

THE DISCHARGEABILITY OF ENVIRONMENTAL LIABILITIES IN BANKRUPTCY

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I. INTRODUCTION.....	61
II. WHEN IS AN ENVIRONMENTAL LIABILITY DISCHARGEABLE?	62
A. <i>Identifying a Dischargeable Claim</i>	62
B. <i>Dischargeability of Known Environmental Liabilities</i>	64
C. <i>Dischargeability of Potential or Contingent Environmental Liabilities</i>	70
III. DISCHARGEABILITY OBJECTIONS	76
A. <i>Section 523(a) Objections</i>	76
1. "Willful and Malicious Injury" Objection ...	77
2. Fines, Penalties or Forfeitures Objection	80
3. Lack of Notice Objection	82
B. <i>Due Process Objections</i>	83
1. Known Claimants	84
2. Unknown Claimants	86
IV. CONCLUSION	87

I. INTRODUCTION

The bankruptcy discharge lies at a critical intersection between environmental laws and the Bankruptcy Code.¹ The discharge releases a debtor from personal liability for prebankruptcy debts. Environmental liabilities enjoy no special treatment under the Bankruptcy Code, so environmental debts, like any other debt, can be discharged. Naturally, a tension exists between the goal of the discharge — a fresh start for debtors by relieving them from liability for prebankruptcy debts — and the goal of many environmental laws — to minimize pollution's costs for the general public by indefinitely imposing pollution-related liability upon responsible persons.²

This article provides an overview of the dischargeability of

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1. *In re Chateaugay Corp.*, 944 F.2d 997, 999 (2d Cir. 1991).

2. *See In re National Gypsum Co.*, 139 B.R. 397, 404 (Bankr. N.D. Tex. 1992).

environmental liabilities.³ First, it discusses the problems of determining when an environmental liability qualifies as a dischargeable claim. Second, it discusses various statutory and constitutional grounds for objecting to the discharge of environmental liabilities. It concludes that the Bankruptcy Code provides adequate means for both determining the dischargeability of environmental liabilities and addressing environmental problems, provided that the courts leave to the other branches of government the question of whether, from a public policy standpoint, the dischargeability of those liabilities is desirable.

II. WHEN IS AN ENVIRONMENTAL LIABILITY DISCHARGEABLE?

A. *Identifying a Dischargeable Claim*

The bankruptcy discharge is at the heart of the relief afforded to debtors by the Bankruptcy Code of 1978. It is the mechanism which allows debtors to make a fresh start by effectively eliminating a debtor's personal liability for prebankruptcy debts. Under Section 524(a) of the Bankruptcy Code, the discharge (1) voids any judgment against the debtor for a claim subject to discharge, and (2) enjoins any action to hold the debtor personally liable for a discharged claim.⁴ Section 524 bars any collection against the debtor for a discharged debt, including lawsuits, personal contacts, letters and telephone calls.⁵

The scope of the discharge varies according to the type of bankruptcy proceeding.⁶ In a Chapter 7 case, the discharge

3. Grounds for objecting to the discharge are set forth in the Bankruptcy Code. 11 U.S.C. §§ 1-151326, at 523, 727 (1988 & Supp. 1992). Section 727(a) sets forth the "discharge" objections, which bar the discharge of all of a debtor's liabilities and which usually apply when a debtor engages in misconduct that affects his bankruptcy case. In contrast, § 523(a) contains the "dischargeability" objections, which allow interested parties to challenge the dischargeability of a single claim rather than all of the debtor's liabilities. Section 523 objections are more common than § 727 objections because an objecting creditor is more likely to be paid only if his claim is not discharged. This article is limited to dischargeability issues and does not discuss discharge objections under § 727 that may apply when environmental liabilities are at issue.

4. *Id.* § 524(a). Section 524(a)(3) extends the discharge to community debts and is not relevant to the discussion in this article.

5. H.R. REP. NO. 595, 95th Cong., 1st Sess. 365-66 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5787, 6320-21; S. REP. NO. 989, 95th Cong., 2d Sess. 80 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 6320.

6. The most common type of bankruptcies involving environmental liabilities are Chapter 11 cases (which allow a debtor to reorganize and continue his business operations),

extends to all debts and to any liability on a claim that arose before the debtor filed his bankruptcy petition, regardless of whether a proof of claim is filed or the claim is allowed.⁷ However, a Chapter 7 debtor who is not an individual, namely a corporation or other business, cannot obtain a discharge.⁸ In a Chapter 11 case, the discharge is broader and extends to any debt that arises before the date of the order confirming the debtor's plan of reorganization.⁹ A Chapter 11 debtor will not receive a discharge if his reorganization plan liquidates his assets or if he fails to engage in business after his reorganization plan is confirmed.¹⁰

The discharge relieves the debtor from personal liabilities that fall within the Bankruptcy Code's definition of debt.¹¹ Debt is defined as "liability on a claim."¹² A claim is defined as:

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

right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.¹³

Congress broadly defined a claim so that "all legal obligations of the debtor, no matter how remote or contingent, will be able to be dealt with in the bankruptcy case" and "[i]t permits the

11 U.S.C. §§ 1101-74, and Chapter 7 cases (which provides for the cessation of a debtor's business and a liquidation of its assets to pay creditors' claims). *Id.* §§ 701-66. Chapter 13 is only available for individuals with limited assets and liabilities and is not addressed fully in this article. *Id.* §§ 1301-30.

7. *Id.* §§ 301, 727(b) (order for relief occurs when voluntary bankruptcy case commences by filing bankruptcy petition). Certain types of claims that may arise after filing are deemed pre-petition and, therefore, are dischargeable. *Id.* § 502(e)(2), (g)-(i).

8. *Id.* § 727(a)(1); *see, e.g.*, *NLRB v. Better Bldg. Supply Corp.*, 837 F.2d 377, 378-79 (9th Cir. 1988) (corporate liability for damages under NLRB survived Chapter 7 bankruptcy proceeding and attached to alter ego formed after bankruptcy).

9. *Id.* § 1141(d)(1)(A).

10. *Id.* § 1141(d)(3).

11. 11 U.S.C. § 727(b) (Chapter 7 discharge extends to debts that arose before date of order for relief, and to any liability on claim under § 502 of Bankruptcy Code); *id.* § 1141(d)(1)(A) (Chapter 11 discharge applies to debts and any debt of kind specified in § 502(g)-(i)); *id.* § 1328(a), (c) (Chapter 13 discharge discharges unsecured debtor and other debts).

12. *Id.* § 101(12).

13. *Id.* § 101(5).

broadest possible relief in the bankruptcy court."¹⁴ Given its broad definition and legislative history, a claim has been interpreted expansively by the courts to include known liabilities, potential liabilities and injunctions.¹⁵ Thus, liabilities that qualify as claims are dischargeable debts.

Environmental liabilities are not distinguished from other types of debts by the definition of claim, by the provisions for discharge, or by the Bankruptcy Code's legislative history. As a result, the same Code provisions that determine the dischargeability of other debts also determine the dischargeability of environmental liabilities. These provisions are more easily discussed by dividing environmental liabilities into two general categories: known liabilities and potential liabilities. Known liabilities include cleanup costs, damages, simple torts, and statutory obligations that arise prior to bankruptcy. Potential liabilities include claims that may arise from prebankruptcy pollution, such as toxic tort claims, property damage and clean-up liabilities. The applicability and effect of the discharge can vary according to the type of claim at issue.

B. Dischargeability of Known Environmental Liabilities

Prebankruptcy environmental liabilities which are, or can be, reduced to an amount of money are usually dischargeable.¹⁶ A debt subject to discharge is a "liability on a claim."¹⁷ Claim includes a "right to payment."¹⁸ As a result, claims for cleanup costs, toxic torts, pollution-related property damage, violations of a mining spoilage statute (including the failure to reclaim mined areas), contracts, response costs, contribution actions and private statutory causes of action are all dischargeable.¹⁹ Liabil-

14. H.R. REP. NO. 595, 95th Cong., 1st Sess. 309 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5787, 6266.

15. *See* *Ohio v. Kovacs*, 469 U.S. 274, 279 (1985); *In re Chateaugay Corp.*, 944 F.2d 997, 1003 (2d Cir. 1991).

16. *See Kovacs*, 469 U.S. at 279 (noting no dispute whether claim for prebankruptcy cleanup costs subject to discharge); *In re Tinkham*, 59 B.R. 209, 217 (Bankr. D.N.H. 1986). Of course, this pretermits any discussion of possible discharge objections.

17. 11 U.S.C. § 101(12).

18. *Id.* § 101(5).

19. *See, e.g., Kovacs*, 469 U.S. at 284-85 (injunction requiring cleanup); *Chateaugay*, 944 F.2d at 999 (claim for CERCLA response costs); *United States v. Whizco, Inc.*, 841 F.2d 147, 151 (6th Cir. 1988) (injunction to extent it required cash expenditures to clean up mining site); *United States v. Union Scrap Iron & Metal*, 123 B.R. 831, 838 (D. Minn. 1990) (\$42,000 pre-petition CERCLA response costs discharged); *In re Charter Corp.*, 113 B.R. 725, 728 (Bankr. M.D. Fla. 1990) (claim for benzene exposure); *In re Kaiser Steel*

ity for prebankruptcy cleanup costs from the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA) can also be discharged.²⁰

Less clear is the dischargeability of prebankruptcy environmental injunctions. Various state and federal laws authorize injunctive relief when pollution is discovered.²¹ Polluters can be ordered to cease damaging activities and to clean up past pollution.²² The dischargeability of these types of injunctions can be critical for both the debtor and the debtor's creditors, since, if such an order survives bankruptcy, it can effectively destroy the debtor's fresh start.

