Polluter’s Haven:
Enforcing Environmental Laws inside and outside Bankruptcy

by

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Introduction

State attorneys general (“AGs”) routinely wield state and federal law to defend their respective states’ natural resources. In this battle, bankruptcy law has all too often been the forgotten weapon in the attorney general’s arsenal. This neglect came to an abrupt end when the Supreme Court announced its decision in *Ohio v. Kovacs*, 469 U.S. 274 (1985).Although Justice White’s opinion dealt with relatively narrow question of statutory interpretation, the case exposed how easily an unscrupulous polluter could use the federal Bankruptcy Code to shift environmental clean-up costs from the polluting company to the state. *Kovacs* sparked a flurry of activity among academics, attorneys general, and state legislatures: law review articles were written;¹ new state environmental and property laws were enacted;² attorneys general expressed outrage;³ and, everyone brushed up on bankruptcy law.

Now twenty years later, the Bankruptcy Code’s effect on environmental protection has again captured the public’s eye – and the state AG’s. In 2005, the bankruptcy of a massive mining and smelting conglomerate ignited a firestorm even larger than the one *Kovacs* produced.⁴ Asarco operated mines, refineries, and smelting facilities at 93 sites in 23 states.⁵ Before Asarco’s bankruptcy filing, attorneys general in many of those 23 states

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⁴ Asarco LLC v. Am. Mining Corp., 2007 Bankr. LEXIS 641 (Bankr. D. Tex. 2007); Case Number 05-21207, Southern District of Texas, Corpus Christi Division.
⁵ Telephone interview with Hal Morris, Assistant Attorney General, Bankruptcy & Collections Division, Office of the Texas Attorney General (Dec. 5, 2007) (hereinafter “Morris Interview”). AGs in Colorado, Texas, and Washington State have been particularly vocal. *See, e.g.*, Press Release, Colorado Attorney
had sued Asarco for cleanup costs at those sites. But, by drawing on the protections offered by federal bankruptcy law, Asarco may end up contributing as little as one-sixth of the $3 billion in clean-up costs – leaving the taxpayers to pick up the remainder. This perceived injustice attracted the attention of U.S. Senator Maria Cantwell, who proposed the Cleanup Assurance and Polluter Accountability Act to Congress. Cantwell specifically singled out Asarco’s behavior, accusing it of exploiting “bankruptcy loopholes” to “stick[] taxpayers with cleanup costs” and to “shirk[] their billion dollar cleanup obligations.” In AGs’ offices around the nation, Asarco’s tactics “raised people’s awareness” about the risks states were being exposed to. Two decades after Kovacs, bankruptcy law has again emerged as a critical tool for the state attorney general.

In the years between Kovacs and Asarco, attorneys general have used the Bankruptcy Code with varying degrees of success. In the interest of avoiding cases like Asarco, it is timely to assess what has worked – and what has not. Therefore, this paper will evaluate the options that the Bankruptcy Code offers the state AG to maximize insolvent debtors’ contributions for environmental cleanup.

This paper first describes the problem: how loopholes in the federal Bankruptcy Code allow polluters to shift environmental cleanup costs onto the taxpayer. In Part II, I will analyze tactics that AGs have used within bankruptcy to force the polluter to pay in full

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6 Marilyn Berlin Snell, Going for Broke, SIERRA CLUB MAGAZINE (May/June 2006), available at http://www.sierraclub.org/sierra/200605/goingforbroke/. Among ASARCO’s 93 sites are 19 Superfund sites. Id.


8 Id.

for cleanup costs. Part III will address the steps that the AG can take before a polluter declares bankruptcy that will position the state to receive the most money in the event of a future bankruptcy. Part IV will assess how an AG’s office can educate its staff and the public about the legal standards that apply to environmental-cleanup costs in bankruptcy.

**Part I: The Problem**

A. Loopholes Built into the Bankruptcy Code

One of the core functions of the Bankruptcy Code (“the Code”) is to establish an orderly and equitable distribution of the debtor’s assets— and it is this feature that polluters exploit. To prevent a chaotic rush on the debtor’s assets by her creditors, the Code imposes an “automatic stay,” which freezes all creditors’ attempts at collection. The automatic stay has a very broad reach, going so far as to halt all lawsuits against the debtor, for instance.

Once the bankruptcy trustee assembles the debtor’s assets, a complicated system of priority determines the order and the amount of payouts to creditors and equity holders. Those creditors with the highest priority generally get paid first and in full – followed by the next creditors in line. Secured creditors (e.i. banks) have security interests in the debtor’s assets and, as a result, generally receive the value of their collateral. Frequently, unsecured creditors (such as vendors or tort victims) get fifty cents on the dollar; those “last

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10 See, e.g., Development in the Law: Toxic Waste Litigation, Bankruptcy and Insurance Issues, 99 HARV. L. REV. 1573 (1986);
in line” (especially equity holders) often get little or nothing.\textsuperscript{15} This system of partial payments enables some debtors to reorganize and resume a productive role in the economy.\textsuperscript{16}

The Code carves out many exceptions to this priority framework. For instance, a specific provision protects divorced spouses of the debtor: regardless of the debtor’s financial situation, bankruptcy will not shield the debtor from alimony or child-support payments.\textsuperscript{17} Employees’ wages too get enhanced priority.\textsuperscript{18} The government even gives itself priority in payment of certain taxes.\textsuperscript{19} These provisions single out certain types of debts for preferential treatment, usually reflecting laudable public policy goals. Absent, however, are provisions dedicated to environmental clean-up costs. Despite expressing a deep commitment to environmental protection elsewhere in federal law, Congress provided no special treatment in bankruptcy for state-funded environmental cleanup costs.\textsuperscript{20}

Because of this omission, bankruptcy can act as a shield against environmental liabilities. If the state has not yet filed suit against the polluter, for instance, the automatic stay can (but not always) block the state’s lawsuit.\textsuperscript{21} If the state has already filed suit and obtained a judgment for money damages, the bankruptcy trustee can convert the judgment into an unsecured claim, virtually ensuring that the debtor pays only a small share of cleanup costs.\textsuperscript{22}

\textsuperscript{15} See Development in the Law: Toxic Waste Litigation, Bankruptcy and Insurance Issues, 99 H\textregistered R. Rev. 1573, 1585 (1986); see also 11 U.S.C. §§ 726, 1129; see Drabkin, Moorman & Kirsch, supra note 2, at 10,171-72.
\textsuperscript{17} 11 U.S.C. § 523(a)(5).
\textsuperscript{18} 11 U.S.C. § 503(b).
\textsuperscript{19} 11 U.S.C. § 523(a).
\textsuperscript{20} Toxic Waste Litigation, 99 Harv. L. Rev. at 1585.
\textsuperscript{21} Morris Interview.
\textsuperscript{22} Id.
The polluter in *Kovacs* took advantage of these very loopholes. After Kovacs ignored numerous orders to clean up hazardous waste on his property, Ohio decontaminated Kovacs’ property and sued him for the costs.\(^{23}\) Almost immediately after Ohio’s suit, Kovacs filed for bankruptcy – and the automatic stay prevented the state from pursuing its suit further. After much litigation, Ohio’s demand for payment became an unsecured “claim” in bankruptcy.\(^{24}\) In the end, Kovacs won: through a conveniently timed bankruptcy, he avoided paying a substantial portion of cleanup costs on his own property.\(^{25}\)

