Bankruptcy's Fresh Start vs. Environmental Cleanup: Statutory Schizophrenia

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This article takes a hard look at the exacerbating conflict between bankruptcy and environmental law, especially after the Third Circuit's recent decision in *In re Torwico Electronics, Inc.* First, this Article outlines the two-step analysis required in administering environmental obligations in bankruptcy. Next, it examines the pertinent case law for each step of the analysis. Finally, this Article attempts to craft a synthesized approach to resolving environmental obligations in bankruptcy, taking into account judicial economies, public policy and the objectives of both bankruptcy and environmental laws. In so doing, the author hopes to simplify and clarify one of the most controversial and confusing areas in bankruptcy and environmental law today.

I. INTRODUCTION

The Bankruptcy Reform Act of 1978, as amended, ("Code") primarily aims to discharge all claims against debtors and provide them with a "fresh start," free of prior debts at the completion of the case. In contrast, the Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA") aims to im-

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3. Id. § 727(b) (discharge of pre-petition debts under Chapter 7); id. § 1141(d)(1)(A) (confirmation of plan of reorganization discharges pre-petition debts under Chapter 11). A debt is defined as a "liability on a claim." Id. § 101(12).

4. See S. Rep. No. 989, 95th Cong., 1st Sess. 309 (1978), reprinted in 1978 U.S.C.C.A.N. 5963, 6266 (defining "claim" broadly to provide "broadest possible relief" for debtor in bankruptcy); see also *In re CMC Heartland Partners*, 966 F.2d 1143, 1146 (7th Cir. 1992) ("Bankruptcy cleaves the [Chapter 11 debtor] in two . . . [with] [e]xisting claims . . . satisfied exclusively from existing assets, while the new firm . . . carries on to the extent current revenues allow.").

pose liability on potentially responsible parties ("PRPs")\textsuperscript{6} for

damage caused by the release or threatened release of a hazardous

material.\textsuperscript{7} Under CERCLA, the Environmental Protection Agency
("EPA") can enforce cleanup liability by: (1) cleaning up a hazardous

site and then seeking reimbursement ("response costs") from a

responsible party pursuant to section 107; or (2) compelling a re-

sponsible party to clean up a site through an injunction under sec-

tion 106.\textsuperscript{8} In addition, most states have enacted cleanup or
disclosure laws, such as New Jersey’s Environmental Cleanup Re-

sponsibility Act ("ECRA"),\textsuperscript{9} which must be followed prior to trans-

fer or closure of a site.\textsuperscript{10}

Because the costs of complying with environmental regulations
can be high, many companies have been forced to seek protection
in bankruptcy in hopes of ultimately discharging their debts upon
confirmation of the reorganization plan.\textsuperscript{11} In assessing whether a
debtor filing under Chapter 11 of the Code ("Chapter 11
debtor")\textsuperscript{12} may discharge an environmental liability, courts have
employed a two-step analysis: (1) whether the liability is a "claim"
for purposes of the Code; and (2) whether the claim arose pre-peti-
tion or post-petition.\textsuperscript{13}

\textsuperscript{6} Under CERCLA, a PRP is any former or present owner and operator, waste
generator or transporter of waste to the site in question. \textit{Id.} \textsection 107(a), 42 U.S.C.
\textsection 9607(a). A PRP is strictly liable for the cost incurred by the government in re-

sponse to the presence of hazardous materials. \textit{Id.}

\textsuperscript{7} \textit{See id.} \textsection 107, 42 U.S.C. \textsection 9607.

\textsuperscript{8} CERCLA \textsection 106, 107, 42 U.S.C. \textsection\textsection 9606, 9607. In addition, CERCLA per-

mits any state or other individual to undertake a cleanup and attempt to recover

from a PRP. \textit{Id.} \textsection 104, 42 U.S.C. \textsection 9604. \textit{See, e.g., In re Chicago, Milwaukee, St.

Paul & Pac. R.R., 3 F.3d 200 (7th Cir. 1993) (action by PRP against debtor’s succes-

sor where debtor previously owned site).

