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7th Circuit: Certain Equitable Environmental Remedies Not Dischargeable in Bankruptcy

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The Seventh Circuit U.S. Court of Appeals recently ruled that an environmental clean-up obligation under the Resource Conservation and Recovery Act ("RCRA") is not dischargeable in bankruptcy, even when the debtor no longer has any internal clean-up operations and would have to contract a third party to provide such services at significant cost.

Section 1141(d)(1)(A) of the Bankruptcy Code permits a discharge of "any debt that arose before the date of confirmation."[1] For an obligation, monetary or otherwise, to qualify under this definition it must constitute either a "right to payment" or a "right to an equitable remedy for breach of performance *if such breach gives rise to a right to payment*."[2] Because environmental injunctions are a form of equitable remedy, courts have found that where the clean-up injunction could be reduced to a monetary obligation, it could be considered a dischargeable "claim" in the bankruptcy of the entity liable for the clean-up. With this in mind, injunctions under the Clean Water Act and the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) have in the past been found dischargeable when the party that contaminated the property no longer owns the land, on the grounds that the contaminating party cannot fulfill the equitable obligations and the injunction has therefore been converted into a monetary obligation, as set forth in *Ohio v. Kovacs*.[3] Under RCRA, however, no monetary relief is available. The Act permits the

[1] 11 U.S.C. § 1141(d)(1)(A) (2009).

[2] *See* 11 U.S.C. § 101(5)(B) (2009) (emphasis added).

[3] 469 U.S. 274 (1985). In *Kovacs*, the State of Ohio initiated receivership actions against Chem-Dyne Corporation after Chem-Dyne failed to fulfill its obligations under a clean-up injunction. The receiver began taking possession of Chem-Dyne's property, including the land in question, which prompted Chem-Dyne to file bankruptcy. Following confirmation, the State of Ohio sought a monetary judgment against Chem-Dyne's CEO for the expense of remediating the property. The Seventh Circuit found that the defendant could not "perform the affirmative obligations properly imposed upon him by the State court except by paying money or transferring over his own financial resources" and that the injunction therefore had been converted to a dischargeable monetary obligation. *In re Kovacs*, 717 F.2d 984, 988 (7th Cir. 1983). The Supreme Court affirmed on the grounds that "the only type of performance in which Ohio [was]…interested [was] a money payment to effectuate the Chem-Dyne cleanup." *Kovacs*, 469 U.S. at 282. Moreover, this result was consistent with the general principle of a fresh start in bankruptcy. *Id.*

government to bring suit against any party that contributes to contamination, but the only available remedy is an injunction requiring the defendant to remediate at the defendant's own expense.[4]

In *United States v. Apex Oil Co.*, No. 08-3433, slip op. (7th Cir. Aug. 25, 2009), the Seventh Circuit refused to apply the *Kovacs* rule to an injunction for the clean-up of an underground oil plume. Apex appealed to the Seventh Circuit from a district court's decision granting an injunction against Apex under RCRA that required Apex to remediate the oil plume created by Apex's corporate predecessor. The plume had been contaminating groundwater and emitting hazardous fumes into residences. Apex contended that its obligations with regard to environmental liabilities had been discharged by an earlier bankruptcy.[5] Thus, Apex contended, it was unable to fulfill the equitable obligations other than through payment of money to an outside contractor. Moreover, Apex argued, the need to pay an outside contractor meant that the equitable remedy could—indeed, had to be—reduced to payment and should therefore be considered a dischargeable claim. Apex also contended that failure to discharge would be inequitable because Apex's successful reorganization was conditioned on discharge of legacy environmental costs; without a discharge Apex would have been forced to liquidate.

The court found these arguments unpersuasive. As an initial matter, the court distinguished this case from *Kovacs* and its progeny involving mandatory environmental injunctions that were reducible to monetary damages. Here, the injunction was brought under RCRA, which does not permit any form of monetary relief. Nor was this a situation where, as in *Kovacs*, the defendant had been dispossessed of the property and the government had undertaken a clean-up effort for which it could seek compensation.

Moreover, the court disregarded Apex's argument that the injunction had converted to a right to payment simply because Apex had to incur costs to contract the clean-up work to a third party. As the court noted, "Almost every equitable decree imposes a cost on the defendant, whether the decree requires him to do something…or, as is more common, to refrain from doing something."[6] Also, if potential cost of compliance rendered an injunction dischargeable, then, no state could effectively enforce its laws.[7] The court found that Apex's position would discourage companies from developing internal clean-up capabilities so that any environmental remediation injunctions would always be dischargeable.[8] Thus, whether an enjoined party must incur costs to comply with an injunction or whether it cleans up contamination itself is irrelevant for discharge purposes.

The ruling in *Apex* suggests the need for bankruptcy-related planning when litigating and settling environmental disputes. It is important to avoid the trap that Apex encountered: the company had effectuated a full reorganization and eliminated internal clean-up capabilities based on the belief that it would emerge from bankruptcy without these legacy costs. Indeed, the allure of the fresh start with regard to environmental costs can be a major consideration for an industrial company considering bankruptcy. Other companies may be able to learn from this decision by settling litigation with the government in a way that structures the injunction not as an affirmative directive under RCRA but, rather, as a true monetary claim or an injunction under one of the other environmental statutory regimes.

4 *See* 42 U.S.C. § 6972 (2009). *See also Meghrig v. KFC Western, Inc.*, 516 U.S. 479, 483-87 (1996).

5 Notably, the government had initially asked for injunctions under either the Clean Water Act or CERCLA but changed positions when confronted with Apex's bankruptcy discharge defense.

6 *See Apex*, slip op. at 6.

7 *Id.*

8 *Id.* at 8.

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