Environmental and bankruptcy experts agree that the cumulative effect of cases like *Kovacs* is colossal.\(^{26}\) According to Hal Morris of the Texas AG’s office, the scale of this problem can be inferred from a quick search of recent bankruptcy filings. Some of the largest companies in the world are among the filings in which “environmental liability” and/or “asbestos liability” has played a significant role: Kaiser Aluminum; energy giants Mirant Corporation, Northwestern Energy, and PG&E; Owens Corning; the Monsanto spin-off of Solutia; and chemicals titan W. R. Grace.\(^{27}\)

Spending on Superfund sites provides another useful metric.\(^{28}\) According to one General Accounting Office estimate, remediation efforts for 142 of the United States’ largest Superfund sites totaled $20 billion.\(^{29}\) Cleanup costs for Asarco’s Superfund sites in

\(^{24}\) Id. at 275.
\(^{25}\) Silbur, *supra* note 3, at 876-878.
\(^{26}\) Telephone interview with Rachel Lehr, Deputy Attorney General, Office of the New Jersey Attorney General (Dec. 8, 2007) (hereinafter “Lehr Interview”).
\(^{27}\) Morris Interview; see also http://www.bankruptcydata.com. Fans of John Travolta and/or Jonathan Harr will remember W.R. Grace as the holding company for the “bad guys” in *A Civil Action*. It would not be a stretch of the imagination to assume that W.R. Grace’s bankruptcy left taxpayers footing the bill for a great deal of environmental remediation.
\(^{28}\) Funding for Superfund cleanup has been severely depleted, so state and federal governments end up contributing for cleanup out of their general funds. *See* GAO Report at 4.
\(^{29}\) GAO Report at 2.
Colorado alone exceeded $200 million.\(^{30}\) And, these figures capture only a small piece of the puzzle: Superfund sites represent only a portion of environmental liabilities whose costs are borne by taxpayers.\(^{31}\) The actual cost imposed on state and federal governments can only be left to the imagination. Because environmental pollution often goes unreported, statistics measuring the full scale of the problem are hard to come by.\(^{32}\)

**B. Incentives for Polluters to Exploit Bankruptcy Laws**

A variety of legal and economic factors have created a situation where polluting companies have powerful incentives to shift environmental cleanup costs to the taxpayer. In the 1970s and 1980s, environmental laws exploded in complexity and breadth; this complexity made it increasingly difficult for companies handling toxic wastes to comply with the law.\(^{33}\) Premiums on environmental insurance, however, did not keep pace with these new risks. Insurers in the 1980s were left with multimillion dollar cleanup costs on properties whose owners paid minimal premiums.\(^{34}\) In a classic example of market failure, these insurers stopped selling environmental-liability insurance.\(^{35}\)

These insurers’ departure left a huge void. Companies handling toxic wastes sometimes could not obtain insurance for their potentially massive environmental

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\(^{31}\) Morris Interview.

\(^{32}\) General Accounting Office, *Environmental Liabilities: EPA Should Do More to Ensure that Liable Parties Meet their Cleanup Obligations* (Aug. 2005), available at http://www.gao.gov/new.items/d05658.pdf (hereinafter “GAO Report”) (observing that “While more than 231,000 businesses operating in the United States filed for bankruptcy in fiscal years 1998 through 2003, the extent to which these businesses had environmental liabilities is not known because neither the federal government nor other sources collect this information.”).


\(^{34}\) *Toxic Waste Litigation*, 99 HARV. L. REV. at 1575.

\(^{35}\) *Id.* at 1575 (concluding that the twin force of “sharp increase[s] in environmental liability litigation” and “the courts’ broad construction of insurance policies” severely jolted the insurance industry in the early 1980s).
liabilities.\(^{36}\) Those insurers that did offer such insurance charged prohibitively high premiums. Left few viable options, many companies in the 1980s opted to self-insure, assuming the risk that environmental liabilities might force them into bankruptcy.\(^{37}\)

Loopholes like those exploited by Kovacs allowed polluting industries to avoid bearing the full cost of environmental remediation.

Public officials’ initial inexperience with the then-new Bankruptcy Code (passed in 1979) worsened this already problematic situation. Sporadic policing of those loopholes created a situation where companies were *under-deterred* to pollute.\(^{38}\) This under-deterrence has been aggravated by many states’ inability to monitor bankruptcy proceedings. Even with one environmental attorney handling bankruptcy matters, AGs’ offices struggled to track the hundreds of bankruptcies involving state interests.\(^{39}\) Quite commonly, an AG’s office will receive hundreds of notices of bankruptcy hearings – many indicating only that a bankruptcy proceeding involving a state interest is occurring.\(^{40}\) Extensive investigation is required in order to identify how the state’s interests are affected.\(^{41}\) A bankruptcy liaison in an AG’s office would also have other responsibilities: coaching other attorneys on bankruptcy; assisting on briefs; keeping track of electronic filings; traveling to bankruptcy courts, etc.\(^{42}\) Because many states have historically lacked the resources to staff a bankruptcy liaison, polluters have seized on this enforcement gap – and used it to shift

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\(^{36}\) *Id.*  
\(^{37}\) *Id.* Although a grave problem in the 1980s, this insurance crisis appears to have subsided – at least partially.  
\(^{38}\) *Id.* at 1595.  
\(^{40}\) Leary Interview. Indeed, the vagueness of these notices may be intentional – a very effective way to discourage the state’s participation. In some instances, the attorney sending the notice will not respond to inquiries from the AG’s office – forcing the AG’s office to expend further resources by sending an attorney to the bankruptcy hearing.  
\(^{41}\) Leary Interview.  
\(^{42}\) *Id.*
clean-up costs to the states.\textsuperscript{43} Weak enforcement actually incentivizes polluters to file for bankruptcy.

State AGs have an obligation to stop exploitive use of the Bankruptcy Code. As the lawyer to state environmental resources agencies, the AG has standing to participate in bankruptcy proceedings.\textsuperscript{44} Despite the limited resources at many AGs’ disposal, the immensity of clean-up costs in cases like \textit{ASARCO} make it worth any AG’s time to ensure that at least one lawyer on her staff has a rudimentary knowledge of bankruptcy laws.

Clearly, a problem exists. The next section of this paper will describe the techniques that assistant attorneys general have used to tackle this problem – by forcing bankrupt polluters (and their lenders) to bear the cost of environmental degradation on their properties. Part III will outline the \textit{pre-bankruptcy} measures that can plug the loopholes that unscrupulous polluters might otherwise abuse in bankruptcy.

\textbf{Part II: Tools for Use during a Polluter’s Bankruptcy}

Creditors of all types dread finding themselves as “unsecured” claimants in bankruptcy,\textsuperscript{45} and so AGs’ strategies in bankruptcy tend to focus on avoiding this inauspicious designation. Successful strategies generally fall into two categories: either 1) attempting to maximize the state’s priority, particularly by achieving \textit{administrative priority}; or, 2) keeping the state’s “claims” \textit{out of the bankruptcy process} entirely, especially through \textit{injunctive obligations}.

\textsuperscript{43} Id.
\textsuperscript{44} Morris Interview. Although not usually necessary, Bankruptcy Rule 2018b also allows the AG to intervene on behalf of consumers if it is in the public interest.
\textsuperscript{45} Morris Interview.
In addition to these offensive strategies, AGs frequently rely on a third defensive strategy: shielding potential future clean-up obligations from discharge in bankruptcy. Underlying the rationale for all three strategies is a hard lesson taught by Kovacs: states are unlikely to get full compensation for clean-up costs incurred directly by the state before bankruptcy. Each strategy has different strengths, but all three can be used at various stages of the bankruptcy process.