\textsuperscript{9} N.J. STAT. ANN. \textsection 13:1K-6-35 (West 1991 & Supp. 1994). The purpose of

this law is to provide adequate preparation and implementation of cleanup proce-

dures for hazardous substances and wastes. \textit{Id.} \textsection 13:1K-7.

\textsuperscript{10} \textit{Id.} \textsection 13:1K-6-14.

\textsuperscript{11} \textit{See, e.g., In re Chateaugay Corp., 944 F.2d 997, 999 (2d Cir. 1991) (debtor

listed twenty-four pages of EPA claims in its schedule of liabilities). The provisions

of a confirmed plan of reorganization bind the debtor, any entity issuing securities

under the plan, and any creditor, equity security holder, or general partner in the

debtor, whether or not the claim or interest of such creditor, equity security

holder, or general partner is impaired under the plan and whether or not these

individuals have accepted the plan. 11 U.S.C. \textsection 1141.

\textsuperscript{12} A corporation files a petition pursuant to Chapter 11 when they are con-

tinuing in business. Under Chapter 11, the corporation must file their reorganiza-

tion plan, and the creditors must approve it. \textit{See 11 U.S.C. \textsection\textsection 1121-29 (providing

explanation of plan procedures).

\textsuperscript{13} \textit{See Kathryn R. Heidt, Environmental Obligations in Bankruptcy \textsection 3.01, at 3-2

(1993) (stating that two key issues in understanding treatment of envi-

ronmental obligations in bankruptcy are: (1) whether the obligation is a claim

under Code; and (2) when a claim arises).
II. WHAT CONSTITUTES A CLAIM?

Section 101(5) of the Code provides that a claim is a right to payment or a right to an equitable remedy for breach of performance where that breach gives rise to a right to payment. Courts consistently have grappled with whether an environmental obligation constitutes a claim for purposes of the Code. An obligation adjudged a claim is rendered dischargeable after confirmation of the plan of reorganization. Conversely, an obligation which is not deemed a claim remains outside or “passes through” the bankruptcy proceedings and the party seeking to enforce the environmental obligation may proceed against the reorganized debtor.

The leading case in the area of environmental obligations in bankruptcy is Ohio v. Kovacs. In Kovacs, the United States Supreme Court held that where the state divested a debtor of all property available to assist in performing the required cleanup and simply was seeking the payment of money, the state had a “right to payment.” According to the Court, this right constitutes a dischargeable claim under the Code. The debtor in Kovacs failed to comply with a pre-petition state injunction mandating the removal of hazardous waste. In response, the state appointed a receiver to take control of the site as well as the debtor’s other assets and undertake the cleanup.

15. A discharge is a release of the debtor from further personal liability for pre-bankruptcy debts. If the debtor is granted a discharge under Chapter 7, all an unsecured creditor receives is its pro-rata distribution. See id. § 727.
16. Id. § 1328(a). See also id. § 1129 (confirmation of a plan).
17. 11 U.S.C. § 1328.
19. Kovacs, 469 U.S. at 283.
20. Id. at 276.
21. Id. The debtor was the chief executive officer and shareholder of a corporation that operated an industrial waste site. Id. After the state sued the debtor and the corporation under state environmental regulations, the debtor, acting in his individual capacity and on behalf of the corporation, entered into a settlement stipulation with the state. Kovacs, 469 U.S. at 276. The stipulation enjoined the corporation and the debtor from causing further air or water pollution, prohibited transporting additional industrial waste to the site, mandated removal of specified waste from the site and ordered the payment of $75,000 in compensation. Id. When the debtor failed to comply with the stipulation, the state obtained an order for the appointment of a receiver and the debtor filed a bankruptcy petition under Chapter 11. Id. The debtor eventually converted the petition to a liquidation proceeding under Chapter 7. Id. at 276 n.1. See 11 U.S.C. § 1112(a) (providing for voluntary conversion by debtor from Chapter 11 to Chapter 7).
Appointment of the receiver eliminated the debtor's ability to comply with the injunction. Therefore, the state wanted payment of money damages from the debtor. These money damages constitute a "claim" within the meaning of the Code. In dicta, the Court noted that its holding did not address the situation in which there had not been a pre-petition appointment of a receiver. Thus, the Kovacs holding is limited in its application.