Environmental injunctions are subject to discharge under the second part of the Bankruptcy Code's definition of a claim. As previously noted, a claim includes: "[a] right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured."²³ This portion of the definition was a compromise. The original House bill would have made any equitable remedy for breach of performance dischargeable; the Senate sought a more restrictive

Corp., 87 B.R. 662, 665 (Bankr. D. Utah 1988) (state's claims for violations of mining reclamation statute and environmental laws); *Tinkham*, 59 B.R. at 217 (\$11,000,000 judgment for state's remediation costs); see also Resource Recovery and Conservation Act (RCRA), 42 U.S.C. §§ 6901-92k (1988); Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA), 42 U.S.C. §§ 9601-75 (1990 & Supp. 1992). State environmental legislation may also apply. E.g., Louisiana Environmental Quality Act, LA. REV. STAT. ANN. §§ 30:2001-2396 (West 1989); New Jersey's Environmental Cleanup Responsibility Act, N.J. STAT. ANN. §§ 13:1K-6 to - 14 (West 1991).

20. *Chateaugay*, 944 F.2d at 999, 1005 (\$32 million in pre-petition CERCLA cleanup costs discharged); *Union Scrap Iron & Metal*, 123 B.R. at 838.

21. See Surface Mining Control and Reclamation Act of 1977, 30 U.S.C. §§ 1201-1328 (1988 & Supp. II 1990); Clean Water Act, 33 U.S.C. §§ 1251-1387 (1988 & Supp. II 1990); RCRA, 42 U.S.C. §§ 6901-92k (1988); Clean Air Act, 42 U.S.C. §§ 7401-7642 (1988 & Supp. II 1990); CERCLA, 42 U.S.C. §§ 9601-75. State statutes can allow injunctive relief to stop or clean up pollution. See, e.g., LA. REV. STAT. ANN. § 30:2171 (Louisiana Hazardous Waste Control Law).

22. See, e.g., Clean Water Act, 33 U.S.C. § 1321(e) (injunctive relief to clean up discharges into water); CERCLA, 42 U.S.C.A. § 9606 (a) (clean-up order); Clean Air Act, 42 U.S.C.A. § 7413(b) (injunctive relief to bar air discharge); RCRA, 42 U.S.C.A. § 6973 (injunctive relief allowed against person contributing to imminent and substantial endangerment to health or environment from waste-related activities); LA. REV. STAT. ANN. § 30:2183 (allowing injunctive relief against violators of Louisiana hazardous waste control law).

23. 11 U.S.C. § 101(5).

definition.²⁴ The final version is briefly discussed in the legislative history, which states that it "is intended to cause the liquidation or estimation of contingent rights of payment for which there may be an alternative equitable remedy with the result that the equitable remedy will be susceptible to being discharged in bankruptcy."²⁵

The leading case on the dischargeability of environmental injunctions is *Ohio v. Kovacs*. In *Kovacs*, the State of Ohio obtained a stipulated judgment against a company and its chief executive officer, Kovacs, which required them to remove wastes from a site, forbade them from allowing additional waste to be brought to the site, barred them from causing additional pollution and ordered the payment of \$75,000 for injury to wildlife.²⁶ Kovacs and his codefendants did not comply with the injunction.²⁷ The State then had a receiver take possession of Kovacs' assets in order to fund the cleanup.²⁸ Before the receiver completed the cleanup, Kovacs declared bankruptcy and sought a discharge of his obligations under the injunction.²⁹

The Supreme Court held that the injunction was dischargeable.³⁰ It reasoned that the appointment of the receiver removed Kovacs' authority over the site and dispossessed him of any assets that might have been used to perform the cleanup.³¹ In effect, the injunction was converted into an obligation to pay money, and therefore, the injunction was a dischargeable claim.³²

Unfortunately, *Ohio v. Kovacs* does not set forth any criteria for determining the dischargeability of other environmental injunctions because the holding is largely fact-specific. However, the court was clear that an injunction against conduct which contributes to pollution was not dischargeable, and that bankruptcy does not relieve whomever is in possession of a polluted site from compliance with environmental laws, including

24. See *Ohio v. Kovacs*, 469 U.S. at 274, 280 nn. 6-7 (1985) H.R. REP. NO. 8200, 95th Cong., 1st Sess. 309-10 (1977); S. REP. NO. 2266, 95th Cong., 1st Sess. 299 (1977).

25. 124 CONG. REC. 32,393 (1978) (remarks of Rep. Edwards); see also *id.* at 33,992 (remarks of Sen. DeConcini); *Kovacs*, 469 U.S. at 280 (comparing House and Senate versions of claim with final definition adopted).

26. *Kovacs*, 469 U.S. at 276.

27. *Id.*

28. *Id.*

29. *Id.* at 277.

30. *Id.* at 283.

31. 469 U.S. at 282-83.

32. *Id.*

cleanup requirements. In the wake of *Ohio v. Kovacs*, two different approaches have surfaced for determining the dischargeability of environmental injunctions.³³ One approach focuses on an injunction's practical effect, while the other focuses on an injunction's legal basis.

The first approach uses a pragmatic test for determining if an environmental injunction is dischargeable. It focuses on the substance, not the form, of the relief sought.³⁴ The critical issue is whether compliance with an injunction would, in effect, require the debtor to spend money.³⁵ If so, the injunction is a dischargeable claim even if it only requires performance.³⁶ On the other hand, an injunction is not a claim to the extent it can be satisfied through personal efforts, such as performing labor, providing equipment or ceasing pollution-causing activities.³⁷

Under this approach, the dischargeability of an environmental injunction largely depends upon a debtor's circumstances. For example, a debtor was subject to a prebankruptcy order requiring him to clean up a mine site. The debtor was sixty-three years old, no longer had access to the mine, did not own the equipment needed to comply with the injunction, and could not have satisfied the injunction, even if he was held in contempt, unless he paid someone to clean up the site.³⁸ Given the debtor's circumstances, the injunction was discharged because it actually sought the payment of cleanup costs from the debtor. However, the injunction was not discharged to the extent that it could be satisfied without expense to the debtor.³⁹

Environmental injunctions are likely to be discharged under this first approach. Some injunctions may create no expense, such as an injunction requiring a debtor in liquidation to stop pollution-causing business practices. Most injunctions, however, will involve some expense for cleanup costs or other remedial

33. *In re Chateaugay Corp.*, 944 F.2d at 997, 1008-09 (2d Cir. 1991) (injunction was deemed claim for money by court). *But see United States v. Whizco, Inc.*, 841 F.2d at 149-50 (6th Cir. 1988) (focusing on effect of injunction upon debtor).

34. *Whizco*, 841 F.2d at 150.

35. *Id.*; *In re Robinson*, 46 B.R. 136, 139 (Bankr. M.D. Fla. 1985) (order obtained by federal government requiring debtor to restore marshlands was claim because the debtor would have been required to expend money to comply), *rev'd on other grounds*, 55 B.R. 355 (M.D. Fla. 1985).

36. *Whizco*, 841 F.2d at 150.

37. *Id.* at 150-51.

38. *Id.* at 149.

39. *Id.* at 151. The debtor would be bound by the injunction if he acquired equipment that he could use personally to reclaim the site.

action. Also, a debtor who uses personal labor to clean up a site has an opportunity cost for his time as well as the costs of operating equipment and overhead. The dividing line between injunctions which cause no expense and those which do is unclear under this approach, although one court suggested that the distinction should be based upon whether the debtor would incur substantial direct expense as opposed to incidental expense.⁴⁰ In any event, this approach favors the dischargeability of environmental injunctions, such as a cleanup orders.

The second approach is less favorable to debtors. It determines whether an environmental injunction is a claim by considering the legal grounds for its issuance. An injunction will not qualify as a claim unless, under its terms and the applicable state law, the debtor could be required to make a payment as an alternative to injunctive relief.⁴¹ Whether the injunction effectively requires the debtor to spend money is not relevant.⁴² The key issue is whether the debtor could have been ordered to make a payment under the law giving rise to the order.⁴³ Stated differently, an environmental injunction is not a claim unless, as a matter of law, its obligations are, in their entirety, an alternative to a right to payment.⁴⁴

Under this approach, environmental injunctions usually are not dischargeable. A CERCLA cleanup order requiring a debtor to prevent ongoing pollution would not be a claim because the injunction was issued under Section 106 of CERCLA, which does not allow the government to accept payment in lieu of the cessation of pollution.⁴⁵ If an order to halt ongoing

40. *In re Robinson*, 46 B.R. 136, 139 (Bankr. M.D. Fla. 1985).

41. *In re Chauteaugay Corp.*, 944 F.2d 997, 1008 (2d Cir. 1991).

42. *Id.* at 1007-08.

