51.
[35] *Id.* at 149 (citing *Kovacs*, 469 U.S. at 987-88).
[36] *Id.* at 150-51.

"the expenditure test")[37], the weight of its precedence is low because no other Circuit has followed this holding, although at least one Bankruptcy Court outside the Sixth Circuit has.[38]

There are two significant problems with the *Whizco* decision. First, the *Kovacs* decision, on which the *Whizco* court blatantly relies, deliberately cautioned that it was not deciding the legal consequences if the state had *not* appointed a receiver to collect funds from the debtor.[39] This key fact was missing from the *Whizco* case, since no receiver was appointed. Secondly, both §101(5)(B) of the Bankruptcy Code (which contains the definition of "claim" under the Code) and the *Kovacs* decision suggest that, for an equitable remedy (such as an injunction to cease mining operations) to constitute a "claim", the holder of the equitable remedy must have a "right to payment" *from the debtor*, not a third party.[40] But in *Whizco*, the debtor's "right to payment" stemmed solely from the debtor's obligation to expend funds *to a third party* to reclaim the mine after the injunctive order. For this reason, the argument that *Whizco* improperly relied on *Kovacs* has significant cogency.[41]

ii. The Pro-Green Shift

The 1985 *Kovacs* and the 1988 *Whizco* decisions were the high point for debtors and the low point for environmentalists. In the early 1990s, the case law slowly began trending in the opposite direction. The Second and Third Circuits initiated this slow switch in direction. First, in *In re Chateaugay Corp.*, LTV corporation, a large steel, aerospace, and energy company, sought to discharge EPA CERCLA claims in Chapter 11 bankruptcy.[42] EPA filed a proof of claim for over $32 million for the pre-petition response costs at contaminated sites.[43] Interestingly, EPA also alleged that it may assert further claims against LTV for potentially contaminated sites not yet discovered.[44] After struggling to decipher an unclear standard from the District Court regarding exactly which EPA claims gave way to a "right to payment" and were dischargeable, the Second Circuit first held that cleanup orders distinct from ongoing pollution are dischargeable claims to the extent that EPA can clean up and sue for response costs.[45] But the Second Circuit's second holding in this case began to tip the scales in the direction of the environmentalists, albeit slightly. The Court further held that an EPA order to correct *ongoing* pollution is not a dischargeable claim, and even orders with "dual objectives" of both correcting

[37] Strochak, Adam P., Wine, Jennifer L. & Yates, Erin K., *Environmental Issues in Bankruptcy Cases* 44 (2009), LexisNexus.
[38] Belzil, *supra* note 25, at 109. *But see* United States v. Robison (In Re Robinson), 46 B.R. 136, 139 (Bankr. M.D. Fla. 1985), rev'd on other grounds by In re Robinson, 55 B.R. 355 (Bankr. M.D. Fla. 1985) (holding that the obligation of the debtor was dischargeable because it required the debtor to spend money).
[39] *Kovacs*, 469 U.S. at 284.
[40] Newton, *supra* note 3, at 75 (citing *Apex Oil*, 579 F.3d at 737; Lawrence R. Ahern, III & Darlene T. Marsh, *Environmental Obligations in Bankruptcy* §3:15 (Tom Loughlin et. al. eds., Thompson West 2010) (2009)).
[41] *See id.*
[42] *Chateaugay*, 944 F.2d at 999.
[43] *Id.*
[44] *Id.*
[45] *Id.* at 1008.

past pollution and stopping ongoing pollution are not dischargeable claims.[46] While the Second Circuit's interpretation of a "claim" was not exactly the polar opposite of the *Kovacs*-*Whizco* liberal definition, it clearly marked a departure from the once-prevalent concept that if a debtor is required to spend money to comply with an injunction, it is dischargeable.

This pro-green baby step was quickly followed by the Third Circuit holding in *In re Torwico* that a cleanup order was not a claim dischargeable by the *former lessee* of the contaminated site.[47] It is notable that the debtor in this case no longer had access to the site to perform the cleanup, so he would have had to spend money to comply with the order.[48] This departure from earlier precedent in both *Whizco* and *Kovacs* is so blatant that at least one commentator has stated that this decision (the *Torwico* decision) was wrongly decided simply because *Kovacs* contradicts it.[49] The idea that obligations to remediate sites "run with the waste"[50] furthered a clear turning point in case law at the Circuit Court level toward a direction favoring the non-dischargeability of environmental liabilities in bankruptcy.

The next step away from the *Kovacs*-*Whizco* beginning precedent came from the Seventh Circuit in *Apex Oil*.[51] The Court held that a debtor, despite not owning the property, could not discharge a cleanup order rendered under RCRA.[52] But it is the Court's reasoning behind this holding that opens up a glaring issue that will be faced by debtors, government agencies, lawyers, and judges for years to come. In writing for the Court, Judge Posner held that EPA, the creditor, did not have a right to payment because the statute under which the government brought the action, RCRA, did not contain a cause of action for the government to sue for money damages.[53] This is notable because the laws under which the government brought actions against the debtors in *Torwico*, *Chateaugay*, and *Kovacs* did contain such causes of action. Furthermore, the *Apex Oil* Court completely ignored the argument that an alternative law that the government could have used, such as the Clean Water Act, or CERCLA, which frequently overlaps in authority with RCRA, could have provided such a cause of action and thus could have rendered the government a "right to payment."[54] One commentator suggests that since the government generally prefers to bring cases under CERCLA (because CERCLA provides causes of actions for both injunctive relief and cleanup costs), the government deliberately chose to bring this action under RCRA so that it could forestall the argument that it had such a right to payment (so

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[46] *Id.*
[47] In re Torwico Elecs., Inc., 8 F.3d 146, 150 (3d. Cir. 1993).
[48] Newton, *supra* note 4, at 81(citing *Torwico*, 8 F.3d at 147; Ahern & Marsh, *supra* note 29 at §3:16).
[49] *Id.*
[50] *Torwico*, 8 F.3d at 151.
[51] *Apex Oil*, 579 F.3d 734.
[52] *Id.* at 738.
[53] *Id.*
[54] Newton, *supra* note 3, at 71-73. *See* Brief and Attached Appendix of Defendant-Appellant Apex Oil, Inc.; *Apex Oil*, F.3d 579 (No. 08-3433) 2009 WL 927822.

that it could not be discharged).[55] Judge Posner played right into the government's hands by ignoring the argument made by the debtor and buried by the government.