A. Administrative Priority – Enhancing the State’s Priority in Bankruptcy

Administrative priority is a designation that allows certain costs to be paid ahead of unsecured creditors, and as a result, administrative priority gives states a powerful tool to capture a larger share of a polluter’s assets. The Code gives administrative priority in payment to the “actual, necessary costs of preserving the estate.” The state’s goal, therefore, is to frame its cleanup costs as “actual, necessary” costs of administering the estate. If the debtor owns the polluted property (rather than leasing it), then the state can petition for administrative priority – under the rationale that environmental remediation helps to “preserve the estate.”

In addition to priority in payment, administrative priority has several attractive features. First, it is effective not only under Chapter 11 reorganization but also under Chapter 7 liquidation, where it is one of the only ways to avoid the plight of the unsecured claimant. Second, administrative costs are paid immediately – whereas most secured and unsecured creditors must wait for the sometimes-lengthy bankruptcy process to finish before

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46 Sward, supra note 11, at 430; Padilla Interview.
48 Padilla Interview.
49 Id.
they receive payments.\textsuperscript{50} Third, the state can incur administrative costs itself – rather than relying on an intransigent debtor to cleanup.

Administrative priority is especially effective when creditors have security interests in the polluted properties. In a typical bankruptcy, secured creditors dominate the process, and the AG can use administrative priority to gain leverage over these powerful parties (who are usually banks that have lent the polluter large sums of money).\textsuperscript{51} Section 506(c) of the Code permits the bankruptcy trustee to deduct the “reasonable, necessary costs” of preserving the collateral.\textsuperscript{52} Because deductions of “reasonable, necessary costs” can easily diminish a bank’s claim from fully secured to unsecured, cleanup costs would jeopardize a bank’s financial stake. If the state credibly threatens to invoke Section 506(c), it can bring a bank “to its knees.”\textsuperscript{53} As a result, the AG can negotiate a settlement in which she extracts a hefty payment for clean-up costs.\textsuperscript{54}

This leverage is unavailable, however, when the polluter owns the property free and clear of any security interests. Without the ability to extract a settlement from a panicked bank, the AG will have fewer tools at her disposal. It can be difficult to convince some bankruptcy judges that clean-up costs merit administrative priority.\textsuperscript{55} Some judges require an imminent health threat, which may not be easy to prove in court.\textsuperscript{56} If confronted by judges who hold this view, the state can obtain partial administrative priority for clean-up

\textsuperscript{50} Toxic Waste Litigation, 99 HARV. L. REV. at 1594.
\textsuperscript{51} Leary Interview.
\textsuperscript{52} 11 USCS §506(c) (“The trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim, including the payment of all ad valorem property taxes with respect to the property.”).
\textsuperscript{53} Leary Interview. According to Leary, this tactic is particularly effective if the state hires an expert to value both the contaminated property and the cost of cleanup.
\textsuperscript{54} Bankruptcy Rule 9019 allows settlements in bankruptcy, and such settlements only need to pass a basic reasonableness test.
\textsuperscript{55} Leary Interview.
\textsuperscript{56} Id.
costs – simply by carving out specific measures that will have an immediate effect on public health.\(^{57}\)

Another limitation on administrative priority’s effectiveness is timing. The state can only invoke administrative priority for costs incurred \textit{during} bankruptcy.\(^{58}\) In spite of these weaknesses, administrative priority still promises far greater returns in bankruptcy than are likely for unsecured claims for money damages.

\section*{B. Injunctive Obligations – Keeping “Claims” out of Bankruptcy}

Another tool for maximizing the debtor’s contribution for clean-up costs is the injunctive order. Instead of cleaning up the polluted property and suing the owner for cleanup costs (as Ohio did in \textit{Kovacs}), the state can issue an injunctive order requiring the debtor to clean up his/her property. The order can come either before or during bankruptcy and, if structured correctly, will be enforceable against post-bankruptcy reorganized polluter.

Why should this injunctive order be more effective than a simple money judgment? Injunctions work because they avoid the bankruptcy process entirely. In the Bankruptcy Code, not all liabilities are dischargeable in bankruptcy; any liability that falls outside the Code’s definition of “claim” is not discharged.\(^{59}\) And, these non-claims will survive as long as the debtor still exists.\(^{60}\) Injunctive clean-up orders can survive bankruptcy (as non-claims) under two theories: 1) the “police and regulatory” exception to bankruptcy’s automatic stay;\(^{61}\) and 2) the doctrine of lien-pass through.\(^{62}\)

\begin{footnotes}
\footnote{57}{Id.}
\footnote{58}{Id.}
\footnote{59}{See 11 U.S.C. § 101(5); see also 11 U.S.C. § 541.}
\footnote{60}{Leary Interview.}
\footnote{61}{11 U.S.C. § 362(b)(4).}
\footnote{62}{See Baird, supra note 1, at 1213.}
\end{footnotes}
The “police and regulatory” exception is the most well trodden path. Under the Code, the automatic stay does not apply to any state action to enforce a governmental unit's police and regulatory power, including the enforcement of a judgment “other than a money judgment.”

To make this distinction (between money judgments and regulatory judgments), courts examine the purpose of the law being enforced. If the primary purpose of the law or action is to promote public safety and welfare or to effectuate public policy, then the “police and regulatory” exception applies – and the presence of secondary pecuniary interests does not affect this distinction.

The “doctrine of lien pass-through” provides states with an alternative means to direct their “claim” outside the bankruptcy process. Under this doctrine, an unsatisfied cleanup order attaches to the debtor’s assets (regardless of who gets those assets in bankruptcy) if, under state law, the state’s right to enforce a clean-up order is “tantamount to a security interest” in the debtor’s assets. Lien pass-through allows the state to cast a cloud over the debtor’s assets.

Once outside the automatic stay’s reach, the state can freely enforce its environmental laws – which require the debtor to expend significant amounts of money to remediate the hazardous pollutants released on his property. In most jurisdictions, courts have concluded that a state’s effort to enforce the debtor’s statutory obligation to clean up hazardous wastes is not a “claim” and is exempt from the automatic stay. Thanks to these

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64 Safety-Kleen, Inc. v. Wyche, 274 F.3d 846, 865 (4th Cir. 2001).
65 See Baird, supra note 1, at 1213.
66 See, e.g., In re Torwico Elecs., 8 F.3d 146 (3d Cir. 1993). In addition, 28 U.S.C. 959(b) requires the debtor to meet any state statutory obligations.
rulings, states routinely enforce their environmental laws while the polluter is still in bankruptcy.  

Nevertheless, it is important that states avoid any appearance of enforcing a “money obligation.” In many cases, the opposing counsel “will try to push the state into the ‘claim box,’” where the debtor may feel more confident that at least some portion of cleanup costs will be discharged.  

Although administrative priority is available for “claims” before the bankruptcy court, participation in the bankruptcy process exposes the state to the risk of full discharge as an “unsecured claim.” If the Debtor is likely to continue operations in a polluting industry, AG’s office should try to keep its injunctive orders outside the bankruptcy process.

The bankruptcy in *Combustion Engineering*, 391 F.3d 190 (3d Cir. 2004), exemplifies the “injunctive relief” tactic. Combustion Engineering filed for bankruptcy in part because of its large (but indeterminate) asbestos liability. In the course of bankruptcy, the debtor agreed not to fight California’s injunctive order requiring cleanup – and, as a result, the state’s order passed through bankruptcy. The reorganized company was still subject to future asbestos liability. While not all debtors will agree to a “pass through,” a negotiated solution is ideal. Litigating the survival of an injunctive order can be extremely time-consuming.