43. See *Chauteaugay*, 944 F.2d at 1008; *In re Combustion Equip. Assocs.*, 838 F.2d 35, 39 (2d Cir. 1988) (dictum that choice of enforcement action under CERCLA may determine dischargeability of injunction if no statutory right exists for payment in lieu of performance); Murray Drabkan, et al., *Bankruptcy and the Cleanup of Hazardous Waste: Caveat Creditor*, 15 ENVTL. L. REP. 10168, 10175 (June 1985). For example, CERCLA cleanup liability can be imposed under a § 106 order or a § 107 claim for reimbursement of cleanup costs and associated damages. Since § 106 does not allow the payment of money as an alternative to compliance with an order issued under its provisions requiring the debtor to prevent ongoing pollution, this approach does not consider such orders to qualify as claims that are dischargeable. *Chauteaugay*, 944 F.2d at 1008.

44. *Chauteaugay*, 944 F.2d at 1008.

45. *Id.* (CERCLA cleanup order which required both site remediation and actions regarding ongoing pollution did not qualify as a claim); see also *In re Heartland Partners*, 966 F.2d 1143, 1146 (7th Cir. 1992) (dictum stating that a § 106 cleanup order was a statutory obligation attached to the current ownership of a site that survived bankruptcy).

pollution is not a dischargeable claim, the debtor effectively remains liable for CERCLA cleanup costs.⁴⁶ Much of the work needed to eliminate prebankruptcy pollution may be necessary to prevent ongoing pollution, assuming that the ongoing pollution is due to the migration of existing pollutants. In contrast, a debtor's liability under Section 107 of CERCLA would qualify as a claim because this section creates a reimbursement claim for the cleanup costs of third parties when the debtor fails to take remedial action.⁴⁷

Neither approach is fully reconcilable with the definition of claim. A claim includes the *right* to an equitable remedy whose breach gives rise to a right to payment, whether or not the equitable remedy (as opposed to the remedy for its breach) is reduced to judgment, contingent, unmatured, or disputed.⁴⁸ It does not require the "right to payment" to arise directly from the particular statute authorizing an injunction. Instead, the legislative history provides that a claim extends to contingent rights of payment for which there *may* be an alternative equitable remedy.⁴⁹ As a result, the second approach appears inconsistent with the definition of claim to the extent that it determines if a right to payment will arise from the breach of an existing environmental injunction, instead of whether a right to payment may exist if a contingent, unmatured, or disputed injunction were breached. The first approach also appears inconsistent because it fails to adequately explain how an injunction's practical effect is equivalent to a "right to payment" for the breach of an injunction. *Kovacs'* refusal to hold that injunctions barring future pollution-causing conduct are dischargeable also suggests that more than just possible expense is needed to make an injunction a claim.⁵⁰

A better approach would be to determine if an environmental injunction is dischargeable using an analysis more closely tailored to the definition of claim. First, the injunction's requirements and relevant legal authority should be reviewed to determine if the injunction's breach gives rise to a direct right to payment. If so, the injunction should qualify as a dischargeable

46. *Chateaugay*, 944 F.2d at 1008 (noting that most environmental injunctions imposing ongoing cleanup obligations will not qualify as dischargeable claims).

47. *Id.* at 1007; see also *supra* note 43 (cases discussing dischargeability of environmental injunctions).

48. *Chateaugay*, 944 F.2d at 1007.

49. *Ohio v. Kovacs*, 469 U.S. 274, 280 (1985).

50. *Id.* at 284-85.

claim. If not, the next issue should be whether the breach of the injunction created a right to an equitable remedy, including any contingent, unmatured, or disputed remedy, whose breach would give rise to a right to payment, even if the legal grounds for the right to payment are not the same as for the breached injunction. This was the case in *Ohio v. Kovacs* where the right to payment arose by virtue of the appointment of a receiver after an environmental injunction based on a different statute was violated. Such contingent equitable remedies also should be dischargeable. This approach is consistent with the definition of claim; with congressional intent to broadly define claim; and with *Kovacs*' recognition that claim should not be interpreted restrictively.

C. *Dischargeability of Potential or Contingent Environmental Liabilities*

Prebankruptcy pollution may cause property contamination and latent health effects that are unmanifested when a debtor files for bankruptcy. These potential and contingent environmental liabilities generally fall into two categories: potential toxic tort claims and potential cleanup liabilities. Depending on the circumstances, these possible claims may fall anywhere on a scale ranging from imminent to unlikely. For example, a debtor may be aware that the Environmental Protection Agency intends to assess him with remediation costs under CERCLA, although no formal demand for payment has been made. On the other hand, the debtor simply may suspect that his, perfectly legal, prebankruptcy business practices may create future environmental litigation.

Potential or contingent environmental liabilities can be discharged. The definition of claim includes a right to payment that is unliquidated, contingent, unmatured, or disputed.⁵¹ It also includes certain injunctions regardless of whether they are reduced to judgment, contingent, unmatured, or disputed.⁵²

The broad definition of claim is tied to the scope of the discharge. Prior to the Bankruptcy Code, only provable claims could share in the estate and be discharged. The concept of provability was overruled by Section 502(c), which expressly allows the estimation of contingent payment rights and payment

51. 11 U.S.C. § 101(5)(A).

52. *Id.* § 101(5)(B).

rights arising from the breach of injunctions, and the definition of claim:

H.R. 8200 abolishes the concept of provability in bankruptcy cases. All claims against the debtor, whether or not contingent or unliquidated, will be dealt with in the bankruptcy case. This is the procedure under current Chapters IX and X. However, under the liquidation chapters of the Bankruptcy Act, certain creditors are not permitted to share in the estate because of the non-provable nature of their claims, and the debtor is not discharged from those claims. Thus, relief for the debtor is incomplete, and those creditors are not given an opportunity to collect in the case on their claims. The proposed law will permit a complete settlement of the affairs of a bankrupt debtor, and a complete discharge and fresh start.⁵³

However, the legislative history and Code do not set specific guidelines for determining when a potential liability is too attenuated to be a claim, leaving this task to the courts. Several judicial tests have been formulated to determine when potential environmental liabilities are dischargeable claims.

Recent cases have emphasized the foreseeability of the potential liability. Whether a contingent environmental liability is dischargeable depends upon whether the claim could have been fairly contemplated by the debtor or creditor prior to bankruptcy.⁵⁴ Potential CERCLA liability for cleanup costs arising from the debtor's prebankruptcy acts is dischargeable when, due to the parties' awareness of polluted areas, the debtor's liability becomes fairly within the contemplation of the debtor and the government.⁵⁵ Determining when a potential environmental liability was fairly contemplated by both the debtor and creditor is not clearcut but should turn on the facts of each case. Under this approach, potential cleanup liabilities may be more likely to qualify as a claim than unknown toxic torts.⁵⁶

Another variation of the "fair contemplation" test focuses more on the connection between potential liability and preban-

53. H.R. REP. No. 8200, 95th Cong., 1st Sess. 180 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6141.

54. *In re National Gypsum Co.*, 139 B.R. 397, 406-07 (Bankr. N.D. Tex. 1992); *NCL Corp. v. Lone Star Bldg. Ctrs.*, 144 B.R. 170, 180 (S.D. Fla. 1992); *cf. In re Chicago, M., St. P. & Pac. R.R.*, 974 F.2d 775, 786 (7th Cir. 1992) (applying § 77 of the Bankruptcy Act and finding potential CERCLA liability was a time-barred claim).

55. *National Gypsum*, 139 B.R. at 412.

56. *See NCL Corp.*, 144 B.R. at 177 (finding the relationship between environmental regulating agencies and those subject to regulation provides sufficient "contemplation" of contingencies to discharge a private CERCLA contribution claim).

krupcy actions. Before a contingent claim can be discharged, it must result from prepetition conduct fairly giving rise to that contingent claim.⁵⁷ For example, a contingent claim for cleanup costs arising from prepetition releases and threatened releases of hazardous waste fairly gave rise to potential liability under CERCLA, resulting in the discharge of any contingent claim for those costs.⁵⁸ Thus, the key concern is the reasonableness of the connection between prebankruptcy conduct and the potential liability, rather than the parties' awareness of the potential liability.

Under another approach, a potential environmental liability is not dischargeable except in two circumstances. First, a liability can be a claim if it gave rise to a prebankruptcy cause of action against the debtor.⁵⁹ Second, a contingent liability can be a claim if it arises from a prebankruptcy relationship, such as a contract, which contemplated that a future event would trigger an obligation of the debtor to pay money to the creditor.⁶⁰ This analysis hinges on the Bankruptcy Code's use of "right to payment" in its definition of claim. The existence of a claim depends upon, (1) whether the claimant possessed a right to payment, and (2) when that right arose.⁶¹ Nonbankruptcy law determines if a "right to payment" exists, absent an overriding federal interest.⁶²

Under this analysis unmanifested or unknown environmental claims usually are not dischargeable.⁶³ A debtor's liability for postbankruptcy CERCLA response costs that were imminent prior to bankruptcy was not a dischargeable claim because a CERCLA cause of action for response costs did not arise until

57. *In re Chateaugay Corp.*, 944 F.2d 997, 1005 (2d Cir. 1991).

58. *Id.* at 1000, 1005.