The Seventh's Circuit's reasoning behind its *Apex Oil* ruling is vulnerable to just as much criticism as the *Whizco* holding is. The Seventh Circuit appears to have misread §101(5)(B) of the Bankruptcy Code. The *Apex Oil* Court held that no "right to payment" existed because the statutory mechanism by which the government brought the original action (in this case, RCRA) did not contain one.[56] "However, it is not important whether the statute provides an alternative 'right to payment'. What is important is whether [the debtor's] 'breach' gives rise to a 'right to payment'."[57] The debtor's breach in *Apex* was the release of harmful waste into the air, and it existed regardless of whether the government brought the action under RCRA or any other statute. The breach in no way depends on the statutory enforcement mechanism. This glaring misread of §101(5)(B) gives debtors hope despite the increasingly anti-debtor direction of the case law. This is significant because, as one commentator notes, The *Apex* Approach's narrow interpretation of §101(5)(B) could make it impossible for debtors to reorganize, hindering the "fresh start" goal of bankruptcy law.[58]

iii. Other Approaches and Beyond

In the 2010 *In re Mark IV Industries, Inc.* decision, the U.S. Bankruptcy Court for the Southern District of New York adopted a new test, known as the *Mark IV* test, for determining whether an environmental injunction is dischargeable.[59] In this case, a company, Mark IV Industries, acquired property in New Mexico that had been previously used by two different companies to make electronic circuit boards.[60] Even though the activities giving rise to the contamination had stopped nearly eight years before Mark IV acquired it, the state of New Mexico assessed the site shortly after Mark IV's acquisition and deemed the groundwater under the site contaminated.[61] After declaring Chapter 11 bankruptcy, Mark IV sought to discharge the cleanup orders.[62] Based on the aggregate case law from *Kovacs* to *Apex Oil*, the Court settled on a three factor test to answer this question: (1) Whether the debtor is capable of carrying out its injunctive obligations, or if it must do so by paying others; (2) whether the pollution is ongoing; and (3) whether the government agency has the option *under the statute* to clean up and then

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[55] David B. Hird, *Supreme Court's Denial of Certiorari in Apex Oil Leaves Standing Seventh Circuit Ruling that Environmental Cleanup Injunctions are Not Dischargeable in Bankruptcy*, Weil, Gotshal & Manges LLP: The Bankruptcy Blog (Oct. 18, 2010), http://business-finance-restructuring.weil.com/environmental/supreme-courts-denial-of-certiorari-in-apex-oil-leaves-standing-seventh-circuit-ruling-that-environmental-cleanup-injunctions-are-not-dischargeable-in-bankruptcy/.
[56] *Apex Oil*, 579 F.3d at 736-37.
[57] Newton, *supra* note 3, at 73.
[58] *Id.* at 95-96.
[59] In re Mark IV Industries, Inc., 438 B.R. 460 (Bankr. S.D.N.Y. 2010).
[60] *Id.* at 462.
[61] *Id.*
[62] *Id.* at 463-64.

seek contribution from the debtor.[63] This test has not yet been adopted by any other jurisdiction, but it is important because of its newness and also because it continues the recent trend of favoring environmental policies over bankruptcy policies.[64] But the third prong of the Mark IV test creates uncertainty for businesses. One commentator asks, "[H]ow can a business know what statute the EPA will invoke?"[65] In *Apex Oil*, the uncertainty for the debtor was roughly $150 million,[66] which demonstrates the dire consequences of this unpredictability-yielding test.

Among the relevant legal scholarship, two notable approaches have been offered to overcome the drastically different approaches among the Circuits in determining when an environmental liability is a dischargeable claim under the Bankruptcy Code. One commentator proposes construing §101(5)(B) to find a "right to an equitable remedy" to be a "claim" if there is some common law or statutory authority which can be used to reduce the equitable right to monetary value.[67] This would avoid the problems associated with the misinterpretation of 101(5)(B) suffered by the *Apex* approach and the *Mark IV* test and appears to strike a decent middle ground in achieving the interests of bankruptcy law and environmental law.[68] Notably, two courts have offered support for this approach, and one did so rather directly.[69] Another commentator offers a different, straightforward fix: simply convert environmental liabilities into administrative priority claims in bankruptcy, forcing them to be paid before all other creditors.[70] But this solution seems haphazardly-ascertained: it simply suggests that the goals of bankruptcy law take a back seat to the goals of environmental law, a far cry from the balanced approach outlined previously in this paragraph. Additionally, as the proponent of this approach suggests, this solution may in some cases turn out to be a producer of problems rather than a solution in that some debtors may not be able to reorganize, defeating the purpose of bankruptcy law entirely.[71]

The Supreme Court's only opinion on this issue may be the factually-unique *Kovacs* case, but in 2010 the Supreme Court perhaps weighed in by *declining* to weigh in on *Apex*. The debtor in *Apex Oil* petitioned the Supreme Court for certiorari, and made the argument ignored by the