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67 Leary Interview.  
68 *Id.*  
69 Padilla Interview.  
70 *Id.*  
71 *Id.*
Although the injunctive order will survive bankruptcy, it also carries force within bankruptcy. As a consequence, the state should apply for administrative priority for the debtor’s clean-up costs (during bankruptcy) arising out of the injunctive order.\textsuperscript{72}

Guterl Special Steel’s bankruptcy illustrates this interplay between an injunctive order and administrative priority. In that case, New York’s Department of Environmental Conservation ordered Guterl Special Steel (already in bankruptcy) to treat water being expelled from Guterl facilities in the Hudson River valley; then, the Attorney General’s office used administrative expense priority to force Guterl to pay \textit{immediately} for its \textit{current obligations} to treat the water.\textsuperscript{73} Thanks to the “police and regulatory” exception, the automatic stay did not reach these orders, and New York prevailed.\textsuperscript{74} Cases like \textit{Guterl Special Steel} make clear that bankruptcy does not protect against enforcement of \textit{current obligations} to comply with environmental laws.\textsuperscript{75}

In this regard, New Jersey’s AG’s office takes a particularly aggressive approach. According to lawyers there, New Jersey does its best to avoid becoming a “claimant” in bankruptcy because so often this status leaves the state “holding the bag” for clean-up costs.\textsuperscript{76} As a result, New Jersey “nearly exclusively” uses injunctive orders to bypass any participation in polluters’ bankruptcies.\textsuperscript{77} On one hand, the injunctive power is fairly far-reaching. For instance, states have used it even when debtor has polluted on leased land that

\textsuperscript{72} Morris Interview.
\textsuperscript{73} Leary Interview.
\textsuperscript{74} Not only did New York win administrative priority, but it also stopped the debtor from abandoning property with hazardous wastes. \textit{See} Guterl Special Steel Corp. v. Economic Dev. Admin. (In re Guterl Special Steel Corp.), 198 B.R. 128 (Bankr. D. Pa. 1996).
\textsuperscript{75} \textit{See} 28 USC § 959(b) (requiring debtor to comply with the laws in which her property is located); \textit{see also} Leary Interview.
\textsuperscript{76} Lehr Interview.
\textsuperscript{77} Padilla Interview.
s/he does not own. 78 On the other hand, this reliance on injunctive orders outside bankruptcy can be risky. If the state later needs to bring the “claim” into the bankruptcy process (or into another related bankruptcy), courts are much less sympathetic to the state’s arguments. 79 In addition, cases regularly get filed in other states – where New Jersey’s injunctive orders have no legal effect. 80

The bankruptcy of Torwico Electronics exemplifies the risks and rewards inherent in issuing injunctive orders to sidestep the bankruptcy process. When the debtor manufacturer filed for Chapter 11 bankruptcy, it listed New Jersey’s Department of Environmental Protection and Energy (DEPE) as a creditor with a disputed and unliquidated claim; however, DEPE opted not to file a claim and instead issued an administrative order requiring Torwico to draft a clean-up plan. 81 The risk in this approach is illustrated by the initial ruling: the bankruptcy court entirely discharged Torwico of any liability for cleanup because DEPE had failed to file a timely claim. 82 Only on appeal to the Third Circuit did New Jersey’s DEPE prevail in asserting that its injunctive action was not a “claim” within the meaning of 11 U.S.C.S. § 101(5). 83

Injunctions will not work in all situations, however. First, injunctions against the debtor are useless if the debtor has already transferred the property to another entity. 84 Second, injunctions are pointless if a corporate debtor is entering Chapter 7 liquidation. Without a “claim” before the court, the state would get nothing because the liquidation

78 Lehr Interview; see also In re Torwico Elecs., 8 F.3d at 151.
79 Id.
80 Id.
82 Id. at 577.
83 See In re Torwico Elecs., 8 F.3d at 151.
84 Morris Interview. However, if the bankruptcy trustee transfers the asset during bankruptcy, then the doctrine of lien pass-through may apply – and the obligation to clean-up probably remains attached to the asset. See Baird, supra note 1, at 1212.
would leave no legal entity for the state to pursue post-bankruptcy.\(^85\) Third, bankruptcy’s “fresh start” policy may impede the state’s effort to enforce some injunctions post-bankruptcy for individuals.\(^86\) In practice, the state probably can enforce some injunctions against individuals: the state can vigorously pursue individual debtors’ assets if s/he had caused “willful or malicious injury” under 11 U.S.C. § 523(a)(6).\(^87\) Lastly, injunctions will not help the state if it has already started to pay for cleanup of the property before the polluter declares bankruptcy.\(^88\)

C. Avoiding Discharge – Ensuring that Future Cleanup Costs Survive Bankruptcy

Bankruptcy confirmation orders can discharge nearly all “claims” before the court.\(^89\) Increasingly, however, these orders include sweeping language discharging all of the debtor’s liabilities – even those outside the bankruptcy process.\(^90\) These overbroad orders pose a grave danger to state environmental interests because they can discharge “all past, present, and future” claims – including environmental liabilities\(^91\) This unseemly practice obligates the state AG to intervene in bankruptcies where future or unknown environmental clean-up liabilities might be discharged.

This sweeping language represents the debtor’s unapologetic attempt to “wipe the slate clean” of as much liability as possible – despite the fact that the bankruptcy court often lacks the power to discharge “all past, present, and future” liabilities.\(^92\) Although

\(^{85}\) Baird, supra note 1, at 1203.
\(^{87}\) See also Jackson, supra note 12, at 727.
\(^{88}\) Sward, supra note 11, at 430; Padilla Interview.
\(^{89}\) 11 U.S.C. § 1141.
\(^{90}\) Padilla Interview.
\(^{91}\) Id.
\(^{92}\) Id. Frequently, this language will be buried with lengthy confirmation orders – but it is relatively easy to spot because the language is nearly always word-for-word the same: “all past, present and future” liabilities.
bankruptcy judges issue these overbroad orders, judges rarely actually write them. The culprits are instead debtors’ counsel, who submit the orders for the court’s approval. 93 Overbroad orders will often affect creditors not represented before the court (especially involuntary creditors like tort victims) and even will attempt to discharge liabilities owed to non-debtor third-parties. 94

These discharge orders are most damaging when the affected state is not present at the bankruptcy hearings and is unaware that its legal rights have just been eviscerated. 95 If the state does not receive notice of discharge, later efforts to enforce environmental cleanup obligations could expose AG staff attorneys to possible contempt charges – for attempting to enforce a discharged liability. 96

As a result, some AGs’ offices have mounted aggressive campaigns to stop these orders. 97 Ideally, overbroad discharges should be challenged before the court approves them – but it is also possible to challenge them after the fact in at least three ways. First, the liabilities arising out of present ownership of contaminated property are not dischargeable and will survive bankruptcy. 98 While the Code authorizes bankruptcy courts to discharge unexempted “claims” arising from past actions, current ownership creates a continuing obligation that is not dischargeable. 99 If the debtor lacks the ability to sell or abandon the property, the state can (and should) continue to pursue the debtor’s assets. 100

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93 Id.
94 Id.
95 Padilla Interview.
96 Leary Interview.
97 Id.
98 Id.; see also Adler, Baird, & Jackson, BANKRUPTCY 684 (Foundation Press 2007).
100 Id.
Second, “claims” that have not come into existence generally cannot be discharged – so future or unknown liabilities fall outside the reach of the bankruptcy court. To determine at what point a “claim” has “come into existence,” courts have taken several approaches – the most common of which is the “fair contemplation test.” In the Ninth Circuit, for instance, an environmental claim arises under the Code once the claim is within the “fair contemplation” of the parties. Therefore, only those “future response and natural resource damage costs based on pre-petition conduct that can be fairly contemplated at the time of the debtor’s bankruptcy are claims under the Code.” The state AG can use the “fair contemplation” test to undo discharges inserted into confirmation orders.