59. See *In re Remington-Rand Corp.*, 836 F.2d 825, 831-32 (3d Cir. 1988); *In re United States M. Frenville Co.*, 744 F.2d 332, 337 (3d Cir. 1984); *United States v. Union Scrap Iron & Metal*, 123 B.R. 831, 835 (D. Minn. 1990) (citing *In re UNR Indus.*, 29 B.R. 741, 745-46 n.4 (N.D. Ill. 1986)); see also *In re Clinton Centrifuge*, 81 B.R. 844, 848-49 (Bankr. E.D. Pa. 1988) (breach of contract and waste of corporate assets claims were sufficient to constitute contingent, pre-petition claim).

60. *Remington-Rand*, 836 F.2d at 832.

61. *Id.* at 830 (citing *In re M. Frenville Co.*, 744 F.2d 332 (3d Cir. 1984)); cf. *Schweitzer v. Consolidated Rail Corp.*, 758 F.2d 936, 942 (3d Cir. 1985) (in railroad reorganization, persons exposed to asbestos prior to filing did not have claims until injury manifested in manner sufficient to give rise to tort cause of action under applicable law, regardless of whether subclinical injury had occurred).

62. See, e.g., *Frenville*, 744 F.2d at 337.

63. See *UNR Indus.*, 29 B.R. at 748.

those costs were actually incurred.⁶⁴ Tort claims arising from a prepetition exposure to toxic substances were not dischargeable for claimants whose injuries were not detected prior to bankruptcy.⁶⁵ An indemnity and contribution claim against a debtor that was not actionable at the time of bankruptcy was not dischargeable.⁶⁶ Similarly, if relevant substantive law does not provide a tort cause of action until an injury is detected, no claim exists even if the debtor's fault occurred prepetition.⁶⁷

At the other extreme is the view that a claim arises when the acts occurred giving rise to the debtor's potential liability.⁶⁸ This view rejects the idea that a "right to payment" arises only when a creditor has a cognizable cause of action against a debtor

64. *Union Scrap Iron & Metal*, 123 B.R. at 835-36 (rejecting the debtor's contention that a prebankruptcy release alone created a contingent claim and noted that EPA was unaware of the pollution that caused certain postpetition response costs until after bankruptcy); see also *United States v. Price*, 577 F. Supp. 1103, 1110 (D.N.J. 1983) (preventing the E.P.A. from suing for relief under § 107 where no costs incurred, but providing action under § 106 for abatement of "imminent and substantial" danger).

65. *Schweitzer*, 758 F.2d at 944; *UNR Indus.*, 29 B.R. at 745; see also *In re Amatex*, 30 B.R. 309, 315 (Bankr. E.D. Pa. 1983) (potential asbestosis victims whose injuries would be caused by prepetition exposure but would not become known until postpetition did not hold claims and were not entitled to have a representative appointed for them in bankruptcy proceeding), *rev'd on other grounds*, 755 F.2d 1034 (3d Cir. 1985).

66. *Frenville*, 744 F.2d at 337 (claim for indemnity and contribution not cognizable cause of action prior to bankruptcy so not subject to discharge); see also *In re Charter Co.*, 862 F.2d 1500, 1502-03 (11th Cir. 1989) (disallowing contingent CERCLA contribution claims, *rev'd on other grounds*, 913 F.2d 1575 (11th Cir. 1990)); *In re Todd Shipyards Corp.*, 92 B.R. 600, 603 (D.N.J. 1988) (refusing to enjoin litigation under the automatic stay in extraordinary circumstances). But see *In re Hemingway Transp.*, 954 F.2d 1, 8 n.9 (1st Cir. 1992) (criticizing *Frenville*).

67. See *Schweitzer*, 758 F.2d at 942 (under Bankruptcy Act, asbestos personal injury claim not subject to discharge because claim could not accrue under FELA until injury manifested); *UNR Indus.*, 29 B.R. at 744 (individuals exposed to toxic substances had not dischargeable claim under state law until injuries are known or should be known.); WILLIAM L. PROSSER, LAW OF TORTS 143-44 (4th ed. 1971) (no tort cause of action until injury arises). But see *Cole v. Celofex Corp.*, 599 So.2d 1058, 1066 (La. 1992) (holding that cause of action in tort for long-term exposure to asbestos arises when exposure occurred even though the disease was not contracted or manifested until later).

68. See, e.g., *In re Hi-Lo Powered Scaffolding*, 70 B.R. 606, 610 (Bankr. S.D. Ohio 1987) (debtor's principals indemnification claim); *In re Johns-Manville Corp.*, 57 B.R. 680, 690 (Bankr. S.D.N.Y. 1986) (right to indemnification was claim subject to automatic stay); *In re A. H. Robins Co.*, 63 B.R. 986, 992 (Bankr. E.D. Va. 1986); *In re Baldwin-United Corp.*, 57 B.R. 759, 765 (Bankr. S.D. Ohio 1985) (discussing scope of automatic stay); *In re Johns-Manville Corp.*, 36 B.R. 743, 754-55 n.6 (Bankr. S.D.N.Y. 1984) (dictum); cf. *In re Baldwin-United Corp. Litig.*, 765 F.2d 343, 348 n.4 (2d Cir. 1985) (questioning, but not ruling upon, the *Frenville* test); *In re Edge*, 60 B.R. 690, 699 (Bankr. M.D. Tenn. 1986) (staying tort claim for dental malpractice where prepetition treatment caused injury that surfaced postpetition because "right to payment" arises at earliest point in the relationship between a debtor-wrongdoer and victim-creditor, even if no cause of action has accrued).

or had a prebankruptcy relationship with the debtor.⁶⁹ Under this analysis, CERCLA response costs incurred postpetition to remedy prepetition pollution are dischargeable.⁷⁰ Also, liability to a state for a prepetition violation of environmental laws can be discharged.⁷¹ However, much of the case law adopting a broad definition of claim has involved automatic stay litigation and some courts have noted that they might adopt a different interpretation if faced with the dischargeability of unknown or unmanifested claims.⁷² While pragmatic, the suggestion that a different interpretation of claim should be used for automatic stay proceedings and dischargeability decisions is inconsistent with the Bankruptcy Code's single definition of claim for all purposes.⁷³

An appropriate test for determining when a potential environmental liability is dischargeable should be based on several factors. First, claim, as defined in the Bankruptcy Code, specifically includes obligations that are unmatured, unliquidated, contingent, and not fixed.⁷⁴ Second, the bankruptcy court is empowered to estimate the value of unliquidated and contingent claims to determine their allowability; this procedure expressly overrules the pre-Code requirement that a claim had to be provable before it could be allowed and discharged.⁷⁵ Third, the Bankruptcy Code's legislative history states that claim was

69. *Grady v. A.H. Robins, Inc.*, 839 F.2d 198, 201-02 (4th Cir. 1988) (declining to follow *Frenville*); *Baldwin*, 765 F.2d at 348 n.4.

70. *In re Chateaugay*, 944 F.2d 997, 1005 (2d Cir. 1991) (response costs were contingent rather than so remote as to fall outside definition of claim).

71. *In re Kaiser Steel Corp.*, 87 B.R. 662, 665 (Bankr. D. Utah 1988) (holding Utah's pre-petition claim for failure of debtor-mining company to reclaim mined property in violation of state law is dischargeable); *In re Dant & Russell*, 853 F.2d 700, 709 (9th Cir. 1988); *In re Microfab*, 105 B.R. 161, 167-68 (Bankr. D. Mass. 1989); *In re Hudson Oil Co.*, 100 B.R. 72, 77 (Bankr. D. Kan. 1989).

72. *In re UNR Indus.*, 725 F.2d 1111, 1119-20 (7th Cir. 1984) (appointing representative for unknown tort claimants but refusing to address dischargeability of their claims); *Edge*, 60 B.R. at 691-92 n.1; *In re Johns-Manville Corp.*, 52 B.R. 940, 942 n.5 (Bankr. S.D.N.Y. 1985); see also *Grady*, 839 F.2d at 203 (allowing potential Dalkon Shield tort claim to be stayed but expressly refusing to address claim's dischargeability); *In re Amatex*, 755 F.2d 1034, 1040 n.6 (3d Cir. 1985) (deeming future claimants "parties in interest" to help inform the court's adjudication).

73. 11 U.S.C. § 101(5). When a different meaning is to be attached to a term for different parts of the Bankruptcy Code, the Code expressly so provides. *E.g.*, §§ 522(a)(2), 548(d)(2) (defining "value").

74. *In re Black*, 70 B.R. 645, 649 (Bankr. D. Utah 1986) (citing extensive list of cases holding that claim is broadly defined).

75. 11 U.S.C. § 502(c); *In re Johns-Manville Corp.*, 57 B.R. 680, 686-87 (Bankr. S.D.N.Y. 1986).

broadly defined so that "all legal obligations of the debtor, no matter how remote or contingent, will be able to be dealt with in the bankruptcy case," to provide the debtor with "the broadest relief possible in the Bankruptcy Court," and to allow all claims to be addressed and discharged in the bankruptcy proceeding.⁷⁶ Fourth, the Bankruptcy Code's fundamental goal is to provide a fresh start to the debtor.⁷⁷ Finally, equating claim with an existing cause of action creates the potential for wasteful litigation and inconsistent treatment of identical claims when the requirements for the accrual of a cause of action differ under applicable nonbankruptcy law.⁷⁸ However, a consistent standard is difficult to obtain because substantive nonbankruptcy law controls when a claim exists.⁷⁹

It is submitted that a debtor should be able to seek the discharge of all possible liabilities, no matter how remote, provided adequate notice and a meaningful opportunity to be heard in the bankruptcy case is given to the affected creditor. Even if potential environmental liabilities are not discharged, a debtor may be able to control his future liability by including unknown claims as a class of debt in a reorganization plan and providing a mechanism for handling and paying such claims in the future.⁸⁰ Also, the debtor may be able to have a representative appointed for unknown and potential claimants, although the appointment does not necessarily mean that these claims will be discharged.⁸¹

76. H.R. REP. NO. 595, 95th Cong., 2d Sess. 309 (1977), reprinted in 1978 U.S.C.A.N. 5963, 6266; see S. REP. NO. 989, 95th Cong., 2d Sess. 21-22 (1978), reprinted in 1978 U.S.C.A.N. 5787, 5807-08; *In re Hi-Lo Powered Scaffolding*, 70 B.R. 606, 610 (Bankr. S.D. Ohio 1987); *In re Baldwin-United Corp.*, 57 B.R. 759, 765 (Bankr. S.D. Ohio 1985).