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[63] *Id.* at 468-69 (citing In re CMC Heartland Partners, 966 F.2d 1143, 1147 (7th Cir. 1992); *Torwico*, 8 F.3d at 151, n.6; *Chateaugay*, 944 F.2d at 1008; *Apex Oil,* 579 F.3d at 736.
[64] Conray C. Tseng, *Mark IV Industries, Inc.- Cleaning Up Confusion Regarding Dischargability of Environmental Liabilities*, Weil, Gotshal & Manges LLP: The Bankruptcy Blog (Nov. 1, 2010) http://business-finance-restructuring.weil.com/claims/mark-iv-industries-inc-%e2%80%93-cleaning-up-confusion-regarding-dischargeability-of-environmental-liabilities/
[65] *Id.* at 116.
[66] *Apex Oil*, 579 F.3d at 736.
[67] Newton, *supra* note 3, at 76.
[68] *Id.* at 76-77.
[69] *See* CRS Steam, Inc. v. Eng'g Res., Inc. (In re CRS Steam, Inc.), 225 B.R. 833, 841 (Bankr. D. Mass. 1998) ("[W]hen [a cause of action providing for a right to payment] is present, the court can compute the 'payment' due and thereby assign a dollar amount to the remedy, treating it like any other claim."); *see also* Rederford v. U.S. Airways, Inc., 589 F.3d 30, 36-37 (1st Cir. 2009) (focusing on the ability of the court to reduce an equitable remedy to a payment amount).
[70] Belzil, *supra* note 25, at 102.
[71] *Id.* at 124.

Seventh Circuit that the statute the government uses need not necessarily contain an alternate right to payment in order for an environmental liability to be a claim under §101(5)(B), especially since if the government had used CERCLA it *would* have had such a right to payment.[72] But the Supreme Court denied this petition.[73] Consequentially, this reinforces the trend of cases suggesting that injunctions requiring debtors to remediate contaminated sites are not dischargeable in bankruptcy.[74] This may ruin one commentator's prediction that the stage is set for "a Supreme Court battle that will determine the fate of the treatment of environmental injunctions in bankruptcy."[75]

II. If Environmental Liabilities, Including Injunctions, Are Claims Dischargeable in Bankruptcy, Then When Exactly Do They Arise?

When a bankruptcy claim arises is of paramount importance in Chapter 11 bankruptcy proceedings because in such instances only claims arising before confirmation of the plan are discharged.[76] Some cases feature environmental liabilities with claims that arise at easily identifiable times, such as cases in which the government fully remediates a site and is seeking payment for the cleanup costs (such liabilities are clearly claims), and cases featuring liabilities related to post-petition pollution (such liabilities are clearly not dischargeable claims under the Bankruptcy Code).[77]

There is no universal rule for when an environmental claim arises in bankruptcy. Rather, different courts follow different rules and uphold different standards for determining this. These different approaches are known as the "right to payment" approach, the "underlying act" approach, the "pre-petition relationship" approach, and the "fair contemplation" approach. Helpfully, a U.S. District Court in Tennessee, when presented with this issue in *Signature Combs v. U.S.*, closely examined each of these different approaches used by various courts, weighing the benefits and drawbacks of each.[78] Each of these approaches are outlined in the following section of this Note.

A. The "Right to Payment" Approach

One standard used by a minority of courts is the "right to payment" approach, which, relying on non-bankruptcy law, holds that a claim does not arise until all elements of a cause of action exist.[79] This approach has been criticized for failing to take into account the broad

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[72] Hird, *supra* note 54.
[73] Apex Oil Co. v. U.S., 562 U.S. 827 (2010) (cert. denied).
[74] *See id.*
[75] Johnson, David A. & Scriven-Young, David, *United States v. Apex Oil Co., Inc.: State of the Law Regarding Discharge of Environmental Injunctions*, Peckar & Abramson, P.C.
[76] § 1141(d).
[77] Koks & Million, *supra* note 8, at 54.
[78] *See* Signature Combs, Inc. v. U.S., 253 F.Supp.2d 1028, 1029 (W.D. Tenn. 2003) (deciding the issue of when a CERCLA claim arose).
[79] *Id.* at 1033 (citing In re Frenville Co., 744 F.2d 332 (3d. Cir. 1984), et al).

definition of a "claim" in bankruptcy law, which includes claims that are unsecured, unmatured, or otherwise contingent.[80] The Ninth Circuit in *In re Jensen* explained why such criticism was a non-starter for the court adopting this approach, writing that, "To hold that a claim for contribution arises only when there is an enforceable right to payment appears to ignore the breadth of the statutory definition of 'claim'.... The breadth of the definition of 'claim' is critical in effectuating the bankruptcy code's policy of giving the debtor a 'fresh start.' "(internal citations omitted).[81]

B. The "Underlying Act" Approach

Another standard used by a minority of courts is the "underlying act" approach, or the "conduct" approach. Under this approach, which, unlike the "right to payment" approach, relies on bankruptcy law,[82] "even if the government does not yet know of a potential environmental claim against the debtor, the debtor's liability is discharged so long as the debtor's conduct relating to the contamination concluded prior to its bankruptcy petition."[83] The glaring flaw in this approach is that it is obviously unfair to EPA in that a polluting party could undergo bankruptcy and receive a discharge from any environmental liabilities "before the EPA ever has a reason to know about the debtor's involvement in the release or threatened release of hazardous waste."[84] As the *Combs* Court notes, this spawns a multitude of other problems, including increased litigation costs on EPA as well as a decreased number of potentially responsible parties, placing an unfairly increased financial burden on other parties.[85]

C. The "Pre-Petition Relationship" Approach

The two previously-mentioned approaches exist at the extremes: the "right to payment" approach requires all elements of a cause of action be present for a claim to arise, while the "underlying act" approach recognizes a claim simply when the debtor releases waste. The final two approaches used by courts to determine when an environmental claim arises are more middle-of-the-road positions. The third approach used by courts is known as the relationship test, or the prepetition relationship test. This test was espoused in *Chateaugay*, when the Second Circuit upheld a dischargeable EPA claim even though EPA did not know the extent of nor the exact sites of such pollution.[86] The Court held that, from EPA's relationship with the debtor, EPA should have been able to ascertain potential claims against that debtor.[87] "EPA is acutely aware of [the debtor] and vice versa."[88] But the main criticism of this approach is powerful because it shows that the rule itself cuts against its rationale. As the *Combs* Court notes, the

