

**News From OBA Bankruptcy
And Reorganization Law Section:**

**The Third Circuit Rules That
Environmental Claims May
Survive Chapter 11
Reorganization**

By Gary D. Hammond

(Editor's Note: OBA Sections have been invited to submit short notes of Section information for publication in the Bar Journal.)

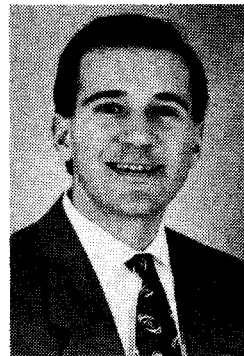
On October 25, 1993, the Third Circuit handed down an important decision dealing with what constitutes a "claim" within the meaning of 11 U.S.C. §101(5). In *In re Torwico Electronics, Inc.*, 8 F.3d 146 (3rd Cir. 1993), the Third Circuit visited the ability of a debtor to discharge a claim for environmental contamination. The holding should cause concern for parties who have ever been involved in potentially contaminated property.

Torwico (the "Debtor") manufactured electronic transformers at a leased facility until approximately September, 1985, when the lease ended and the Debtor relocated. In August, 1989, the Debtor filed a Chapter 11 petition. During the first part of October, 1989, the bankruptcy court set a bar date of early January, 1990, for filing claims. Approximately one month later, in mid-November, 1989, the New Jersey Department of Environmental Protection and Energy (the "Department") did an inspection of the facility and determined that the facility had a hidden, illegal seepage pit which contained hazardous waste that was apparently migrating into local waters. The Department sent a notice to Torwico concerning the contamination.¹ Unfortunately, however, the Department did not file a proof of claim by the January, 1990, deadline set by the bankruptcy court.

After the date for filing proof of claims had run the Department issued an order to the Debtor concerning the Debtor's violation of state law by failing to clean up the seepage pit problem. The Department's order required the Debtor to submit a written plan for the seepage pit and also assessed Torwico a \$22,500 penalty for failing to remedy the problem pursuant to the Department's previous notice.²

Torwico took the position that the order was an attempt by the Department to assert a claim against it. Because the bar date for filing proof of claims had run, Torwico asserted that the claim was not timely and it was not required to pay the claim. The Department argued that the order was not a claim within the meaning of 11 U.S.C. §101(5) which was subject to the bar date established by the court or any discharge in bankruptcy. The bankruptcy court agreed with Torwico. The district court reversed and Torwico appealed to the Third Circuit.

The Third Circuit affirmed the district court and held that Torwico's obligations to remedy the environmental contamination did not constitute a "debt" under the Bankruptcy Code. The Third Circuit began its analysis by recognizing that because debts are dischargeable in a Chapter 11, critical to the resolution of the case was whether the Debtor's obligations constitute a "debt" under the Bankruptcy Code. The Third Circuit recognized that a "debt" is defined as a "liability on a claim."³ A "claim," in turn, is defined pursuant to 11 U.S.C. § 101(5).⁴



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The Debtor contended that the broad definition of "claim" encompassed its obligations to the Department under the order and the state statute pursuant to which the order was issued. The Department argued that it had no "right to payment"; rather it only had the right to enforce laws requiring the Debtor to clean up the hazardous wastes it was responsible for under state law. Both the Debtor and the Department argued that a proper interpretation of *Ohio v. Kovacs* was instrumental in resolving the case.⁵ In *Kovacs*, the State of Ohio obtained an injunction against Kovacs requiring him to clean up hazardous wastes on his property. When Kovacs

failed to comply, the state obtained an order appointing a receiver. The receiver was directed to take possession of the property and complete the clean up. After the receiver was appointed, but before the receiver had completed the clean up, Kovacs filed bankruptcy. The state, seeking to obtain some of Kovacs' post-bankruptcy income to help pay the clean up costs, argued that Kovacs' obligations to clean up the property was not a "debt" and was not dischargeable. The United States Supreme Court disagreed.