77. *Black*, 70 B.R. at 649-50.

78. *Id.*; *Johns-Manville*, 57 B.R. at 685; *In re Baldwin-United Corp.*, 48 B.R. 901, 903-04 (Bankr. S.D. Ohio 1985) (claim is broader than cause of action). Another factor also suggests that the Third Circuit's analysis is misguided. A debtor's bankruptcy estate consists of all of his property, including potential causes of action and insurance rights arising from prebankruptcy events. 11 U.S.C. § 541. It seems incongruous to include the debtor's potential claims as part of the bankruptcy estate that benefits creditors while, on the other hand, excluding similar claims held by creditors from the bankruptcy process.

79. *In re Frenville*, 744 F.2d 332, 337 (3d Cir. 1984).

80. See *In re Johns-Manville Corp.*, 52 B.R. 940, 942 (Bankr. S.D.N.Y. 1985). The Johns-Manville bankruptcy resulted in a confirmed plan of reorganization that did not decide whether future or unknown asbestosis plaintiffs had claims but instead included them as a class of creditors whose prospective claims would be handled in accordance with the plan's terms, not without some small controversy. *Kane v. Johns-Manville Corp.*, 843 F.2d 636, 645 (2d Cir. 1988).

81. See, e.g., 11 U.S.C. § 1109(b) (allowing parties in interest to be heard in Chapter 11 case); *In re UNR Indus.*, 725 F.2d 1111, 1119-20 (7th Cir. 1984) (failure to discharge

III. DISCHARGEABILITY OBJECTIONS

An environmental liability that qualifies as a claim will be discharged unless a valid objection exists. Section 523(a) of the Bankruptcy Code sets forth ten dischargeability objections. Three of Section 523(a)'s objections are potentially relevant for environmental liabilities although none of the objections specifically apply to environmental claims. These objections are for claims that arise from willful and malicious injury claims constituting fines and penalties; as well as claims held by creditors who do not receive proper notice of the bankruptcy.⁸² Lack of notice may also give rise to a constitutional dischargeability objection based on due process.⁸³

It is important to note that a successful objection may not equally affect all liabilities arising from pollution or environmental problems. Dischargeability objections are debt-specific. For example, a debtor may be discharged from claims for cleanup costs while an objection prevents the discharge of fines or penalties arising from the same pollution.⁸⁴

A. *Section 523(a) Objections*

Several common principles apply to Section 523(a) objections. First, the objections apply to debts, thereby including known and unknown environmental liabilities or injunctions that qualify as claims.⁸⁵ Second, Section 523(a) objections can be asserted only against a debtor who is an individual.⁸⁶ As a result, the dischargeability objections discussed hereinafter will not be available in the typical business reorganization, although this limitation does not apply to the due process objection.⁸⁷

future asbestosis claims could adversely affect reorganization but court refused to decide dischargeability); *In re Amatex*, 755 F.2d 1034, 1041 (3d Cir. 1985) (approving appointment of representative of unknown prospective tort claimants but refusing to address their status); *Johns-Manville*, 52 B.R. at 942. The appointment of a representative can involve input from the debtor, the United States Trustee and also creditors holding similar claims, and the representative can be compensated by the debtor with court approval. *In re Forty-Eight Insulations*, 58 B.R. 476, 478 (Bankr. N.D. Ill. 1986) (approving appointment of representative for future asbestos claimants in reorganization proceeding).

82. 11 U.S.C. §§ 523(a)(3), (6)-(7).

83. U.S. CONST. Amend. V.

84. See *supra* note 19 and accompanying text.

85. 11 U.S.C. § 523(a).

86. *Id.*

87. *Id.*; *Beard v. A.H. Robins, Inc.*, 828 F.2d 1029, 1031 (4th Cir. 1987) (upholding constitutionality of broader discharge for non-individuals under § 1141(d)); *In re*

Third, the objecting creditor has the burden of proving his case by a preponderance of the evidence.⁸⁸ Fourth, the objections relevant to environmental liabilities are unavailable in Chapter 13 cases.⁸⁹ Finally, because discharge is favored, section 523(a) is typically construed against the objecting creditor and in favor of the debtor.⁹⁰

1. "Willful and Malicious Injury" Objection

Section 523(a)(6) prevents the discharge of a debt "for willful and malicious injury by the debtor to another entity or to property." The elements of a Section 523(a)(6) objection are an injury to a creditor or property that, under the totality of the circumstances, was caused by the debtor's willful and malicious acts.

The key issue is identifying a "willful and malicious" injury. Willful and malicious are two separate elements of the objection.⁹¹ Willful is defined as deliberate or intentional.⁹² Malicious is defined as a conscious disregard of one's duties or without just cause or excuse.⁹³ These terms were included in Section 523(a)(6) to overrule pre-Code cases applying a "reckless disregard" standard.⁹⁴

The courts have split over the proper interpretation of "willful and malicious." Under one view, the phrase requires a wrongful act by the debtor with specific intent to injure a creditor or his property.⁹⁵ A less strict view only requires an inten-

Wisconsin Barge Lines, 91 B.R. 65, 68 (Bankr. E.D. Mo. 1988) (section 523(a)(7) not available against corporate Chapter 11 debtor); *Yamaha Motor Corp. U.S.A. v. Shadco, Inc.*, 762 F.2d 668, 670 (8th Cir. 1985) (no § 523(a)(6) objection against corporation).

88. *Grogan v. Garner*, 498 U.S. 279, 111 S. Ct. 654, 661 (1991).

89. 11 U.S.C. § 1328(b). However, § 523(a) objections are available in a Chapter 13 case if the debtor seeks a hardship discharge. A debtor receives a "hardship" discharge if, for reasons beyond his control, he is unable to complete the payments required by his Chapter 13 plan. 11 U.S.C. § 1328(c).

90. *In re Long*, 774 F.2d 875 (8th Cir. 1985); see also WILLIAM M. COLLIER, 3 COLLIER ON BANKRUPTCY 523.05A (15th Ed. 1986).

91. *Long*, 774 F.2d at 881.

92. *Wheeler v. Laudani*, 783 F.2d 610, 615 (6th Cir. 1986) (citing legislative history).

93. *Chrysler Credit Corp. v. Perry Chrysler Plymouth*, 783 F.2d 480, 486 (5th Cir. 1986).

94. H.R. REP. NO. 595, 95th Cong., 2d Sess. 363 (1978), reprinted in 1978 U.S.C.A.N. 5787, 6320-21. The legislative history states: "Under [§ 523(a)(6)], willful means deliberate or intentional. To the extent that *Tinker v. Coldwell*, 193 U.S. 473 (1902), held that a looser standard is intended, and to the extent that other cases have relied on *Tinker* to apply a reckless disregard standard, they are overruled." *Id.* [hereinafter *Legislative History*].

95. See *Long*, 774 F.2d at 882; *In re Compos*, 768 F.2d 1155, 1158 (10th Cir. 1985).

tional, wrongful act which results in an injury.⁹⁶ However, reckless disregard or gross negligence is not willful and malicious conduct.⁹⁷ Some case law suggests morally reprehensible acts are "willful and malicious" conduct although these decisions should be viewed as aberrations that are contrary to legislative intent as well as highly subjective.⁹⁸ Which test is used can often determine the success of a Section 523(a)(6) objection for environmental liabilities. While it is likely to be difficult to show that pollution is done with a specific intent to injure; it is much easier to show that pollution resulted from intentional conduct. The application of Section 523(a)(6) to environmental liabilities is illustrated by three cases.⁹⁹

In *In re Tinkham*, the debtor created a major pollution problem when he illegally dumped chemical wastes.¹⁰⁰ Prior to declaring bankruptcy, the debtor was found liable to the State of New Hampshire for cleanup costs in excess of \$11 million.¹⁰¹ The state objected to the discharge of the damages award, contending that it arose from a "willful and malicious injury."¹⁰² Using the less strict interpretation of "willful and malicious," the court considered whether the debtor knew and intended to take the actions giving rise to the claim and undertook those actions knowing that they would cause injury to another person or property.¹⁰³ The objection was dismissed because, although the debtor was aware that his disposal activities were illegal, the state did not show that the debtor knew that the waste-related damage was substantially certain to occur.¹⁰⁴

A similar conclusion was reached in *In re Carracino*.¹⁰⁵

96. See *Perkins v. Scharffe*, 817 F.2d 392, 394 (6th Cir. 1987); *In re Cecchini*, 780 F.2d 1440, 1443 (9th Cir. 1986); *Wheeler*, 783 F.2d at 615; *In re Franklin*, 726 F.2d 606, 610 (10th Cir. 1984); *In re Quezada*, 718 F.2d 121, 123 (5th Cir. 1983); *In re Tinkham*, 59 B.R. 209, 214 (Bankr. D.N.H. 1986).