Furthermore, the Court indicated that prospective environmental regulatory remedies may not be dischargeable under the Code. This carefully articulated limitation had the effect of alerting the United States Circuit Courts of Appeals that a case involving forward-reaching injunctive relief could be decided differently. Thus, after Kovacs, a court could hold that a prospective order from an environmental regulatory agency is not a claim under the Code and therefore such an obligation would be nondischargeable.

The United States Court of Appeals for the Second Circuit took just this step in deciding In re Chateaugay Corp. In Chateaugay, the Second Circuit held that an EPA order which focused on the dual objectives of alleviating continued pollution and removing accumulated waste did not constitute a claim under the Code. In Chateaugay, the Chapter 11 debtor, LTV Corporation, had filed its schedule of liabilities, which included twenty-four pages of contingent claims of EPA and state environmental enforcement agen-

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22. Kovacs, 469 U.S. at 283. When the debtor failed to clean up the site as he was obligated to do under the settlement stipulation, the state secured the appointment of a receiver who took possession of the debtor’s nonexempt assets and the assets of the corporate defendants. Id. at 282-83. Thus, this course of action divested the debtor of assets that might have been used to clean up the site.

23. See id. at 283 (noting that state conceded that only performance sought from debtor was payment of money). For a discussion of how payment of money is a claim under the Code, see supra note 14 and accompanying text.

24. Id. at 284. This determination apparently was left for the circuits to resolve. Furthermore, the Court noted that, absent appointment of a receiver prepetition, a bankruptcy trustee who enjoys the power of abandonment under the Code could have minimized the debtor’s obligations. Id. at 284-85 n.12 (citing 11 U.S.C. § 554 (providing that after notice and hearing, trustee may abandon property that is burdensome to estate or that is of inconsequential value to estate)).

25. Kovacs, 469 U.S. at 284-85 (explaining that Court does not hold “that the injunction against bringing further toxic wastes on the premises . . . is dischargeable in bankruptcy,” nor that possessor of site may fail to comply with local environmental regulations).


27. Id. at 1008 (“Any order that to any extent ends or ameliorates continued pollution is not an order for breach of an obligation that gives rise to a right of payment and is for that reason not a ‘claim.’”).
BANKRuPtcy's FRESH START

cies. LTV and EPA disagreed over whether response costs incurred by EPA after the bankruptcy court confirmed LTV's plan of reorganization were discharged at confirmation because these costs constituted claims under the Code.

In holding that an order containing prospective injunctive relief is nondischargeable, the Second Circuit factually distinguished Chateaugay from Kovacs. This was because in Kovacs the State made a pre-petition appointment of a receiver which prevented the debtor from undertaking any action to comply with the state injunction. The Court read Kovacs to stand for the proposition that any order focusing on alleviating or ending environmental pollution is nondischargeable. Thus, Chateaugay appears to provide environmental regulatory agencies with a prescription for nondischargeability of environmental claims: include a directive for prospective relief in the injunction to remove current waste and cease continued pollution.

In Torwico, the United States Court of Appeals for the Third Circuit expanded the Chateaugay holding to encompass prospective relief even if the debtor no longer owns or occupies the contaminated property. In Torwico, the Third Circuit held that efforts of the New Jersey Department of Environmental Protection and Energy ("NJDEPE") to compel a Chapter 11 debtor to clean up environmental waste that represents a continuing danger does not constitute a claim for purposes of the Code.

28. Id. at 999. EPA subsequently filed a $32 million proof of claim in LTV's bankruptcy. Id. The $32 million represents pre-petition response costs from 14 sites where LTV had been identified as a PRP. Chateaugay, 944 F.2d at 999. For a discussion of PRPs, see supra note 6 and accompanying text.

29. Id. Typically, confirmation of a plan discharges the debtor from liability on all claims that arose prior to confirmation, whether pre-petition or post-petition. See 11 U.S.C. § 1141(d)(1)(A).