Third, overbroad discharge orders are subject to a number of constitutional challenges. If the state did not participate in the bankruptcy hearing (and was not notified of the discharge), then the AG can rely on Due Process grounds to challenge any discharge of environmental liabilities. In addition, bankruptcy judges may actually lack constitutional authority to discharge certain environmental liabilities. Arguably, some determinations about environmental liability need to be made by an Article 3 judge – or in state court.

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101 Padilla Interview; see, e.g., California Dep’t of Health Servs. v. Jensen (In re Jensen), 995 F.2d 925, 930 (9th Cir. 1993); see also In re Chicago, Milwaukee & St. P. & Pac. R.R., 974 F.2d 775 (7th Cir. 1992). For the Code’s definition of a “claim,” see 11 U.S.C. § 101(5).

102 In re Jensen, 995 F.2d at 930.

103 Id. (quoting In re National Gypsum, 139 Bankr. 397, 409 (N.D. Tex. 1992)).

104 As explained above, it is sometimes desirable to exclude a “claim” from the bankruptcy process – to avoid discharge, for instance. But, on other occasions, participation in the bankruptcy process may have strong advantages. In those cases, the “fair contemplation” test can also be used to bring claims into the bankruptcy process. The bankruptcy of Hexcel Corporation provides an example of this strategy. Hexcel Corp. v. Stepan Co. (In re Hexcel Corp.), 239 B.R. 564 (N.D. Cal. 1999) (affirming the bankruptcy court’s decision to allow appellee company to seek contribution for an environmental claim because the environmental damage was within the fair contemplation of the parties at the time of filing).

105 Padilla Interview; Leary Interview.

106 Leary Interview.
When the AG’s office is actively involved in a bankruptcy, an overbroad discharge order is easy to spot and relatively easy to challenge.\(^{107}\) A properly drafted confirmation order may only require one page – while the problematic orders will stretch on for seventy or more pages.\(^{108}\) Mounting an aggressive defense against discharge orders can be extremely time consuming. States frequently lack the resources to actively participate in every bankruptcy where the debtor might submit an overbroad discharge order. The next best option is to monitor ongoing bankruptcies statewide.\(^{109}\) In addition, communication between AGs’ offices can ease the collective burden: AGs can notify each other of pending bankruptcies affecting state interests in each AG’s respective jurisdiction. Because hundreds of bankruptcies occur daily, AGs’ offices tend to focus on debtors with many properties on which the scope of environmental degradation is unknown.\(^{110}\)

Finally, debtors may attempt to insert broad discharge language in other court orders besides confirmation orders. For instance, the court may order the sale of some of the debtor’s assets under 11 U.S.C. §363, and these sale orders could also contain discharge provisions. Not all of these discharge provisions are inappropriate. For instance, in TWA’s bankruptcy, the Third Circuit approved a sale of TWA’s assets to another airline even though the sale included a provision “wiping” the assets clean of liabilities associated with certain labor contracts.\(^{111}\) In other cases, however, courts have detected abusive use of discharge language inserted into sale orders. In the Northern District of California, the bankruptcy courts issued a harsh rule that explicitly outlined what could and could not be

\(^{107}\) Leary Interview.
\(^{108}\) Id.
\(^{109}\) Leary Interview.
\(^{110}\) Id.
\(^{111}\) In re Trans World Airlines, Inc. 322 F.3d 283 (3d Cir. 2003).
included in a sale order.\footnote{Model Sale Order, United States Bankruptcy Court, Northern District of California.} Presumably, much like in confirmation orders, debtors were attempting to discharge liabilities that were not actually dischargeable. Certainly, the fact that bankruptcy courts would need such a detailed rule implies the existence of widespread abuse.

Unfortunately, few punishments are available to discourage debtors from abusing discharge orders. If the AG manages to intervene in bankruptcy before the judge approves an overbroad discharge order, she may be able to use the debtor’s potentially unscrupulous behavior to gain leverage in the case. If the debtor submitted an order with particularly egregious discharge provisions, the AG’s office could ask for an admonition from the bench – or even sanctions.\footnote{Padilla Interview.} Alternatively, once the judge’s attention has been drawn to the possibility of massive future environmental liabilities, the state might request that the debtor establish a trust fund to pay for present and future environmental claims.\footnote{Such a trust fund could be modeled after ones established in asbestos cases. See Joseph, Judge Urges Manville Have 20-Year Fund for Payment of Future Asbestos Claims, WSJ, Oct. 2, 1983, at 16; see also In re Amatex Corp., 755 F.2d 1034, 1043-44 (3d Cir. 1985); In re UNR Indus., 725 F.2d 1111, 1116-21 (7th Cir. 1984).}

D. Avoiding Abandonment

Abandonment is another bankruptcy concept that debtors sometimes exploit in order to avoid environmental liability. Normally, abandonment is used to exclude property of limited value from the debtor’s estate.\footnote{See 11 U.S.C. § 554.} But, some debtors use it as a means to shed property on which they have cleanup obligations.\footnote{Toxic Waste Litigation, 99 HARV. L. REV. at 1592} The Supreme Court has stepped in, however, to bar abandonment “in contravention of a state statute or regulation that is
reasonably designed to protect the public health or safety from identifiable hazards.”

Armed with this case law, the State AG should be able to block strategic abandonment.

E. Damaged Natural Resources

The AG’s office in New Jersey has pioneered an innovative way to collect money for environmental clean-up of large ecosystems. The Delaware River is one such ecosystem where New Jersey earned a small but impressive success. Because the Delaware River watershed is so large, countless polluters have damaged the area’s ecosystem. This size makes it very difficult for the AG’s office (or the New Jersey Department of Environmental Protection) to determine to what extent each polluter contributed. Without this information, the state would find it very difficult to force these polluters to pick up the tab for the massive cleanup costs. In response to this puzzle, New Jersey has cast a wide net: whenever a likely polluter in the area files for bankruptcy, New Jersey files an unsecured claim for damaged natural resources. In some cases, New Jersey gets nothing – because the estate has very few assets. But, in other cases, creditors get 100% payouts, and New Jersey receives a modest payout. By filing a few claims with the right companies, New Jersey was able to collect thousands of dollars that were able to be directed towards recuperating the Delaware River.

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118 Lehr Interview.
119 Id.
120 Id.
Part III: Tools for Use outside Bankruptcy and Before Bankruptcy

The tactics described in Part II focused on bankruptcy proceedings: what steps an AG’s office should take in order to maximize the state’s payout in or after bankruptcy. But, unless the state follows the right preparations before a polluter declares bankruptcy, many of the tools in Part II will have limited or no effect. As a result, it is vital to assess the state’s options before bankruptcy -- with an eye towards a potential bankruptcy.

States’ efforts before a polluter’s bankruptcy focus on nearly the same goal as during bankruptcy – to position the state to have the highest priority to the debtor’s assets. This paper addresses four of the most common pre-bankruptcy mechanisms for protecting the state’s priority in bankruptcy: a) injunctive obligations; b) financial assurances; c) super priority statutory liens; and d) consensual liens.