97. *In re Wren*, 791 F.2d 1542, 1543-44 (11th Cir. 1986); *Wheeler*, 783 F.2d at 615 (citing legislative history); *In re Compos*, 768 F.2d 1155, 1157-58 (10th Cir. 1985); COLLIER, *supra* note 90, at 523.16[1]; see also *In re Wood*, 96 B.R. 993, 995-96 (Bankr. 9th Cir. 1988) (finding the debtor's retention of his former wife's share of his retirement pension to be "willful and malicious").

98. See *Legislative History supra* note 94.

99. *In re Berry*, 84 B.R. 717 (Bankr. W.D. Wash. 1987).

100. 59 B.R. at 210.

101. *Id.*

102. *Id.*

103. *Id.* at 213. An unresolved issue is whether a § 523(a)(6) objection exists if the debtor causes environmental damage only to the debtor's property.

104. *Id.* at 217.

105. 53 B.R. 513 (Bankr. D.N.J. 1985).

Carracino, through a corporation, operated a dump site where twenty thousand drums of hazardous waste were stored. A fire released some of the waste into a nearby river, resulting in cleanup costs in excess of \$23.6 million paid by the State of New Jersey. Prior to bankruptcy, Carracino was found liable for the cleanup costs and the State sought to have those costs declared nondischargeable under Section 523(a)(6). The court rejected the State's objection, concluding that the debtor's accumulation of waste at the dump and his strict liability for any damages caused by its improper release were not tantamount to malicious conduct.¹⁰⁶

In *In re Berry*, the debtor operated an automobile restoration business that generated hazardous waste.¹⁰⁷ He stored the waste at his garage in unlabeled and open containers in violation of environmental laws.¹⁰⁸ After declaring bankruptcy, Berry vacated his building, leaving the waste for his unwitting landlord.¹⁰⁹ The landlord's estate was subsequently fined \$3000 for Berry's activities and ordered to reimburse the state for cleanup costs of \$45,000 because Berry had no funds.¹¹⁰ The landlord objected to the discharge of his claim against Berry for the cleanup costs and penalties. Finding that Section 523(a)(6) requires an intentional act that causes injury, not specific intent to injure, the court held that the claim was not dischargeable because Berry had left dangerous chemicals in unmarked containers upon vacating the premises, failed to advise the authorities or his landlord that he was abandoning chemical waste, took no steps to mitigate the problems, and was aware that the waste presented environmental and health risks.¹¹¹ The court concluded that polluters who endanger public safety should not be able to use the discharge as a refuge, despite the lack of evidence that Berry intended to cause any damage.¹¹²

A less strict "willfulness" requirement in environmental cases for policy reasons is attractive. Debtors who endanger the environment, public health and safety are not attractive candidates for a discharge, particularly when the objecting creditor may face absolute liability, despite its lack of fault, for environ-

106. *Id.* at 516.

107. 84 B.R. 717 (Bankr. W.D. Wash. 1987).

108. *Id.* at 718.

109. *Id.*

110. *Id.* at 719.

111. *Id.* at 720-21.

112. 84 B.R. at 720-21.

mental liabilities caused by the debtor. However, given the definition of "willful and malicious," an objection to the discharge of environmental liabilities should be measured under the same standards applied to other debts.

A section 523(a)(6) objection will be lost unless it is timely filed. Section 523(c) provides that a claim for a willful and malicious injury shall be discharged unless the creditor to whom the debt is owed timely objects. In Chapter 7 and Chapter 11 cases, the objecting creditor must file a lawsuit, known as an adversary proceeding, in the bankruptcy court asserting his dischargeability objection within sixty days after the first date set for the meeting of creditors unless the deadline is extended by the bankruptcy court.¹¹³ The sixty day period commences from the date set for the first meeting of creditors, regardless of whether the meeting is reset and held at a later date.

2. Fines, Penalties or Forfeitures Objection

Section 523(a)(7) provides that a discharge, other than a Chapter 13 discharge, does not affect a debtor's liability for a debt "to the extent such debt is a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss"¹¹⁴ The elements of a Section 523(a)(7) objection are a fine, penalty or forfeiture; payable to a government unit; for the benefit of a governmental unit; that is not compensation for actual pecuniary loss. Section 523(a)(7)'s legislative history reflects that this objection was primarily aimed at tax penalties. However, it can also bar the discharge of other government-imposed sanctions.¹¹⁵

Section 523(a)(7) can prevent the discharge of liabilities arising from violations of environmental laws. This section prevented the discharge of penalties of \$110,000 per day imposed on

113. Bankr. Rule 4007(c), 11 U.S.C. § 523.

114. 11 U.S.C. § 523(a)(7).

115. *In re Tinkham*, 59 B.R. 209, 213 (Bankr. D.N.H. 1986) (criminal fine for \$40,000 not dischargeable and civil penalty of \$670,000 not dischargeable where based on statutory limit of \$10,000 per day for 67 days); *In re Carracino*, 53 B.R. 513, 516-17 (Bankr. D.N.J. 1985) (environmental fines totalling \$29,000 not dischargeable). Criminal liability for the violation of environmental laws is not subject to discharge. *In re Robinson*, 46 B.R. 136, 139 (Bankr. M.D. Fla. 1985). The United States Supreme Court has stated, in dictum, that a fine or penalty imposed upon a debtor for violating state environmental laws would be nondischargeable under § 523(a)(7). *Ohio v. Kovacs*, 469 U.S. 274, 284 (1985). Criminal prosecution of a debtor for environmental crimes is not subject to the automatic stay. 11 U.S.C. § 362(b)(1).

a debtor for violating New Jersey's environmental laws.¹¹⁶ Similarly, a debtor was not allowed to discharge civil penalties resulting from his prebankruptcy violation of state strip mining laws.¹¹⁷

Distinguishing "compensation for actual pecuniary loss" from nondischargeable sanctions is often an important issue. Factors used to make this determination are the relation of the fine amount to actual damages; whether actual damages were awarded separately; the role of actual damages in the assessment of the fine, whether the fine, when paid, must be used to remedy the effects of the debtor's acts; and whether the statute giving rise to the fine or penalty is penal or pecuniary in nature.¹¹⁸ The statute authorizing a fine or penalty and the government's explanation for the amount of the penalty should determine if a sanction is for "actual pecuniary loss."¹¹⁹ Also, prosecution costs expended by the state in exercising its police powers to obtain a sanction are nondischargeable under section 523(a)(7) because they are not "compensation for actual pecuniary loss."¹²⁰

Another issue is whether section 523(a)(7) applies to restitution orders arising from environmental violations. A cursory review of Section 523(a)(7)'s requirement that the debt must be a sanction "payable to and for the benefit of a governmental unit that is not compensation for actual pecuniary loss" suggests that this objection does not apply to restitution orders. However, the Supreme Court has held that Section 523(a)(7) can bar the discharge of a restitution order imposed as part of a criminal sentence, even though the order may be based on the pecuniary loss caused by the illegal conduct and result in payments to private persons.¹²¹ It reached this conclusion because a criminal sentence reflects the state's interest in penal and rehabilitative concerns that outweigh bankruptcy's policy of affording a fresh start to debtors.¹²² As a result, restitution obligations arising from

116. *Tinkham*, 59 B.R. at 213.

117. *In re Daugherty*, 25 B.R. 158, 160 (Bankr. E.D. Tenn. 1982).

118. See *United States v. Lueking*, 125 B.R. 513, 516 (Bankr. E.D. Tenn. 1990); *In re Renfrow*, 112 B.R. 22 (Bankr. W.D. Ky. 1989); *Daugherty*, 25 B.R. at 160.

119. A question can arise whether a sanction is for "actual pecuniary loss" if it was assessed under a penalty matrix. Some agencies use a multifactor matrix to set fines which simultaneously considers various factors, including the cost of remedying the damage caused by an environmental violation.

120. *In re Zarzynski*, 771 F.2d 304, 306 (7th Cir. 1985).

121. *Kelly v. Robinson*, 479 U.S. 36, 53 (1986).

122. *Id.*

environmental sanctions may be nondischargeable. This holding is difficult to reconcile with Section 523(a)(7)'s plain language and its legislative history and it is submitted that Section 523(a)(7) should not be extended to restitution claims unless the statute is amended by Congress.

3. Lack of Notice Objection

Section 523(a)(3) bars the discharge of a debt:

neither listed nor scheduled [by the debtor] with the name, if known to the debtor, of the creditor to whom such debt is owed, in time to permit—

(A) if such debt is not of a kind specified in [Section 523(a)(2),(4),(6)], timely filing of a proof of claim, unless such creditor had notice or actual knowledge of the case in time for such timely filing; or

(B) if such debt is of a kind specified in [Section 523(a)(2),(4),(6)], timely filing of a proof of claim and timely request for a determination of dischargeability of such debt under one of such paragraphs, unless such creditor had notice or actual knowledge of the case in time for such timely filing and request.¹²³

Subsections 523(a)(2), (4) and (6) refer to claims arising from the debtor's fraud, breach of fiduciary duty, and willful and malicious conduct, respectively. Thus, a debtor is not entitled to be discharged from environmental liabilities unless potential creditors receive adequate notice of the bankruptcy.