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[80] *See id.* at 1034 (citing In re Jensen, 995 F.2d 925, 929 (3d. Cir. 1993)).
[81] *Id.*
[82] *Combs*, 253 F.Supp. at 1035.
[83] *Id.*
[84] *Id.*
[85] *Id.* at 1035-36.
[86] *See Chateaugay*, 944 F.2d at 1005.
[87] *Id.*
[88] *Id.*

problem with this approach is that courts, including the Second Circuit in *Chateaugay*, have "defined 'relationship' so broadly that they have made it [this relationship approach] the equivalent of the underlying acts approach."[89] The rationale for this approach is supposed to stem from the creditor's ability to ascertain potential claims. But just as in the underlying acts approach, the debtor could get discharged from liabilities that EPA had no idea existed.[90]

D. The "Fair Contemplation" Approach

This pitfall of both the underlying acts approach and the relationship approach set the stage for the development of the test currently used by a majority of U.S. courts: the fair contemplation, or foreseeability test.[91] This test is best exemplified in *In re Chicago*, when the Seventh Circuit held that a CERCLA claim arises when the claimant can "tie the bankruptcy debtor to a known release of a hazardous substance which this potential claimant knows will lead to CERCLA response costs."[92] In *National Gypsum*, a U.S. District Court applying this test spelled out the following factors to determine whether "fair contemplation" of future response costs existed for particular property: knowledge by the parties of a site in which a potentially responsible party may be liable, listing of the site on the National Priorities List, EPA notification of a potentially responsible party's liability, commencement of an investigation and cleanup activities, and incurrence of response costs.[93]

The *Combs* Court settled on this test because, unlike the other three tests used by courts, it does not completely displace the interests of either bankruptcy law or environmental law at the expense of the other.[94] Rather, the fair contemplation test allows a claim to accrue earlier than the extreme right to payment approach, but also gives EPA a fair chance to be aware that such a claim exists, unlike the similarly extreme underlying acts and relationship approaches.[95] While the fair contemplation test is the majority rule in the U.S. and courts such as the *National Gypsum* court have laid down multiple factors to assist in defining "fair contemplation", some disagreement in the case law exists as to what exactly constitutes "fair contemplation."[96]

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[89] *Combs*, 253 F.Supp. at 1038 (citing Saville, Kevin J., *Discharging CERCLA Liability in Bankruptcy: When Does a Claim Arise?*, 76 Minn. L. Rev. 327 at 353 (1991)).
[90] *Id.*
[91] Brimmer, *supra* note 12, at 176.
[92] In re Chicago, Milwaukee, St. Paul & Pac. R.R. Co., 974 F.2d 775, 786 (7th Cir. 1992).
[93] In Re Nat'l Gypsum Co., 139 B.R. 397, 408 (Bankr. N.D. Tex. 1992).
[94] *Combs*, 253 F.Supp. at 1038.
[95] *Id.* at 1037-38.
[96] *See* AM Int'l, Inc. v. Datacard Corp., 106 F.3d 1342 (7th Cir. 1997) (holding that a claimant's predecessor had insufficient information to link the debtor to the contaminated site despite the fact that the property was a tank farm with 6 to 8 tanks holding over 6,000 gallons at which the debtor made a cleaning product, the predecessor leased the tank farm grounds back to the debtor prepetition, and former employees of the debtor who knew of releases of contaminants were employed for the predecessor, who operated a business adjacent to the site). *But see* Murray & Franco, *supra* note 2 at 362 (expressing shock that such a claim is not a "fairly contemplated" or foreseeable claim).

CONCLUSION

Determining whether an environmental liability is a claim and when it arises will involve examining the current standards and trends in particular jurisdictions due to the many intrajurisdictional differences in the case law. While some commentators have predicted that the Supreme Court will eventually standardize the law around one or both of these questions,[97] the Supreme Court's denial of certiorari in *Apex Oil* has left plenty of questions unanswered, leaving significant jurisdictional differences across the U.S., creating both uncertainty for debtors and creditors but also opening up space for attorneys to present many different legal arguments in bankruptcy proceedings.

[97] Johnson, *supra* note 74.

Addressing Environmentally Contaminated Property: A Primer

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Addressing Environmentally Contaminated Property: A Primer

≈ Characteristics

≈ Categories

≈ Recognition

≈ Measurement

≈ Valuation

≈ The EPA

≈ Summary of Key Points

Characteristics

Courts are not restricted to valuing a debtor's reported debt and trade payables in adjudicating solvency

- Obligations that may be considered by courts in determining solvency include off-balance sheet as well as contingent liabilities
  - **Off-balance sheet liabilities**
    - Arise where there has been a transfer of rights, or settlement of obligations, from an accounting or legal point of view, but where generally accepted principles do not recognize completely, or at all, the associated liabilities
      - *Unconsolidated legal entities* —Special purpose entities, pension trusts, joint ventures, project financing structures
      - *Executory contracts* — operating leases, forward purchase or sale commitments, take-or-pay contracts
  - **Contingent liabilities**
    - Originate from existing situations involving uncertainty as to possible loss, that will result in the incurrence of a liability, when one or more future events occur or fail to occur
      - *Situational* – active and inactive disposal sites, facility operations, accidental and intentional releases from operating facilities, releases from underground storage sites, accidental releases during transport
      - *Contractual* — guarantees, standby liquidity facilities, letters of credit, warranties
      - *Non-contractual* —government investigations, lawsuits, tax structure unwinds and **ENVIRONMENTAL REMEDIATION**
- Contingent liabilities, are not recognized for accounting purposes, however, unless
  - It is *probable* that a liability has been *incurred*, and
  - The *amount* of the liability can be *reasonably estimated*
- **A contingent *environmental remediation obligation* may therefore become a liability for *solvency* purposes prior to when it is recognized for *accounting* purposes**