30. Chateaugay, 944 F.2d at 1008-09. For a discussion of the appointment of the receiver in Kovacs, see supra notes 20-24 and accompanying text.

31. Chateaugay, 944 F.2d at 1009 ("[T]o the extent an order is obtained under CERCLA or any other environmental statute that seeks to end or ameliorate pollution, . . . nothing in Kovacs permits a discharge of such obligation.").

32. Torwico, 8 F.3d at 151. In finding the environmental obligation nondischargeable, the court was not persuaded by the assertion that the debtor "no longer owns or occupies the land." Id.

33. Id. The NJDEPE found a hidden seepage pit which contained hazardous materials and determined that the waste was mixing with the local water supply. Id. at 147. In holding that the NJDEPE did not have a claim for purposes of bankruptcy, the Torwico court determined that the NJDEPE was attempting to obligate the debtor to "ameliorat[e] ongoing pollution emanating from [accumulated] wastes" which posed an ongoing and continuing danger. Torwico, 8 F.3d at 150 (quoting Chateaugay, 944 F.2d at 1008).
The Third Circuit reasoned that where a debtor has access to the contaminated facility and was the generator of the hazardous waste within the meaning of the state regulation, the debtor's obligations "run with the waste," regardless of whether the debtor presently owns or operates the property.34 Thus, to the extent that the debtor's waste constitutes a continuing hazard, environmental obligations are not claims under the Code and therefore are nondischargeable. As a result, a Chapter 11 debtor (at least in the Third Circuit) must contend with this cleanup obligation even after confirmation of its plan of reorganization.35

III. Torwico: A Case Discussion and Analysis

In Torwico, the debtor operated a manufacturing business on a leased site until September 1985 when it moved its operations from the property.36 Shortly thereafter, Torwico filed a bankruptcy petition under Chapter 11 of the Code, and in its schedules, Torwico listed both the NJDEPE and the Attorney General of New Jersey as unsecured creditors holding disputed, unliquidated claims.37 The NJDEPE then issued an administrative order directing Torwico to take certain remedial actions concerning a hidden seepage pit containing hazardous wastes.38 The order expressly addressed potential conflicts with the Code, maintaining that the obligations which it imposed did not constitute a dischargeable debt.39

34. Id. at 150.
35. Id. The Torwico court noted that the NJDEPE simply was exercising its regulatory and police powers to remedy an existing and ongoing hazardous waste site. Id. at 151. Thus, the NJDEPE was not seeking money damages for past conduct, but instead was attempting to preclude future environmental damage. Torwico, 8 F.3d at 151. But see Kovacs, 469 U.S. at 282-83 (state conceded that only performance sought from debtor was payment of money).
36. Torwico, 8 F.3d at 147.
37. Id.
38. Id.
39. Id. at 148. The administrative order provided that "'[n]o obligations imposed [by this order] . . . are intended to constitute a debt, damage claim, penalty or other civil action which should be limited or discharged in a bankruptcy proceeding.'" Id. (quoting Administrative Order and Notice of Civil Administrative Penalty Assessment issued by NJDEPE to Torwico Elec., Inc.). The order further noted that all obligations were imposed by the NJDEPE pursuant to the state's police powers and were intended to protect the public and environment. Id. An action by a governmental entity undertaken to enforce the entity's police or regulatory powers is excepted from the automatic stay's limitation on the commencement or continuation of proceedings against the debtor. 11 U.S.C. § 362(b)(4). See, e.g., Penn Terra Ltd. v. Dep't of Env'l Resources, 733 F.2d 267 (3d Cir. 1984) (focusing on whether action by Pennsylvania Department of Environmental Resources constituted action to enforce police or regulatory powers, outside scope of automatic stay).
In affirming the United States District Court for the District of New Jersey's reversal of the bankruptcy court, the Third Circuit relied extensively on Chateaugay. In accordance with Chateaugay's directive, the Third Circuit found that the seepage pit was a continuing problem because it was leaking hazardous waste into the surrounding environment. Thus, the NJDEPE merely was directing the debtor to "ameriorat[e] ongoing pollution." In so doing, the Third Circuit expanded the group of parties potentially responsible for prospective environmental relief from present owners to prior lessees.