Under this objection, creditors who do not receive notice of a debtor's bankruptcy may be entitled to object to the discharge of their claims. Once an objection is made, the debtor has the burden of proving that the objecting creditor had "notice or actual knowledge" of the bankruptcy.¹²⁴ As a result, a debtor will not be discharged from unlisted claims held by creditors who did not receive notice or did not have actual knowledge of the claims bar date or the deadline for filing discharge objections.

A creditor who has any knowledge of a debtor's bankruptcy is under a heavy duty to promptly determine the deadline for filing claims and discharge objections.¹²⁵ A creditor who fails to

123. 11 U.S.C. § 523(a)(3).

124. *United States v. Bridges*, 894 F.2d 108, 111 (5th Cir. 1990) (citing *Hill v. Smith*, 260 U.S. 592, 594-95 (1923)).

125. *In re Compton*, 891 F.2d 1180, 1185 (5th Cir. 1990) (discharge bars claims if creditor aware of case even if creditor had no formal notice of any pertinent dates); *see also*

file a claim will be barred from asserting a Section 523(a)(3) objection despite the lack of formal notice.¹²⁶ Knowledge of a bankruptcy case can be imputed to a creditor whose attorney receives notice, regardless of whether the attorney advises the creditor of the notice, provided that the notice adequately identifies the creditor for whom it was intended.¹²⁷

B. Due Process Objections

In a Chapter 11 case, a creditor other than the government¹²⁸ who has inadequate notice of the debtor's bankruptcy may have a nonstatutory dischargeability objection based on procedural due process. Under the Fifth Amendment,¹²⁹ procedural due process requires notice that is reasonably calculated, under all circumstances, to convey all information necessary to apprise interested parties that their rights are before the court.¹³⁰ Whether due process is satisfied in a bankruptcy case requires a balancing of the individual's interest in adequate procedure against the interest in an efficient and final resolution of claims.¹³¹

In re Walker, 927 F.2d 1138, 1145 (10th Cir. 1991) (claimants who received an unrelated bankruptcy notice six weeks before claims bar date in Chapter 7 case not entitled to assume receipt of further notice and barred by actual knowledge from asserting § 523(a)(3) objection) (citing *In re Green*, 876 F.2d 854, 857 (10th Cir. 1989)); *In re Price*, 871 F.2d 97, 98-99 (9th Cir. 1989) (two months actual knowledge of bar date adequate for claimant to file objection); *In re Alton* 837 F.2d 457, 460 (11th Cir. 1988) (no extension of time permitted even though debt arose from debtor's fraud); *Neeley v. Murchison*, 815 F.2d 345, 347 (5th Cir. 1987) (no § 523(a)(3) objection available where creditor aware of proceeding even if creditor did not receive notice of dischargeability objection date).

126. *Compton*, 891 F.2d at 1185.

127. See *Price*, 871 F.2d at 97-98 (attorney representing creditor in state court fraud action received notice in time to object to discharge but did not pass information on to client); *In re Sam*, 94 B.R. 893, 894 (Bankr. W.D. La. 1988) (inexperience of counsel with bankruptcy coupled with actual notice of bankruptcy to his client did not prevent discharge of claim).

128. *United States v. Cardinal Mine Supply*, 916 F.2d 1087, 1089 n.3 (6th Cir. 1990) (a state is not a person entitled to due process under the Fifth Amendment).

129. The Fourteenth Amendment has been found inapplicable to the due process issue. See *In re Nutri-Bevco*, 117 B.R. 771, 777 (Bankr. S.D.N.Y. 1990); *Waterville Indus. v. First Hartford Corp.*, 124 B.R. 411, 413 (D. Me. 1991) (debtor's failure to give notice to claimant of potential environmental claim barred discharge of the claim after the reorganization plan's confirmation).

130. *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 313 (1950); see *United States v. Bridges*, 894 F.2d 108, 112 (5th Cir. 1990); *In re Longardner & Assocs.*, 855 F.2d 455, 459 (7th Cir. 1988) (citing *Mullane*, 339 U.S. at 318); *In re Waterman S.S. Corp.*, 59 B.R. 724, 726 (Bankr. S.D.N.Y. 1986) (notice of claims bar date in bankruptcy case satisfied due process and § 523(a)(3) discharged unknown tort claim).

131. *In re Leading Edge Prods.*, 120 B.R. 616, 618 (Bankr. D. Mass. 1990) (citing *In re DCA Dev. Corp.*, 489 F.2d 43, 46-47 (1st Cir. 1973)).

The method of notice that is necessary to satisfy due process depends on whether a claimant is reasonably ascertainable. Chapter 11 claimants who are reasonably ascertainable are entitled to actual notice; claimants who are not reasonably ascertainable are entitled to notice by publication.¹³²

The classification of an environmental liability as an unknown claim or known claim can significantly affect the due process discharge objection. A debtor is obligated to identify potential creditors who are reasonably ascertainable and to give actual notice to any creditor who is known to the debtor.¹³³ However, an impracticable and extended search to identify possible claimants is not required by due process.¹³⁴ Nor is everyone who may conceivably have a claim considered a creditor entitled to actual notice.¹³⁵ The debtor is not required to search for those who might, or might not, have tort claims due to prepetition activities.¹³⁶ For example, a debtor who believes that some of its many employees were exposed to toxic substances is not required to treat each employee as a known potential tort claimant.¹³⁷ Also, a debtor is not required to review third parties' records to identify potential claimants.¹³⁸ Of course, the debtor has an incentive to identify and notify all potential claimants as specifically as possible to insure the dischargeability of their claims.

1. Known Claimants

For known claimants, due process requires that actual notice of pertinent bar dates and hearings be given in accordance with the procedural rules for bankruptcy proceedings.¹³⁹ When notice is mailed to a creditor at a proper address, a presumption

132. *Nutri-Bevco*, 117 B.R. at 779 (citing *Wright v. Placid Oil Co.*, 107 B.R. 104, 108 (Bankr. N.D. Tex. 1989)).

133. See *Nutri-Bevco*, 117 B.R. at 778-79.

134. *In re Charter*, 113 B.R. 725, 728 (Bankr. M.D. Fla. 1990) (citing *Mullane*, 339 U.S. at 317-18).

135. *Tulsa Processional Collection Serv. v. Pope*, 485 U.S. 478, 489-90 (1988).

136. *In re Waterman S.S. Corp.*, 59 B.R. 724, 727 (Bankr. S.D.N.Y. 1986).

137. *Id.* at 722; *Charter*, 113 B.R. at 728.

138. *Waterman*, 59 B.R. at 727 (debtor not required by due process to review union's records to identify employees who might have claims arising from exposure to asbestos aboard debtor's vessels).

139. Bankruptcy Rule 2002(a) provides for twenty days notice by mail of the deadline for filing proofs of claim in a Chapter 11 case. Bankr. R. 2002(a). Bankruptcy Rule 2002(b) provides for twenty-five days notice by mail to interested parties of the hearing on the disclosure statement and objections thereto and the hearing on the confirmation of the debtor's plan of reorganization and objections thereto. *Id.* The constitutionality of the

arises that the creditor was properly notified and that due process was satisfied.¹⁴⁰ However, a known creditor has a right to assume that he will receive all notices required by statute and is under no independent duty to determine bankruptcy deadlines that might affect his claim.¹⁴¹ As a result, notice by publication will not satisfy due process for claimants whose names and addresses are known to the debtor.¹⁴²

If notice is not properly sent to a known creditor, due process may still be satisfied if he had actual knowledge of the deadline or hearing that affected his claim.¹⁴³ Actual knowledge exists only if the creditor knew of the specific hearing or event that affected his claim; it does not exist simply because a claimant was generally aware of the bankruptcy due to the creditor's right to assume that he will receive notices.¹⁴⁴ Also, actual knowledge must be obtained in time to afford the creditor the same opportunity for a hearing as a properly notified creditor.¹⁴⁵

"notice by mail" procedures set forth in the Bankruptcy Rules has been upheld. *In re Park Nursing Ctr.*, 766 F.2d 261, 263-64 (6th Cir. 1985).

140. *In re Longardner & Assocs.*, 855 F.2d 455, 459 (7th Cir. 1988) (holding that actual receipt of notice was not required if the debtor mailed notice of its plan confirmation hearing to the creditor, although the address did not include a zip code, noting that the notice was not returned as undeliverable by the post office); *In re Bicoastal Corp.*, 124 B.R. 602, 605 (Bankr. M.D. Fla. 1991) (holding that notice by publication was sufficient where the only knowledge of the creditor had been an "information request" one year earlier).