A. Issuing Injunctions

Even an injunction that the polluter blithely ignores will create an enforceable obligation in bankruptcy, and for this reason, the injunction is the primary tool in a state’s pre-bankruptcy toolkit. Only under dire circumstances should a state undertake cleanup and sue for damages because states will find it difficult to collect money damages in bankruptcy. Whenever possible in pre-bankruptcy situations, states should rely on injunctions and fines – rather than money damages – to enforce environmental laws.

Injunctive relief drives its power from the “police and regulatory” exception to the automatic stay (mentioned earlier).\(^\text{121}\) And, as Kovacs taught, this exception is unavailable if the state pays pre-bankruptcy costs directly.\(^\text{122}\) Police-power-related compliance costs only have priority over unsecured claims if the clean-up costs have not yet been incurred at

\(^{122}\) Kovacs, 469 U.S. at 276.
the time of the debtor’s filing. Consequently, if a company might tilt into insolvency, the AG should avoid suing for environmental damages and instead rely on injunctive orders.

Admittedly, this “wait and see” situation is less than ideal. It gives the state the incentive to delay clean-up efforts until after a company declares bankruptcy. And, for this reason, attorneys in an AG’s office should also look to the other strategies outlined below. On its own, injunctive relief will only go so far.

**B. Active Enforcement of Obligations to Maintain Financial Assurances**

Financial assurances are the best preventative measure that a state can take to avoid paying for cleanup of a polluter’s property. Federal hazardous waste laws (“Superfund statutes”) require companies handling hazardous waste to provide “evidence of their ability to pay their expected future cleanup costs” in the event that a worsening financial situation leaves the company without sufficient cash to pay for cleanup directly. This evidence of polluters’ ability to pay for clean-up costs is also known as a financial assurance, which can take the form of trust funds, surety bonds, letters of credit, insurance policies, and (in some limited cases) guarantees from parent corporations with ample financial resources.

Federal statutes delegate oversight of financial assurances to the states. The Resource Conservation and Recovery Act (“RCRA”), 42 U.S.C.S. §§6901 et seq., authorizes states both to regulate hazardous waste management facilities that treat, store, or

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123 Sward, supra note 11, at 430.
124 If it is necessary to sue for actual monetary damage, it is advisable to delay the suit until after a financially troubled polluter files for bankruptcy and after the bankruptcy court lifts the automatic stay. Needless to say, this “wait and see” approach is easier said than done: the AGs’ office will usually lack sufficient information to predict a company’s financial fortunes. But, this strategy is very effective because post-petition expenses get high priority in bankruptcy. If the AG chooses to sue an intransigent polluter, the state should make no effort to cleanup the property itself – or risk the discharge of the polluter’s obligation to repay the state.
126 *Id.*; Padilla Interview.
dispose of hazardous waste and to enforce financial assurance requirements.\textsuperscript{127}

Unfortunately, many states (as well as the EPA) have failed to vigorously enforce financial assurance requirements. According to one GAO study in 2005, about half of the parties subject to Superfund financial assurance requirements were not in compliance.\textsuperscript{128} This study, entitled, “EPA Should Do More to Ensure That Liable Parties Meet Their Cleanup Obligations,” lists greater enforcement (of financial-assurance requirements) as one of its nine core recommendations. Enforcement of financial assurance requirements is an area where an AG’s office could have a great impact.

Like injunctive obligations, financial assurances’ utility derives from their exemption from bankruptcy’s automatic stay. This exemption has several sources. For instance, some courts have concluded that financial assurances fall under the “police and regulatory” exception in 11 U.S.C. § 362(b)(4).\textsuperscript{129} Or, alternatively, financial assurances can be viewed as instruments set aside for the state’s benefits. Because such legal interests only fall within the estate when the debtor has legal title in property under 11 U.S.C. § 541(d), many legal interests are excluded – including letters of credit and insurance policies held for the benefit of others.\textsuperscript{130} Since financial assurances can take the form of insurance policies or letters of credit, they are not “property of the estate” and therefore not subject to the bankruptcy process, including the automatic stay.\textsuperscript{131}

Even when financial assurances are initially set aside for cleanup costs, changed circumstances often make them insufficient to cover actual environmental remediation costs.

\textsuperscript{127} 42 U.S.C. § 6926; see also Safety-Kleen, 274 F.3d at 860-863.
\textsuperscript{128} GAO Study at 5.
\textsuperscript{129} Safety-Kleen, 274 F.3d at 846, 864.
\textsuperscript{130} Padilla Interview. A third way to view the financial assurance is like a trust. Under this view, the financial assurance is a power that the debtor may only exercise “solely for the benefit of an entity other than the debtor.” See 11 U.S.C. § 541(d).
\textsuperscript{131} 11 U.S.C. § 541; Padilla Interview.
Most commonly, the steady march of inflation slowly dilutes a financial assurance’s relative value. Also, the polluting party might have expanded his polluting activities without increasing the size of the financial assurance. Or, initial estimates of cleanup costs might prove to be gross underestimations. All three of these factors combined in IT Corporation’s 1991 bankruptcy: state and local governments ended up paying significant portions of cleanup costs because the financial assurances did not cover the full cleanup costs. Finally, some debtors resist (or ignore) financial-assurance requirements and simply “self-insure.” Debtors find this (illegal) solution tempting because financial assurances are an extremely inefficient use of scarce financial resources: the money sits unavailable to the polluter and generates little or no interest.

A state’s success in enforcing financial assurance requirements is also a function of the strength of the state statute implementing RCRA. In order to regulate financial assurance requirements, a state must pass a statute that establishes criteria for evaluating financial assurances at a level equal to or higher than those in RCRA. As a result, there is a wide variety in the strictness of states’ financial assurance requirements. One of the more stringent is New Jersey’s Industrial Site Recovery Act (“ISRA”). Under ISRA, a qualifying company must meet financial assurance requirements before a site may close, be transferred, or be sold. These multiple checkpoints help ensure that the financial assurance is constantly re-evaluated to match actual environmental risk.

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132 Padilla Interview.
133 Id.
134 Lehr Interview.
135 IT Corp. v. Solano County Bd. of Supervisors, 1 Cal. 4th 81 (Cal. 1991)
136 Padilla Interview.
137 Susan M. King, Lender’s Liability for Cleanup Costs, 18 ENVTL L. 241, 246-248 (1988); Lehr Interview.
138 N.J. STAT. § 13:1K-6; Lehr Interview.
139 Id.
140 Id.
ISRA’s impact even stretches into bankruptcy. If the debtor does not have enough money, he might try to sell the polluted property. Thanks to ISRA, the buyer must sign a remediation agreement assuming responsibility for undertaking remedial cleanup and establishing a remediation fund (e.g., a financial assurance).\textsuperscript{141} If the buyer defaults, then the remediation fund pays for cleanup. As a result, the AG’s office relies heavily on ISRA when the debtor lacks sufficient funds to pay for cleanup.\textsuperscript{142} Clearly, a strong state statute implementing RCRA can be a tremendous asset for the AG’s office—but the converse is also true: weak statutes will hinder enforcement.