Chateaugay and Torwico significantly undermine the "fresh start" objective of the Code. Following the prescription of Chateaugay's dictum, environmental regulators now can seek to preclude a bankruptcy court from finding that an environmental obligation is a claim by limiting their initial demands to prospective injunctive relief. In Torwico, the Third Circuit extended the Chateaugay analysis to include prior lessees, thereby solidifying the ability of environmental regulators to impose liability on Chapter 11 debtors operating in bankruptcy. In broadening the range of PRPs to include not just present owners but prior lessees, the Third Circuit purported to rely in part on the Seventh Circuit's decision in In re CMC Heartland Partners. Yet, this reliance seems untenable. There is little factual connection between the situations in Torwico and CMC Heartland Partners. Unlike Torwico, the PRP in CMC Heartland Partners was not the debtor, but a successor to the debtor. Second, the PRP in CMC Heartland Partners owned the property at the time EPA assessed cleanup obligations, while the debtor in Torwico did not. Finally, the CMC Heartland Partners court determined that a CERCLA section 106 order runs with the land to current owners. Without explanation, however, the Torwico court concluded that a section 106 order runs with the waste to prior lessees.

40. See Torwico, 8 F.3d at 149 (noting that Chateaugay provides insight into issue of whether debtor's environmental obligations are liabilities on a claim). The Torwico court also relied on In re CMC Heartland Partners, 966 F.2d 1143 (7th Cir. 1992). Id.
41. Torwico, 8 F.3d at 150 (quoting Chateaugay, 944 F.2d at 1008).
42. 966 F.2d 1143 (7th Cir. 1992) (holding that EPA order to debtor and owner of site requiring removal and remediation activity based on ownership survived reorganization).
43. Id. at 1145.
44. Id.
45. Id.
46. Torwico, 8 F.3d at 146.
It is the authors' belief that the Third Circuit's opinion in *Torwico* goes too far in favoring environmental regulations over bankruptcy's "fresh start" objective.\(^{47}\) Congress intended that the term "claim" be defined very broadly for purposes of bankruptcy.\(^{48}\) To implement this legislative intent, courts should ensure that environmental obligations, designed in part to compel collection of cleanup costs arising as a result of pre-petition contamination, constitute claims under the Code. This treatment of environmental obligations especially should hold true for former owners and lessees. Failure to classify pre-petition environmental obligations as claims will prevent many debtors with significant cleanup obligations from emerging from bankruptcy and may cause their eventual liquidation with the attendant loss of jobs and business. Additionally, environmental regulators should assess present owners and lessees for potential future cleanup obligations, leaving present owners and prior lessees free to negotiate price modifications and indemnities to account for the risk of future environmental obligations.

### IV. When Does a Claim Arise? Three Differing Approaches

Once an environmental obligation is deemed a claim under the Code, the critical issue becomes whether the claim arose pre-petition or post-petition.\(^{49}\) Debts arising pre-petition under Chapter 7, or prior to confirmation of a plan of reorganization under...
Chapter 11, are dischargeable.\textsuperscript{50} Since the Code does not expressly define when an environmental obligation becomes a claim in bankruptcy, courts have been required to make this determination. Courts have espoused three different views as to when a claim arises in bankruptcy. The first, and broadest view, followed by the Second Circuit, provides that a claim arises once the release or threatened release of hazardous substances occurs. The second, and narrowest view, followed by the Third Circuit and the District of Minnesota, provides that a claim arises only once the cause of action accrues; under CERCLA, this occurs when response costs are incurred.\textsuperscript{51} The third view, adopted by the Northern District of Texas, the Ninth Circuit and the Seventh Circuit, adopts the first view and incorporates a knowledge or foreseeability requirement.\textsuperscript{52}

A. Release or Threatened Release

The Second Circuit broadly defined when a claim arises, providing debtors with ample protection from environmental claims. In \textit{Chateaugay}, the United States Court of Appeals for the Second Circuit held that a claim for response costs arose when a release or
threatened release of hazardous substance occurred. Because there was a pre-petition release to the extent that EPA directed the debtor to clean up existing waste, EPA's claim was dischargeable in bankruptcy. Thus, under the Second Circuit's approach, virtually any environmental obligation relating to hazardous waste, provided the waste was generated pre-petition, is a dischargeable claim.