Categories

Environmental liabilities are legal obligations to make future payments for past or ongoing production, use, release or threatened release of a substance, or other action, that adversely affects the environment

- ≈ Environmental liabilities derive from a wide variety of sources including federal, state and local statutes, regulations, ordinances and case law, i.e.,
  - – Remediation focused-laws include the *Comprehensive Environmental Response, Compensation and Liability Act* **(CERCLA)**, *Superfund Amendments and Reauthorization Act* (**SARA**) and corrective action provisions of the *Resource Conservation and Recovery Act* (**RCRA**)
  - – Laws aimed at pollution control include the *Clean Air Act, Clean Water Act, Emergency Planning and Community Right-to-Know Act, Toxic Substances Control Act* and pollution control directives of the *RCRA*
- ≈ In general, however, environmental liabilities can be organized into six different types
  - – **Compliance:** costs to conform with laws and regulations that apply to the production, use or release of regulated substances
    - ▪ Record keeping and reporting, pretreating, exit, closure, decommissioning
  - – **Remediation:** current and future costs of cleaning contaminated real property at
    - ▪ inactive sites
    - ▪ property never or not currently owned or used
    - ▪ property acquired but not contaminated by the acquirer
      - • Investigation and feasibility study; machinery and equipment; labor, management and legal costs
      - • Construction, drilling, excavation, pumping, soil and water treatment, purchase of property and relocation costs, monitoring

Environmental liabilities are legal obligations to make future payments for past or ongoing production, use, release or threatened release of a substance, or other action, that adversely affects the environment (Continued)

- **Fines and penalties:** cost of civil or criminal fines and penalties for failing to comply with statutes and regulations
  - Can range up to several million dollars per violation
  - Civil penalties at least equal to costs saved by failure to comply
- **Compensation:** cost of damages from the use or release of toxic substances
  - *Personal injury* – wrongful death, bodily injury, medical monitoring, pain and suffering
  - *Property damage* – diminution of real estate, buildings and automobiles; crop losses
  - *Economic loss* – lost profits, leasing of alternate buildings and equipment
- **Punitive damages:** cost of damages due to gross negligence
  - Based on a ratio of punitive to actual damages rather than actual injury sustained
  - Typically exceed $1 million, but can run into the billions of dollars and are highly variable
  - Punitive damages in the *Exxon Valdez* oil spill case were initially set at $5 billion; after nearly twenty years of litigation, the award was reduced on appeal to roughly $500 million by U.S. Supreme Court using a ratio of 1:1
- **Natural resource damages**: cost of damages due to injury, destruction, loss or loss of use of natural resources that are not private property
  - Must belong to or be controlled by federal, state, local, foreign or tribal governments
  - Vegetation, wild life, land, air and water
  - Can originate from accidental as well as lawful releases

Recognition

Environmental *remediation* liabilities are *recognized* for *accounting purposes only* when it is *probable* that a liability has been incurred and the amount can be *reasonably estimated*

- *Recognition* refers to the point in time at which a liability should be reported in the financial statements
- For an environmental *remediation* liability to be *recognized*, *on or before the date* of the financial statement, the firm must be a
  - Current or past owner or operator, or contributor or transporter of hazardous waste
  - To a site where remedial actions *must* be taken
- The criteria used to assess whether it is *probable* that a liability for remediation has been incurred are that:
  - A claim or assessment has been asserted, or litigation has begun, or
  - It is probable based on available information that the resolution of the litigation, assessment or claim will be unfavorable
- It is presumed that the outcome will be unfavorable if (1) litigation, a claim or assessment has been asserted, and (2) the firm is a current or past owner or operator, or contributor or transporter of hazardous waste to the site
  - If both conditions are true, the firm must recognize an accrual for *at least the minimum amount* that can be *reasonably estimated*
  - Factors considered in developing cost estimates include
    - The extent and types of hazardous materials at the site
    - Range of technologies available for use in remediation
    - Changing standards for acceptable remediation
    - The number and financial condition of other potentially responsible parties (PRPs)

A firm’s environmental remediation liability is generally *not fixed nor an actual amount* determinable at a specific point in time

≈ Liabilities for environmental remediation are defined, verified, measured and recognized along a continuum of benchmarks that correspond to the sequence of stages of the Superfund remediation and comparable RCRA corrective-action processes

≈ The benchmarks that correspond to the stages of the Superfund remediation process consist of the

- *Identification and verification of an entity as a PRP*
  - A firm may be notified or otherwise learn that it may be a PRP with respect to a site
  - It the firm determines it is or has been associated with the site, it is *probable* that a liability has been incurred
- *Receipt of a unilateral administrative order*
  - A firm may receive a unilateral administrative order directing it to take remedial action at a site
  - The actions may range from investigations to feasibility studies and up through removal and remediation
  - The cost of performing the remedial actions *will generally be estimable within a range*, and should be recognized as a liability
- *Participation as a PRP in a remedial investigation and or feasibility study (RI/FS)*
  - The firm and other PRPs will have agreed to share in the costs of the RI/FS, providing a basis for the firm to determine its allocable share
  - Total costs for the RI/FS will be *estimable within a reasonable range*
  - A liability equal to the firm’s *best estimate*, or minimum of the range of the cost of the RI/FS, should be recognized

A firm's environmental remediation liability is generally *not fixed nor an actual amount* determinable at a specific point in time (Continued)

