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SUPREME COURT TO DECIDE WHETHER TO REVIEW SEVENTH CIRCUIT DECISION HOLDING THAT BANKRUPTCY DOES NOT DISCHARGE ENVIRONMENTAL CLEAN-UP LIABILITY UNDER THE RESOURCE CONSERVATION AND RECOVERY ACT

In a decision that may create a significant roadblock for companies saddled with environmental clean-up liability to continue as a going concern, the Seventh Circuit in U.S. v. Apex Oil Company, Inc., 579 F.3d 734 (7th Cir. 2009) affirmed a district court injunction requiring the clean-up of a contaminated site in Illinois under section 7003 of the Resource Conservation and Recovery Act (RCRA) despite the company's bankruptcy. On September 27, 2010, the Supreme Court is scheduled to discuss whether to grant review of the Apex decision.

In Apex, the district court held that an oil refinery owned by Apex's predecessor created a plume of millions of gallons of oil that is contaminating groundwater and emitting surface fumes that pose a hazard to the environment and to the health of the citizens of Hartford, Illinois. The district court held that RCRA imposes liability on Apex to "abate this nuisance." The principal question on appeal to the Seventh Circuit was whether the United States' claim for a mandatory injunction under RCRA was discharged in Apex's bankruptcy and, therefore, could not be renewed in a subsequent lawsuit.

Bankruptcy cases interpreting pre-petition liability under various environmental laws, including Apex, have found that certain equitable claims are not dischargeable. To begin with, confirmation of a plan of reorganization under Chapter 11 of the Bankruptcy Code allows a debtor to obtain a discharge of "any debt that arose before the date of such confirmation." 11 U.S.C. § 1141(d)(1)(A). This allows the debtor a fresh start coming out of bankruptcy. The Bankruptcy Code defines "debt" as "liability on a claim." 11 U.S.C. § 101(12). A "claim" is defined as, among other things, 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." 11 U.S.C. § 101(5)(B) (emphasis added). Thus, as explained by the Seventh Circuit in Apex, the crucial question in determining whether an equitable remedy is discharged in bankruptcy is whether that remedy gives rise to a right to payment. If it does, the claim is discharged in bankruptcy.

The Seventh Circuit held that RCRA entitles the government to require a defendant to clean up a contaminated site at the defendant's expense. However, RCRA does not entitle the government to demand payment of the clean-up costs from the defendant. Apex argued that the cost of complying with an equitable decree under RCRA should be deemed a monetary claim and, thus, be dischargeable in bankruptcy. Citing cases in the Seventh, Third and

Second Circuits, the Apex court held that the cost to Apex of complying with the injunction is not a "right to payment" as used in the Bankruptcy Code. The court reasoned that because every equitable decree imposes a cost on the defendant, under Apex's argument, every equitable claim would be dischargeable in bankruptcy unless there was an exception in the Bankruptcy Code. The court held this was inconsistent with the spirit and framework of the Bankruptcy Code. In sum, the Seventh Circuit held that the government's equitable claim was not discharged in bankruptcy and it upheld the injunction requiring Apex to clean-up the contaminated site in Illinois.

Of note, in deciding Apex, the Seventh Circuit expressly distinguished Ohio v. Kovacs, 469 U.S. 274 (1985), a case in which the Supreme Court held that an equitable obligation to clean up a contaminated site by the debtor was discharged in the debtor's bankruptcy. In Kovacs, the debtor failed to comply with its clean-up obligation post-bankruptcy. A receiver was appointed to take possession of the debtor's assets and obtain from the debtor money to pay for cleaning the contaminated site. The Seventh Circuit in Apex held that, because the receiver in Kovacs was seeking money, as opposed to an order mandating the clean up, this was a "right to payment" and therefore a "claim" that could be discharged under the Bankruptcy Code. By contrast, in Apex, the government was not seeking the payment of money and the underlying statute did not entitle it to payment. Accordingly, the Seventh Circuit held that the Supreme Court's decision in Kovacs did not mandate a different result.

As Apex no longer had the capacity to perform the clean-up itself, Apex estimated that it would cost $150 million to hire another company to complete the job, minus any recovery Apex could obtain from other contributors of the contamination. Apex argued that had it known that the government's equitable claim was not dischargeable in bankruptcy, it would have had to liquidate, rather than reorganize.

The Apex ruling may erode the ability of a company with environmental contamination liability to continue as a going concern. To the extent courts follow the reasoning of Apex and hold that equitable claims for environmental clean-up costs are nondischargeable, a chapter 11 bankruptcy may have marginal to no benefit to companies saddled with such liability. In that instance, a chapter 7 liquidation may be the company's only option. Further, the Apex ruling may guide lawmakers on how to draft future environmental legislation to prevent companies from shedding their contamination liability. That is, if an environmental law confers no right to payment on the plaintiff and only imposes an obligation on the defendant to take some affirmation action (such as cleaning up contamination), then courts following Apex will hold that the plaintiff's equitable claim is not dischargeable in bankruptcy.

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