B. Response Costs Incurred

In *United States v. Union Scrap Iron & Metal*, the United States District Court for the District of Minnesota held that the mere release of hazardous materials prior to confirmation of a reorganization plan does not give rise to a dischargeable claim under the Code. Instead, the court focused on the four elements of a CERCLA obligation, including incurring response costs. Since EPA had incurred no response costs prior to confirmation of the debtor's plan of reorganization, the Minnesota Federal District Court found that EPA had no claim under the Code and was free to proceed against the reorganized debtor. In distinguishing *Chateaugay*, the court noted that the debtor could not show that EPA had actual or presumed knowledge of potential CERCLA claims against the debtor before confirmation.

Although *In re M. Frenville Co.* did not involve environmental claims in bankruptcy, this decision elucidates the Third Circuit's position regarding when a claim arises. In *M. Frenville Co.*, the United States Court of Appeals for the Third Circuit held that under state law, a claim for indemnity or contribution by a Chapter 7 debtor's accounting firm did not arise until the suit was instituted by the accounting firm. Because a right to payment did not arise

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53. *Chateaugay*, 944 F.2d at 1006. See also *In re Jensen* 127 B.R. 27 (Bankr. 9th Cir. 1991) (claim arises when debtor commits act), aff'd, 995 F.2d 925 (9th Cir. 1993). The United States Court of Appeals for the Ninth Circuit, in affirming the United States Bankruptcy Appellate Panel for the Ninth Circuit, adopted a different view. See *Jensen*, 995 F.2d at 930 (fair contemplation test balances policy objectives of Code and CERCLA). For a discussion of the different standards adopted by each court in *Jensen*’s appellate process, see infra notes 63-65.


55. *Id.* at 838-39.

56. *Id.* at 835. The four elements of a legal obligation under CERCLA are: (1) a facility; (2) a release or threatened release of a hazardous substance at the facility; (3) a responsible party; and (4) expenditure of necessary response costs by the United States in responding to the release. *Id.* at 835 (citing United States v. Aceto Agric. Chems. Corp., 872 F.2d 1373 (8th Cir. 1989)).


58. *Id.*

59. 744 F.2d 332 (3d Cir. 1984).

60. *Id.* at 337.
until the accounting firm initiated its indemnity suit, and because the suit was not initiated until fourteen months after the commencement of the debtor’s case, the Third Circuit reasoned that the accounting firm’s right to payment did not arise pre-petition. Therefore, their right to payment was not a claim that could be discharged. 61

Under a test like this, which focuses on when response costs are incurred, environmental regulators successfully can avoid discharge of agency claims by deferring assessment of response costs. Under this frequently criticized approach, virtually all hazardous waste claims will be nondischargeable in bankruptcy.

C. Release or Threatened Release and Foreseeability

In an effort to better balance the objectives of environmental regulations with the Code’s focus on a fresh start, several courts have adopted a “fair contemplation” test. 62 In In re National Gypsum Co., 63 the District Court for the Northern District of Texas held that a debtor’s potential liability for future CERCLA response costs gives rise to dischargeable claims to the extent that the liability could be fairly contemplated by the parties on the petition date. 64 In National Gypsum, the debtors objected to the government’s proof of claim, filed on behalf of EPA, which contained seven listed sites and at least thirteen unlisted sites for which EPA reserved its right to assert liability. 65

In promulgating the “fair contemplation” standard, the court expressly stated that the Second Circuit in Chateaugay adopted an overly broad test for when a claim arises; in so doing, the Second Circuit included costs not fairly contemplated by EPA, including pre-petition releases of environmental waste not discovered by EPA. 66 The court then identified several factors relevant to determining when the “fair contemplation” standard is satisfied: “knowledge by the parties of a site in which a PRP may be liable, N[ational] P[riorities] L[ist] listing, notification by EPA of PRP liability, commencement of investigation and cleanup activities, and