Another major limitation on financial assurances comes from the Superfund statutes themselves.\textsuperscript{143} Financial assurance requirements only apply if the polluter’s activities rise to “hazardous” levels outlined in RCRA and CERCLA. Many polluters will never need to post a financial assurance. Nevertheless, lawyers in AGs’ offices seem to agree that financial assurance are one of the most effective ways to avoid exploitative use of bankruptcy.\textsuperscript{144}

C. Statutory Liens and Superpriority Liens

Statutory liens and their stronger cousins, superpriority liens, are another way for the AG to leapfrog the state’s claims in front of other creditors.\textsuperscript{145} State hazardous waste cleanup statutes generally include some form of statutory lien—just like the Comprehensive Environmental Response, Compensation and Liability Act of 1980 ("CERCLA"), which

\textsuperscript{141} Lehr Interview.
\textsuperscript{142} Id.
\textsuperscript{143} Id.
\textsuperscript{144} Padilla Interview; Morris Interview; Lehr Interview.
\textsuperscript{145} In some states, superpriority liens can even be used in bankruptcy. But, other states’ statutes impose so many limitations on the use of superpriority that it can only realistically be used before the polluter files for bankruptcy. For this reason, I have opted to address superpriority statutory liens as a pre-bankruptcy remedy.
gives the EPA a lien against property that it cleans up. State statutory lien statutes perform similarly to CERCLA. They give the state a lien in favor of the environmental agency with respect to property that the agency has cleaned up. In bankruptcy, a state armed with a statutory lien will get paid before unsecured creditors.

State “superliens,” in turn, are a subset of statutory liens – but with one addition power: superliens allow environmental cleanup costs to “take priority over all other liens, including previously existing recorded liens.” Thus, like administrative priority (see above), superpriority statutory liens are one of the few ways for the state to outmaneuver secured creditors.

Many states enacted statutory liens and their kin in the 1980s after Kovacs and other environmental injustices. Because these statutes vary so widely in their form, scholars do not actually agree which states have “superliens” and which have vanilla statutory liens – but the list of states that have one or the other usually includes Massachusetts, New Hampshire, Maine, Connecticut, New Jersey, California, Colorado, Illinois, Maryland, Montana, Ohio, South Dakota, Virginia, Louisiana, Wisconsin, Michigan, and Washington state.

New Hampshire’s superlien statute exemplifies the attributes that make superpriority liens a powerful weapon against polluters and their secured creditors. Thanks to the retroactivity built into the New Hampshire law, the state attorney general can invoke

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147 Id.
148 I will use the term “statutory lien” to refer to both the vanilla statutory lien and the “superpriority” statutory lien. See William L. Norton, JR., 6A Norton Bankruptcy Law and Practice 2d § 149:21 at 149-70 (2000); see also Nash, supra note 148, at 146 n78 (discussing the wide disagreement over which state statutes constitute superliens).
149 See Nash, supra note 148, at 147 n.78 (2002); see also Silbur, supra note 3, at 890 n.150.
superpriority at any point. In determining the lien’s priority over other liens, the bankruptcy trustee will look to the date on which the pollution occurred.\(^{151}\) Also, the lien extends to “business revenues generated from the facility on which hazardous waste or hazardous materials is located and personal property located at the facility…”\(^{152}\) As a result, the size of New Hampshire’s superlien is not limited by the low property value of a contaminated site.

Superpriority liens not only increase the likelihood that the state is a fully secured creditor in bankruptcy, but they also eliminate the incentive for pre-bankruptcy delay. Instead of issuing injunctions under the “wait and see” approach advocated above, the state can initiate environmental cleanup immediately and then, in the event of the polluter’s bankruptcy, use superpriority to get the highest possible payout.\(^{153}\) Because security interests are threatened by superliens, the enacting statutes may increase the chances that the polluter’s lenders will undertake cleanup themselves.\(^{154}\)

Surprisingly little case law addresses superpriority statutory liens – perhaps suggesting that their use is relatively infrequent. One notable success occurred before the First Circuit in \textit{229 Main St. Ltd. Pshp. v. Mass. EPA}, 262 F3d. 1 (1st Cir. 2001). In that case, the property required an emergency cleanup to prevent contamination of drinking water.\(^{155}\) Massachusetts threatened to use its superpriority lien statute to take a lien on the property for present and future cleanup costs.\(^{156}\) When the debtor contested the lien, a mandatory administrative hearing was scheduled – and then the debtor filed for bankruptcy. The First Circuit ruled that the hearing was exempt from the automatic stay due to the

\(^{151}\) See King, \textit{supra} note 139, at 281; see also Nash, \textit{supra} note 148, at 147-149, 155.

\(^{152}\) N.H. REV. STAT. ANN. §147-B:10-b(III)(b) (Supp. 2001).


\(^{154}\) Nash, \textit{supra} note 148, at 143.

\(^{155}\) \textit{229 Main St. Ltd. Pshp. v. Mass. EPA}, 262 F3d. 1 (1st Cir. 2001).

superlien statute. The First Circuit’s holding has given credence to the argument that the automatic stay does not prevent a state from simultaneously creating and perfecting a superlien on a debtor’s property after the institution of a bankruptcy proceeding.157

New Jersey’s AG’s office has also enjoyed success with statutory liens. Under New Jersey law, the Department of Environmental Protection and Energy can cleanup a polluted property and then place a lien on it when a buyer purchases it.158 And, because New Jersey’s statute is retroactive, the state can add the lien while the polluter is in bankruptcy.159 This “wonderful” statute only faces one major limitation: the state’s cleanup costs must be paid from a state spill fund that receives only limited funding via a gasoline tax.160

Successes in New Jersey and Massachusetts, however, were not repeated in states with weaker superpriority lien statutes. For instance, the mortgage industry mounted a fairly successful campaign against statutory liens, leading to their repeal in Arkansas and Tennessee and to their amendment in several others.161 Because of this lobbying effort and because of shortsighted drafting, many states’ statutes suffer from fatal defects. For instance, some liens will only apply to the polluted property – rather than on all of the responsible party’s property. Because a heavily polluted property will be worth little in its contaminated form, the state will only have superpriority up to the value of property – leaving the state as an unsecured creditor for most of the cleanup costs.162

Also, in some states, the automatic stay can prevent the AG from recording the state’s lien against the polluter’s property. The ideal superpriority statute would permit

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157 See 21-1 ABIJ 22
158 Best of all, the state never has to take possession of the polluted property. New Jersey Spill Compensation and Control Act, 58 N.J. STAT. ANN. §10-23.11f (West 1982 & Supp. 1983); Lehr Interview.
159 Id.
160 Id.
161 See Nash, supra note 148, at 131 n.15.
“automatic perfection,” which allows the state’s lien to take effect without any action on the part of the state. Unfortunately, most statutes require the state to notify preexisting lienholders before the lien will take effect. As a result, the state cannot use its statutory lien powers in bankruptcy unless it has already given pre-bankruptcy notice to the polluter’s creditors of its intention to invoke a statutory lien.  

In practice, an AG’s office rarely knows of a site’s contamination until the polluter declares bankruptcy. So, not only are statutory liens’ notice requirements burdensome, but they undermine AGs’ ability to use statutory liens at all.

California’s experience with its lien statute illustrates these shortcomings. California’s statute requires both notice to other lienholders and a time-consuming hearing. In addition, the California AG’s office cannot use the statutory lien unilaterally. As the AG’s client on these matters, the California Department of Toxic Substance Control must first determine whether it is appropriate to use the statutory lien statute. Although the AG is given independent powers under the California Constitution to protect the health and safety of Californians, this power has its practical limitations. Because the Department of Toxic Substance Control handles cleanup operations, the AG’s office must seek their approval. Notice, administrative hearings, and coordination with state agencies all combine to make California’s statutory lien very difficult to use.