The Supreme Court concluded that the state had a right to payment and therefore possessed a claim. The Court also noted that Kovacs no longer had possession of the sight nor control over the clean up. Therefore, all the state sought from Kovacs was money to fund the clean up. The Supreme Court specifically noted that it was not addressing the legal consequences of the result if Kovacs had taken bankruptcy before a receiver had been appointed. The Supreme Court also stated that it was not holding that an injunction against bringing further toxic wastes on the premises or against any conduct that will contribute to the pollution of the site or the state's waters is dischargeable in bankruptcy.

The Debtor contended that *Kovacs* applied to the issue before the Third Circuit because the Debtor's affirmative duty to clean up the site and the duty to pay money to that end is a claim. The Department contended that *Kovacs* was inapplicable because it was not seeking a monetary judgment, but rather to remedy ongoing pollution by forcing the Debtor to clean up the site.

The Third Circuit decided that *Kovacs* was inapplicable because in *Kovacs* the debtor no longer owned the property upon which contamination had occurred and as such the only thing that the State of Ohio could recover from the debtor in that case was reimbursement for expenses for remediating the environmental contamination. The problem in *Torwico* was that the Debtor was no longer in possession of the site, so the Third Circuit had to dispense with the Debtor's claim that the only thing that the Department had against the Debtor was a "claim." The Third Circuit sloughed off this argument by holding that, although the Debtor was no longer in possession of the site, it had "access" to the site. The Third Circuit stated: "(e)ven though *Torwico* no longer possesses the property, it is still, allegedly, *Torwico's* wastes that are presenting a continuing environmental hazard." The Third Circuit agreed with the Department's argument that *Kovacs* was not

controlling because the Department was not seeking reimbursement, but rather its order was in the nature of a mandatory injunction requiring the Debtor to remedy the contamination, and as such was not a "claim" subject to discharge or to the bankruptcy court's order requiring claims to be filed by the bar date.

The Third Circuit's decision ultimately turned on whether the Department's order was an attempt to obtain clean up of old environmental contamination or whether it was an attempt to end ongoing, continued pollution. The Third Circuit relied upon *In re CMC Heartland Partners*,⁶ and *In re Chateaugay*.⁷ The Third Circuit agreed with the *Chateaugay* rationale that there is a difference between a clean up order which seeks to obtain payment for costs incurred for remediating nonmigratory contamination and an order designed at ending continued pollution. The former would be a claim dischargeable in bankruptcy while the latter is not a claim and therefore is not dischargeable in bankruptcy. Therefore, as long as a state or federal environmental protection agency makes an affirmative showing that the environmental contamination is an ongoing and continued problem the state or federal authority will not be bound by bar dates and discharges in the Chapter 11 case of a generator of the contamination.

Torwico makes it clear that courts are going to continue to do everything within their power to make sure that clean up costs will have to be paid by debtors. Ultimately, Congress should revise the Bankruptcy Code and address the problem of environmental claims.⁹ Until then, debtors should be aware that as long as the environmental contamination is continuing, the debtor will be responsible for the clean up costs irrespective of whether it continues to own or control the contaminated property. As some commentators have noted, "...the Third Circuit would essentially join the Seventh Circuit in creating a *de facto* nondischargeability provision to the Bankruptcy Code for environmental contamination."⁸

1. According to the opinion, *Torwico* claimed to have no knowledge of the seepage pit and the wastes found there.

2. Interestingly, the order also stated: "No 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...."

3. 11 U.S.C. §101(12).

4. 11 U.S.C. §101(5) states in pertinent part as follows:

(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or

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- (B) right to 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.
5. *Ohio v. Kovacs*, 469 U.S. 274, 105 S. Ct. 705, 83 L.Ed. 2d 649 (1985).
 6. 966 F.2d 1143 (7th Cir. 1992)
 7. 944 F.2d 997 (2nd Cir. 1991)
 8. See, Ames, Kilpatrick, and Salerno, "Third Circuit Joins Seventh and Puts Yet Another Nail in the Reorganization Coffin," Vol. 12, No. 1, *Am. Bankr. Inst.*, 8, 16 (February 1994).
 9. The United States Supreme Court may ultimately decide the issue. On January 24, 1994, a petition for *certiorari* was filed *In re Torwico Electronics, Inc.*