61. Id.
62. See Jensen, 995 F.2d 925 (9th Cir. 1993); In re National Gypsum Co., 139 B.R. 397 (N.D. Tex. 1992); In re Chicago, Milwaukee, St. Paul & Pac. R.R., 974 F.2d 775 (7th Cir. 1992).
64. Id. at 407-08.
65. Id. at 400.
66. Id. at 406-07.
incuring response costs.\textsuperscript{67} In addition, the court cautioned that the “fair contemplation” standard should not be used by an environmental regulatory agency to subvert the objectives of the Code.\textsuperscript{68} This caution addressed the inherent weaknesses of the dictum in \textit{Chateaugay}.\textsuperscript{69}

In \textit{In re Jensen},\textsuperscript{70} the United States Court of Appeals for the Ninth Circuit held that where a state environmental regulatory agency had sufficient knowledge of the debtor’s potential liability pre-petition, any subsequent environmental liability constitutes a claim under the Code.\textsuperscript{71} In \textit{Jensen}, the California Department of Health Services (“CDHS”) sued the debtors to recover response costs expended to clean up waste generated by the debtor’s fungicide tanks.\textsuperscript{72} Because the waste was generated pre-petition, the debtors asserted that their 1984 discharge in bankruptcy eliminated any obligation to satisfy the CDHS claim.\textsuperscript{73}

The bankruptcy court granted CDHS’s motion for summary judgment, reasoning that environmental obligations did not become claims under the Code until CDHS incurred response costs.\textsuperscript{74} The Ninth Circuit Bankruptcy Appellate Panel applied the release or threatened release standard described above and reversed the bankruptcy court.\textsuperscript{75} The Ninth Circuit affirmed the Ninth Circuit Bankruptcy Appellate Panel’s reversal of the bankruptcy court. However, the Court rejected the release or threatened release standard and reasoned that the “fair contemplation” standard ade-

\textsuperscript{67} \textit{National Gypsum}, 139 B.R. at 408.

\textsuperscript{68} \textit{Id.} The court noted that, because no statute of limitations exists under \textit{CERCLA} foreclosing EPA response to hazardous waste, regulators may not act quickly to pursue remedies against a debtor under the “fair contemplation” standard. \textit{Id.} at 408-09.

\textsuperscript{69} \textit{Id.} at 406-07 (noting that \textit{Chateaugay} court departs from standard it espouses in adopting definition of claim so broad as to encompass costs that could not “fairly” have been contemplated by EPA pre-petition).

\textsuperscript{70} 995 F.2d 925 (9th Cir. 1993).

\textsuperscript{71} \textit{Id.} at 931.

\textsuperscript{72} \textit{Id.} at 926-27.

\textsuperscript{73} \textit{Id.}.

\textsuperscript{74} \textit{In re Jensen}, 114 B.R. 700, 703 (Bankr. E.D. Cal. 1990), rev’d, 127 B.R. 27 (Bankr. 9th Cir. 1991), \textit{aff’d}, 995 F.2d 925 (9th Cir. 1993). Since CDHS did not know of the presence of toxic waste on the debtors’ site as of the petition date, the court held that the response costs incurred to clean up the site were nondischargeable. \textit{Id.} at 705.

\textsuperscript{75} \textit{In re Jensen}, 127 B.R. 27, 33 (Bankr. 9th Cir. 1991), \textit{aff’d}, 995 F.2d 925 (9th Cir. 1993).
quately balanced the competing policy goals of the Code and CERCLA.76

The Seventh Circuit similarly adopted a "fair contemplation" standard. In *In re Chicago, Milwaukee, St. Paul & Pacific R.R. Co.*, 77 the United States Circuit Court for the Seventh Circuit held that a claim existed under the Bankruptcy Act of 1898 ("Act")78 when an environmental regulatory agency had knowledge that a debtor was a PRP under CERCLA.79 Where the regulatory agency had knowledge that the debtor was tied to the release of a hazardous substance prior to the close of the bankruptcy case, yet failed to file a proof of claim, the agency's claim was discharged and could not be asserted against the debtor's successor.80

Hence, under the "fair contemplation" standard, courts must make two determinations: (1) when the regulatory agency identified the hazardous waste; and (2) when the agency identified the debtor as a PRP. If the regulator knew of both the presence of the waste and the debtor's PRP status pre-petition, any ensuing environmental obligation is a claim under the Code and is therefore dischargeable.