Superpriority liens also face constitutional and bankruptcy challenges. Even if the state statute permits the state to invoke superliens without notifying other lienholders, the

163 Padilla Interview.
164 See Nash, supra note 148, at 149.
165 CAL. HEALTH & SAF. CODE § 25365.6.
166 Padilla Interview.
167 Id.
168 Id.
bankruptcy trustee may still have grounds to defeat the lien. The Code permits the bankruptcy trustee to avoid statutory liens that are not “perfected or enforceable at the time of the commencement of the case against a bona fide purchaser.”\footnote{169} This requirement might not be met if the state has begun cleanup already.\footnote{170} Despite the First Circuit’s endorsement of superpriority liens’ exemption from the automatic stay, practitioners and commentators seem to agree that these statutes remain vulnerable to challenge.\footnote{171}

In short, the state statutory lien appears quite powerful, but it has not lived up to expectations. Results have varied greatly by state, and many states’ statutes have yet to be truly tested in the courts. The verdict is still out on statutory liens.

D. Consensual Liens

Consensual liens generally are granted by the polluter in the course of negotiations with the state. In exchange for some benefit (or the avoidance of some detriment), the debtor will offer the state a security interest in some of its property. AGs’ offices have succeeded in bargaining for these liens on “clean” property after an environmental cleanup – as protection for the state against a “relapse” by the polluting debtor.\footnote{172} Bankruptcy-experienced attorneys from state AGs’ offices describe consensual liens as relatively difficult to obtain.

On the other hand, informal conversations with bankruptcy attorneys in private practice suggest that AGs (or their client agencies) could demand consensual liens on more occasions. These practitioners expressed surprise that states ask for consensual liens so

\footnote{169}{11 U.S.C. § 545(2).}
\footnote{170}{See Sward, supra note 11, at 440-441.}
\footnote{171}{Padilla Interview; Nash, supra note 148, at 149; see also Kessler v. Tarrats, 476 A.2d 326 (N.J. Super. App. Div. 1984).}
\footnote{172}{Padilla Interview.}
rarely. It is possible that this difference of opinion can be explained by state agencies’ “client” relationship with the AG’s office. It may be that the bankruptcy-experienced attorneys in an AG’s office are not involved in all pre-bankruptcy discussions. Instead, various state agencies might be negotiating with potential polluters without close counsel from the AG’s office. If true, this pattern might suggest the need to educate key lawyers with state agencies – or even with major municipalities.

The consensual lien is best used as a preventative measure. An AG’s office can demand this protection when the state environmental agency becomes concerned about a solvent company’s impact on the environment or its future financial stability.\footnote{Padilla Interview.} Consensual liens also can be used as a supplement to RCRA financial assurances or when RCRA does not apply to the polluter’s activities.

E. Other Options to Extract Payments before Bankruptcy

State AGs may use sundry other tactics to position itself for a polluter’s potential bankruptcy. Some states demand payment schedules from polluters. And, to protect the state against bankruptcy, the AG attaches an acceleration clause – so that the entire liability will come due if the polluter misses one payment.\footnote{Morris Interview; Padilla Interview.} Other times, daily fines help to incentivize good behavior and to extract a financial toll. If the polluter declares bankruptcy, then these daily fines will continue and will receive administrative priority.\footnote{Padilla Interview. Note, however, that these fines may lose their administrative priority if they deemed “punitive.”} These various measures have mixed records of success, however.
Texas has used setoffs to great success. Because Texas is a trust-fund state with a unitary system, it can deduct cleanup costs from the polluter’s tax refund. Essentially, the setoff transforms the state into a secured creditor. Unfortunately, most states are not unitary systems and cannot use setoffs for environmental claims.

**Part IV: Education**

State AGs’ battle against exploitative bankruptcies requires education in two arenas: in their own offices and in courtrooms.

A. **Educating Judges and Opposing Counsel**

To win favorable payments for cleanup, state AGs need receptive audiences. Education is an essential component in AGs’ struggle against exploitative bankruptcies.

In some courtrooms, staff attorneys report encountering misunderstandings about environmental claims’ place in bankruptcy. In these lawyers’ experience, both judges and debtors’ counsel have sometimes assumed that environmental cleanup is the state’s job – not bankrupt companies’. Particularly in jurisdictions where the AGs office has not aggressively participated in bankruptcy proceedings, the AG’s office must convince judges that the state is an involuntary creditor – who did not have the chance to negotiate the terms of cleanup with the debtor. It is also important to convey that the polluter’s creditors collectively profited from the polluter’s attempt as “self-insuring.”

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176 Padilla Interview.
178 The sources of these observations have been withheld to preserve their anonymity.
179 *Id.*
Oral arguments are an important part of this education. AGs’ offices with attorneys actively participating in bankruptcy proceedings report marked improvements in courts’ receptiveness to their arguments. In some states, courts readily accept that environmental injunctions fall within the “police and regulatory” exception.\textsuperscript{180} These efforts also discourage judges from approving a reorganization that discharges future liability.\textsuperscript{181} In New Jersey, the AG’s office’s persistence has already borne fruit: “nearly every judge recognizes our right to compel cleanup.”\textsuperscript{182}

B. Staff Training and Organization

In an ideal world, every state’s attorney general would hire a separate group of bankruptcy “experts” to deal with bankruptcy matters. Although this vision is unrealistic in smaller states, Texas has embraced just such a strategy. Ten bankruptcy lawyers handle not only cleanup claims in bankruptcy but also non-environmental issues that arise in the bankruptcy courts.\textsuperscript{183} Due to the complexity of bankruptcy proceedings, all ten lawyers in this group have experience as bankruptcy attorneys. Although environmental lawyers can retrain themselves to navigate bankruptcy, the scale of modern bankruptcies necessitates drawing upon lawyers with extensive bankruptcy backgrounds.\textsuperscript{184} Because debtors can manipulate their financial structure to deprive the state of its assets, the AG’s office should consider retaining outside counsel to negotiate with the wildest polluters.\textsuperscript{185}

States with modest resources dedicated to bankruptcy should consider building a competency group within the AG’s office. California’s Attorney General has assembled an

\textsuperscript{180} Id.
\textsuperscript{181} Padilla Interview.
\textsuperscript{182} Lehr Interview.
\textsuperscript{183} Morris Interview.
\textsuperscript{184} Morris Interview.
\textsuperscript{185} Id.
informal cluster of environmental lawyers with bankruptcy experience. Each attorney
assumes an advisor role in any bankruptcy issues that come up in the office: they give
advice, review briefs, and monitor bankruptcy filings.\textsuperscript{186}

In New York and New Jersey, one person has assumed this role. This single-
attorney model, however, stretches his/her time very thin. Because hundreds of bankruptcy
notices come into the AG’s office in a given week, one person will struggle to keep pace.\textsuperscript{187}
Even a vigilant office will occasionally be caught off guard by a large bankruptcy affecting
the state’s interests – particularly when it occurs in another state and affects properties in
several jurisdictions.\textsuperscript{188}

\textbf{Conclusion}

With its own courts and its own procedures, bankruptcy law has been carefully
exploited by polluters to shift cleanup responsibilities onto state and federal governments.
In recent years, many AGs’ offices have found themselves playing catch-up. Matched
against a sophisticated bar and massive multinational companies, states have been
outgunned and outmanned. In at least a few states, however, AGs have turned the corner.
The above tools should assist those states attempting to grow bankruptcy expertise in their
AG’s offices. This investment in talent and training will be very worthwhile – especially as
the economy slows and the pace of bankruptcies increases.

\textsuperscript{186} Padilla Interview.
\textsuperscript{187} Lehr Interview.
\textsuperscript{188} Id.