141. *Shettleman v. Standard Metals Corp.*, 839 F.2d 1383, 1386 (10th Cir. 1987); *Reliable Elec. Co. v. Olson Constr. Co.*, 726 F.2d 620, 622-23 (10th Cir. 1984); *In re Leading Edge Prods.*, 120 B.R. 616, 619 (Bankr. D. Mass. 1990) (citing *City of New York v. New York, New Haven & Hartford R.R.*, 344 U.S. 293 (1953)). The same rule applied under the Bankruptcy Act of 1898. See *In re Spring Valley Farms*, 863 F.2d 832, 834 (11th Cir. 1989). This contrasts sharply with the rule for creditors who are entitled to assert a § 523(a)(3) objection since they are under a heavy burden to investigate the bankruptcy and become aware of relevant dates, regardless of whether they received any formal notice of the proceeding. The Fifth Circuit has noted the distinction which the Tenth Circuit has developed between due process notice objections and § 523(a)(7) objections but has not addressed the issue. See *In re Compton*, 891 F.2d 1180, 1186 n.11 (5th Cir. 1990).

142. *Broomall Indus. v. Data Design Logic Sys.*, 786 F.2d 401, 404 (Fed. Cir. 1986) (citing *City of New York*, 344 U.S. at 293).

143. *Spring Valley*, 863 F.2d at 835 n.2; *Leading Edge*, 120 B.R. at 620.

144. See *Spring Valley*, 863 F.2d at 835 (noting that it might find actual knowledge if the creditor did not receive notice but was aware of the bar date at issue) (citing *In re Intaco Puerto Rico, Inc.*, 494 F.2d 94, 99-100 n.11 (1st Cir. 1974)); *Leading Edge*, 120 B.R. at 620 (actual knowledge of bankruptcy did not constitute actual knowledge sufficient to satisfy due process).

145. *Leading Edge*, 120 B.R. at 618 (dictum). But see *In re Sharon Steel Corp.*, 110 B.R. 205, 206-07 (Bankr. W.D. Pa. 1990) (publication of bar date for filing proof of claims did not bar claim of CERCLA potentially responsible party (PRP) who was unaware of its PRP status when publication of notice was made).

2. Unknown Claimants

For unknown claimants, due process requires notice by publication.¹⁴⁶ Notice by publication is adequate because more definite and certain notice is not reasonably possible or practical.¹⁴⁷ Due process is satisfied if the debtor acts reasonably in selecting the means of notice.¹⁴⁸ Whether a potential claimant actually receives published notice is irrelevant to due process, provided that the method of notice was appropriate.¹⁴⁹

The application of these principles in a Chapter 11 case involving an unknown toxic tort claim is illustrated by *In re Charter Co.*¹⁵⁰ The Charter Company had obtained a standard Chapter 11 order setting a bar date for claims. The order stated that notice of the bar date would be reasonably calculated to apprise unknown claimants of the need to file a claim, based on a plan to publish notices in the *Wall Street Journal*, in local newspapers throughout the country and in a trade newspaper.¹⁵¹ Two years later, a tort action was brought against Charter by the survivors of an individual who allegedly died due to benzene exposure caused by Charter and others before Charter filed for bankruptcy. Charter was not aware of the claim when the bar date notice was published.

The court held that the tort action was discharged. Notice by publication was reasonably calculated to apprise unknown claimants of their right to file claims, given the method of notice that was used.¹⁵² The unknown claimants were not aware of the claims bar date but due process only required the debtor to use a reasonable means of notice. As a result, the claimant's dischargeability objection was denied.¹⁵³

146. *Vancouver Women's Health Collective Soc'y v. A.H. Robins Co.*, 820 F.2d 1359, 1364 (4th Cir. 1987); *In re GAC Corp.*, 681 F.2d 1295, 1300 (11th Cir. 1982); *In re Charter*, 113 B.R. 725, 727-28 (Bankr. M.D. Fla. 1990); cf. *Tulsa Professional Collection Serv. v. Pope*, 485 U.S. 478, 489-90 (1988) (applying due process requirement to state nonclaim statute for probate).

147. *Tulsa*, 485 U.S. at 489-90; *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 317 (1950).

148. *Charter*, 113 B.R. at 727.

149. *Id.* (citing *Weigner v. City of New York*, 852 F.2d 646, 649 (2d Cir. 1988)); see also *In re Bicoastal Corp.*, 124 B.R. 602, 604-05 (Bankr. M.D. Fla. 1991) (publication by notice satisfied due process and barred California's cleanup claim when state was aware of environmental problem and did not respond to published notice).

150. 113 B.R. 725 (Bankr. M.D. Fla. 1990).

151. *Id.* at 726-27.

152. *Id.* at 728.

153. *Id.* at 729.

The procedures for notice by publication do not favor due process discharge objections for unknown claimants. Before notice by publication can occur, the Bankruptcy Rules require the bankruptcy court to approve the proposed form of notice and the manner of notice, including the medium to be used and the number of publications.¹⁵⁴ Methods of notice have included publication of notices in local, national and trade newspapers, and giving notice to groups such as unions that are likely to include potential claimants.¹⁵⁵ As a result, a due process inquiry is often made before notice by publication is given, effectively undermining any subsequent due process discharge objection.

IV. CONCLUSION

The bankruptcy discharge can significantly impair the remedies of parties injured by pollution and toxic substances. It will typically release a debtor from all known and, possibly, unknown prebankruptcy environmental liabilities in the absence of a valid objection. Because the definition of claim is unsettled, potential debtors and potential creditors must consider the law of the appropriate jurisdiction to determine the scope of the discharge and its impact upon particular liabilities.

Although the discharge can significantly affect environmental claims, it should be kept in perspective. The discharge only eliminates a debtor's personal liability for environmental claims. The discharge does not necessarily mean that prebankruptcy environmental problems will go unremedied. To the contrary, a bankruptcy trustee may be required to use the debtor's bankruptcy estate to fund the cleanup of prebankruptcy pollution; and be unable to abandon property that creates an imminent environmental danger.¹⁵⁶ Postbankruptcy cleanup costs and

154. Bankr. R. 9008. This rule applies whenever notice by publication is required or authorized by the Bankruptcy Rules, but may also be persuasive when a court is faced with evaluating the adequacy of notice by publication in circumstances not contemplated by the rules.

155. *Charter*, 113 B.R. at 726-27; *In re Waterman S.S. Corp.*, 59 B.R. 721, 727 (Bankr. S.D.N.Y. 1986). A savvy debtor can be expected to decide, possibly using professional marketing services, the best means for reaching potential claimants after balancing his potential exposure for those claims against the expense of various options. In general, the best forms of constructive notice will provide several opportunities for potential claimants to learn of the proceeding without unusual effort.

156. *Midlantic Nat'l Bank v. New Jersey Dep't of Env'tl. Protection*, 474 U.S. 494, 502 (1986) citing *Ohio v. Kovacs*, 469 U.S. 274, 285 (1985) (person in possession of site must comply with environmental laws and may not maintain a nuisance, pollute, or refuse to remove source of conditions).

other environmental claims may qualify as administrative claims that are paid ahead of most other debts.¹⁵⁷ The discharge does not relieve a debtor in a Chapter 11 reorganization from the need to comply with environmental laws during postbankruptcy operations.¹⁵⁸ In short, the Bankruptcy Code provides several avenues for remedying a debtor's environmental problems despite the debtor's discharge from personal liability for those remedies.

In addition, the dischargeability provisions of the Bankruptcy Code can adequately protect environmental claims. Due process prevents the discharge of claims without adequate notice and the Bankruptcy Code bars the discharge of unlisted debts. A creditor holding a known or potential claim can appear in the bankruptcy proceeding and protect his interests; by filing a proof of claim; seeking an administrative claim for cleanup costs; by insuring the debtor or trustee takes action to remedy environmental problems and adequately provides for such problems in a plan of reorganization; by insuring that the debtor satisfies any applicable postpetition environmental obligations; and, if necessary, by having the amount of his claim set by the court so that he can share in any payments made to creditors. In addition, discharge objections are available for those types of environmental claims that Congress, as a matter of public policy, decided could be nondischargeable.¹⁵⁹ Thus, the discharge does not stop a creditor from forcing the debtor to deal with an environmental liability during bankruptcy.

It is submitted that the present, sometimes ambiguous, definition of claim is appropriate for determining the dischargeability of environmental liabilities. Further restricting the definition of claim would prevent creditors with potential claims from sharing in the distribution of assets in a liquidation proceeding, thereby leaving them with a meaningless claim in the

157. See *In re Chateaugay Corp.*, 944 F.2d 997, 1009-10 (2d Cir. 1991); *In re National Gypsum Co.*, 139 B.R. 397, 412 (Bankr. N.D. Tex. 1992) (costs of remedying pollution that presented imminent and identifiable threat to health and environment were entitled to administrative status under §§ 507 and 503(b) of the Bankruptcy Code).

158. See 28 U.S.C. § 959 (1988) (actions may be maintained against trustee for conduct regarding the bankruptcy estate); *Kovacs*, 469 U.S. at 285; *In re CMC Heartland Partners*, 966 F.2d 1143, 1146-47 (7th Cir. 1992); *In re Kaiser Steel Corp.*, 87 B.R. 662, 666-67 (Bankr. D. Utah 1988).

159. Legislation has been proposed which would restrict the dischargeability of pollution abatement costs incurred by government entities for which a debtor may be liable under CERCLA, the Solid Waste Disposal Act, and similar state statutes. See H.R. 1270, 103 Cong., 1st Sess. (proposed Mar. 9, 1993).

future against a defunct company. In addition, exempting contingent environmental liabilities from discharge is contrary to the definition of claim, and would create, in effect, an eternal debtor's prison for individuals and companies facing environmental liabilities.