– *Completion of feasibility study*
  - The feasibility study should be substantially complete no later than when the PRPs propose a course of action to the Environmental Protection Agency (EPA)
  - A minimum remediation liability and the firm's allocated share *in general* will be *reasonably estimable*
  - A remediation liability should be recognize at that time if not already recognized

– *Issuance of record of decision*
  - The PRPs will have begun or completed negotiations, litigation, or both, concerning their allocated share of the remediation liability at the time the EPA issues its determination of a preferred remedy
  - The EPA's preferred remedy may be used to refine the firm's estimated liability together with the preliminary allocation of the total remediation costs

– *Remedial design through operation and maintenance, including post remediation monitoring*
  - The precision of the estimates for the total cost of remediation will increase during the design phase as engineers get a better understanding of the work required
  - Additional information will become known at various times during the process until the site is removed from the EPA's national priorities list, subject only to post-remediation monitoring
  - The additional information should be used to refine the firm's best estimate of its final obligation as it becomes available

Measurement

Environmental liabilities are *measured* accounting for the *incremental* costs directly attributable to the remediation effort plus *expected* post-remediation monitoring costs

- Incremental direct costs to be accounted for in measuring an environmental liability include the costs of
  - Undertaking the remedial investigation and feasibility study
  - Fees to external engineering and consulting firms for site investigations, development of remedial action plans and designs
  - Compensation and benefits for employees expected to focus on the remediation effort
  - Contractors carrying out remedial actions
  - Machinery and equipment that can not be redeployed to alternative uses
  - Operating and maintaining remedial actions and post-remediation monitoring
  - Government oversight and emergency cleanup charges
  - Law firms for work determining the extent of remedial actions necessary, type of remedial actions and allocation of costs between PRPs
  - Assessments by other PRPs to recover their costs of the remediation
- Legal costs incurred for normal environmental compliance purposes and litigation related to potential recoveries would not be included
  - Litigation costs are charged to expense until recovery is probable and a related asset is recognized
- Expected legal defense costs may be accrued but are typically expensed when incurred

If a site has more than one PRP, a firm must estimate and recognize an environmental liability *measured* as its allocable share of the total

- Where the remediation liability for a site is joint and several, the estimation of a firm's allocable share of the total liability requires that the firm
  - Identify the other PRPs for the site
  - Determine the percentage of the liability that it will be allocated
  - Evaluate the likelihood that the other PRPs can contribute
- Identified PRPs are classified as belonging to one of five categories
  - ***Participating PRPs*** acknowledge their potential involvement
    - Some PRPs may actively engage in the administrative, negotiating, monitoring and remediating activities for the site, while others may limit their involvement to passively monitoring the activities and decisions of others
  - ***Recalcitrant PRPs*** resist being associated with the remediation effort despite existing evidence indicating their involvement
    - PRPs in this category typically must be sued to induce them to accept their allocable share of the remediation liability
  - ***Unproven PRPs*** have been identified by the EPA but do not acknowledge their involvement since there is no substantive evidence linking them to the site
  - ***Parties that have not yet been identified as PRPs*** but may be on further investigation and as remediation takes place
  - ***Parties that are PRPs but cannot be located or have no assets*** and consequently will never contribute

If a site has more than one PRP, a firm must estimate and recognize an environmental liability *measured* as its allocable share of the total (Continued)

≈ While the allocation method or percentages used may change as the remediation process progresses, the percentage of the liability that a firm will be allocated should be determined using the allocation method and percentage that

- The PRPs have agreed to,
- Has been assigned by an allocation consultant, or
- Has been determined by the EPA

≈ The methods used to allocate an environmental liability between ***Participating PRPs*** are the

- ***Element of fair share*** – amount, type and toxicity of waste or length to time the site was used
- ***Classification of PRP*** – owner, operator, transporter or generator of waste
- ***Limitation of payments*** – applicable statutory or regulatory limitations on contributions
- ***Degree of care exercised*** – in selecting the disposal site or waste transporter

≈ A PRP must evaluate the likelihood that other PRPs will pay their allocable share of the remediation liability based on an analysis of each PRPs financial condition

- Based on this assessment, the PRP may accrue a liability for its estimated share of amounts that will not be paid by other PRPs or the government

Environmental liabilities should be *measured* based on contemporaneous laws, regulations and technologies

- Remediation programs generally extend over several years from start to finish
- Over the course of the period, laws, regulations and policies may change in a way that affects the cost of the remediation
- Remediation technologies are also constantly evolving, and in many instances, new technologies have resulted in changes to the expected costs of the remediation
- Environmental liabilities should therefore be estimated based on currently enacted laws and technologies expected to be used so as to not misstate the liability and amount most likely to be paid
- Once a technology is approved, it should be used as the basis for estimating the liability until such time as it is probable that a revised technology will be formally accepted
- The estimate should reflect the cost to perform each segment of the remediation, taking into account inflation and productivity improvements from experience at similar sites with similar remedial action plans
- If not practicable to estimate inflation and other factors due to uncertainty regarding the timing of future expenditures, a current-cost estimate will be the minimum of the range of the liability to be recognized until the cost effects can be reasonably estimated

The measurement of environmental liabilities for accounting purposes does not and is not intended to represent fair value

- The objective of accounting for environmental liabilities is to *measure the estimated cost* to complete each segment of the remediation plan at the time at which it is expected to be performed
- If the aggregate amount of the obligation and amount and timing of the related cash payments are *fixed or reliably determined*, **while not required**, the measurement of the liability may be discounted
- This determination requires that the amounts and timing of the cash flows underlying the estimates of the expected costs be based on detailed site-specific plans supported with objective and verifiable information
- The cash flows must therefore equal the estimated amounts expected to be paid on each settlement date, be calculated using explicit assumptions and methods used in preparing the remediation plan, and be verifiable by a knowledgeable third party
- As the *fixed or reliably determined* criteria for discounting cash flows are rarely met during the early years, however, environmental liabilities will often be recognized initially without discounting
- In later years or for sites that do meet the criteria for discounting, the cash flows may be discounted at a rate not greater than that for monetary assets that are in essence risk-free and have comparable maturities
- The discounted value ***will not represent fair value***, however, given the cost measurement objective and likelihood that a third party would typically demand a rate much higher than a risk-free return