V. ANALYSIS AND CONCLUSION

The Code's definition of claim expressly includes rights to payment or equitable relief that are unmatured or unliquidated.81 Since bankruptcy looks to substantive, nonbankruptcy law to determine when a right to payment arises,82 the determination of when an environmental claim arises in bankruptcy ultimately should balance the interests of the Code and environmental regulations. As between the three differing judicial approaches discussed above, only the foreseeability standard attempts to fashion an equitable balance of the interests of the Code and environmental regulations.

A test based on when the release or threatened release occurs unfairly favors a debtor at the expense of both environmental regu-

76. *Jensen*, 995 F.2d at 930 (*National Gypsum* court carefully balanced competing policy objectives of Code and environmental laws).
77. 974 F.2d 775 (7th Cir. 1992).
80. *Id.* at 787-88.
latory agencies and, ultimately, the public. The primary objective of environmental laws is to encourage business organizations to maintain a clean and safe environment. When necessary, regulators require these organizations to incur costs to maintain this objective. Under a release or threatened release test, once a debtor is aware of a potential release, it has significant incentives to file immediately for bankruptcy protection.

Under Chapter 11, if environmental regulators discover the waste post-petition but before plan confirmation, environmental claims likely will be afforded priority status, thereby eroding estate assets which otherwise would be available for other creditors. If environmental regulators do not discover the waste pre-confirmation, the bankruptcy discharge effectively stays any action by regulators to collect environmental obligations from the debtor. Thus, environmental agencies and the public will be asked to shoulder the cost of the cleanup.

Conversely, a test based on when response costs are incurred unreasonably favors environmental regulators and undermines the "fresh start" objective of the Code. First, under this test, since claims in bankruptcy do not arise until response costs are incurred, regulators are encouraged to delay enforcement of environmental obligations until confirmation or, at a minimum, until after the petition has been filed. In so doing, regulators will attempt to ensure that environmental obligations either survive bankruptcy or enjoy administrative priority. Second, since environmental laws mandate speedy cleanup at minimal cost to the public, a test based on when response costs are incurred may encourage regulators to clean up a site with public funds yet delay assessing response costs against a potential Code debtor. Third, by saddling a Chapter 11 debtor with substantial post-confirmation cleanup obligations, regulators may preclude successful reorganizations under the Code and force debtors to liquidate their businesses. Fourth, since different Circuits have adopted different standards, a test based on incurring response costs, which is most onerous to the debtor, encourages debtors to "forum shop" for a Circuit with a more favorable standard. Finally, courts in both the District of Minnesota and the Third Circuit either have declined to follow or have sought to distinguish Union Scrap Iron & Metal and M. Frenville Co., respectively.83

A standard based on foreseeability more effectively balances the objectives of the Code and environmental regulations. Instead of encouraging debtors and regulators to make tactical decisions about when and where to file and when and how to impose environmental obligations, this standard promotes both environmental and Code objectives. Once cognizant of a release or a threatened release, environmental regulators who are able to link hazardous waste to a debtor are encouraged to assert their claims immediately. As a result, the bankruptcy court and other creditors are notified at an early stage of the possibility of a substantial environmental claim against the estate. Reimbursement for response costs may proceed more efficiently as regulators need not wait until the close of the bankruptcy proceedings to commence litigation. Accelerating the claims assertion and claims resolution processes enhances administrative efficiency, eliminates expense, and encourages the consensual resolution of claims. At the same time, it provides a debtor faced with significant environmental claims a fair opportunity to reorganize under the Code.

A system which facilitates the resolution of all claims against a debtor in a single forum at a single time would go far toward resolving the continuing schizophrenia arising out of the tensions between these two competing sets of federal statutory regulations.

(plaintiffs' tort claims did not arise until plaintiffs suffered identifiable, compensable injuries)).