The recognition and measurement of environmental liabilities for accounting purposes may render financial statement reserves in and of themselves unreliable and irrelevant for determining solvency

≈ The accounting recognition of environmental liabilities is *limited* to those that are *probable and reasonably estimated*

≈ Environmental liabilities are generally *not fixed nor an actual amount* determinable at a specific point in time, but are defined, verified, measured and recognized *along a continuum* of benchmarks *through the end* of post remediation monitoring

≈ Where a site has more than one PRP, a firm's allocable share of the total liability *may vary over the remediation period* due to changes in the identity of other PRPs, allocation methods and percentages, ability of other PRPs to pay their allocable share, laws, regulations and technology

≈ Discounting of environmental liabilities, which is *not required*, is allowed *only* if the aggregate amount of the obligation and amount and timing of the cash flows are *fixed and reliably determined*, which will rarely be the case early on

≈ Given the *cost measurement objective* underlying the measurement of environmental liabilities, and likelihood that a third party would typically demand a return higher than a risk-free rate, the discounted value *will not represent fair value*

Valuation

As compared to accounting measurements, the valuation of an environmental liability in a solvency context entails a judgment *as to the probability* of the liability being *realized*

≈ As the court opined *In re Xonics Petrochemical, Inc.,* contingent obligations should not be listed on the balance sheet at their full face value

≈ And in contrast to how contingent liabilities are recognized and measured under GAAP, it need not be *probable* that a liability *has been incurred* and be *reasonably estimated* for it to be included

≈ Rather, the valuation of a contingent liability within the context of a solvency analysis requires a *judgment as to the probability* of the liability being *realized*

≈ This is accomplished in part using what has been referred to as the ***"Probability Discount Rule,"*** in which

- ***The value of a contingent liability = the face amount of the liability x the likelihood of its occurrence at the relevant point in time***

≈ Applying the probability discount rule requires

1) Estimating the costs the debtor will incur on certain dates in the future if the liabilities are realized
2) Estimating the probabilities that the liabilities will be realized on certain dates in the future
3) Applying the estimated probabilities to their associated liabilities
4) Discounting the probability-adjusted liabilities to present value

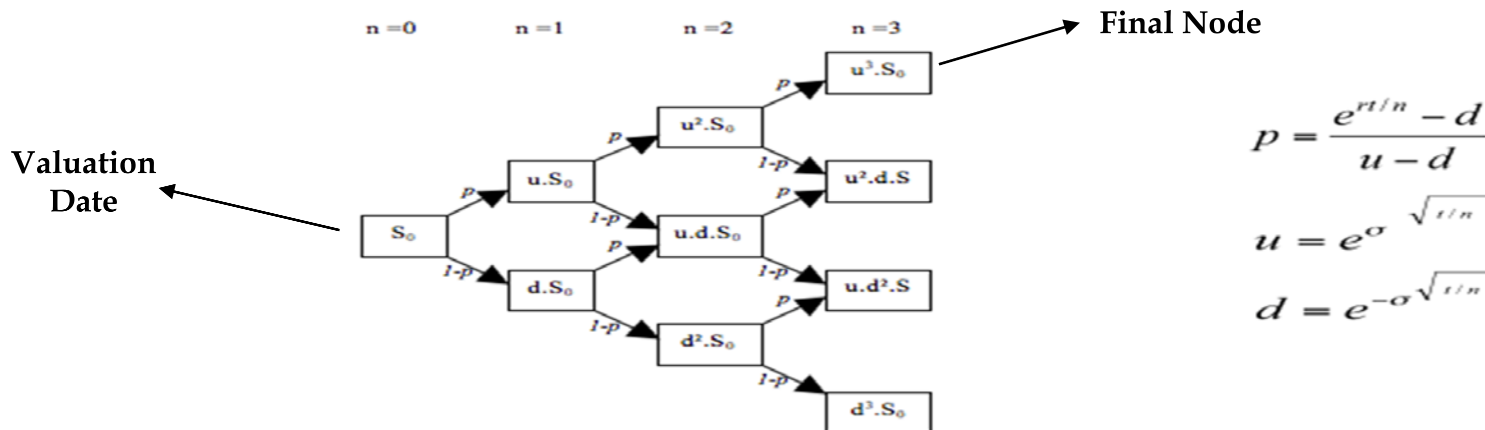
≈ Per *Tronox,* the discount rate should not consider the debtor's ability to pay

Environmental liabilities may be valued for solvency purposes using methodologies including the Discounted Cash Flow, Binomial Option Pricing and Monte Carlo methods

- The Discounted Cash Flow method estimates the value of an asset or liability based on the present value of its expected future cash flows
  - The first step is to estimate the expected cash flows for each period
  - Each period's cash flows are then discounted back to the valuation date with a rate of return that reflects their risk
  - However, while the expected cash flows in a DCF model represent the most likely outcomes, the cash flows of an environmental liability are volatile and contingent on the resolution of multiple factors
  - The use of the DCF method may therefore require the preparation of multiple, probability weighted scenarios
- The Binomial Option Pricing method estimates the value of an asset or liability based on the present value of its expected future cash flows estimated using a decision tree, or lattice framework
  - Step (1) is to estimate the tree, or lattice of cash flows, for each time period or node, working forward from the valuation date to the ending time period
    - At each node, the cash flows for the period are assumed to move either up or down to the next node based on probabilities u and $(1 - u)$
    - The probabilities u and $(1 - u)$ are calculated using the underlying volatility, σ , and the time duration of the node, t , measured in years with the day count convention, i.e., $u = e^{\sigma\sqrt{t}/n}$ $d = \frac{1}{u}$

Environmental liabilities may be valued for solvency purposes using methodologies including the Discounted Cash Flow, Binomial Option Pricing and Monte Carlo methods (Continued)

- Step 2 is then to calculate the present value of the cash flows at each final node of the tree, while Step 3 is to calculate the present value of the cash flows at each of the preceding nodes, working backwards from the final node to the first node of the tree, or valuation date
- The present value of the cash flows at each node is calculated as equal to the present value of the cash flows of the two subsequent nodes, weighted by their respective probabilities



$$p = \frac{e^{rt/n} - d}{u - d}$$

$$u = e^{\sigma \sqrt{t/n}}$$

$$d = e^{-\sigma \sqrt{t/n}}$$

Environmental liabilities may be valued for solvency purposes using methodologies including the Discounted Cash Flow, Binomial Option Pricing and Monte Carlo methods (Continued)

- The Monte Carlo Method estimates the value of an asset or liability based on the present value of its expected future cash flows simulated by repeatedly generating random values for variables that are uncertain based on predefined probability distributions
- More specifically, a Monte Carlo simulation calculates and then averages the results for numerous scenarios of a model by repeatedly selecting random values from the probability distribution for the variables that are uncertain and using those values in the model
- The Monte Carlo Method entails the following procedures:
  - Develop a Discounted Cash Flow model
  - Identify the variables (aka, random variables) and functions (aka, functions of a random variable) in the model that are uncertain
    - i.e., discount rate, tax rate, revenues, costs; margins, cash flow, present value
  - Assign probability distributions to the variables that reflect their uncertainty
  - Define the present value function as the result and run 1,000 simulations

The EPA

The EPA is committed to using its enforcement authority to pursue all sources of recovery so that responsible parties rather than tax payers pay for the clean up of hazardous waste

≈ Firms that file for bankruptcy must make environmental disclosures in their Statement of Financial Affairs filed with the bankruptcy court

≈ When a known PRP files for bankruptcy protection, the EPA receives the notice and files a proof of claim

≈ As an unsecured creditor, the EPA has standing to recover from the assets available on environmental claims approved by the bankruptcy court, though the amount may be less than the full value of the claim

≈ Historically the EPA has won significant recoveries through bankruptcy settlements

- In February 2014, the EPA received a distribution of roughly $54 million from W.R. Grace to resolve environmental liability claims pursuant to the company's plan of reorganization
- Tronox Incorporated agreed in February 2011 to resolve its environmental liabilities with the EPA, the Navajo Nation and various other federal, state and local agencies. The claimants received in addition to other consideration, $270 million and 88 percent of Tronox's interest in a pending fraudulent conveyance litigation. Following on April 3, 2014, in a settlement of the fraudulent conveyance claims against Kerr-McGee Corporation and certain subsidiaries of Anadarko Petroleum Corporation, Anadarko agreed to pay $5.15 billion plus interest to a litigation trust so that the settlement proceeds could be distributed to the trust's environmental and tort beneficiaries.

The EPA is committed to using its enforcement authority to pursue all sources of recovery so that responsible parties rather than tax payers pay for the clean up of hazardous waste (Continued)

- In October 2010, the EPA announced a bankruptcy settlement with Motors Liquidation Corporation (aka "Old GM“) to establish a $773 million Environmental Response Trust to conduct, manage and finance the cleanup of 89 owned sites across 14 states. In addition, under the terms of an additional seven settlements following in March 2011, the EPA received cash along with allowed general unsecured claims and work performance collectively exceeding $51 million

- In 2009, the EPA achieved a number of record recoveries in several multi-regional, multi-site bankruptcy cases, including over $1 billion from the American Smelting and Refining Company (ASARCO) and G-I Holdings bankruptcies alone

- In 2008, the EPA reached settlements in the W.R. Grace bankruptcy and American International Specialty Lines Insurance Co. (AISLIC) bankruptcy-related insurance litigation having potential cost recoveries of $34 million and $42.5 million respectively

Summary of Key Points

Summary of key points

≈ Courts are not restricted to valuing a debtor's reported debt and trade payables in adjudicating solvency

≈ Environmental liabilities are legal obligations to make future payments for past or ongoing production, use, release or threatened release of a substance, or other action, that adversely affects the environment

≈ Environmental *remediation* liabilities are *recognized* for *accounting purposes only* when it is *probable* that a liability has been incurred and the amount can be *reasonably estimated*

≈ A firm's environmental remediation liability is generally *not fixed nor an actual amount* determinable at a specific point in time

≈ Environmental liabilities are *measured* accounting for the *incremental* costs directly attributable to the remediation effort plus *expected* post-remediation monitoring costs

≈ If a site has more than one PRP, a firm must estimate and recognize an environmental liability *measured* as its allocable share of the total

≈ Environmental liabilities should be *measured* based on contemporaneous laws, regulations and technologies

≈ The *measurement* of environmental liabilities for accounting purposes does not and is not intended to represent fair value

Summary of key points

- ≈ The recognition and measurement of environmental liabilities for accounting purposes may render financial statement reserves in and of themselves unreliable and irrelevant for determining solvency
- ≈ As compared to accounting measurements, the valuation of an environmental liability in a solvency context entails a judgment *as to the probability* of the liability being *realized*
- ≈ Environmental liabilities may be valued for solvency purposes using methodologies including the Discounted Cash Flow, Binomial Option Pricing and Monte Carlo methods
- ≈ The EPA is committed to using its enforcement authority to pursue all sources of recovery so that responsible parties rather than tax payers pay for the clean up of hazardous waste

Addressing Environmentally Contaminated Property: A Primer

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